

United States General Accounting Office

GAO

Fact Sheet for the Chairman, Committee
on Banking, Finance and Urban Affairs,
House of Representatives

August 1988

FINANCIAL ANALYSIS

FADA's Preliminary and Final 1987 Financial Statements



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United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-231275

August 5, 1988

The Honorable Fernand J. St Germain
Chairman, Committee on Banking, Finance
and Urban Affairs
House of Representatives

Dear Mr. Chairman:

This letter responds to your request of July 18, 1988, that we identify and explain major differences between the Federal Asset Disposition Association's (FADA) unaudited, preliminary financial statements for the year ended December 31, 1987, and its final statements for that period, as audited by Peat Marwick Main & Co. In addition, you asked that we comment on FADA's primary sources of income and expenses, the volume of its Federal Home Loan Bank advances, and whether all necessary fee income adjustments were reflected in the audited December 31, 1987, financial statements.

As you know, we are currently reviewing the work of the certified public accounting firm of Peat Marwick Main & Co., FADA's independent auditor for 1987. Section 403 of Public Law 100-86, the Competitive Equality Banking Act of 1987, provides that the Comptroller General perform a financial audit of FADA on whatever basis he determines to be necessary. To fulfill our audit responsibility and avoid duplication of effort, we undertook a review of the independent auditor's work and reports for calendar year 1987. While we have not completed all aspects of this review, our work to date has provided a sufficient basis to respond to your questions.

To fulfill your request, we compared the preliminary, unaudited December 31, 1987, financial statements with FADA's final statements, which were audited by Peat Marwick Main & Co. As agreed with your office, we limited our analysis to financial statement line items which differed by \$100,000 or more between the two sets of statements, and we excluded from our analysis any differences which were caused solely by changes in report presentation and which

had no overall effect on the financial statements. To explain the differences and respond to your other questions, we examined FADA's financial records, working papers of the independent auditor, and related materials. We also interviewed appropriate officials of FADA and of the independent auditor.

In summary, our analysis disclosed that (1) the changes to the financial statements resulted in a reduction of about \$4.2 million in FADA's losses for 1987; (2) the fee agreement between FADA and its parent organization, the Federal Savings and Loan Insurance Corporation (FSLIC), changed several times, the most recent change put into effect July 15, 1988; (3) the advances from the Federal Home Loan Bank of Topeka totaled \$7 million at December 31, 1987; and (4) the fee income at year-end was uncertain and subject to adjustment.

FADA, a wholly-owned subsidiary of the Federal Savings and Loan Insurance Corporation, was chartered by the Federal Home Loan Bank Board in 1985 as a savings and loan association to manage and dispose of assets FSLIC acquired from financially troubled thrifts. Although FADA is a federally chartered savings and loan association, it does not accept deposits and derives substantially all of its income from FSLIC, primarily from fees for asset management and advisory services.

MAJOR DIFFERENCES BETWEEN PRELIMINARY
AND FINAL STATEMENTS

Appendix I presents an analysis and explanation of the differences between the 1987 preliminary, unaudited financial statements and the final financial statements, audited by Peat Marwick Main & Co. Appendix II contains FADA's preliminary 1987 financial statements. Appendix III contains the auditors' opinion and FADA's final 1987 financial statements.

In summary, the more significant changes reflected in the final, audited financial statements are attributable to

- an increase in Asset Management Fees Receivable of about \$5 million to reflect FSLIC's agreement to compensate FADA for managing assets considered to have negligible realizable value and for certain legal and appraisal services not specifically covered in FADA's contract with FSLIC,

- a \$1.7 million decrease in Asset Management Fees Receivable to reflect a downward adjustment to values of some assets managed by FADA in 1987,
- a \$0.9 million decrease in liabilities to reflect a reduction in planned bonuses for employees, and
- a \$0.2 million increase in liabilities to reflect additional accounts payable identified during FADA's annual audit.

Overall, the changes resulted in a reduction of about \$4.2 million in FADA's losses for 1987 and thus in its deficit at December 31, 1987.

FADA'S INCOME, EXPENSES,
AND BANK ADVANCES

You also inquired about FADA's primary sources of income and expenses, and the volume of its borrowings through Federal Home Loan Bank advances. FADA's primary source of revenue is the fees it charges to manage and dispose of receivership assets. FADA's total 1987 operating revenue was about \$22 million, of which \$20.4 million was for managing receivership assets, \$1.3 million for advisory services to receiverships, and \$0.3 million for services to FSLIC headquarters.

Since FADA's formation, its fees for asset management services have been computed several different ways. Through calendar year 1986, the asset management agreement between FADA and FSLIC specified that monthly fees would be initially based upon a percentage of the managed assets' recorded values on the books of the failed institution (takeover book value) until net realizable values were calculated and agreed to by the receivers. Once the net realizable values were established, they would become the basis for future monthly fees, but a retroactive adjustment was not required. In 1987, the agreement was revised to specify that fees based upon approved estimated net realizable values would be netted against previous billings, creating a retroactive adjustment mechanism that did not exist before.

Early in 1988, FSLIC and FADA entered into a new agreement which specified that beginning January 1, 1988, the fees would be based upon takeover book values, much as they were through 1986. This agreement did not affect the adjustment mechanism applicable to 1987 income. Recently, however,

FADA and FSLIC agreed to eliminate the adjustment mechanism for 1987, effective July 15, 1988. Accordingly, no adjustments will be made for net realizable values determined subsequent to July 15, 1988.

The asset management agreement FADA and FSLIC entered into in 1988 will increase FADA's potential income. The new fee structure is based on the assets' book values at takeover rather than on estimated net realizable values. The 1988 contract also changed the management fee rate to be applied from a fixed fee of 0.75 percent in 1987 to 0.50 percent and added separate fees for other services such as accounting which could amount to 0.40 percent for a maximum of 0.90 percent. Accordingly, in 1988, there is a potentially higher fee rate applied to the assets' book values at takeover which is expected to be higher than the estimated net realizable values. Also, the 1988 agreement, unlike previous contracts, provides FADA with a fee for asset sales to encourage its efforts in marketing assets.

FADA's 1987 operating expenses totaled \$29.4 million and were primarily for payroll, rent of office space, travel, and professional services such as consulting. In addition, FADA incurs costs on a reimbursable basis on behalf of receiverships holding assets that FADA is managing, including property taxes and payments to third parties for subcontracted property management services. During 1987, FADA billed receiverships \$53 million for such reimbursable costs.

FADA's advances from the Federal Home Loan Bank of Topeka amounted to \$7 million at December 31, 1987. The advances totaled \$800,000 at the beginning of 1987. During the year, FADA received advances of \$12,123,181 and made repayments of \$5,923,181. These advances are drawn against a \$50 million open line of credit with the Topeka bank. According to FADA officials, the Topeka bank advances were used solely to fund the reimbursable costs incurred by FADA for the receivers.

UNCERTAINTY OVER 1987
FEE ACCRUALS

Finally, you asked whether all necessary fee income adjustments were made to FADA's final December 31, 1987, financial statements. Peat Marwick Main & Co. qualified its opinion on FADA's 1987 financial statements because it could not determine the reasonableness of the amounts recorded as asset management fee income.

The reasons for the uncertainty with respect to 1987 fee accruals relate to the 1987 basis for calculating FADA's compensation for asset management services. As previously noted, FADA's 1987 asset management agreement with FSLIC provided for its fees to be computed based upon a percentage of the agreed upon net realizable values of managed assets, and contained a provision for retroactively adjusting any fees billed before net realizable values were determined. Accordingly, FADA's 1987 asset management fee income could not be known with certainty until the managed assets' values were determined and agreed upon.

As of March 1988 when the audit opinion was issued, the net realizable values had been agreed upon for only 27 percent of the managed assets, and determination of the values for the remainder was not expected to be completed until the end of 1988. While FADA developed an estimate for the remaining 73 percent of assets primarily based upon historical experience, in the auditor's view, there existed serious uncertainty as to whether this was an appropriate indicator of the assets' realizable values. A sizeable adjustment to the asset values would have a significant effect upon FADA's financial statements. For example, a downward adjustment of 20 percent in the valuation of certain assets would decrease FADA's 1987 income and equity by about \$2 million.

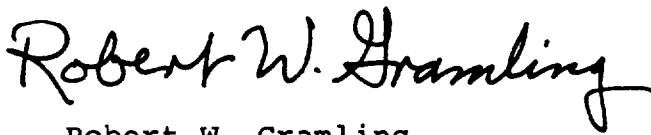
Subsequent to the issuance of the audit opinion, FSLIC set a cutoff date for retroactively adjusting the 1987 income. In a notice to receiverships dated June 30, 1988, FSLIC announced its decision to establish July 15, 1988, as the cutoff date. The notice stated that FADA would retroactively adjust all of its pre-January 1, 1988, billings for net realizable values determined before July 15, 1988. After that date, no retroactive adjustments would be made. At the current time, the full effect of this decision on the 1987 income reported in the final audited financial statements has not been determined.

As requested by your office, we did not obtain official agency comments on this report from FADA or Peat Marwick Main & Co. because of time constraints. However, we did discuss information contained in this report with representatives from the two organizations, and we incorporated their views, as appropriate. Unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send the report to interested parties

B-231275

and make copies available to others upon request. If you have any questions regarding the contents of this document, please call me on (202) 275-9406.

Sincerely yours,

A handwritten signature in black ink that reads "Robert W. Gramling". The signature is written in a cursive style with a large, prominent initial "R".

Robert W. Gramling
Associate Director

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ABBREVIATIONS

FADA	Federal Asset Disposition Association
FSLIC	Federal Savings and Loan Insurance Corporation

MAJOR DIFFERENCES BETWEEN FADA'S PRELIMINARY
AND FINAL 1987 FINANCIAL STATEMENTS

As requested, we have identified and explained the major differences between FADA's preliminary 1987 financial statements provided to the House Committee on Banking, Finance and Urban Affairs and the final 1987 financial statements as audited by Peat Marwick Main & Co. The following three schedules identify the major differences and represent a reconciliation between the two sets of financial statements. The explanations for the major differences are contained in tables 1 through 7 which follow.

Schedule 1: Major Changes Between the Preliminary and the Final Statements of Financial Condition

ASSETS	<u>Amount</u>
Balance per Preliminary Statements	\$29,558,606
<u>Increases</u>	
Asset management fees receivable (Table I.1)	3,307,048
Reimbursable expenditures receivable - advisory contracts (Table I.2)	106,554
Other minor increases in property	20,080
<u>Decreases</u>	
Reimbursable costs receivable (Table I.3)	(6,180,654)
Balance per Final Statements	<u>\$26,811,634</u>
 LIABILITIES	
Balance per Preliminary Statements	\$19,272,368
<u>Decreases</u>	
Contingent liability - reimbursable costs receivable (Table I.3)	(6,180,654)
Other liabilities and accrued expenses (Table I.4)	(704,557)
Balance per Final Statements	<u>\$12,387,157</u>
 STOCKHOLDER'S EQUITY	
Balance per Preliminary Statements	\$10,286,238
<u>Increases</u>	
Reduced retained deficit (Table I.5)	4,138,239
Balance per Final Statements	<u>14,424,477</u>
Liabilities and Stockholder's Equity per Final Statements	<u>\$26,811,634</u>

APPENDIX I

APPENDIX I

Schedule 2: Major Changes Between the Preliminary
and the Final Statements of Operations

	<u>Amount</u>
Net Loss per Preliminary Statements	\$(11,221,601)
Decreases	
Asset management fee income (Table I.6)	1,329,449
Compensation and related benefits (Table I.7)	885,357
Other minor expense (net)	45,861
Effect of accounting change - adjustment in asset management fees ^a	<u>1,946,814</u>
Net Loss per Final Statements	<u>\$(7,014,120)</u>

^aThe preliminary statements contained this line item as a separate component of income. This line item was eliminated in the final statements and its balance was included in the "asset management fee income" line item. Since this is a matter of presentation, it had no actual effect on the final loss reported by FADA. It is shown here only to reconcile the preliminary and final statements.

Schedule 3: Major Changes Between the Preliminary
and the Final Retained Deficit

	<u>Amount</u>
Retained Deficit per Preliminary Statements	\$14,713,762
Decrease	
Net loss (Table I.5)	(4,207,481)
Increase	
Prior year adjustments (Table I.5)	<u>69,242</u>
Retained Deficit per Final Statements	<u>\$10,575,523</u>

Table I.1: Differences in Asset Management Fees Receivable

	<u>Preliminary</u>	<u>Net Increase</u>	<u>Final</u>
Amounts	\$3,300,291	\$3,307,048	\$6,607,339

Explanation

- a. The receivable was increased \$4,994,803 to reflect the March 1988 agreement with FSLIC to compensate FADA for managing assets considered to have no net realizable value (about \$600,000) and providing legal and appraisal services (about \$4,400,000) during 1987. FADA based its claim for the legal and appraisal services on the belief that these services were not provided by other asset management contractors and, therefore, it should be reimbursed for providing these services. The assets with a net realizable value of zero were reportedly provided management services by FADA, but the contract did not provide for payment of fees on such assets. FADA initially recorded this total claim on the balance sheet at \$6,180,654 and planned to restate the balance sheet and income statement upon collection of the claim.
- b. The receivable was decreased \$1,687,755 to reflect adjustments in income because FADA's asset disposition plans had not been finalized for all assets under its management. FADA had approved values for about 27 percent of assets as of March 1988, and it recomputed the fees on those assets. Also, FADA estimated the fees on the remaining assets through various estimation processes based on its judgment of the probable value of the assets.
- c. The above two transactions increased receivables by \$3,307,048.

Table I.2: Differences in Reimbursable Expenditures Receivable - Advisory Contracts

	<u>Preliminary</u>	<u>Increase</u>	<u>Final</u>
Amounts	\$166,678	\$106,554	\$273,232

Explanation

- a. The receivable was increased \$106,554 to reflect additional receivables due from FSLIC which were identified during the auditor's examination for unrecorded liabilities.

Table I.3: Elimination of Line Items Entitled, "Reimbursable Costs Receivable" and "Contingent Liability - Reimbursable Costs Receivable"

	<u>Preliminary</u>	<u>Decrease</u>	<u>Final</u>
Amounts	\$6,180,654	\$6,180,654	0

Explanation

- a. The preliminary statement contained these offsetting line items to reflect the claim to FSLIC for managing zero value assets and providing legal and appraisal services during 1987. These line items were deleted from the final, audited statement when the actual receivable amount was recorded as explained in Table I.1.

Table I.4: Differences in Other Liabilities and Accrued Expenses

	<u>Preliminary</u>	<u>Net Decrease</u>	<u>Final</u>
Amounts	\$2,899,201	\$704,557	\$2,194,644

Explanation

- a. Liabilities were decreased \$915,000 to reflect FADA's decision to reduce bonus payments to employees.
- b. Liabilities were increased \$210,443 to reflect additional accounts payable identified by the auditors during their examination for unrecorded liabilities. Examples were appraisal services and temporary employee costs.
- c. The above two transactions decreased liabilities by \$704,557.

Table I.5: Differences in Retained Deficit

	<u>Preliminary</u>	<u>Net Decrease</u>	<u>Final</u>
Amounts	\$14,713,762	\$4,138,239	\$10,575,523

Explanation

- a. The net loss was reduced by \$4,207,481 and this reduction decreased the retained deficit and increased stockholders' equity accordingly. (See Schedule 2.)
- b. The retained deficit in the Preliminary Statements did not reflect \$69,242 of prior year audit adjustments and this increased the retained deficit.
- c. The above two transactions netted to \$4,138,239.

Table I.6: Differences in Asset Management Fee Income

	<u>Preliminary</u>	<u>Net Increase</u>	<u>Final</u>
Amount	\$19,058,825	\$1,329,449	\$20,388,274

Explanation

- a. The income line item was decreased \$1,946,814 as a change in report presentation by the auditors. This amount was shown separately in the unaudited financial statements as "Effect of change in accounting estimates: Adjustment in asset management fees." The adjustment reflected estimated net realizable values for six receiverships, in accordance with an amended asset management agreement dated May 27, 1987.
- b. The income was increased \$4,994,803 to reflect the March 1988 agreement with FSLIC to compensate FADA for managing zero value assets and providing legal and appraisal services during 1987. See Table I.1 for further details.
- c. The income was decreased \$1,687,755, a FADA estimated amount, to reflect income adjustments because FADA's asset disposition plans had not been finalized for all assets under its management. See Table I.1 for further details.
- d. The income was decreased by \$30,785 to reverse audit differences for 1986 that FADA entered in the records in 1987 and which were reflected incorrectly in the 1987 amounts.
- e. The above four transactions increased asset management fee income by \$1,329,449.

Table I.7: Differences in Compensation and Related Benefits

	<u>Preliminary</u>	<u>Net Decrease</u>	<u>Final</u>
Amounts	\$19,059,268	\$885,357	\$18,173,911

Explanation

- a. The compensation expense was decreased \$915,000 to reflect FADA's decision to reduce bonus payments to employees.
- b. The compensation expense was increased \$29,643 to reflect a liability and related expense for temporary help identified during the audit.
- c. The above two transactions decreased compensation expense by \$885,357.

PRELIMINARY 1987 FINANCIAL STATEMENTS

Federal Asset Disposition Association

FINANCIAL STATEMENTS

DECEMBER, 1987

FADA

Administrative Offices
One Market Plaza
Spear St. Tower, 38th Floor
San Francisco, CA 94105
(415) 543-3232

APPENDIX II

APPENDIX II

FEDERAL ASSET DISPOSITION ASSOCIATION
Balance Sheet
December 31, 1987

	12-31-87	11-30-87
	-----	-----
ASSETS		
Cash and Cash Equivalents	\$ 1,553,521	\$ (102,987)
Investment in FHLB Stock	424,100	410,200
Marketable Securities (Notes 1, 4)	5,017,314	6,006,634
Reimbursable Costs Receivable (Note 3)	6,180,654	
Asset Management Fees Receivable (Notes 1, 7)	\$ 3,300,291	
Advisory and Other Fees Receivable (Note 1)	187,350	

Total Fees Receivable	3,487,641	4,007,926
Expenses Receivable from Receiverships (Note 1)	8,410,104	
Expenses Receivable from Contracts (Note 1)	166,678	

Total Reimbursable Expenses Receivable	8,576,782	6,673,010
Interest Receivable	45,173	86,504
Other Accounts Receivable	160,608	155,354
Furniture & Equipment, L/H Improvements (Note 1, 5)	6,720,395	
Less: Allowance for Depreciation, Amortization	(1,017,931)	

Furniture & Equipment, Net	3,702,464	3,148,924
Prepaid Expenses and Other Assets	410,349	481,038

TOTAL ASSETS	\$ 29,558,606	\$ 20,866,603
	-----	-----
LIABILITIES & STOCKHOLDER'S EQUITY		
Liabilities		
Short Term Borrowings (Note 6)	10,192,513	6,651,784
Interest Payable	2,175	
Taxes Payable		
Accrued Expenses Payable	2,897,026	2,654,990
Contingent Liability - Reimbursable Costs Receivable (Note 3)	6,180,654	

TOTAL LIABILITIES	\$ 19,272,368	\$ 9,306,774
	-----	-----
Stockholder's Equity		
Common Stock - 500,000 Shares Authorized No Par, 25,000 Shs Issued	25,000,000	25,000,000
Preferred Stock - 500,000 Shares Authorized None Issued		
Retained Earnings (Deficit) (Note 7)	(14,713,762)	(13,440,171)
	-----	-----
TOTAL STOCKHOLDER'S EQUITY	10,286,238	11,559,829
	-----	-----
TOTAL LIABILITIES & STOCKHOLDER'S EQUITY	\$ 29,558,606	\$ 20,866,603
	-----	-----

UNAUDITED, ACCRUAL BASIS

(The accompanying Notes are an integral part of these Financial Statements)

APPENDIX II

APPENDIX II

FEDERAL ASSET DISPOSITION ASSOCIATION
Income Statement - Actual vs. Plan
December 31, 1987 Year-to-Date

	12-31-87 Year-to-Date	Plan Year-to-Date	Better (Worse) Than Plan
REVENUE			
Asset Management Fees (Notes 1, 3, 7)	\$ 19,058,825	\$22,635,000	\$ (3,576,175)
Asset Advisory Fees (Note 1)	1,318,665	2,377,000	(1,058,335)
FSLIC Corporate Fees (Note 1)	264,164	1,871,000	(1,606,836)
Total Revenue	20,641,654	26,883,000	(6,241,346)
OPERATING EXPENSE			
Personnel Expense	19,059,268	17,841,000	(1,218,268)
Occupancy Expense	1,917,105	1,741,000	(176,105)
Equipment Expense (Note 1)	1,878,056	2,087,000	208,944
Telephone Expense	805,480	878,000	72,520
Travel Expense	1,341,084	1,537,000	195,916
Management Consulting	1,587,656	151,000	(1,436,656)
Public Accountants	70,879	80,000	9,121
Executive Search Fees	644,137	237,000	(407,137)
Systems Consulting	599,485	500,000	(99,485)
Legal Expenses	453,820	500,000	46,180
Other Professional Services	323,265	220,000	(103,265)
Insurance	255,327	631,000	375,673
Contingency		1,000,000	1,000,000
All Other Expense	1,376,541	1,377,000	459
Total Operating Expense	30,312,103	28,780,000	(1,532,103)
OPERATING INCOME (LOSS)	(9,670,449)	(1,897,000)	(7,773,449)
OTHER INCOME AND EXPENSE			
Interest and Dividend Income	963,571	1,655,000	(691,429)
Interest Expense	533,112	202,000	(331,112)
Gain (Loss) on Investment Securities	(24,522)	0	(24,522)
Gain (Loss) on Fixed Asset Sales	(10,812)	0	(10,812)
Other Income	537	0	537
Net Other Income and Expense	395,662	1,453,000	(1,057,338)
NET INCOME (LOSS) BEFORE EFFECT OF CHANGE IN ACCOUNTING ESTIMATES	(9,274,787)	(444,000)	(8,830,787)
EFFECT OF CHANGE IN ACCOUNTING ESTIMATES			
Adjustment in Asset Management Fees (Note 7)	(1,946,814)	0	(1,946,814)
NET INCOME (LOSS) AFTER EFFECT OF CHANGE	\$(11,221,601)	\$ (444,000)	\$(10,777,601)

UNAUDITED, ACCRUAL BASIS

(The accompanying Notes are an integral part of these
Financial Statements)

APPENDIX II

APPENDIX II

FEDERAL ASSET DISPOSITION ASSOCIATION
Statement of Changes in Financial Position
for the Twelve Months Ending December 31, 1987

CASH AND CASH EQUIVALENTS - DECEMBER 31, 1986		\$ 9,258,103
OPERATING ACTIVITIES:		
Net earnings (loss)	\$ (11,221,601)	
Items not requiring cash:		
Depreciation and amortization	940,339	

Cash provided by (used for) operations		\$ (10,281,262)
CASH PROVIDED BY OTHER SOURCES:		
Additional short term borrowings	9,392,513	
Contingent Liability- Reimbursable Costs Receivable	6,180,654	
Sale of Marketable Securities	4,801,192	
Increase in accrued expenses payable	1,968,108	
Interest Payable	2,175	

Cash provided by other sources		22,344,642
CASH USED FOR:		
Additions to furniture, equipment and leasehold improvements	2,775,659	
Purchase of FHLB stock	376,100	
Increases in:		
Reimbursable expenses receivable	7,637,370	
Reimbursable Costs Receivable	6,180,654	
Asset management fees receivable	2,332,333	
Prepaid expenses and other assets	292,976	
Interest and other accounts receivable	121,264	
Asset advisory and other fees receivable	51,606	

Cash used		19,767,962
DECREASE IN CASH		(7,704,582)

CASH AND CASH EQUIVALENTS - DECEMBER 31, 1987		\$ 1,553,521

UNAUDITED, ACCRUAL BASIS

(The accompanying Notes are an integral part of these Financial Statements)

FEDERAL ASSET DISPOSITION ASSOCIATION**NOTES TO THE FINANCIAL STATEMENT****1. Accounting Policies****General**

The Federal Asset Disposition Association (FADA) is a special purpose Federally Chartered Savings and Loan Association, chartered on November 5, 1985 pursuant to Section 406 of the National Housing Act. The FADA is wholly owned by the Federal Savings and Loan Insurance Corporation (FSLIC).

The accounting and reporting policies of the FADA are in accordance with generally accepted accounting principles.

Furniture and Equipment

Furniture and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are charged to expense over the estimated useful lives of the assets on a straight line basis.

Fee Income and Reimbursable Expenses

Asset management and advisory fees are accrued and billed monthly. Until net realizable values are established, asset management fees are accrued on the basis of estimated value of the assets managed and are subject to retroactive adjustment.

Reimbursable expenses for the management of assets are accrued to accounts receivable as incurred and billed monthly.

Marketable Securities

Marketable Securities are recorded as of settlement date.

2. Assets Under Management

As of the end of December, the FADA was managing approximately \$4.4 billion of real estate assets based on estimated current book value from thirty-two FSLIC liquidating and supervised associations. Estimated net realizable value of these assets is approximately \$3 billion. Per the management contracts with FSLIC or supervised associations, FADA is required to calculate net realizable values per prescribed procedures requiring R41(c) appraisals. These real estate assets are owned by the institutions and thus do not appear on the balance sheet of the FADA.

3. Reimbursable Costs Receivable

FADA has requested \$6,180,654 from the FSLIC to compensate FADA for legal services, appraisal services, and management fees on assets with no book value for fee billing purposes. During 1987, FADA has provided legal and appraisal services that are not being provided by other asset management contractors retained by the FSLIC.

The \$6,180,654 has been shown on the balance sheet as reimbursable costs receivable and as contingent liability. Upon collection of the receivable these statements will be restated to include this amount in the income statement as revenues or as a reduction in expenses. The amount is subject to adjustment pending final approval of the FSLIC.

4. Marketable Securities

Marketable securities include obligations of the U.S. Government, other Federal Agencies and Bankers Acceptances. As of December 31, 1987 market value was \$4,856,563.

5. Capital Lease

In 1987, FADA entered into a five year lease on data processing equipment that has been recorded as a capital lease. The fair market value of that equipment on the date of lease was \$589,000.

The following is a schedule by years of future minimum lease payments under this lease:

Year ending December 31:	(In Thousands)
1988	\$139
1989	\$139
1990	\$139
1991	\$139
1992	\$ 35

6. Short Term Borrowing

FADA's short term borrowings are drawn against an open line of credit with the Federal Home Loan Bank of Topeka, which is backed by a contract between the FSLIC and Federal Home Loan Bank, under which the FSLIC has guaranteed repayment of up to \$50 million in advances to FADA. The repayment guarantee applies only to advances used for funding asset related activities in which FADA has an agreement with the FSLIC as receiver or conservator for an insured institution.

In addition to the guarantee from the FSLIC, the FHLB of Topeka asked for additional collateral in the form of an Advance Agreement whereby FADA provides collateral from its management fees and reimbursable advances receivable. In addition, FADA will leave securities equal to 20% of advances in the possession of the Bank. This agreement was signed in September.

7. Change in Accounting Estimates

In July, FADA adjusted downwards the asset base of six receiverships to reflect estimated net realizable values (NRV), in accordance with the amended asset management agreement dated May 27, 1987. Per the management contracts with FSLIC or supervised associations, FADA is required to calculate net realizable values per prescribed procedures requiring R41(c) appraisals.

Net realizable values estimated to date are approximately two-thirds of net takeover values, and significantly below what FADA estimates will be ultimately recovered. The change in the estimate of the net realizable values reduced FADA's fee income by \$2.5 million. Annualized, the change will reduce FADA's fee income by approximately \$5.7 million. Prior to the amendment, FADA's management fee was based on net takeover values (including reserves). Year to date earnings have been restated.

As additional net realizable values are determined for assets under management, adjustments may be necessary to revenues. It is difficult to say whether any future adjustments will have a material impact on these financial statements.

AUDITORS' OPINION AND FINAL 1987 FINANCIAL STATEMENTS

RPMG Peat Marwick

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Financial Statements

December 31, 1987 and for the period November 5, 1985
(date of inception) to December 31, 1986

(With Auditors' Report Thereon)


Peat Marwick

Certified Public Accountants

Peat Marwick Main & Co.
 Three Embarcadero Center
 San Francisco, CA 94111

The Board of Directors
 The Federal Asset Disposition Association
 San Francisco, California:

We have examined the statements of financial condition of the Federal Asset Disposition Association (the FADA) as of December 31, 1987 and 1986, and the related statements of operations, stockholder's equity and changes in financial position for the year ended December 31, 1987 and for the period November 5, 1985 (date of inception) to December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As more fully described in note 1, the FADA is a wholly-owned subsidiary of the Federal Savings and Loan Insurance Corporation (FSLIC). The FADA is economically dependent upon and derives substantially all of its income from providing services (primarily asset management and advisory services) for the FSLIC and various FSLIC receiverships.

As discussed in note 3, approximately \$10,648,000 of asset management fee income recorded in 1987 by the FADA is based solely on contract terms applicable to fiscal 1987 billing calculations and was computed using the estimated values of certain assets managed by the FADA. Ultimately, the 1987 management fee calculations related to such assets will be recomputed on the basis of final values to be determined by the FADA and approved by the receiverships. At such time as the final asset values are resolved, billings to receiverships will be adjusted and related fee income adjustment amounts will be reflected in the then current operations. Due to the uncertainty inherent in the 1987 asset management fee income estimation process, the ultimate outcome of this matter cannot be presently determined.

In our opinion, subject to the effects on the 1987 financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the aforementioned financial statements present fairly the financial position of the FADA at December 31, 1987 and 1986 and the results of its operations and the changes in its financial position for the year ended December 31, 1987 and for the period November 5, 1985 to December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.



March 30, 1988



Member Firm of
 Klynveld Peat Marwick Goerdeler

APPENDIX III

APPENDIX III

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Statements of Financial Condition

December 31, 1987 and 1986

<u>Assets</u>	<u>1987</u>	<u>1986</u>
Cash (including interest bearing deposits: 1987, \$1,214,495; 1986, \$25,000)	\$ 1,553,521	158,103
Federal funds	-	9,100,000
Investment in U.S. Government and Federal Agency securities (approximate market value: 1987, \$4,856,562; 1986, \$9,759,000) (note 7)	5,017,314	9,818,506
Fees receivable:		
Asset management fees (notes 3 and 7)	6,607,339	997,893
Advisory fees (note 7)	187,350	135,744
Reimbursable expenditures receivable (notes 4 and 7):		
Receivership contracts	8,410,104	849,726
Advisory contracts	273,232	93,151
Accrued interest receivable	45,173	35,084
Property, equipment and leasehold improvements, net (note 5)	3,212,077	2,223,632
Leased property under capital lease, net (note 6)	510,467	-
Federal Home Loan Bank Stock, at cost (note 7)	424,100	48,000
Prepaid expenses and other assets	<u>570,957</u>	<u>166,805</u>
	<u>\$ 26,811,634</u>	<u>23,626,644</u>
<u>Liabilities and Stockholder's Equity</u>		
Short-term borrowings, including bank overdraft in 1987 of \$3,192,512 (note 7)	10,192,513	800,000
Other liabilities and accrued expenses	1,339,555	1,309,554
Obligation under capital lease (note 6)	521,412	-
Deferred rent payments	<u>333,677</u>	<u>78,493</u>
Total liabilities	<u>12,387,157</u>	<u>2,188,047</u>
Stockholder's equity (note 11):		
Preferred stock, no par value Authorized 500,000 shares; none issued	-	-
Common stock, no par value, stated value \$1,000 per share. Authorized 500,000 shares; issued and outstanding 25,000 shares	25,000,000	25,000,000
Retained deficit	<u>(10,575,523)</u>	<u>(3,561,403)</u>
Total stockholder's equity	<u>14,424,477</u>	<u>21,438,597</u>
Commitments and contingencies (notes 10 and 11)		
	<u>\$ 26,811,634</u>	<u>23,626,644</u>

See accompanying notes to financial statements.

APPENDIX III

APPENDIX III

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Statements of Operations

Year ended December 31, 1987 and period from November 5, 1985
(date of inception) to December 31, 1986

	<u>1987</u>	1985 and <u>1986</u>
Revenues:		
Asset management fee income (note 3)	\$ 20,388,274	1,343,067
Asset advisory fee income	1,318,665	291,951
FSLIC corporate fee income	<u>264,164</u>	<u>-</u>
Total revenues	<u>21,971,103</u>	<u>1,635,018</u>
Operating expenses:		
Compensation and related benefits (note 8)	18,173,911	3,363,527
Other professional services	1,978,396	558,605
Occupancy	1,884,601	318,566
Travel	1,343,698	468,299
Depreciation and amortization	923,952	94,268
Property and equipment rentals and supplies	886,903	366,829
Telephone	816,142	136,548
Executive search fees	644,137	244,463
Systems consulting	598,385	394,749
Legal services	453,820	149,384
Office supplies	453,679	161,362
Postage and delivery	366,332	44,884
Insurance	255,327	20,524
Other	<u>601,602</u>	<u>155,640</u>
Total operating expenses	<u>29,380,885</u>	<u>6,477,648</u>
Operating loss	7,409,782	4,842,630
Other income and expense:		
Interest and dividend income	974,983	1,281,833
Interest expense	(544,526)	(606)
Loss on sale of investment securities	(24,522)	-
Other expense	<u>(10,273)</u>	<u>-</u>
Loss before income taxes	7,014,120	3,561,403
Income taxes (note 9)	<u>-</u>	<u>-</u>
Net loss	<u>\$ 7,014,120</u>	<u>3,561,403</u>

See accompanying notes to financial statements.

APPENDIX III

APPENDIX III

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Statements of Stockholder's Equity

December 31, 1987 and period from November 5, 1985
(date of inception) to December 31, 1986

	<u>Preferred stock</u>	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained deficit</u>	<u>Total</u>
Initial issuance of common stock	\$ -	25,000,000	-	-	25,000,000
Net loss from date of inception to December 31, 1986	<u>-</u>	<u>-</u>	<u>-</u>	<u>(3,561,403)</u>	<u>(3,561,403)</u>
Balances at December 31, 1986	-	25,000,000	-	(3,561,403)	21,438,597
Net loss, 1987	<u>-</u>	<u>-</u>	<u>-</u>	<u>(7,014,120)</u>	<u>(7,014,120)</u>
Balances at December 31, 1987	\$ <u>-</u>	<u>25,000,000</u>	<u>-</u>	<u>(10,575,523)</u>	<u>14,424,477</u>

See accompanying notes to financial statements.

APPENDIX III

APPENDIX III

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Statements of Changes in Financial Position

Year ended December 31, 1987 and period from November 5, 1985
(date of inception) to December 31, 1986

	1987	1985 and 1986
Sources of cash:		
Additional short-term borrowings	\$ 9,392,513	800,000
Proceeds from stock issuance to FSLIC	-	25,000,000
Sales of Federal funds	9,100,000	-
Sale of investment securities	4,801,192	-
Increase in obligation under capital lease	521,412	-
Increase in other liabilities and accrued expenses	<u>30,001</u>	<u>1,309,554</u>
Total sources of cash	<u>23,845,118</u>	<u>27,109,554</u>
Uses of cash:		
Operating activities:		
Net loss	7,014,120	3,561,403
Items not providing (requiring) cash:		
Depreciation and amortization	(923,952)	(94,268)
Deferred rent payments, net	<u>(255,184)</u>	<u>(78,493)</u>
Cash used for operations	<u>5,834,984</u>	<u>3,388,642</u>
Purchase of investment securities	-	9,818,506
Purchase of Federal funds	-	9,100,000
Additions to furniture, equipment, capital lease, and leasehold improvements	2,422,864	2,317,900
Purchase of FHLB stock	<u>376,100</u>	<u>48,000</u>
Cash used for investment transactions	<u>2,798,964</u>	<u>21,284,406</u>
Increases in:		
Reimbursable expenses receivable	7,740,459	942,877
Asset management fees receivable	5,609,446	997,893
Prepaid expenses and other assets	404,152	166,805
Interest and other accounts receivable	10,089	35,084
Asset advisory and other fees receivable	<u>51,606</u>	<u>135,744</u>
Cash used for financing operating activities	<u>13,815,752</u>	<u>2,278,403</u>
Net increase in cash	1,395,418	158,103
Cash, beginning of period	<u>158,103</u>	<u>-</u>
Cash, end of period	\$ <u>1,553,521</u>	<u>158,103</u>

See accompanying notes to financial statements.

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

December 31, 1987 and 1986

(1) Organization and Significant Accounting Policies

The Federal Asset Disposition Association (the FADA), whose stock is wholly-owned by the Federal Savings and Loan Insurance Corporation (FSLIC), was chartered in 1985 under Sections 406(a) and (b) of the National Housing Act of 1934 to help financially troubled Thrifts manage and dispose of real estate assets, including loans, pursuant to asset management contracts with these Thrifts or, in most circumstances, the Thrift receivers. As agent serving on behalf of receivers, the FADA does not take title to underlying assets but does have the fiduciary responsibilities inherent in the agency function. The FADA derives substantially all of its income from providing services (primarily asset management and advisory services) for the FSLIC and various FSLIC receiverships and Management Consignment Programs.

The following accounting policies, together with those disclosed elsewhere in the notes to financial statements, represent significant accounting policies that the FADA follows in preparing its financial statements.

(a) Investment in Securities

Investment securities are stated at cost, adjusted for amortization of premiums or accretion of discounts. Interest and dividends on investment securities include interest earned on investment securities and dividends earned on stock of the Federal Home Loan Bank of Topeka. Amortization of premium or accretion of discount is accounted for over the term of each investment on a straight-line basis.

(b) Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (FHLB) System, the FADA is required to acquire and hold a specified number of shares of the capital stock of the Federal Home Loan Bank of Topeka, Kansas. In addition, the short-term borrowing agreement between the FADA and the Federal Home Loan Bank of Topeka (note 7) stipulates that the FADA will purchase additional FHLB stock as short-term borrowings are made. The amount of stock held at December 31, 1987 satisfied both of the requirements as of that date.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(c) Property, Equipment and Leasehold Improvements

Property and equipment are stated at cost less accumulated depreciation and amortization. Purchases of equipment are capitalized to the extent that the expenditures individually exceed \$350, except software for which the amount is \$450. Purchases of equipment between \$100 and \$350 are capitalized in annual pools. Separate pools are established for office furniture and equipment, and computer hardware and accessories. Purchases of supplies are charged to expense as incurred.

Depreciation of office property and equipment is computed on a straight-line basis over the estimated useful lives of the various classes of assets. The period used for depreciation of assets is based on the following table:

<u>Asset type</u>	<u>Capitalized cost</u>	<u>Estimated useful life</u>
<u>I. Assets individually capitalized</u>		
Furniture - new	\$350+	96 months
Furniture - used	\$350+	60 months
Office equipment	\$350+	60 months
Systems hardware	\$350+	60 months
Systems software	\$450+	36 months
<u>II. Assets capitalized in pools</u>		
Furniture - new or used	\$100+ less than \$350	60 months
Office equipment - new or used	\$100+ less than \$350	60 months
Systems hardware	\$100+ less than \$350	60 months
<u>III. Installation costs</u>		
Systems installation	\$1,000+	36 months

Leasehold improvements are amortized on a straight-line basis over the remaining term of the lease or the estimated useful life of the asset, whichever is shorter. Maintenance and repairs are charged to expense; improvements are capitalized.

(d) Fee Income and Reimbursable Expenses

Asset management and advisory fee income is accrued and billed monthly. Reimbursable expenditures in connection with the management of assets are recorded as receivables when paid by the FADA and are billed to receivers monthly. These third-party expenditures are not recorded in the FADA statements of operations. FADA management evaluates the collectibility of fee income and reimbursable expenses on an ongoing basis and deemed all related receivables as of December 31, 1987 to be collectible.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(e) Collections on Behalf of Receivers

The FADA collects revenues in connection with income producing assets under management and remits such revenues directly to the receiver. The FADA generally does not collect or process loan payments related to assets under management.

(f) Start-up Costs

In 1986 the FADA incurred significant start-up costs, including fees in connection with the design and implementation on its asset accounting and reporting system software. These start-up costs have been charged to 1986 expense.

(g) Reclassifications

Certain of the 1986 financial statement amounts have been reclassified to conform to the 1987 presentation.

(2) Assets Under Management

At December 31, 1987 the FADA managed real estate assets, including loans and loan participations, on behalf of thirty FSLIC liquidating receiverships and two institutions in the FSLIC's Management Consignment Program (MCP). The total net book value of managed assets, per receivership and MCP records, was approximately \$4.3 billion at December 31, 1987 (\$1.5 billion at December 31, 1986), which unaudited amounts are not reflected in the accompanying statements of financial condition. The unaudited net book values are not intended to be indicative of current market values. These assets are located in all areas of the United States, with major concentrations in Texas (\$2.2 billion), California (\$.5 billion) and Florida (\$.5 billion). The assets under management include a significant number of assets subject to loan participation agreements. For participations in which the receiver or MCP is not the lead participant, the asset book value includes only the receiver's or MCP's percentage interest in the total asset.

From inception through 1987, the FADA effected dispositions and settlements of managed assets totaling approximately \$583 million, as shown in the following table (unaudited):

	(In millions) <u>(unaudited)</u>
Real estate sales (net sales value)	\$ 155
Loan sales and loan payoffs (net proceeds)	153
Loan restructures and settlements (book value)	<u>275</u>
	\$ 583

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(3) Asset Management Fees

The FADA manages and disposes of receivership and MCP assets for a fee. For the year ended December 31, 1987, this fee was calculated using .75% of the net realizable asset values per annum. For assets subject to participation agreements, asset management fees were calculated on 100% of the asset value in those instances when the receiver or MCP is the lead participant, and on the actual participation percentage when the receiver or MCP is the non-lead lender. Asset values initially assigned for fee calculation purposes are generally the receivership or MCP net book values, although the FADA in certain circumstances assigns a lower value for fee purposes. These values are subsequently adjusted, as are previous billings to receiverships and MCPs, to reflect net realizable values pursuant to appraisals and asset disposition plans, as approved by receivers and MCPs.

As of December 31, 1987, asset disposition plans had not been finalized for all assets under management. For such assets, the FADA generally records fee income on the basis of estimated net realizable values. As of March 1988, management estimates that, of total assets under management at year end 1987 of approximately \$4.3 billion (at unaudited net book value), 27% or approximately \$1.2 billion have approved net realizable values. Approximately \$10,648,000 of FADA's 1987 management fee income was recorded on the basis of estimated net realizable values for assets which did not yet have approved values. As additional net realizable values are determined for assets under management at December 31, 1987, income in future periods will be adjusted to reflect fee income as if the approved values were in place from the inception date of the management contract pertaining to the assets. It cannot presently be determined whether any such future adjustments will have a material impact on the accompanying financial statements.

In 1986, under the original asset management contracts with receivers prior to amendments adopted in May 1987, receivers generally were billed based on net book values. When net realizable values for assets were approved, management fee billings were adjusted to reflect the approved values prospectively from the date of approval.

A new FADA/FSLIC asset management contract, with an effective date of January 1, 1988 and signed in March of 1988, has changed the FADA asset management fee structure. Management fees will depend on the level of services provided, with a minimum base annual fee of .50% of agreed upon asset values. These values for new assets are to be determined within 60 days after FADA commences management of the asset. FADA will also be paid a disposition fee on assets. Such fee decreases each year a given asset remains under FADA management.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

The billing policy changes made under contract terms with the FSLIC and FSLIC receiverships and MCPs as between 1986, 1987, and 1988 do not represent changes in the consistent application of accounting principles but do affect the comparability of the financial statements.

Asset management fees receivable at December 31, 1987 and related management fee income include approximately \$4.4 million due from the FSLIC to compensate the FADA for legal and appraisal services provided by the FADA beyond the scope of the receivership and MCP contracts in force at year end 1987. The entire \$4.4 million was received in March 1988. Asset management fees receivable at December 31, 1987 also includes approximately \$.6 million related to FADA-managed assets having zero book values. This amount has been approved by the FSLIC and is payable by the individual receiverships and MCPs.

(4) Reimbursable Expenditures

In addition to management fees, the FADA is reimbursed by the various receiverships and MCPs for expenditures related to assets it manages. Such expenditures include all third party payments related to the assets under management, including subcontracted property management fees. Under the new 1988 contract with the FSLIC certain third party payments, including business plan preparation costs, which were reimbursable under the old contract, will be expensed by the FADA.

For the year ended December 31, 1987, the FADA billed receiverships and MCPs approximately \$53 million for reimbursable expenditures (approximately \$1.5 million for the period ended December 31, 1986).

(5) Property, Equipment and Leasehold Improvements

Property and equipment at December 31 is comprised of the following:

	<u>1987</u>	<u>1986</u>
Computer hardware and software	\$ 2,437,099	1,783,151
Furniture and fixtures	1,457,402	534,749
Leasehold improvements	<u>256,974</u>	<u>-</u>
	4,151,475	2,317,900
Less accumulated depreciation and amortization	<u>939,398</u>	<u>94,268</u>
	<u>\$ 3,212,077</u>	<u>2,223,632</u>

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(6) Obligation Under Capital Lease

In 1987, the FADA entered into a five-year lease on data processing equipment that has been recorded as a capital lease and, accordingly, the asset is stated at cost of \$589,000 less accumulated depreciation of \$78,533. Depreciation is computed on a straight-line basis over the five-year lease period which is equivalent to the estimated useful life.

The following is a schedule by years of future minimum lease payments under capital lease together with the present value of the minimum lease payments as of December 31, 1987:

Year ending December 31:	
1988	\$ 139,068
1989	139,068
1990	139,068
1991	139,068
1992	<u>46,356</u>
Net minimum lease payments	602,628
Less amount representing interest	<u>81,216</u>
Obligation under capital lease	\$ <u>521,412</u>

(7) Short-term Borrowings

The FADA short-term borrowings of \$7.0 million at December 31, 1987 and \$800,000 at December 31, 1986 were drawn against a \$50 million open line of credit advance with the Federal Home Loan Bank of Topeka. The open line of credit advance is backed by a contract between the FSLIC and the Federal Home Loan Bank of Topeka under which the FSLIC has guaranteed repayment of up to \$50 million of Bank advances to the FADA. Under the terms of the contract, the repayment guarantee applies only to advances used for the purpose of funding operations in which the FADA has a legal agreement with the FSLIC in the FSLIC's capacity as receiver or conservator for an insured institution.

Under terms of the borrowing agreement between the FADA and the FHLB of Topeka the FADA is required to maintain qualifying collateral equal to 120 percent of outstanding borrowings. Qualifying collateral includes the FADA's investment securities and reimbursable expenditures and fees receivable. The FADA is required to maintain investment securities, in the possession of the FHLB of Topeka, equal to the greater of 20 percent of outstanding borrowings or 120 percent of such borrowings, as reduced by qualifying reimbursable expenditures and fees receivable.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

The FADA's FHLB stock is also pledged as additional collateral for borrowings from the FHLB of Topeka.

Interest is charged to the FADA on outstanding draws at the FHLB cost of funds rate, which was 7.625% at December 31, 1987 (6.750 percent at December 31, 1986). The line of credit arrangement is reviewed on an annual basis by the lender.

(8) Incentive Compensation and 401(K) Savings and Investment Plan

The FADA has established an incentive compensation plan for its key officers and managers. The plan is designed to add an incentive element to FADA management compensation packages. Awards under the plan are based on both individual performance and overall corporate performance. The maximum award as a percentage of base salary generally ranges from 15% to 50%. Award amounts are not linked to proceeds from asset disposition and must be approved by the Board of Directors. For the years ended December 31, 1987 and 1986, the FADA recorded incentive compensation expense totaling approximately \$300,000 and \$291,000, respectively.

The FADA established a 401(K) Savings and Investment Plan for its salaried employees in October 1986. Employer contributions required under the Plan include a minimum of two percent of each employee's compensation per annum. In addition to the minimum two percent contribution, the FADA matches 100 percent of employee contributions under the Plan, limited to four percent of employee compensation per annum. Employer contributions to the Plan vest with participants over time and become fully vested after three years of service. Compensation and related benefits expense in the accompanying 1987 statement of operations includes approximately \$560,000 related to the Plan.

(9) Income Taxes

The FADA has incurred net operating losses from inception through December 31, 1987. Accordingly, no provision for income taxes has been recorded. At December 31, 1987, the FADA had net operating loss carryforwards for tax purposes of approximately \$9.3 million (\$10.6 million for financial statement purposes). The net operating loss carryforwards are available to offset future Federal taxable income and expire, for Federal purposes beginning in the year 2001. Additionally, under new California legislation, 50 percent of net operating losses incurred in taxable years beginning on or after January 1, 1985 and ending January 1, 1992 are available for carryforward for California franchise tax purposes. Net operating losses from taxable years beginning in 1985 and 1986 may be carried forward to taxable years beginning in 1987, 1988 and 1989. Net operating losses incurred in taxable years beginning on or after January 1, 1987 may be carried forward to fifteen years.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(10) Commitments and Contingencies

Commitments

At December 31, 1987 the FADA leased office space and equipment in headquarters and regional locations. Future minimum lease payments under the terms of existing noncancelable operating leases in excess of one year are as follows:

Year ending December 31:	<u>Office Space</u>	<u>Equipment</u>	<u>Total</u>
1988	\$ 2,037,153	415,367	2,452,520
1989	2,164,182	415,387	2,579,569
1990	2,018,763	377,146	2,395,909
1991	1,736,941	192,045	1,928,986
1992	807,907	27,058	834,965
Thereafter	<u>430,416</u>	<u>-</u>	<u>430,416</u>
	\$ <u>9,195,362</u>	<u>1,427,003</u>	<u>10,622,365</u>

Contingencies

In its capacity as asset manager for FSLIC receiverships and MCPs, the FADA is a defendant (as is the FSLIC and/or FSLIC receiverships and MCPs) in several pending and threatened litigation matters. Certain of these matters involve substantial claim amounts and were unresolved as of December 31, 1987. Pursuant to its contract with the FSLIC and FSLIC receiverships the FADA is indemnified by the FSLIC for losses and expenses, if any, resulting from such litigation in the event that the FSLIC in its capacity as receiver is deemed to have been grossly negligent or breached its fiduciary responsibilities. Although the asserted and unasserted claim amounts are significant, it is the opinion of management, after consultation with counsel, that the resolution of these matters will not have a material adverse impact on the FADA's financial position. Pursuant to terms of the revised asset management contract effective January 1, 1988, the FADA will be indemnified by the FSLIC for losses and expenses, if any, unless the FADA acts in a negligent manner.

The FADA is also involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with counsel, the ultimate disposition of these matters will not have a material adverse effect on the FADA's financial position.

In 1987 the House Banking Committee of the United States Congress initiated an investigation of the FADA organization. The Committee has not as yet issued a report on its findings. In the opinion of management, matters identified in any such findings would not have a material adverse impact on the FADA's financial position.

(Continued)

THE FEDERAL ASSET DISPOSITION ASSOCIATION
(a wholly-owned subsidiary of the FSLIC)

Notes to Financial Statements

(11) FHLBB Regulations

Since the FADA is chartered under Section 406 of the National Housing Act, it is considered subject to Federal Home Loan Bank Board (FHLBB) Regulation. Such regulations govern the activities of Thrift Institutions and contain various financial requirements, e.g., that Thrifts maintain levels of regulatory net capital and investment in liquid assets, as defined by regulation. At December 31, 1987, the FADA's regulatory capital and investment in liquid assets exceeded amounts required by FHLBB regulation.

Because the FADA does not engage in traditional Thrift-oriented activities, management is in the process of investigating which FHLBB regulations pertaining to Thrifts should apply to the FADA.

Requests for copies of GAO reports should be sent to:

**U.S. General Accounting Office
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