MEMORANDUM FOR NICOLAS P. RETSINAS
DIRECTOR, OFFICE OF THRIFT SUPERVISION

FROM: Valerie Lau
 Inspector General //S//

SUBJECT: Audited Calendar Year 1996 Financial Statements of the Office of Thrift Supervision

The attached Calendar Year 1996 financial statements of the Office of Thrift Supervision (OTS) were audited by the firm of Deva & Associates, an Independent Public Accountant (IPA), under contract to the Office of Inspector General. The audit was performed as required by the Chief Financial Officers (CFO) Act of 1990. The IPA issued the following reports which are included in the attachment:

- Auditor's Report on Financial Statements (Page A-1);
- Auditor's Report on Internal Control Structure (Page C-1); and
- Auditor's Report on Compliance with Laws and Regulations (Page D-1).

The IPA rendered an unqualified opinion on the financial statements for the year ended December 31, 1996. However, the Auditor's Report on Internal Control Structure cited one reportable condition. Certain users of the payroll/personnel system have data entry capability for both personnel and payroll functions, thereby eliminating proper separation of duties for these users. The Auditor's Report on Compliance with Laws and Regulations contained no instances of noncompliance.

As done in prior years, my staff monitored the conduct of the audit and performed a quality control review of the IPA's working papers. The audit was performed in accordance with generally accepted government auditing standards and met the requirements of the CFO Act.

We have submitted a copy of the attached package to the Secretary of the Treasury and to the Assistant Secretary for Management/Chief Financial Officer for transmission to the Office of Management and Budget. In addition, the IPA will issue a
management letter discussing various matters that were identified during the audit which are not required to be included in the audit reports.

Should you have any questions, please contact me at (202) 622-1090 or a member of your staff may contact Danny L. Athanasaw, Director, Financial Audits at (202) 927-5791.

Attachment
1996
Chief Financial Officers
Annual Report
(Audited)

OTS Mission

Effectively and efficiently supervise thrift institutions to maintain the safety and soundness and viability of the industry. Support the industry's efforts to meet housing and other community credit and financial services needs.
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Message From the Director

For the thrift industry, the most significant event during 1996 occurred on September 30; on that date Congress passed and President Clinton signed into law the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). As a result, for the first time in many years the thrift industry can focus its attention on its primary business - serving the American consumer. The key provisions of EGRPRA include:

**Special assessment:** A special assessment to fully capitalize the Savings Association Insurance Fund (SAIF) was imposed on SAIF-assessable deposits held as of March 31, 1995. The fund was declared capitalized as of October 1, 1996.

**FICO sharing:** The obligation for the Financing Corporation (FICO) bonds will be spread among all FDIC-insured institutions as of January 1, 1997. Assessments imposed on BIF-assessable deposits will be at a rate one-fifth that imposed on SAIF-assessable deposits through December 31, 1999; thereafter, all assessable deposits will be assessed at the same rate.

**Expanded powers for the thrift charter:** Just as important as the SAIF/FICO resolution for thrifts, the new legislation also expanded the powers of the thrift charter by amending Sections 5 and 10 of the Home Owners' Loan Act (HOLA) as set forth below:

- The Qualified Thrift Lender (QTL) test was amended to permit all credit card, education and small business loans to count as qualified thrift investments without restriction.

- The limit on the amount of commercial lending thrifts may pursue was expanded from 10 percent to 20 percent of total assets, provided that amounts over 10 percent of total assets must be small business loans.

- The HOLA includes a provision that thrifts "may not in any manner extend credit, lease or sell property, or furnish any service, on the condition that the customer shall obtain additional credit, property, or service..." This provision is called an “anti-tying provision.” The new legislation grants the Office of Thrift Supervision (OTS) express authority to grant exceptions to the anti-tying restrictions found in HOLA equivalent to the exceptions that the Federal Reserve Board has granted to commercial banks.

- The new legislation raises the limit on the asset size of institutions with satisfactory examination ratings that can qualify for the 18-month examination cycle from $175 million to $250 million.
Congress' adoption of the EGRPRA is a triumph for the American public as it has put the SAIF and the FICO bonds on a sound footing. By its action, Congress has taken an important step toward securing the insurance funds.

With this enhanced lending flexibility, federal thrifts can now invest in consumer, small business, agricultural and other business loans in amounts that are at least comparable (measured as a percentage of total assets) to the actual investments of most commercial banks in those loans. Thus, federal thrifts that wish to operate more like community banks will be able to adjust their business to do so. This does not, however, mean that the differences between banks and thrifts have been eliminated. The practical effect of the amended QTL test is to ensure that thrifts may hold a significant percentage of their portfolios in consumer, small business, and mortgage loans. Banks are not subject to a QTL requirement. On the other hand, federal thrifts retain options not available to banks, such as broader powers for their holding companies and service corporations, more expansive branching, and a single regulator at both the holding company and depository institution level; in addition, broader federal preemption is authorized by the HOLA (which means that in key areas such as lending, state law generally does not apply to federal thrifts).

**Objectives During 1997:** A primary goal of the OTS during 1997 will be to maintain and enhance our risk-focused, differential and proactive approach to the supervision of thrift institutions. We believe that OTS' continued emphasis on this objective has contributed to the industry's current financial strength. Except for the substantial impact of the SAIF special assessment recorded in the third quarter of 1996, the industry has been profitable since 1991 including earnings of $4.8 billion during 1996. Thrifts' equity capital of 7.92 percent is comparable to banks' capital, and other key measures also reflect the thrift industry's health and strong performance.

Thrifs continue to play an important role as mortgage and community lenders. It is clear, however, that competition has intensified on both the asset and liability sides of their balance sheets. Non-bank lenders and government sponsored enterprises have moved strategically into the residential mortgage market; thus, thrifts have lost market share. Thrifts, like banks, have seen their deposit base erode in recent years as the inflow of money to mutual funds has accelerated in the last several years.

As a result of market forces, momentum is building to reform the bank and thrift charters. This is an important and significant goal. But to achieve this, Congress, the Administration, the regulators, the financial institutions, analysts and others must answer the fundamental question, "What does the future hold for both thrifts and banks?" Financial institutions must be able to anticipate the future needs of their customers, and have the flexibility to meet the changing demands for financial services.

As a regulator, the OTS has the responsibility to remove barriers that impede prudent lending. Regulations must be streamlined and allow for more product flexibility. Modernization, however, is a much broader proposition than just streamlining regulations and expanding lending authority. Thus, the OTS will work to focus the
debate on more than just issues related to the charters of insured depository institutions; issues such as the dynamics of change in the broader financial services industry and community reinvestment responsibilities must also be addressed.

Financial institutions (both thrifts and banks) are in the midst of a tidal wave of changes in how financial services are delivered. Market forces are driving these changes, not government regulation. Many new players have found opportunities in the financial services marketplace, and more are likely to follow, further increasing competition. One aspect of this change is the expanded use of technology in banking. Today, consumers enjoy access to transactional services, such as bill paying, funds transfer and opening new accounts - from their homes. They can use electronic cash, smart cards and electronic checks. This wave of change raises crucial public policy questions. What will be the role of federally-insured depository institutions in this ever more competitive world of financial services? What say should the government have in determining the future financial services infrastructure and who will be allowed to offer insured financial products? How do we ensure that all consumers will have access to financial services? What is the proper use of deposit insurance in a financial market where a technological explosion is occurring? I strongly believe that we must take the time to weigh these questions thoughtfully if we are to enable thrift institutions to move to where their customers of the future will be.

By focusing on these issues as the Congressional deliberations go forward, we should make informed decisions about the financial system and the regulatory structure that will be needed to ensure the safety, soundness, competitiveness and responsiveness of insured depository institutions into the next century.

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Nicolas P. Retsinas
Director
PROFILE OF THE OFFICE OF THRIFT SUPERVISION

The OTS was established as a bureau of the Department of the Treasury on August 9, 1989, by the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA). OTS is headed by a Director who is appointed by the President, with Senate confirmation, for a 5-year term. The Director also serves on the boards of the Federal Deposit Insurance Corporation (FDIC) and the Neighborhood Reinvestment Corporation. In addition, he will also serve as Chairman of the Federal Financial Institutions Examination Council until March 31, 1997.

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

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

- Maintain and enhance our risk-focused, differential and proactive approach to the supervision of thrift institutions.
- Improve credit availability by encouraging safe and sound lending in those areas of greatest need.
- Enhance competitiveness of the thrift industry to ensure its safety and soundness.
- Enhance organizational efficiency of the OTS.
- Retain a qualified and motivated work force.

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

Organization - To carry out its mission, the OTS is organized as follows (see page 9 for a summary organization chart):

◊ The Director determines policy for the OTS and makes final decisions on regulations, policies and administrative adjudications governing the thrift industry as a whole and on measures affecting individual institutions.
The Office of Supervision develops regulations, directives and other policies to ensure the safe and sound operation of savings institutions as well as their compliance with federal laws and regulations and processes all corporate applications. It oversees the direct examination and supervision of savings institutions by regulatory staff in the five regions and responds to consumer and discrimination complaints against savings associations.

The Office of Administration directs policy development for administrative operations including contracting and procurement, training, human resources, automated data processing, telecommunications, financial management (including payroll, accounting, and compliance with Generally Accepted Accounting Principles) and the agency's nationwide computer system. Administration is also responsible for implementing the requirements of the Chief Financial Officers Act, the Federal Managers' Financial Integrity Act, the Government Performance and Results Act and the Information Technology Management Reform Act of 1996. The Executive Director of Administration serves as the Chief Financial Officer.

The Office of Chief Counsel provides a full range of legal services to the Director, OTS and other agency staff including providing effective and timely legal advice and opinions on regulatory and administrative matters, drafting regulations, advising on transactional matters, representing the OTS in court, and the prosecution of enforcement actions related to thrift institutions and institution-affiliated parties.

The Office of External Affairs communicates information concerning OTS regulations, policies and key developments within the agency to the thrift industry, the public, government agencies and other key constituencies. External Affairs also maintains a liaison between the OTS and Congress and the Federal Deposit Insurance Corporation.

The Office of Research and Analysis collects and analyzes thrift industry and general economic data. It tracks and reports on the financial condition of the thrift industry, assesses savings associations' interest rate risk exposure and conducts research related to the thrift industry and housing markets.

Critical 1996 Accomplishments

The most critical issue facing the thrift industry in 1996 was the presence of a significant 23 basis point differential in the insurance premiums thrifts paid for federal deposit insurance relative to banks. This differential arose from two sources. First, the SAIF had not achieved its designated reserve ratio (1.25 percent of insured deposits) and thrift premiums were continuing to build the fund net worth to achieve full capitalization. Second, a substantial portion of the annual thrift premium was being diverted to pay the annual interest on FICO bonds issued in 1986 - 1988 to provide resources for the SAIF's predecessor insurance fund, the FSLIC. As noted in the Director's message, the EGRPRA resolved both of the problems causing the insurance premium differential by
requiring the thrift industry to make a substantial one-time payment to fully capitalize the SAIF and by spreading the FICO interest payment burden among all FDIC-insured institutions. BIF-insured institutions will pay only 1/5th of the amount paid by SAIF-insured institutions for the FICO debt until January 1, 1999. On that date the amounts paid will become equal.

A second significant accomplishment for 1996 was the enactment of legislation to increase substantially the flexibility of thrifts to meet changes in the demand for their financial services. Two separate legislative items, elimination of the bad debt provision and liberalization of the Qualified Thrift Lender (QTL) test, have provided thrifts with greater operating flexibility in structuring their portfolios. The Small Business Job Protection Act, enacted on August 2, 1996, eliminated the tax bad debt provision by repealing the tax advantages (special bad debt reserves) that thrifts accrued from holding sufficient levels of qualifying residential mortgages and related products and negating the majority of any tax recapture penalties for thrifts that opt to reduce their mortgage holdings below the qualifying limit in the future. The QTL reforms enacted in the EGRPRA permit thrifts to further diversify their community lending activities, particularly in small business and consumer loans.

A final significant accomplishment for 1996 was the OTS' ability to balance its expenditures with its revenues on a cash basis while maintaining both its current assessment fees on the industry and a stable work force. This accomplishment is described more fully in the Financial Highlights section of this report.

Other Accomplishments

**Supervision Program:** One of the ways in which the OTS seeks to achieve its mission is through the effective examination and supervision of thrifts. During 1996 the OTS Regional Office staff conducted 2,121 examinations including 958 safety and soundness, 574 compliance, 390 holding company, 169 electronic data processing and 30 trust examinations. The examination process helps to increase the awareness of both thrift managers and the OTS staff to potentially risky ventures, alerts the OTS to the risk profile of individual institutions, violations of law or regulation, unsafe and unsound practices, and encourages thrift management to focus on fair lending and community reinvestment issues. In addition, the examination process helps to further identify and determine a course of action for institutions that are not maintaining their capital at adequate levels.

**Enforcement Program:** The OTS' enforcement staff utilizes its enforcement powers to advance the agency's supervisory mission of enforcing the thrift laws and regulations and maintaining a safe and sound thrift industry. During 1996 OTS' enforcement program issued 46 removal and/or prohibition orders, 35 cease and desist orders, 11 supervisory agreements, and 10 civil money penalties.
Corporate Activities: During 1996 the OTS analyzed 4,027 applications and either approved or denied these applications in accordance with current OTS rules, regulations and policies. The primary types of applications analyzed during 1996 included: 1) branch offices (including many interstate branch offices), 2) holding company, 3) acquisitions by a bank holding company or a commercial bank, 4) conversion to either a state-chartered institution, a commercial bank or a national bank, 5) conversions by commercial banks to a thrift charter, 6) acquisitions of banks by a thrift, 7) stock conversions, and 8) mergers. Ninety-eight percent of these applications were processed within the established time frames.

Community Affairs Program: In December 1993, the OTS established the Community Affairs program to encourage OTS-supervised institutions’ efforts to support community development initiatives and compliance with the community reinvestment and fair lending laws. The program also helps to ensure that the industry’s community development activities are conducted in a safe and sound manner.

The objectives of the OTS’ Community Affairs program include:

- Acting as liaison between the OTS, the industry, community groups, government agencies and others on community development matters.

- Providing education and technical assistance on community development matters.

- Identifying and addressing regulatory barriers, and safety and soundness issues related to community development activities.

Over the past three years, the Community Affairs Liaisons have:

1. established relationships with hundreds of community groups, thrifts, government agencies and others involved in community development efforts;
2. worked one-on-one with numerous institutions on specific community development problems or initiatives;
3. provided forums for thrifts to meet with local community groups and residents to talk about credit and housing needs and to tour their neighborhoods;
4. sponsored or co-sponsored industry training sessions on various community development topics;
5. provided training to OTS examination staff;
6. addressed regulatory barrier and investment authority issues;
7. provided policy guidance to the industry;
8. published a periodic newsletter highlighting current issues and community development initiatives of thrifts around the country, and;
9. worked to address specific safety and soundness issues related to community development lending and investments.
Office of Thrift Supervision
Regional Structure

Southeast Region — includes Puerto Rico and the Virgin Islands
West Region — includes Alaska, Hawaii, Guam and the Northern Mariana Islands
Office of Thrift Supervision

ORGANIZATIONAL STRUCTURE

Office of Thrift Supervision
  Director
  Ombudsman
  Special Assistants

Office of External Affairs
  Executive Director
    Press Relations Division
      Director
    Congressional Affairs Division
      Director
    Associate Director for FDIC

Office of Research & Analysis
  Executive Director
    Risk Management Division
      Director
    Economic Analysis Division
      Director
    Industry Analysis Division
      Director
    Financial Reporting Division
      Director

Office of Administration
  Executive Director
    Human Resources & Training Division
      Director
    Planning, Budget & Finance Division
      Director
    Procurement & Admin. Services Division
      Director
    Information Resources Management Division
      Director
    Records Mgmt. & Info. Policy Division
      Director

Office of Supervision
  Executive Director
    Regional Operations Division
      Director
    5 OTS Regional Offices (NE, SE, C, MW, & W)
      Regional Directors
    Office of Supervision
      Deputy Executive Director
      Corporate Activities Division
        Director
      Compliance Policy Division
        Director
      Supervision Policy Division
        Director
      Accounting Policy Division
        Chief Accountant

Chief Counsel
  Litigation Division
    Deputy Chief Counsel
  Enforcement Division
    Deputy Chief Counsel
  Business Transactions Division
    Deputy Chief Counsel
  General Law Division
    Deputy Chief Counsel
  Regulations & Legislation Division
    Deputy Chief Counsel
THRFIT INDUSTRY HIGHLIGHTS

Condition of the Thrift Industry

The OTS-regulated thrift industry posted earnings of $4.8 billion for 1996, the fourth best annual earnings in history despite the large, one-time SAIF special assessment expense incurred in the third quarter. The industry's earnings through the 1990s have been strong, representing five of the most profitable eight years in history with 1995 earnings of $5.4 billion being a record. Absent the estimated after-tax special assessment expense of $2.1 billion, 1996 earnings would have set a new earnings record for the thrift industry, exceeding 1995 earnings by $1.4 billion, or 26 percent.


The industry's return on average assets ("ROA") for 1996 was 62 basis points, a level comparable to the early 1990s but below the ROA of 70 basis points posted in 1995. As with earnings, the SAIF special assessment had a large, negative impact on 1996 ROA. Without the SAIF special assessment expense 1996 ROA would have measured 89 basis points, a level higher than any ROA posted by the industry since 1962.

Under the Prompt Corrective Action provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), there are five categories of depository institutions based on their capital levels — well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of
December 1996, 99.9 percent of the private sector thrifts regulated by the OTS were adequately or well-capitalized and these thrifts held over 99.9 percent of the private-sector industry assets. As of December 1996, none of the thrift institutions regulated by the OTS were "critically undercapitalized." As of December 1996, the thrift industry had an equity capital to total assets ratio of 7.92 percent. The following chart shows the increase in the equity capital-to-total assets ratio of the OTS-regulated thrift industry since 1990.
PROGRAM PERFORMANCE

The OTS has specified five major goals; one or more objectives have been specified for each major goal, and performance measures have been defined for each objective. The success of achieving each of the performance measures is discussed below.

Goal 1: Maintain and enhance our risk-focused, differential and proactive approach to the supervision of thrift institutions.

The mission of OTS' Examination staff is to effectively and efficiently supervise thrift institutions regulated by the OTS; maintain the safety, soundness and viability of the industry; and support the industry's efforts to meet housing and other community credit and financial services needs. Through the examination process, OTS assesses the financial condition and risk profile of thrift institutions, identifies violations of laws and regulations and potential financial and economic problems. The examination process assists in preventing the development or continuation of unsafe operating practices and effects timely resolution of identified problems or weaknesses including Community Reinvestment Act (CRA) weaknesses.

OTS' examination and supervision responsibilities are divided among five regional offices located in Jersey City, New Jersey; Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; and San Francisco, California. Each region is managed by a Regional Director who reports directly to the Executive Director of Supervision, in Washington D.C.

Objectives and Performance Measures

Objective: Improve the value of examinations to thrift institution directors and management.

♦ Measure: The number of times thrifts rated the value of the examination process as being "satisfactory" or "better than satisfactory" divided by the total number of thrifts that responded to the examination survey.

Level of Success: 98 percent

The Customer Service Plan for the Examination Process was published in September, 1994. Since then, shortly after an institution receives a Safety and Soundness, Compliance, Community Reinvestment Act, or Information Systems examination, it also receives a survey form, the purpose of which is to assess the OTS' performance against the Customer Service Plan. The current survey form contains 11 questions that assess performance, such as:
1. Was a Preliminary Examination Response Kit (PERK) received at least four weeks prior to the start of the examination?
2. Was the institution provided with an estimate of examination staffing levels and the time required to conduct the exam?
3. Was an examination entrance meeting conducted on the first day of the examination?
4. Did a member of the examination team meet at least weekly with institution personnel during the examination to convey issues, concerns, and examination findings?

To assess performance under the Customer Service Plan, the OTS sends each institution a survey questionnaire shortly after each examination. OTS received responses from over 60 percent of the 1,783 institutions surveyed. Of those that responded, 98 percent of the responses indicated that the overall examination process was "overall positive." In 1995, 97 percent of survey responses judged performance "overall positive." Thus, a 1 percent improvement was made between 1995 and 1996.

One of the significant elements in the Examination Customer Service Plan is the level of communication between the examination team and the institution's management and board of directors. This element includes regular communication between examinations, through post-examination interviews, and frequent discussions during examinations. The results of this emphasis are evident: of the survey respondents, 99 percent were satisfied with the level of communications with examiners, and 1 percent were not.

Most of the survey questions showed improvement from 1995. For example, PERKs were received at least four weeks before the start of the examination 98 percent of the time, compared to 95 percent of the time in 1995; in addition, 99 percent of respondents reported that all material findings were communicated during the exam ("no surprises") compared to 93 percent in 1995.

Objective: Improve the consistency of examinations.

◆ Measure: The number of examination reports deemed generally consistent with OTS examination policies and procedures divided by the number of examination reports reviewed.

Level of Success: 100 percent

The OTS believes that examination reports should effectively communicate safety and soundness concerns to boards of directors, and that supervisory efforts should be responsive to the concerns of thrift managers. National examination policies are contained in the examination handbooks entitled Thrift Activities, Compliance Activities, Trust Activities, and the interagency EDP Examination Handbook. Examination handbooks are updated continuously, to reflect new statutes and policies, and new activities being undertaken by the thrift industry.
The OTS examination staff has extensive experience and generally produces high quality Reports of Examination (ROEs). ROEs are subject to a review process by regional management (Field Managers, and Assistant Directors). As an additional quality review, most ROEs are finally reviewed by regional Examination Outreach Program managers, for consistency and clarity, before the ROE is transmitted to the thrift institution.

This measure evaluates the consistency of ROEs with national policies after the review process, so a high level of consistency is expected. In 1996, 1,161 of 1,162 ROEs, which were reviewed under the Examination Outreach Program, or approximately 100 percent of ROEs reviewed, were found to be consistent with OTS policies.

Objective: Enhance examination documentation procedures.

♦ Measure: The number of examination work paper reviews that deem OTS work papers to contain adequate documentation, pursuant to OTS documentation standards, divided by the number of examination work paper reviews conducted.

| Level of success: 81 percent |

The purpose of the work papers is to document and provide detailed support for the conclusions and findings made in the ROE. Since 1992, quality assurance reviews of examination reports have also included an evaluation by the Quality Assurance Managers of the related examination work papers for adherence to national policy and regional guidance and support of the examination conclusions. The work paper documentation requirements are specific and inclusive. Each year, each of the five Regional offices performs approximately five quality assurance reviews of some aspect of examinations, each of which include the review of a sample of examinations and the supporting examination work papers. A typical quality assurance review includes an evaluation of ten examinations and the supporting work papers.

In fiscal year 1996, the Regional Quality Assurance Program sampled 382 examination work papers, as part of the quality assurance reviews. The work papers were related to specific parts of the examination process under review (i.e., review of allowance for loan and lease losses, examination of nondeposit investment products, examination of earnings component, etc.) Of these work paper reviews, 81 percent were judged to be satisfactory. The Quality Assurance Program dictates that a recommendation be made for each negative finding; in addition, the Senior Regional Manager must affirm in writing that corrective actions will be taken for each negative finding. The percentage of work papers judged satisfactory varied among the regional offices, possibly reflecting inconsistent standards used in evaluating work paper quality. These standards will be reviewed under the Quality Assurance Program in 1997.

Objective: Conduct safety and soundness, compliance, holding company, trust and electronic data processing examinations of all thrift institutions scheduled to receive such examinations.
Measure: The number of thrifts that received each type of examination divided by the number of thrifts scheduled to receive this type of examination.

Level of success: 96 percent

During 1991, the OTS adopted the policy of annual examinations for all thrift institutions; the objective of this strategy is to determine the overall safety and soundness of each institution and to ensure the accuracy of performance ratings. Effective September 1, 1993, the OTS revised its safety and soundness examination policy to comply with Section 111 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Effective November 1, 1994, the OTS again revised its safety and soundness examination policy to comply with the Riegle Community Development and Regulatory Improvement Act of 1994. Both of these acts expanded the interval between examinations for small, well-managed thrifts.

The following chart presents the number of thrifts which received each type of examination compared with the number of thrifts scheduled to receive this type of examination.

**1996 Exams Conducted Compared With Exams Scheduled**

Of the 2,202 examinations scheduled, 2,121 were conducted. This is an overall success rate of 96 percent. The success rate for electronic data processing examinations completed during 1996 (78.6 percent success rate) was lower than usual because the Information System examination program suffered from an unusually high level of staff attrition during 1996. With the sudden departure of two key program administrators in Washington and other regional examination staff who were attracted by private-sector companies, the OTS faced Information System staffing shortages throughout most of the year. Consequently, the agency was unable to achieve a high level of success in reaching the 1996 Information System examination goals. The OTS is actively seeking to fill
current Information System vacancies and expects to meet its 1997 Information System examination goals.

<table>
<thead>
<tr>
<th>Type of Exam</th>
<th>1995</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Safety &amp; Soundness</td>
<td>96.8%</td>
<td>98.2%</td>
</tr>
<tr>
<td>Compliance</td>
<td>85.4%</td>
<td>99.7%</td>
</tr>
<tr>
<td>Holding Company</td>
<td>90.6%</td>
<td>96.7%</td>
</tr>
<tr>
<td>Electronic Data Proc.</td>
<td>85.0%</td>
<td>78.6%</td>
</tr>
<tr>
<td>Trust</td>
<td>71.4%</td>
<td>90.9%</td>
</tr>
</tbody>
</table>

The above table indicates that the 1996 success rate exceeded the 1995 success rate in all categories except the EDP exams.

Objective: Recommend enforcement action or a waiver of enforcement action within 60 days of the examination report transmittal for thrifts with CAMEL ratings of 4 or 5.

◆ Measure: Enforcement actions or waivers must be in place within 60 days of the transmittal date of the examination for 100 percent of all thrifts with CAMEL ratings of 4 or 5.

The CAMEL system is similar to the CAMEL rating system used by the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) for describing the condition of banks. The OTS adopted the CAMEL system on April 1, 1994. Using the CAMEL system (an acronym for Capital Adequacy, Asset Quality, Management, Earnings and Liquidity/Risk Management), OTS classifies thrifts into three categories:

- Institutions with CAMEL ratings of 1 or 2 are the healthiest thrifts;
- Institutions with CAMEL ratings of 3 are thrifts experiencing some difficulties but their overall strength makes their failure unlikely;
- Institutions with CAMEL ratings of 4 or 5 are troubled thrifts and present the highest degree of concern.

In 1996, 26 safety and soundness examinations were completed which resulted in a 4 or 5 composite rating. All 26 of these institutions were issued enforcement actions or had enforcement actions waived within 60 days. Compliance with this measure is 100 percent.
Goal 2: Improve credit availability by encouraging safe and sound lending in those areas of greatest need.

In December 1993, the OTS established the Community Affairs program to encourage and support community development initiatives by OTS-supervised institutions and compliance with the community reinvestment and fair lending laws. The program was also designed to help ensure that the industry's community development activities are conducted in a safe and sound manner.

The objectives of the OTS' Community Affairs program include:

- Acting as liaison between the OTS, the industry, community groups, government agencies and others on community development matters.

- Providing education and technical assistance on community development matters.

- Identifying and addressing regulatory barriers, and safety and soundness issues related to community development activities.

Objective: Encourage institutions' efforts to meet the housing and other credit needs of their communities, particularly the needs of low to moderate income persons and areas, through the reduction of regulatory barriers, and the continued implementation of the national community affairs program.

Measure: The degree to which the defined tasks of the community affairs program are met in any given year.

Level of Success: 95 percent

The OTS' Community Affairs Program defined 6 primary tasks (which accounted for 75 percent of the total score) and 4 secondary tasks (which accounted for 25 percent of the total score) for 1996.

Each of the program's secondary tasks were met. Four of the primary tasks were fully met. Two of the primary tasks; namely, 1) Assistance to those institutions which received a CRA rating of "needs to improve" and 2) Conduct regional and industry training sessions on community reinvestment topics, were only partially met as one region was unable to provide any training or to meet with any "needs to improve" institutions due to a prolonged medical absence and then subsequent retirement of their Community Affairs Liaison.

One of the 1996 highlights was a comprehensive community development training session developed by the Southeast Region in conjunction with the three other banking regulatory agencies. That training was offered to all compliance examiners in the Southeast Region.
(four, two-day courses). The Northeast and West Regions co-sponsored, with local community organizations, bus tours for financial institutions of community development activities in the South Bronx area of New York City and South Central Los Angeles, California, respectively. The West Region also co-sponsored, with the local Federal Reserve Bank, a number of technical symposiums for small business lenders and owners. The Midwest Region conducted a series of presentations around the region focusing on low-income housing tax credits. In addition, the OTS addressed certain regulatory barriers and clarified a number of community development investment authority issues.

**Goal 3: Enhance competitiveness of the thrift industry to ensure its safety and soundness.**

At the beginning of 1996, the thrift industry was facing two issues that could have adversely impacted the future of the industry.

- In mid-1995, the Federal Deposit Insurance Corporation approved a new BIF premium rate structure for commercial banks which eliminated insurance premiums for the best rated banks. The insurance premiums of SAIF-insured thrifts could not be reduced because, unlike the BIF, the SAIF had not reached the 1.25 percent designated reserve ratio statutorily required for each fund. A continued, large premium disparity between banks and savings and loans could have had a serious detrimental effect on the thrift industry including a negative impact on thrift earnings and a lower return on assets.

- One of the most pressing issues arising from the BIF/SAIF premium disparity concerned the annual interest obligation imposed on the SAIF from the outstanding Financing Corporation (FICO) bonds. The FICO obligation, which arose from bonds floated between 1987 - 1989 to finance the cleanup of failed thrifts, was also the heart of the reason why the SAIF was not fully capitalized. Approximately 67 cents of every thrift premium dollar paid to the SAIF was diverted to cover the annual FICO payment. Thus, the SAIF problem was largely a FICO problem.

Without a resolution of the BIF/SAIF/FICO problem, there could have been formidable consequences for the thrift industry and the American taxpayer. Thus, the following objective was set forth in the OTS' Strategic Plan as the most important issue requiring resolution if the thrift industry was to achieve competitiveness with the commercial banking industry.

**Objective: Support efforts to resolve the SAIF/FICO funding problems and to modernize the thrift charter.**
The performance measures include:

♦ Measure: Development of a proposal supported by the bank regulators, the thrift industry, and key members of the House and Senate Banking Committees.

♦ Measure: Work with Congress and the Administration to secure an agreement and identify legislation to enact the proposal.

♦ Measure: Achievement of a permanent resolution of the SAIF/FICO funding problems.

**Level of Success: 100 percent**

The OTS has successfully achieved the three measures identified above with the enactment of the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) which was signed into law on September 30, 1996.

During 1996, the OTS, in conjunction with the Administration, Treasury and the Federal Deposit Insurance Corporation, effectively communicated the seriousness of the BIF/SAIF/FICO problem to Congress. With the passage of EGRPRA, the thrift industry can focus its attention on its business; meeting the financial services needs of community home buyers, consumers and small businesses. The new law included a special assessment to capitalize the Savings Association Insurance Fund to the fully capitalized level, and the fund was declared capitalized as of October 1, 1996. In addition, the obligation of the FICO bonds was spread among all FDIC-insured institutions as of January 1, 1997. The new legislation also contained additional provisions which expanded and enhanced the powers of the thrift charter (see the Message from the Director for a more complete discussion of this subject).

**Objective:** Work with undercapitalized thrifts to develop strategies for timely recapitalization and ongoing viability.

♦ Measure: The number of FDICIA Section 131 Prompt Corrective Action (PCA) directives issued to institutions by OTS within 150 days of a thrift becoming "undercapitalized" or institutions which are recapitalized to at least "adequately capitalized" without SAIF financial assistance, divided by the number of thrift institutions which become "undercapitalized."

**Level of Success: 100 percent**

In 1996, five institutions became "undercapitalized." Four recapitalized to at least "adequately capitalized" within 150 days (thus, not requiring a directive), the fifth was issued a PCA Directive within 150 days. Therefore, the OTS achieved 100 percent compliance with this measure.
Goal 4: Enhance organizational efficiency of the OTS.

The OTS' goal to enhance organizational efficiency started with the agency's creation in 1989. Due to the shrinkage of the thrift industry, reorganization and streamlining of the OTS was necessary. The OTS responded by combining 12 district offices into five regional offices, significantly reducing both the staff and expenses. Today the emphasis is on using the current staff more efficiently through the introduction of higher-grade technology, and keeping the customer's best interest in mind.

Objective: Develop, distribute and monitor adherence to customer service plans for all major agency functions.

In response to President Clinton's September 11, 1993 Executive Order entitled "Setting Customer Service Standards" the OTS has set standards (without compromising safety and soundness) for core, external, customer groups based on what was learned from front-line employees, customer surveys, town meetings, focus groups and industry trade group representatives.

The OTS' primary customers are the thrift institutions it charters, examines and supervises and the customers these institutions serve. The first OTS customer service plan, published in 1994, was for the Examination Process. The OTS measures the standards set forth in this plan by conducting formal surveys and participating in town meetings and focus groups throughout the nation.

Customer service plans were published for Congressional Correspondence (July 1995), Interpretive Opinions and Public Information (both in January 1996) and Corporate Activities (May 1996). Each of these plans sets forth both qualitative and quantitative standards.

Every office with a published customer service plan sends to the OTS Ombudsman a quarterly report regarding its progress in meeting its stated customer service standards. The Ombudsman reviews the information and meets with the office staff submitting the report to discuss the data and suggest ways to improve its customer service. Subsequently, the Ombudsman presents a detailed report to the Executive Committee and the OTS Director. The OTS goal is that each customer service plan will meet its specified standards at least 80 percent of the time. The rationale for selecting 80 percent as a benchmark of success is that the OTS wants the stated standards to be challenging yet reasonable.

◆ Measure: Number of customer service plans that were adhered to divided by the total number of customer service plans.
Level of Success: 100 percent
Each office with an active customer service plan during 1996 met or exceeded the OTS goal of satisfying their total standards 80 percent of the time or greater.

Examination Process

The customer service standards for examinations are grouped by pre-examination process, examination fieldwork, and post-examination process. There are 13 standards; the examination staff met 11 of these standards at least 80 percent of the time. The primary measurement tool used to determine customer service performance is a nonmandatory survey. During 1996, 1,783 institutions were supplied with the survey form; of these, over 60 percent responded. Survey results were encouraging; they indicate that communication between the OTS and examined institutions was excellent totaling an aggregate satisfaction score of 98.9 percent. Questions pertaining to the Report of Examination (ROE) including the institution's assessment of the validity of the ROE's findings and recommendations as well as its timeliness, substance, tone and clarity, received an aggregate satisfaction level of 98 percent.

Congressional Correspondence

The customer service standards state that the OTS will answer all correspondence within ten working days and forward constituent complaints within fifteen days. All correspondence will receive an interim acknowledgment within five days. Within two days of receipt of misdirected correspondence, both the congressional office and the appropriate agency will be notified. All correspondence will include a name and contact phone number. Of the 6 standards included; 5 were met at least 80 percent of the time. On average, Congressional Affairs was successful in meeting its customer service standards 88 percent of the time.

Public Information

The Public Information Customer Service Plan standards include responding immediately to in-person requests for readily available information; mailing acknowledgment of information requests within one day; responding within three days of receipt of written requests that do not require research; responding to requests that require research within 30 days; filing new documents received within two days; and keeping customers informed regarding the status of Public Reference Room and Freedom of Information Act requests. There are a total of 6 standards; 5 were met at least 80 percent of the time. The only standard that was not fully successful was "responding to requests requiring research within 30 days." Both the Public Reference Room and Freedom of Information Act (FOIA) staff devoted the early part of 1996 to reducing the backlog; in addition, the Reference Room was given additional responsibilities. Most importantly, requests for information received during 1996 were more complex than those received during 1995. During 1997
the Public Information staff will strive to streamline procedures and provide more information through public access mechanisms (i.e., fax-on-demand, and the OTS web site). Public Information achieved an aggregate success rate of 94 percent.

Consumer Assistance

During 1996 the Consumer Assistance staff received approximately 4,900 inquiries and complaints. In December 1996 a customer service plan was published in both English and Spanish. The plan was developed after reviewing the results of a customer survey designed by OTS and approved by the Office of Management and Budget. It provides a toll-free telephone number for consumer assistance. The customer service plan is being monitored and the annual results will be reported next year.

Corporate Activities

The customer service plan for Corporate Activities was published in May 1996. The starting point for the plan is the Competitive Equality Banking Act of 1987 (CEBA) which contains specific processing time requirements. The timeframes contained in Corporate Activities' Customer Service Plan are even stricter than the mandates contained in CEBA. There are 12 customer service standards; 11 were met at least 80 percent of the time. During 1996, the OTS processed 4,027 applications. Of these, 3,948 or 98 percent were completed within the standard or expedited timeframes.

Interpretive Opinions

The customer service plan for interpretive opinions was published in January 1996. Inquiries that raise major issues of law or policy must receive a full, formal, interpretive response within 90 days of the receipt of the request. All other inquiries must receive a short form reply, briefly stating the issue and the OTS' conclusion in no more than 60 days. Of the requests received during 1996, 100 percent of the "short form" replies were timely while 83 percent of the "long form" requests were timely; giving an overall success rate of 92 percent. There are 4 standards; all 4 standards were achieved at least 80 percent of the time.

Customer Service Awards

Recently, Secretary of the Treasury, Robert Rubin, presented to two OTS teams Vice President Gore's Hammer Award for outstanding customer service during 1996. One team worked to update, revise and rewrite a substantial portion of the agency's regulations to make them more compact, readable and understandable. The revisions in all cases strike a balance between increasing the flexibility of savings associations to compete in a changing marketplace and maintaining adequate safety and soundness guidance to protect depositors and taxpayers.
The second team worked with Security First Network Bank to establish the first full service
Internet Federal Savings Bank, resolving many novel issues of law and policy. This team
provided outstanding customer service assistance without compromising either its
independence or its responsibility for promoting banking innovation within the parameters
of safety and soundness.

Objective: Meet the application processing timeframes except when an
application contains an issue of law or policy.

OTS regulations require thrift institutions to file an application before engaging in certain
activities. Most applications are reviewed and acted upon at the OTS’ five Regional
Offices. Certain complex transactions and those containing issues of policy or law are
reviewed and acted upon in Washington.

The mission of the applications program is to ensure that applications are processed
within established timeframes and that application decisions are consistent with current
OTS regulations and policies. All applications, unless eligible for expedited treatment,
should be processed to a decision within 60 days from the date they are deemed
complete. Expedited applications should be processed to a decision within 30 days from
the date they are deemed complete. Applications eligible for expedited treatment include
establishment of a finance subsidiary, higher lending limitations, issuance of subordinated
debt or mandatorily redeemable preferred stock, securities brokerage activities, charter
conversion to a commercial, national or state-chartered savings bank, acquisition/merger
by a commercial bank or bank holding company and establishment or change of location
of branch offices.

♦ Measure: The number of decisions made within the standard or expedited timeframes
divided by the total number of completed applications.

| Level of success: 98 percent |

During 1996, the OTS processed 4,027 applications. Of these, 3,948 or 98 percent were
completed within the standard or expedited timeframes specified above. This represents
an improvement over the 1995 level of success of 97 percent. Sixty-four applications
were removed from timeframe constraints due to the issuance of extension of time letters
and 15 applications did not meet these timeframes due to the issuance of law or policy
letters.

The OTS issues an extension of time letter when the reviewing offices need additional
time to analyze a transaction due to unresolved issues on a pertinent factor of the
transaction and/or to review the recommendation of another agency. Extension of time
letters must be issued within 10 days prior to, and must not extend for more than 30 days
beyond, the automatic approval date. In extremely rare instances, applications containing
precedential issues of policy or law may also be removed from timeframe constraints. In
these cases, letters extending processing timeframes may be issued up to the automatic approval date and do not place time restrictions on OTS actions.

The 64 applications on which extension of time letters were issued were completed, on average, in 54 calendar days. Of the 15 applications that did not meet the specified timeframes due to issues of law or policy, 12 were completed, on average, in 109 calendar days. There are 3 applications with issues of law or policy that remain pending.

Objective: Convert agency operations to personal computer (PC) environment through acquisition of standard hardware and software, development of PC-based programs and comprehensive staff training.

- **Measure:** Percentage of OTS staff using a PC compared to yearly target percentage. This performance measure includes two variables: 1) having access to a PC, and 2) being trained in the use of that PC. The quantitative value for this measure will be calculated by multiplying the percentage of OTS staff that have access to a PC by the percentage of staff that have been trained in the use of their PC.

| Level of Success: 100 percent |

During 1996, OTS was totally successful in achieving its goal of implementing a standard hardware and software platform for all employees. As of December 1996, every employee had access to either a 486-based PC or Pentium computer (either desktop or laptop as appropriate). Each PC was equipped with Windows 95 and the standard office suite of Microsoft Word and Excel. In addition, the desktop PCs were equipped with Microsoft Powerpoint and Access. Every OTS employee (100 percent) has been trained in the use of their PC.

- **Measure:** Percentage of OTS staff trained to use new software compared to the yearly target percentage.

| Level of Success: 1996's target of training 80 percent of the OTS staff was exceeded in 1996. |

In early 1996 the OTS implemented a PC infrastructure and initiated a program to train all OTS staff in the use of Windows 95 and Microsoft Word from July through October 1996; some OTS staff were also to receive Excel training during this timeframe. Given the fact that some OTS personnel could have a schedule conflict or an emergency on their specified training date, the 1996 target was set at successfully training 80 percent of the staff identified to receive training.
During the months of July through October 1996, over 95 percent of the OTS staff completed training in the use of Windows 95 and Microsoft Word. This accomplishment was well in excess of the 1996 projected training goal of 80 percent.

Objective: Improve efficiency of employees through satisfactory response by computer support staff to OTS employee calls to the National Helpline.

The mission of the OTS National Helpline is to provide a central point of contact for assistance to OTS staff who use office automation, national system applications, mainframe hardware and software, PC hardware and software, and telecommunications. The Helpline is answered from 7:30 a.m. until 6:30 p.m. Eastern Time, Monday through Friday. If a problem occurs after the normal hours of operation, all Helpline requests are recorded on the Helpline Voice Mail System. The Helpline Voice Mail System is supported by a pager system.

Helpline personnel render assistance immediately over the telephone whenever possible, based on the complexity of the problem and their level of expertise. If Helpline personnel are unable to solve the problem, it is their responsibility to forward the call to the appropriate support personnel for resolution.

A sampling of 10 percent of all Helpline calls are followed up with a verbal survey regarding the level of satisfaction the caller experienced. The three levels of satisfaction are: "unsatisfied," "met expectation," or "exceeded expectation." Information Resources Management has set a benchmark of satisfying 95 percent of all National Helpline callers.

◆ Measure: Number of Helpline calls in which responses "met or exceeded" expectations divided by the total number of Helpline calls. This measure will be quantified by dividing the number of callers surveyed that stated that the service either "met or exceeded" their expectations, by the total number of callers surveyed.

| Level of Success: exceeded the 95 percent target |

During 1996 the OTS' National Helpline received 9,213 calls, 4 percent less than the previous year when 9,601 calls were received. Ten percent of all callers to the National Helpline were surveyed to determine their level of satisfaction. Of those surveyed a total of 98 percent rated the level of service at "met expectation" or "exceeded expectation," thus, the National Helpline staff exceeded their target of satisfying 95 percent of all callers.
Goal 5: Retain a qualified and motivated work force.

Retaining a qualified, efficient and motivated work force has always been one of the OTS' major goals. Attaining this goal has sometimes been difficult due to recent downsizing. In 1994, the Acting Director of the OTS noted twice in testimony before Congress that it was difficult to retain employees, particularly those with the most sophisticated and marketable skills. During the six-year period between December 1990 and December 1996 the OTS' staff decreased from 2,989 to 1,372, or by an average of more than 9 percent each year. Thus, the OTS is actively seeking ways to retain and motivate its remaining work force. Recent initiatives include enhancing employee training and rewarding employees who demonstrate outstanding performance and initiative.

Objective: Improve training efforts to better fulfill the needs of all agency staff and reflect the shifting training needs of an evolving financial services industry, and a maturing and shrinking work force.

Subgoal: Identify skills (computer skills and other skills) needed by employees to effectively and efficiently perform their assigned functions and provide all employees with the appropriate identified training.

♦ Measure: Number of employees receiving training divided by the total number of employees.

| Level of Success: 100 percent |

During 1996 the OTS management surveyed the staff to identify skills (computer and other skills) needed by employees to effectively and efficiently perform their assigned functions. Additionally, the OTS management determined to provide employees with appropriate training to perform their assigned functions.

As a result of the aforesaid survey, 1996 was an extremely successful training year for the OTS. Ninety-five percent of the OTS staff received training in Windows 95 and Microsoft Word. Additionally, 44 percent of the staff completed training in Microsoft Excel Fundamentals. Finally, approximately 32 percent of the OTS staff were trained in Advanced Microsoft Office software programs such as Excel, Powerpoint and Access.

Other areas of technical training completed during 1996 included regulatory training. Approximately 74 percent of OTS' examiners received training in regulatory courses such as Affordable Housing, Interest Rate Risk and other technical courses.
Measure: Issuance of a comprehensive training policy that sets forth agency priorities to maintain a work force with the knowledge and skills critical to both the OTS' mission and employee development.

Level of Success: 100 percent

During 1996, a comprehensive training policy was written and adopted by OTS. The policy sets forth agency priorities necessary to maintain a work force with the knowledge and skills critical to the OTS' mission and employee development.

The comprehensive training policy provides guidance in the development of 1997 individual / departmental training plans for the OTS workforce. In addition to the comprehensive training policy, the Executive Directors established training priorities in accordance with the policy guidelines. The Training Steering Committee scrutinized the 1997 employee training plans to ensure the plans met the Agency's and Executive Director's goals and needs. The level of success for this measure is 100 percent.
FINANCIAL HIGHLIGHTS

Funding Sources

The OTS receives no appropriated funds from Congress. FIRREA provided the OTS with the authority to fund its operations through periodic assessments charged to the thrift industry. The current Assessment Regulation was developed in 1990. This regulation establishes assessment rates based on each thrift institution's CAMEL rating (a supervisory rating of safety and soundness) and its consolidated assets. The establishment of standard and premium rates is based on two premises: 1) larger institutions cost less to regulate/supervise per asset dollar; and 2) institutions with poor CAMEL ratings cost more to regulate/supervise per asset dollar.

Assessments constitute the largest single component of the OTS income. In 1996 assessments constituted 88 percent ($133 million) of total income ($151.4 million). The OTS also receives funds from application fees, interest, rents and subleases, exam fees and other miscellaneous sources.

1996 Total Revenue = $151.4 million

![Pie chart showing the distribution of revenue sources. Assessments account for 87.8%, with other sources indicated as application, exam and security filing fees (4.3%), interest (4.7%), rents and subleases (2.0%), and other (1.2%).]
Since the establishment of the OTS in 1989, the thrift industry has experienced a dramatic decline in the number of institutions and the level of industry assets. In December 1990 there were 2,539 thrift institutions holding $1,129 billion in consolidated assets. By December 1996 the thrift industry had declined to 1,335 institutions holding $769 billion in consolidated assets; a 47 percent reduction in the number of institutions, and a 32 percent reduction in the dollar value of assets.
Due to the shrinkage of the thrift industry, the OTS' income from assessments has declined substantially. In 1990, assessments totaled $265.8 million; in 1996 this figure had fallen to $133.0 million, a decrease of 50 percent in six years. The decrease in assessment revenue has caused a sharp decline in the OTS' income.

**Total OTS Income (1990 - 1996)**

![Bar chart showing OTS income from 1990 to 1996](chart)

The OTS believes that due to the resolution of the BIF/SAIF/FICC issue (see Message from the Director), that the decline in thrift institutions and assets may lessen. Thus, the OTS' income could stabilize; although with the continuing consolidation of the banking and thrift industries, some decline in revenues is projected.

**Funding Uses**

Total OTS expenses declined in 1996 by $13.2 million or 9 percent when compared with 1995, primarily because of a decrease in personnel and benefit costs. Personnel costs declined $4.4 million or 5 percent due to a 6 percent decline in staff. The $6.2 million or 27 percent reduction in benefit costs was due to net actuarial experience gains of the Financial Institutions Retirement Fund which covers approximately two-thirds of the OTS employees.

The remaining expenses decreased with the exception of data processing costs which increased $574,000 or 21 percent as a result of the OTS regulatory system modifications and Year 2000 system changes.
1996 Total Operating Expense = $133.4 million

Due to the shrinkage of the thrift industry, the OTS trimmed its staff from 3,379 as of October 1989, to 1,373 as of December 1996, or by 59.4 percent.

OTS Staff (1990 - 1996)
Management's Discussion and Analysis of Financial Performance

The OTS' Executive Director, Administration, serves as the Chief Financial Officer and is responsible for directing policy development for administrative operations including contracting and procurement, training, human resources, automated data processing, the agency's nationwide computer system, telecommunications, financial management (payroll, accounting, and compliance with Generally Accepted Accounting Principles). The Director of Administration is also responsible for implementing the requirements of the Chief Financial Officers Act, the Federal Managers' Financial Integrity Act, the Government Performance and Results Act and the Information Technology Management Reform Act of 1996.

The OTS complies with all applicable Generally Accepted Accounting Principles (GAAP), Federal Financial Accounting Standards and internal control principles. The OTS' financial transactions are reported on an accrual basis. The bureau's Planning, Budget and Finance Division continually reviews new Statements of Federal Financial Accounting Standards and modifies accounting policy, procedures and reporting as needed. The Division's Policy and Procedures Manual reflects current regulations and internal standards governing accounting, payroll, and travel processing. The manual was first issued in August 1991 and is revised at least biannually to incorporate the latest policy and regulation changes.

FMFIA mandated the establishment of agency internal control programs and regular evaluations of management controls and accounting systems to protect federal programs from fraud, waste and abuse. The OTS maintains strong internal controls, comprehensive financial management controls, personnel security controls, computer security, and strong asset accountability programs.

In accordance with the CFO Act, the OTS has developed a Five-Year Financial Management Plan. This Plan addresses the current status of financial management, summarizes accomplishments, and presents an overview of planned financial management initiatives. Most of the major milestones required by the CFO Act to be addressed in the Five-Year Plan, including audited financial statements and integrated financial management information systems, were achieved by the OTS prior to the law's enactment. This is a result of management foresight and an organizational focus on efficient, cost-effective operations.

The Prompt Payment Act and OMB Circular A-125 focus on improving the timeliness of payments from government agencies to the private sector. OMB defines "on time" as "those payments made 23 to 30 days after receipt, earlier payments where discounts were taken, and earlier payments made in accordance with management guidance." The OTS has been successful in increasing timely payments. During fiscal year 1996 the OTS sampled 12 percent of its payments; of those sampled 3.7 percent were paid late and zero percent were paid "early without reason." This compares with 3.2 percent paid late and zero percent paid early during 1995. A majority of the payments paid late during 1996 were as a result of a blizzard that
dropped 20 inches of snow in the Washington D.C. metro area in January 1996 causing the Federal Government to close for four days. The OTS' utility payments were paid early ("early with reason") because they were due earlier than the 23 - 30 day time frame set forth by OMB.

Electronic payments provide efficient and effective accounting services, greater control over the timing of payments and receipts, and low payment costs compared to paper checks. The OTS' accounting system was modified to provide reports in the Standard General Ledger (SGL) format and our trial balance is transmitted to Treasury electronically in the SGL format. The OTS' software package allows Civil Money Penalties to be electronically posted through Treasury's Bulletin Board System and accounts receivable reports due from the public are transmitted electronically.

The OTS Regional Offices use the GELCO Processing/Payment System which eliminates redundant data entry for travel vouchers. The OTS utilizes the Retirement and Insurance Transfer System (RITS) which electronically provides benefit information to OPM. Assessments, which make up approximately 88 percent of the OTS' revenues, are collected electronically on the due date. The OTS has notified its vendors that electronic funds transfer (EFT) is the expected payment method for all vendors. We are in the process of expanding the number of vendors paid through EFT. In addition, the OTS has surpassed OMB's prescribed goal for agencies to process 90 percent of their payroll by EFT; approximately 97.5 percent of the OTS employees receive their payroll via EFT.

The OTS maintains budgetary integrity through the continual oversight and monitoring of its annual budget. Generated reports allow the budget staff to regularly analyze the status of all accounts, review all expenditures, and make recommendations to senior management regarding potential savings and/or possible overages in the various accounts.

The OTS manages its assets successfully. The automated system for managing and disposing of property, including capitalized and noncapitalized furniture, fixtures and equipment is maintained. Annual inventories are taken and the records updated; items no longer needed are surplus to the Department of Agriculture. Approximately 69 percent of the OTS' assets are held as cash or cash equivalents. Another 24 percent of its assets are the OTS land and building used in Washington, D.C., and the furniture and equipment used throughout the bureau. The OTS holds cash or cash equivalent assets in U.S. Treasury securities.

The foundation of the OTS' financial management control program is its annual financial statement audit. The 1996 audit was conducted by the independent, certified public accounting firm of Deva & Associates, P.C. The audit was completed in January 1997. For the seventh consecutive year, the OTS was given an unqualified opinion on its financial statements.

As shown in the chart below, the OTS' operating expenses have consistently been lower than the authorized budget for that year except during 1994 when the authorized budget and operating expenses were equivalent. This is principally the result of cost control and personnel rightsizing measures, and continued personnel attrition at levels exceeding projections.
CURRENT STATUS OF FINANCIAL MANAGEMENT SYSTEMS

The OTS uses an off-the-shelf accounting system purchased from Computer Data Systems, Inc., as the key component of its financial management system. The accounting system operates on a calendar-year basis and integrates the procurement, budget execution, accounts payable, accounts receivable, general ledger and financial reporting functions and is directly interfaced with the payroll/personnel system. Approved budget data are electronically uploaded to the accounting system at the outset of each budget year. The OTS provides financial cross servicing to the Federal Maritime Commission, the Federal Housing Finance Board and the Office of Financial Institutions Adjudication in the payroll, personnel and accounting areas. This cross servicing structure supports the goal of reducing duplicative functions within the Federal Government as promoted by the National Performance Review.

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

1996 ACCOMPLISHMENTS

The OTS continually upgrades its data processing systems to ensure that they remain current with all applicable regulations and laws. In addition to this ongoing maintenance, several significant system initiatives were undertaken in 1996 which focused on the improvement of financial reporting and efficiency. They included the following:

- A major review of the administrative automated systems was undertaken as part of the OTS' three year system support cycle (year one - review; year two - modification; year three - maintenance). Included in this year's review were the payroll/personnel, accounting, budget, merit increase decision, personnel information query, assessment billing, carpool and positions/personnel. Recommendations for system enhancements were presented to the OTS Management Information System (MIS) Committee which resulted in the establishment of a priority set of modifications for 1997. When completed, these enhancements will improve data accuracy, streamline cumbersome processes and reduce inefficiencies within the systems.

- An automated transaction entry system was developed which enables purchase card holders to enter a record of their transactions online and automatically transfers
this data to the accounting system for processing. This system removed duplicative entry of purchase information, instituted standardized reporting for the accounting office and distributed transaction entry among all cardholders instead of utilizing one entry technician in the central office.

- The accounting and payroll/personnel systems were upgraded to electronically transmit EFT and check payment information to the regional treasury processing site. Prior to this enhancement, the data were transmitted via magnetic tape which was mailed to the processing site. This new method is a half hour process versus the previous three day process.

- The payroll/personnel system was modified to properly handle the use of the year 2000.

- The data processing environment at the OTS is in the midst of changing from a mainframe based system to a personal computer (PC) network with the future role of the mainframe yet to be determined. As part of the move toward the PC environment, the OTS is looking towards the development of a data warehouse structure supported by a graphical user interface which would be utilized by management staff for ad hoc database query and reporting.

- A review of the OTS' Disaster/Recovery Preparedness Plan was begun giving special emphasis to the agency's new PC infrastructure. This review is projected to be completed by December 1997.

- New telecommunication hardware was purchased in December, 1996 which will be installed during 1997 to support new protocols and provide higher processing speed.

**Financial Management System Plans for 1997**

As described earlier, the financial management systems will undergo major upgrades and enhancements in 1997. The following are the most significant modifications:

**Accounting System**

- The system will be enhanced to ensure the proper handling of the year 2000. This modification is critical to the continued successful system processing and has top priority.

- The system's invoice field will be expanded to allow for the entry of more invoice information. This enhancement will permit greater utilization of the vendor express system because vendors will be able to identify each payment specifically. The
current field size does not allow for sufficient information required by vendors to identify the payment.

- The annual financial reports will be automated to ease the reporting burden of the accounting office staff.

- The search capabilities in the system will be enhanced to reduce the time required when reviewing transactions. The current processing is cumbersome and time consuming.

- Additional improvements in the system will include an enhanced on-line help capability, automated prompt payment reconciliation, and the automatic assignment of voucher numbers.

- As a security measure, the use of the social security number in the system will be modified to require only six characters of entry.

- The Financial Institutions' Thrift Plan (FITP) loan processing within the FIRF retirement system will be automated. Currently, these loans are tracked manually on a PC which is a labor intensive process. The automation, for the loan processing, should provide tremendous time savings.

All Administrative Systems

- Graphical query tools are being reviewed and a purchase is being considered for 1997. This tool will be used to allow management staff outside the immediate system user community to generate ad hoc queries and reports from the data stored in these major systems.
FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA) PROGRAM SUMMARY

The OTS evaluated its management control systems for the fiscal year ending September 30, 1996, according to the Office of Management and Budget guidance and General Accounting Office standards. The results of the evaluation show that our management controls provide reasonable assurance that:

- obligations and costs comply with applicable law;
- all assets are safeguarded against waste, loss, unauthorized use and misappropriation; and
- revenues and expenditures applicable to the OTS operations are recorded and accounted for properly.

No Section 2 (Program and Administrative) material weaknesses or Section 4 (Financial) nonconformances were identified. In addition, audit report OIG-96-062, 1995 Audited Annual Financial Statements for the OTS (CFO Report), dated February 28, 1996, did not identify any material weaknesses in the FMFIA program.

Following the revision of OMB Circular A-123, Management Control and Accountability, the OTS evaluated its FMFIA program for ways to streamline the review process. Currently, our senior managers and responsible officials are using a new form to certify that management controls were evaluated against the GAO minimum standards contained in the circular, and that the controls were or were not found to be adequate. This change in procedure has eased rigid reporting requirements, created a less structured FMFIA environment, and permitted managers greater flexibility in describing the basis for certifying that all GAO minimum standards have been met.

Although annual FMFIA training is no longer required by OMB, the OTS continues to brief managers and staff in the preferred procedures for conducting management reviews.
FINANCIAL STATEMENTS

The attached audited financial statements have been prepared to report the financial position and results of operations of the OTS, pursuant to the requirements of the CFO Act of 1990.
**UNited States Department of the Treasury**  
**Office of Thrift Supervision**  
**Statements of Financial Position**  
(in Thousands)

### ASSETS

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<tbody>
<tr>
<td><strong>Entity Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intragovernmental assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund balance with Treasury and cash equivalents</td>
<td>$20,663</td>
<td>$38,785</td>
</tr>
<tr>
<td>Investments held to maturity</td>
<td>94,380</td>
<td>55,145</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>336</td>
<td>202</td>
</tr>
<tr>
<td>Interest receivable</td>
<td>194</td>
<td>1,340</td>
</tr>
<tr>
<td>Governmental assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable, less allowance for uncollectible accounts of $0 for 1996 and $84 for 1995</td>
<td>762</td>
<td>910</td>
</tr>
<tr>
<td>Advances and prepayments</td>
<td>11,994</td>
<td>12,601</td>
</tr>
<tr>
<td>Property and equipment, net</td>
<td>39,448</td>
<td>41,047</td>
</tr>
<tr>
<td><strong>TOTAL ENTITY ASSETS</strong></td>
<td>$167,777</td>
<td>$150,030</td>
</tr>
</tbody>
</table>

### LIABILITIES AND NET POSITION

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities Covered by Budgetary Resources:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intragovernmental liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>$1,398</td>
<td>$1,554</td>
</tr>
<tr>
<td>Governmental liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>689</td>
<td>1,259</td>
</tr>
<tr>
<td>Accrued annual leave</td>
<td>7,737</td>
<td>7,887</td>
</tr>
<tr>
<td>Accrued workers' compensation</td>
<td>4,029</td>
<td>3,294</td>
</tr>
<tr>
<td>Deferred compensation liability</td>
<td>1,345</td>
<td>1,575</td>
</tr>
<tr>
<td>Deferred rent credit</td>
<td>2,676</td>
<td>2,522</td>
</tr>
<tr>
<td>Post-retirement benefit liability</td>
<td>4,790</td>
<td>3,554</td>
</tr>
<tr>
<td>Other accrued liabilities</td>
<td>5,271</td>
<td>6,555</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$27,935</td>
<td>$28,200</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Position:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assumed capital</td>
<td>$41,037</td>
<td>$41,037</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>98,805</td>
<td>80,793</td>
</tr>
<tr>
<td><strong>Total Net Position</strong></td>
<td>$139,842</td>
<td>$121,830</td>
</tr>
</tbody>
</table>

**TOTAL LIABILITIES AND NET POSITION**

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL LIABILITIES AND NET POSITION</strong></td>
<td>$167,777</td>
<td>$150,030</td>
</tr>
</tbody>
</table>

These financial statements should be read in conjunction with the accompanying summary of significant accounting policies and notes to financial statements.

B-1
UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION
Years Ended December 31
(in Thousands)

<table>
<thead>
<tr>
<th>REVENUES</th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry assessments</td>
<td>$133,019</td>
<td>$136,310</td>
</tr>
<tr>
<td>Examination, application, and security filing fees</td>
<td>6,446</td>
<td>7,699</td>
</tr>
<tr>
<td>Interest</td>
<td>7,120</td>
<td>6,554</td>
</tr>
<tr>
<td>Rental income</td>
<td>3,038</td>
<td>2,779</td>
</tr>
<tr>
<td>Other</td>
<td>1,805</td>
<td>2,969</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td><strong>$151,428</strong></td>
<td><strong>$156,311</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXPENSES</th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personnel compensation</td>
<td>$84,655</td>
<td>$89,104</td>
</tr>
<tr>
<td>Benefits</td>
<td>17,084</td>
<td>23,325</td>
</tr>
<tr>
<td>Rent, communication, and utilities</td>
<td>8,301</td>
<td>9,408</td>
</tr>
<tr>
<td>Travel and transportation</td>
<td>9,368</td>
<td>9,977</td>
</tr>
<tr>
<td>Services</td>
<td>2,475</td>
<td>2,136</td>
</tr>
<tr>
<td>Data processing</td>
<td>3,275</td>
<td>2,701</td>
</tr>
<tr>
<td>Building expenditures</td>
<td>3,805</td>
<td>4,140</td>
</tr>
<tr>
<td>Office equipment and software</td>
<td>1,754</td>
<td>2,383</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>1,070</td>
<td>1,559</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,629</td>
<td>1,926</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td><strong>$133,416</strong></td>
<td><strong>$146,659</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EXCESS OF REVENUES OVER EXPENSES</th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$18,012</td>
<td>$9,652</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NET POSITION, beginning balance</th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>NET POSITION, ending balance</td>
<td>$139,842</td>
<td>$121,830</td>
</tr>
</tbody>
</table>

These financial statements should be read in conjunction with the accompanying summary of significant accounting policies and notes to financial statements.
UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF THRIFT SUPERVISION  
STATEMENTS OF CASH FLOWS  
Years Ended December 31  
(In Thousands)

<table>
<thead>
<tr>
<th>CASH FLOWS FROM OPERATING ACTIVITIES</th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess of revenues over expenses</td>
<td>$ 18,012</td>
<td>$ 9,652</td>
</tr>
<tr>
<td>Adjustments affecting cash flow:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decrease (increase) in accounts receivable</td>
<td>14</td>
<td>368</td>
</tr>
<tr>
<td>Decrease (increase) in advances and prepayments</td>
<td>1,753</td>
<td>1,882</td>
</tr>
<tr>
<td>(Decrease) increase in due to OPM</td>
<td>-</td>
<td>(10,993)</td>
</tr>
<tr>
<td>(Decrease) increase in accounts payable</td>
<td>(570)</td>
<td>482</td>
</tr>
<tr>
<td>(Decrease) increase in other liabilities</td>
<td>305</td>
<td>(2,037)</td>
</tr>
<tr>
<td>Amortization of net bond discount (premium)</td>
<td>765</td>
<td>(73)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,629</td>
<td>1,926</td>
</tr>
<tr>
<td>Loss on disposal of equipment</td>
<td>9</td>
<td>428</td>
</tr>
</tbody>
</table>

Net cash provided by operating activities  
$ 21,917  $ 1,635

<table>
<thead>
<tr>
<th>CASH FLOWS FROM INVESTING ACTIVITIES</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchases of investment securities</td>
<td>$(40,000)</td>
<td>$ (270)</td>
</tr>
<tr>
<td>Purchases of property, plant, and equipment</td>
<td>(32)</td>
<td>(541)</td>
</tr>
</tbody>
</table>

Net cash used by investing activities  
$(40,032)  $(811)

NET CASH (USED) PROVIDED BY OPERATING AND INVESTING ACTIVITIES  
$(18,122)  $ 824

FUND BALANCE WITH TREASURY AND CASH EQUIVALENTS, beginning of year  
38,785  37,961

FUND BALANCE WITH TREASURY AND CASH EQUIVALENTS, end of year  
$ 20,663  $ 38,785

These financial statements should be read in conjunction with the accompanying summary of significant accounting policies and notes to financial statements.
<table>
<thead>
<tr>
<th></th>
<th>Resources</th>
<th>Actual Obligations</th>
<th>Actual Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1996</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation</td>
<td>$89,273</td>
<td>$85,357</td>
<td>$84,655</td>
</tr>
<tr>
<td>Benefits</td>
<td>24,397</td>
<td>23,148</td>
<td>17,084</td>
</tr>
<tr>
<td>Travel and Transportation</td>
<td>10,224</td>
<td>9,431</td>
<td>9,368</td>
</tr>
<tr>
<td>Rent, Communication, and Utilities</td>
<td>8,463</td>
<td>8,940</td>
<td>8,301</td>
</tr>
<tr>
<td>All Other</td>
<td>16,401</td>
<td>14,424</td>
<td>14,008</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>$148,758</td>
<td>$141,300</td>
<td>$133,416</td>
</tr>
<tr>
<td><strong>1995</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation</td>
<td>$92,680</td>
<td>$90,184</td>
<td>$89,104</td>
</tr>
<tr>
<td>Benefits</td>
<td>40,193</td>
<td>37,771</td>
<td>23,325</td>
</tr>
<tr>
<td>Travel and Transportation</td>
<td>10,693</td>
<td>9,995</td>
<td>9,977</td>
</tr>
<tr>
<td>Rent, Communication, and Utilities</td>
<td>10,331</td>
<td>9,812</td>
<td>9,408</td>
</tr>
<tr>
<td>All Other</td>
<td>16,403</td>
<td>13,845</td>
<td>14,845</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>$170,300</td>
<td>$161,607</td>
<td>$146,659</td>
</tr>
</tbody>
</table>

These financial statements should be read in conjunction with the accompanying summary of significant accounting policies and notes to financial statements.
UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
December 31, 1996 and 1995
(Dollar Amounts in Thousands)

REPORTING ENTITY

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

FIRREA provided that OTS make assessments to recapture its operating costs. Assessments are based on OTS' budget and are collected from savings and loans.

Assumed capital in the financial statements is the net assets assumed from FHLBB by OTS at inception, October 8, 1989, in accordance with FIRREA.

BASIS OF PRESENTATION

OTS is operated substantially as a commercial enterprise and records its calendar year transactions on an accrual basis in accordance with generally accepted accounting principles (GAAP) and the applicable provisions of OMB Bulletin 94-01 “Form and Content of Agency Financial Statements.” OTS receives no appropriated funds from the federal government and financial activities are recorded on an agency-wide basis versus a program or fund basis.

CASH EQUIVALENTS

OTS considers its Overnight Treasury Securities as cash equivalents.

INVESTMENTS

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

This information is an integral part of the accompanying financial statements.
POSTRETIREMENT BENEFITS

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

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

ANNUAL, SICK, AND OTHER LEAVE

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

PROPERTY AND EQUIPMENT

The land and building owned by FHLBB was transferred to OTS under FIRREA. OTS also assumed all of FHLBB's furniture, fixtures, and equipment. These assets were recorded at their existing book values established in FHLBB's accounting records. Other fixed assets acquired subsequent to that date are capitalized at cost based on the existing OTS capitalization policy.

Fixed assets in excess of $5 are capitalized. Depreciation is computed on a straight-line basis over the estimated useful lives as follows:

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Useful Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>50 years</td>
</tr>
<tr>
<td>Furniture, Fixtures, and Equipment</td>
<td>5 years</td>
</tr>
</tbody>
</table>

INCOME TAXES

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

CLASSIFICATION

Certain 1995 financial statement amounts have been reclassified for comparative purposes.

This information is an integral part of the accompanying financial statements.
NOTE 1 - CASH AND CASH EQUIVALENTS

OTS invests its cash in overnight Treasury Securities and at the Federal Home Loan Bank of Des Moines. They are stated at cost as follows:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1996</td>
<td>1995</td>
</tr>
<tr>
<td>Cash</td>
<td>$ 408</td>
<td>$ 135</td>
</tr>
<tr>
<td>Cash Equivalents</td>
<td>20,255</td>
<td>38,650</td>
</tr>
<tr>
<td>Total Cash and Cash Equivalents</td>
<td>$20,663</td>
<td>$38,785</td>
</tr>
</tbody>
</table>

Interest earned on overnight investments totaled $2,241 and $3,504 for 1996 and 1995, respectively.

NOTE 2 - INVESTMENTS

Investment securities held at December 31, 1996 and 1995 are marketable Treasury securities that have maturities through December 1998. The amortized cost and market value of these securities are summarized as follows:

<table>
<thead>
<tr>
<th>Intragovernmental government securities:</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments, at par</td>
<td>1996</td>
</tr>
<tr>
<td></td>
<td>$ 95,000</td>
</tr>
<tr>
<td>Unamortized premium (discount)</td>
<td>(620)</td>
</tr>
<tr>
<td>Investments at amortized cost</td>
<td>$ 94,380</td>
</tr>
<tr>
<td>Market Value</td>
<td>$ 93,955</td>
</tr>
</tbody>
</table>

Management intends to hold these investments to maturity. Stated interest rates range from 5.1% to 5.9%. Interest earned on these investments totaled $4,879 and $3,050 for 1996 and 1995, respectively.

This information is an integral part of the accompanying financial statements.

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NOTE 3 - PROPERTY AND EQUIPMENT

OTS' property and equipment is comprised of the following:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1996</td>
<td>1995</td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$ 7,101</td>
<td>$ 7,101</td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>47,802</td>
<td>47,802</td>
<td></td>
</tr>
<tr>
<td>Furniture, Fixtures, and Equipment</td>
<td>5,752</td>
<td>6,282</td>
<td></td>
</tr>
<tr>
<td>Total Cost</td>
<td>60,655</td>
<td>61,185</td>
<td></td>
</tr>
<tr>
<td>Accumulated Depreciation:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>(16,343)</td>
<td>(15,336)</td>
<td></td>
</tr>
<tr>
<td>Furniture, Fixtures, and Equipment</td>
<td>(4,864)</td>
<td>(4,802)</td>
<td></td>
</tr>
<tr>
<td>Property and Equipment, net</td>
<td>$ 39,448</td>
<td>$ 41,047</td>
<td></td>
</tr>
</tbody>
</table>

NOTE 4 - WORKERS' COMPENSATION

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for OTS' employees under FECA are administered by the U.S. Department of Labor (DOL) and are ultimately paid by OTS. These future workers' compensation estimates were generated by DOL from an application of actuarial procedures developed to estimate the liability for FECA benefits. This DOL estimated actuarial liability for FECA benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability was determined using the paid losses extrapolation method calculated over the next 23-year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using the discount rate of 7%. Based on information provided by the DOL, the U.S. Department of the Treasury determined that the estimated liability of OTS as of December 31, 1996 and 1995, was $4,029 and $3,294, respectively. Changes in the actuarial liability related to FECA are reflected as reductions or increases in benefits expense in the appropriate year.

Intragovernmental Accrued Liabilities include outstanding charges from the FECA Program at December 31, 1996 and 1995 of $477 and $965, respectively.

This information is an integral part of the accompanying financial statements.
NOTE 5 - ACCRUED LIABILITIES

Accrued liabilities are comprised of the following:

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1996</td>
<td>1995</td>
</tr>
<tr>
<td>Intragovernmental accrued liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal Employee Retirement System</td>
<td>$136</td>
<td>$237</td>
</tr>
<tr>
<td>Federal Employees' Compensation Act</td>
<td>$477</td>
<td>$965</td>
</tr>
<tr>
<td>Other</td>
<td>$785</td>
<td>$352</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,398</strong></td>
<td><strong>$1,554</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Governmental other accrued liabilities:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll and withholding</td>
<td>$2,541</td>
</tr>
<tr>
<td>Relocations</td>
<td>$99</td>
</tr>
<tr>
<td>Goods and Services</td>
<td>$2,539</td>
</tr>
<tr>
<td>Other</td>
<td>$92</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$5,271</strong></td>
</tr>
</tbody>
</table>

NOTE 6 - POSTRETIREMENT BENEFIT PLAN

OTS sponsors a life insurance plan (the Plan) for all employees that meet eligibility requirements. OTS funds benefit costs principally on a pay-as-you-go basis, with retiree contributions that are adjusted annually based on factors, some of which are discretionary. The Plan is unfunded, with Plan participants paying a portion of the costs. As stated in the Summary of Significant Accounting Policies, OTS changed its accounting policy with respect to the Plan as of January 1, 1993. OTS elected to defer recognition of the Plan's transition obligation of $81,125 at January 1, 1993, and amortize such obligation over twenty years on a straight-line basis.

A Memorandum of Understanding (MOU) was signed in December 1994, between the Office of Personnel Management (OPM) and the OTS. The purpose of the MOU was to implement legislation permitting annuitants who retired from OTS prior to January 1995, and who were enrolled in the OTS health plan, to enroll in the Federal Employees Health Benefits Program (FEHB) for coverage effective on or after January 8, 1995. The OTS agreed to pay a one-time fee to the OPM of $10,993 in consideration of OPM assuming the health portion of the postretirement plan liability. In accordance with FASB 106, the agreement with OPM constitutes a settlement and, accordingly, OTS recognized a gain on the settlement of $16,694 in 1994. Such gain includes the health portion of the transition obligation that OTS elected to initially recognize over 20 years in 1993. The Postretirement liability of $4,790 in the Statements of Financial Position at December 31, 1996, represents OTS' recognized portion of the remaining liability for participants future life benefits.

This information is an integral part of the accompanying financial statements.
NOTE 6 - POSTRETIREMENT BENEFIT PLAN (Continued)

Net periodic postretirement benefit cost for life insurance provisions in 1996 and 1995, under the Plan included the following components:

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost - benefits attributable to service during the year</td>
<td>$457</td>
<td>$498</td>
</tr>
<tr>
<td>Interest on accumulated postretirement benefit obligation</td>
<td>685</td>
<td>573</td>
</tr>
<tr>
<td>Amortization of transition obligation</td>
<td>298</td>
<td>298</td>
</tr>
<tr>
<td>Amortization of (gain) or loss</td>
<td>23</td>
<td>-</td>
</tr>
<tr>
<td><strong>Net Postretirement Benefit Expense</strong></td>
<td><strong>$1,463</strong></td>
<td><strong>$1,369</strong></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated postretirement benefit obligation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retirees</td>
<td>$3,404</td>
<td>$3,240</td>
</tr>
<tr>
<td>Other fully eligible participants</td>
<td>4,275</td>
<td>3,930</td>
</tr>
<tr>
<td>Other active participants</td>
<td>2,703</td>
<td>2,728</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,382</strong></td>
<td><strong>9,898</strong></td>
</tr>
<tr>
<td>Plan assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accumulated postretirement benefit obligation in excess of plan assets</td>
<td>10,382</td>
<td>9,898</td>
</tr>
<tr>
<td>Unrecognized transition obligation</td>
<td>(4,771)</td>
<td>(5,069)</td>
</tr>
<tr>
<td>Unrecognized net gain</td>
<td>(821)</td>
<td>(1,275)</td>
</tr>
<tr>
<td><strong>Obligations included in the Statements of Financial Position</strong></td>
<td><strong>$4,790</strong></td>
<td><strong>$3,554</strong></td>
</tr>
</tbody>
</table>

The weighted average discount rate used in estimating the accumulated postretirement benefit obligation at December 31, 1996 and 1995 was 7%.

This information is an integral part of the accompanying financial statements.
NOTE 7 - RENTAL INCOME

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

OTS also subleases some of its existing unused leased facilities under similar terms and these amounts are also included below. The future minimum rentals to be received under both types of noncancellable operating lease arrangements are as follows:

Year ending December 31:

<table>
<thead>
<tr>
<th>Year</th>
<th>Leases</th>
<th>Sub-Leases</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>$2,128</td>
<td>$877</td>
<td>$3,005</td>
</tr>
<tr>
<td>1998</td>
<td>1,876</td>
<td>488</td>
<td>2,364</td>
</tr>
<tr>
<td>1999</td>
<td>551</td>
<td>528</td>
<td>1,079</td>
</tr>
<tr>
<td>2000</td>
<td>571</td>
<td>549</td>
<td>1,120</td>
</tr>
<tr>
<td>2001</td>
<td>537</td>
<td>538</td>
<td>1,075</td>
</tr>
<tr>
<td>Thereafter</td>
<td>2,619</td>
<td>1,875</td>
<td>4,494</td>
</tr>
<tr>
<td></td>
<td>$8,282</td>
<td>$4,855</td>
<td>$13,137</td>
</tr>
</tbody>
</table>

NOTE 8 - RETIREMENT PLANS

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

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

This information is an integral part of the accompanying financial statements.

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NOTE 8 - RETIREMENT PLANS (Continued)

For employees with more than five years of service (not necessarily continuous), hired on or after January 1, 1984, OTS withholds, in addition to Social Security withholdings 0.8 percent of their regular earnings, but matches such withholdings with a 7 percent contribution. At the point such earnings exceed the FICA maximum wages of $62,700 for 1996, employees covered under this tier of CSRS are required to have 7 percent of their earnings withheld while the agency expense remains at a 7 percent contribution. This second employee group will receive retirement benefits from the CSRS along with the Social Security System, to which they concurrently contribute.

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

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

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

In 1996 and 1995, due to changes in retirement plan provisions of the Internal Revenue Code and net actuarial experience gains, OTS was not required to fund the FIRF plan. Accordingly, in 1996 and 1995, benefit expenses were reduced and prepaid assets increased by approximately $7,000 and $4,000 for the net effect of these changes. The retirement expenses for all three OTS plans, included in benefits expense on the accompanying Statements of Operations and Changes in Net Position, were as follows:

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSRS</td>
<td>$1,057</td>
<td>$1,171</td>
</tr>
<tr>
<td>FERS</td>
<td>1,601</td>
<td>1,908</td>
</tr>
<tr>
<td>FIRF</td>
<td>(2,029)</td>
<td>2,102</td>
</tr>
<tr>
<td>Net Expense</td>
<td>$629</td>
<td>$5,181</td>
</tr>
</tbody>
</table>

This information is an integral part of the accompanying financial statements.
NOTE 9 - DEFERRED COMPENSATION

As part of FIRREA, OTS assumed the Deferred Compensation Plans of the employees working for the Federal Home Loan Banks of Dallas and San Francisco. These plans allowed employees to defer a portion of their income and provided for employer matching contributions. OTS froze these plans and discontinued any deferrals or employer matches to these plans effective January 1, 1991. Benefits under the assumed plans were intended to be provided by cash value of life insurance policies issued by Mutual Benefit Life which went into rehabilitation on July 16, 1991. Under the rehabilitation plan, withdrawal of cash value prior to December 31, 1999 is restricted and subject to substantial withdrawal penalties. Current plan withdrawals have been funded by OTS. The cash value of those policies, included in advances and prepayments in the accompanying Statements of Financial Position, was $381 greater than OTS' liability in 1996 and $69 greater than OTS' liability in 1995.

NOTE 10 - LEASE COMMITMENTS

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

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

The minimum rental commitments under noncancellable operating leases are as follows:

<table>
<thead>
<tr>
<th>Year ending December 31:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>$ 5,583</td>
</tr>
<tr>
<td>1998</td>
<td>4,704</td>
</tr>
<tr>
<td>1999</td>
<td>4,527</td>
</tr>
<tr>
<td>2000</td>
<td>4,428</td>
</tr>
<tr>
<td>2001</td>
<td>2,417</td>
</tr>
<tr>
<td>Thereafter</td>
<td>7,625</td>
</tr>
<tr>
<td></td>
<td>$29,284</td>
</tr>
</tbody>
</table>

Rent expense under these leases was approximately $5,585 in 1996 and $6,767 in 1995. Sublease income relating to the above leases was approximately $911 in 1996 and $1,150 in 1995 and has been included in rental income. Future minimum rentals to be received under these subleases totals $4,855.

This information is an integral part of the accompanying financial statements.
NOTE 11- COMMITMENTS AND CONTINGENCIES

There are numerous legal actions pending against the United States in the U.S. Court of Federal Claims where the claims may be based on actions taken by OTS ("Court of Federal Claims Cases"). The U.S. Department of Justice is defending these cases. In July of 1996, the United States Supreme Court held that the United States was liable for breach of contract in three such cases, captioned United States v. Winstar Corporation, et. al. The Supreme Court did not determine the appropriate measure or amount of damages, if any, and it remanded the three cases for further proceedings. Under federal law, in the event a monetary judgment is rendered against the United States in any of the Court of Federal Claims Cases, the judgment must be satisfied from various claims and judgment funds maintained by the Department of the Treasury. OTS would not be required to expend its own funds, which are non-appropriated, to pay such a judgment. Therefore, no loss accrual has been made for any of these cases.

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

On February 5, 1997, a district court entered a judgment against OTS in the amount of $723,533. OTS intends to appeal this judgment. OTS believes it has substantial grounds for appeal, and believes it more likely than not that OTS will prevail in this matter. Accordingly, no loss accrual has been made relating to this matter.

This information is an integral part of the accompanying financial statements.