

**1997 Chief Financial  
Officers Report**  
*(Audited)*



**Office of Thrift  
Supervision**



# Table of Contents

	Page
• <b>Message from the Director</b> .....	<b>1</b>
• <b>Profile of the OTS</b> .....	<b>3</b>
• <b>Thrift Industry Highlights</b> .....	<b>7</b>
• <b>Management's Discussion and Analysis of OTS' Financial Performance</b> .....	<b>12</b>
• <b>Independent Auditor's Report</b> .....	<b>17</b>
• <b>Financial Statements</b> .....	<b>19</b>
• <b>Notes to Financial Statements</b> .....	<b>22</b>
• <b>Independent Auditor's Report on Internal Control Structure</b> .....	<b>31</b>
• <b>Independent Auditor's Report on Compliance with Laws and Regulations</b> .....	<b>33</b>

## Message from the Director

Two events occurred in 1997 that mark the start of a new era for the Office of Thrift Supervision. First, there was newfound interest in the federal thrift charter. With the elimination of the premium differential between banks and thrifts in late 1996 and the extension to thrifts of broader consumer and small business lending authority, new types of companies decided a thrift charter would be a good addition to their business strategy.

OTS received 51 new applications for thrift charters during 1997, including about a dozen from major insurance and securities firms. The agency approved 27 applications, including some filed in 1996. The applications of two major insurance companies were among those approved. While OTS still lost more institutions to consolidation and charter conversions than we gained, some of those that entered the industry provide significant new challenges because of the types of activities they plan to engage in.

For the first time in many years, thrifts made significant acquisitions of commercial banks and mortgage companies. Combined with internal growth of those already in the industry, this led to the first year-to-year increase in assets of OTS-regulated thrifts since FIRREA became law in 1989.

The other event was my appointment as the first permanent Director in five years. My expectation is that having a Senate-confirmed Director appointed for a full five-year term will give the agency a sense of stability and a new grasp of mission that it hasn't enjoyed since the end of 1992. These two events made 1997 a truly new beginning.

Both the thrift industry and OTS remain in solid financial condition, as this report shows. Industry earnings and equity ratios set records, and returns on assets reached levels not seen since the 1960s. Troubled assets fell to 1 percent of assets, and at year-end there were only 18 troubled thrifts. OTS itself showed a slight operating surplus – a welcome addition to reserves as we (expend funds to further) enhance our workforce's ability to meet the industry's new challenges.

In pursuing our mission to ensure the safety and soundness of the thrift industry, we have identified four main challenges. First, we must rekindle the energy and drive of OTS's highly competent workforce. Five years of leadership uncertainty, coupled with concerns about the survival of both the industry and the agency, have taken a toll. But the new stability on several fronts and the challenges posed by a dynamic industry are generating the optimism and energy to overcome those uncertainties that remain. We will build on the efforts already begun to provide OTS staff with the tools and training they need to do the best job they can. And we will work together on workplace enhancements to make OTS a place where people are proud to work.

Second, we must not only prepare our agency for the Year 2000 computer rollover, but also lead the industry into compliance. OTS started the internal conversion process early, with the result that 13 of our 15 mission critical systems are already converted and tested. The remaining two systems will be ready by November 1998. We have also surveyed, tested and upgraded our non-information technology systems, such as our voice mail and building systems. With the other banking regulators, we are in the midst of a multi-year effort to ensure that thrift institutions and those that provide data processing services to them are actively working their way into full compliance well ahead of the rollover date. Currently, we are field examining all of our institutions to determine how far they have progressed. All OTS-regulated thrifts are to have their critical systems ready for testing before the start of 1999.

Third, we face the challenge of dealing with a spurt of nontraditional thrift-owning institutions entering the industry, and more importantly, understanding how to supervise the new ways of doing business that they propose. Although insurance companies have owned thrifts for more than 15 years, several insurance companies now entering the business want to integrate the thrifts more fully into their corporate business strategies than was previously the case.

Traditional thrifts, meanwhile, are taking advantage of the 1996 statutory amendments to expand their consumer and commercial lending. At the end of 1997, consumer lending had risen to 5.8 percent of assets from 4.6 percent four years earlier – and the percentage continues to increase. Commercial loans doubled to 1.5 percent of assets from barely seven-tenths of a percent in 1993. Nonetheless, whole 1-4 family mortgage loans still constituted more than half of total thrift assets. Indications are that asset quality, as well as interest rate risk management, remain strong, but the changing marketplace and industry will certainly challenge us going forward.

Finally, we have an on-going commitment to help thrift institutions better serve their communities. Thrifts have a long history of community service, starting from the first mortgage loan in 1831. But we have entered an era that demands more from lenders if communities are to remain or become healthy. Healthy communities and a healthy industry are a virtuous circle. In response to the need, we are expanding our Community Affairs program, enhancing the staff's ability to work with those we regulate to foster partnering with other financial institutions, businesses, non-profit entities such as universities and hospitals, and community organizations.

All in all, 1997 was a very good year for OTS. We're working to make the prospects for 1998 even better.



---

Ellen Seidman  
Director

# PROFILE OF THE OFFICE OF THRIFT SUPERVISION

The OTS was established as a bureau of the Department of the Treasury on August 9, 1989, by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). OTS is headed by a Director who is appointed by the President, with Senate confirmation, for a 5-year term. The OTS Director serves on the boards of the Federal Deposit Insurance Corporation (FDIC) and the Neighborhood Reinvestment Corporation, and is a member of the Federal Financial Institutions Examination Council.

**OTS Mission** - The mission of the OTS is to effectively and efficiently supervise thrift institutions to maintain the safety and soundness and viability of the industry and to support the industry's efforts to meet housing and other community credit and financial services needs.

**OTS' Five Major Goals** - The OTS identified five major goals as listed below:

- In order to contribute to a safe and sound industry, the OTS will maintain and enhance its risk-focused, differential and proactive approach to the supervision of thrift institutions.
- Improve credit availability by encouraging safe and sound lending in those areas of greatest need.
- Enhance competitiveness of the thrift industry to ensure its safety and soundness.
- Conduct operations efficiently to keep regulatory burdens on the thrift system at the minimum necessary level.
- Provide exceptional customer service to all major customer groups, including the thrift institutions regulated by the OTS and members of the public that deal with those thrift institutions, to make government more responsive.

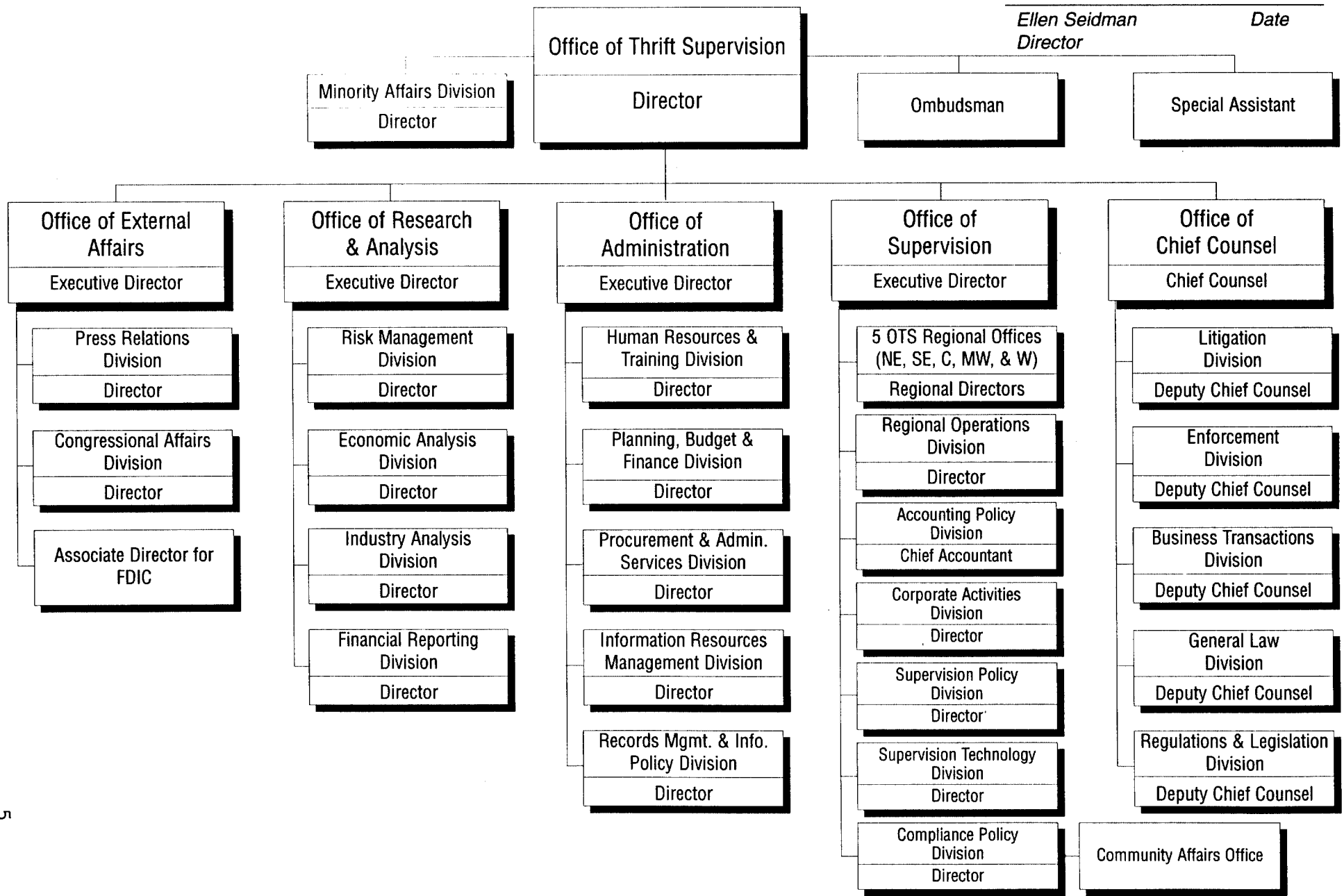
**Statutory Authority** - The OTS' primary statutory authority is the Home Owners' Loan Act (HOLA). Under HOLA, the OTS is responsible for chartering, examining, supervising, and regulating federal savings associations and federal savings banks. HOLA also authorizes the OTS to examine, supervise, and regulate state-chartered savings associations belonging to the Savings Association Insurance Fund (SAIF) and provide for the registration, examination, and regulation of savings association affiliates and holding companies.

**Organization** - To carry out its mission, the OTS is organized as follows (see page 5 for a summary organization chart):

- ◇ The Director determines policy for the OTS and makes final decisions on regulations, policies and administrative adjudications governing the thrift industry as a whole and on measures affecting individual institutions. ***Five offices (as set forth below) report to the Director.***
- ◇ The Office of Supervision develops regulations, directives and other policies to ensure the safe and sound operation of savings institutions as well as their compliance with federal laws and regulations and processes all corporate applications. It oversees the direct examination and supervision of savings institutions by regulatory staff in the five regions and responds to consumer and discrimination complaints against savings associations. The Office of Community Affairs, OTS' community outreach arm, is part of the Office of Supervision.
- ◇ The Office of Administration directs policy development for administrative operations including contracting and procurement, training, human resources, automated data processing, telecommunications, financial management (including payroll, accounting, and compliance with Generally Accepted Accounting Principles) and the agency's nationwide computer system. Administration is also responsible for implementing the requirements of the Chief Financial Officers Act, the Federal Managers' Financial Integrity Act, the Government Performance and Results Act and the Information Technology Management Reform Act of 1996. The Executive Director of Administration serves as the Chief Financial Officer.
- ◇ The Office of Chief Counsel provides a full range of legal services to the Director, OTS and other agency staff including providing effective and timely legal advice and opinions on regulatory and administrative matters, drafting regulations, advising on transactional matters, representing the OTS in court, and the prosecution of enforcement actions related to thrift institutions and institution-affiliated parties.
- ◇ The Office of External Affairs communicates information concerning OTS regulations, policies and key developments within the agency to the thrift industry, the public, government agencies and other key constituencies. External Affairs also maintains a liaison between the OTS and Congress and the Federal Deposit Insurance Corporation.
- ◇ The Office of Research and Analysis collects and analyzes thrift industry and general economic data. It tracks and reports on the financial condition of the thrift industry, assesses savings associations' interest rate risk exposure and conducts research related to the thrift industry and housing markets.



Office of Thrift Supervision  
**ORGANIZATIONAL STRUCTURE**



# Office of Thrift Supervision Regional Structure



**Southeast Region** – includes Puerto Rico and the Virgin Islands

**West Region** – includes Alaska, Hawaii, Guam and the Northern Mariana Islands

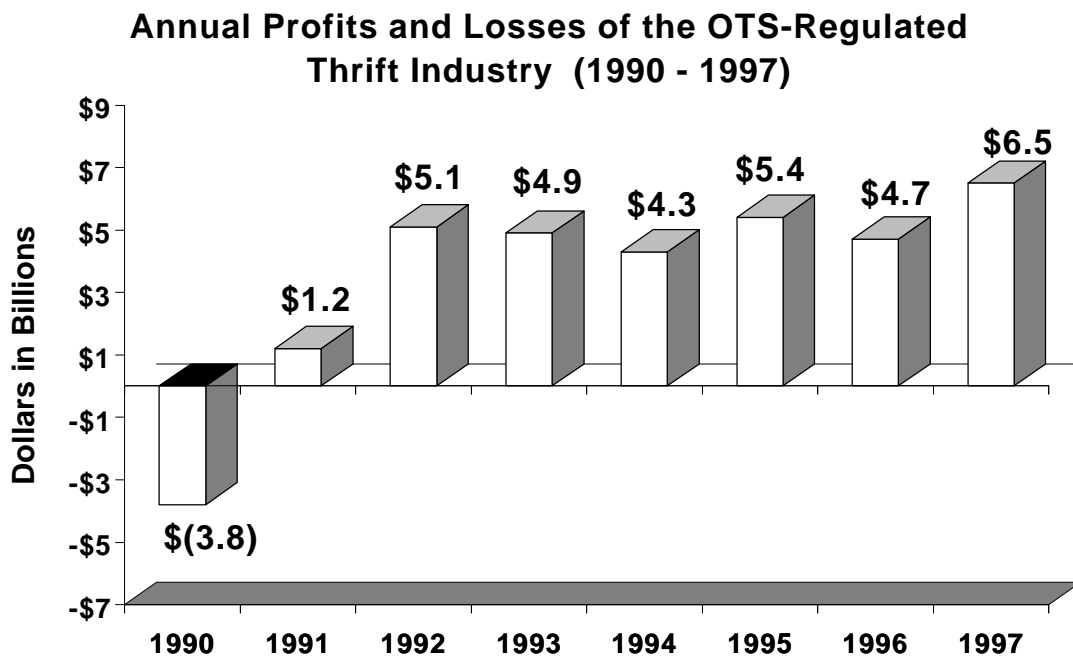


# THRIFT INDUSTRY HIGHLIGHTS

The thrift industry is not the same industry that existed when FIRREA was enacted in 1989. It is smaller, but much healthier financially, well capitalized, profitable and highly focused in meeting community lending needs — principally mortgage financing. The industry's earnings have been strong since 1992. During 1997 the thrift industry benefited from two factors:

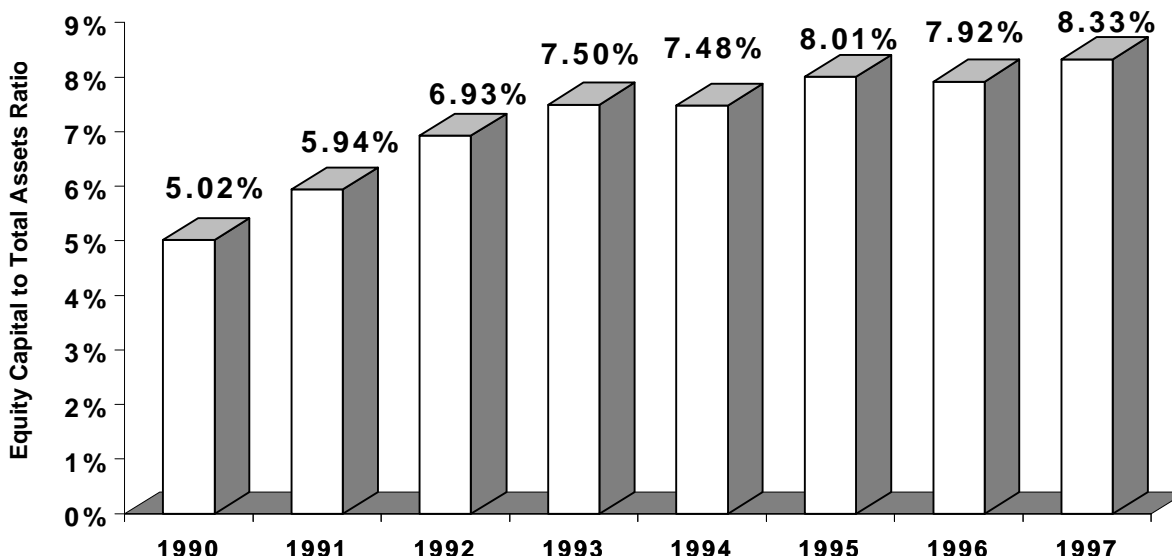
- a favorable economy, and
- 1997 was the first year since the passage of the Reform, Recovery, and Enforcement Act (FIRREA) that thrifts did not have to pay high premiums for federal deposit insurance.

As a result, the industry set a yearly earnings record posting net income of \$6.5 billion. Earnings for 1997 exceeded the previous yearly earnings record of \$5.4 billion by 20 percent. Annual earnings during the 1992 - 1997 period represent six of the nine most profitable years in the history of the thrift industry and earnings for the last two years have been especially strong.



The industry's strong economic performance during 1997 is both fundamentally sound and broad-based. Current thrift profits reflect improvements in thrift core income, rather than temporary gains from one-time or transitory transactions. The industry's aggregate return on assets (ROA) was 85 basis points during 1997. In addition, equity capital for the industry increased to a record 8.33 percent in the fourth quarter, breaking the prior record of 8.18 percent set in the third quarter of 1997.

### Ratio of Equity Capital to Total Assets for the OTS Regulated Thrift Industry (1990 - 1997)



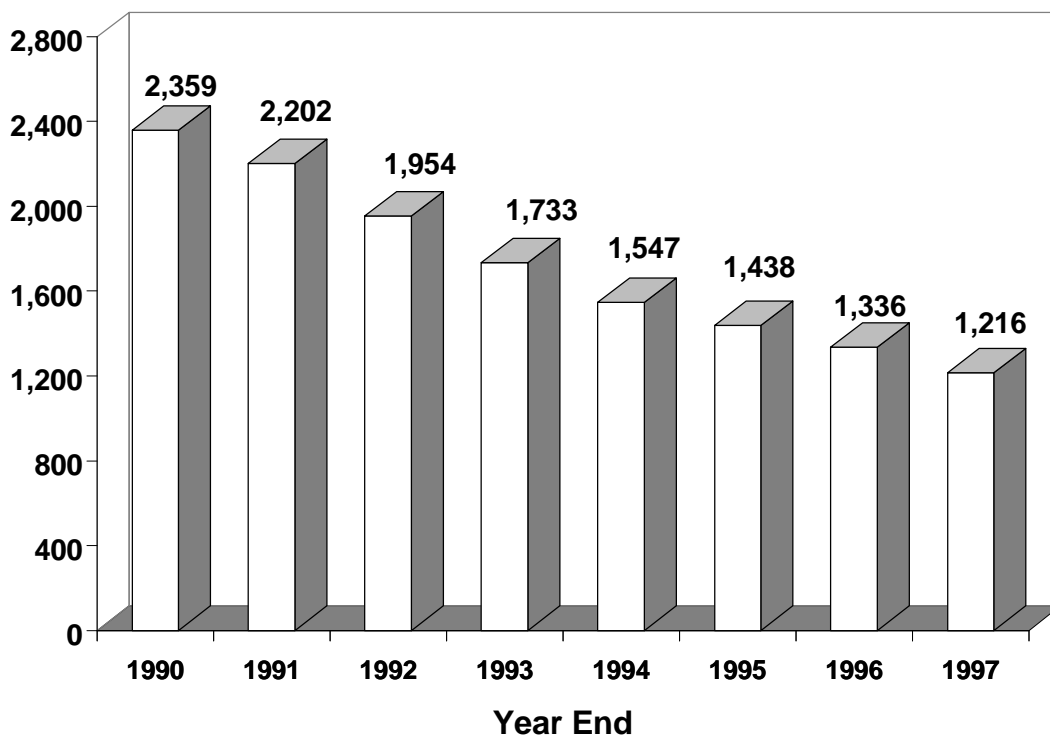
Under the Prompt Corrective Action provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), there are five categories of depository institutions based on their capital levels -- well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of the end of 1997, virtually all thrifts (97.4 percent) met or exceeded the well-capitalized standards. More than 90% of the OTS regulated industry has met or exceeded well-capitalized standards for the last 18 consecutive quarters. At the end of 1997, only 31 thrifts (2.6 percent of total thrifts) were rated "adequately capitalized," only one thrift was rated "undercapitalized" and none of the thrifts were "critically undercapitalized."

Problem thrifts, those with CAMEL ratings of "4" or "5" on their most recent safety and soundness examination, fell to 18 (or 1.5 percent) of all thrifts from 29 (or 2.2 percent) one year ago. The aggregate assets of problem thrifts fell to \$1.6 billion (or 0.2 percent of industry assets), from \$5.4 billion (or 0.7 percent of industry assets) at the end of 1996. Not only are there fewer problem thrifts, but their financial condition is much stronger than that of problem thrifts in the early 1990s. For example, problem thrifts at the end of 1997 had, as a group, an average equity capital ratio of 7.49 percent. In contrast, problem thrifts at the end of 1991 had average equity capital of 3.34 percent.

At the end of 1997, troubled assets (non-current loans and repossessed assets) were at the lowest level since 1990 when this measure of asset quality was first used in the thrift industry. Troubled assets at the end of 1997 totaled \$7.8 billion (1.0%), down from \$8.7 billion (or 1.13 percent) at the end of 1996. There were no thrift failures in 1997. The last year that there were no thrift failures was 1959. In 1996, only one thrift failed.

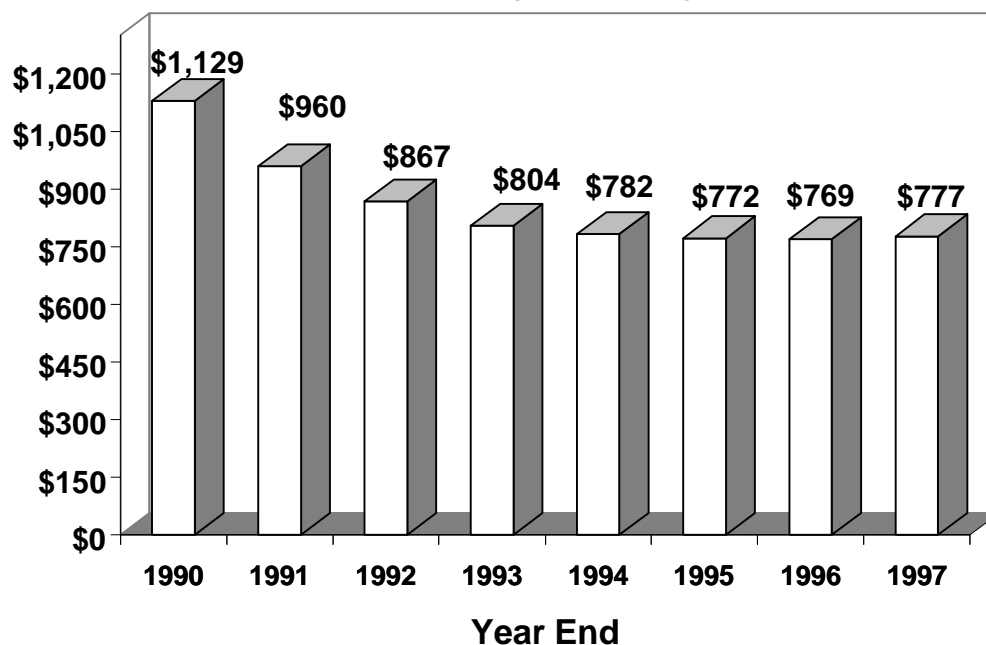
The number of thrift institutions regulated by the OTS continued to decline during 1997 falling to 1,216 at the end of 1997, a decline of 120 institutions since December 1996 and a decline of 517 institutions (or 29.8 percent) since December 1993. The thrift consolidation trend has mainly been due to two distinct trends; 1) intra-industry mergers, primarily mergers among thrifts and 2) inter-industry mergers from bank acquisitions of thrifts and conversions of OTS-regulated thrifts to banks.

**Number of OTS Regulated Thrift Institutions  
(1990 - 1997)**



Although the number of thrifts has continued to decline, aggregate OTS-regulated industry assets have remained fairly stable since 1993, hovering around \$770 billion. Aggregate thrift assets grew by slightly more than one percent during 1997, the first year that aggregate thrift assets have increased since 1988. The relative stability of the industry's assets during the last four years in the face of significant declines in the number of thrift institutions reflects strong underlying asset growth by the remaining thrifts. New assets acquired from commercial banks and non-OTS thrifts, and assets of de novo thrifts, have also augmented aggregate thrift industry assets.

### OTS Regulated Thrift Consolidated Assets 1990 - 1997 (In Billions)



For the first time in many years, thrifts acquired several commercial banks and mortgage companies. In addition, during 1997 the OTS observed an increased interest in the Federal thrift charter; 51 new applications for thrift charters were received and a total of 27 de novo applications were approved, including about a dozen from major insurance and securities firms.

#### **Year 2000**

The primary responsibility for Year 2000 compliance rests with the regulated institutions, including those institutions that rely on service providers. The OTS is doing everything possible to ensure that all OTS regulated thrifts have made the Year 2000 issue a top priority.

During 1997, OTS examiners conducted off-site supplemental examinations of OTS regulated thrifts. The examiners obtained and reviewed Year 2000 information supplied by each thrift and prepared a report of examination for each board of directors. The examiners also completed an internal assessment which was entered into a national data base to enable OTS staff to analyze the industry-wide Year 2000 risk profile and track the industry's progress in preparing for the calendar year rollover.

The initial Year 2000 examinations, which focused on the thrift managers' awareness of Year 2000 issues and the need to plan and prioritize for Year 2000, are now being followed-up by on-site examinations which focus on actual renovation efforts and on planning for testing and contingencies. Although some of these examinations were started as early as November 1997, the OTS examiners will conduct most of these examinations between February and June 1998. Every OTS-regulated thrift will be examined for Year 2000 readiness.

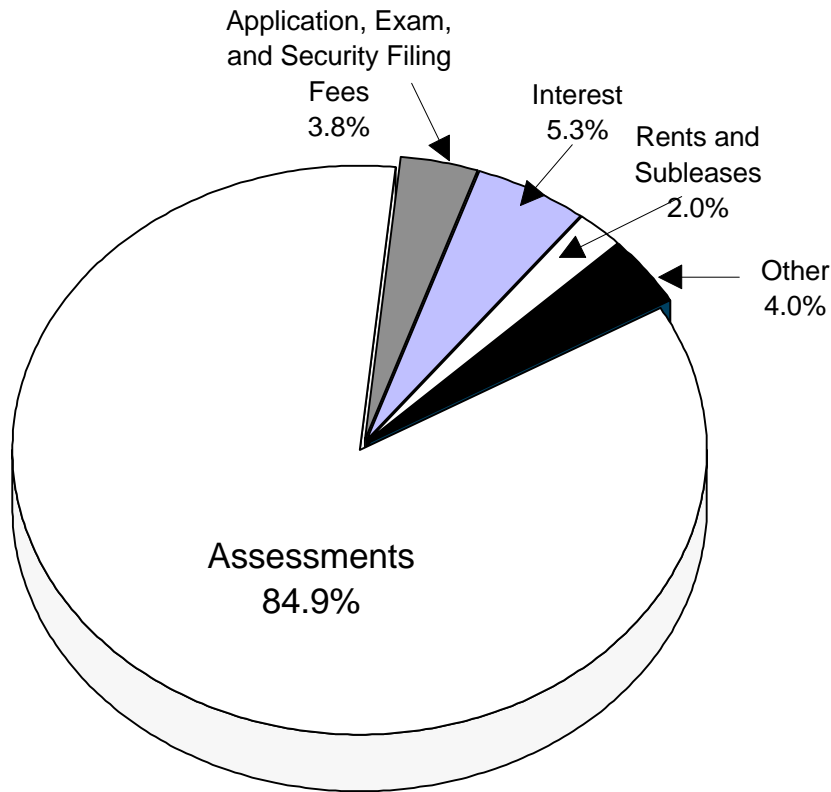
OTS Information Systems examiners have included Year 2000 matters in their examinations since 1995. As we move closer to January 2000, the examination process has become more formalized and more intense. In addition to examining OTS regulated thrifts, the OTS examiners are examining entities that provide data services or shared application software to the thrift industry. When these entities service commercial banks as well as thrifts, the OTS is cooperating with the other banking agencies in scheduling and staffing the examinations.

# Management's Discussion and Analysis of OTS' Financial Performance

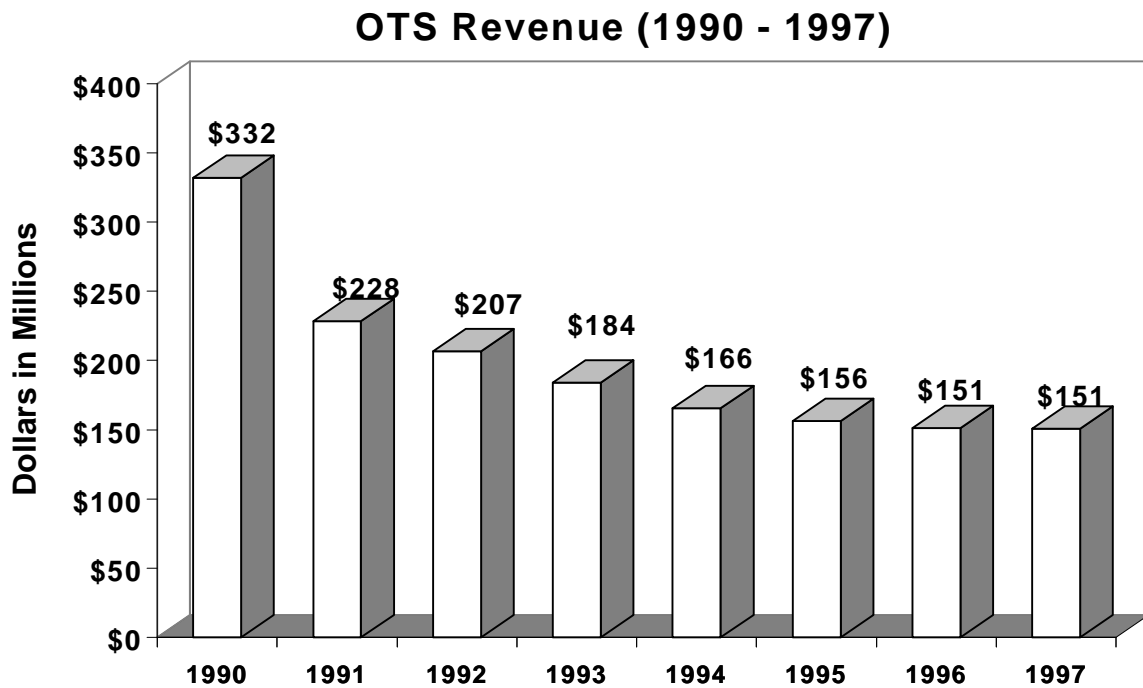
## Funding Sources

The OTS receives no appropriated funds from Congress. FIRREA provided the OTS with the authority to fund its operations through periodic assessments charged to the thrift industry. Assessments constitute the largest single component of the OTS income. In 1997, assessments constituted 84.9 percent (\$128.2 million) of total income (\$151.0 million). The OTS also receives funds from application fees, interest, rents and subleases, exam fees, and other miscellaneous sources.

### 1997 Total Revenue = \$151.0 million



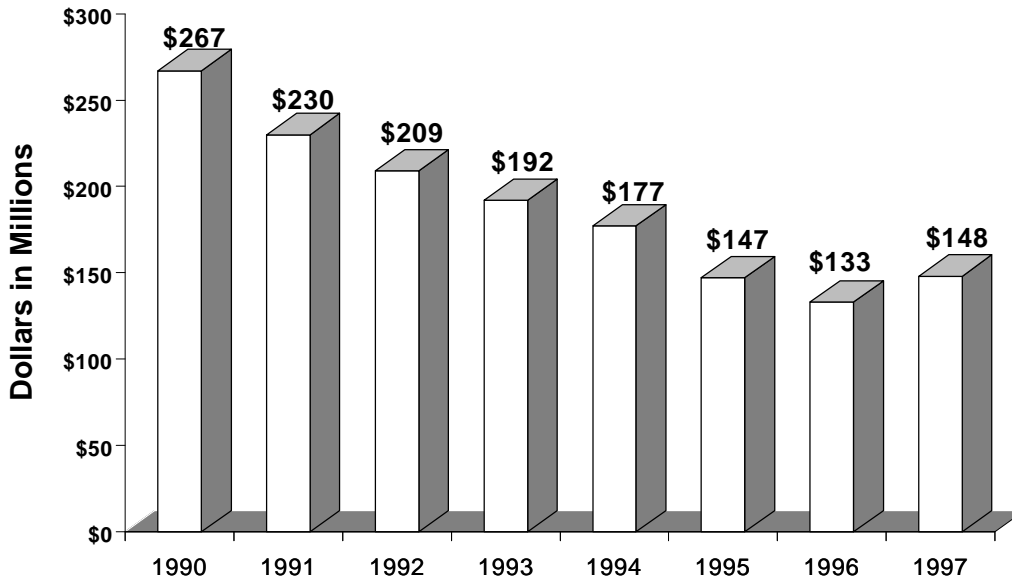
Due to the shrinkage of the thrift industry, OTS' revenue from assessments has declined substantially. In 1990, assessments totaled \$265.8 million; in 1997 this figure had fallen to \$128.2 million, a decrease of 51.8 percent in eight years. The decrease in assessment revenue has caused a sharp decline in OTS' income since 1990, but income has basically stabilized since 1995.



### **Funding Uses**

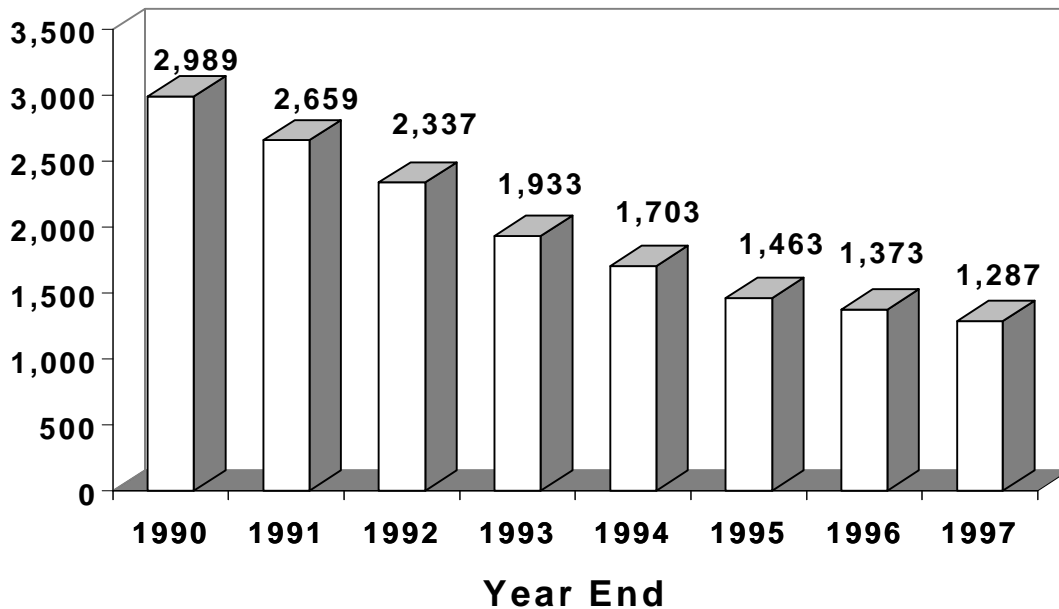
Total OTS operating expenses increased slightly in 1997 compared with 1996, primarily due to an increase in: 1) staff benefits and 2) office equipment and software. Even with this slight increase, however, OTS' revenues exceeded its expenses by approximately \$3.2 million.

### OTS Operating Expenses (1990 - 1997)



Due to the shrinkage of the thrift industry, the OTS has trimmed its staff from 3,379 as of October 1989, to 1,287 as of December 1997, or by 61.9 percent.

### OTS Staff (1990 - 1997)





## **Compliance**

The OTS complies with all applicable Generally Accepted Accounting Principles (GAAP), Federal Financial Accounting Standards and internal control principles. The OTS' financial transactions are reported on an accrual basis. The Planning, Budget and Finance Division continually reviews new Statements of Federal Financial Accounting Standards and modifies accounting policy, procedures, and reporting, as needed.

## **FMFIA**

The Federal Managers' Financial Integrity Act (FMFIA) mandated the establishment of agency internal control programs and regular evaluations of management controls and accounting systems to protect federal programs from fraud, waste and abuse. The OTS maintains strong internal controls, comprehensive financial management controls, personnel security controls, computer security, and strong asset accountability programs. The OTS maintains budgetary integrity through the continual oversight and monitoring of its annual budget. Generated reports allow the budget staff to regularly analyze the status of all accounts, review all expenditures, and make recommendations to senior management regarding potential savings and/or possible overages in the various accounts.

The foundation of the OTS' financial management control program is its annual financial statement audit. The 1997 audit was conducted by the independent, certified public accounting firm of Deva & Associates, P.C. The audit was completed in February 1998. For the eighth consecutive year, the OTS was given an unqualified opinion on its financial statements.

OTS' Annual Assurance Statement for the fiscal year ending September 30, 1997, as required by FMFIA, indicated that OTS' management control systems are adequate and ensure that programs achieve their intended results; resources are used consistent with the OTS mission; programs and resources are protected from waste, fraud, and mismanagement; laws and regulations are followed; and reliable and timely information is obtained and used for decision making.

In addition, none of the quality assurance and other reviews, audits, management studies, or program and annual evaluations conducted during FY 1997 identified any Section 2 (programs and administrative functions) significant or "material" weaknesses, or Section 4 (financial systems) material nonconformances.

## **Current Status of OTS' Financial Management Systems**

The OTS uses an off-the-shelf accounting system purchased from Computer Data Systems, Inc., as the key component of its financial management system. The accounting system operates on a calendar-year basis and integrates the procurement, budget execution, accounts payable, accounts receivable, general ledger, and financial reporting functions and is directly interfaced with the payroll/personnel system. Approved budget data are electronically uploaded to the accounting system at the outset of each budget year. The

OTS provides financial cross-servicing to the Federal Maritime Commission, the Federal Housing Finance Board, and the Office of Financial Institutions Adjudication in the payroll, personnel, and accounting areas. This cross-servicing structure supports the goal of reducing duplicative functions within the Federal Government as promoted by the National Performance Review.

The OTS' financial management systems currently produce accurate, relevant, timely, and useful information and meet GAO requirements. A review of these systems as part of the Inspector General's annual audit requirement has produced an unqualified audit for the past eight years. The system utilizes an automated Standard General Ledger (SGL) crosswalk which allows the OTS to meet federal reporting standards while permitting OTS' internal management to continue receiving a more detailed breakout of accounting information. Financial reports are provided to senior management on a monthly basis to assist them in monitoring their program area.

### **Year 2000 Issues**

The OTS is actively addressing the conversion of its internal systems and is well on the way toward accomplishing Year 2000 goals. In 1996, OTS' Information Resources Management division (IRM) completed an assessment of the national application systems and developed a conversion plan to have all coding efforts completed by the end of 1998. To date, approximately 89 percent of the computer code modifications have been completed, tested, and implemented. Another 2 percent of the code revisions are currently underway and modification to the remaining computer code will begin shortly.

Fifteen national systems were identified as mission critical. All but two of these systems are now Year 2000 compliant. The remaining two systems, Home Mortgage Disclosure Act (HMDA) and Interest Rate Risk, are scheduled to be completed by November 1998. In addition, OTS is working with the electronic filing software vendor to ensure that its product is Year 2000 compliant for the industry's 1998 reporting cycles.

Validation testing of converted systems began in September 1997. IRM tested and converted systems at its disaster recovery site during the annual recovery test. For three days, the compliant systems operated under dates ranging from December 31, 1999 to June 1, 2000. This validated the date rollover from December to January and allowed IRM to test leap year and quarterly processes. The tests were successful and identified only small correctable problems. Two similar tests have been scheduled and budgeted for June and October of 1998. During 1998 and 1999, all national systems will be tested under similar conditions.

## INDEPENDENT AUDITOR'S REPORT

To the Inspector General,  
U.S. Department of the Treasury

We have audited the accompanying statements of financial position of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of December 31, 1997 and 1996, and the related statements of operations and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of OTS' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of the Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of OTS as of December 31, 1997 and 1996, and the results of its operations, and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 26, 1998 on our consideration of OTS' internal control structure and a report dated February 26, 1998 on its compliance with laws and regulations.

**INDEPENDENT AUDITOR'S REPORT**  
**(continued)**

Our audits were conducted for the purpose of forming an opinion on the principal financial statements described above. We have inspected the financial information presented in the accompanying Management's Discussion and Analysis of Financial Performance. The information presented in the Management's Discussion and Analysis of Financial Performance is presented for the purposes of additional analysis. Such information has not been audited by us and, accordingly we do not express our opinion on this information.

*Deva & Associates, P.C.*

Deva & Associates, P.C.  
Certified Public Accountants

Bethesda, Maryland  
February 26, 1998, except for Note 14, as to  
which the date is March 19, 1998.

**UNITED STATES DEPARTMENT OF THE TREASURY**  
**OFFICE OF THRIFT SUPERVISION**  
**STATEMENTS OF FINANCIAL POSITION**  
(in thousands)

	<b>December 31</b>	
	<b>1997</b>	<b>1996</b>
<b>ASSETS</b>		
Federal assets:		
Cash and cash equivalents (Note 3)	\$ 25,756	\$ 20,663
Investments held to maturity (Note 4)	99,302	94,380
Accounts receivable	146	336
Interest receivable	492	194
Nonfederal assets:		
Accounts receivable	1,200	762
Advances and prepayments	8,671	11,994
Property and equipment, net (Note 5)	38,628	39,448
<b>TOTAL ASSETS</b>	<b>\$ 174,195</b>	<b>\$ 167,777</b>
<b>LIABILITIES AND NET POSITION</b>		
Federal liabilities:		
Accrued workers' compensation (Note 6)	\$ 4,842	\$ 4,029
Accrued liabilities (Note 7)	151	922
Nonfederal liabilities:		
Accounts payable	621	689
Accrued annual leave	7,805	7,737
Deferred compensation liability	1,345	1,345
Deferred rent credit	2,513	2,676
Postretirement benefit liability (Note 8)	5,947	4,790
Other accrued liabilities (Note 7)	7,920	5,747
Total Liabilities	\$ 31,144	\$ 27,935
Net position:		
Assumed capital (Note 2)	\$ 41,037	\$ 41,037
Retained earnings	102,014	98,805
Total Net Position	\$ 143,051	\$ 139,842
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$ 174,195</b>	<b>\$ 167,777</b>

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

**UNITED STATES DEPARTMENT OF THE TREASURY**  
**OFFICE OF THRIFT SUPERVISION**  
**STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION**  
**Years ended December 31**  
**(in thousands)**

	<u>1997</u>	<u>1996</u>
<b>REVENUES</b>		
Industry assessments	\$ 128,209	\$ 133,019
Examination, application, and security filing fees	5,674	6,446
Interest	8,009	7,120
Rental income (Note 9)	3,093	3,038
Imputed financing - expenses paid by other entities (Note 10)	4,469	0
Other	<u>1,511</u>	<u>1,805</u>
Total Revenues	<u>\$ 150,965</u>	<u>\$ 151,428</u>
<b>EXPENSES</b>		
Personnel compensation	\$ 84,039	\$ 84,655
Benefits	27,486	17,084
Rent, communication, and utilities	7,859	8,301
Travel and transportation	10,102	9,368
Services	3,093	2,475
Data processing	3,637	3,275
Building expenditures	4,201	3,805
Office equipment and software	3,960	1,754
Miscellaneous	1,801	1,070
Depreciation	<u>1,578</u>	<u>1,629</u>
Total Operating Expenses	<u>\$ 147,756</u>	<u>\$ 133,416</u>
<b>EXCESS OF REVENUES OVER EXPENSES</b>	<u>\$ 3,209</u>	<u>\$ 18,012</u>
<b>NET POSITION, beginning balance</b>	<u>139,842</u>	<u>121,830</u>
<b>NET POSITION, ending balance</b>	<u><u>\$ 143,051</u></u>	<u><u>\$ 139,842</u></u>

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

**UNITED STATES DEPARTMENT OF THE TREASURY**  
**OFFICE OF THRIFT SUPERVISION**  
**STATEMENTS OF CASH FLOWS**  
**Years ended December 31**  
**(in thousands)**

	<u>1997</u>	<u>1996</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Excess of revenues over expenses	\$ 3,209	\$ 18,012
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Amortization of net bond discount (premium)	(405)	765
Depreciation	1,578	1,629
Loss on disposal of equipment	5	9
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	(248)	14
Decrease in advances and prepayments	3,025	1,753
Decrease in accounts payable	(68)	(570)
Increase in other liabilities	<u>3,277</u>	<u>305</u>
Net cash provided by operating activities	<u>\$ 10,373</u>	<u>\$ 21,917</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investment securities	\$ (56,517)	\$ (115,000)
Maturities of investment securities	52,000	75,000
Purchases of property and equipment	<u>(763)</u>	<u>(39)</u>
Net cash used in investing activities	<u>\$ (5,280)</u>	<u>\$ (40,039)</u>
Net cash provided (used) by operating and investing activities	\$ 5,093	\$ (18,122)
Cash and cash equivalents, beginning of year	<u>20,663</u>	<u>38,785</u>
Cash and cash equivalents, end of year	<u><u>\$ 25,756</u></u>	<u><u>\$ 20,663</u></u>

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

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

**1. REPORTING ENTITY**

The Office of Thrift Supervision (OTS) was created when the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the Federal Home Loan Bank Board (FHLBB) and transferred all examination and supervisory activities to OTS under the Department of the Treasury. OTS' primary functions are to: (1) charter federal savings and loan associations; (2) adopt regulations governing the operation of the thrift industry; (3) conduct examinations of federal and state chartered savings institutions and their holding companies; and (4) supervise compliance with federal laws and regulations and OTS directives, taking measures needed to enforce such compliance and rehabilitate troubled institutions.

FIRREA provides that OTS assess the institutions it regulates to recapture operating costs. Assessments are based on OTS' budget and are collected from savings and loans semiannually on January 31 and July 31.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**BASIS OF PRESENTATION**

OTS is operated substantially as a commercial enterprise and records its calendar year transactions on an accrual basis in accordance with generally accepted accounting principles (GAAP) and the applicable provisions of Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements." OTS receives no appropriated funds from the federal government and financial activities are recorded on an agency-wide basis versus a program or fund basis. OTS classifies its assets and liabilities as federal and nonfederal. Federal assets and liabilities arise from transactions among OTS and other federal entities. Nonfederal assets and liabilities arise from OTS transactions with persons and organizations outside of the United States government.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of OTS' account at Treasury, various imprest funds and other accounts in Washington and at regional offices, and funds invested overnight by Treasury on OTS' behalf.

**INVESTMENTS HELD TO MATURITY**

Effective January 1, 1994, OTS adopted Statement of Financial Accounting Standards No. 115, "Accounting for Investments in Certain Debt and Equity Securities". Under the statement, OTS is required to classify investment securities under three categories: trading, available for sale, and held to maturity. All of OTS' investments consist of U.S. Treasury obligations. OTS has the intent and ability to hold these investments to maturity. Therefore, all investments are classified as held to maturity and are stated at amortized cost. Premiums and discounts are amortized over the term of the investment using the straight-line method, which approximates the interest method.

**POSTRETIREMENT BENEFITS**

OTS provides certain health and life benefits for all retired employees that meet eligibility requirements. Effective January 1, 1993, OTS adopted Financial Accounting Standards Board (FASB) Statement No. 106 to account for its share of the costs of those benefits. Under this statement, OTS' share of the estimated costs that will be paid after retirement is being accrued by charges to expense over the employee's active service periods to the dates that they are fully eligible for benefits, except that OTS has elected to amortize the transition amount (unfunded cost at January 1, 1993) over 20 years beginning in 1993 in accordance with the option available in the statement. Prior to 1993, OTS expensed its share of the costs as claims were incurred by the retirees and as premiums were paid by OTS.



**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

Pursuant to an agreement with the Office of Personnel Management (OPM) in 1994, OTS agreed to pay a one-time fee to OPM in consideration of OPM assuming the health care portion of the postretirement plan liability.

**ANNUAL, SICK, AND OTHER LEAVE**

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. The balance in the accrued annual leave account reflects current pay rates. Sick leave and other types of nonvested leave are charged to operating costs as taken.

**PROPERTY AND EQUIPMENT**

The land and building owned by FHLBB were transferred to OTS under FIRREA. OTS also assumed all of FHLBB's furniture, fixtures, and equipment. These assets were recorded at their existing book values established in FHLBB's accounting records. Their value is included on the Statements of Financial Position in net position as assumed capital. Other fixed assets acquired subsequent to that date were capitalized at cost based on the existing OTS capitalization policy.

Fixed assets in excess of \$50,000 were capitalized in 1997. In 1996 and prior years, fixed assets in excess of \$5,000 were capitalized. OTS' building is being depreciated over 50 years and furniture, fixtures, and equipment are depreciated over 5 years. Depreciation is computed on a straight-line basis.

**INCOME TAXES**

As an agency of the U.S. Department of the Treasury, OTS is exempt from all federal and state taxes based on income. OTS is also exempt from state and local property and real estate taxes.

**CLASSIFICATION**

Certain 1996 financial statement amounts have been reclassified for comparative purposes.

**3. CASH AND CASH EQUIVALENTS**

The following table summarizes the balances of cash and cash equivalents (in thousands):

	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
Cash	\$ 356	\$ 408
Overnight investment with Treasury	<u>25,400</u>	<u>20,255</u>
Total	\$ <u><u>25,756</u></u>	\$ <u><u>20,663</u></u>

Interest earned on overnight investments totaled \$1,279,359 and \$2,241,067 for 1997 and 1996, respectively.

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

**4. INVESTMENTS HELD TO MATURITY**

Investment securities held at December 31, 1997 and 1996 are marketable Treasury securities that have maturities through April 1999. The amortized cost and market value of these securities are summarized as follows (in thousands):

	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
Face value	\$ 99,517	\$ 95,000
Unamortized discount, net of unamortized premium	<u>(215)</u>	<u>(620)</u>
Book value	<u>\$ 99,302</u>	<u>\$ 94,380</u>
Market value	<u>\$ 99,085</u>	<u>\$ 93,955</u>

Effective interest rates range from 5.125% to 7.0%. Interest earned on these investments totaled \$6,729,802 and \$4,879,177 for 1997 and 1996, respectively.

**5. PROPERTY AND EQUIPMENT (in thousands)**

The following table summarizes the fixed asset balances on the Statements of Financial Position:

	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
Land	\$ 7,101	\$ 7,101
Building	48,361	47,802
Furniture, fixtures, and equipment	<u>5,651</u>	<u>5,752</u>
Total cost	<u>\$ 61,113</u>	<u>\$ 60,655</u>
Accumulated depreciation, building	\$ (17,350)	\$ (16,343)
Accumulated depreciation, furniture, fixtures, and equipment	<u>(5,135)</u>	<u>(4,864)</u>
Total accumulated depreciation	<u>\$ (22,485)</u>	<u>\$ (21,207)</u>
Property and equipment, net	<u>\$ 38,628</u>	<u>\$ 39,448</u>

**6. ACCRUED WORKERS' COMPENSATION**

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered 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 OTS' employees under FECA are administered by the U.S. Department of Labor (DOL) and are ultimately paid by OTS. These future workers' compensation estimates were generated by DOL from an application of

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

actuarial procedures developed to estimate the liability for FECA benefits. This DOL estimated actuarial liability for FECA benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability was determined using the paid losses extrapolation method calculated over the next 37-year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using OMB's June 10, 1997 economic assumptions for 10-year Treasury notes and bonds. Based on information provided by the DOL, the U.S. Department of the Treasury determined that the estimated liability of OTS as of December 31, 1997 and 1996, was \$4,842,142 and \$4,028,737, respectively. Changes in the actuarial liability related to FECA are reflected as reductions or increases in benefits expense in the appropriate year.

**7. ACCRUED LIABILITIES (in thousands)**

	December 31	
	1997	1996
Federal accrued liabilities:		
Payroll taxes	\$ 109	\$ 866
Other	42	56
	\$ 151	\$ 922
 Nonfederal other accrued liabilities		
Payroll and withholding	\$ 2,828	\$ 3,017
Relocations	119	99
Goods and services	4,002	2,539
Other	208	92
	\$ 7,157	\$ 5,747

**8. POSTRETIREMENT BENEFIT PLAN**

OTS sponsors a life insurance plan (the Plan) for all employees that meet eligibility requirements. OTS funds benefit costs principally on a pay-as-you-go basis, with retiree contributions that are adjusted annually based on factors, some of which are discretionary. The Plan is unfunded, with Plan participants paying a portion of the costs. As stated in the Summary of Significant Accounting Policies, OTS changed its accounting policy with respect to the Plan as of January 1, 1993. OTS elected to defer recognition of the Plan's transition obligation, and amortize such obligation over twenty years on a straight-line basis.

A Memorandum of Understanding (MOU) was signed in December 1994, between OPM and OTS. The purpose of the MOU was to implement legislation permitting annuitants who retired from OTS prior to January 1995, and who were enrolled in the OTS health plan, to enroll in the Federal Employees Health Benefits Program (FEHB) for coverage effective on or after January 8, 1995. OTS agreed to pay a one-time fee to OPM of approximately \$10,993,000 in consideration of OPM assuming the health portion of the postretirement plan liability. In accordance with FASB 106, the agreement with OPM constitutes a settlement and, accordingly, OTS recognized a gain on the settlement of approximately \$16,694,000 in 1994. Such gain includes the health portion of the transition obligation that OTS elected

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

to initially recognize over 20 years in 1993. The postretirement liability of approximately \$5,947,000 in the Statements of Financial Position at December 31, 1997, and approximately \$4,790,000 at December 31, 1996, represent OTS' recognized portion of the remaining liability for participants' future life benefits.

Net periodic postretirement benefit cost for life insurance provisions under the Plan included the following components in 1997 and 1996 (in thousands):

	For the Years Ended	
	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
Service cost - current year	\$ 392	\$ 457
Interest on accumulated postretirement benefit obligation	718	685
Amortization of transition obligation	298	298
Amortization of loss	<u>0</u>	<u>23</u>
Net postretirement benefit expense	<u>\$ 1,408</u>	<u>\$ 1,463</u>

The following table sets forth the Plan's funded status reconciled with the liability recognized in the Statements of Financial Position.

	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
Accumulated postretirement benefit obligation:		
Retirees	\$ 3,397	\$ 3,404
Other fully eligible participants	5,179	4,275
Other active participants	<u>3,209</u>	<u>2,703</u>
Accumulated postretirement benefit obligation	11,785	10,382
Unrecognized transition obligation	(4,472)	(4,771)
Unrecognized net gain	<u>(1,366)</u>	<u>(821)</u>
Total postretirement benefit liability	<u>\$ 5,947</u>	<u>\$ 4,790</u>

The weighted average discount rate used in estimating the accumulated postretirement benefit obligation at December 31, 1997 and 1996 was 7%.

**9. RENTAL INCOME**

OTS leases a portion of its building space to retailers under noncancellable operating leases expiring at various dates through 2009. Certain of these leases provide renewal options. The leases provide for annual base rent, some of which are subject to contingency rents for increased building costs, annual increases based upon changes in the Consumer Price Index or a percentage of sales in excess of a specified amount. Other leases provide for fixed future increases in rents over the term of the lease. OTS also subleases some of its existing unused leased facilities under similar terms.

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

The future minimum rentals to be received under both types of noncancellable operating lease arrangements are as follows (in thousands):

<u>Years ending December 31</u>	<u>Leases</u>	<u>Subleases</u>	<u>Total</u>
1998	\$ 2,182	\$ 482	\$ 2,664
1999	556	528	1,084
2000	574	549	1,123
2001	538	538	1,076
2002	329	538	867
Thereafter	<u>2,078</u>	<u>1,337</u>	<u>3,415</u>
	<u>\$ 6,257</u>	<u>\$ 3,972</u>	<u>\$ 10,229</u>

**10. IMPUTED FINANCING - EXPENSES PAID BY OTHER ENTITIES**

In 1997 OTS adopted Statement of Federal Financial Accounting Standards No. 5 (SFFAS No. 5), "Accounting for Liabilities of the Federal Government." SFFAS No. 5 requires, among other things, current recognition by federal employers of estimated future expenses related to the postretirement costs of pension and health benefits provided to employees under federal programs. The employer portion of postretirement pension and health benefits is paid by the Office of Personnel Management. The value of these future payments are included on the Statements of Operations and Changes in Net Position as imputed financing - expenses paid by other entities. The corresponding expenses are included in benefits.

In 1997, OTS recognized approximately \$1,270,000 of pension expense and \$3,199,000 of health benefits under SFFAS No. 5.

**11. RETIREMENT PLANS**

OTS employees participate in three retirement systems which are classified as multi-employer plans. Two are administered by OPM. For funding purposes, these two plans function as defined contribution plans; however, the retirement benefits accrue in a manner consistent with a defined benefit plan. The third is a private defined benefit plan administered by the Financial Institutions Retirement Fund (FIRF).

The Civil Service Retirement System (CSRS) is currently two-tiered. For employees hired prior to January 1, 1984, OTS withholds approximately 7 percent of their regular earnings. This contribution is then matched by OTS and the sum is transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits.

For employees with more than five years of service (not necessarily continuous), hired on or after January 1, 1984, OTS withholds, in addition to Social Security withholding, 0.8 percent of their regular earnings, but matches such withholdings with a 7 percent contribution. At the point such earnings exceed the FICA maximum wages (\$65,400 for 1997), employees covered under this tier of CSRS are required to have 7 percent of their earnings withheld while the agency expense remains at a 7 percent contribution. This second employee group will receive retirement benefits from the CSRS along with the Social Security System, to which they concurrently contribute.

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

Beginning in January 1987, all employees hired since January 1, 1984, either as new employees or as having less than 5 years of accumulated service (with a break in service over one year) are included in the new Federal Employee Retirement System (FERS). For such employees, OTS withholds 0.8 percent of their regular earnings and matches those withholdings with an 11.4 percent contribution. This group of employees will receive benefits from the FERS as well as the Social Security System to which they concurrently contribute.

Pursuant to FIRREA, the Office of Regulatory Activities and the twelve examination districts became part of OTS. As a result, OTS assumed the costs of their retirement system, which is part of FIRF. Under this private retirement system, OTS contributes a percentage of total FIRF salary. This percentage varies from year to year. Employees do not contribute to FIRF but do contribute to the Social Security System. Changes in percentages are based on the number of active FIRF OTS employees, the number of people that have retired, the benefits paid out, and adjustments to the actuarial gain or loss.

Although OTS funds either all (FIRF) or a portion (CSRS and FERS) of pension benefits under any of the above retirement systems relating to its employees and makes the necessary payroll withholdings, OTS does not account for the assets of either retirement plan nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for both government retirement systems and are not allocated to the individual agencies.

In years prior to 1997, OTS was not required to fund the FIRF plan due to changes in retirement plan provisions of the Internal Revenue Code and cumulative net actuarial experience gains. OTS established a prepaid asset representing the Future Employer Contribution Offset, and adjusted its balance and the corresponding expense annually according to actuarial valuation reports prepared by the Plan Administrator. In 1997, OTS elected to eliminate this prepaid asset by amortizing the remaining balance over three years. This change was due to the FIRF plan's status as a multiemployer plan and as such, the inherent uncertainty of the OTS' portion of the Future Employer Contribution Offset. The prepaid balances included in the Statements of Financial Position were approximately \$6,657,000 in 1997 and \$10,053,000 in 1996.

In addition to the retirement plans described above, OTS employees have the option of participating in one of two retirement savings programs. Employees covered under CSRS or FERS may participate in the OPM-sponsored Thrift Savings Plan (TSP), a plan with characteristics similar to a private-sector 401(k) plan. CSRS participants may contribute up to five percent of their earnings to TSP on a pretax basis. FERS participants may contribute up to ten percent of their earnings to TSP on a pretax basis. OTS makes contributions to TSP on the behalf of FERS participants as follows: OTS contributes to an employee's TSP account an amount equal to one percent of the employee's earnings whether or not the employee contributes. OTS also matches 100 percent of the first three percent of earnings that an employee contributes, and 50 percent of the next two percent that an employee contributes.

Employees covered under FIRF may participate in the Financial Institutions Thrift Plan (FITP), a 401(k) plan. Participants may contribute up to 15 percent of their earnings to FITP on a pretax basis. OTS matches 100 percent of the first five percent that an employee contributes.

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

The retirement expenses for all OTS plans, included in benefits expense on the accompanying Statements of Operations and Changes in Net Position, were as follows (in thousands):

	For the Years Ended	
	<u>December 31</u>	
	<u>1997</u>	<u>1996</u>
CSRS	\$ 2,535	\$ 1,057
FERS	1,578	1,601
FIRF	3,396	(2,029)
TSP	687	683
FITP	<u>2,586</u>	<u>2,667</u>
	<u>\$ 10,782</u>	<u>\$ 3,979</u>

**12. DEFERRED COMPENSATION**

As part of FIRREA, OTS assumed the Deferred Compensation Plans of the employees working for the Federal Home Loan Banks of Dallas and San Francisco. These plans allowed employees to defer a portion of their income and provided for employer matching contributions. OTS froze these plans and discontinued any deferrals or employer matches to these plans effective January 1, 1991. Benefits under the assumed plans were intended to be provided by cash value of life insurance policies issued by Mutual Benefit Life which went into rehabilitation on July 16, 1991. Under the rehabilitation plan, withdrawal of cash value prior to December 31, 1999 is restricted and subject to substantial withdrawal penalties. Current plan withdrawals have been funded by OTS. The cash value of those policies, included in advances and prepayments in the accompanying Statements of Financial Position, were \$1,725,000 in 1997 and 1996.

**13. LEASE COMMITMENTS**

OTS conducts most of its regional operations in leased facilities under noncancellable operating leases expiring at various dates through 2005. Many of the leases contain a provision to renew at the end of the initial term for an additional one to ten years. The rental payments are based on a minimum rental plus a proportional share of building operating expenses and taxes.

Some of the operating leases provide for rental escalations or stated annual rental increases in the amount of base rent over the lives of the leases. The accompanying Statements of Operations and Changes in Net Position reflect rent expense on a straight-line basis over the lives of the leases.

**UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION**

**NOTES TO FINANCIAL STATEMENTS**

The minimum rental commitments under noncancellable operating leases are as follows (in thousands):

Years ending <u>December 31</u>	
1998	\$ 4,856
1999	4,622
2000	4,493
2001	2,452
2002	2,249
Thereafter	<u>5,393</u>
	\$ <u><u>24,065</u></u>

Rent expense under noncancellable operating leases totaled \$5,376,677 and \$5,584,588 in 1997 and 1996, respectively.

**14. COMMITMENTS AND CONTINGENCIES**

On March 16, 1998, a federal appellate court upheld a judgment entered against OTS in February 1997 in the amount of \$723,533, plus post-judgment interest, in a case involving a former OTS employee's claim of wrongful termination. Although OTS plans to seek rehearing of the appellate court's decision, OTS has recognized an expense and established a liability in the amount of \$762,510.

OTS is defending several other cases that could subject OTS to expenditure of funds. OTS believes it has substantial legal and factual defenses to the claims asserted. For most of these cases, OTS believes it is more likely than not that OTS will prevail, but for some of the cases OTS is unable to estimate the likelihood of success, or the potential loss to the agency should OTS' defense be unsuccessful.

In addition, there are approximately 125 legal actions pending against the United States in the U.S. Court of Federal Claims in connection with the elimination of the capital treatment of supervisory goodwill of certain thrift institutions. These cases arise from the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The U.S. Department of Justice is defending these cases on behalf of the United States.

The U.S. Court of Federal Claims has not yet imposed any damage awards against the United States in any of the 125 supervisory goodwill cases. The Justice Department has advised that, although the amounts claimed are not stated with precision, they are estimated to total approximately \$20 billion to \$30 billion. However, while it is likely that the United States will have to pay some amount of damages on the claims, the ultimate costs cannot be reasonably estimated at this time.

With regard to the supervisory goodwill cases, it has not yet been determined which Federal entity (or entities) is the "appropriate Federal entity" to recognize any liability, nor has it been determined whether the Judgment Fund or some other fund would be the ultimate source for payment of any damage awards against the United States. In any event, under federal law, any monetary judgment rendered against the United States in any of the supervisory goodwill cases must be satisfied from appropriated funds. OTS would not be required to expend its own funds, which are non-appropriated, to pay such a judgment. For that reason, and because the amount of damages that may ultimately result in these cases cannot be reasonably estimated at this time, OTS has made no loss accrual for these cases.



## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE

To the Inspector General,  
U.S. Department of the Treasury

We have audited the financial statements of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of and for the year ended December 31, 1997, and have issued our report thereon dated February 26, 1998.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of OTS for the year ended December 31, 1997, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of OTS is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Assessments, cash receipts, and deferred revenue;
- Procurement, cash disbursements, and accounts payable; and
- Payroll.

For all of the internal control structure categories listed in the preceding paragraph, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk and performed tests of the internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control structure and its operations that we considered to be material weaknesses as detailed above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of OTS in a separate letter dated February 26, 1998.

Our audit of the principal financial statements of OTS as of and for the year ended December 31, 1997, disclosed the status of the reportable condition noted during the 1996 audit as follows:

<u>Reportable Condition</u>	<u>Status</u>
Lack of separation of duties for certain users of the Payroll/Personnel System	Resolved

This report is intended solely for the information and use of the Inspector General of the Department of the Treasury, the management of the Office of Thrift Supervision and the Office of Management and Budget. However, this report is a matter of public record and its distribution is not limited.

*Deva & Associates, P.C.*

Deva & Associates, P.C.  
Certified Public Accountants

February 26, 1998

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE  
WITH LAWS AND REGULATIONS**

To the Inspector General,  
U.S. Department of the Treasury

We have audited the financial statements of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of and for the year ended December 31, 1997, and have issued our report thereon dated February 26, 1998.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to OTS is the responsibility of OTS' management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of OTS' compliance with certain provisions of applicable laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 93-06, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin 93-06, as amended.

Under FFMIA, we are required to report whether OTS' financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997.

The results of our tests disclosed no instances where OTS' financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on overall compliance with certain provisions was not an objective of our audit of the financial statements. Accordingly, we do not express such an opinion. This report is intended for the information of the Inspector General of the Department of the Treasury, the management of the Office of Thrift Supervision and the Office of Management and Budget. However, this report is a matter of public record, and its distribution is not limited.

*Deva & Associates, P.C.*

Deva & Associates, P.C.  
Certified Public Accountants

February 26, 1998