We expect to deploy our financial assets to increase staffing levels, increase staff expertise through hiring experienced employees and training, investing in sophisicated enterprise-wide system solutions, and making long-overdue upgrades to our technical infrastructure.

V. Financial Management

Letter from the CFO

I am pleased to present the OCC's financial statements for the FY 2006 Annual Report. I am also pleased to note that for FY 2006 our independent auditors rendered an unqualified opinion with no material internal control weaknesses. The OCC's commitment to effective financial management continues to be my highest priority, as the following key initiatives show:

- *Implementation of OMB Circular A-123—Management's Responsibility for Internal Control (A-123).* During the past year we completed our A-123 implementation. The Financial Management staff documented our financial processes, performed a risk assessment, and tested all of our critical processes. The testing showed no material internal control weaknesses, and we have developed plans to strengthen our internal controls. A communications strategy is an essential element in our A-123 program. We sent regular messages to OCC employees highlighting this effort and reminding them of their responsibilities to maintain an effective internal control environment. Though significant resources were required, we firmly established a stronger internal control environment. I look forward to the evolving benefits that this process will offer.
- *Migration of OCC Financial Platform to the Bureau of Public Debt (BPD).* OCC has signed a letter of intent to migrate its financial and acquisition systems to the Administrative Resource Center (ARC) at BPD. This decision will enhance financial reporting and yield long-term financial benefits from the expertise of an established service provider. The expected conversion to the new platform is October 2007.
- *Financial Management Restructuring.* After analyzing the organization of the Financial Management department, we determined that structural changes would serve the financial needs of the OCC more effectively and efficiently. Highlights of the restructuring include consolidation of accounting processes into two groups, one focused on operational accounting and the other on financial accounting. We also created an internal control unit focused on A-123 and process reengineering.

I would also like to update you on the continued success of our process reengineering initiatives. After embracing the Lean Six Sigma methodology, the Office of Management turned its focus to reengineering core processes in FY 2006. We completed 15 new reengineering projects during the fiscal year. Because Lean Six Sigma stresses the "voice of the customer," internal customer participation in these projects has been vital for success. As measured by the Office of Management "balanced scorecard," the OCC has saved approximately $1.3 million through these efforts since FY 2005, but more importantly, our processes more efficiently address the needs of the OCC.

The Budget and Finance Subcommittee, which I chair, had a full agenda during the past year. Responsible for managing the financial performance of the agency, the subcommittee continued to oversee the budgeting process and made key recommendations to establish the direction of the FY 2007 budget. The goal of the subcommittee is to ensure that the budget is not only prudent, but also links directly with the agency's strategic goals and objectives. The subcommittee also serves as an investment review board for non-information-technology investments, such as leasing arrangements. One area of subcommittee focus was the OCC's need for additional office space to accommodate increased staffing levels. The panel reviewed and analyzed options and recommended an office space plan that is being implemented.

Finally, I would like to take a few moments to review the overall financial condition of the OCC. In FY 2006, the OCC has seen an increase in its balance-sheet assets, reflecting the overall growth of assets in the national banking system. As the agency responds to that growth through its primary programs, we expect to deploy our financial assets to increase staffing levels, increase staff expertise through hiring experienced employees and training, investing in sophisticated enterprise-wide system solutions, and making long-overdue upgrades to our technical infrastructure. These investments are designed to maintain our strong regulatory presence.

While FY 2006 has been a year of significant accomplishments, we do not intend to rest on our laurels. We plan to continue to meet our financial responsibilities and contribute to the overall strength of financial management in the federal government. In closing, I would like to repeat my commitment from last year—to ensure we have the finest people and resources dedicated to managing and monitoring the effective and efficient use of agency resources.

Thomas R. Bloom, Chief Financial Officer

Financial Management Discussion and Analysis

Historical Perspective

In FY 2006, the Office of Management's Financial Management department (FM) employed an operating strategy focused on achieving and maintaining data integrity across its organization. During the previous year, FM began improving its business processes and further refining the department's alignment with strategic goals through the use of the "balanced scorecard." The scorecard measures performance and initiatives in four operational areas. As a result of these efforts, the department began FY 2006 in a much stronger position to provide consistently reliable information to OCC decision-makers for managing their programs effectively, and the department was poised to meet the agency's emerging needs.

Strategic Focus

Last year, Financial Management continued to demonstrate its commitment to customer service, stewardship, and continuous improvement. Managing for results and using widely recognized best practices, such as the "balanced scorecard" and business process improvement, FM made significant progress toward achieving key business goals. The department's strategic focus has been to prepare for implementing new systems for financial management and acquisitions, and to meet significant new internal control requirements for federal agencies. The department adopted a new organizational structure, ensuring that units are better aligned for efficient processes and valued customer service. FM has focused heavily on staff and leadership development, and on increasing employee engagement as measured through the Gallup employee engagement survey.

Goal for Financial Management

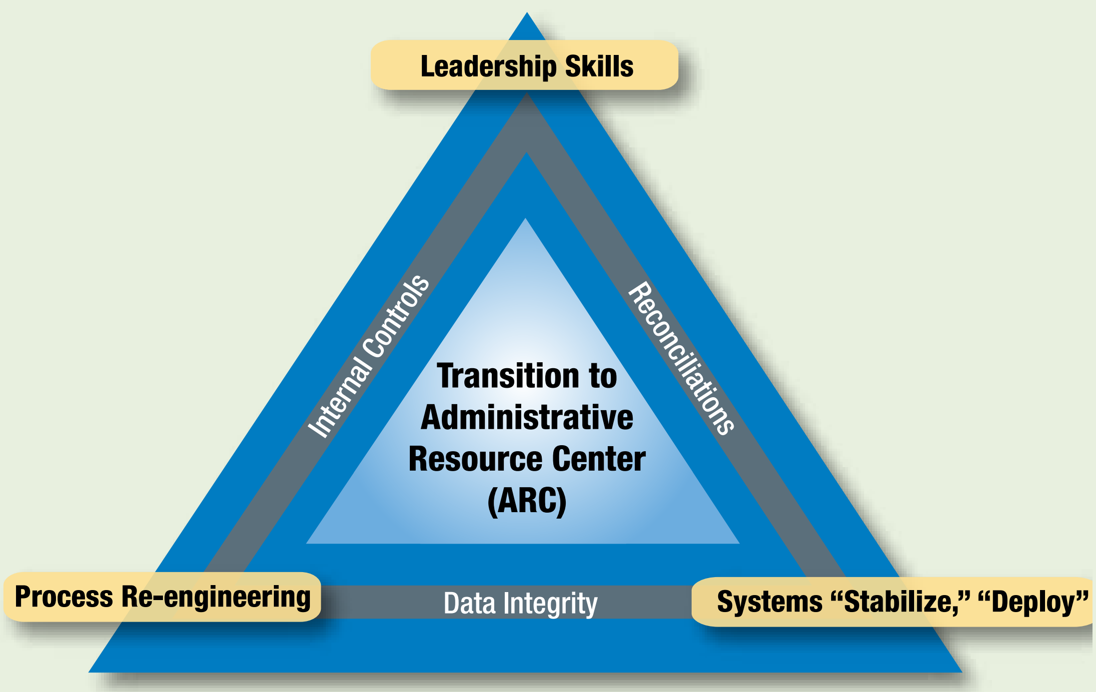
The goal for FM is to be an efficient organization that reflects:

- An engaged workforce committed to the business strategy of operational excellence.
- A solid understanding of customer needs and expectations.
- Efficient processes that take advantage of system capabilities.
- A focus on developing staff competencies for the evolving organization.
- An effective management of projects and programs.

Operating Strategy

The FM operating strategy for FY 2006 is shown in Figure 1. The strategy emphasized FM's most important business objectives. Business process improvement will be used throughout the department's preparation for implementing the new systems for financial management and acquisitions

Figure 1: FY 2006 FM Operating Strategy



that are scheduled for deployment in early FY 2008. FM fully adopted the new process documentation and internal control testing requirements outlined in OMB Circular A-123, Appendix A, "Internal Control over Financial Reporting," and has begun to refine its internal control program to ensure that it is effective in all FM business processes. Implementing the requirements of Circular A-123 required significant participation and support from staff and management across all FM units. This first year effort required a proactive approach that included visible senior management support, a strong communication strategy throughout the agency, and the on-going involvement of a strong agency governance team. The comprehensive assessment resulted in the Comptroller's ability to provide reasonable assurance that the OCC has effective internal controls over financial reporting.

Additional major accomplishments include the use of the redesigned process for collecting annual OCC operating funds from the national banks and negotiating more than 7 percent, or approximately $5 million, in contractual savings for annual contracts awarded.

The FM organization was restructured this year to ensure that responsibilities are aligned to enhance efficiency, facilitate implementation of new automated systems, and improve customer-service delivery. FM concentrated on employee development through specific training and developmental assignments for staff at all levels.

The Balanced Scorecard

The FM "balanced scorecard" measures performance and initiatives from these four perspectives:

- Customer
- Financial management
- Internal processes
- Learning and growth

The customer perspective ensures that FM's products and services reflect an accurate identification of its customers and their needs. During FY 2006, FM carried out a customer service action plan to ensure that the "voice of the customer" was integrated into all FM products and services. Using valuable input received from OCC customers through the 2005 annual customer satisfaction survey, FM engaged in on-going dialogue with key customers and is working to improve the delivery of guidance and information on the agency's intranet. In August 2006, FM participated again in the annual OM OCC-wide customer satisfaction survey. FM management and staff will use the results of this year's survey to plan FY 2007 and later customer-focused initiatives.

The financial management perspective ensures that FM is using the OCC's financial resources to support the agency's overall strategic financial goals and objectives. It serves as a mechanism to help FM use financial resources to produce the best value for the OCC. In FY 2006, FM met the target of maintaining its costs at or below 1.9 percent of total planned OCC operating costs, even with the increased costs of its expanded responsibilities for OMB A-123.

The internal processes perspective ensures that FM focuses on improving the processes that are most critical to achieving its business goals. As reflected in the FY 2006 operating and strategic business strategies, FM devoted the most attention and effort this fiscal year to processes that had known inefficiencies or would be significantly affected by the implementation of a new system for financial management and acquisitions. FM carried out several business process reengineering projects for key areas, such as acquisitions and file planning, contract closeouts, federal records retention scheduling, and file room management.

The learning and growth perspective ensures that FM identifies the critical staff skills needed to achieve its business goals and that management works with staff to ensure that those skills are fully developed. Each unit of FM worked on action plans in response to the Gallup employee engagement survey. FM hired several new employees during FY 2006 and began focusing on developing the next generation of leaders. The department also augmented its workforce by hiring several undergraduate and graduate-level financial interns, who introduced fresh perspectives and the latest learning in various disciplines to the work environment.

Future Focus

Financial Management will continue to focus on achieving strategic business goals and on measuring progress by using the "balanced scorecard" and business process improvement. The department will benchmark performance through key business metrics. The department will continue to explore the latest business models, such as outsourcing and e-commerce, and will focus on modernizing internal controls, ensuring that the agency is up-to-date with the current guidance in financial management policies.

Funding Sources and Uses

Funding Sources

The OCC does not receive appropriations. The OCC's operations are funded primarily by assessments collected from national banks and other income, including interest on investments in U.S. Treasury securities. The Comptroller, in

Table 7: Components of Total Revenue, FY 2006 and 2005 (in millions)

	FY 2006	FY 2005	Change
Assessments	$609.5	$557.8	$51.7
Investment Income	$20.5	$17.0	$3.5
Other[1]	$3.6	$2.9	$0.7
Total Revenue	$633.6	$577.7	$55.9

[1] Other sources of revenue include bank licensing fees, revenue received from the sale of publications, and other miscellaneous sources.

accordance with 12 USC 482, establishes budget authority for a given fiscal year. The total budget authority available for use by the OCC in FY 2006 was $579.4 million, which represents an increase of $60 million, or 11.6 percent, over the $519.4 million budget in FY 2005.

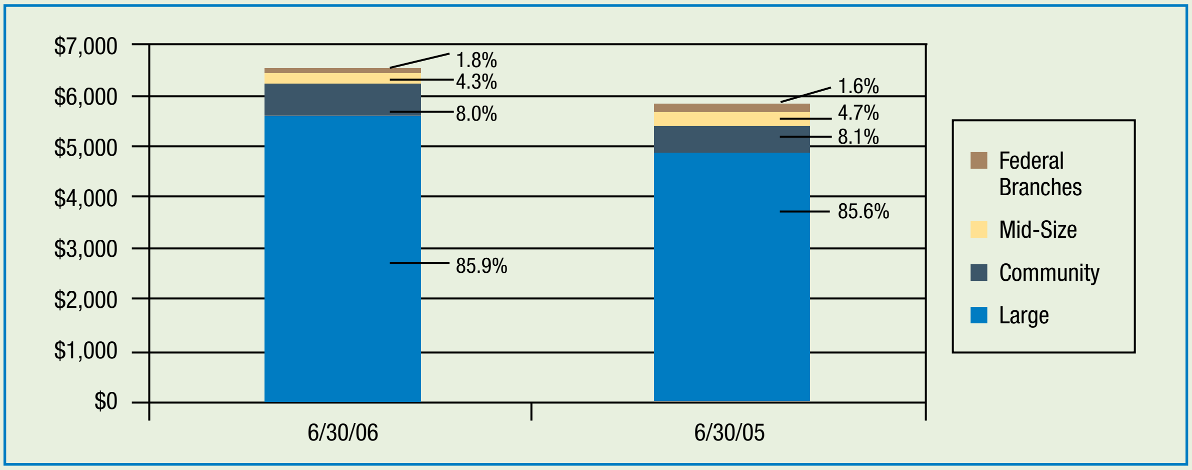
Total FY 2006 revenue of $633.6 million is a $55.9 million, or 9.7 percent, increase over FY 2005 revenues of $577.7 million. The increase is primarily attributed to a rise in bank assessment revenue stemming from the overall increase in the assets of the national banking system and the growth of investment income from an expanded investment portfolio in a rising interest-rate environment. Table 7 depicts the components of total revenue for FY 2006 and FY 2005.

Investment income is earned on investments in U.S. Treasury securities. The OCC increased its investments by $102.3 million during the fiscal year by investing its increased assessment revenue and earning interest. The book value of the OCC's portfolio on September 30, 2006 was $709.6 million, compared to $607.3 million a year earlier. The portfolio earned an annual yield for 2006 of 3.94 percent. The OCC's annual portfolio yield is calculated by dividing the total interest earned during the year by the average ending monthly book value of investments.

Bank Assets and Assessment Revenue

Total assets under OCC supervision increased during FY 2006 from $5.9 trillion to $6.5 trillion; of this total, 86 percent ($5.6 trillion) is attributable to large national banks. Large banks' share of total OCC assessment revenue remains at almost 70 percent, followed by community banks 19 percent, mid-size banks 8 percent, and federal branches 3 percent. Strong national bank asset growth combined with the movement of assets into the national banking system resulted in the higher total assets of national banks in FY 2006. Figure 2 shows the composition of national bank assets by large banks, mid-size banks, community banks, and federal branches for FY 2006 and FY 2005.

Figure 2: Composition of National Bank Assets as of June 30, 2006 and 2005 (in billions)



Funding Uses
The OCC classifies its funding uses as pay, discretionary, and fixed. Pay encompasses payroll-related costs; discretionary reflects all other funding uses, such as contractual services, travel, training, and capital projects; and fixed primarily includes rent, utilities, and office maintenance. In FY 2006, the OCC's total funds used were $553.0 million, an increase of 10.6 percent over the FY 2005 level. Of the total funds used in FY 2006, $370.6 million was categorized as pay, $146.3 million as discretionary, and $36.1 million as fixed. The OCC's operations are service-intensive; therefore, the majority of funds are used for pay. The OCC experienced a $17.8 million increase in non-pay funds used primarily for training, travel, relocations, contractual services and the capital investment program. Figure 3 depicts the uses of the OCC's funding for FYs 2006 and 2005.

While the influx of assets into the national banking system has increased assessment revenue, corresponding costs of supervising the increased asset base, along with the increased complexity of those assets also have risen, a trend expected to continue. Supervision costs during FY 2006 related to staffing, training, and travel increased by $60.5 million, or 14.4 percent, compared with FY 2005.

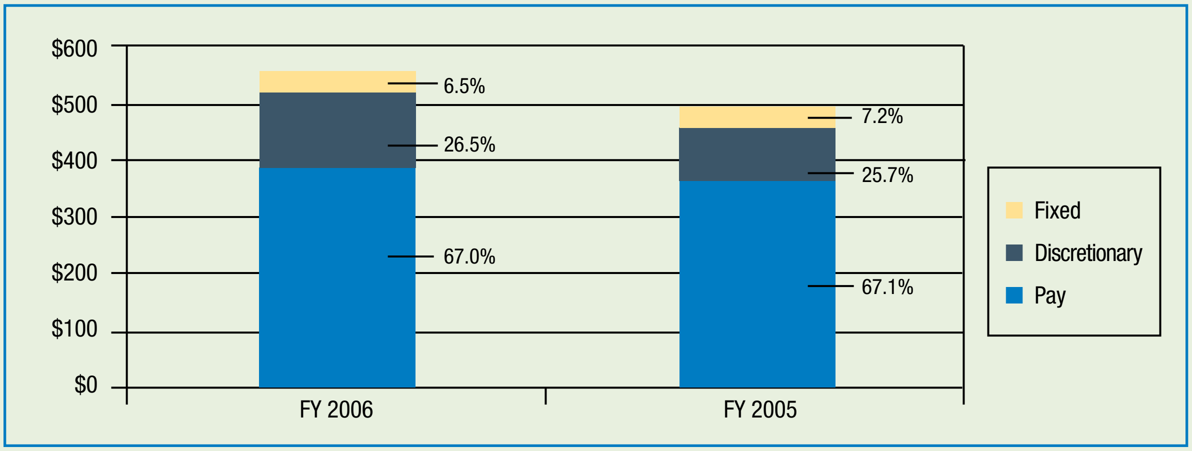
Financial Review

The OCC received an unqualified opinion on its FY 2006 and FY 2005 financial statements. The financial statements include Balance Sheets and Statements of Net Cost, Changes in Net Position, Budgetary Resources, Financing, and Custodial Activities. The financial statements and notes are presented on a comparative basis, providing financial information for FYs 2006 and 2005. These financial statements summarize the OCC's financial activity and position. Highlights of information presented on the financial statements follow.

Balance Sheets

The Balance Sheets, as of September 30, 2006 and 2005, present the resources that are owned by the OCC and available for use (assets), the resources due to others or held for future recognition (liabilities), and the resources that comprise the residual (net position). For clarity in presentation, assets and liabilities are differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and nonfederal entities (with the public).

Figure 3: FY 2006 and 2005 Funding Uses (in millions)



Composition of OCC Assets

The Balance Sheets show that total assets as of September 30, 2006, increased by $104.3 million or 15.8 percent from their level at September 30, 2005, which is primarily attributable to the changes in investments and accrued interest. The increase of $101.3 million in investments and accrued interest was attributed to a rise in assessment collections during FY 2006. Figure 4 shows the composition of the OCC's assets.

Composition of OCC Liabilities

Total liabilities, as of September 30, 2006, increased by a net of $20.3 million, or 9.0 percent, over their level on September 30, 2005. The OCC's liabilities are largely comprised of deferred revenue, accrued liabilities, and accounts payable. Deferred revenue represents the unearned portion of semiannual assessments that have been collected but not yet earned. The increase of $12.8 million in deferred revenue was due to a rise in assessment collections during FY 2006. The increase of $6.1 million in accounts payable and accrued liabilities was due primarily to an increase in payroll and employee benefits over last year and to disbursement timing differences. Figure 5 illustrates the composition of the OCC's liabilities.

Figure 4: Composition of FY 2006 and FY 2005 Assets (in millions)

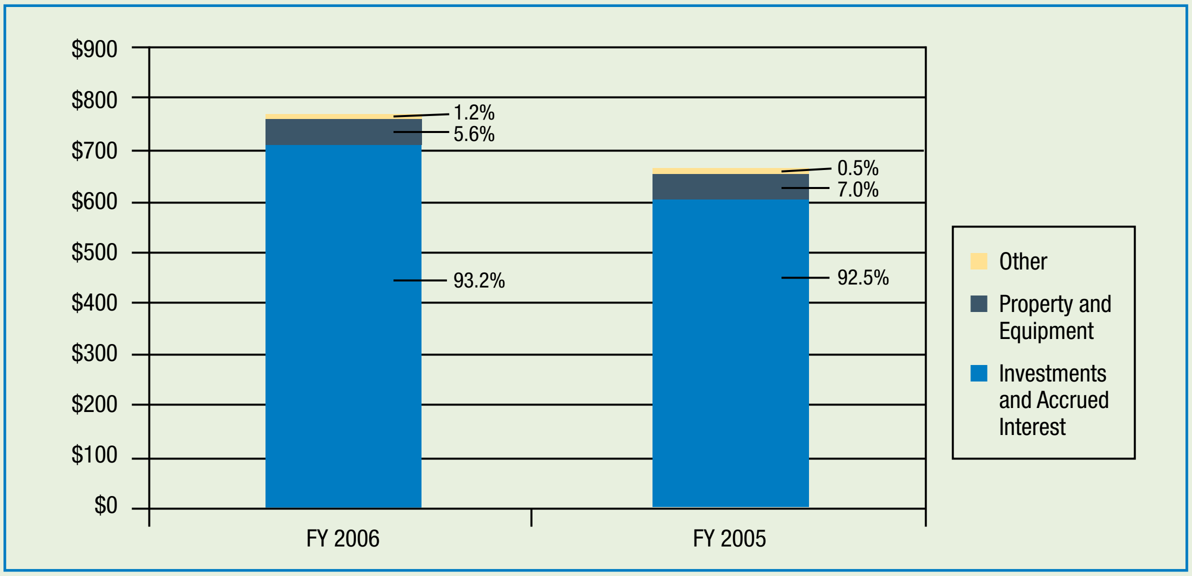
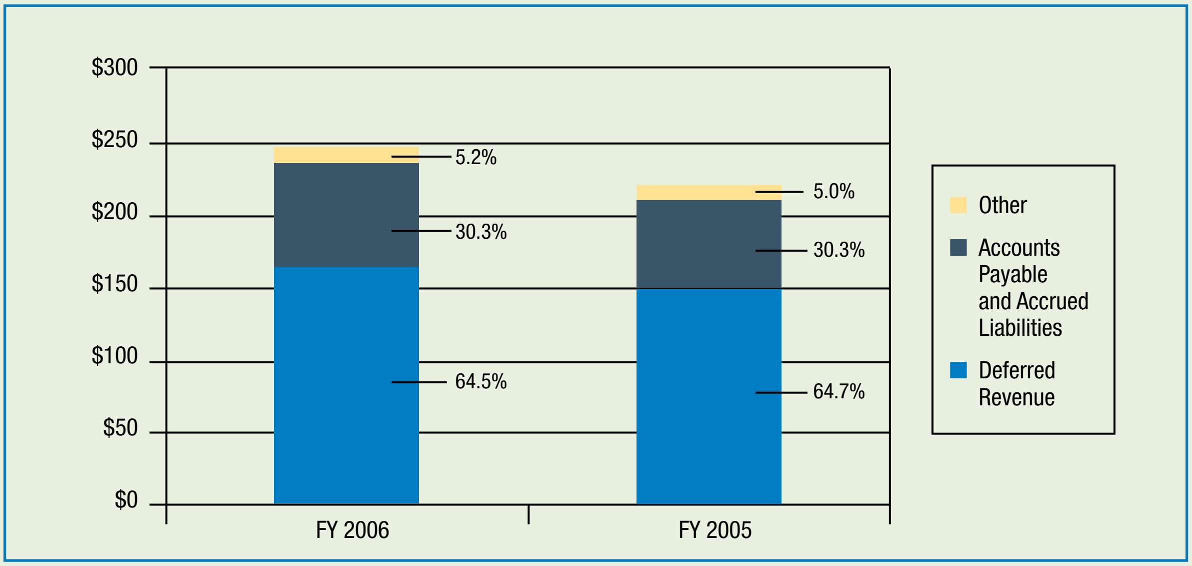


Figure 5: Composition of FY 2006 and 2005 Liabilities (in millions)



Composition of OCC Net Position

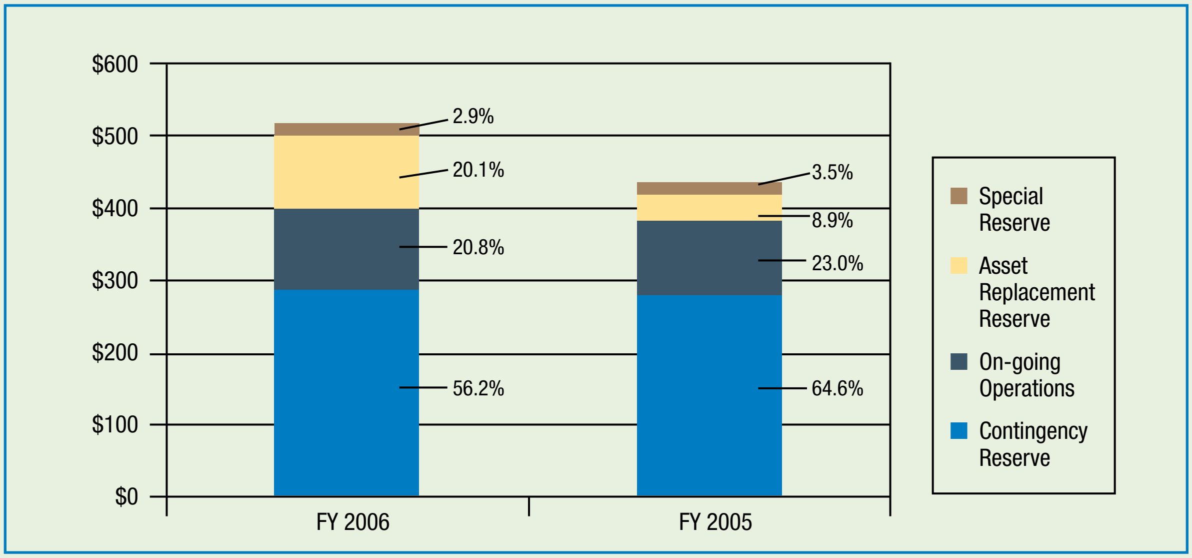
The OCC's net position of $518.4 million as of September 30, 2006, and $434.4 million as of September 30, 2005, represent the cumulative net excess of the OCC's revenues over its cost of operations since inception. This represents an increase of $84.0 million, or 19.3 percent. The majority of this increase is directly related to increases in assessment revenue, which has been allocated to the OCC's asset replacement reserve.

The net position is presented on both the Balance Sheets and the Statements of Changes in Net Position. As discussed in the next section, the OCC reserves a significant portion of its net position to supplement resources made available to fund the OCC's annual budget and to cover foreseeable but rare events. The OCC also earmarks funds for on-going operations to cover undelivered orders, the consumption of assets, and capital investments. Figure 6 shows the composition of the OCC's net position.

Reserves

The establishment of financial reserves is integral to the effective stewardship of the OCC's resources, particularly because the agency does not receive congressional appropriations. The contingency reserve is for foreseeable but rare events that are beyond the control of the OCC, such as a major change in the national banking system or for instance, a fire, flood, or significant impairment to the OCC's information technology network that interferes with the OCC's ability to accomplish its mission. The asset replacement reserve is for the replacement of IT equipment, leasehold improvements, and furniture replacements for future years. The target level in the replacement reserve is established annually based on the gross value of existing property and equipment plus a growth rate factor and a margin for market cost adjustments. The Special Reserve reduces the effect of unforecasted shortfalls, or unbudgeted and unanticipated requirements.

Figure 6: Composition of FY 2006 and 2005 Net Position (in millions)



Statements of Net Cost

The Statements of Net Cost present the full cost of operating the OCC's programs for the years ended September 30, 2006, and 2005. The net cost of operations is reported on the Statements of Net Cost, the Statements of Changes in Net Position, and on the Statements of Financing. The OCC uses an activity-based time allocation process to allocate costs between the programs. Costs are further differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and non-federal entities (with the public). The full cost includes contributions made by the Office of Personnel Management (OPM) on behalf of the OCC to cover the cost of the Federal Employees Retirement System (FERS) and Civil Service Retirement System (CSRS) plans, totaling $24.5 million in FY 2006 and $22.9 million in FY 2005. The full program cost increased by $72.5 million, primarily due to increases in pay and benefits, resulting from increases to full-time equivalents to 2,827.4 in FY 2006, from 2,680.9 in FY 2005, and additions to or improvements in benefit programs in FY 2006. Additional contributing factors include increases to contractual services supporting maintenance and non-capitalized IT investments, loss on the write-off of internal use software assets, and imputed costs. The full cost is reduced by earned revenues to arrive at net cost. Earned revenues increased by $55.9 million because of a rise in assessments collected during FY 2006. The increases in assessments are a direct result of the addition of new charters and increases in bank assets of existing charters.

Statements of Changes in Net Position

The Statements of Changes in Net Position present the change in the OCC's net position resulting from the net cost of the OCC's operations and financing sources other than exchange revenues for the years ended September 30, 2006, and 2005. Imputed financing from costs absorbed by others increased by $1.6 million. The OCC's financing source resulted from a contribution of $24.5 million in FY 2006 and $22.9 million in FY 2005 by the OPM toward the OCC's FERS and CSRS retirement plans.

Statements of Budgetary Resources

The Statements of Budgetary Resources, designed primarily for appropriated fund activities, present the budgetary resources available to the OCC for the year, the status of these resources at the end of the year, and the net outlay of budgetary resources at the end of the year. The OCC, which is a non-appropriated agency, executed $553.0 million or 95.4 percent of its FY 2006 budget of $579.4 million, with the remaining funding being applied to its asset replacement and contingency reserves.

Statements of Financing

The Statements of Financing demonstrate the relationship between the OCC's proprietary (net cost of operations) and budgetary accounting (net obligations) information. For FY 2006, the statements show $66.6 million in excess resources available to finance activities, a net decrease of $18.5 million over September 30, 2005. This net decrease resulted from a $52.8 million increase in resources available netted against the increase of $69.7 million in resources used (obligations incurred) and the $1.6 million increase in imputed financing. The increase in net resources available is due primarily to increased assessments and imputed financing, while the increase in resources used results primarily from various office space and IT investments as well as pay and employee benefits.

Statements of Custodial Activities

The Statements of Custodial Activities identify revenues collected by the OCC on behalf of others. These revenues result primarily from CMPs that are assessed through court-enforced legal actions against a national bank and/or its officers. CMP collections are transferred to the Department of the Treasury's General Fund.

Audits and Program Analyses

Enhanced OCC's Effectiveness through Audits and Program Analyses

The OCC's management control program involves OCC's major programs and all Executive Committee members. OCC relies in part on the work of the GAO, OIG, and independent auditors for an assessment of OCC's annual statement of assurance. Internally, OCC relies on a two-tier, enterprise-level assurance framework.

The first tier is the general requirement that all Executive Committee-level department heads establish satisfactory quality assurance programs in their respective areas of responsibility and annually certify their level of assurance. Executive Committee members design quality assurance processes that are tailored to their operations and work best for them. However, those quality assurance program frameworks must provide reasonable assurance to those department heads that:

- OCC programs are achieving their intended results.
- Resources are aligned with our mission and strategic plan.
- Resources are protected from waste, fraud, and abuse.
- Laws and regulations that apply to OCC operations are being followed.
- Reliable and timely management information systems support decisions.

The Executive Committee members must provide annual written certifications on these five areas to the Comptroller.

The Program and Management Accountability (P&MA) office administers the second tier of the enterprise-level assurance framework—validation, testing, and analysis.

To ensure that identified weaknesses are responded to appropriately, the Executive Committee's Audit Subcommittee provides a forum for monitoring progress, resolving problems, and developing consensus recommendations on issues that arise from the Executive Committee member self-assessments, quality assurance activities, and audits.

For FY 2006, P&MA completed six reviews and has two under way. In addition, the unit administered management control self-assessments from OCC line managers and senior managers.

Audit and program analysis during the year continued to enhance the effectiveness of the OCC workforce and strengthen its organization performance and corporate governance. With guidance provided by the chief of staff and the Audit Subcommittee, this year's initiatives included:

- *Matters requiring attention (MRA) diligence:* Assessed examiner diligence with matters requiring attention (contrasted the operational use of MRA against the standards that apply).
- *Pay flexibility:* Concluded that all Executive Committee areas are using some of OCC's pay flexibility tools for recruiting or retention. Recommended Workforce Effectiveness report pay flexibility usage semiannually to the Executive Committee.
- *Supervision of novel bank activities authorized by Licensing:* Completed a review of a sample of large banks and mid-size/community banks.
- *Implementation of internal controls:* Completed assessing test results of OCC's internal controls, under a requirement from the Office of Management and Budget for federal agencies to establish and maintain effective internal controls over financial reporting, and to submit an annual assurance statement on the effectiveness of those controls.
- *Review of OCC's exit interview process:* Provided findings to management on opportunities to improve the usefulness of exit interviews.
- *Safeguarding personal employee information:* Completed phase 1 of the project to collect best-practice information from private and public sector organizations.

In addition, the unit assisted business units with process improvement projects involving: Web content, external outreach to bankers, records management, and communications processes.

Three audit reports issued by the U.S. Government Accountability Office (GAO) during the year addressed various aspects of the OCC's preemption and visitorial powers rulemaking. Congress asked GAO to look at the rulemaking process, the OCC's assistance to consumers, and the applicability of state consumer protection laws to national banks. The OCC implemented the GAO's suggestions to improve the rulemaking process, and we are in the process of implementing GAO's recommendations to improve outreach to consumers and to clarify the applicability of state consumer protection laws to national banks.

Both the GAO and the Treasury Department Office of Inspector General (OIG) issued reports to the OCC that contained recommendations for improving bank supervision for compliance with laws and regulations focused on anti-money laundering and the deterrence of terrorist financing activities. The OIG also recommended improvements to systems security and disaster recovery.

OCC is required to implement controls and periodically submit information to the Department of the Treasury in support of various department-wide compliance initiatives. Specific examples include compliance under FISMA (Federal Information Security Management Act of 2002), IPIA (Improper Payments Information Act), the Erroneous Payments Recovery Act of 2002, and GPRA (Government Performance and Results Act). The OCC continues to monitor its performance under these acts and has been responsive to each related data call from the Department of the Treasury.

Assurance Statement

The Office of the Comptroller of the Currency (OCC) has made a conscientious effort during fiscal year (FY) 2006 to meet the internal control requirements of the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), and Office of Management and Budget (OMB) Circular A-123.

OCC systems of management control are designed to ensure that:

a) Programs achieve their intended results;
b) Resources are used in accordance with the agency's mission;
c) Programs and resources are protected from waste, fraud, and mismanagement;
d) Laws and regulations are followed;
e) Controls are sufficient to minimize improper or erroneous payments;
f) Performance information is reliable;
g) Systems security is in substantial compliance with relevant requirements;
h) Continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels; and
i) Financial management systems are in compliance with Federal financial systems standards, *i.e.*, FMFIA Section 4 and FFMIA.

I am providing reasonable assurance that the above listed management control objectives were achieved by the OCC without material weakness during FY 2006. Specifically, this assurance is provided relative to Sections 2 and 4 of the Federal Managers' Financial Integrity Act (FMFIA). However, control deficiencies in our financial management systems were identified by external auditors requiring improvements in information technology controls, and the Inspector General criticized certain network and information security practices. Accordingly, I am reporting a lack of substantial compliance with the requirements imposed by the Federal Financial Management Improvement Act (FFMIA). As discussed below, these areas are receiving heightened management attention, and plans of corrective action have been developed for resolving both by mid-year 2007.

The OCC also conducted its assessment of the effectiveness of internal control over financial reporting, which includes the safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, the OCC can provide reasonable assurance that its internal control over financial reporting as of June 30, 2006, was operating effectively, and no material weaknesses were found in the design or operation of the internal control over financial reporting.

Reportable Condition

External auditors found that the OCC needs to improve its information technology (IT) controls over financial management systems. Specifically, they identified IT deficiencies related to security program planning and management, service continuity, and selected access controls.

These deficiencies are based on a certification and accreditation methodology that was found to be inconsistent with the latest National Institute of Standards and Technology guidance. A revised methodology will allow OCC to identify appropriate access controls consistent with sensitivity ratings.

Other access control deficiencies are due to a lack of clear policy and procedures for confirming employee awareness training, acknowledgement of information systems responsibilities, and management of computer system accounts.

Additionally, certain security settings were not configured properly, and there is no process to promptly detect and remove unauthorized personal and public domain software. A plan of corrective actions has been developed to address all of these issues by March 31, 2007.

Other Control Deficiency

I am also bringing to your attention physical and computer security issues that are receiving heightened management attention. These internal control deficiencies do not rise to the level of materiality, and we are not aware of any management control weakness or non-conformance that significantly impairs our ability to fulfill our mission, or otherwise significantly weakens established safeguards against waste, fraud, or mismanagement.

On June 24, 2006, a breach of multiple layers of physical security at our Phoenix Field Office resulted in the theft of two server hard drives and a router. OCC took the appropriate steps to contain and control the incident. Subsequently, but unrelated to the Phoenix incident, OCC also received Office of the Inspector General audit findings critical of certain OCC network and information security practices. Where possible, device or software specific vulnerabilities cited in the report have been corrected. In other cases, a plan of corrective actions has been developed to address these issues by June 30, 2007.

These actions highlight the risks facing the agency in safeguarding sensitive information. I have initiated a comprehensive end-to-end review of our physical and computer security processes and procedures to identify opportunities to improve and further strengthen our management controls in this area. The evaluation will be completed in the first half of FY 2007.

Analytical Basis of Assurance Statement

OCC evaluated its management controls in accordance with the FY 2006 Secretary's Assurance Statement Guidance of July 19, 2006, signed by Richard Holcomb, Deputy Chief Financial Officer, and also considered the following guidance:

- Office of Management and Budget (OMB) Circular A-123, Management Accountability and Control;
- OMB Circular A-127, Financial Management Systems;
- OMB Circular A-130, Management of Federal Information Systems Resources; and
- Treasury Directive 40-04, Treasury Internal Control Program.

Information considered in our control assessment included the following:

- FMFIA certifications submitted by each Executive Committee member;
- OCC's risk assessment analysis for FY 2006;
- Results of internal control testing under OMB Circular A-123, Appendix A;
- Executive Committee descriptions of business unit quality assurance programs;
- Results of internal audits and reviews;
- Results of control self-assessments completed by OCC managers in FY 2006;
- Audit reports and evaluations issued by the Government Accountability Office and the Office of the Inspector General;
- Completion of risk assessment materials related to the Improper Payments Information Act by our Deputy Chief Financial Officer, which was submitted to the Department in May 2006;
- Program information submitted by OCC's Chief Information Security Officer, Deputy Chief Financial Officer, and Office of Critical Infrastructure Protection and Security;
- Completion of GAO's Core Financial System Requirements Checklist;
- Unqualified and timely audit opinion on FY 2005 financial statements; and
- CPA's Gardiner, Kamya and Associates' status report of October 20, 2006 on the FY 2006 financial statement audit.

John C. Dugan
Comptroller of the Currency

GARDINER KAMYA
& ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

Independent Auditors' Report on Financial Statements

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the accompanying balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of the management of OCC. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements.* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the OCC as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources, the reconciliation of budgetary obligations to net costs, and custodial activities for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in Sections II through V of OCC's fiscal year 2006 Annual Report is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and accordingly, we express no opinion on it.

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Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information included in Sections I and VII of OCC's fiscal year 2006 Annual Report is presented for purposes of additional analysis and is not a required part of the financial statements. We did not audit this information and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued reports dated October 31, 2006, on our consideration of the OCC's internal control over financial reporting, and on our tests of its compliance with certain provisions of applicable laws, regulations and contracts. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards*, and these reports should be read in conjunction with this report in considering the results of our audits.

October 31, 2006

Independent Auditors' Report on Internal Control over Financial Reporting

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended, and have issued our report thereon dated October 31, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements.*

In planning and performing our audits, we considered the OCC's internal controls over financial reporting by obtaining an understanding of the OCC's internal controls, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives describes in OMB Bulletin No. 06-03 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audits was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation in internal control, which could adversely affect OCC's ability to meet the objectives of internal control. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud or noncompliance in amounts that would be material in relation to the financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements due to error or fraud may occur and not be detected. However, we noted a certain matter discussed in Exhibit 1 involving the internal control over financial reporting and its operation that we consider to be a reportable condition. However, this reportable condition is not believed to be a material weakness.

Finally, with respect to internal control related to performance measures determined by management to be key and reported in Sections III and VII of the OCC's fiscal year 2006 Annual Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they have been placed in operation, as required by OMB Bulletin No. 06-03. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

This report is intended solely for the information and use of the OCC's management, the Department of the Treasury Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available as a matter of public record.

October 31, 2006

EXHIBIT 1

REPORTABLE CONDITION

Improvements Needed in Information Technology General Controls over OCC's Financial Systems.

In our fiscal year 2005 audit, we identified weaknesses in the area of security program planning and management and access controls. We reported these weaknesses to management in a separate letter. Since these weaknesses were identified, OCC has made significant progress by devoting the necessary resources for resolving these weaknesses within its information technology (IT) environment as evidenced in OCC's Plan of Actions and Milestones (POAM) and our verification of correction of prior year issues. However in our review this year, we noted certain weaknesses in OCC's IT general controls. These weaknesses related to the entity-wide security program planning and management, access controls, service continuity, and application software development and change control and are summarized below.

Entity-Wide Security Program Planning and Management

Entity-wide security program planning and management provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. We noted that OCC's (a) procedures for risk assessment, (b) fiscal management security plan, and (c) Certification and Accreditation methodology related to its Fiscal Management System need improvement. In addition, OCC lacked an updated General Support System Risk Assessment, and a Memorandum of Understanding (MOU) or Interconnection Security Agreement (ISA) with external entities it shared data with or whose systems were interconnected with OCC systems. We also noted that new employees were not always given security awareness training before granting access to information resources and that OCC does not require all employees to sign Non-Disclosure agreements. As a result, OCC was vulnerable to the loss of integrity and confidentiality of its financial data.

Access Controls

Access controls limit or detect access to computer resources (data, programs, equipment and facilities), thereby protecting these resources against unauthorized modification, loss and disclosure. We noted that OCC does not have (a) security parameters (i.e. password configuration) for certain systems identified during the audit, (b) adequate documentation to support the recent change in the sensitivity rating for the Fiscal Management System, and (c) adequate account management procedures for managing information system accounts. We also noted that OCC could not provide signed Employee Acknowledgement of Information Systems Responsibility (EAISR) forms for a sample of new employees. These access control weaknesses may diminish the reliability of computerized data and increase the risk of destruction or inappropriate disclosure of information.

Service Continuity

Service continuity controls ensure that when unexpected events occur, critical operations continue without interruption or are promptly resumed and critical and sensitive data are protected. We noted that (a) OCC has not developed and implemented a Business Impact Analysis (BIA) for its Fiscal Management System as part of its contingency planning activities, (b) the current OCC Contingency Plan, which is currently in development, for the Fiscal Management System does not meet the requirements of NIST Special Publication 800-34, and (c) testing of off-site storage backup tapes are not regularly performed. We also noted that the offsite storage facility currently used for storing backup tapes associated with the Fiscal Management System, is subject to the potential risk of being affected by the same natural disaster as the main Fiscal Management System application process facility because of their close proximity to each other. As a result, OCC may be unable to implement effective contingency procedures for the Financial Management System in the event of a disaster or disruption in processing.

Application Software Development and Change Control

Application software development and change controls prevent unauthorized programs or modifications to an existing program from being implemented. We noted that OCC has not implemented a mechanism for promptly detecting and removing unauthorized software from OCC systems (desktops). The lack of monitoring of OCC systems for the use of unauthorized software could result in the introduction of non-approved software in OCC's networking environment, which could negatively impact processing operations, introduce harmful viruses, and/or cause the loss of data.

RECOMMENDATIONS:
We recommend that the Chief Information Officer ensure that OCC:

1. Documents its risk assessment activities in a form that will make them verifiable and in accordance with NIST Special Publication 800-30.
2. Adheres to its current plans for finalizing the security plans for the Fiscal Management System and Network Infrastructure Security Plans and their corresponding certifications and accreditations in accordance with NIST Special publications 800-18 and 800-37.
3. Finalizes its MOUs and ISAs with the National Finance Center, Federal Deposit Insurance Corporation and Federal Reserve Board.
4. Continues implementing its new processes to ensure that new employees complete their initial Security Awareness Training in a timely manner.
5. Requires all new employees and contractors to complete and sign all access agreements (e.g. Non-Disclosure Agreements).
6. Implements password configuration settings for certain systems identified during the audit in accordance with NIST Special Publication 800-12.

7. Continues its effort to improve documentation for "security impact ratings" of its Federal Information Security Management Act (FISMA) systems in accordance with NIST Special Publication 800-60, Volume 1.
8. Develops and implements a policy that requires user accounts to be disabled and removed when they are no longer needed in accordance with NIST Special Publication 800-53.
9. Requires employees to sign the EAISR forms in a timely manner in accordance with OCC Information Security Handbook, Section 3.3, and maintains adequate documentation of signed forms.
10. Develops and implements a BIA for its Fiscal Management System in accordance with NIST Special Publication 800-34.
11. Completes the Contingency Plan that is currently under development in accordance with NIST Special Publication 800-34.
12. Develops and implements a policy for regular testing of off-site storage backup tapes.
13. Expands the existing offsite tape storage contract to include a secondary rotation of tapes on a regular basis to a remote facility, if it is cost-beneficial, in accordance with NIST Special Publication 800-34, Section 3.4.1.
14. Develops and implements a process for the active and systematic detection, notification, and prompt removal of unauthorized personal and public domain software in accordance with NIST Special Publication 800-53.

MANAGEMENT RESPONSE:
OCC management concurs with the reportable condition that is described in this report. Corrective actions are underway to address each recommendation and they are confident that they will be able to rectify these deficiencies before the next annual report cycle is completed.

GARDINER KAMYA
& ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

Independent Auditors' Report on Compliance with Laws and Regulations

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2006 and 2005, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity, for the years then ended, and have issued our report thereon dated October 31, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

The management of the OCC is responsible for complying with laws, regulations and contracts applicable to the OCC. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the OCC's compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, including certain requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations and contracts applicable to the OCC. However, our objective was not to provide an opinion on overall compliance with laws, regulations and contracts. Accordingly, we do not express such an opinion.

The results of our tests of compliance with laws, regulations and contracts described in the preceding paragraph, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 06-03.

Under FFMIA, we are required to report whether the OCC's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The results of our tests of FFMIA Section 803(a) requirements disclosed one instance in which OCC's financial management systems did not substantially comply with federal financial management system requirements related to information technology general controls, which is

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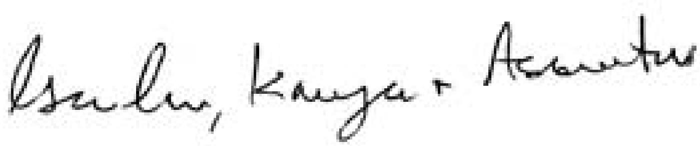
described in Exhibit 1 of our Report on Internal Control over Financial Reporting dated October 31, 2006.

The results of our tests disclosed no instances in which OCC's financial management systems did not substantially comply with applicable Federal accounting standards and the United States Government Standard General Ledger at the transaction level.

This report is intended solely for the information and use of the OCC's management, the Department of the Treasury Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available as a matter of public record.



October 31, 2006