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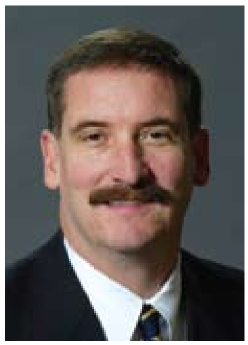
X.

Financial Management Discussion and Analysis

Letter from the Chief Financial Officer



I am pleased to present the OCC's financial statements as an integral part of the FY 2007 *Annual Report.* I am also pleased to report that for FY 2007 our independent auditors rendered an unqualified opinion with no material internal control weaknesses. The OCC's commitment to effective financial management and a strong internal control environment continues to be my highest priority.

Internal controls were strengthened last year as a result of OCC's implementation of Appendix A to Circular A-123—Management's Responsibility for Internal Controls (A-123). Now in its second year, our program is beginning to mature and yield the expected benefits of a robust internal control environment. Some of these benefits include a stronger culture of control and accountability for safeguarding OCC assets. OCC's Financial Management staff documents our financial processes, performs a risk assessment of all significant financial statement line items, and tests all critical processes. There were no material internal control weaknesses noted as a result of the testing, and where appropriate we have developed plans of corrective action to strengthen our internal controls. Additionally, plans of corrective action from the prior year have been completed.

The OCC is committed to maintaining strong controls and taking appropriate measures as required to ensure that we comply with federal security standards. An end-to-end security control review was conducted this year to identify potential internal control issues related to information technology (IT) and physical security. IT security controls related to our financial systems have been enhanced, however, our efforts continue as we address the challenges presented in this important area of our operations.

I would also like to provide a brief update on the Office of Management's Lean Six Sigma program. This program is designed to re-engineer and improve burdensome administrative processes throughout the OCC. Additionally, the program is intended to continually increase the quality of services delivered to our workforce, increase overall administrative productivity, and optimize or decrease total overhead cost. This year, 20 administrative projects were completed in Bank Supervision, the Ombudsman's Office, and the Office of Management with savings of approximately $1.7 million as reported in the Office of Management Balanced Scorecard. Key projects this year included Procurement, Recruiting and Hiring, Financial Reporting, and the Employee Relocation process.

Turning to the financial condition of the agency, OCC budgetary expenses continue to reflect the growing complexity of the national banking system and the overall increase in assets supervised by the OCC. As noted earlier in our annual report, the OCC currently supervises 68 percent of all U.S. commercial banking assets, a 19.3 percent increase from the levels of assets supervised as recently as FY 2004. The increase in bank assets supervised has required the OCC to respond with corresponding growth in bank examination staff, IT infrastructure, and office space. Although these are the primary cost drivers, because over 50 percent of our staff travel to conduct bank examinations, we have been affected by the overall increase in fuel, air travel, and hotel costs.

Currently, bank assessment revenue has adequately addressed the increase in operating costs. Since we receive no federal appropriation and must fund our operations primarily from these revenues, we review our cost performance on a continual basis. Last year, the OCC implemented an efficiency performance measure that examines the OCC costs relative to every $100,000 in assets regulated. In FY 2007 the estimated cost is $8.89, higher than last year's cost of $8.57, but this is 7 percent less than our target of $9.55. However, efficient regulation may not always translate into effective regulation. Therefore our focus from a cost perspective has been, and always will be, to ensure that the OCC uses resource levels that successfully achieve its mission to maintain the safety and soundness of the national banking system. The results of other significant agency performance measures can be found in section XIII to the *Annual Report.*

The Budget and Finance Subcommittee, which I chair, continues to closely monitor the overall financial condition of the OCC. This past year, the subcommittee continued its focus on the agency's investment activities. The subcommittee oversees the agency investment portfolio and on a quarterly basis reviews the activity and strategy of the investment committee. The subcommittee also has been actively involved in addressing the office space needs that have arisen as a result of the growth in staff. Office space will continue to be on the agenda of the subcommittee as we approach the expiration of the lease on our current headquarters location in Washington, D.C. To avoid an increase in bank assessments, each year the OCC has prudently reserved its excess bank assessment revenue, so that funds will be available to address this long-term need.

Though FY 2007 has been a year of significant achievement, the core values associated with our responsibility to oversee OCC financial operations continues to motivate us to seek out the latest trends and best practices associated with financial management. In closing, I would like to repeat my commitment from last year—to ensure that 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

Historical Perspective

In FY 2006, the Office of Management's Financial Management department (FM) focused on its commitment to customer service, stewardship, and continual process improvement. Using the balanced scorecard (BSC) to measure progress toward key business goals, FM made significant progress in FY 2006. The department's efforts were focused on implementing stringent new internal control requirements for federal agencies, carrying out several business process improvement efforts, adopting a new organizational structure to align units for efficiency and customer service, and continuing leadership development and employee engagement as measured by the Gallup employee engagement survey.

Strategic Focus

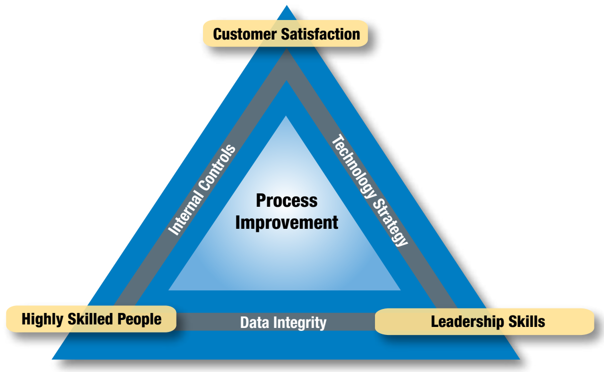
This year, FM continued to manage for results and use widely recognized best practices, such as the balanced scorecard and Lean Six Sigma. FM's strategic focus in FY 2007 has been to improve and strengthen internal controls across the department, while improving business processes and financial systems, and optimizing costs in the delivery of products and services. FM continued to focus this year on staff and leadership development, and on increasing employee engagement.

Strategic Goals

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

- An engaged workforce that is 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.
- Optimized costs in delivering products and services.

Chart 4: FM operating strategy



FM Operating Strategy

The FM operating strategy is shown in Chart 4. The strategy focuses on FM's most important business objectives, which include developing a robust process improvement program to ensure that continual improvement is an integral component of the organizational culture. As part of the department's efforts to achieve continual improvement and improve management of financial systems, FM used Lean Six Sigma as the chosen tool for business process improvement. Additional major accomplishments include improved efficiencies from the redesigned process for collecting semi-annual assessments from national banks, implementation of improvements to financial systems, continuing refinements to the department's internal control program, ongoing employee and leadership development efforts, and continued reduction of FM costs as a percentage of OCC planned operating costs.

FM secured benchmarking data for major department functional areas, and will launch an effort to benchmark operations against other entities that are known for adopting best practices. These data will be used to identify opportunities for process improvement and adopting metrics for BSC initiatives. Managers and team leaders have begun preparing recurring trend analyses to ensure that FM is anticipating and preparing for changes in the arena of federal financial management. The FM department began a new initiative to improve and ensure consistently high quality in communications with customers. FM continued to concentrate on employee development through specific training and developmental assignments for staff at all levels. The department focused again this year on developing strong leadership skills and on increasing employee engagement.

The FM Balanced Scorecard

The FM Balanced Scorecard covers performance measures and initiatives from four perspectives: customer, financial, internal processes, and learning and growth.

The customer perspective ensures that FM identifies its customers and understands their needs and expectations. FM measures performance on how well FM products and services meet those customer needs and expectations. During FY 2007, FM carried out a customer service action plan to ensure that the voice of the customer is integrated into all FM products and services. Using valuable input received from OCC customers through the 2006 annual customer satisfaction survey, FM engaged in ongoing dialogue with key customers and significantly improved the delivery of guidance and information on the agency's intranet. In August 2007, 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 customer-focused initiatives in FY 2008 and beyond.

The financial perspective ensures that FM is using the OCC's financial resources to support the OCC'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 2007, FM met its goal of maintaining operating costs at less than 1.7 percent of OCC planned operating costs. This was a decline from 1.9 percent in FY 2006.

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 2007 operating and strategic business strategies, FM processes that had known inefficiencies, especially for customers, received the most attention and effort this year. FM carried out several Lean Six Sigma business process reengineering projects for key areas, such as time and attendance reporting and travel voucher processing and auditing.

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 those skills are fully developed. In addition to each unit of FM working on Gallup Q12 employee engagement survey action plans, FM ensured that key vacancies were filled during FY 2007, and continued focusing on developing the next generation of leaders.

Looking Forward

FM will continue to focus on achieving its strategic business goals, to measure progress using the balanced scorecard, and to concentrate its efforts on continual process improvement using Lean Six Sigma as its primary tool. The department will continue to benchmark performance through key business metrics. Recognizing that financial management and financial reporting are much more than the mechanics of transaction processing and financial statement preparation, the department will continue to explore the latest business models, such as e-commerce and digitization. Finally, the department will focus on modernizing internal controls and ensuring that the agency is up-to-date with the current guidance in financial management and accounting policies.

Financial Highlights

Overview

The OCC received an unqualified opinion on its FY 2007 and FY 2006 financial statements. The financial statements include a Balance Sheet and Statements of Net Cost, Changes in Net Position, and Budgetary Resources. The financial statements and footnotes are presented on a comparative basis, providing financial information for FYs 2007 and 2006. These financial statements, which were prepared from the OCC's accounting records in conformity with the U.S. generally accepted accounting principles (GAAP) for federal agencies, summarize the OCC's financial activity and position. The financial statements, footnotes and auditor's opinion appear in Sections XI and XII of the *Annual Report.* A summary of the OCC's financial activities in FY 2007 and 2006 is presented as follows.

Assets

The OCC's assets include both "entity" and "non-entity" assets. Entity assets belong to the agency and are used to fund the OCC's operations. The OCC earns revenue through the collection of assessments from national banks, and from other income, including interest on investments in U.S. Treasury securities. Non-entity assets are assets that are held by the OCC on behalf of another federal agency or other third party. The OCC's non-entity assets are comprised of civil money penalties due to the federal government through court-enforced legal actions. Once collected, these amounts are transferred to the General Fund of the Treasury.

As of September 30, 2007, total assets of $881.5 million increased by $114.3 million or 14.9 percent from the level at September 30, 2006. This increase is primarily attributable to the changes in investments and accrued interest. The increase of $105.1 million in investments and accrued interest was attributed to a rise in assessment collections during FY 2007. Chart 5 shows the composition of the OCC's assets.

Liabilities

The OCC's liabilities represent the resources due to others or held for future recognition and are largely comprised of deferred revenue, accrued liabilities, and accounts payable. Deferred revenue represents the unearned portion of semi-annual assessments that have been collected but not yet earned. The OCC records a custodial liability for the net amount of enforcement-related receivables. Upon collection, these amounts are transferred to the General Fund of the Treasury.

As of September 30, 2007, total liabilities of $277.9 million increased by a net of $29.0 million, or 11.7 percent, over the level on September 30, 2006. The increase of $12.0 million in deferred revenue was due to a rise in assessment collections during FY 2007. The increase of $13.0 million in accounts payable and accrued liabilities was due primarily to an increase in payroll and employee benefits over last year. Chart 6 illustrates the composition of the OCC's liabilities.

Net Position

The OCC's net position of $603.6 million as of September 30, 2007, and $518.4 million as of September 30, 2006, represent the cumulative net excess of the OCC's revenues over its cost of operations since inception. This represents an increase of $85.2 million, or 16.4 percent. The majority of this increase is directly related to increases in assessment revenue. The net position is presented on both the Balance Sheet and the Statement of Changes in Net Position.

Chart 5: Composition of FY 2007 and FY 2006 assets (in millions)

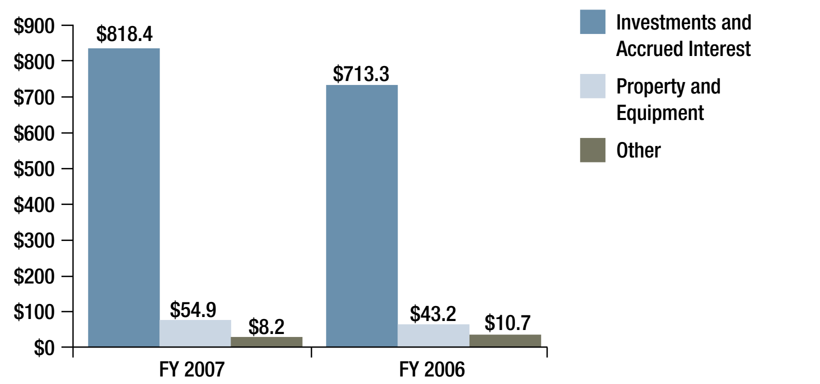


Chart 6: Composition of FY 2007 and FY 2006 liabilities (in millions)

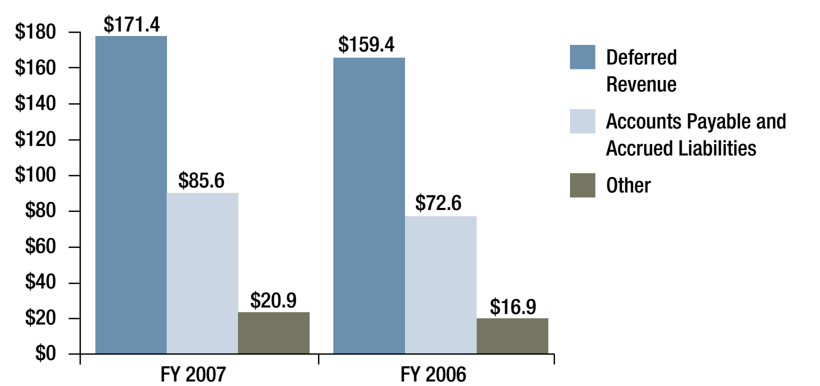
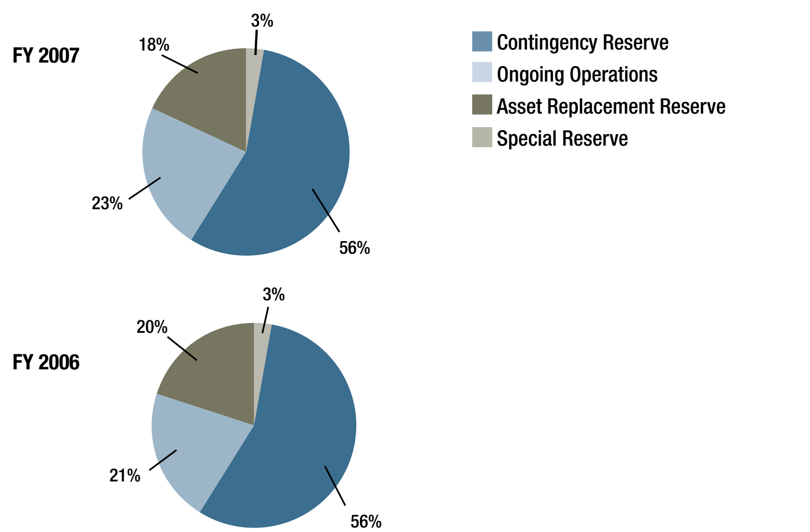


Chart 7: Composition of FY 2007 and FY 2006 net position



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 ongoing operations to cover undelivered orders, the consumption of assets, and capital investments. Chart 7 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 replacement 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.

Revenues and Costs

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 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 2007 was $671.2 million, which represents an increase of $91.8 million, or 15.8 percent, over the $579.4 million budget in FY 2006.

Total FY 2007 revenue of $695.4 million reflects a $61.8 million, or 9.8 percent, increase over FY 2006 revenues of $633.6 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. Table 9 depicts the components of total revenue for FY 2007 and FY 2006.

Table 9: Components of total revenue, FY 2007 and FY 2006 (in millions)

	FY 2007	FY 2006	Change
Assessments	$666.0	$609.5	$56.5
Investment Income	$26.6	$20.5	$6.1
Other[1]	$2.8	$3.6	($0.8)
Total Revenue	$695.4	$633.6	$61.8

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

Bank Assets and Assessment Revenue

Total assets (including federal branches) under OCC supervision increased during FY 2007 from $6.5 trillion in FY 2006 to $7.2 trillion; of this total, 86.3 percent ($6.2 trillion) is attributable to large national banks. Large banks' share of total OCC assessment revenue remains at almost 67.5 percent, followed by mid-size and community banks 29.4 percent, and federal branches 3.1 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 2007. Chart 8 shows the composition of national bank assets by large banks, mid-size banks, community banks, and federal branches for FY 2007 and FY 2006.

Investments

The book value of the OCC's portfolio on September 30, 2007 was $814.3 million, compared to $709.6 million a year earlier. The OCC invests available funds in non-marketable U.S. Treasury securities issued through the Department of Treasury's Bureau of Public Debt in accordance with the provisions of 12 USC 481 and 12 USC 192. The increase in investments of $104.7 million during the fiscal year reflects the investment of increased assessment revenue and the interest on investments held in the portfolio. The portfolio earned an annual yield for 2007 of 4.4 percent. The OCC calculates annual portfolio yield by dividing the total interest earned during the year by the average ending monthly book value of investments.

Cost of Operations

The OCC's net cost of operations is reported on the Statements of Net Cost and the Statements of Changes in Net Position. The OCC uses an activity-based time reporting system to allocate costs among 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 Statements of Net Cost present the full cost of operating the OCC's three major program areas (supervise, regulate, and charter national banks) for the years ended September 30, 2007, and 2006. Chart 9 illustrates the breakdown of costs of operations for FY 2007 and FY 2006.

The full cost presented in the Statements of Net Cost includes contributions made by the OPM on behalf of the OCC to cover the cost of the Federal Employees Retirement System and Civil Service Retirement System retirement plans, totaling $26.4 million in FY 2007 and $24.5 million in FY 2006. The total program cost increased by $62.5 million, primarily due to increases in pay and benefits, resulting from a 5.1 percent increase to full time equivalents of 2,956.6 in FY 2007 from 2,812.3 in FY 2006 and additions to or improvements in benefit programs in FY 2007. Additional contributing factors include increases to contractual services supporting maintenance and non-capitalized IT investments and imputed costs.

The full cost is reduced by earned revenues to arrive at net cost. Earned revenues increased by $61.8 million because of a rise in bank assessments earned during FY 2007. The increases in assessments are a direct result of the addition of new charters and increases in bank assets of existing charters. The influx of assets into the national banking system has increased the OCC assessment revenue. Correspondingly, the costs of supervising the national banks have risen because of the increasing size and complexity of national bank assets.

Chart 8: Composition of national bank assets as of June 30, 2007 and FY 2006 (in billions)

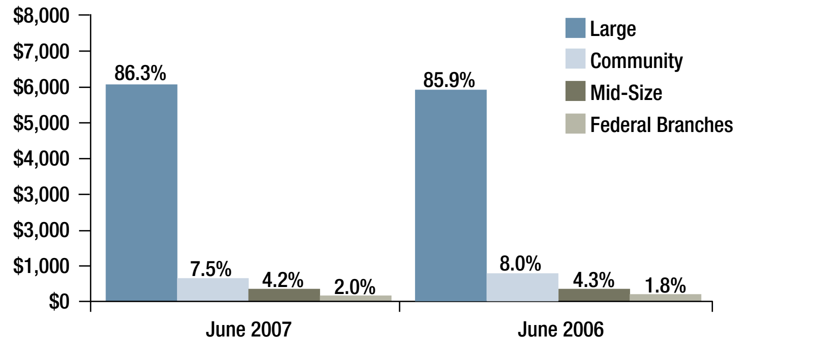
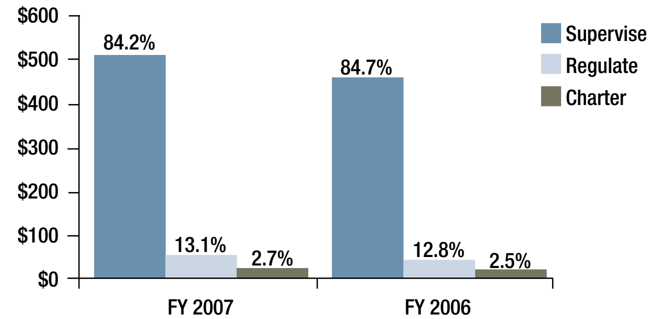


Chart 9: Costs of operations by major program, FY 2007 and FY 2006 (in millions)



Budgetary Resources

As discussed above, the OCC receives the majority of its funding from assessment revenue earned and investment income. The Statement of Budgetary Resources, designed primarily for appropriated fund activities, presents 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 $633.9 million or 94.4 percent of its FY 2007 budget of $671.2 million, with the remaining funding being applied to its asset replacement and contingency reserves.

XI.

Financial Statements and Notes

Financial Statements

Office of the Comptroller of the Currency
Balance Sheets
As of September 30, 2007 and 2006

	FY 2007	Restated FY 2006
Assets		
Intragovernmental:		
Fund balance with Treasury	$ 6,762,090	$ 9,104,809
Investments and related interest (Note 2)	818,361,022	713,281,888
Advances and prepayments	82,904	-
Total intragovernmental	**825,206,016**	**722,386,697**
Cash	11,944	12,256
Accounts receivable, net	1,347,977	1,626,336
Property and equipment, net (Note 3)	54,882,947	43,165,142
Advances and prepayments	24,193	39,031
Total assets	**$ 881,473,077**	**$ 767,229,462**
Liabilities		
Intragovernmental:		
Accounts payable and other accrued liabilities	$ 2,019,543	$ 1,894,147
Total intragovernmental	**2,019,543**	**1,894,147**
Accounts payable	7,251,284	10,005,032
Accrued payroll and benefits	22,677,144	13,902,932
Accrued annual leave	29,996,291	27,533,285
Other accrued liabilities	23,671,832	19,129,317
Deferred revenue	171,380,008	159,421,459
Other actuarial liabilities (Note 5)	20,882,737	16,986,832
Total liabilities	**277,878,839**	**248,873,004**
Net position (Note 6)	**603,594,238**	**518,356,458**
Total liabilities and net position	**$ 881,473,077**	**$ 767,229,462**

The accompanying notes are an integral part of these financial statements.

Office of the Comptroller of the Currency
Statements of Net Cost
For the Years Ended September 30, 2007 and 2006

	FY 2007	FY 2006
Program Costs		
Supervise National Banks		
Intragovernmental	$ 74,331,808	$ 68,025,152
With the public	462,006,442	418,553,951
Subtotal - Supervise National Banks	**$ 536,338,250**	**$ 486,579,103**
Regulate National Banks		
Intragovernmental	$ 11,790,685	$ 10,459,084
With the public	71,519,547	62,743,342
Subtotal - Regulate National Banks	**$ 83,310,232**	**$ 73,202,426**
Charter National Banks		
Intragovernmental	$ 2,462,667	$ 2,119,060
With the public	14,513,285	12,267,183
Subtotal - Charter National Banks	**$ 16,975,952**	**$ 14,386,243**
Total Program Costs (Note 7)	**$ 636,624,434**	**$ 574,167,772**
Less: Earned revenues not attributed to programs	(695,443,263)	(633,598,176)
Net Cost of Operations	**$ (58,818,829)**	**$ (59,430,404)**

The accompanying notes are an integral part of these financial statements.

Office of the Comptroller of the Currency
Statements of Changes in Net Position
For the Years Ended September 30, 2007 and 2006

	FY 2007	FY 2006
Beginning Balances	$ 518,356,458	$ 434,421,291
Other Financing Sources:		
Imputed financing sources (Note 8)	26,418,951	24,504,763
Net Cost of Operations	58,818,829	59,430,404
Net Change	85,237,780	83,935,167
Ending Balances	**$ 603,594,238**	**$ 518,356,458**

The accompanying notes are an integral part of these financial statements.

Office of the Comptroller of the Currency
Statements of Budgetary Resources
For the Years Ended September 30, 2007 and 2006

	FY 2007	FY 2006
Budgetary Resources		
Unobligated balance, brought forward, October 1	$ 597,772,320	$ 506,623,014
Spending authority from offsetting collections		
Earned		
Collected	707,929,667	649,009,263
Receivable from Federal sources	392,256	(1,034,307)
Subtotal	708,321,923	647,974,956
Total Budgetary Resources	**$ 1,306,094,243**	**$ 1,154,597,970**
Status of Budgetary Resources		
Obligations incurred	$ 638,433,261	$ 556,825,650
Unobligated balance available	667,660,982	597,772,320
Total Status of Budgetary Resources	**$ 1,306,094,243**	**$ 1,154,597,970**
Change in Obligated Balance		
Obligated balance, net, beginning of period		
Unpaid obligations brought forward, October 1	$ 117,900,706	$ 98,950,249
Uncollected customer payments from Federal sources, October 1	(3,644,462)	(4,678,768)
Total unpaid obligated balance, net	114,256,244	94,271,481
Obligations incurred	638,433,261	556,825,650
Gross outlays	(604,612,639)	(537,875,194)
Change in uncollected customer payments from Federal sources	(392,256)	1,034,307
Obligated balance, net, end of period		
Unpaid obligations	151,721,328	117,900,706
Uncollected customer payments from Federal sources	(4,036,718)	(3,644,462)
Obligated balance, net, end of period	147,684,610	114,256,244
Net outlays		
Gross outlays	$ 604,612,639	$ 537,875,194
Offsetting collections	(707,929,667)	(649,009,263)
Net Outlays	**$ (103,317,028)**	**$ (111,134,069)**

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

Note 1—Significant Accounting Policies

A. Reporting Entity

The OCC was created as a bureau within the U.S. Department of the Treasury by an act of Congress in 1863. The mission of OCC was to establish and regulate a system of federally chartered national banks. The National Currency Act of 1863, rewritten and reenacted as the National Bank Act of 1864, authorized the OCC to supervise national banks and to regulate the lending and investment activities of federally chartered institutions.

The financial statements report on OCC's three major programs: supervise, regulate, and charter national banks. These programs support OCC's overall mission by ensuring the safety and soundness of the national banking system, fostering a flexible legal and regulatory framework that enables the national banking system to provide a full, competitive array of financial services, and promoting fair access to financial services and fair treatment of bank customers.

B. Basis of Accounting and Presentation

The accompanying financial statements present the operations of the OCC and custodial activities managed on behalf of the U.S. government. The OCC's financial statements are prepared from its accounting records in conformity with the generally accepted accounting principles (GAAP) in the United States.

The OCC's financial statements consist of Balance Sheets, and the Statements of Net Cost, Changes in Net Position, and Budgetary Resources. These financial statements are presented on a comparative basis providing information for FYs 2007 and 2006. In previous years, the OCC's financial statements also included the Statements of Custodial Activity. However, as the amounts for FY 2006 and FY 2007 are immaterial, these statements have been eliminated from the FY 2007 presentation. Should amounts become material in the future the Statements of Custodial Activity will be included in the OCC's financial statement presentation at that time. The OCC's financial information is included in the Department of the Treasury's consolidated financial statements. Transactions and balances among the OCC and other Treasury entities are eliminated from the Treasury consolidated financial statements.

The financial statements reflect both the accrual and budgetary bases of accounting. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to cash receipt or payment. The budgetary method recognizes the obligation of funds according to legal requirements, which in many cases, is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and controls over the use of federal funds.

In accordance with federal GAAP, the preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Such estimates and assumptions could change in the future as more information becomes known, which could affect the amounts reported and disclosed herein.

Throughout these financial statements, intragovernmental assets, liabilities, earned revenues, and costs have been classified according to the entity responsible for these transactions. Intragovernmental assets and liabilities are defined as those occurring within or between other federal entities. Intragovernmental earned revenues are collections or accruals of revenue from other federal entities, and intragovernmental costs are payments or accruals of expenditures to other federal entities.

C. Revenues and Other Financing Sources

The OCC's revenue is derived primarily from assessments and fees paid by national banks and income on investments in U.S. Treasury securities. The OCC does not receive congressional appropriations to fund any of its operations. Therefore, the OCC does not have any unexpended appropriations.

By federal statute 12 USC 481, the OCC's funds are maintained in a U.S. government trust revolving fund. The funds remain available to cover the annual costs of the OCC's operations in accordance with policies established by the Comptroller.

D. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the government's general revenues. In accordance with Federal Accounting Standards Advisory Board (FASAB) Statements of Federal Financial Accounting Standards (SFFAS) No. 27, *Identifying and Reporting Earmarked Funds*, all of the OCC's revenue meets this criterion and constitutes an earmarked fund.

The federal government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. Treasury securities are an asset to the OCC and a liability to the U.S. Treasury. Because the OCC and the U.S. Treasury are both parts of the federal government, the corresponding assets and liabilities offset one another from the standpoint of the government as a whole. For this reason, they do not represent an asset or a liability in the U.S. government-wide financial statements.

Treasury securities provide the OCC with authority to draw upon the U.S. Treasury to make future payments or expenditures. When the OCC requires redemption of these securities to make expenditures, the government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the government finances all other expenditures.

E. Fund Balance with Treasury

The OCC's cash receipts and disbursements are processed by the U.S. Treasury. Sufficient funds are maintained in a U.S. government trust revolving fund and are available to pay current liabilities. The OCC invests available funds in non-marketable U.S. Treasury securities (Note 2). In accordance with SFFAS No. 1, *Accounting for Selected Assets and Liabilities,* the OCC has the positive intent and ability to hold these securities until maturity.

The OCC's Statements of Budgetary Resources reflect the status of its Fund Balance with Treasury. It consists of the unobligated balance amount of $667.7 million at September 30, 2007 and $597.8 million at September 30, 2006, which is included in the OCC's net investment balance of $808.6 million for FY 2007 and $702.9 million for FY 2006, and the obligated balances not yet disbursed (*e.g.,* undelivered orders) of $147.7 million for FY 2007 and $114.3 million for FY 2006. These balances reflect the budgetary authority remaining for disbursements against current or future obligations.

F. Accounts Receivable

As presented in the OCC's Balance Sheets, Accounts Receivable represent monies owed for services and goods provided. Also included are civil money penalty (CMP) amounts that, when collected, are transferred to the Treasury General Fund. CMP collections totaled $12.7 million at September 30, 2007, of which $12.3 million have been transferred to Treasury, and $3.9 million at September 30, 2006 of which $3.7 million had been transferred as of September 30, 2006. If applicable, accounts receivable from the public are reduced by an allowance for loss on doubtful accounts. In accordance with SFFAS No. 1, *Accounting for Selected Assets and Liabilities,* the OCC updates its allowance for loss on accounts receivable account annually or as needed to reflect the most current estimate of accounts that are most likely uncollectible.

The OCC's practice has been to reserve 50 percent of outstanding receivable balances between 180 and 365 days delinquent and 100 percent for outstanding balances greater than 365 days delinquent. Since CMPs are not debts due the OCC, the amount outstanding does not enter into the calculation for the allowance. In addition, debts owed by other government entities and interest receivable on investments in U.S. Treasury securities are considered collectible, and therefore also do not enter into the calculation for the allowance. The balance in the OCC's allowance for loss on accounts receivable account was $2,374 at September 30, 2007 and $52,645 at September 30, 2006.

G. Advances and Prepayments

Payments in advance for receipt of goods and services are recognized as advances or prepayments and are reported as assets on the Balance Sheet. In FY 2007, OCC participated in a simplified acquisition pilot with the Department of Interior's GovWorks, resulting in an outstanding intragovernmental balance of $82,904.

H. Property and Equipment

Property, equipment, and internal use software (Note 3) are accounted for in accordance with SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* and SFFAS No. 10, *Accounting for Internal Use Software.*

I. Liabilities

Liabilities represent the amounts owing or accruing under contractual or other arrangements governing the transactions, including operating expenses incurred but not yet paid. Payments are made in a timely manner in accordance with the Prompt Payment Act. Interest penalties are paid when payments are late. Discounts are taken when cost effective, and the invoice is paid within the discount period. The OCC accounts for liabilities in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. In accordance with SFFAS No. 5, annual leave is accrued and funded by the OCC as it is earned, and the accrual is reduced as leave is taken or paid. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. Sick leave and other types of leave are expended as taken.

The OCC's activities are primarily financed by assessments on assets held by national banks and the federal branches of foreign banks. These assessments are due March 31 and September 30 of each year, based on asset balances as of call reports dated December 31 and June 30, respectively. Assessments are paid in mid-cycle and are recognized as earned revenue on a straight-line basis over the six months following the call report date. The unearned portions are classified as deferred revenue.

The custodial liability amount of $1.2 million recognized represents the amount of net accounts receivable that, when collected, will be deposited to the Treasury General Fund. Included in the custodial liability are amounts collected for fines, CMPs, and related interest assessments.

The SFFAS No. 12, *Recognition of Contingent Liabilities Arising from Litigation*, defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The OCC recognizes contingencies as liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated. For FY 2006 and FY 2007, the OCC neither identified nor recognized any such contingent liabilities.

J. Employment Benefits

Retirement Plan

OCC employees are eligible to participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they were hired by the federal government. Pursuant to the enactment of Public Law 99-335 which established the FERS, most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, are covered by CSRS, with the exception of those who, during the election period, joined the FERS.

Thrift Savings Plan

OCC employees are eligible to participate in the Federal Thrift Savings Plan (TSP). For those employees under FERS, a TSP account is automatically established, and the OCC contributes a mandatory 1.0 percent of base pay to this account. In addition, the OCC matches employee contributions up to an additional 4.0 percent of pay, for a maximum OCC contribution amounting to 5.0 percent of base pay.

OCC 401(k) Plan

In addition to the Federal Thrift Savings Plan, employees can elect to contribute up to 10.0 percent of their base pay in the OCC 401(k) Plan administered by Prudential Financial Incorporated, subject to Internal Revenue regulations. Currently, the OCC contributes a fixed 2.0 percent of the base pay to the plan for all qualified employees, regardless of whether they contribute to the plan or not. In addition, the OCC will match an additional 1.0 percent employee contribution, for a maximum OCC contribution of 3.0 percent of base pay. In both FY 2006 and FY 2007, the OCC funded a special lump sum contribution of $1,000 to be deposited in the 401(k) accounts of all permanent employees. The OCC contracted with an independent public accounting firm to perform an audit of the plan and related financial statements for the year ended December 31, 2006. The financial statements for the plan received an unqualified opinion.

Federal Employees Health Benefits and Federal Employees Group Life Insurance

Employees and retirees of the OCC are eligible to participate in Federal Employees Health Benefits (FEHB) and Federal Employees Group Life Insurance (FEGLI) plans that involve a cost sharing of bi-weekly coverage premiums by employee and employer. Both of these employee benefit plans are administered by OPM.

K. Restatements and Reclassification

In previous years, the OCC disclosed in the notes to the financial statements, CMPs due the federal government through court-enforced legal actions. For FY 2007, to more closely align its presentation with that of the Department of the Treasury's, the OCC has included these restricted, non-entity assets in its financial statements. As a result, the OCC's financial statements for FY 2006 have been restated as well. Both the "Accounts receivable, net" and the "Accounts payable and other accrued liabilities" lines on the Balance Sheet are impacted by the amount of outstanding CMPs at September 30, 2006, which totaled $1,619,114. There is no impact on Net Position.

In addition, the amounts in OCC's FY 2006 financial statements have been reclassified to more accurately reflect actuarial Federal Employees' Compensation Act (FECA) liability amounts as required by SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. Amounts were previously included on the Balance Sheet as "Accrued payroll and other employee benefits." Actuarial FECA liability amounts at September 30, 2006, totaled $4,147,544 and are presented on the Balance Sheet as "Other actuarial liabilities" in accordance with fiscal year-end reporting requirements previously issued to all federal agencies by the Financial Management Service bureau of the Department of the Treasury.

L. Effects of Recent Accounting Pronouncements

Presentation of the OCC's financial statement disclosures was affected by the publication of SFFAS No. 27, *Identifying and Reporting Earmarked Funds.* All of the OCC's sources of revenue are characteristic of earmarked funds as outlined in SFFAS No. 27.

The OCC's benefits program includes a Postretirement Life Insurance Plan, a defined benefit program not typically offered within the federal government and therefore not addressed by accounting standards issued by the Federal Accounting Standards Advisory Board. For this program, the OCC follows Financial Accounting Standards Board Statement of Financial Accounting Standard (SFAS) No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. As a result, the OCC implemented SFAS 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans* in FY 2007. This standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multi-employer plan) as an asset or liability in its Statement of Financial Position and to recognize changes in that funded status in the year in which the changes occur. Implementation of this standard resulted in an increase to the OCC's liability for the funded portion in the amount of $3.1 million (Note 5), in accordance with the current actuarial estimate.

Note 2—Investments and Related Interest

The OCC invests available funds in non-marketable U.S. Treasury securities and has the positive intent and ability to hold all U.S. Treasury securities to maturity. It does not maintain any available for sale or trading securities. The OCC's objective is to manage risk by diversifying the OCC's portfolio across maturities within established parameters. Diversifying maturities of the individual securities is meant to help manage the inherent risk of interest rate fluctuations. As part of its investment strategy, the OCC evaluates, at least annually, performance benchmarks with objectives and holdings comparable to those within the OCC's investment portfolio.

Investments are stated at amortized cost and the related accrued interest. Premiums and discounts are amortized over the term of the investment using the effective yield method. The fair market value of investment securities was $815.9 million at September 30, 2007, and $703.7 million at September 30, 2006. The total return on the OCC's portfolio, which includes income from interest and the change in the market value of the securities held in the portfolio during the reporting period, was 6.2 percent and 3.5 percent, respectively. The overall portfolio earned an annual yield of 4.4 percent for FY 2007 and 4.0 percent for FY 2006.

The yield-to-maturity on the non-overnight portion of the OCC's investment portfolio ranged from 2.9 percent to 4.9 percent in FY 2007, and from 2.4 percent to 4.9 percent in FY 2006.

FY 2007 Investments and Related Interest

Intragovernmental Securities	Cost	Amortization Method	Amortized (Premium)/ Discount	Investment, Net	Market Value Disclosure
Non-Marketable Market Based	$ 815,967,809	Effective Yield	(1,643,505)	814,324,304	$ 815,902,463
Accrued Interest	4,036,718		0	4,036,718	4,036,718
Total Intragovernmental Interest	**$ 820,004,527**		**(1,643,505)**	**818,361,022**	**$ 819,939,181**

FY 2006 Investments and Related Interest

Intragovernmental Securities	Cost	Amortization Method	Amortized (Premium)/ Discount	Investment, Net	Market Value Disclosure
Non-Marketable Market Based	$ 712,871,813	Effective Yield	(3,234,387)	709,637,426	$ 703,712,750
Accrued Interest	3,644,462		0	3,644,462	3,644,462
Total Intragovernmental Interest	**$ 716,516,275**		**(3,234,387)**	**712,281,888**	**$ 707,357,212**

Note 3—Property and Equipment, net

Property and equipment purchased at a cost greater than or equal to the thresholds noted on the following charts with useful lives of three years or more are capitalized at cost and depreciated or amortized, as applicable. Leasehold improvements are amortized on a straight line basis over the lesser of the terms of the related leases or their estimated useful lives. All other property and equipment are depreciated or amortized, as applicable, on a straight line basis over their estimated useful lives. The following tables summarize property and equipment balances as of September 30, 2007, and 2006.

FY 2007 Property and Equipment, net

Class of Assets	Capitalization Threshold/ Useful Life		Cost	Accumulated Depreciation	Net Book Value
Leasehold Improvements	$ 50,000	5-20	$ 28,480,815	$ (21,989,589)	$ 6,491,226
Equipment	$ 50,000	3-10	26,941,592	(18,213,271)	8,728,321
Internal Use Software	$500,000	5	39,922,748	(27,290,315)	12,632,433
Internal Use Software-Dev	$500,000	N/A	22,583,709	-	22,583,709
Leasehold Improvements-Dev	$ 50,000	N/A	4,447,258	-	4,447,258
Total			**$ 122,376,122**	**$ (67,493,175)**	**$ 54,882,947**

FY 2006 Property and Equipment, net

Class of Assets	Capitalization Threshold/ Useful Life		Cost	Accumulated Depreciation	Net Book Value
Leasehold Improvements	$ 50,000	5-20	$ 27,794,731	$ (20,971,319)	$ 6,823,412
Equipment	$ 50,000	3-10	21,952,518	(13,920,781)	8,031,737
Internal Use Software	$500,000	5	38,631,354	(20,764,024)	17,867,330
Internal Use Software-Dev	$500,000	N/A	9,298,819	-	9,298,819
Leasehold Improvements-Dev	$ 50,000	N/A	1,143,844	-	1,143,844
Total			**$ 98,821,266**	**$ (55,656,124)**	**$ 43,165,142**

Note 4—Leases

The OCC leases office space for headquarters operations in Washington, D.C., and for district and field operations. The lease agreements expire at various dates. In FY 2007, the OCC entered into 60-month occupancy agreements in various locations throughout the continental United States as current leases expire. These leases are treated as operating leases. All annual lease costs under the operating leases are included in the Statements of Net Cost.

FY 2007 Future Lease Payments

Year	Amount
2008	$ 29,064,300
2009	28,735,823
2010	27,189,128
2011	21,338,482
2012	9,068,922
2013 and beyond	18,780,610
Total	**$ 134,177,265**

FY 2006 Future Lease Payments

Year	Amount
2007	$ 25,665,528
2008	25,887,021
2009	24,739,474
2010	24,060,079
2011	18,921,229
2012 and beyond	18,905,173
Total	**$ 138,178,504**

Note 5—Other Actuarial Liabilities

OCC's other actuarial liabilities are reported on the Balance Sheets and include the components as shown in the following table.

Actuarial Liabilities

Component	FY 2007	FY 2006
Federal Employee's Compensation Act (FECA)	$ 3,418,308	$ 4,147,544
Postretirement Life Insurance Benefits	17,464,429	12,839,288
Total Other Actuarial Liabilities	**$ 20,882,737**	**$ 16,986,832**

Federal Employees Compensation Act

The FECA provides income and medical cost protection to cover federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for OCC employees covered under FECA are administered by the U.S. Department of Labor and later billed to the OCC. The FY 2007 present value of these estimated outflows are calculated using a discount rate of 4.9 percent in the first year and 5.1 percent in subsequent years.

Postretirement Life Insurance Benefits

The OCC sponsors a life insurance benefit plan for current and retired employees. This plan is a defined benefit plan. The following table sets forth the plan's funded status reconciled with the actuarial liability.

Accrued Postretirement Benefit Liability and Net Periodic Postretirement Benefit Cost

Liability Component	FY 2007	FY 2006
Accumulated Postretirement Benefit Obligation	$ 17,464,429	$ 17,354,262
Unrecognized Transition Obligation	(864,197)	(1,037,034)
Unrecognized Net Gain	(2,279,106)	(3,477,940)
SFAS 158 Funded Status Adjustment	3,143,303	0
Total Postretirement Benefit Liability	**$ 17,464,429**	**$ 12,839,288**
Cost Component		
Service Cost	$ 598,961	$ 583,972
Interest Cost	967,799	923,884
Amortization of Transition Obligation	172,837	172,837
Amortization of Unrecognized Loss	148,431	273,864
Total Postretirement Benefit Cost	**$ 1,888,028**	**$ 1,954,557**

The actuarial cost method used to determine costs for the retirement plans is the Projected Unit Credit method, a benefit valuation method, according to SFAS No. 87, *Employers Accounting for Pensions*. The weighted-average discount rate used in determining the accumulated postretirement benefit obligation was 6.0 percent. Gains or losses due to changes in actuarial assumptions are amortized over the service life of the plan. The actuarial assumptions and methods used in calculating actuarial amounts comply with the requirements for postretirement benefits other than pensions as set forth in SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* and for health benefit plans as set forth in AICPA Statement of Position 92-6.

Net periodic postretirement benefit costs for life insurance provisions under the plan include the components as shown in the previous table. The total benefit expenses are recognized as program costs in the Statements of Net Cost.

Note 6—Net Position

Net Position represents the net result of operations since inception, and includes cumulative amounts related to investments in capitalized assets. The OCC is affected by the publication of SFFAS No. 27, *Identifying and Reporting Earmarked Funds.* All of the OCC's revenues and financing sources constitute earmarked funds.

The OCC sets aside a portion of its net position as contingency, asset replacement, and special reserves to be used at the discretion of the Comptroller. In addition, funds are set aside to cover the cost of ongoing operations.

The contingency reserve supports the OCC's ability to accomplish its mission in the case of foreseeable but rare events. Foreseeable but rare events 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 of its information technology systems.

The asset replacement reserve funds the replacement of IT equipment, leasehold improvements, and furniture replacements for future years. The target level for 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 supplements revenue from assessments and other sources that are made available to fund the OCC's annual budget. The special reserve reduces the effect on operations of unforecasted revenue shortfalls or unbudgeted and unanticipated requirements or opportunities.

Net Position Availability

Components	FY 2007	FY 2006
Contingency Reserve	$ 340,256,659	$ 291,689,618
Asset Replacement Reserve	111,200,000	104,000,000
Special Reserve	15,000,000	15,000,000
Set Aside for Ongoing Operations:		
Undelivered Orders	50,972,975	30,068,275
Consumption of Assets	60,742,789	49,930,100
Capital Investments	25,421,815	27,668,465
Net Position	**$ 603,594,238**	**$ 518,356,458**

Note 7—Total Program Costs

The following table illustrates the OCC's operating expenses for FY 2007 and FY 2006.

Operating Expenses

Expense Category	FY 2007	FY 2006
Personnel Compensation and Benefits	$ 423,596,167	$ 376,550,302
Contractual Services	77,945,521	71,813,368
Travel and Transportation of Persons and Things	41,099,328	37,563,564
Rent, Communicaton, and Utilities	36,486,810	34,417,329
Imputed Costs	26,418,951	24,504,763
Depreciation	12,112,108	12,147,306
Other	18,965,549	17,171,140
Total	**$ 636,624,434**	**$ 574,167,772**

Note 8—Imputed Costs and Financing Sources

In accordance with SFFAS No. 5, *Liabilities of the Federal Government*, federal agencies must recognize the portion of employees' pension and other retirement benefits to be paid by the OPM trust funds. These amounts are recorded as imputed costs and imputed financing for other agencies. OPM provides federal agencies with cost factors for the computation of current year imputed costs. These cost factors are multiplied by the current year salary or number of employees, as applicable, to provide an estimate of the imputed financing that the OPM trust funds will provide for each agency.

The imputed costs categories for FY 2007 and FY 2006 are listed as follows. These imputed costs are included on the Statements of Net Cost. The financing sources absorbed by OPM are reflected on the Statements of Changes in Net Position and in Note 9, Reconciliation of Net Cost of Operations to Budget.

Imputed Costs Absorbed by OPM

Component	FY 2007	FY 2006
Retirement	$ 10,971,155	$ 10,756,713
Federal Employees Health Benefits	15,417,724	13,720,896
Federal Employees Group Lfe Insurance	30,072	27,154
Total Imputed Costs Covered by Others	**$ 26,418,951**	**$ 24,504,763**

Note 9—Reconciliation of Net Cost of Operations to Budget

The reconciliation of Net Cost of Operations to Budget demonstrates the relationship between OCC's proprietary (net cost of operations) and budgetary accounting (net obligations) information. For FY 2007, the following table shows $43.5 million in excess resources available to finance activities, a net decrease of $23.1 million over September 30, 2006. This net decrease resulted from a $60.3 million increase in resources available netted against the increase of $81.6 million in resources used (obligations incurred) and the $1.9 million increase in imputed financing. The increase in net resources available is primarily because of increased assessments, while the increase in resources used results from various office space and IT investments as well as salary and employee benefits.

Reconciliation of Net Cost of Operations to Budget

	FY 2007	FY 2006
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 638,433,261	$ 556,825,650
Less: Spending authority from offsetting collections	(708,321,923)	(647,974,956)
Net obligations	(69,888,662)	(91,149,306)
Other Resources		
Imputed financing sources (Note 8)	26,418,951	24,504,763
Total resources used to finance activities	**(43,469,711)**	**(66,644,543)**
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(16,455,629)	(10,258,699)
Resources that finance the acquisition of assets	(24,244,583)	(13,105,666)
Other resources or adjustments to net obligated resources that do not affect net cost of operations	(107,415)	263,333
Total resources used to finance items not part of the net cost of operations	**(40,807,627)**	**(23,101,032)**
Total resources used to finance the net cost of operations	**$ (84,277,338)**	**$ (89,745,575)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Change in deferred revenue	11,958,547	12,757,084
Total components that will require or generate resources in future periods	11,958,547	12,757,084
Components not Requiring or Generating Resources:		
Depreciation and amortization	12,112,109	12,147,307
Net decrease in bond premium	973,181	1,426,622
Other	414,672	3,984,158
Total components that will not require or generate resources	13,499,962	17,558,087
Total components of net cost of operations that will not require or generate resources in the current period	**25,458,509**	**30,315,171**
Net Cost of Operations	**$ (58,818,829)**	**$ (59,430,404)**