Comptroller of the Currency
Administrator of National Banks

1997

CFO

Chief Financial Officer's Annual Report

Contents

Comptroller's Message

It is often said that the OCC's mission, as the administrator of the national banking system, is to lean against the wind. That was never more true than in 1997. At a time in which banks were earning record profits and maintaining some of the highest capital levels in the history of the industry, we continued to speak out about the slippage in underwriting standards—a trend that could lead to loan losses and bank failures if not checked now. We also used this time of extraordinary industry health to continue developing our system of supervision by risk, which directs examiner resources to those areas that pose the greatest threat to safety and soundness. Supervision by risk reverses the long-standing practice of analyzing lagging indicators and focuses our attention on data that helps us anticipate future developments.

The ability to peer into the future has never been more important. The Asian banking crisis reminded us just how quickly events can affect the system. Long before the crisis broke in the news, we had staff in Asia evaluating the system's potential weaknesses and the likely effect upon U.S. banks. The year-2000 computer bug is another example of a major issue that crept into the public consciousness only recently. The OCC began work on this problem long before year-2000 became a buzzword. We will have finished the first round of on-site examinations for year-2000 compliance by June 1998 and will be actively monitoring the progress of national bank remediation efforts each quarter until year 2000.

Through all of the change, our strategic goals—the "four pillars," as we call them—held up as well in 1997 as they did in 1993, when they were first established. The four pillars are listed below and are described more fully on page 3.

- Ensuring bank safety and soundness to advance a strong national economy.
- Assuring fair access to financial services for all Americans by enforcing the Community Reinvestment Act and fair lending laws and encouraging national bank involvement in community development activities.
- Fostering competition by allowing banks to offer new products and services to their customers as long as banks have the expertise to manage their risks effectively and provide the necessary consumer protections.
- Improving the efficiency of bank supervision and reducing burden by streamlining supervisory procedures and regulations.

To help meet these goals, the OCC identified seven priority objectives in 1997:

(1) Implement supervision by risk

This program, which was initiated in 1996, was further refined last year with the development of supervisory strategies to help us meet the next economic downturn, including the creation of a special training program for dealing with problem banks. The OCC also issued an advisory to all national banks providing guidance on making adequate provisions to a bank's allowance for loan and lease losses. Based upon the results of our survey of underwriting policies, the OCC warned the industry against further weakening in credit standards. The OCC revised the supervisory policies and procedures governing federal branches and agencies of foreign banks to collect more information about the entity as a whole.

The OCC also redesigned its examination structure and standards to consistently integrate risk-based supervision into all aspects of the supervisory process. As part of this process, the OCC is changing the focus of its fiduciary supervision to reflect a more risk-oriented assessment of assets under management. In addition, the OCC's National Risk Committee continues to monitor and advise OCC's Executive Committee on emerging risks.

Another critical concern of the OCC is the prevention of money laundering activities conducted within the national banking system. To coordinate these efforts, the OCC established a new employee task force, the National Anti-Money-Laundering Group, to be the OCC's focal point for Bank Secrecy Act and anti-money-laundering supervisory activities.

(2) Develop technology to support the workforce

The OCC is using and investing in technology, wherever practical, to improve the quality, effectiveness, and efficiency of bank supervision and to support other OCC activities. In 1997, we continued development of two automated examination support systems—the Integrated Bank Information System (IBIS), which gives examiners and analysts access to data on banks, bank customers, and the competitive and economic environment in which banks operate; and the Industry Sector Information Service (ISIS), which provides data on different categories of bank customers to help examiners and analysts in credit risk evaluation and research. These systems, which should be fully on-line in

1998, will make it easier for examiners to identify potentially high-risk areas of bank operations—both for individual banks and the system as a whole—so that examiners can focus on the areas of greatest risk as soon as they enter the banks. Full implementation of these new systems will help make the examination process more efficient and more effective. Access to these systems was ensured through completing wide area network/local area network installations and providing training in 85 field offices and multinational banks. Dial-in modem capacity support was also increased by more than 400 percent to ensure access when employees are not working in OCC offices.

(3) Enhance workforce skills, abilities, and resources

While the number of national banks has steadily decreased in recent years, the complexity of bank activities has increased. To meet the new supervisory challenges of this changing industry, the OCC staff is becoming a more highly skilled workforce. As part of this process, the OCC is aligning employee skills and expertise more closely with changes in bank activities and products. To that end, the OCC is setting up programs to improve employee expertise in specific areas and recruiting people needed for additional expertise, such as in bank technology systems. In addition, the OCC is modifying the examiner training curriculum to ensure that examiners have the tools they need to examine banks effectively. To increase the cost-efficiency of OCC operations, the OCC evaluated its existing office space nationwide to identify lower-cost alternatives.

(4) Implement effectiveness measures for OCC programs, processes, and projects

This objective enables the OCC to measure its performance in carrying out its mission, one of the fundamental objectives of the Government Performance and Results Act (GPRA). The Chief Financial Officers (CFO) Act of 1990 required the OCC to institute a performance measurement and reporting system to evaluate how well the agency is meeting its goals and objectives, and OCC has included performance measures in the CFO Annual Report since 1991. Three years ago, we enhanced our efforts by measuring performance relative to our overall mission.

In 1997, to measure the effectiveness of our Regulatory Review Program, the OCC conducted focus group sessions with banks, community organizations, and members of the general public; distributed informal voluntary surveys; and added a feedback form to the OCC's Internet site to solicit input from our customers. We also developed draft measures for the 1997 objectives. In 1998, pilot projects will be conducted to determine how well these draft measures actually assess progress in achieving these objectives.

(5) Improve internal communications

Good internal communication is a critical element in promoting employee understanding of and commitment to carrying out the OCC's mission and objectives. Employees need a broad variety of information to do their jobs, and management needs regular input from staff. Risk-based supervision, in particular, relies on information from examiners as well as other sources to identify potential high-risk areas in banks and the industry as a whole.

Focus group meetings were held throughout the OCC in 1997 to discuss the strategic goals and begin developing objectives for 1998. Feedback from these meetings showed a significant increase in employees' knowledge and understanding of OCC's goals and objectives, and helped identify areas where employees wanted additional information.

To improve employee access to broader information and to speed the dissemination of up-to-date information, we developed an intranet system—the OCCnet—that was piloted in 1997 and became fully functional in January 1998. Information available on OCCnet includes new policies and procedures, databases of economic and banking information, information released publicly, announcements of upcoming events about which employees may be asked by bankers, and information about changes in compensation and benefits. The OCCnet also includes sites where employees can ask questions about particular subjects or OCC projects or submit comments on initiatives currently under consideration. Because this information is in electronic format, it can be readily updated or modified so that employees always have access to the most current information.

(6) Monitor and analyze electronic money and banking issues

In 1996, Secretary Rubin designated the OCC as the coordinator for the Treasury Department on electronic money activities. In support of this role and recognizing that electronic money and banking would have a significant impact on banking in the future, we established a 1997 objective to develop a timely and appropriate supervisory response to the introduction of electronic money and banking products and technologies.

The OCC has provided policy and technical support to the Treasury Department in its efforts to address the issues raised by emerging technology. In particular, the OCC chairs Treasury's Consumer Electronic Payments Task Force, an interagency effort, to examine consumer issues raised by electronic money and banking technologies. The OCC serves as the Department of the Treasury's delegate to the G-10 Working Party on electronic money, and made major contributions to its report on consumer, law enforcement, and supervisory issues related to electronic money. The Comptroller also chairs the Basle Committee's Small Group, a forum to facilitate sharing of information on supervisory issues raised by electronic money and banking. The Basle Small Group was formed to strengthen international cooperative efforts to address the cross-border issues posed by electronic money and banking systems.

In 1997, the OCC worked on developing guidance for examiners and bankers to manage the most significant risks posed by new technology-based products and services. Efforts are under way at the OCC to focus our bank information systems examinations more precisely on the most significant risks facing banks. The staff also continued educational activities to make sure the agency is knowledgeable about current developments in electronic money and banking, both domestically and internationally.

Also, the OCC worked to provide timely and appropriate responses to national banks filing applications or seeking legal opinions in connection with electronic money and banking products. During the year, the OCC granted preliminary conditional approval for the first electronic national bank, CompuBank, National Association, which will be headquartered in Houston, Texas. CompuBank will deliver products and services to customers primarily through electronic means—by telephone and personal computer. The bank will focus exclusively on offering checking and savings accounts and electronic bill payment services.

(7) Improve access to financial services

This multi-year objective is being accomplished through the enforcement of the Community Reinvestment Act and fair lending laws. In addition, pursuant to this objective, we encourage national bank involvement in community development activities and in providing financial services profitably to those currently outside the banking system.

The Native American Working Group, formed by the OCC in 1994, produced an information guide earlier this year, "A Guide to Mortgage Lending in Indian Country," that helps banks understand and address legal and operational challenges confronted when making home loans in Indian country.

The OCC encourages expansion of banking services in low-to-moderate income areas through its licensing activities. No corporate filing fee is charged for applications for new national bank charters and branches to be located in nonbanked low-to-moderate income areas. The OCC also continues to work to facilitate chartering national community development banks. The first such bank opened for business in September, located in a low-to-moderate income neighborhood. It was capitalized through a combination of direct equity investments from other national banks and a Community Development Financial Institution Program award.

The OCC is also working to develop an understanding of the impediments that limit access to banking services for other pockets of the economy, especially small businesses, low-income individuals, victims of illegal discrimination, and nonbanked individuals. The OCC initiated a project during 1997 called Expanding the Financial Frontier to collect and present information on the nonbanked population; barriers that prevent banks from reaching them; and innovative bank practices for servicing the nonbanked population.

In 1998, the OCC will undertake an initiative to identify and address the reasons many low-income individuals and households do not have banking relationships and will collect and disseminate information on innovative and profitable efforts by banks to reach this sector of the population.

In addition to OCC's emphasis on both supervising the national banking system and addressing the 1997 objectives, the OCC also restructured its operations; lowered assessments and reduced fees; and issued revised rules, policies, and procedures for corporate activities.

Restructuring

The OCC requires a flexible structure that allows it to keep pace with the changes that have occurred within the banking industry. The OCC responded to changes in the industry by announcing a new organizational structure in March 1997. The agency's new structure has realigned the supervisory function into two lines of business—large banks and mid-size/community banks. The agency also realigned its supervisory policy department into two central processes—core policy and risk specialties.

Reduced fees and a new approach to assessments

The OCC relies almost exclusively on assessments to fund its operations, unlike the state regulatory agencies that share their bank supervisory responsibilities and costs with the Federal Deposit Insurance Corporation or the Federal Reserve. Recognizing this, the OCC studied alternative ways to structure its assessments and to assure adequate revenue flows while minimizing financial burdens on the banks it regulates. In 1997, OCC updated 12 CFR 8 to reallocate assessments to problem banks through a 25 percent surcharge and finalized its rules for a 12 percent assessment discount for non-lead national banks. The OCC also eliminated separate trust examination fees and securities dealers' fees on national banks. These actions have reduced charges on national banks. We also waived the inflationary adjustment for 1998 for the fourth consecutive year.

Revised rules, policies, and procedures for corporate activities

The OCC has a responsibility to foster competition in the industry through licensing appropriate activities that expand banking services, while ensuring the safety and soundness of the banking system. To maintain this balance and to streamline the corporate application process for the industry, the OCC revised and reorganized its policies and procedures for national bank corporate transactions and activities. The changes streamline requirements and time frames for the industry and enable the OCC to focus its resources on applications that present greater risk to bank safety and soundness or raise significant legal, policy, or compliance concerns. The revised regulation also expands public involvement in the corporate process, by providing opportunities for public and private meetings where interested parties may surface issues regarding the proposed activity.

Finally, it would be impossible to conclude without taking note of the fine men and women who are responsible for the good work of the OCC. We have accomplished much in the past five years, but none of it would have been possible without their hard work and keen professionalism. Americans can sleep easier knowing that our national bank system is in such capable and dedicated hands. It has been my great privilege to work with them.

Eugene A. Ludwig
Comptroller of the Currency
April 3, 1998

1997 Chief Financial Officer's Annual Report

Overview

Bureau Profile

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller, who is appointed for a five-year term by the President, with the advice and consent of the Senate. The OCC is headquartered in Washington, D.C. At the end of 1997, the OCC had 2,766 employees nationwide.

The OCC is responsible for chartering, regulating, and supervising the national banking system. The OCC also supervises the federally licensed branches and agencies of foreign banks. In addition to supervising national banks, the OCC has continued its efforts to strengthen the banking industry, by encouraging national banks to improve the quality of their loan portfolios, increase capital, diversify their sources of income, ensure year-2000 compliance, and generally strengthen the banks' operations.

At year-end 1997, there were 2,597 federally chartered national banks representing about 28 percent of the 9,143 commercial banks in the United States. The national banking system had approximately $2.9 trillion in assets, accounting for about 58 percent of the commercial banking system assets. During the past several years, national bank assets have increased significantly. Between 1993 and 1997, national bank asset growth averaged 8.4 percent on an annual basis.

The decline in the number of national banks primarily results from the effect of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, which allowed banks to consolidate entities across state lines, and the intrastate consolidation of bank charters. This decrease has been slightly offset by an increase in the number of banks converting into the national banking system.

Organizational Structure

During 1997, the Comptroller received advice on policy and operational issues from an executive committee that consisted of the chief counsel, the ombudsman, and six senior deputy comptrollers (SDC), representing Economic and Policy Analysis, Public Affairs, Bank Supervision Policy, International Affairs, Bank Supervision Operations, and Administration.

In addition, the Comptroller's office, through the direction of the senior advisor, also oversees the management of OCC's Information Technology Services. Figure 1 displays the first level of organizational structure in the OCC at the end of 1997.

The SDC for Economic and Policy Analysis oversees the OCC's economic research, risk analysis, data analysis, and evaluation programs. The economists also provide technical support to national bank examinations. The SDC for Economic and Policy Analysis is also responsible for the preparation of congressional testimony.

The SDC for Public Affairs advises the Comptroller on external relations with the media, the banking industry, Congress, consumer and community organizations, other government agencies, and the public. The SDC for Public Affairs is also responsible for the OCC's Minority and Urban Affairs program.

The SDC for Bank Supervision Policy formulates, implements, and monitors examination policies and procedures. This area is also responsible for the development, maintenance, and dissemination of information and specialized expertise required to evaluate and supervise the risks of particular activities and procedures associated with banking.

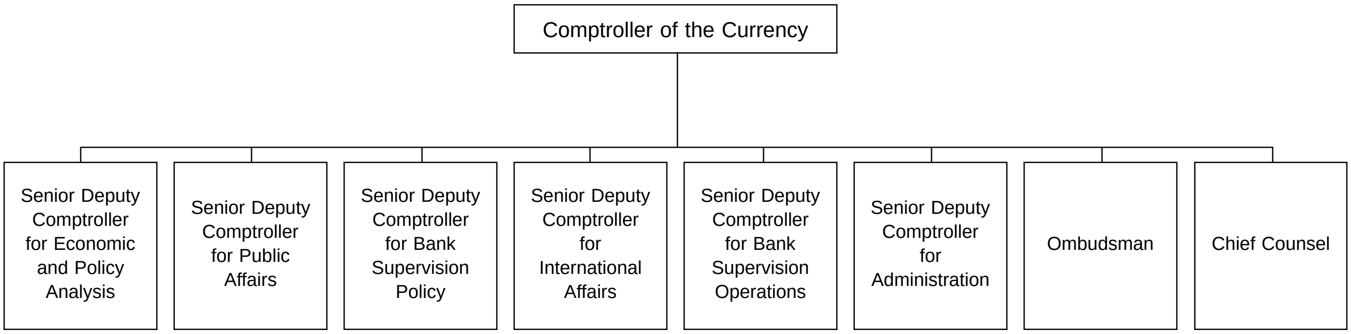
The SDC for International Affairs oversees OCC's supervision of the federal branches and agencies of foreign banks in the United States, maintains OCC's relationships

Table 1—Trends of national banks by number and assets, 1993–1997
($ in billions)

	1993	1994	1995	1996	1997*
Number of national banks	3,319	3,078	2,861	2,726	2,597
National bank assets	$2,102	$2,258	$2,403	$2,528	$2,894

* Based on preliminary call report data—subject to adjustments.

Figure 1—Organizational structure

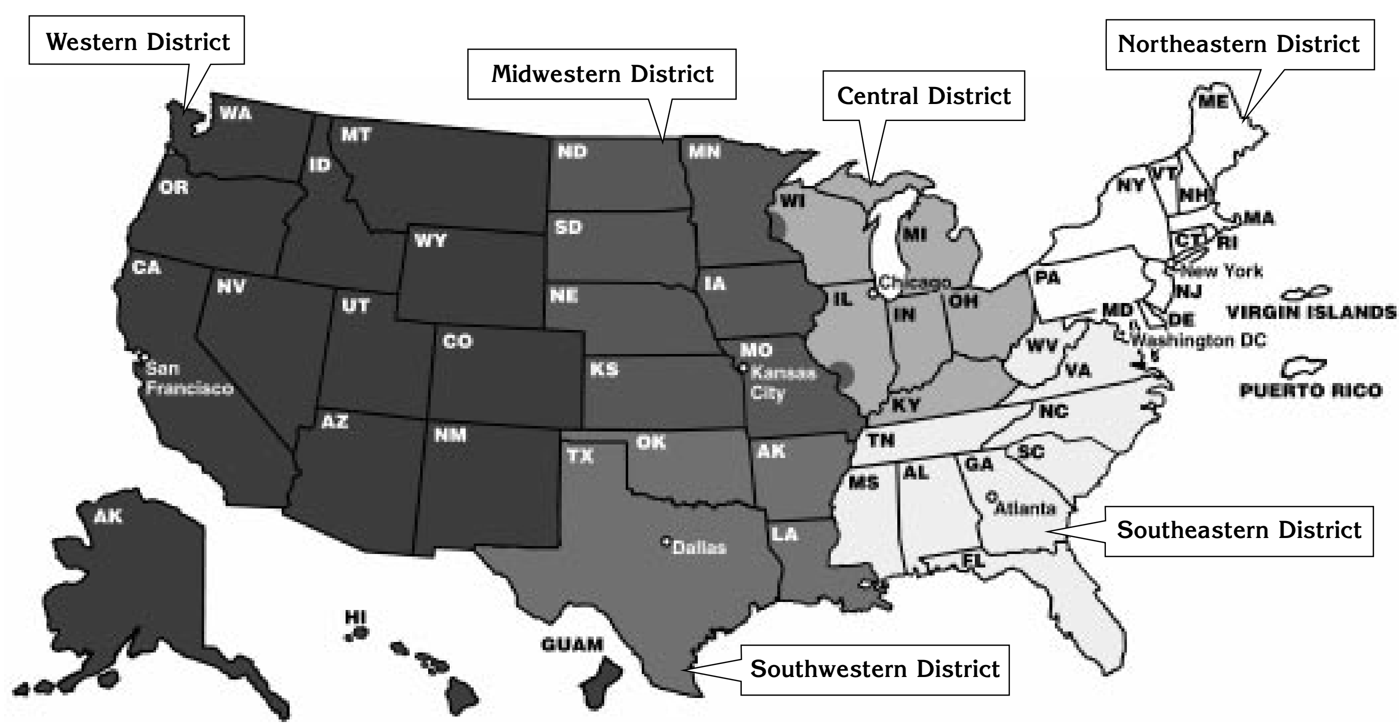


with the international financial community and foreign supervisory organizations, and conducts analyses of international banking issues.

The SDC for Bank Supervision Operations administers the OCC's direct examination and supervision of all national banks and the training of examiners and staff. Supervision activities are conducted by six district offices (see figure 2 for geographic districts), large bank teams, and supervision support staff. The OCC Large Bank Supervision department directs the examination, supervision, and analysis of large national banks, including their international banking activities. The SDC for Bank Supervision Operations also formulates, implements, and monitors quality assurance and enforcement policies and procedures, supervises national banks with problem conditions, and coordinates bank closings.

The SDC for Administration manages the OCC's human resources department, administrative operations, financial functions, and provides guidance and assistance to the district administrative operations. In addition, the SDC for Administration has been designated by the Comptroller to administer the OCC's Equal Employment and Diversity programs.

Figure 2—Geographic districts



The ombudsman oversees the national bank appeals process. With the consent of the Comptroller, the ombudsman has the discretion to supersede any agency decision or action during the resolution of an appealable matter. The ombudsman functions independently, outside of the bank supervision and examination area, and reports directly to the Comptroller. The ombudsman is also responsible for overseeing the Customer Assistance unit.

The chief counsel advises the Comptroller on legal matters arising from the administration of laws, regulations, and rulings governing national banks. The chief counsel also oversees the OCC's Community Development division and the Bank Organization and Structure department, including corporate licensing functions at headquarters and in the six district offices.

The OCC's Mission

The OCC charters, regulates, and supervises national banks to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States.

The OCC's Four Pillars

- Ensure bank safety and soundness to advance a strong national economy. The OCC must maintain a proactive focus to identify potential problems in banking. The OCC must ensure its supervisory practices are both up-to-date and adaptable to the rapid evolution of highly complex new products and services being offered by the banking industry.

- Foster competition by allowing banks to offer new products and services to their customers as long as banks have the expertise to manage the risks effectively and to provide the necessary consumer protections. At the same time, the OCC must act responsibly to understand, to monitor, and where appropriate, to limit the risks of new banking activities.

- Improve the efficiency of bank supervision and reduce burden by streamlining supervisory procedures and regulations. The OCC must continue to introduce new examination procedures that reduce burden by focusing on banking activities that pose the highest risk. The OCC must ensure its regulations are clearly written to minimize regulatory burden and costs, and continuously eliminate regulations that are no longer necessary.

- Ensure fair access to financial services for all Americans by enforcing the Community Reinvestment Act (CRA) and fair lending laws and encouraging national banks' involvement in community development activities. The OCC must develop an understanding of and try to eliminate impediments that limit the access to banking services for certain segments of the population, especially small businesses, low-income individuals, rural individuals and businesses, and victims of illegal discrimination.

Priority Objectives

A formal plan for accomplishing the OCC's mission is set out in the OCC's Priority Objectives, which provide specific operating goals. The 1997 objectives include implementing supervision by risk; monitoring and analyzing electronic money and banking issues; improving internal communications; implementing effectiveness measures for OCC programs, processes and projects; enhancing workforce skills, abilities and resources; developing technology to support the workforce; and improving access to financial services, as discussed in more detail in the preceding Comptroller's Message.

Each of the 1997 priority objectives supports one or more of the four pillars. These objectives enhance the OCC's opportunity to make further progress in identifying and responding to systemic risks, and the need to address actual and potential risks related to the year-2000 effect on automated systems and the growth of banks' use of technology. Furthermore, the objectives are intended to reflect the recognition of working environment issues raised by employees, improve internal communications, and provide enhancements in automated systems and equipment for the OCC workforce. The objectives also continue OCC's commitment to promoting fair access to financial services for all Americans.

Overview of Funding Sources and Uses

The financial statements that follow summarize the OCC's December 31, 1997 financial position, including the

Table 2—OCC total revenue and expense trends, 1995–1997
($ in millions)

	1995	1996	1997	$ Change 95 vs. 96	$ Change 96 vs. 97
Revenue	$372.9	$373.7	$390.0	$0.8	$16.3
Expenses	$372.3	$374.5	$350.3	$2.2	($24.2)
Surplus/(Deficit)	$0.6	($ 0.7)	$39.7	($1.3)	$40.4

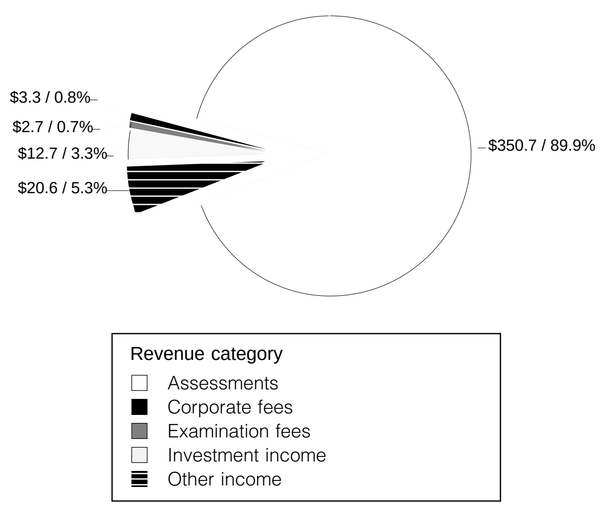
Note: Totals may not add because of rounding.

costs of its operations and all significant sources and uses of resources during 1997 and 1996. The OCC's revenue was $390.0 million in 1997 and $373.7 million in 1996. Expenses totaled $350.3 million and $374.5 million respectively, resulting in a $39.7 million surplus in 1997 and a $0.7 million deficit in 1996. The 1997 surplus results from staffing under budget levels and increased revenue from asset-level changes in the national banking system. A secondary cause of the surplus is lower-than-planned spending on items other than salary.

Funding Sources

The OCC does not receive any appropriations from Congress. The OCC's operations are funded primarily by assessments on national banks for the supervision it provides. The OCC operates on a "trust fund" basis. In the financial statements, the OCC's revenues are categorized in accordance with federal accounting guidelines as "Revenues from goods sold/services provided to the public" and are generated from semiannual assessments on all federally chartered national banks (89.9 percent), fees for corporate applications (0.8 percent), and special examinations (0.7 percent). The OCC also receives other revenue (3.3 percent) categorized as "investment income," which is primarily generated from the interest earned from the investment of its operating funds in U.S. Treasury securities. In addition, revenue is collected from the sale of publications. In 1997, the OCC's total revenue was $390 million.

Figure 3—Components of OCC's 1997 revenues
($ in millions)

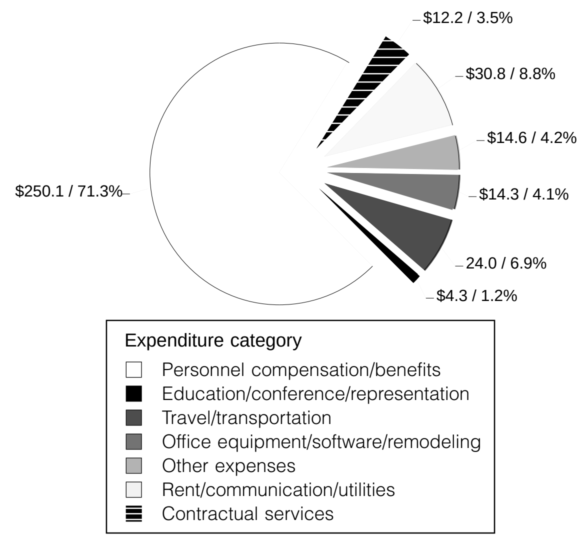


Funding Uses

The OCC is a personnel-intensive organization. In 1997, the OCC's expenses were $350.3 million, with $278.4 million or 79.5 percent of total expenditures incurred for "personnel compensation and benefits, travel, and education." These expenses primarily supported bank supervision and examination activities.

Of the OCC's remaining expenditures, 11.7 percent include costs for office equipment, software, contractual services, repairs and maintenance, supplies and materials, depreciation of assets, and printing and reproduction. "Rent, communications, and utilities" expenses required to support the nationwide system of examiner offices represents the 8.8 percent remainder of total expenditures.

Figure 4—Components of OCC's 1997 expenditures
($ in millions)



Limitations of the Financial Statements

The OCC's financial statements have been prepared to report the financial position and results of its operations, pursuant to the requirements of the Chief Financial Officers Act of 1990. The statements have been prepared from the books and records of the OCC in accordance with the format prescribed by the Department of the Treasury, in conjunction with the Office of Management and Budget, generally accepted accounting principles, and the Federal Accounting Standards Advisory Board (FASAB). These statements differ in format from the internal financial reports used by the OCC to monitor and control its budgetary resources.

Management Discussion and Analysis—Program Highlights and Performance

Bank Supervision

Bank Supervision fundamentally entails promoting the safety and soundness of national banks, and ensuring their compliance with applicable laws and regulations.

As OCC heads toward the millennium, this role has become an even greater challenge as banks continue to expand into nontraditional activities. Changes in the banking industry resulting from consolidation, new and rapidly developing technologies, increased competition, and the globalization of the economy have placed new demands on the OCC to adapt its operations and to develop specialized expertise in its workforce.

To assure Bank Supervision remains effective in this environment, a comprehensive reorganization was undertaken during 1997 to better position the OCC to address supervisory demands in the future. The reorganization also enhanced the effectiveness of the OCC's supervision by risk program.

In the operations area, the new organizational structure has fewer managerial layers and centralizes responsibility for training and administrative activities in the OCC's headquarters office in Washington. This allows more effective and consistent communications between field examiners and banks, and allows examiners to focus greater attention on direct supervision of the banks.

The reorganization consolidates oversight of large bank supervision in the OCC's Washington office and structures OCC's district operations to focus on the particular needs of community and mid-size national banks. The new organization assigns dedicated examiner staff to the 32 largest banks on a full-time basis. This program enhances the traditional annual or periodic examination, by allowing examiners to better understand a bank's operations and more quickly identify increases in risk or deterioration in risk management. This allows the OCC to act more quickly to ensure that weaknesses are corrected.

The restructuring also placed the supervision of all federal branches and agencies under the jurisdiction of the Northeastern district office where the majority of these institutions are located. As result, multiple federal branches under the same parent company in different geographic locations are now the responsibility of the same OCC manager.

The policy area was restructured to enhance its risk and product line focus. It was divided into two main functions that include: the development of core philosophies and policies used by the OCC to supervise banks; and the development, maintenance, and dissemination of policies and specialized expertise required to evaluate and supervise the risks of various banking activities and products.

Core Policy has the primary responsibility of developing and maintaining OCC's core policy platform for bank supervision; maintaining general examination programs; integrating policies into supervisory information systems; and developing policy to address emerging issues affecting the banks' capital, accounting, management, and operations.

The specialized risk units include Asset Management, Credit Risk, Community and Consumer Policy, Treasury and Market Risk, and Bank Technology. These units are primarily responsible for developing and maintaining the OCC's specialized expertise in their respective areas of risk and other banking products. The risk units create communication networks with field experts in order to better maintain and disseminate specialized knowledge, and improve the timeliness and quality of responses and analysis of risks associated with new areas of banking services and products. In early 1998, the Year 2000 Supervision Policy division was created to focus on this important risk and challenge to the banking industry.

The OCC is also continuing efforts to automate the examination process and to expand information resources. These efforts include connecting the field staff to the Internet and employing intranet-deliverable statistical and analytical resources and tools.

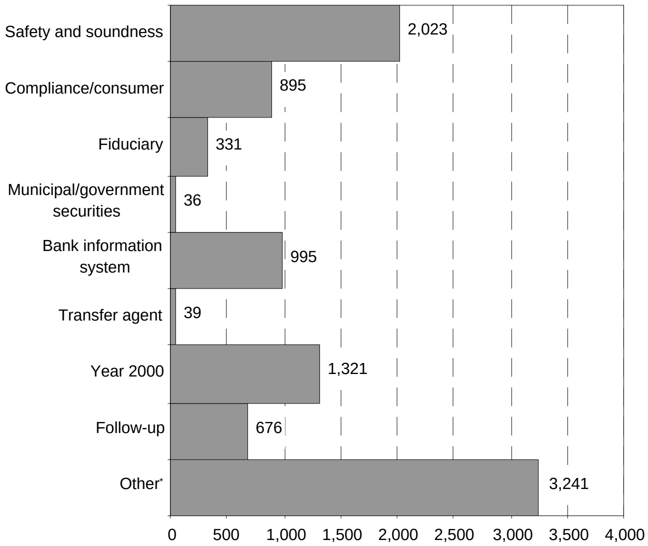
Examinations

To ensure the safety and soundness of banks and compliance with laws and regulations, the OCC conducts various on-site examinations and inspections in addition to its off-site monitoring efforts. Examinations, including speciality exams, are completed in accordance with Federal Deposit Insurance Corporation Improvement Act (FDICIA) and OCC requirements.

In 1997, 92 percent of safety and soundness examinations were started on schedule. This represents a 5 percent improvement over 1996. Without exception, high-risk banks are examined annually in compliance with FDICIA. With the reorganization of Bank Supervision Operations, resources are now more efficiently allocated geographically to meet this goal. Also, hiring efforts began during the last quarter of 1997 to acquire additional resources and specific expertise needed for the examination effort. Late exams are regularly tracked to ensure that they are scheduled for an examination as quickly as possible.

A total of 8,236 examinations (excluding year-2000 exams) were completed in 1997 compared to 9,330 in 1996. The number of examinations decreased not only as a result of consolidations and mergers within the national banking system, but also from a change in the examination cycle definition. At the beginning of 1997, the Economic Growth and Regulatory Paperwork Reduction Act extended the examination cycle from 12 months to 18 months for some 1- and 2-rated banks with up to

Figure 5—Type and number of OCC examinations in 1997



* Other targeted exams, e.g., credit review, liquidity analysis, etc.

$250 million in assets. For a bank to be eligible, they also must be well-capitalized, well-managed, not subject to an enforcement proceeding, and have not undergone a change in control in the previous 12 months. As a result, approximately 300 additional banks were changed from 12-month to 18-month examination cycles, increasing the total of national banks on a 18-month cycle to nearly 1,850. However, when a bank's examination cycle is extended from 12 months to 18 months, the OCC examiner-in-charge stays in regular communication with its management, and the OCC can accelerate an examination whenever the OCC believes it is necessary.

Year-2000 Examination Efforts

The OCC has an aggressive strategy to ensure that national banks are prepared to address the year-2000 problem. Bank readiness is especially important given that banks are at the center of our payments and credit system, and a program malfunction related to the century date could have a significant impact on the public and the financial marketplace.

The OCC's year-2000 supervisory strategy consists of an initial round of on-site examinations of all the banks it supervises by June 30, 1998; quarterly reviews in each institution to monitor their year-2000 efforts; and additional on-site examinations whenever necessary. All safety and soundness exams scheduled between now and the first quarter of 2000 will include year-2000 procedures.

As a part of OCC's supervisory oversight, examiners monitor the banking industry's actions to correct all year-2000 data exchange issues. Examiners consider the effect that external parties will have on banks' year-2000 efforts, including vendors, service providers, clearing houses, government entities, domestic and international customers, and other financial institutions. They also review the bank's efforts relating to environmental systems that use microchips such as security systems, elevators, and vaults. Additionally, a bank's lending practices are evaluated to ensure that they address the effect that year-2000 compliance may have on a customer's creditworthiness.

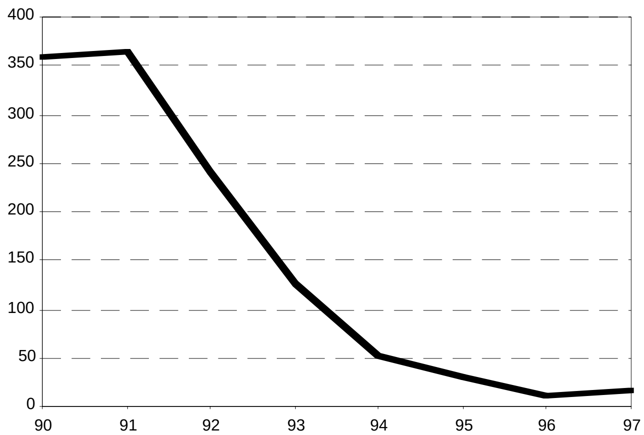
The OCC supervises about 2,800 national banks, federal branches and agencies, and uninsured trust companies. The Federal Financial Institutions Examination Council (FFIEC), (comprised of representatives of the five federal depository institutions regulators including the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Association, and the Office of Thrift Supervision), oversees year-2000 policy development for member agencies. It also oversees the supervision of about 300 large and medium-sized data processing servicers. The FFIEC, through its member agencies, performs joint reviews in 16 large national data services and 12 large providers of bank application software. The OCC leads the examinations of 10 of these entities. The remaining data centers are small regional servicers that are divided among the FFIEC agencies. The OCC is the lead supervisor for 79 of these data centers. We also assist in the examinations of 44 of the data centers for which other regulatory agencies are the lead agency.

The OCC, along with the other FFIEC member agencies, meets quarterly with the major bank trade organizations to address year-2000 issues. The associations attending these meetings include the American Bankers Association (ABA), the Independent Bankers Association of America (IBAA), the Bankers Administration Institute (BAI), Bankers Roundtable, and Robert Morris Associates, among others. We also have participated in 25 year-2000 related conferences. And the OCC, through the Basle Committee on Banking Supervision, is working with foreign supervisors to ensure that foreign banks and their supervisors are fully aware of the issue, and we are encouraging foreign bank supervisors to take appropriate remedial action.

Problem National Banks

Under the Uniform Financial Institutions Rating System, banks are ranked on a scale of 1 through 5 CAMELS ratings in ascending order of supervisory concern. The CAMELS rating is based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. National banks rated either a 4 or 5 under the CAMELS rating system are considered to be "problem banks." Currently, there are 20 problem banks, representing less than 1 percent of the national bank population. The assets of these banks total less than $2 billion, representing only 0.06 percent of total national bank system assets. After reaching a high in the early 1990s, the number of problem banks has remained below 1 percent of all national banks since the beginning of 1996, reflecting favorable economic conditions and improvements in banks' risk management processes.

Figure 6—Number of problem national banks, by year, 1990–1997



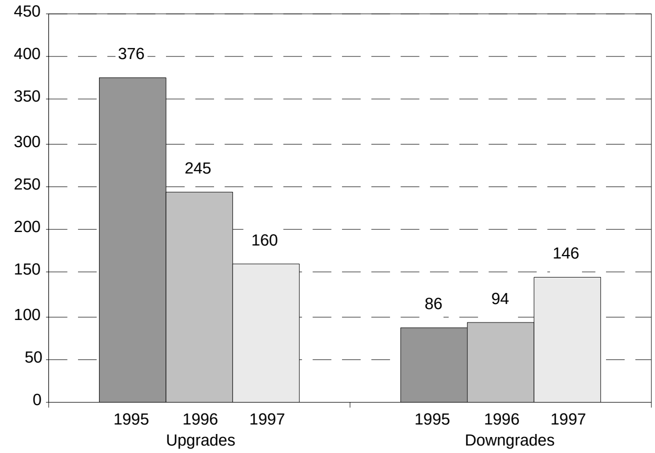
Only one problem bank has assets over $150 million. The others have assets under $125 million. Of these banks, over half have assets under $50 million. Additionally, no national banks failed during 1997.

Change in Bank Ratings

In recent years, the improving condition of the national banking system was reflected in the overall positive trend in upgrades to banks' CAMELS ratings. Ratings are evaluated at least once during the supervisory cycle. For both 1995 and 1996, rating upgrades by far dominated downgrades. The condition of the national banking system has now stabilized as reflected in the balance between upgrades and downgrades. Banks with rating upgrades in calendar year 1997 totaled 160 versus 146 downgrades. This trend reflects that 93 percent of national banks are either 1- or 2-rated. Figure 7 provides a summary of the levels of change in composite CAMELS ratings.

Although the overall good health of the banking industry is good news, the OCC remains vigilant for any negative trend that may affect bank condition and result in an increase in the number of rating downgrades. During 1997, the Comptroller cautioned banks about the loosening of loan underwriting standards. In response to this slippage, the Comptroller took several steps to help ensure that banks identify and address weaknesses in

Figure 7—Levels of change in composite CAMELS ratings, 1995–1997



their portfolios. Examiners have been instructed to review credit underwriting standards with the banks' Chief Executive Officer, discuss with them loans that demand their attention, and evaluate the banks' ability to deal with increases in problem loans.

In August, the OCC issued an advisory letter to banks reminding them of the need to perform quarterly reviews of their loan loss reserves because of a trend in weaker loan underwriting standards. In March 1998, the OCC issued definitive guidance on techniques for managing risk for loan portfolios as a whole. By taking such measures now, the OCC hopes to reduce the likelihood of more serious problems.

Enforcement

In addition to examinations, the OCC uses a number of other tools to carry out its supervisory responsibilities. These tools range from advice and moral suasion to specific types of enforcement actions. Enforcement actions are initiated to correct safety and soundness or compliance weaknesses and to memorialize, in writing, management and board commitments to enact specific measures addressing OCC concerns. Enforcement actions may be formal or informal and may be taken against banks or the individuals associated with the banks.

In 1997, the OCC completed 192 formal and informal enforcement actions against banks and individuals (this includes actions that were initiated in prior years). The OCC initiated slightly more enforcement actions in 1997 than in 1996 (193 in 1997, 170 in 1996, and 159 in 1995).[1] At year-end 1997, the OCC had either formal or

[1] Statistics for prior years may be adjusted to reflect revised aggregates.

informal enforcement actions outstanding against approximately 4.6 percent of the institutions it supervises (national banks and federal branches and agencies).

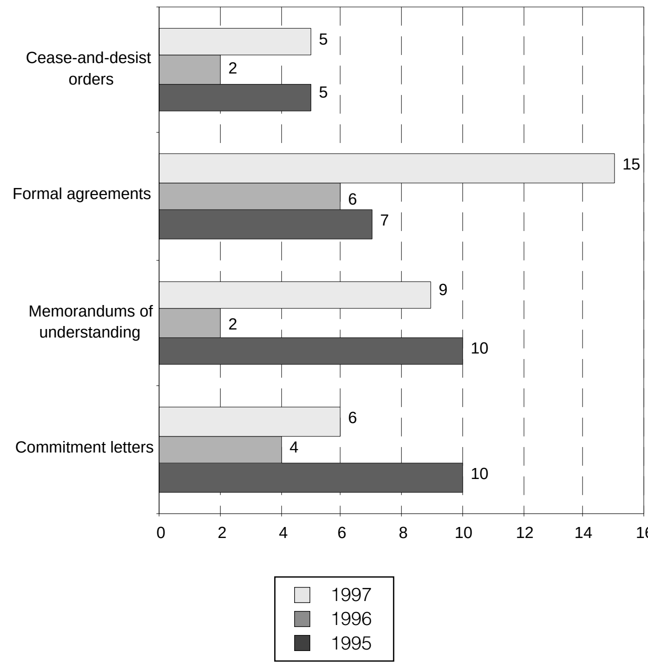
Informal enforcement actions against banks include commitment letters and memorandums of understanding. Generally, these actions are used to provide bank management with direction and guidance in addressing weaknesses in management or procedures before they result in more serious problems. Failure to correct practices identified through informal actions provide the OCC with evidence of the need to take formal action.

The OCC uses formal enforcement actions against banks to secure commitments in a legally binding form when serious compliance or safety and soundness problems pose a threat to a bank's condition. Formal enforcement actions against banks include written formal agreements and cease-and-desist orders, which may be issued by consent or after litigation. Formal agreements are documents signed by a national bank's board of directors and the OCC that require specific corrective and remedial measures to return the bank to a safe and sound condition. Cease-and-desist orders are virtually identical in form and legal effect to formal agreements, but may be enforced in federal district court. The OCC may also impose civil money penalties (CMPs) upon banks for failing to comply with laws, regulations, formal agreements, cease-and-desist orders, or conditions imposed in writing in connection with an application or request, or for engaging in unsafe or unsound practices. The OCC issued two CMPs against banks in 1997, and one in 1996.

In most cases, however, the OCC imposes CMPs on the individuals responsible for the violation or unsafe or unsound practice rather than upon the institution. Figure 8 provides totals from 1995 through 1997 for some of the primary enforcement actions that the OCC completed against banks to help supervise troubled institutions.

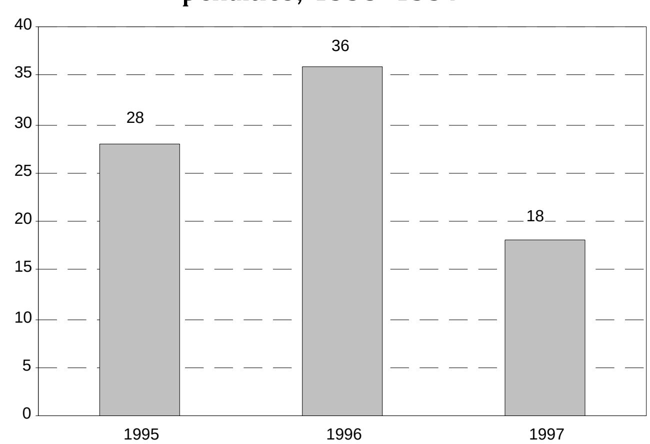
When appropriate, the OCC also takes formal and informal action against individuals at national banks—officers, directors, or other institution-affiliated parties. The primary informal enforcement tools used by the OCC for individuals are supervisory letters and letters of reprimand. Supervisory letters are used when a CMP is not warranted, but the OCC nonetheless wants to call attention to a supervisory problem. A letter of reprimand is a strongly worded document used in cases that may warrant a CMP, but when the assessment of a small CMP would consume excessive agency resources or when the individual has recognized the supervisory problem and taken steps to correct it. The OCC sent 41 supervisory letters and 12 letters of reprimand in 1997.

Figure 8—Type and number of traditional enforcement actions completed against banks, 1995–1997



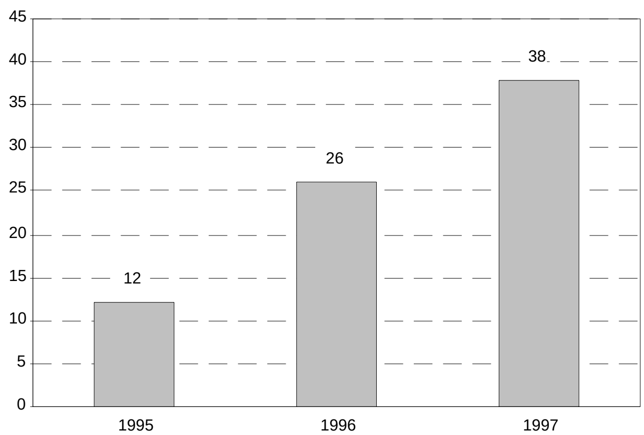
Formal actions against individuals include CMPs, removals, prohibitions, and personal cease-and-desist orders. Civil money penalties are imposed for violations of laws, regulations, rules, and noncompliance with formal written agreements, final orders, conditions imposed in writing, and, under certain circumstances, for unsafe or unsound banking practices or breaches of fiduciary duty. During 1997, the OCC imposed CMPs against individuals totaling $706,400. Figure 9 provides the number of CMPs levied during the past three years against individuals.

Figure 9—Number of civil money penalties, 1995–1997



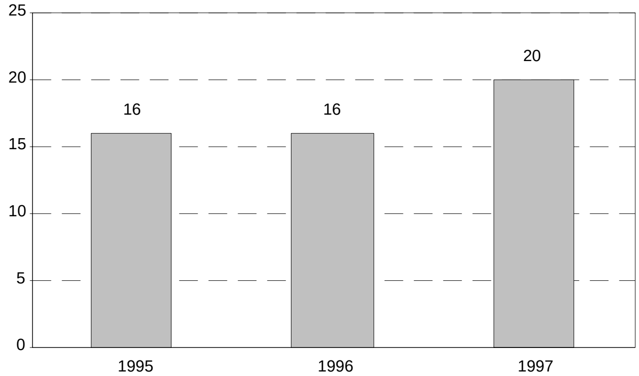
In addition, the OCC is sometimes compelled to take action to remove an individual from his or her current position and/or prohibit that person from further involvement in the banking industry. Figure 10 shows an increase in the number of removals processed since 1995. This increase can largely be attributed to the OCC's Fast Track Enforcement Program, which was implemented in 1996. The program follows up on Suspicious Activity Reports filed by banks in connection with suspected crimes committed by bank officials and employees. Under the Fast Track Program, the OCC initiates removal and prohibition orders against certain bank insiders and employees to ensure that they do not continue to be employed in the banking industry.

Figure 10—Number of removal and prohibition orders, 1995–1997



Finally, cease-and-desist orders against individuals address such issues as requiring restitution to the bank and/or prohibiting or restricting activities in the banking industry. During 1997, the OCC ordered restitution of $1.8 million. Figure 11 shows the number of personal cease-and-desist orders completed during the past three years.

Figure 11—Number of cease-and-desist orders against individual bankers, 1995–1997



Licensing

National banks must, by law and regulation, seek OCC approval for various types of corporate activities and changes. These changes include new bank charters, conversions to national banks, corporate reorganizations, mergers, branches, bank relocations, operating subsidiaries, capital and subordinated debt issues, and bank acquisitions. Most licensing requests are reviewed and decided in the licensing units located in the six district offices and in Washington, D.C. (Federal branches and agencies file with OCC's International Banking and Finance division.) Complex issues are forwarded to OCC's Bank Organization and Structure (BOS) in Washington for analysis and decision by senior management.

The total number of applications filed with the OCC decreased from 3,928 in 1996 to 2,886 in 1997. Much of the difference reflects statutory, regulatory, and processing changes. (Please refer to table 3.) During the first nine months of 1996, 866 automated teller machine (ATM) applications were filed with the OCC, which is included in the total applications for 1996. However, the Economic Growth and Regulatory Paperwork Reduction Act, which became effective September 30, 1996, eliminated the requirement for national banks to file ATM applications. The 1997 count was also reduced because 92 operating subsidiary filings were effected through after-the-fact notices under OCC's revised regulation; in 1996, before the regulatory change, full applications, and OCC approval, would have been required. In 1997, excluding ATM applications, OCC experienced a decrease in the number of branch, operating subsidiary, fiduciary powers, capital, and conversion filings, and an increase in reorganization, change-in-control, and merger filings.

From 1996 to 1997, new charter applications decreased by 1 to 80, after a 45 percent increase from 56 applications in 1995. The OCC received 43 charter applications from independent groups during 1997. Of these, 34 were for full-service banks, 3 for trust banks, and 6 for credit-card banks. The other 37 charter applications received in 1997 were sponsored by existing holding companies. Of this group, 21 were for full-service banks, 15 for trust banks, and 1 for a credit-card bank.

The OCC denied two applications in 1997, compared to none in 1996 and two denials in 1995. Of the 2,910 decisions in 1997, 42 were conditional approvals. Conditional approvals decreased over 1996, when 83 of 2,911 decisions were conditionally approved.

Processing Timeliness

One measure of OCC's effectiveness in processing corporate applications is the percentage of applications

Table 3—Corporate licensing activity in 1997

	Applications received		District decisions 1997			Washington decisions 1997			Total
	1996	1997	Approved	Conditionally approved[4]	Denied	Approved	Conditionally approved[4]	Denied	1997 decisions
ATMs[1]	866	0	0	0	0	0	0	0	0
Branches	1,838	1,771	1,735	0	0	35	2	0	1,772
Capital	127	93	73	2	0	7	0	0	82
Change in control	17	23	21	0	0	3	0	0	24
Charters	81	80	56	5	0	4	12	2	79
Conversions[2]	75	58	69	6	0	16	1	0	92
Federal branches	0	1	0	0	0	0	0	0	0
Fiduciary powers	47	24	33	0	0	6	0	0	39
Mergers	111	128	126	1	0	13	0	0	140
Relocations	260	243	232	0	0	9	0	0	241
Reorganizations	238	309	209	0	0	97	1	0	307
Stock appraisals	3	5	0	0	0	3	0	0	3
Subsidiaries[3]	265	151	104	3	0	15	9	0	131
Total	3,928	2,886	2,658	17	0	208	25	2	2,910

Note: Approved decisions include conditional approvals. Mergers include failure transactions where the national bank is the resulting institution.

[1] The Economic Growth and Regulatory Paperwork Reduction Act, effective September 30, 1996, eliminated the requirement to file ATM applications.

[2] Conversions are conversions to national bank charters.

[3] Subsidiaries do not include 16 after-the-fact notices received in 1996 and 92 after-the-fact notices received in 1997.

[4] Final approval subject to applicant fulfilling additional regulatory and/or operational requirements

processed within target time frames. To ensure applications are processed in a timely manner, Bank Organization and Structure measures the processing time using benchmark time frames for routine applications and for more complex applications. Processing timeliness varies with the volume and complexity of applications. These, in turn, vary with economic conditions and changes in banking law. Table 4 shows the time-frame performance for the applications processed by the OCC in 1996 and 1997 (without including ATMs which did not require an application after September 30, 1996, and after-the-fact notices for subsidiaries in 1996 and 1997). The OCC generally meets target time frames for all application types. Deviations from these targets are primarily the result of application complexity, the need to acquire additional information, or peak workload demands.

Changes to 12 CFR 5, OCC's regulation governing all corporate applications, became effective on December 31, 1996. The revised regulation established an "expedited review" process for certain applications from banks that are well capitalized, have a CAMELS rating of 1 or 2, have a CRA rating of "satisfactory" or better, and are not subject to an OCC formal enforcement action. Overall, target time frames were shortened. In addition, for some routine transactions, OCC approval is no longer required.

The time frames for application processing have significantly improved from 1995 to 1997. To provide consistent comparisons with prior years results, the following statistics have been adjusted for regulatory and processing changes. In 1995, the OCC met target time frames on 88 percent of the applications it decided. In 1996, on an adjusted basis, the OCC met target time frames on 90 percent of the applications it decided. In 1997, under the revised regulation, performance continued to improve. Even with shorter target time frames, the OCC met its targets 96 percent of the time.

Change in Bank Control Act

The Change in Bank Control Act of 1978 (CBCA) requires parties who wish to acquire control of a national bank through purchase, assignment, transfer or pledge, or other disposition of voting stock to notify the OCC in writing 60 days prior to the proposed acquisition (unless a filing is required under the Bank Merger Act or the Bank Holding Company Act).

Any party acquiring 25 percent or more of a class of voting securities of a national bank must file a change in bank control notice. In addition, if any party acquires 10 percent or more (but less than 25 percent), that party must file a change in bank control notice under certain conditions. The acquiring party must also publish an announcement of the proposed change in control to allow for public comment.

The CBCA gives the OCC the authority to disapprove changes in control of national banks. The OCC's objec-

Table 4—OCC licensing actions and timeliness, 1996–1997

		1996[1]			1997			Annual change		
Application type	Target time frame in days[2]	Number of decisions	Within target	Percent	Number of decisions	Within target	Percent	Number of decisions	Within target	Percent
Branches	45/60	1,848	1,773	95.9	1,772	1,762	99.4	–76	–11	3.5
Capital/sub debt	30/45	94	86	91.5	82	71	86.6	–12	–15	–4.9
Change in control	NA/60	13	13	100.0	24	21	87.5	11	8	–12.5
Charters[3]		69	41	59.4	79	63	79.7	10	22	20.3
Conversions	30/90	44	37	84.1	92	90	97.8	48	53	13.7
Federal branches & agencies	NA/120	0	0	0.0	0	0	0.0	0	0	0.0
Fiduciary powers	30/45	31	25	80.6	39	38	97.4	8	13	16.8
Mergers	45/60	100	95	95.0	127	110	86.6	27	15	–8.4
Relocations	45/60	262	235	89.7	241	236	97.9	–21	1	8.2
Reorganizations	45/60	223	173	77.6	320	292	91.3	97	119	13.7
Stock appraisals	NA/90	5	0	0.0	3	1	33.3	–2	1	33.3
Subsidiaries	30/60	222	147	66.2	131	112	85.5	–91	–35	19.3
Total	NA	2,911	2,625	90.2	2,910	2,796	96.1	–1	171	5.9

Note: Most decisions (93 percent in 1997) were decided in the district offices, International Banking and Finance, and the Large Bank unit in BOS under delegated authority. Decisions include approvals, conditional approvals, and denials.

[1] Adjustments for regulatory and processing changes include the addition of decisions made in Washington, as well as those made in the district offices for both years; these were not included last year. The adjusted 1996 totals also exclude 843 ATM decisions and 16 subsidiary filings that qualified for "after-the-fact" notices during the Part 5 testing phase. The 1997 subsidiary totals do not include 92 "after-the-fact" notices and the 1997 capital/debt totals do not include 95 dividend approval requests made under 12 USC 60 filings nor decisions on 93 of those filings.

[2] Those filings that qualify for the "expedited review" process are subject to the shorter of the time frames listed. The longer time frame is the standard benchmark for more complex applications. New time frames commenced in 1997 with the adoption of the revised Part 5. The target time frame may be extended if the OCC needs additional information to reach a decision, permits additional time for public comment, or processes a group of related filings as one transaction.

[3] For independent charter applications, the target time frame is 120 days. For holding company-sponsored applications, the target time frame is 45 days for applications eligible for expedited review and 90 days for all others.

Source: Bank Organization and Structure, Comptroller of the Currency.

tive in its administration of the CBCA is to enhance and maintain public confidence in the national banking system by preventing identifiable serious and adverse effects resulting from anti-competitive combinations or inadequate financial support and unsuitable management in national banks. The OCC reviews each notice to acquire controls of a national bank and disapproves transactions that could have serious harmful effects. If the notice is disapproved, the disapproval letter contains a statement of the basis for disapproval. The OCC's actions for 1997 are shown in Table 5. The OCC received 24 change in bank control notices in 1997, up from 17 in 1996. Two changes in bank control notices received in 1996 were acted on in 1997. Of the 24 notices received in 1997, 22 were acted upon, with no disapprovals.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), 12 USC 2901, et seq., the OCC must assess a national bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation. The OCC also must consider the bank's record in its evaluation of an application for a deposit facility. A written performance evaluation describing the bank's activities, which includes the rating, is prepared at the end of each CRA examination and made available to the general public.

A bank's CRA performance may be rated "outstanding record of meeting community credit needs," "satisfactory record of meeting community credit needs," "needs to improve record of meeting community credit needs," or "substantial noncompliance in meeting community credit needs." In 1997, the OCC conducted examinations in 878 national banks. The OCC also considers CRA performance when it evaluates corporate applications. In 1997, the OCC conditionally approved two applications, based on CRA performance issues.

In 1997, the OCC, along with the other federal financial institution regulators, completed the implementation of the revised CRA regulation that focused on a bank's actual CRA performance. The OCC began examining large banks using the lending test, investment test, and service test. All CRA performance evaluations of large banks conducted after July 1, 1997, along with those for any large institution that chose to be examined under the lending, investment, and service tests prior to July 1, 1997, were reviewed by Community and Consumer

Table 5—Change in Bank Control Act notices processed at OCC districts and headquarters, 1988–1997

Year	Received	Acted on	Not disapproved	Disapproved	Withdrawn
1997	24	24	24	0	0
1996	17	15	13	0	2
1995	15	16	16	0	0
1994	15	16	15	1	0
1993	28	30	21	5	4
1992	30	29	21	4	4
1991	20	15	6	6	3
1990	31	42	32	5	5
1989	55	55	48	3	4
1988	45	42	34	4	4

Policy to ensure consistency among the OCC district offices. Also during 1997, all performance evaluations for banks designated limited purpose/wholesale were reviewed by OCC's Community and Consumer Policy.

In 1997, the OCC, together with other federal financial institution regulators, supplemented, and amended its "Interagency Questions and Answers Regarding Community Reinvestment" to provide further guidance and clarification on the CRA regulation to the banking industry and the public. During the year the OCC approved 18 requests from banks for limited purpose/wholesale designations and approved 5 strategic plan submissions.

Customer Complaints

The Federal Trade Commission Improvement Act of 1975 (15 USC 41, et seq.) requires the OCC to receive and take appropriate action on complaints directed against national banks and to report them annually to Congress.

During 1997, the OCC received 15,999 written customer complaints (compared to 13,695 in 1996) and 19,338 telephone inquiries (compared to 14,077 in 1996). Refer to table 6 for the major subjects of written complaints received during 1997.

As of January 27, 1998, the OCC had resolved 12,248 of the written complaints (77 percent) received during 1997, compared to 10,732 resolved (78 percent) in 1996. The remaining 1997 complaints were in process. Complaints involving loans accounted for 61 percent of the total complaints received by December 31, 1997. Credit cards were involved in 65 percent of those lending complaints. Complaints involving deposits were the next

Table 6—1997 written complaints received, resolved, or pending

Finding	Deposits	Credit cards	Consumer installment loans	Home purchase loans	Other loans	All other	Total
Bank error	510	473	70	141	92	80	1,366
Bank legally correct	1,114	1,741	256	222	277	253	3,863
Communications problem	968	1,394	247	279	252	274	3,414
Conciliation agreement	2	15	2	3	2		24
Contractual dispute	138	181	41	65	59	73	557
Factual dispute	297	143	36	31	33	84	624
File transferred	37	61	13	21	26	183	341
Matter for litigation	185	49	15	21	32	52	354
Matter in litigation	35	23	7	26	28	25	144
Not a national bank	60	274	58	65	89	607	1,153
Violation of Reg B		10	3		1		14
Violation of Reg CC	6						6
Violation of Reg DD	1						1
Violation of Reg E	8					1	8
Violation of Reg Z		37	1		2		40
Violation of other law or reg	1	17		2			20
Withdrawn by customer	82	107	18	31	33	48	319
Pending	944	1,771	271	225	301	239	3,751
Total	4,388	6,296	1,038	1,132	1,227	1,918	15,999

largest category, representing 27 percent of the total written complaints. No other category of complaints equaled or exceeded 5 percent of the total.

The OCC also received 43 complaints alleging violations of the Fair Housing Act. In accordance with the OCC's memorandum of understanding with the Department of Housing and Urban Development (HUD), those complaints were referred to HUD for administrative processing and, if appropriate, investigation.

Congressional Appearances

The OCC is often requested by Congress to submit written statements or appear before the various House and Senate committees and subcommittees to address significant public policy issues and questions affecting the national banking industry. In 1997, the Comptroller participated in nine hearings. Four of the hearings focused on financial modernization issues, two addressed the OCC's efforts to ensure that national banks are year-2000 compliant, one discussed the OCC's supervisory philosophy and practices, one focused on oversight of the OCC's overall operations, and the final hearing addressed the OCC's strategic planning process in response to the Government Performance and Results Act.

Examination Support Activities

The Economics Department provided significant statistical and modeling support to fair lending and safety and soundness examinations. Specifically, economists provided direct support to 14 fair lending examinations, through data collection and analysis and application of statistical sampling and modeling techniques that helped the OCC assess fair lending performance. Economists also supported 45 on-site, safety and soundness examinations through the application of quantitative methods and analysis of risks in bank portfolios and supervisory policies addressing those risks. In addition, the Economics Department provided safety and soundness examination support in seven different subject areas during 1997: interest rate risk; credit scoring; derivatives trading and pricing; mortgage banking; credit portfolio management; asset management; and internal models to comply with the new market risk regulation (currently being applied to seven internationally active banks).

Economics Research and Analysis

In 1997, the OCC completed four quarterly reports on the condition and performance of the banking industry. The OCC also undertook several long-term research projects in 1997. This research explored a variety of topics important to the mission of the OCC, including deposit insurance; derivatives market; interstate banking; bank risk-taking and returns; international bank regulations; newly chartered banks; bank organizational form; and CAMELS ratings. This work contributed to the completion of 13 Economics Working Papers, 14 papers for scholarly and trade journal publications, and 36 presentations of research to academic, government agency, and foreign audiences.

Electronic Money and Banking Issues

The OCC reorganized itself in 1997 to better address broad policy issues arising from emerging electronic money and banking technologies and to bring an increased focus on OCC's supervision of technology within the banking industry. The OCC worked aggressively to develop guidance and examination procedures for new technology-based products and services, making significant progress on the development of several key banking bulletins, including technology risk management, PC banking, and digital signatures, that will be issued in 1998.

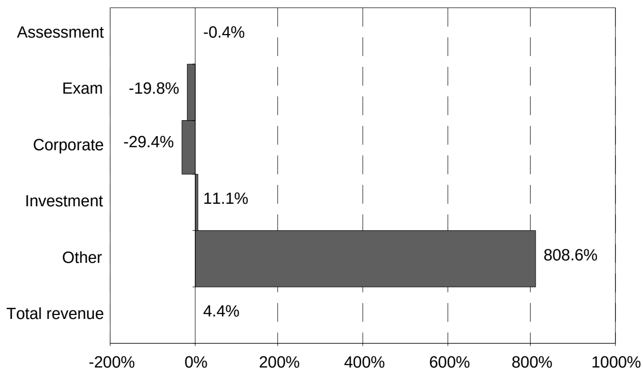
The OCC also played a Treasury-wide role as the coordinator for the Department of the Treasury on electronic money issues. In this role, the Comptroller chaired the Secretary's Consumer Electronic Payments Task Force. The Comptroller also chaired bi-monthly meetings with senior Treasury officials to focus on E-money developments, and advised the Secretary and Deputy Secretary on issues of significance to the Department. In addition, the OCC sponsored a series of briefings on emerging technology issues, and OCC management and staff made numerous speeches at industry meetings. Finally, the OCC made major contributions to the Report of the Working Party on E-Money that looked at consumer, law enforcement, supervisory, and cross-border issues. The report was presented by the G–10 Finance Ministers and Governors to the heads of state at the June 1997 Denver summit.

Financial Highlights and Performance

Revenue

Revenue—Prior Year Comparison: The OCC's 1997 revenue increased by $16.3 million and was approximately 4.4 percent more than 1996. This increase in revenue primarily resulted from additional income received for investments, publications, and other miscellaneous sources. Also note that an adjustment was required under the Statement of Federal Financial Accounting Standards (SFFAS) No. 5, "Accounting for Liabilities of the Federal Government." The adjustment was required to cover the costs associated with the Federal Employees Retirement System and the Civil Service Retirement System adjustments. The $15.9 million adjustment was subsequently offset by a similar adjustment posted to the OCC benefits expense account.

Figure 12—Percentage change in revenue, 1996–1997



Assessment revenue decreased by $1.3 million or 0.4 percent. This decrease resulted from the 12 percent reduction in assessments for the "non-lead" national banks and the continued effect of bank consolidation on OCC's regressive fee schedule. "Non-lead" banks are other than the largest national bank in assets in a bank holding company. The OCC also waived inflationary adjustments to its rates for 1997.

Examination fees are hourly charges for examinations that are not included in a bank's assessment and are primarily for fiduciary examinations. These fees decreased by $670,836 or 19.8 percent as a result of fewer billable hours. The OCC eliminated the fees charged for fiduciary examinations during the latter part of 1997.

Corporate fees decreased by $1.4 million or 29.4 percent during 1997. Contributing factors include an overall decline in the number of applications received in 1997 and the elimination of application fees for automated teller machines (ATMs) from OCC's fee schedule. During 1997, the OCC experienced a decrease in the number of branch, operating subsidiary, fiduciary powers, capital, and conversion filings. The decrease also resulted from the waiver of fees for charter and branch applications in low-income and moderate-income areas that have no depository institution offices.

Investment revenue increased by $1.3 million or 11.1 percent in 1997. This increase resulted from an increase in the amount of investable funds and higher interest rate yields earned on the OCC's portfolio of U.S. Treasury securities.

Other revenue showed an increase of $18.4 million. This primarily resulted from an adjustment required under SFFAS No. 5, "Accounting for Liabilities of the Federal Government." A $15.9 million adjustment was required and subsequently offset by a similar adjustment posted to the OCC benefits expense account.

Revenue—Budget Performance: Total revenue was over budget by $12.9 million or 3.4 percent in 1997. Table 7 provides a summary of the OCC's budget performance for revenue.

Expenses

Expenses—Prior Year Comparison: The OCC's 1997 total expenses decreased by $24.2 million or 6.5 percent over prior year expenses. The volume of staff vacancies and the organizational restructure are the primary factors contributing to the decrease.

Personnel compensation and benefits decreased by $28.3 million or 10.2 percent. The decrease stems from cost savings resulting from a decline in staffing levels. The number of OCC employees decreased by nearly 500 during 1997.

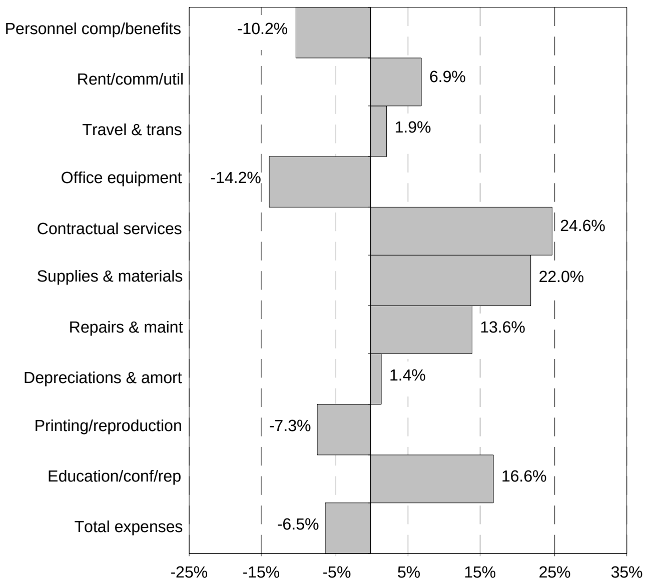
Rent, communications, and utilities increased by $2.0 million or 6.9 percent. The increase results from OCC's installation of the LAN/WAN and Windows 95 throughout the districts, field offices, and headquarters. Development and implementation of Human Resources pilot

Table 7—1997 summary of budget performance for revenue
($ in millions)

Revenue category	1997 actual	1997 budget	$ variance	Percent variance
Revenues from goods sold and services provided to the public				
Assessment revenue	$350.7	$343.5	$7.2	2.1%
Examination fees	2.7	1.5	1.2	80.0%
Corporate fees	3.3	3.5	–0.2	–5.7%
Investment revenue	12.7	10.6	2.1	19.8%
Other revenue*	20.6	18.0	2.6	14.4%
Total revenue	$390.0	$377.1	$12.9	3.4%

* Note: Refer to the discussion in text for SFFAS No. 5, under "Revenue—Prior Year Comparison" that substantiates the actual, dollar variance, and percentage change for "Other revenue" as cited above.

Figure 13—Percentage change in expenses, 1996–1997



benefits program for the interactive voice response communications system was another factor contributing to the additional costs. Enhancements to the telephone services for the Customer Assistance Unit also contributed to the increased costs.

Travel and transportation increased by $0.4 million or 1.9 percent as a result of the costs incurred after the organizational restructure for relocating employees who were transferred to other locations. Additional costs were incurred for the district staff conferences and the cultural audit focus sessions held at various locations.

Supplies and materials increased by $0.6 million or 22.0 percent more than 1996 levels. This increase is primary due to the additional cost incurred to purchase supplies and materials resulting from the organizational restructure.

Education, conference, and representation increased by $0.6 million or 16.6 percent. The increased costs resulted from new training schools established to enhance examiners' skills in retail credit, treasury and market risks, and the evaluation of bank management. The introduction of the Senior Examiner Training Pilot (SETP) program was another factor that contributed to the increased costs. The SETP program was developed to maintain a highly skilled examiner workforce in a rapidly changing environment, giving them the knowledge and skills necessary to perform their jobs better. This program encouraged the senior examiners to take external (vendor-provided) training that was generally more costly than the OCC's internal training programs. The costs incurred for several major fiduciary and community development conferences sponsored by the OCC also increased costs.

Office equipment, software, and remodeling expenses decreased by $2.4 million or 14.2 percent. Extensive remodeling work and major computer purchases were made during 1996 and as a result fewer of these costs were incurred during 1997; therefore, expenses were lower.

Contractual services expenditures increased by $2.4 million or 24.6 percent. The increase is primarily due to the additional costs incurred during 1997 for investments made in contractual services that provided the technological knowledge and expertise required to perform tasks more proficiently using electronic and computer based programs.

Depreciation and amortization increased by $0.1 million or 1.4 percent.

Repairs and maintenance increased by $0.4 million or 13.6 percent as a result of inflationary factors and increased costs for equipment and microcomputer maintenance contracts.

Printing and reproduction decreased by $0.1 million or 7.3 percent. During 1996, the OCC produced and distributed the regulations that were revised as part of the Regulatory Review Program and also issued new guidelines to examiners and bankers for supervision by risk. There were fewer regulatory revisions published during 1997, which has resulted in lower printing and production costs.

Expenses—Budget Performance: Table 8 provides a summary of the OCC's budget performance for expenses. In 1997, the OCC's expenditures were $18.7 million under budget or 5.1 percent.

Payments

Prompt Payment: The Prompt Payment Act and OMB Circular A-125 require agencies to make payments on time, to pay interest penalties when payments are late, and to take discounts only when payments are made on or before the discount date. The OCC's prompt payment of invoices has improved consistently over past years. The percentage of invoices paid on time continues to exceed the Treasury Department's standard.

Electronic Funds Transfer: Electronic funds transfer (EFT) of payments provides efficient and effective accounting services, greater control over the timing of payments, and lower payment cost compared with paper checks. The Debt Collection Improvement Act of 1996 requires government agencies to issue all payments electronically by January 1, 1999. The OCC has initiated a program, whereby some vendor, contractual, and employee payments will be issued by electronic funds transfer in 1997. It is anticipated that all of OCC's payments will be issued electronically by the act's deadline.

The percentage of the OCC's payroll payments made by electronic funds transfer has increased over the past three years. In 1997, the OCC met and surpassed OMB's prescribed goal for agencies to process 90 percent of their payroll payments through EFT.

Accounts Receivable: A comprehensive debt collection program was established in the OCC to assure collection of receivables and to allow management to evaluate debts owed to the agency. Table 11 identifies annual write-offs and delinquent accounts receivable. In accordance with the Debt Collection Improvement Act of 1996, the OCC continues to review delinquent accounts in order to determine if any are eligible for referral to the Treasury Department, Financial Management Services, for debt collection.

Financial Efficiency

The OCC's indirect rate measures the relationship between the OCC's direct and indirect costs. Direct costs are salary and travel costs incurred to examine banks and costs to review and decide upon corporate applications. Indirect costs are costs incurred within the OCC to perform other related activities including: other bank supervisory functions and analyses, the development of bank supervision policy, the review of bank supervision and examination products, legal analyses, outreach to bankers, support operations, and training. Indirect costs also include overhead, such as facilities, supplies, telephone service, and data processing.

Table 8—1997 summary of expense budget performance
($ in millions)

Expense category	1997 actual	1997 budget	$ variance	Percent variance
Personnel compensation/benefits	$250.1	$265.4	$–15.3	–5.8%
Rent/communications/utilities	30.8	34.0	–3.2	–9.4%
Travel/transportation	24.0	25.1	–1.1	–4.4%
Education/conference/other	4.3	4.8	–0.5	–10.4%
Other expenses	41.1	39.7	1.4	3.5%
Total expenses	$350.3	$369.0	$–18.7	–5.1%

Note: Totals may not add because of rounding.

Table 9—Prompt payment comparisons, 1995–1997

Payments	1995	1996	1997
Invoices paid on time as a percentage of total invoices	97	97	97
Number of invoices paid late as a percentage of total invoices paid	2.9	1.9	2.6
Interest penalties paid as a percentage of total dollars paid	0.011	0.010	0.018

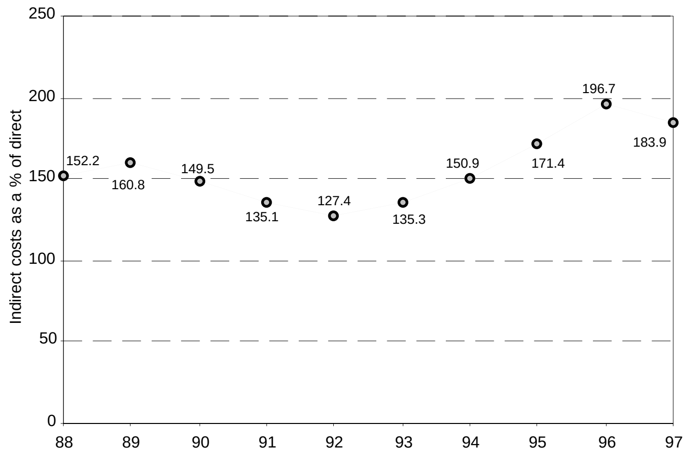
Table 10—Percentage of use for electronic funds transfer, 1995–1997

	1995	1996	1997
Percentage of payroll payments issued by EFT	93.8	95.2	96.1

Table 11—Percentage of annual write-offs and delinquent accounts receivable, 1995–1997

	1995	1996	1997
Accounts receivable write-offs as a percentage of dollar volume in accounts receivable	3.01	0.14	1.08
Percentage dollar volume of accounts receivable 30 days or more past due	4.90	6.90	9.71

Figure 14—Ratio of indirect costs to direct costs, 1988–1997



In 1997, the indirect/direct cost-ratio moved downward because of the decrease in OCC's proportion of costs attributable to the indirect activities associated with examination and supervision of national banks. The decrease for indirect costs is primarily due to the cost savings resulting from the organizational restructure that consolidated various functions, locations, and processes. The new structure has fewer managerial layers and centralizes greater responsibility for training and administrative activities within the OCC's headquarters office in Washington.

The reorganization also yielded savings in direct costs. The oversight for large bank supervision was consolidated in the OCC's Washington office. This enables the OCC's district operations to focus on the particular needs of community and mid-size national banks. The new organization assigns dedicated examiner staff to the 32 largest banks. Most of this staff is assigned on a full-time basis. As a result of this change, the examination process is improved, thereby allowing examiners to better understand a bank's operations and more quickly identify changes in risk.

Financial Management Systems Initiatives

The OCC is committed to continuing its progress in the following areas:

- Developing an integrated OCC financial management system that complies with applicable accounting principles and standards, provides timely information, responds to the OCC's management needs, conforms to governmentwide systems requirements, and provides timely monitoring of the budget through performance reports.
- Enhancing the OCC's systems ability to provide integrated reporting on the performance of programs, finances, and financial management.
- Streamlining processes to reduce data entry burdens through automatic uploads from other systems and more user-friendly screens.
- Eliminating antiquated system components, such as general financial system (GFS) accounts receivable, and replacing them with "off-the shelf" system components that provide more efficient operations and a better integrated system.

Current Status: The OCC's financial system is accrual-based and provides monthly budget reports and financial statements to management. The system operates on a calendar-year basis (January 1 through December 31). Financial personnel have on-line access to OCC's mainframe computer through remote terminals.

The primary financial information system is integrated with the following modules:

Accounts payable/cash disbursements
Accounts receivable/cash receipts
Budget/planning
Capital expenditures
Investments
Payroll

During 1997 OCC initiated plans to replace its antiquated financial and resource systems. A project team was formed to identify the financial and resource information needs of OCC management to assure that new systems addressed those needs. As part of that effort, interviews were conducted with private firms and other government agencies to determine the financial and resource information they use to manage.

Future Plans: As a result of the efforts begun in 1997, OCC will seek to acquire new financial, time reporting, and travel software during 1998, with a goal of 1999 implementation with enhanced delivery of financial and resource information that takes full advantage of modern technology. These efforts are synchronized with OCC's technical architecture and data architecture efforts.

Year-2000 Date Transition

The year-2000 problem represents one of the OCC's top priorities. An Oversight Committee, consisting of many of the OCC's most senior managers, was established to coordinate OCC's year-2000 strategy, and to provide guidance. The OCC has focused on internal year-2000 issues by redirecting resources, allocating funds to identify and renovate systems, and hiring consultants and contractors to assist in year-2000 activities. The OCC's attention has been devoted to identifying mission critical systems, establishing priorities, reviewing system interfaces and interdependencies, and implementing strategies.

The OCC designated 13 systems as mission critical to the agency's mission. As of April 1998, one system has been retired and six have been renovated, tested, and implemented as year-2000 compliant. Plans call for renovation, testing, and implementation of the remaining six mission critical systems by July 1998. All other noncritical systems are expected to be tested and certified as compliant by September 1998.

The OCC completed a draft Non-Information Technology (IT) Project Management plan with a final plan expected in April 1998. The plan details Non-IT objectives, an assessment of the current environment, the management team, site priorities, approach, and the scope of the Non-IT working group. The OCC currently has over 100 facilities with 9 deemed to be mission critical. An independent consultant was contracted to assist the OCC in implementing the Non-IT Management plan.

Compliance with Financial Management Laws—FMFIA/FFMIA Program Summary

The OCC has evaluated its systems of internal control for the fiscal year ending September 30, 1997, according to the procedures and standards prescribed by the Office of Management and Budget (OMB) and the General Accounting Office (GAO). In addition, pursuant to Section 4 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA), we have reviewed the Financial Management Information System—Administrative. The OCC's financial management/accounting system conforms to generally accepted accounting principles; the relevant principles, standards, and related requirements of the Comptroller General; and the relevant financial management system and information objectives of the OMB, including implementation of the standard general ledger.

The OCC's internal control systems provide reasonable assurance that:

- Expenditures and costs comply with applicable law.
- All assets are safeguarded against waste, loss, unauthorized use, and misappropriation.
- Revenues and expenditures applicable to agency operations are recorded and accounted for properly, i.e., accounts and reliable financial and statistical reports are prepared and accountability for assets is maintained.
- The financial management/informational accounting system conforms to generally accepted accounting principles; the relevant principles, standards, and related requirements of the Comptroller General; and the relevant financial management system and information objectives of the Office of Management and Budget, including implementation of the standard general ledger.

Various feedback mechanisms and formal reviews serve as bases for this assurance. Among them are employee feedback from the OCC's first cultural audit, feedback from focus groups discussions of the effectiveness of the regulatory burden reduction program, and bankers' feedback on the examination process. Formal reviews include the community bank quality assurance program, an Office of Inspector General audit of examiner conflict of interest, a GAO audit of money laundering through private banking, and a Department of the Treasury review of the OCC's security program. Weaknesses revealed by these processes were addressed promptly and none was considered to be material.

One issue, however, warrants mentioning under Section 2 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). During the year, the Congress expressed interest in the OCC's procurement practices as a result of preliminary information provided to them by the Office of Inspector General. Prior to those congressional inquiries, the OCC retained a professional services firm to conduct a review of one type of the OCC's contracts to determine the accuracy and reasonableness of costs, pricing, and payments. The results of that review indicated no problems related to the equipment acquired or money expended, although it found insufficient controls over the contract administration process. The OCC has already taken steps to improve controls over the contract administration process and its linkage to payments. Starting in 1998, an external professional services firm will conduct a review of the OCC's contracting and simplified acquisition processes. Also, in carrying forward the OCC's strategic objective of developing technology to support the workforce into 1998, the focus will shift to internal administrative systems. The OCC will continue the process of upgrading its procurement, financial, and administrative systems in such a way as to eliminate these control concerns from the procurement area and enhance the linkage between the systems.

In addition, the OCC provides reasonable assurance that its accounting and financial systems achieve the objectives of Section 4 of the FMFIA and Section 803(a) of the

FFMIA. This year's assurance is based on assurances from senior officials. Those assurances are supported by an audit of OCC's financial statements, detailed review of subsystems for cash receipts and accounts receivable, cash disbursements, and accounts payable. In addition, independent reviews were conducted throughout the year of financial operations in one district and financial activities in the agency (e.g., time and travel reporting, capital leases and related expenses, prompt pay, imprest and petty cash fund verification, and district quarterly reporting of financial activities).

No material weaknesses were reported in 1997 nor in the two previous years. None of our functions was or is a high risk area. OCC management is confident that the Office of the Comptroller of the Currency, as a whole, meets the requirements of 31 USC 3512 and the policies and standards of OMB and GAO.

1616 North Fort Myer Drive
Arlington, VA 22209-3100

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT OF INDEPENDENT ACCOUNTANTS

To the Comptroller of the Currency

We have audited the accompanying statements of financial position of the Office of the Comptroller of the Currency (OCC) 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 OCC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 No. 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 audited by us present fairly, in all material respects, the financial position of the Office of the Comptroller of the Currency at 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 April 3, 1998 on our consideration of OCC's internal controls and a report dated April 3, 1998 on its compliance with laws and regulations.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

1616 North Fort Myer Drive
Arlington, VA 22209-3100

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT ON INTERNAL CONTROLS

To the Comptroller of the Currency

We have audited the financial statements of the Office of the Comptroller of the Currency (OCC) as of and for the year ended December 31, 1997, and have issued our report thereon dated April 3, 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 No. 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.

The management of OCC is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls 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 controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls 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.

In planning and performing our audit of the financial statements of OCC for the year ended December 31, 1997, we obtained an understanding of the internal controls. With respect to the internal controls, 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 in order to determine our auditing procedures and performed tests of the internal controls for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal controls. Accordingly, we do not express such an opinion.

Our consideration of the internal controls would not necessarily disclose all matters in the internal controls that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control 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 the internal controls and their operation that we considered to be material weaknesses as defined above.

We also noted other matters involving internal controls and their operation that we have reported to the management of OCC in a separate letter dated April 3, 1998. Matters related to information systems are discussed in a limited-distribution report, as open discussion of these items could compromise OCC's existing controls.

This report is intended for the information of the Executive Committee, and the management of the Comptroller's Office. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

1616 North Fort Myer Drive
Arlington, VA 22209-3195

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

To the Comptroller of the Currency

We have audited the financial statements of the Office of the Comptroller of the Currency (OCC) as of and for the year ended December 31, 1997, and have issued our report thereon dated April 3, 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 No. 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.

The management of OCC is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of 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 No. 93-06, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

An audit of the financial statements conducted in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Bulletin No. 93-06, as amended, is not designed to detect whether OCC's systems are Year 2000 compliant. Further, we have no responsibility with regard to OCC's efforts to make its systems, or any other systems, such as those of OCC's vendors, service providers, or any other third parties, Year 2000 compliant or provide assurance on whether OCC has addressed or will be able to address all of the affected systems on a timely basis. These are responsibilities of OCC's management.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraph.

Under FFMIA, we are required to report whether the agency's 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 the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express an opinion. This report is intended for the information of the management of OCC. However, this report is a matter of public record, and its distribution is not limited.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

Office of the Comptroller of the Currency
Statement of financial position

	As of December 31, 1997	1996
Assets		
Fund balance with Treasury and cash		
Fund balance with Treasury (Note 2)	$7,997,719	$15,080,525
Cash (Note 2)	74,442	4,109,947
Subtotal, fund balance with Treasury and cash	8,072,161	19,190,472
Receivables, non-federal		
Accounts receivable, net	1,995,341	2,285,895
Travel advances	12,836	40,725
Prepayments and other advances	1,492,277	1,582,403
Subtotal, receivables, non-federal	3,500,454	3,909,023
Receivables, federal		
Accounts receivable	435,177	1,621,638
Advances and prepayments	882,173	490,981
Subtotal, receivables, federal	1,317,350	2,112,619
Investments, federal (Note 3)	192,665,669	163,530,268
Property, plant, and equipment, net (Note 4)	93,651,649	98,667,684
Total assets	$299,207,283	$287,410,066
Liabilities and net position		
Funded liabilities		
Non-federal liabilities		
Accounts payable	$21,987,168	$24,253,563
Accrued payroll and benefits	13,462,592	37,841,791
Capital lease liabilities	101,298,238	102,741,313
Subtotal, non-federal liabilities	136,747,998	164,836,667
Federal liabilities		
Accounts payable	848,421	32,767
Subtotal, federal liabilities	848,421	32,767
Total funded liabilities	137,596,419	164,869,434
Unfunded liabilities		
Accrued annual leave	16,631,920	18,083,488
Post-retirement benefits	5,135,948	4,333,735
Total unfunded liabilities	21,767,868	22,417,223
Total liabilities	159,364,287	187,286,657
Net position	139,842,996	100,123,409
Total liabilities and net position	$299,207,283	$287,410,066

The accompanying notes are an integral part of these statements.

Office of the Comptroller of the Currency
Statement of operations and changes in net position

	Years ended December 31, 1997	1996
Revenue and financing sources		
Revenue from goods sold/services provided		
Semiannual assessments	$350,687,810	$351,977,507
Corporate fees	3,280,167	4,649,401
Investment income	12,711,392	11,436,400
Examination fees	2,720,886	3,391,722
Other	20,620,900	2,269,528
Total revenues and financing sources	390,021,155	373,724,558
Expenses		
Operating expenses		
Personnel compensation and benefits (Note 6)	250,099,609	278,363,855
Rent, communications, and utilities (Note 5)	30,768,583	28,772,138
Travel and transportation	24,010,466	23,564,737
Office equipment, software, and remodeling (Note 4)	14,276,028	16,643,716
Contractual services	12,247,572	9,827,841
Depreciation and amortization (Note 4)	6,288,708	6,203,046
Education, conference, and representation expense	4,306,187	3,693,270
Repairs and maintenance	3,588,441	3,158,908
Office supplies	3,312,350	2,714,998
Printing, reproduction, and other	1,403,624	1,514,612
Total expenses	350,301,568	374,457,121
Excess of revenue and financing		
Sources over funded expenses	39,719,587	(732,563)
Net position, beginning balance	100,123,409	100,855,972
Net position, ending balance	$139,842,996	$100,123,409

The accompanying notes are an integral part of these statements.

Office of the Comptroller of the Currency
Statement of cash flows

	Years ended December 31, 1997	1996
Cash flows from operating activities		
Excess of revenue and financing		
Sources over total expenses	$39,719,588	$(732,563)
Adjustments affecting cash flow		
Decrease in non-federal receivables	408,569	689,063
Decrease (increase) in federal receivables	795,269	(573,399)
(Decrease) Increase in non-federal liabilities	(26,645,594)	32,136,956
Increase (decrease) in federal liabilities	815,654	(594,305)
(Decrease) Increase in unfunded liabilities	(649,356)	2,211,691
Depreciation and amortization	6,288,708	6,203,046
Net Cash Provided by Operating Activities	20,732,838	39,340,489
Cash flow from investing activities		
Proceeds from sales of investment securities	563,054,749	496,972,296
Purchases of investment securities	(592,190,150)	(546,151,412)
Purchases of property, plant, and equipment	(1,272,673)	(12,382,869)
Net cash provided (used) by investing activities	(30,408,074)	(61,561,985)
Cash flows from financing activities		
Principal payments on capital lease obligations	(1,443,075)	(1,225,820)
Net cash used by financing activities	(1,443,075)	(1,225,820)
Net cash provided (used) by operating, investing, and financing activities	(11,118,311)	(23,447,316)
Fund balances with Treasury and cash, beginning	19,190,472	42,637,788
Fund balances with Treasury and cash, ending	$8,072,161	$19,190,472

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

Note 1—Organization

The Office of the Comptroller of the Currency (Comptroller's Office) was created by an Act of Congress for the purpose of establishing and regulating a national banking system. The National Currency Act of 1863, rewritten and reenacted as the National Bank Act of 1864, created the Comptroller's Office and provided for its supervisory functions and the chartering of banks.

No funds derived from taxes or federal appropriations are allocated to or used by the Comptroller's Office in any of its operations. The revenue of the Comptroller's Office is derived principally from assessments and fees paid by the national banks and income on investments in U.S. government obligations. The Comptroller's Office is exempt from federal and state income taxes.

The Comptroller's Office is a bureau within the Department of the Treasury. The Department of the Treasury provides certain administrative services to the Comptroller's Office, which pays the Department of the Treasury for services rendered pursuant to its interagency agreements. Periodically, payments are made in advance for anticipated services in accordance with instructions from the Department of the Treasury. Administrative services provided by the Department of the Treasury totaled $2,869,204 and $1,772,812 for the years ending December 31, 1997 and 1996, respectively.

Note 2—Significant Accounting Policies

Basis of Accounting

The accounting policies of the Comptroller's Office conform to generally accepted accounting principles, and as required by the Chief Financial Officers Act of 1990. Accordingly, the financial statements are presented on the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to cash receipt or payment.

Funds with the U.S. Treasury and Cash

Cash receipts and disbursements are processed by the U.S. Treasury. The funds with the U.S. Treasury are primarily trust funds that are available to pay current liabilities and finance authorized purchase commitments. The Comptroller's Office considers demand deposits and overnight certificate investments to be cash equivalents.

Accounts Receivable

No allowance for uncollectible accounts is applied to "accounts receivable—federal," as OCC expects to collect these amounts in full.

Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the Comptroller's Office as the result of a transaction or event that has already occurred. They are removed when liquidated (i.e., paid). Liabilities represent the amounts owing or accruing under contractual or other arrangements governing the transactions, including operating expenses incurred but not yet paid. Payments are made promptly to take discounts offered by vendors when the discount terms are cost effective. Payments are also made in accordance with OMB Circular A-125 "Prompt Payment Act."

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. Sick leave and other types of manifested leave are expended as taken.

Note 3—Investments

Investment securities reflect maturities through May 15, 2006 and are U.S. Treasury obligations stated at amortized cost, which is an approximation of market value. The Comptroller's Office plans to hold these investments to maturity. Premiums and discounts on investment securities are amortized over the term of the investment. The fair value of investment securities is estimated based on quoted market prices for those or similar investments. The cost and estimated fair value of investment securities as of December 31, 1997 and 1996 is as follows:

	1997	1996
Investments, amortized cost	$192,665,669	$163,530,268
Gross unrealized holding gains	1,868,501	—
Gross unrealized holding (losses)	—	(3,049,962)
Market value	$194,534,170	$160,480,306

Investments mature as follows:	
During 1998	$167,262,649
During 2006	27,271,521
Total	$194,534,170

Note 4—Property and Equipment

Property and equipment, including assets under capital leases, are stated at cost. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. Leasehold improvements are stated at cost, less accumulated amortization computed over the terms of the related leases (including renewal options) or their estimated useful lives, whichever is shorter. Expenditures for furniture and fixtures, machines and equipment, portable computers, and motor vehicles costing less than $25,000 and for computer software and leasehold improvements costing less than $50,000 and for all maintenance and repairs are expended as incurred.

The following table summarizes property and equipment balances as of December 31, 1997 and December 31, 1996:

Classes of fixed assets	Service life (years)	Acquisition value	Accumulated depreciation/ amortization	1997 net book value	1996 net book value
Leasehold improvements	5–20	$22,887,180	$13,281,505	$9,605,675	$9,520,160
ADP software	5–10	2,021,763	1,977,677	44,086	63,859
Equipment	3–10	7,023,924	5,030,021	1,993,903	2,549,642
Building under capital lease	25	107,558,539	26,208,283	81,350,256	85,767,463
Furniture and fixtures	5–10	1,464,213	806,484	657,729	766,560
Motor vehicles	5	16,330	16,330	—	—
Total		$140,971,949	$47,320,300	$93,651,649	$98,667,684

Note 5—Leases

Office Space Leases

The Comptroller's Office occupies office space in Washington, D.C. under a lease agreement with an initial lease period of 15 years. The lease provides for two consecutive, five-year renewal options that will provide for occupancy through the year 2016. The Comptroller's Office classified this lease as a capital lease.

The district and field offices lease space under agreements which expire at various dates through 2008. These leases are treated as operating leases.

Future lease payments under office space leases for the district and field offices, as well as the Washington, D.C. office, are shown in the following table:

Year	Washington, D.C. capital lease	District and field office operating leases
1998	$11,966,721	$10,385,406
1999	12,006,958	8,496,710
2000	12,049,208	7,521,796
2001	12,093,570	7,059,509
2002	12,140,150	5,372,039
2003 and after	168,630,267	6,819,355
Total minimum lease payments	$228,886,874	$45,654,815
Less: amount representing interest	127,588,636	
Present value of net minimum lease payments	$101,298,238	

Certain of these leases provide that annual rentals may be adjusted to provide for increases in taxes and other related expenses. Total rental expense under district and field office operating leases was $11,538,398 and $12,185,495 for the years ended December 31, 1997 and 1996, respectively.

Other Leases

The Statement of Operations and Changes in Net Position caption "Rent, communications, and utilities" includes interest expense related to capital leases, which equaled interest paid, as follows:

	1997	1996
Washington, D.C. office	$10,485,324	$10,258,624
Equipment	—	608
Total interest expense	$10,485,324	$10,259,232

Depreciation expense on all leased assets was $4,417,209 and $4,293,853 in 1997 and 1996, respectively.

Note 6—Retirement and Benefit Plans and Accrued Annual Leave

Retirement Plans

The Comptroller's Office contributes to the Civil Service Retirement System and the Federal Employees' Retirement System administered by the Office of Personnel Management (OPM) for the benefit of U.S. government employees. The Comptroller's Office contributions aggregated $16,505,465 and $17,889,234 in 1997 and 1996, respectively. The retirement plans are participatory. Under the Civil Service Retirement System the employer and employee each contribute 7 percent of salary to the plan. Under the Federal Employees' Retirement System, 13 percent of salary is contributed by the Comptroller's Office and 0.8 percent of salary is contributed by the employee.

Although the Comptroller's Office contributes a portion of pension benefits under the Civil Service and Federal

Employees' Retirement Systems for its employees and withholds the necessary payroll deductions from them, it has no liability for future payments to employees under these programs, and is not accountable for the assets of the Civil Service and Federal Employees' Retirement Systems nor does the Comptroller's Office record actuarial data concerning the accumulated plan benefits or the unfunded pension liability relating to its employees. These amounts are reported by OPM for the retirement systems and are not allocated to the individual employers.

Benefit Plans

The Comptroller's Office contributes up to 5 percent of base pay for participants in the Thrift Savings Plan under the Federal Employees' Retirement System. The Comptroller's Office contributions for the savings plan totaled $3,957,365 and $4,380,123 in 1997 and 1996, respectively. The Comptroller's Office also contributes for Social Security and Medicare benefits for all eligible employees.

Similar to federal retirement plans, OPM, rather than the Comptroller's Office, reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits (FEHB) plans and Federal Employees Group Life Insurance (FEGLI) plan. The Comptroller's Office contributions for active employees who participate in the FEHB plans were $7,233,138 and $8,322,402 for 1997 and 1996, respectively. The Comptroller's Office contributions for active employees who participate in the FEGLI plan were $137,608 and $151,521 for 1997 and 1996, respectively.

The Comptroller's Office sponsors a life insurance benefit plan for current and former employees who are not enrolled in FEGLI plans. This plan is a defined benefit plan, and the Comptroller's Office is fully responsible for the associated liability. Premium payments made during 1997 for current employees totaled $120,369, while payments made on behalf of retirees totaled $21,241.

The following table shows the unfunded accrued post-retirement benefit cost at December 31, 1997 and the post-retirement benefit expenses for 1997.

Accumulated post-retirement benefits obligation	
Retired participants	$(2,572,254)
Active eligible	(564,726)
Active ineligible	(3,642,333)
Total	(6,779,313)
Fair value of assets	—
Funded status	(6,779,313)
Unrecognized transition obligations	2,592,562
Unrecognized net (gain)/loss	(949,197)
Accrued post-retirement benefit cost	$(5,135,948)

Net periodic post-retirement benefit cost for 1997	
Service cost	$246,001
Interest cost	524,986
Amortization of transition obligation over 20 years	172,837
Net periodic post-retirement benefit cost	$943,824

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 7.5 percent. Gains or losses due to changes in actuarial assumptions are fully recognized in the year in which they occurred.

Note 7—Disclosure About Fair Value of Financial Instruments

The carrying amount approximates the fair value of OCC's financial instrument assets and liabilities, because the amounts stated on the statement of position for Fund Balances with Treasury, Accounts Receivable, Travel Advances, Prepayments and Other Advances, Investments, Accounts Payable, and Accrued Payroll and Benefits are the amounts expected to be realized or paid.