NEW YORK STATE
OFFICE OF THE STATE COMPTROLLER

H. Carl McCall
STATE COMPTROLLER

NEW YORK STATE BANKING DEPARTMENT

OPERATION OF OVERSEAS OFFICES

99-S-53

DIVISION OF MANAGEMENT AUDIT AND
STATE FINANCIAL SERVICES

OSC Management Audit reports can be accessed via the OSC Web Page:

http://www.osc.state.ny.us

If you wish your name to be deleted from our mailing list or if your address has changed,

contact the Management Audit Group at (518) 474-3271

or at the

Office of the State Comptroller

Alfred E. Smith State Office Building

13th Floor

Albany, NY 12236

H. Carl McCall
STATE COMPTROLLER

Report 99-S-53

Ms. Elizabeth McCaul
Superintendent
New York State Banking Department
2 Rector Street
New York, NY 10006

Dear Ms. McCaul:

The following is our report on the operations of the overseas offices of the New York State Banking Department for the period from April 1, 1997 through March 31, 2000.

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article 2, Section 8 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

August 15, 2001

Executive Summary

New York State Banking Department Operation of Overseas Offices

Scope of Audit

The New York State Banking Department (Department) is responsible for supervising and regulating State-licensed and State-chartered financial entities, including domestic banks, foreign agencies, branches and representative offices operating in New York, mortgage bankers and brokers and check cashers among others. The assets of these institutions exceed $1.8 trillion. The Department seeks to promote the State charter as a competitive alternative to the national banking charter in recognition of its link to job creation and economic growth for New York State. All banks that do business in New York State are required to pay an annual assessment to pay for the Department's operating costs. The Department's annual budget for the 1999-00 State fiscal year is $61.8 million.

Article II, Section 36 of the New York State Banking Law states that all State-chartered banks, including domestic banks and foreign branches of State-chartered banks, must be examined once every 12 or 18 months. The 230 staff in the Department's Examinations Division perform these examinations. The Department has two permanent overseas offices whose seven staff do examinations of the foreign branches of ten State-chartered banks. Each overseas office has a Director, clerical staff and examiners: four examiners in Tokyo and three in London. These foreign-based staff receive additional compensation for cost of living differences which adds a net total of $765,883 to their $632,283 base salaries. The budgets for the Tokyo and London offices for the 1999-00 State fiscal year were $2.2 million and $530,000, respectively.

Our audit addressed the following questions about the operation of the overseas offices for the period from April 1, 1997 through March 31, 2000:

- Does the benefit the Department gains from its overseas offices justify the expense of maintaining them?

- Are selected Department expenditures for its overseas offices appropriate?

Audit Observations and Conclusions

We found the Department could not demonstrate the benefits derived from operating a Tokyo office, and could not document why it opened and continues to maintain its London office. We also found the Department did not competitively bid furniture purchased for the Tokyo office and inappropriately paid for certain education costs. Since banks doing business in New York

State pay for Department operations, this represents an additional cost of doing business in New York State.

Department management is responsible for using their resources to achieve program goals and objectives efficiently and effectively, and should reassess periodically the need for, and cost-effectiveness of, dedicating additional resources to a specific function. Department officials state that having overseas offices allows for enhanced oversight of larger banks, efforts by overseas Directors that can help reinforce contacts with foreign banks, and staff familiarity with the banks they examine. We found that Department officials have not developed written, specific goals or objectives for the Tokyo or London office; explained how the offices facilitate "enhanced oversight;" or stated how such oversight could be measured. Nor has the Department demonstrated that it is more efficient to have staff live overseas, rather than travel to foreign sites. Department officials conceded the lack of cost-effectiveness, and were unable to provide any other justification for retaining these offices. Only one of the 45 states we surveyed indicated it had considered opening an overseas office; and Federal Reserve Bank examiners regularly travel to worldwide work locations while the U.S. Office of the Comptroller of the Currency has just one foreign office, in London. We recommend the Department either develop a measurable cost benefit justification for these foreign offices, or consider closing them for annual cost savings of about $800,000. The Department should act promptly to develop goals for overseas offices, measure achievement of these goals, and evaluate the cost benefit involved. (See pp. 5-12)

We also found the Department purchased furniture costing almost $139,000 for its Tokyo office without the required competitive bidding, and repeatedly paid excessive educational costs for the children of Tokyo staff. Due to management's error, $26,000 was paid incorrectly for pre-school tuition. We recommend that, if the Department continues to operate these offices, they should comply with competitive bidding requirements and set limits on reimbursement of education costs. (See pp. 15-17)

Comments of Department Officials

Department officials disagree with our recommendations or maintain that their current operating practices are appropriate.

We believe that the Department is not acting in a responsible manner or properly considering that resources are not being used efficiently. This appears to be partially a result of its position that ". . . the Department's operations are not funded by New York's taxpayers." Rather, as the audit itself concedes, it is the banks doing business in this State who "foot the bill." However, we indicate on page 12 of the report that these higher costs to banks may have negative results.

Contents

Introduction

Background

The New York State Banking Department (Department) is responsible for supervising and regulating New York State-chartered banking organizations, including commercial banks, trust companies, savings banks, savings and loan associations, credit unions and other licensed registered institutions. The Department seeks to preserve and promote the State charter as a competitive alternative to the national banking charter in recognition of its link to job creation and economic growth for New York State. The Department supervises approximately 500 domestic and foreign banking institutions, and approximately 4,000 other financial entities operating within New York State. The combined assets of these organizations exceed $1.8 trillion. All banks that do business in New York State are required to pay an annual assessment used to cover for the Department's operating costs. The Department's annual budget for the 1999-2000 State fiscal year was $61.8 million.

Article II, Section 36 of the New York State Banking Law requires that all State-chartered banks be examined every 12 or 18 months. This function is carried out by the Department's Examinations Division, whose operation is managed and overseen by a Chief Examiner. In addition to examining domestic banks, the Department is also responsible for examining the foreign branches of New York State-chartered banks. Currently, there are ten State-chartered banks with foreign branches that must be examined each year. The Department opened an office in London, England in 1974, and an office in Tokyo, Japan in 1998. Staff in the foreign offices perform annual examinations of the foreign branches of State-chartered banks. Of the 230 total staff in the Examinations Division, 211 examiners are based in New York City, 12 are located in State regional offices (Albany, Buffalo, Rochester and Syracuse) and 7 are assigned to the overseas offices. The budgets for the Tokyo and London offices for the 1999-2000 State fiscal year including fringe benefits, were $2.2 million and $530,000, respectively.

Staff assigned to the overseas offices receive additional reimbursement to compensate them for extra costs of living. For the 1999-2000 State fiscal year, the additional compensation added a net total of $765,883 to their $632,283 base salaries. In addition, the Department contracted with Arthur Andersen for $105,000 to develop a reimbursement package for employees stationed in Japan because of the high cost of living. The five Tokyo-based staff (the Director and four examiners) receive base salaries totaling $339,884 and additional compensation totaling $474,959. The additional compensation includes cost of living adjustments, a utility allowance, an annual education allowance estimated at $14,000 per child and housing allowances (offset by an estimate of their housing costs in the United States) ranging from $36,923 to $98,100. Department staff are generally exempt

from Japan's income taxes. The Department deducts amounts ranging from $7,627 to $19,200 from the salaries of these staff to estimate the local, state and federal taxes they would pay on their income if they were based in the U.S.

Since 1984, Department staff assigned to London were given pay increases equivalent to two grades higher than that of similar staff based in the U.S. to compensate them for the additional costs of living there. The Department also paid a share of staff housing expenses to a maximum of 15 percent of their salary and reimbursed staff for the education costs of their children, storage costs and United Kingdom Social Security taxes. London staff paid their own United Kingdom income taxes. However, according to Department officials, London office employees will be compensated in the same manner as the Tokyo office employees beginning April 2000. The four London-based staff (the Director and three examiners) will receive base salaries totaling $292,399 and additional compensation of $290,924. The additional compensation consists of cost of living adjustments, a utilities allowance and a housing allowance of $41,441 to $44,678 (offset by an estimate of their housing costs in the U.S., ranging from $7,433 to $12,687). The State will also pay the employees' United Kingdom income taxes ranging from $42,923 to $60,677 per examiner (offset by amounts ranging from $8,840 to $28,787 that represent estimates of the local, state and federal taxes these employees would have paid in the U.S.).

Audit Scope, Objectives and Methodology

We reviewed the revenues, expenses and activities of the Department's overseas offices for the period from April 1, 1997 through March 31, 2000. The objectives of our financial-related audit were to determine whether the benefit the Department gains from its overseas offices justifies the expense of maintaining them, and to examine the propriety of selected procurement practices. To accomplish these objectives, we reviewed the Department's policies and procedures, applicable rules and regulations, monthly activity reports from overseas offices and other appropriate documentation. We interviewed management and staff at the New York and overseas offices and tested selected controls and transactions. We also surveyed banking regulatory agencies from the other 49 states and from 4 U.S. territories and contacted two Federal regulatory agencies (the Federal Reserve Bank and the Office of the Comptroller of the Currency) to determine their practices with regard to maintaining overseas offices.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of the Department which are included in our audit scope. These standards also require that we understand

the Department's internal control structure and its compliance with those laws, rules and regulations that are relevant to the Department's operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

We use a risk-based approach when selecting activities to be audited. This approach focuses our audit efforts on those operations that have been identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, finite audit resources are used to identify where and how improvements can be made. Thus, little audit effort is devoted to reviewing operations that may already be relatively efficient or effective. As a result, our audit reports are prepared on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Internal Control and Compliance Summary

Our consideration of the Department's internal controls identified weaknesses with respect to purchases and subsidies of employee expenses. These weaknesses are explained in the section of this report entitled "Selected Procurement Practices."

Comments of Department Officials to Audit

A draft copy of this report was provided to Department officials for their review and comment. Their comments have been considered in preparing this final report and are included as Appendix B. Subsequent to our closing conference the Department provided us with an estimate that closing the foreign offices would save $178,000. The decision to provide information after our field work was completed did not allow for an opportunity to discuss audit areas when the auditors were at the field site and the exchange of information is most effective.

Department officials disagreed with our recommendations because they consider all of the anecdotal information about their overseas activities as sufficient justification for the added costs. They also indicate that because the banks "foot the bill," and not taxpayers, it appears to be acceptable to them to incur increased operating costs. We believe that ultimately the banks' customers (i.e., taxpayers) are impacted by the higher costs of business and, as such, the Department needs to reconsider its position regarding the overseas offices. We point out that none of the 45 states who

responded to our survey or the Federal Reserve Bank have permanent overseas offices. The Department was also unwilling to consider the proposal that it share offices with the Department of Economic Development in the interest of more efficient use of resources.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Superintendent of the New York State Banking Department shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein and where recommendations were not implemented, the reasons therefor.

Operation of Overseas Offices

We found the Department could not demonstrate the benefits it derives from operating a Tokyo office and could not document why it opened and continues to maintain a London office. An alternative to having overseas offices is to have Department staff travel to these locations on an as needed basis, as do their counterparts from other states and from the Federal Reserve Bank. Although Department managers stress that the importance of these offices, and the role of the Directors, is to foster essential channels of communication with foreign banking supervisors, prior to our audit, the London office was without a Director for two years. For that two-year period, examiners assigned to the London office were supervised by the Chief Examiner in the New York City office. Another potential benefit of maintaining overseas offices could be higher productivity and lower travel costs. However, the London office did not show its office produced such benefits, and our analysis of the Tokyo office data showed relatively low productivity. For example, the Tokyo Director projected that, for the year ended May 2000, only 50 percent of staff time would be billed for examination work; the balance will be charged to general expense. Further, about 85 percent of the time that the Tokyo office staff spent on bank examinations between February 1999 and March 2000 was on exams at other Asian locations, such as Hong Kong and Singapore, resulting in significant travel time and expense. We believe the Department should consider closing these offices, and, in so doing, save an estimated $800,000 annually.

Objectives and Expected Benefits of Overseas Offices

According to the State Comptroller's *Standards for Internal Control in New York State Government*, Department management is responsible for using agency resources in a manner that is consistent with the Department's mission and for achieving Department program goals and objectives as efficiently and effectively as possible. For this to occur, the Department should establish goals and objectives, design a strategic plan to achieve them, and develop a system to measure actual performance to determine the extent to which goals are achieved. The Department should also periodically reassess the need for, and cost-effectiveness of, dedicating resources to a specific function (such as operating overseas offices).

Department officials told us that they provided the Division of the Budget with justification for establishing a Tokyo office. Documentation from both the Department and the Division of the Budget were reviewed to determine the Department's rationale for opening an office in Tokyo, the goals the Department established for the office and how it planned to measure progress in achieving these goals. The Department provided information that three

foreign banks which failed to establish adequate controls and comprehensive systems of risk management incurred billion dollar losses. It also stated that Asian offices of New York State institutions accounted for more than $40 billion of on-balance sheet exposure and $800 billion of off-balance sheet risk. Within this context, the Department indicated its Tokyo office would:

- enhance the oversight of some of the larger banks; and

- reinforce the contacts with the Japanese Ministry of Finance, the Bank of Japan and bank supervisors in other Asian countries.

However, we found the Department never converted these very general expectations into measurable objectives. The Department also did not define what "enhanced oversight" or "reinforcing contacts" with banking officials meant or how it would be measured. Therefore, it is not possible to determine what specific benefits the Department expected or has actually achieved from establishing this office.

When we asked Department officials about the accomplishments of the Tokyo office, they acknowledged it was not cost effective. However, they indicated the office helps establish better relationships and communications with Asian banks and banking regulators, and noted that Federal Reserve Bank officials have come to the Tokyo office Director for assistance in making contacts in Asia. Department officials could only provide anecdotal information about several instances where contacts made with Asian officials had proven beneficial to the Department. However, we could not determine whether these contacts had any impact on the Department or whether the likelihood of making such contacts was improved by having Department examiners live in - rather than travel to - Tokyo. Department officials told us that many of these benefits are intangible and cannot be put in terms of dollar value or otherwise quantified. We acknowledge that some of the benefits of the Tokyo office may not readily lend themselves to measurement. However, the Department should track and periodically report on how the use of these resources has benefitted the Department.

Department officials told us they do not have written, specific goals or objectives for the London office or documentation to justify its opening in 1974. Officials stated that these records no longer exist and there are no recent studies or analyses that would show the benefits, fiscal or otherwise, of maintaining the London office. Instead, Department officials provided the following list of benefits they believe are derived from operating the London office:

- The Department can do more efficient work because the same staff do the London examinations and are familiar with the institutions and their managers.

- There is enough work in the United Kingdom to justify keeping staff there year round.

- Department officials want the London office Director to establish channels of communication with foreign banking supervisors and with other banking entities.

In our view, these assertions by themselves, do not justify the need to maintain a London office. While it is understandable that Department staff who are familiar with London institutions can be more efficient in doing the examinations, the Department has not done any analysis to demonstrate why it is more efficient to have such staff live in London, rather than travel to London. In other words, the Department has not measured the benefits gained from maintaining a permanent London office and compared them to the cost of maintaining the office.

It is clearly reasonable that the Department seeks to improve communications with foreign banking institutions. Ten State-chartered banks do business in foreign countries and many foreign banks do business in New York State. As of December 31, 1998, 172 foreign banks maintained State-chartered branches or foreign agencies in New York with total assets of $643 billion. Again, however, Department officials do not measure the cost benefit of the improved communication with foreign banks achieved through a permanent London office, and, specifically, through the efforts of the London office Director. Whatever these benefits might be, the Department was willing to forego them for the two-year period ended December 1999 while this position remained vacant. Department officials did not fill the Director position until January 2000 when we began this audit.

To determine how common it is for government banking entities to maintain foreign offices to conduct overseas business, we surveyed banking regulators of the other 49 states and 4 U.S. territories. Of the 45 responses received, only 11 respondents monitor the overseas operations of their State-chartered banks, and none of the 11 had opened an overseas office. One state (Connecticut) said it might consider opening an overseas office in the future. We also determined that the New York State Department of Economic Development (DED) has offices in several foreign cities including Tokyo, London and Jerusalem. This represents an opportunity for the Department

to have a presence by assigning a liaison to the DED offices, rather than maintain separate offices.

We also contacted two Federal banking regulators: the Federal Reserve Bank (Federal Reserve) and the Office of the Comptroller of the Currency (OCC). OCC has an office in London, but OCC officials told us they have no plans to open an office in Asia. The Federal Reserve does not maintain foreign offices in Europe or Asia and has no plans to do so. Instead, their examiners travel overseas from the United States. For calendar year 1999, the Federal Reserve reported it participated in 24 overseas examinations (Japan, United Kingdom, Germany, Hong Kong, Brazil, Argentina and Korea) and incurred foreign travel expenses, including personal service costs, of approximately $1 million.

Staffing and Function of the Foreign Offices

As noted above, the Department views enhanced communication with foreign banking officials as one of the primary functions of its overseas offices. To determine the types of activities and tasks performed by the staff assigned to the foreign offices, we requested job descriptions for the staff and any specialized procedures related to those offices that would distinguish their staff or their office functions from those of U.S. offices. Department officials told us there are no specialized procedures for overseas offices related to bank examinations or to efforts to establish communication with foreign banking officials. The job descriptions for the Directors of the Tokyo Office (Chief Risk Management Specialist) and the London Office (Assistant Deputy Superintendent) are not specific to overseas offices and do not include the performance of liaison work with foreign banking officials.

A potential benefit of maintaining an overseas office is an increase in productive time (hours billed to examination work or other assessable activity), because staff spend less time traveling to examination sites. In an effort to track the activities of Department examiners, the Division's Chief Examiner has requested each Department office, including the two foreign offices, compile a monthly Activity Report. The report shows the activities (such as examination work, meetings, etc.) performed in each office during the previous month and the staff who carried out the activities. To evaluate the productivity of the overseas offices, we requested the monthly Activity Reports for calendar year 1999 for both offices. The Tokyo office provided eight of the 12 reports for calendar year 1999. These reports describe the progress of the annual bank examinations as well as meetings and dinner engagements with Japanese banking officials. They do not contain any details that showed any increase in staff productivity or specific accomplishments resulting from establishing relationships with foreign banking officials. The London office did not have any Activity Reports for 1998 and 1999, the two

years during which the office had no Director. The Chief Examiner told us that the lack of a Director does not mean that the London-based staff were not supervised, in fact, he supervised them directly from New York. The new Director provided an Activity Report for January 2000, however, one month of data was insufficient for an analysis of the amount of work done by the London office.

The Director of the Tokyo office prepared an analysis of the percentage of actual direct billable time staff spent on examinations for the five-month period ended May 1999. His analysis also included a forecast of Tokyo staff time utilization for the 12-month period ended May 2000. The analysis showed that only 50.2 percent of the staff time during the above 17-month period would involve doing examinations, Y2K preparation, training and leave. He estimated that the remaining 49.8 percent of the time would be "general expense" time not charged to any specific activity (e.g., downtime between assignments). The results of this analysis prompted the Department to recall one Tokyo office staff person to New York, reducing the number of Tokyo office examiners from five to four. Department officials said the purchase of a New York-chartered bank by a Europe-based bank was another reason for the staff reduction.

Regarding the productivity of Tokyo office staff, the Chief Examiner said that, ideally, there should be no charges to general expense for the New York City office. However, he told us that up to 20 percent of the Tokyo office staff time would be expected to be general expense because it is inherent in an office with such a small staff. In the New York City office, such charges account for no more than 15 percent of overall staff time. The Chief Examiner explained that the reason for the almost 50 percent general expense charge in the Tokyo office is the difficulty that office has in scheduling examinations to start right after the previous engagement is completed. Whatever the reason for the low productivity of this office, the apparent underutilization of Tokyo staff and the reduction in the number of staff assigned to the office suggest the Department has not improved its examination efficiency (through savings in travel time) by relocating its staff to Japan. At the exit conference for this audit, Department officials told us their analysis of general expense time for the first six months of calendar year 2000 shows it declined to 39 percent. They added that they plan to reduce it to 20 percent.

Another potential benefit of relocating staff to a foreign office is reducing the costs (plane tickets, meals and lodging) and time loss (time spent in airports and on planes) spent to get to foreign examination sites. However, Department records show that it may not be avoiding significant travel costs

and travel time by having a Tokyo office. In reviewing examination records for Tokyo-based staff for the period August 24, 1998 (the date the first examination was begun at this office) through November 19, 1999, we found they spent 3,877 of their total billable bank examination hours (55 percent) on exams outside Tokyo. That means they spent more than half their time on examinations for which the Department incurred travel and per diem expenses in addition to the expense of housing employees and their families in Japan. Having Tokyo office staff spend such a high percentage of examination time out of Japan reduces the rationale for having staff permanently assigned to Tokyo rather than traveling to Japan and to other Asian locations, as needed.

Cost Savings Available By Closing the Foreign Offices

Department officials concede that the operation of the Tokyo office is not cost effective and that the fees charged for overseas examinations are insufficient to cover the costs of the overseas offices. Department officials estimated the additional costs of operating the London and Tokyo offices that would be saved if the offices were closed, such as office expenses and cost of living compensation for the staff, as well as additional costs that would be incurred by conducting the functions directly from New York, such as travel expenses. The Department's estimate showed that it would cost about $178,000 less if the two offices were closed and employees traveled to the foreign countries to do the bank exams as shown in Exhibit A.

We reviewed the Department's estimate and found that it understated the cost savings because it did not include all of the additional costs of operating the offices that would be saved if they were closed and overstated some of the travel costs that would be incurred to perform and supervise bank examinations if staff travel from New York. We estimate the Department would save about $800,000 by closing both foreign offices as shown in Exhibit B. There are several areas where our estimates differ from the Department's. However, 90 percent of the difference between the two estimates are due to the Directors salaries and the additional travel costs for the exams done by the Tokyo-based staff.

In estimating the cost savings from closing the foreign offices, the Department did not include the salaries for the foreign office Directors totaling $204,092. Department officials told us that even if the offices were closed, the Directors would be reassigned to other functions. However, we included the Directors salaries as cost savings because the salaries would be attributed to the program that they were reassigned to, not the bank examination function.

Our review of the Department's estimate of additional travel expenses to conduct exams of overseas banks with New York-based staff showed that they overstated the additional travel costs for the Tokyo office exams. The Department estimated these additional travel costs at $628,000. The Department's estimate was based on the exams conducted by the Tokyo office staff for the period February 1999 through March 2000. The Tokyo-based staff spent 5,390 hours on bank exams during this period. However, we found that the Tokyo staff spent about 85 percent of their exam time traveling to banks in other Asian locations for which the Department already incurs travel expenses. Most of the travel expenses (e.g., hotels) would not be any different if the examiner traveled from New York or Tokyo. To determine whether airfare would be different, we compared the costs of airfare to the Asian examination sites (as of March 2000) from New York City and from Tokyo and found the differences to be relatively minimal as shown in the following table:

Comparison of Flight Costs and Duration for Asian Destinations						
Destination	Round Trip Air Fare			One-Way Flight Time (to nearest hour)		
	From Tokyo	From New York	Difference	From Tokyo	From New York	Difference
Tokyo		$1,260			14	
Hong Kong	$1,288	$1,069	$(219)	5	19	14
Seoul	$829	$927	$98	3	17	14
Singapore	$722	$986	$264	7	21	14
Sydney	$3,127	$2,031	$(1,096)	9	22	13

To allow for the longer flight times from New York City, we included additional per diems in our estimate. Our estimate of the additional costs for the examinations if the Tokyo office is closed is about $261,818, or $366,000 less than the Department's estimate.

Banks doing business in New York State pay for the Department costs, including the unrecovered costs (the portion of the operating costs that exceed the amounts billed for examinations for the same office for a given time period) of the Tokyo and London offices, through their annual assessments. This assessment contributes to the overhead costs banks must pay to do business in the State. The higher these costs, may make New York State less competitive in attracting and maintaining banks. As part of the Department's commitment to promoting the State charter in recognition of its link to job creation and economic growth for New York State, we believe the Department should be promoting cost savings whenever practical. In this instance, we estimate that the Department could save about $800,000 a year by closing its overseas offices.

Recommendations

1. Either document the cost benefit of continuing to maintain foreign offices, or consider closing the Tokyo and the London overseas offices and use New York-based staff to perform the overseas examinations.

2. If the Tokyo and London offices are not closed, the Department should:

   - develop specific goals and objectives for overseas offices;
   - measure the overseas offices' progress toward these goals; and
   - continue to periodically evaluate the cost benefit of maintaining the offices.

3. Contact the Department of Economic Development to pursue the assignment of a Department liaison at some of DED's offices (specifically, Tokyo and London), which would allow it to maintain a presence and avoid the costs of operating a separate office.

Recommendations (Cont'd)

(Department officials replied that they disagree with the above recommendations and will not implement them. They also indicate that the auditors did not consider the information provided by them regarding the foreign offices' operations, accomplishments and costs.

Auditors' Comment: The Department's response is incomplete and inaccurate because it fails to disclose that its estimate of the cost savings that would have resulted if the foreign offices had been closed was not given to the auditors until July 17, 2000, after we completed our field work. In fact, the Department's failure to provide information was noted in our draft report. Despite the Department's late submission, we reviewed the cost information provided and included it as Exhibit A in our draft report. Department officials incorrectly conclude we did not review their information because we did not change our conclusions about the value of the foreign offices. While the Department's response provides anecdotes about the activities of these offices, it does not address certain issues such as why 49.8 percent of the Tokyo office time reports for a 17-month time period indicated "general expense," which meant the expense was not charged to any specific activity. In addition, the London office functioned without a Director for two years. Department officials replied that taxpayers are not paying the Department's operating costs, and they conclude they do not have to monitor operating costs because "the banks doing business in the State foot the bill." Such a conclusion is inappropriate because of the likelihood that, ultimately, the banks will pass along to their customers various fees to cover their costs.)

Selected Procurement Practices

We reviewed foreign office expenditures for furniture and children's education. Our review focused on Tokyo because the London office was furnished several years ago and there were no supplemental educational expenses for children.

We found that the Department purchased furniture costing almost $139,000 for its Tokyo office without competitive bidding, as required by the State's procurement and disbursement guidelines. We also found that the Department paid education costs that regularly exceed the Department's annual budget estimate of $14,000 per child, and inappropriately paid for pre-school tuition costs totaling over $26,000.

Furniture Purchases

The State's procurement and disbursement guidelines, require State agencies to seek competitive bids whenever possible for procurement exceeding $15,000. In cases where competition may not be feasible or available, agencies must justify and document their selection of a vendor on a sole source or single source basis. A sole source situation occurs when only one contractor can supply the goods or services. Single source situations occur when two or more contractors can supply the goods or services, but the state agency selects one over the other for good and valid reasons (such as the vendor's special expertise or previous experience with similar contracts).

The Department purchased furniture costing $138,657 for the Tokyo office from one vendor as a sole source without competitive bidding. The furniture included items such as the following:

- 6 room partitions for $36,661, ranging in cost from $1,903 to $18,583;
- One work top for $12,693;
- One custom-made reception counter for $6,379;
- One custom-made desk for $5,887;
- 3 custom-made meeting tables totaling $8,728;
- 2 custom-made sideboards totaling $7,143, and
- 29 chairs for $21,735, including 15 leather armchairs costing over $1,000 each.

In documentation submitted to justify these purchases, Department officials indicated they had been told that furnishing an office in Tokyo would be four to six times more expensive than furnishing an office in New York. This documentation also indicated it was necessary for the Department to present an appropriate image in Japan and to have an office that inspired the respect of people who Department officials did business with. The documentation further noted that the firm that was asked to furnish and design the space confirmed it would have the office ready by June 1, 1998 and that finding another firm to deliver an office to meet the Department's time schedule was impossible. Department records also show that the vendor who provided the furniture was recommended by another firm in Tokyo.

We believe the "time crisis" to furnish the Tokyo office could have been avoided if Department officials would have scheduled the opening for a date that allowed sufficient time to adequately plan for the furniture needs of the office, to identify suitable furniture vendors, and to obtain competitive bids. However, Department officials said they had little time to get this office furnished since they did not select the Tokyo office space until April 1998. By purchasing the furniture in a relatively short time period, the Department limited its opportunity to benefit from the advantages of competitive bidding and likely paid more than necessary for the office furniture.

Tuition Costs for Children of Employees

According to the compensation plan for the Tokyo-based employees, the education allowance covers the costs of tuition for the children of employees from kindergarten through 12th grade. The costs of education per student is estimated at $14,000 per year. The compensation plan does not specifically limit education expense as it does housing costs.

We found that the Department incorrectly paid preschool tuition expenses for the children of two Tokyo-based employees. The combined tuition expenses for the 1998/99 and 1999/2000 school years totaled $26,480. Department officials told us that prior to relocating to Tokyo employees were advised that preschool tuition expenses would be eligible for reimbursement. However, the Department subsequently reevaluated this policy and changed it to not cover preschool tuition. They further explained they will make it plain to all overseas employees that the school fees for pre-school age children are not eligible for reimbursement. However, Department officials said that they will not seek to recover the inappropriate payments from the two employees.

We also found that the tuition for the school age children of the Tokyo staff regularly exceeded the estimate of $14,000 a year. The tuition for the children of the Tokyo office employees exceeded $14,000 for 4 of the 5

children in 1998/99 and for all 5 children in 1999/2000. The annual tuition costs ranged from $15,630 to $21,924. We found the Department's payments for the tuition exceeded the estimated annual amount by $32,249 in aggregate for the two years. We believe that the Department should establish a firm tuition reimbursement limit and have the employees bear the costs of any excess tuition costs.

Recommendation

4. If the Tokyo and London offices remain open, the Department should control the costs of operating these offices by:

   - improving the planning of purchases to take advantage of competition through the use of bids to comply with the State's procurement requirements;

   - issuing written guidance clarifying that state pre-school tuition expenses are not eligible for reimbursement from the Department; and

   - establishing limits on the amount of reimbursement overseas employees can receive for their children's education costs.

   (The Department replied to our draft report that its actions for both procuring furniture and the payments for educational costs were reasonable and proper under the circumstances. They indicated that they will not implement the recommendation.

   Auditors' Comment: It is unfortunate that Department officials maintain the position that the use of additional resources for the overseas offices without any measurable benefits is appropriate. For example, they should not pay educational costs without regard to the amount budgeted for tuition, particularly where the estimate was derived with the services of a paid consultant. It is reasonable to expect that employees of these overseas offices function within the limits of a budget. We believe Department officials should act in a responsible manner regardless of who "foots the bill.")

BANKING DEPARTMENT ESTIMATE OF ANNUAL COST SAVINGS FROM CLOSING OVERSEAS OFFICES			
Cost Category	**London**	**Tokyo**	**Total**
Personal Service	$151,377	$151,782	$303,159
Housing	165,764	296,077	461,841
Office Expense	51,527	260,170	311,697
Education	0	57,300	57,300
Other (Storage, misc. Contractual services)	28,150	68,588	96,738
Total Estimated Annual Costs	$396,818	$833,917	$1,230,735
Less: Additional Travel Costs			
Airfare	$19,000	$70,560	$89,560
Per Diems	287,639	407,956	695,595
Lost Productivity	67,579	99,590	167,169
Supervisory Visits	50,000	50,000	100,000
Additional Travel Costs	424,218	628,106	1,052,324
Net Cost Savings	($27,400)	$205,811	$178,411

Exhibit A

OSC ESTIMATE OF ANNUAL COST SAVINGS FROM CLOSING OVERSEAS OFFICES			
Cost Category	**London**	**Tokyo**	**Total**
Personal Service	$275,154	$260,787	$535,941
Housing	169,001	296,077	465,078
Office Expense	51,527	260,170	311,697
Education	0	70,000	70,000
Other (Storage, misc. Contractual services)	28,150	114,575	142,725
Total Estimated Annual Costs	$523,832	$1,001,609	$1,525,441
Less: Additional Travel Costs			
Airfare	$19,500	$10,080	$29,580
Per Diems	294,590	58,776	353,366
Lost Productivity	69,358	97,812	167,170
Supervisory Visits	62,616	62,616	125,232
Weekend Allowance	4,400	6,636	11,036
Miscellaneous	14,450	3,050	17,500
Additional Costs for Non-Tokyo Trips		22,848	22,848
Additional Travel Costs	464,914	261,818	726,732
Net Cost Savings	$58,918	$739,791	$798,709

Exhibit B

Major Contributors to This Report

Carmen Maldonado
Frank Houston
Stanley Evans
Dominick Vanacore
Stephen Goss
Keith Murphy
Alina Mattie
Richard Moriarty
Nancy Varley

Appendix A

STATE OF NEW YORK
BANKING DEPARTMENT
2 RECTOR STREET
NEW YORK, NY 10006

May 21, 2001

Ms. Carmen Maldonado
Audit Director
Office of State Comptroller
Division of Management Audit & State Financial Services
123 William Street - 21st floor
New York, N.Y. 10038

Dear Ms. Maldonado:

In accordance with Section 170 of the Executive Law, we are responding to your audit report 99-S-53 on the operations of the overseas offices of the NYS Banking Department.

Sincerely,

Gideon Weingarten
Director, Internal Audit

Att.
cc:Elizabeth McCaul
Dan Muccia
Michael Lesser
Diana Rulon
Robert Weaver
Dave Billet
Don Capone, Division of Budget, Albany
Charles Conaway, Albany
Christopher McCarthy, Albany
Audit Dept. File: 2 copies

RESPONSE TO AUDIT 99-S-53:

'The Operations of the Overseas Offices of the NY State Banking Department'

***

New York is the epicenter of international banking in the United States and the Banking Department is the country's most important regulator of US branches and agencies of foreign banking organizations. As of the end of 2000, the Department supervised more than 75% of the assets held by such entities in the United States. The foreign banking organizations' presence in New York makes an important contribution to New York State's economy. Their presence also helps provide healthy competition for our domestic institutions and greatly enhance liquidity in both national and local financial markets. At the same time, New York banks and financial services companies themselves have significant global operations that also strengthen the business climate here in New York.

In each case, it is absolutely essential that the Banking Department maintain open, direct and comprehensive relationships with foreign banks and regulators by maintaining offices in the principal European and Asian financial centers, London and Tokyo. The offices help the Banking Department to more effectively supervise foreign banks doing business in New York. They also help assure foreign regulators that it is safe to let New York banks do business in these jurisdictions because New York State properly supervises their activities, both at home and abroad. They also help the Department understand the opportunities and risks encountered by New York institutions in their overseas activities.

The State Comptroller's audit asks, "does the benefit the Department gains from its overseas offices justify the expense of maintaining them?" For the reasons enumerated above, and as more fully discussed in the body of this response, the answer is an unequivocal yes. The audit itself acknowledges the "link" between promoting a strong State banking charter and "job creation and economic growth for New York State." Moreover, it is important to note that the Department's operations are not funded by New York's taxpayers. Rather, as the audit itself concedes, it is the banks doing business in this State who foot the bill. The

benefits derived from funding the Department's London and Tokyo operations are clear to our institutions that engage in foreign business. And because it is the New York State Banking Department that supervises the vast bulk of foreign bank assets in this country, the overseas operations of other regulators queried by the State Comptroller simply do not offer a germane comparison.

With respect to the State Comptroller's audit itself, the Banking Department received a draft report (see title above) on April 10, 2001 of a Management Audit started in December 1999, where field work was completed in May 2000, and the 'Exit' meeting took place on July 12, 2000.

*
Note
1

None of the changes agreed upon between the OSC Auditors and the Banking Department were made (as reflected in this response), none of the figures supplied to the OSC Auditors were used in the OSC report, and none of the factors which require keeping the overseas offices open were recognized by OSC.

*
Note
2

The Banking Department appreciates the need and the desirability for an independent review of its operations, particularly where internal control issues are identified for enhancement. However, the Banking Department does not agree that the recommendations contained in the OSC report provide such constructive guidance. Instead, they evidence a fundamental failure to appreciate the important function performed by the overseas offices of the Banking Department. The Banking Department's responses to the particular recommendations in the report follow:

*
Note
3

Recommendation

1. "Either document the cost benefit of continuing to maintain foreign offices, or consider closing the Tokyo and the London overseas offices and use New York-based staff to perform the overseas examinations."

Response

The OSC Auditors were at the Banking Department conducting their fieldwork for this audit between January and May 2000. In that time, many discussions ensued between the auditors and Banking Department management. Banking noted that the value and importance of the London and Tokyo offices must be measured by the opportunity they provide the Department to maintain open, direct and comprehensive relationships with foreign banks and regulators, as described in the introduction to this response, as much or more than by any cost-benefit analysis. The following examples illustrate the importance of the personal relationships developed with both Asian and European regulators as a result of these offices:

- As a result of our relationship with a senior Asian bank supervisor, the Department was entrusted with critical information, which resulted in the discovery of a major fraud scheme affecting a bank-holding company in New York. Without the contacts established and the on-site location, this would not have occurred.

- The relationships with the UK supervisors, built up through the 25 years of operating the London office, have directly resulted in their allowing NY based financial institutions to operate banking subsidiaries in the UK with this Department as the supervisor of their international banking activities. This supervisory framework has facilitated the ability of major NY based organizations such as Merrill Lynch and American Express to conduct their banking business in the UK.

- The recognition of this Department as being capable of performing comprehensive consolidated supervision, made possible to a large extent by its presence in Europe and Asia, has allowed General Electric Capital Corporation, one of the largest US based financial conglomerates, to structure its overseas banking network under a New York State Article XII charter under our supervision. The supervision of this entity requires examination work and supervisory contact in a

number of European and Asian countries and would be difficult to accomplish without these overseas offices.

- When the UK was restructuring its financial supervisory system, resulting in the establishment of the UK Financial Services Authority, the Department was involved in discussions with them on establishing the new structure that assumed supervisory responsibility from the Bank of England.

- The Japanese Financial Services Agency (JFSA) recognized New York State's procedural expertise when they used NYS examination protocols as a model for developing their regional protocols. This is a dramatic achievement that enabled the Department to influence Asian banking practices at some of the world's largest banking institutions.

- The Banking Department provided examination guidance to the Korean Financial Supervisory Service and has been asked by both the Hong Kong Monetary Authority and the Monetary Authority of Singapore to assist them by providing capital markets training for their examiners. This type of assistance, which could not occur without the Department's presence, helps build supervisory relationships throughout the region.

- The relationships the Banking Department has built already have provided value-added to the New York institutions supervised by the Department. We have been able to discuss areas of mutual concern directly with the cabinet minister who oversees financial supervision in that country.

- Through close contact with local regulators, the Department has been able to clarify local requirements and application procedures, which help our institutions doing business in these jurisdictions understand local rules and practices.

- Through interaction with both client banks and regulatory officials in Asia and Europe, the Department has laid the groundwork for the timely exchange of information concerning issues that affect the financial strength of these regions. Department expertise, built up through the operation of the overseas offices, results in a more attractive state charter.

These benefits cannot always be measured in dollars, pounds and yen. The Banking Department will not implement this recommendation.

*
Note
3

4

Recommendation

2. "If the Tokyo and London offices are not closed, the Department should:

- Develop specific goals and objectives for overseas offices;
- Measure the overseas offices' progress toward these goals; and
- Continue to periodically evaluate the cost benefit of maintaining the offices."

Response

The following listed objectives apply to our London and Tokyo offices:

Objective #1 - To enhance the Department's oversight of U.S.-based institutions with significant European and Asian operations

The London and Tokyo offices are the center of bank examinations activity for our State-chartered institutions that operate in European and Asian markets. These institutions all have significant operations in London and Tokyo as well as in several other European and Asian venues. While London and Tokyo remain the most important financial centers in Europe and Asia respectively, several other cities, including Frankfurt, Singapore and Hong Kong, also have gained prominence in recent years.

On-balance sheet risk at European and Asian offices is relatively modest; however, the off-balance sheet exposure is significantly higher. At year end 2000, European and Asian offices of New York State institutions accounted for more than $164 billion of on-balance sheet exposure ($12 billion in Tokyo) plus an additional $26 trillion of off-balance sheet risk ($576 billion in Tokyo offices). As indicated by those numbers, for the majority of European and Asian operations, the trading of financial products is the most significant activity. In recognition of this fact the London and Tokyo offices are staffed with examiners who are trained to perform evaluations of market and credit risk management policies, procedures and exposures. These evaluations are best conducted through on-site reviews. The examiners' constant local presence enables us to examine European and Asian operations in-depth.

In addition, several investment companies charted pursuant to Article XII of the Banking Law have operations in Europe and Asia through branches of their London and Tokyo merchant bank subsidiaries. Worldwide-consolidated supervision requirements increasingly demand that an institution be under the supervision of a

home country regulator as a precondition for entry and continued maintenance of a banking presence in other countries. The Department fulfills this requirement for these New York companies by serving as a home country supervisor. This contributes to the health of the State's financial services sector since these New York-based companies could not meet international banking standards without being subject to the Banking Department's regulation. The global activities of these companies must be examined as part of our regulatory responsibility to these companies and the industry.

Objective #2 - To reinforce our contacts with the European and Asian banking regulators

For some time, the Banking Department has recognized the need for a presence in European and Asian markets. To improve regulation and address the needs of its institutions, the Department must actively coordinate supervisory efforts with other regulators, not only in this country, but around the world.

In concert with other regional agencies, the Banking Department is providing a forum to foster more concise thought on regulatory issues concerning Europe and Asia. In Europe, the Department has 25 years of experience closely coordinating with UK banking supervisors. Through these efforts the Department has handled countless issues to the mutual satisfaction of US, UK and European regulators. Additionally, in Japan we have coordinated with the Financial Supervisory Agency (FSA) concerning information sharing, training and examination methodologies. This type of supervisory coordination half-way around the world, in different time zones and cultures, simply could not happen without a local presence.

Objective #3 - To build upon our existing relationships with banks headquartered in Europe and Asia, many of which have offices in New York

As noted above, the Banking Department licenses branches and agencies of foreign banks and is responsible for the examination and supervision of these locations in New York. These offices account for more than 75% of the assets held by such entities in this country. However, the main offices of these institutions and their activities outside New York are not subject to direct supervision or examination by the Banking Department. Since the activities of these main offices have a direct impact on the branches and agencies the Department does regulate, we need to strengthen our relationship with and gather intelligence on these institutions, which include the largest banks in the world. This objective has been accomplished through a program of visitations to the head offices of institutions located in

London and Tokyo and other European and Asian centers.

Building upon the Banking Department's 25 years experience doing this in London, the Tokyo office has made substantial progress in laying the foundation for meeting this goal. Contacts and relationship-building sessions have already occurred. In addition, the Banking Department continues to evaluate the staffing of the offices based on the efficiency and effectiveness as measured by the Banking Department management.

It is our opinion that we have documented objectives and that they are measured and evaluated periodically as suggested by the OSC Audit.

*
Note
4

7

*See State Comptroller's Notes, Appendix C

Recommendation

3. "Contact the Department of Economic Development to pursue the assignment of a Department liaison at some DED's offices (specifically, Tokyo and London), which would allow it to maintain a presence and avoid the costs of operating a separate office."

Response

The Banking Department believes that the important work performed by each agency warrants maintaining their separate offices. Certainly, the Department's needs and objectives cannot be met by having a "banking interests" desk at any other state agency. Moreover, all bank regulatory agencies are required to maintain separate and secure facilities because of the confidential nature of examination and investigation materials. Indeed, the ability to regulate banks effectively depends upon the confidence of regulated entities that such materials are kept in a secure environment.

*
Note
5

Therefore, the Banking Department will not implement this recommendation.

Recommendation

4. "If the Tokyo and London offices remain open, the Department should control the costs of operating these offices by:

- Improving the planning of purchases to take advantage of competition through the use of bids to comply with the State's procurement requirements;

- Issuing written guidance clarifying that State pre-school tuition expenses are not eligible for reimbursement from the Department; and

- Establishing limits on the amount of reimbursement overseas employees can receive for their children's education costs."

Response

The "Selected Procurement Practices" section of the State Comptroller's audit asserts that the Department failed to follow the State procurement guidelines for purchasing the furniture and, therefore, spent more money than necessary for these items, and that the Department exceeded the budgeted amount for education. The Department does not agree with these assertions for the following reasons:

- The Department followed the State's Procurement Guidelines in obtaining a vendor for the design and furnishing of the Asian Office.

The audit states that the Department purchased "furniture costing $138,657 for the Tokyo office from one vendor as a sole source without competitive bidding". Sole source purchases, by definition, do not require competitive bidding. Section Three of the Procurement Guidelines outlines a series of questions the Department should consider in determining the appropriate procurement technique. "The answers to these questions, along with the agency's professional judgement, will result in the choice of a method for conducting procurement". The first question asks, "is it a routine problem (procurement), or one that is highly unique? Is it a recurring need or a one-time occurrence?" The answer as explained more fully below is clearly is that this is a highly unique, one-time occurrence.

Section Four of the State's Procurement Guidelines entitled "Procurement Techniques" further outlines the steps necessary to determine the best procurement method. The Department must do a complete "needs assessment" of

the procurement. If the needs can not be "best met by competitive bid", the Department should determine whether there is more than one company that could meet the Department's requirements. The opening of the Tokyo office was a highly unique, one-time transaction, one that needed to take into account business practices in Japan and the amount of time needed to open the office on time at reasonable costs. Throughout the process, the Department sought the advice of banking officials, other expatriates, other state agencies who do business overseas, and with Arthur Andersen Consulting, with whom the Department contracted to help us set up the office. Each stressed that business in Japan is based on long term relationships. Competitive bidding is not utiized there. Referrals are made between business partners and colleagues, and the client is expected to maintain a long-term relationship with the vendor. New York State's objective in competitive bidding, as stated in the Procurement Guidelines, is to "ensur(e) the procurement process produces an optimal solution at a reasonable price; guard(s) against favoritism, fraud and collusion; and allow(s) qualified vendors an opportunity to obtain State business." The goal is to get the "best value", which is not synonymous with "lowest price", and to give all vendors a level playing field on which to compete. This method is not readily transplanted into the Japanese business culture.

To obtain information on firms able to do this work, the Department e-mailed an introduction and explanation of the work needed to several companies in the area. After two weeks, two companies responded. When the second company failed to respond to initial contacts, Okamura was selected. This was the only firm prepared to meet the timeframes necessary to open the office. Based on these factors, the Department determined that "sole source" was the appropriate procurement method.

The State Comptroller notes that the Department's "time crisis" to open the Tokyo Office could have been avoided if Department officials had scheduled the opening for a date that allowed sufficient time to adequately plan for the furniture needs...". This is incorrect. Until the office space was leased, there was no point in retaining a firm to design and furnish it, as there would have been nothing for them to bid on, refer to, plan for, or do. The Department put a deposit on space in March, but was not allowed into the space until the first rent payment was received, which was in April, for a May occupancy. Space planning began as soon as the deposit was placed. Because the Department was concerned that expensive rental space be ready for occupancy as soon as reasonably practicable, any vendor had to be willing to work expeditiously.

- The price for the furniture was reasonable.

The State Comptroller charges that "by purchasing the furniture in a relatively short time period, the Department limited its opportunity to benefit from the advantages of competitive bidding, and likely paid more than necessary for the office furniture." Again, this is incorrect. The Department was cost-conscious and careful in furnishing the Tokyo office.

The office was designed with systems workstations for employees, similar to those found in many state offices in New York. There is an open work area for all employees, including the Director, two conference rooms, a workspace for the xerox and fax machines and storage, and a reception area. The $139,000 cost cited by the State Comptroller includes furniture, taxes, delivery, installation and some equipment. The breakdown of the costs is as follows:

Conference Room (2)	$27,057
Meeting area	3,383
Equipment area	9,546
Reception area	21,616
Workstation including Manager	66,990
Delivery and installation	6,150
Refrigerator	742
Fax machine	3,390
Total	$138,874

The "6 room partitions" and the "work top" referred to in the report are employee workstations. The "custom-made desk" is attached to these workstations as the Director's station. This provides workspace for seven employees, at a cost of $55,241, according to the items listed in the audit. Since there were additional pieces not mentioned in the findings, the total cost was actually $63,400 (without tax or installation for comparison). There are six workstations sized at approximately 5' X 6'. The manager's area consists of an L shaped top 5' x 3' and 5' X 1.5' and a 2-drawer cabinet, 3' X 1.5' X 28". Based on sample workstation estimates from two vendors on State Contract, the list price of similar workstations in New York would be approximately $52,500 for seven workstations @7' X 7', assuming no differential for Director, from Herman Miller Company. Knoll Furniture's estimate for six employee stations (6' X 6') and one manager's station (6' X 8') was approximately $51,100. The State of New York obtained substantial discounts against these list prices when they entered into contracts with these vendors, These discounts reflect the buying power of all of New York State Government. Reasonable people might expect that the cost for only 7 items, purchased in a foreign country known for being very expensive, would be higher. Even so, the cost of furnishings for the employees is comparable and certainly not excessive.

The other items listed by the State Comptroller are described as custom-made, leaving the impression that the furniture was specially produced by master craftsmen. In fact, it only means that the tables and sideboards were cut at the factory or on site to be other than a standard size. They are "customized" to the size of the conference and meeting rooms and to the size of the reception area. This makes the best use of space. Furnishings for two conferences areas cost $25,800 (before tax), and the reception area costs $20,600 (before tax).

- The Department's compensation package provided full payment of education costs at selected schools.

On the matter of education costs, the Department consulted with Arthur Andersen (AA) to give an estimate of the cost of schooling in Japan. Arthur Andersen identified five schools that expatriates use. Based on discussions with AA, the Department established a budget number of $14,000 for tuition. However, there were other costs, including registration fees and various one-time building use fees that were required in the year a student enrolls in a school. The Department paid all charges mandated by the schools. Charges for extracurricular activities were, and continue to be, the responsibility of the expatriate. The commitment to pay for education costs was honored, even if the estimated (budgeted) figures were low.

AA also indicated that it is usual and customary for preschool costs to be paid. The first group of expatriates was told, based on AA's information, that these costs would be covered. When the question was revisited after the first semester, AA again indicated these were costs that could be paid. Upon further consideration, however, the Department determined that nursery and preschool costs would not continue to be covered when new employees rotated to Tokyo assignments. Since a commitment was made to the original expatriates, however, and the welfare of the children was at stake, the Department determined that payment for preschool would continue for the two children already enrolled under the former policy.

The Banking Department has no plans to close either office and considers this recommendation as applying to a situation which already has been resolved. We maintain that our policy and procedures relating to our overseas offices are strong, effective and properly controlled.

State Comptroller's Notes

Note 1. It is surprising that Department officials chose to comment on the time it took from the closing conference to the draft report. As previously stated, despite our repeated requests, they did not provide any documentation from the start of the audit until July 2000 after the closing conference. We conclude the analysis was either not prepared until after the closing conference or the Department chose to withhold it during the fieldwork. The auditors were reassigned to another audit and had to evaluate the information including requesting additional documentation from the Department. Clearly, the entire process would have been expedited if Department officials had given us the documents in a timely manner.

Note 2. We disagree with the Department's statements that we did not consider information they provided us. The Department's response to our preliminary findings did not provide any information, stating "its first official response to this audit will be to the draft report when received," and that "[a]s to justification relating to costs of opening and maintaining the London and Tokyo offices, we will respond in detail to the draft report upon receipt." At the exit conference, the Department provided oral explanations; but did not give us a cost savings analysis and a written response to our questions regarding that analysis until afterwards. We thoroughly reviewed their analysis and response and included it in the report on pages 10, 11, and Exhibit A. However, we did not agree with the Department's position in all cases, particularly where statements are not supported by other forms of evidence.

As a regulatory agency, we expect that the Department would require sufficient evidence in conducting examinations of financial institutions it oversees and would not rely solely on statements to draw their conclusions.

Note 3. We are pleased that the Department has attributed its achievements to having a foreign presence. The achievements recorded in the Department's response are far more extensive than the evidence provided to us during the audit. However, many of the cases still make no direct connection to the need for foreign offices. Foreign contacts can be maintained without these separate offices. While we acknowledge that such benefits are not always easily measured, the Department cannot be absolved of the responsibility to periodically document these benefits and evaluate them against the cost of their achievement.

Note 4. Although the Department's response documents the broad goals of relationship-building in foreign locations, they offer no measurable objectives, and, we are unaware of any reports that periodically measure the accomplishment of specific objectives.

Note 5. We are not suggesting that the Department use space that is not secure. However, a more efficient use of resources would be possible if the Department shared space with DED when the Examiners travel overseas.