# NATIONAL CREDIT UNION ADMINISTRATION

## OFFICE OF INSPECTOR GENERAL

## NCUA FINANCIAL STATEMENT AUDITS
## FOR

## OPERATING FUND
## SHARE INSURANCE FUND
## CENTRAL LIQUIDITY FACILITY
## COMMUNITY DEV. REVOLVING FUND

**For the year ended December 31, 1998**

| Audited Financial Statements | Audit Report Number |
|---|---|
| NCUA Operating Fund | 993 |
| NCUA Share Insurance Fund | 994 |
| Central Liquidity Facility | 995 |
| Community Development Revolving Loan Program | 996 |

March 31, 1999

Frank Thomas
Inspector General

**NATIONAL CREDIT UNION ADMINISTRATION**

**AUDIT OF THE 1998 FINANCIAL STATEMENTS**

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# EXECUTIVE SUMMARY

**PURPOSE AND SCOPE** The National Credit Union Administration (NCUA) Office of Inspector General contracted with the independent public accounting firm of Deloitte & Touche to perform the financial statement audits of the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Program, for the year ended December 31, 1998.

The purpose of the audits is to express an opinion on whether the financial statements are fairly presented. The independent firm also reviewed the internal control structure and evaluated compliance with laws and regulations, as part of their audit.

The audits were performed in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. The NCUA Office of Inspector General reviewed the independent firm's workpapers, as part of its oversight function.

**FINANCIAL STATEMENT CONTRACT** Deloitte & Touche and their subcontractors, Brown & Company contracted with the Inspector General in May 1996 to perform the financial statement audits mentioned above. The contract was for 1996, with four option years. The Assistant Inspector General for Audits is the contracting officer's technical representative for this contract.

**AUDIT RESULTS** Deloitte & Touche expressed unqualified opinions, stating that the financial statements present fairly, in all material respects, the financial position of the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Program, at December 31, 1998, and the results of operations for the year then ended.

Although Deloitte & Touche does not express an overall opinion of the Funds' compliance with laws and regulations, their testing of compliance did not disclose any significant deviations.

Deloitte & Touche did not find any matters considered to be *material* weaknesses in their review of the Funds' internal control structures pertinent to financial reporting. However, during the performance of the audit, we developed the following recommendations related to internal control over financial reporting and certain observations and recommendations on other accounting, administrative, and operating matters.

# OBSERVATIONS AND RECOMMENDATIONS

**Adequate OTIS Resources** The NCUA Office of Technology and Information Services (OTIS) has several vacancies. As a result, resources were supplemented by outside consultants such as the one hired to perform security work for NCUA.

Inadequate staffing has put OTIS behind in security monitoring activities and maintaining adequate service levels. Additionally, inadequate staffing could result in improper segregation of duties.

**Recommendation:**

NCUA management should consider the requirements to adequately staff the Office of Technology and Information Services. Once adequate staffing levels have been reached, management should periodically review the duties and responsibilities of each staff member to determine that duties are properly segregated.

**Data Center Access** We noted that several individuals, approximately 20% of local personnel, have been granted unrestricted access to the data center. Management had not been able to justify such unrestricted access to the data center. It is important to keep data center access restricted to necessary personnel whose job functions require their presence. This will facilitate accountability among authorized personnel and limit the potential for unintentional or intentional damage to network hardware.

**Recommendation:**

NCUA should review the data center, telephone room, and the check-printer room access listings to ensure that only authorized personnel have access.

**Security Issues** We noted security issues related to firewall security; account security; and SAP security. These issues along with our recommendations have been communicated to OTIS management and are included in a "restricted appendix" which is not part of this report.

**Other Issues** During the audit procedures, we noted some issues that did not impact our overall assessment of the general computer or application controls. However, it would be beneficial for NCUA to address these concerns in order to strengthen the control and security of the information systems environment. The issues are summarized briefly below:

- We reviewed the Business Continuity Plan and noted that the Octel Voice Systems have not been addressed. NCUA should review the Business Continuity Plan to determine the business impact due to a lack of Octel Systems, and address the procedures to reinstate this system.
- We noted that the following finding from the prior year has not been resolved: "Programmers have update access to the production data and system controls." Management should evaluate the programmers' access and adequately restrict system access to production data or ensure there are adequate mitigating controls to ensure data and system integrity.
- We observed cardboard boxes scattered on the data center floor that blocked an emergency exit. We also noticed such boxes within some of the telephone/hub rooms. In addition, we noted that several of the hub rooms were not kept cool. Management should routinely examine the physical security, including potential fire hazards, of the data center and the telephone/hub rooms. Additionally, management should consider acquiring air conditioners for the telephone/hub rooms.
- We noted that not all workstations are running the most recent version of the anti-virus software containing the most recent virus definition files. We encourage NCUA to move the most recent version of the antiviral software and definition files into the production environment on all workstations. Additionally, we encourage NCUA to frequently monitor the vendor website for new versions of definition files. Once released, the definition files should be tested in the development environment and moved to the production environment on all workstations as soon as possible.
- A computer policy has been developed to address the issues of software piracy; however, this policy is not being actively monitored. During the audit procedures, we did not find any unlicensed software; however, this does not mean there are no violations in existence. We encourage NCUA to establish monitoring procedures to ensure that only licensed software is maintained on the employees' computers. Such procedures may include the use of program audit software.
- NCUA's network contains one primary domain controller (PDC), HQNT, and eight resource domains. There are two-way trusts between these domains. We encourage NCUA to review the necessity of maintaining a two-way trust.

## CURRENT STATUS OF PRIOR-YEAR COMMENTS

**Systems Development Life Cycle**

Last year we recommended that OTIS management develop a formal SDLC that encompasses procedures for developing and testing new or modified hardware/software. Based on Deloitte & Touche's understanding of industry "Best Practices," we recommended that such a policy address the following key areas:

- Statement of Information Systems Strategy
- Information Systems Administration
- Project Initiation Procedures
- Project Development Procedures
- Technology Acquisition Procedures
- Testing Requirements
- Migration and Implementation Procedures

**Recommendation:**

We noted during our audit that NCUA OTIS management maintains an informal Systems Development Life Cycle. Management has reported that they are currently in the process of formalizing these procedures. We continue to recommend that NCUA OTIS management complete the development and implementation of the formal SDLC.

## AUDIT REPORT FOLLOW-UP

NCUA should respond to this audit report and accompanying recommendations in accordance with the NCUA Audit Follow-up Instruction (1910.6, May 16, 1995).

# NATIONAL CREDIT UNION ADMINISTRATION OPERATING FUND

**Financial Statements for the Years Ended December 31, 1998 and 1997, and Independent Auditors' Reports**

## INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
National Credit Union Administration:

We have audited the accompanying balance sheets of the National Credit Union Administration Operating Fund (the Fund) as of December 31, 1998 and 1997, and the related statements of revenues, expenses, and changes in fund balance, and of cash flows for the years then ended. These financial statements are the responsibility of the National Credit Union Administration Operating Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Operating Fund as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 1999, on our tests of the National Credit Union Administration Operating Fund's compliance with certain provisions of laws, regulations, contracts and grants, and our consideration of its internal control over financial reporting.

February 26, 1999

## NATIONAL CREDIT UNION ADMINISTRATION
## OPERATING FUND

### BALANCE SHEETS
### DECEMBER 31, 1998 AND 1997
### (Dollars in Thousands)

| ASSETS | 1998 | 1997 |
|---|---|---|
| Cash and cash equivalents | $ 12,736 | $ 7,549 |
| Due from National Credit Union Share Insurance Fund (Note 4) | 2,129 | 114 |
| Employee advances | 865 | 706 |
| Other accounts receivable | 113 | 94 |
| Prepaid expenses | 164 | 113 |
| Fixed assets - net of accumulated depreciation and amortization (Note 3) | 41,233 | 43,187 |
| Employee residences held for resale | - | 611 |
| TOTAL ASSETS | $ 57,240 | $ 52,374 |

### LIABILITIES AND FUND BALANCE

| | | |
|---|---|---|
| LIABILITIES: | | |
| Accounts payable | $ 4,064 | $ 2,623 |
| Accrued wages and benefits | 4,864 | 2,089 |
| Accrued annual leave | 4,952 | 4,892 |
| Accrued employee travel | 735 | 688 |
| Notes payable to National Credit Union Share Insurance Fund (Note 4) | 34,574 | 35,987 |
| Total liabilities | 49,189 | 46,279 |
| COMMITMENTS AND CONTINGENCIES (Notes 5 and 8) | | |
| FUND BALANCE | 8,051 | 6,095 |
| TOTAL LIABILITIES AND FUND BALANCE | $ 57,240 | $ 52,374 |

See notes to financial statements.

## NATIONAL CREDIT UNION ADMINISTRATION
## OPERATING FUND

### STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCE
### YEARS ENDED DECEMBER 31, 1998 AND 1997
### (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| REVENUES: | | |
| Operating fees | $ 50,591 | $ 44,701 |
| Interest | 1,396 | 1,278 |
| Other | 262 | 317 |
| Total revenues | 52,249 | 46,296 |
| EXPENSES (Note 4): | | |
| Employee wages and benefits | 35,853 | 34,197 |
| Travel | 4,958 | 5,281 |
| Rent, communications, and utilities | 1,723 | 1,380 |
| Contracted services | 2,532 | 2,131 |
| Other | 5,227 | 5,618 |
| Total expenses | 50,293 | 48,607 |
| EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES | 1,956 | (2,311) |
| FUND BALANCE, BEGINNING OF YEAR | 6,095 | 8,406 |
| FUND BALANCE, END OF YEAR | $ 8,051 | $ 6,095 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# OPERATING FUND

## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Excess (deficiency) of revenues over expenses | $ 1,956 | $ (2,311) |
| Adjustments to reconcile excess (deficiency) of revenues over expenses to cash provided by operating activities: | | |
| Depreciation and amortization | 3,205 | 4,680 |
| Loss on disposal of fixed assets | 162 | 149 |
| Miscellaneous allowances | - | 70 |
| (Increase) decrease in assets: | | |
| Due from National Credit Union Share Insurance Fund | (2,015) | 210 |
| Employee advances | (159) | (488) |
| Other accounts receivable | (19) | 487 |
| Prepaid expenses | (51) | (23) |
| (Decrease) increase in liabilities: | | |
| Accounts payable | 1,441 | 286 |
| Accrued wages and benefits | 2,775 | (2,416) |
| Accrued annual leave | 60 | (452) |
| Accrued employee travel | 47 | 19 |
| Net cash provided by operating activities | 7,402 | 211 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of fixed assets | (2,016) | (4,930) |
| Proceeds from sale of fixed assets | 1,214 | 830 |
| Net cash used in investing activities | (802) | (4,100) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayments of notes payable | (1,413) | (1,413) |
| Net cash used in financing activities | (1,413) | (1,413) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 5,187 | (5,302) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 7,549 | 12,851 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 12,736 | $ 7,549 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# OPERATING FUND

## NOTES TO FINANCIAL STATEMENTS
## YEARS ENDED DECEMBER 31, 1998 AND 1997

### 1. ORGANIZATION AND PURPOSE

The National Credit Union Administration Operating Fund (the Fund) was created by the Federal Credit Union Act of 1934. The Fund was established as a revolving fund in the United States Treasury under the management of the National Credit Union Administration Board for the purpose of providing administration and service to the Federal Credit Union System.

### 2. SIGNIFICANT ACCOUNTING POLICIES

*Cash Equivalents* - The Federal Credit Union Act permits the Fund to make investments in United States Government securities or securities guaranteed as to both principal and interest by the United States Government. Cash equivalents are highly liquid investments with original maturities of three months or less. All investments in 1998 and 1997 were cash equivalents and are stated at cost, which approximates market.

*Depreciation and Amortization* - Building, furniture and equipment, and leasehold improvements are recorded at cost. Depreciation and amortization are computed by the straight-line method over the estimated useful lives of the building and furniture and equipment, and the shorter of the estimated useful life or lease term for leasehold improvements. Estimated useful lives are forty years for the building and three to ten years for the furniture and equipment and leasehold improvements.

*Operating Fees* - The Fund assesses each federally chartered credit union an annual fee based on the credit union's asset base as of the preceding December 31. The fee is designed to cover the costs of providing administration and service to the Federal Credit Union System. The Fund recognizes this operating fee revenue ratably over the year.

*Income Taxes* - The Fund is exempt from Federal income taxes under §501(c)(1) of the Internal Revenue Code.

*Fair Value of Financial Instruments* - The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

> Cash and cash equivalents, receivable from National Credit Union Share Insurance Fund (NCUSIF), employee advances, other accounts receivable, accounts and notes payable to NCUSIF, and other accounts payable are recorded at book values, which approximate the respective fair market values.

*Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimates.

*Reclassifications* - Certain reclassifications to 1997 amounts were made to the conform to the 1998 presentation.

## 3. FIXED ASSETS

Fixed assets are comprised of the following (in thousands):

| | 1998 | 1997 |
|---|---|---|
| Office building and land | $ 42,229 | $ 42,229 |
| Furniture and equipment | 21,780 | 20,544 |
| Leasehold improvements | - | 19 |
| Total | 64,009 | 62,792 |
| Less: Accumulated depreciation and amortization | 22,776 | 19,605 |
| Fixed assets, net | $ 41,233 | $ 43,187 |

## 4. TRANSACTIONS WITH NCUSIF

Certain administrative services are provided by the Fund to NCUSIF. The Fund charges NCUSIF for these services based upon an annual allocation factor approved by the NCUA Board derived from an estimate of actual usage. The allocation factor was 50% to NCUSIF and to the Fund for 1997 and 1998. The cost of the services allocated to NCUSIF, which totaled approximately $50,293,000 and $48,607,000 for 1998 and 1997, respectively, are reflected as a reduction of the corresponding expenses in the accompanying financial statements.

In 1988, the Fund entered into a $2,161,000 thirty-year unsecured term note with NCUSIF for the purchase of a building. Interest costs incurred were approximately $81,000 for 1998 and $83,000 for 1997. The outstanding principal balance at December 31, 1998 and 1997, was $1,386,000 and $1,458,000, respectively.

In 1992, the Fund entered into a commitment to borrow up to $41,975,000 in a thirty-year secured term note with NCUSIF. The monies were drawn as needed to fund the costs of constructing a new building. Interest costs incurred were approximately $1,926,000 and $1,945,000 for 1998 and 1997, respectively. The note payable balance at December 31, 1998, was approximately $33,188,000.

The above notes require principal repayments as follows (in thousands):

| | Unsecured Term Note | Secured Term Note | Total |
|---|---|---|---|
| 1999 | $ 72 | $ 1,341 | $ 1,413 |
| 2000 | 72 | 1,341 | 1,413 |
| 2001 | 72 | 1,341 | 1,413 |
| 2002 | 72 | 1,341 | 1,413 |
| 2003 | 72 | 1,341 | 1,413 |
| Thereafter | 1,026 | 26,483 | 27,509 |
| | $ 1,386 | $ 33,188 | $ 34,574 |

The variable rate on both notes is equal to NCUSIF's prior-month yield on investments. The average interest rate during 1998 and 1997 was 5.70% and 5.53%, respectively. The interest rate at
December 31, 1998, was 5.74%.

## 5. COMMITMENTS

The Fund leases office space under lease agreements that expire through 2003. Office rental charges amounted to approximately $976,000 and $678,000 of which approximately $488,000 and $339,000 was reimbursed by NCUSIF for 1998 and 1997, respectively. In addition, the Fund leases office equipment under operating leases with lease terms of less than one year.

The future minimum lease payments as of December 31, 1998, are as follows (in thousands):

| | Operating Leases |
|---|---|
| 1999 | $ 888 |
| 2000 | 538 |
| 2001 | 561 |
| 2002 | 571 |
| 2003 | 88 |
| Total | $ 2,646 |

Based on the allocation factor approved by the NCUA Board for 1998, NCUSIF will reimburse the Fund for approximately 50% of the future lease payments.

## 6. RETIREMENT PLAN

The employees of the Fund are participants in the Civil Service Retirement and Disability Fund, which includes the Federal Employees' Retirement System (FERS). Both plans are defined benefit retirement plans covering all of the employees of the Fund. FERS is comprised of a Social Security Benefits Plan, a Basic Benefits Plan, and a Savings Plan. Contributions to the plans are based on a percentage of employees' gross pay. Under the

Savings Plan, employees can also elect additional contributions between 1% and 10% of their gross pay, and the Fund will match up to 5% of the employees' gross pay. In 1998 and 1997, the Fund's contributions to the plans were approximately $6,863,000 and $6,705,000, respectively, of which approximately $3,432,000 and $3,352,000 were reimbursed by NCUSIF, respectively.

The Fund does not account for the assets of the above plans and does not have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported by the U.S. Office of Personnel Management for the Civil Service Retirement and Disability Fund and are not allocated to individual employers.

## 7. DISCLOSURES OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the Fund's financial instruments are as follows (in thousands):

| | December 31, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | $ 12,736 | $ 12,736 | $ 7,549 | $ 7,549 |
| Due from NCUSIF | 2,129 | 2,129 | 114 | 114 |
| Employee advances | 865 | 865 | 706 | 706 |
| Other accounts receivable | 113 | 113 | 94 | 94 |
| Accounts payable | 4,064 | 4,064 | 2,623 | 2,623 |
| Notes payable to NCUSIF | 34,574 | 34,574 | 35,987 | 35,987 |

## 8. CONTINGENCIES

*Field of Membership Litigation* - Four North Carolina Banks and the American Bankers Association (ABA) have challenged NCUA's approval of charter amendments granted to AT&T Family Federal Credit Union (FCU). The banks challenged amendments that allowed select employee groups that were unrelated to the original sponsor to join the FCU. Their claim is that the amendments violate the common bond requirements of the FCU Act.

In First National Bank & Trust Co., *et al*. v. National Credit Union Administration, the District Court concluded that NCUA's select employee group policy, which permitted more than one distinct employee group to exist in a single credit union, each with its own common bond, was a reasonable interpretation of the FCU Act. The banks appealed. On July 30, 1996, the U.S. Court of Appeals for the D.C. Circuit issued an opinion reversing the District Court. The Court concluded that all groups in a credit union must share a single common bond.

On remand to the District Court, the plaintiffs sought a nationwide injunction barring all federal credit unions from adding select employee groups that did not share a single common bond or adding new members to select employee groups already within their field of membership. NCUA objected arguing that this relief went far beyond what was sought in the AT&T case. The District Court then permitted the filing of a new lawsuit, ABA *et al*. v. NCUA *et al*., which for the first time directly challenged NCUA's multiple group policy nationwide. The Court then issued a nationwide injunction barring NCUA's group policy nationwide and prohibiting all federal credit unions from adding new select employee groups or new members to existing select employee groups.

On December 24, 1996, the Court of Appeals issued a partial stay whereby credit unions were allowed to admit new members to existing select employee groups, but were still prevented from adding new groups. On February 24, 1997, the Supreme Court agreed to hear the case. On February 25, 1998, the Supreme Court issued a decision holding that banks do have standing to challenge NCUA's interpretation of Section 109 of the FCU Act, and that NCUA's interpretation of the section was contrary to the unambiguous intent of Congress. However, in August 1998, Congress passed the Credit Union Membership Access Act (CUMAA), amending the FCU Act in favor of NCUA. The CUMAA allowed federal credit unions to retain their then-existing members and groups and to charter multiple common bond credit unions. CUMAA also authorized the chartering by NCUA of multiple common bond credit unions.

On December 17, 1998, NCUA's Board issued a final rule implementing the CUMAA. In response, on January 8, 1999, the ABA filed a new lawsuit, <u>ABA</u> v. <u>NCUA</u>, which seeks to challenge and invalidate NCUA's field of membership rule (IRPS 99-1) on the premise that the NCUA Board-approved membership rule unlawfully expands membership in, and eases restrictions on the formation of, federal credit unions.

In the opinion of management, the ultimate resolution of these matters will not be material to NCUA's financial position.

*Office of Personnel Management Action* - In September 1997, the U.S. Office of Personnel Management (OPM) transmitted to NCUA a report entitled "Report of a Delegated Examining Oversight Review, National Credit Union Administration," dated June 16-20, 1997 (the OPM Report). The OPM Report concluded that NCUA had violated merit systems principles and committed prohibited personnel practices. As a result of the OPM Report, NCUA lost its hiring authority and was required to undertake certain remedial actions with respect to its personnel practices. During 1998, NCUA took all corrective actions required by OPM and, on July 31, 1998, OPM returned NCUA's appointing authority.

During 1997, the OPM referred the aforementioned matter to the Office of Special Counsel (OSC) for an investigation of prohibited personnel practices. The OSC has not yet completed its investigation. Once the investigation is complete, the OSC will either take corrective action on its own or order NCUA to do so.

The resolution of these matters may result in claims against NCUA, as well as additional costs related to the remedial personnel actions required. In the opinion of management, the ultimate resolution of these matters will not be material to NCUA's financial position.

*Other Matters* - In addition, NCUA is currently party to a number of other disputes which involve or may involve litigation. In the opinion of management, the ultimate liability with respect to these disputes, if any, will not be material to NCUA's financial position.

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# NATIONAL CREDIT UNION ADMINISTRATION
# SHARE INSURANCE FUND

**Financial Statements for the Years Ended December 31, 1998 and 1997, and Independent Auditors' Reports**

## INDEPENDENT AUDITORS' REPORT

To the Inspector General of the
National Credit Union Administration:

We have audited the accompanying balance sheets of the National Credit Union Administration Share Insurance Fund as of December 31, 1998 and 1997, and the related statements of operations, fund balance and cash flows for the years then ended. These financial statements are the responsibility of the National Credit Union Administration Share Insurance Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Share Insurance Fund as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 1999, on our tests of the National Credit Union Administration Share Insurance Fund's compliance with certain provisions of laws, regulations, contracts, and grants, and our consideration of its internal control over financial reporting.

February 26, 1999

# NATIONAL CREDIT UNION ADMINISTRATION
# SHARE INSURANCE FUND

## BALANCE SHEETS
## DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| ASSETS | 1998 | 1997 |
|---|---|---|
| Investments (Note 5) | $2,827,099 | $3,125,921 |
| Cash and cash equivalents | 981,230 | 472,962 |
| Accrued interest receivable | 40,071 | 37,803 |
| Assets acquired in assistance to insured credit unions | 14,253 | 21,136 |
| Capital notes advanced to insured credit unions | 1,466 | 1,211 |
| Notes receivable - National Credit Union Administration Operating Fund (Note 8) | 34,574 | 35,987 |
| Other notes receivable | 947 | 454 |
| TOTAL ASSETS | $3,899,640 | $3,695,474 |

| LIABILITIES AND FUND BALANCE | | |
|---|---|---|
| LIABILITIES: | | |
| Estimated losses from supervised credit unions (Note 3) | $ 78,626 | $ 80,775 |
| Estimated losses from asset and merger guarantees (Note 3) | 42 | 257 |
| Amounts due to insured shareholders of liquidated credit unions | 7,612 | 20,148 |
| Due to National Credit Union Administration Operating Fund (Note 8) | 2,129 | 114 |
| Accounts payable | 554 | 494 |
| Total liabilities | 88,963 | 101,788 |
| COMMITMENTS AND CONTINGENCIES (Notes 3, 8, 10, and 11) | | |
| FUND BALANCE: | | |
| Insured credit unions' accumulated contributions | 2,938,503 | 2,772,896 |
| Insurance fund balance | 872,174 | 820,790 |
| Total fund balance | 3,810,677 | 3,593,686 |
| TOTAL LIABILITIES AND FUND BALANCE | $3,899,640 | $3,695,474 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# SHARE INSURANCE FUND

## STATEMENTS OF OPERATIONS
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| REVENUES: | | |
| Interest | $217,965 | $201,938 |
| Other | 2,033 | 2,151 |
| Total revenues | 219,998 | 204,089 |
| EXPENSES (Note 8): | | |
| Administrative expenses (Note 8): | | |
| Employee wages and benefits | 35,852 | 34,196 |
| Travel | 4,958 | 5,281 |
| Rent, communications, and utilities | 1,723 | 1,380 |
| Contracted services | 2,532 | 2,131 |
| Other | 6,006 | 6,779 |
| Total administrative expenses | 51,071 | 49,767 |
| Provision for insurance losses | - | - |
| Total expenses | 51,071 | 49,767 |
| EXCESS OF REVENUES OVER EXPENSES | $168,927 | $154,322 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# SHARE INSURANCE FUND

## STATEMENTS OF FUND BALANCE
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | Insured Credit Unions' Accumulated Contributions | Insurance Fund Balance |
|---|---|---|
| BALANCE AT JANUARY 1, 1997 | $2,637,743 | $ 774,421 |
| Contributions from insured credit unions | 135,153 | - |
| Excess of revenues over expenses | - | 154,322 |
| Dividends to insured credit unions | - | (107,953) |
| BALANCE AT DECEMBER 31, 1997 | 2,772,896 | 820,790 |
| Contributions from insured credit unions | 165,607 | - |
| Excess of revenues over expenses | - | 168,927 |
| Dividends to insured credit unions | - | (117,543) |
| BALANCE AT DECEMBER 31, 1998 | $2,938,503 | $ 872,174 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# SHARE INSURANCE FUND

## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Excess of revenues over expenses | $ 168,927 | $ 154,322 |
| Adjustments to reconcile excess of revenues over expenses to cash provided by operating activities: | | |
| Receipts (payments) relating to losses from supervised credit unions and assets and merger guarantees - net | (2,364) | (8,822) |
| (Increase) decrease in assets: | | |
| Accrued interest receivable | (2,268) | (313) |
| Assets acquired from credit unions, net | 6,883 | 694 |
| Capital notes advanced to credit unions - net | (255) | (946) |
| Other notes receivable | (493) | 1,852 |
| (Decrease) increase in liabilities: | | |
| Amounts due to National Credit Union Administration Operating Fund | 2,015 | (210) |
| Amounts due to insured shareholders of liquidated credit unions | (12,536) | (912) |
| Accounts payable | 60 | (99) |
| Net cash provided by operating activities | 159,969 | 145,566 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Investments, net | 298,822 | (201,454) |
| Collections on note receivable - National Credit Union Administration Operating Fund | 1,413 | 1,413 |
| Net cash provided by (used in) investing activities | 300,235 | (200,041) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Contributions from insured credit unions | 165,607 | 135,153 |
| Dividends to insured credit unions | (117,543) | (107,953) |
| Net cash provided by financing activities | 48,064 | 27,200 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 508,268 | (27,275) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 472,962 | 500,237 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 981,230 | $ 472,962 |

See notes to financial statements.

### 1. ORGANIZATION AND PURPOSE

The National Credit Union Share Insurance Fund Administration Share Insurance Fund (the Fund) was created by the Public Law 91-468 (Title II of the Federal Credit Union Act), which was amended in 1984 by Public Law 98-369 as discussed in Note 4. The Fund was established as a revolving fund in the United States Treasury under the management of the National Credit Union Administration (NCUA) Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state credit unions that request insurance. The maximum amount of insurance is $100,000 per shareholder account.

NCUA exercises direct supervisory authority over federal credit unions and coordinates required supervisory involvement with the state chartering authority for state-chartered credit unions insured by the Fund. Insured credit unions are required to report certain financial and statistical information to NCUA on a semiannual or quarterly basis depending on the size of the credit union and are subject to periodic examination by NCUA. Information derived through the supervisory and examination process provides the Fund with the ability to identify credit unions experiencing financial difficulties that may require assistance from the Fund.

Credit unions experiencing financial difficulties may be assisted by the Fund in continuing their operations if these difficulties are considered by the Fund to be temporary or correctable. This special assistance may be in the form of a waiver of statutory reserve requirements, a guarantee account, and/or cash assistance. If continuation of the credit union’s operations with Fund assistance is not feasible, a merger partner may be sought. If the assistance or merger alternatives are not practical, the credit union is liquidated.

The first form of special assistance is waivers of statutory reserve requirements, whereby the credit union is permitted to cease making additions to its regular reserve and, in more severe cases, to commence charging operating losses against its regular reserve. When all reserves have been depleted by the credit union, the fund may provide a reserve guarantee account in the amount of the reserve deficit. In addition, the Fund may provide cash assistance in the form of share deposits and capital notes, or may purchase assets from the credit union.

Mergers of financially troubled credit unions with stronger credit unions may also require Fund assistance. Merger assistance may be in the form of cash assistance, purchase of certain assets by the Fund, and/or guarantees of the values of certain assets (primarily loans).

When a credit union is no longer able to continue operating and the merger and assistance alternatives are not practical, the Fund will liquidate the credit union, dispose of its assets, and pay members’ shares up to the maximum insured amount. The values of certain assets sold (primarily loans) are sometimes guaranteed to third-party purchasers by the Fund.

## 2. SIGNIFICANT ACCOUNTING POLICIES

*Cash Equivalents and Investments* - Title II of the Federal Credit Union Act limits the Fund's investments to United States Government securities or securities guaranteed as to both principal and interest by the United States Government. Cash equivalents are highly liquid investments with originalmaturities of three months or less. All investments are classified as held-to-maturity under Statement of Financial Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Accordingly, the Fund records investments at amortized cost.

*Advances to Insured Credit Unions* - The Fund provides cash assistance in the form of interest and non-interest-bearing capital notes (carried at face value), share deposits, and loans to certain credit unions to assist them in continuing their operations.

*Assets Acquired from Credit Unions* - The Fund acquires the assets of liquidating credit unions pending their ultimate disposition. To assist in the merger of credit unions, the Fund may purchase certain credit union assets. In addition, the Fund may provide cash assistance by acquiring nonperforming assets of a credit union experiencing financial difficulty. These acquired assets are maintained by the Asset Management and Assistance Center in Austin, Texas, and are recorded by the Fund at their estimated net realizable value.

*Premium Revenue* - The Fund may assess each insured credit union a regular annual premium of 1/12 of 1% of its member share deposits (insured member share deposits in the case of corporate credit unions) outstanding as of December 31st of the preceding insurance year. The NCUA Board waived the 1998 and 1997 share insurance premiums.

*Income Taxes* - The Fund is exempt from Federal income taxes under §501(c)(1) of the Internal Revenue Code.

*Fair Value of Financial Instruments* - The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

a. *Cash and Cash Equivalents* - The carrying amounts for cash and cash equivalents approximate fair values.

b. *Investments* - The fair value for investments is the quoted market value.

c. *Capital Notes and Other Notes Receivable* - It is not practicable to estimate the fair value of these assets as there is no secondary market, and the Fund has the ability and the intention to hold these notes to maturity.

d. *Other* - Accrued interest receivable, notes receivable from NCUA Operating Fund, payable to NCUA Operating Fund, due to insured shareholders of liquidated credit unions and other accounts payable are recorded at book values, which approximate the respective fair values.

*Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimates.

*Reclassifications* - Certain reclassifications to 1997 amounts were made to conform to the 1998 presentation.

## 3. PROVISION FOR INSURANCE LOSSES

Management identifies credit unions experiencing financial difficulty through the Fund's supervisory and examination process. The estimated losses from these supervised credit unions are determined by management on a specified case basis. Management also evaluates overall economic trends and monitors potential system-wide risk factors such as increasing levels of consumer debt, bankruptcies, and delinquencies. Nonspecified case reserve requirements are determined based upon an assessment of insured risk and historic loss experience. The anticipated losses are net of estimated recoveries from the disposition of the assets of failed credit unions.

Total insurance in force as of December 31, 1998, is $322 billion. The total net reserves for identified and anticipated losses from supervised credit unions' failures were $79 million at December 31, 1998. Should there be no recoveries provided during the resolution process, possible additional reserves for $30 million would be required.

In exercising its supervisory function, the Fund will, at times, extend guarantees of assets (primarily loans) to third-party purchasers or to credit unions to facilitate mergers. Such guarantees totaled approximately $556,000 and $933,000 at December 31, 1998 and 1997, respectively. The estimated losses from asset and merger guarantees are determined by management on a case-by-case evaluation.

In addition, the Fund guarantees loans made by the NCUA's Central Liquidity Facility (CLF). Total line-of-credit guarantees of credit unions at December 31, 1998 and 1997, are approximately $25,311,000 and $4,241,000, respectively. The total balances outstanding under these line-of-credit guarantees at December 31, 1998 and 1997, are approximately $384,000 and $-0-, respectively.

The activity in the reserves for estimated losses from supervised credit unions and asset and merger guarantees was as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | **1998** | **1997** |
| BEGINNING BALANCE | $ 81,032 | $ 89,855 |
| Insurance losses | (5,139) | (12,916) |
| Recoveries | 2,775 | 4,093 |
| ENDING BALANCE | $ 78,668 | $ 81,032 |

## 4. FUND CAPITALIZATION

Title VIII of Public Law 98-369, effective July 14, 1984, provided for the capitalization of the Fund through the contribution by each insured credit union of an amount equal to 1% of the credit union's insured shares to be paid initially by January 21, 1985, and to be adjusted annually thereafter. The annual adjustment of the contribution is based on member share deposits outstanding as of December 31st of the preceding year and is billed on a calendar year basis. The 1% contribution will be returned to the insured credit union in the event that its insurance coverage is terminated, or is obtained from another source, or the operations of the Fund are transferred from the NCUA Board.

The law requires that, upon receipt of the 1% contribution, the total fund balance must be maintained at a normal operating level as determined by the NCUA Board. The NCUA Board has determined this level to range from 1.25% to 1.30% of insured shares. The level at both December 31, 1998 and 1997, was 1.30%. Total insured shares at December 31, 1998 and 1997, were $322 billion and $294 billion, respectively.

The NCUA Board declared and paid dividends of approximately $117,543,000 and $107,953,000 during 1998 and 1997, respectively.

## 5. INVESTMENTS

All cash received by the Fund that is not used for outlays related to assistance to insured credit unions and liquidation activities is invested in U.S. Treasury securities.

Investments consist of the following (in thousands):

| | December 31, 1998 | | | | |
|---|---|---|---|---|---|
| | **Yield to Maturity at Market** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Estimated Market Value** |
| U.S. TREASURY SECURITIES: | | | | | |
| Maturities up to one year | 5.98 % | $1,528,491 | $10,899 | $ (15) | $1,539,375 |
| Maturities after one year through five years | 6.11 % | 1,298,608 | 29,361 | - | 1,327,969 |
| Total | | $2,827,099 | $40,260 | $ (15) | $2,867,344 |

| | December 31, 1997 | | | | |
|---|---|---|---|---|---|
| | **Yield to Maturity at Market** | **Amortized Cost** | **Gross Unrealized Gains** | **Gross Unrealized Losses** | **Estimated Market Value** |
| U.S. TREASURY SECURITIES: | | | | | |
| Maturities up to one year | 5.40 % | $1,399,078 | $ 330 | $(2,205) | $1,397,203 |
| Maturities after one year through five years | 6.25 % | 1,726,843 | 18,395 | (590) | 1,744,648 |
| Total | | $3,125,921 | $18,725 | $(2,795) | $3,141,851 |

Total investment purchases during both 1998 and 1997 were approximately $1.1 billion. Investment maturities during 1998 and 1997 were approximately $1.4 billion and $900 million, respectively. The Fund has the capability and management has the intention to hold all investments held at December 31, 1998 and 1997, to maturity. There were no investment sales during 1998 and 1997.

## 6. OTHER ASSETS

Other assets are primarily comprised of secured and unsecured term notes related to the sale of assets held by the Asset Management and Assistance Center and recoveries on failed credit unions. The notes are being repaid in monthly principal installments with terms ranging from one to thirty years and interest rates ranging from 8.0% to 10.5%.

## 7. AVAILABLE BORROWINGS

The Fund is authorized by the Federal Credit Union Act to borrow from the Treasury of the United States, upon authorization by the NCUA Board, up to a maximum of $100,000,000. The CLF is authorized to make advances to the Fund under terms and conditions established by the NCUA Board. No borrowings were obtained from these sources during 1998 and 1997.

## 8. TRANSACTIONS WITH NCUA OPERATING FUND

Substantial administrative services are provided to the Fund by the NCUA Operating Fund. The NCUA Operating Fund charges the Fund for these services based on an annual allocation factor approved by the NCUA Board derived from a study of actual usage conducted by the management of these Funds. The allocation factor was 50% to the Fund and 50% to the NCUA Operating Fund for 1998 and 1997. The cost of services provided by the NCUA Operating Fund was approximately $50,293,000 and $48,607,000 for 1998 and 1997, respectively, and includes pension contributions of approximately $3,432,000 and $3,353,000 to the Civil Service Retirement System and Federal Employees Retirement System defined benefit retirement plans for 1998 and 1997, respectively.

In 1988, the Fund entered into a $2,161,000 thirty-year unsecured term note with the NCUA Operating Fund. Interest received was approximately $81,000 for 1998 and $83,000 for 1997. The note receivable balance at December 31, 1998 and 1997, was approximately $1,386,000 and $1,458,000, respectively.

In 1992, the Fund entered into a commitment to fund up to $41,975,000 through a thirty-year secured term note with the NCUA Operating Fund. The monies were advanced to the NCUA Operating Fund as needed to fund the costs of constructing a new building. Interest income was approximately $1,926,000 and $1,945,000 for 1998 and 1997, respectively. The note receivable balance at December31, 1998, was approximately $33,188,000.

The above notes mature as follows (in thousands):

| | Unsecured Term Note | Secured Term Note | Total |
|---|---|---|---|
| 1999 | $ 72 | $ 1,341 | $ 1,413 |
| 2000 | 72 | 1,341 | 1,413 |
| 2001 | 72 | 1,341 | 1,413 |
| 2002 | 72 | 1,341 | 1,413 |
| 2003 | 72 | 1,341 | 1,413 |
| Thereafter | 1,026 | 26,483 | 27,509 |
| Total | $ 1,386 | $ 33,188 | $ 34,574 |

The variable rate on both term notes is equal to the Fund's prior-month yield on investments. The average interest rate during 1998 and 1997 was approximately 5.70% and 5.53%, respectively. At December 31, 1998, the rate was 5.74%.

The NCUA Operating Fund leases certain office space and equipment under operating lease agreements that expire through 2003. Based on the allocation factor approved by the NCUA Board for 1998, the Fund will reimburse the NCUA Operating Fund for approximately 50% of the future lease payments. The cost of services provided by the NCUA Operating Fund includes rental charges of approximately $488,000 and $339,000 for 1998 and 1997, respectively. The amounts were derived using the current annual allocation factor.

The NCUA Operating Fund's total future minimum lease payments as of December 31, 1998, are as follows (in thousands):

| | |
|---|---|
| 1999 | $ 888 |
| 2000 | 538 |
| 2001 | 561 |
| 2002 | 571 |
| 2003 | 88 |
| Total | $ 2,646 |

## 9. DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the Fund's financial instruments are as follows:

| | December 31, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Investments | $2,827,099 | $2,867,344 | $3,125,921 | $3,141,851 |
| Cash and cash equivalents | 981,230 | 981,230 | 472,962 | 472,962 |
| Accrued interest receivable | 40,071 | 40,071 | 37,803 | 37,803 |
| Notes receivable - NCUA Operating Fund | 34,574 | 34,574 | 35,987 | 35,987 |
| Amounts due to insured shareholders of liquidated credit unions | 7,612 | 7,612 | 20,148 | 20,148 |
| Due to NCUA Operating Fund | 2,129 | 2,129 | 114 | 114 |
| Accounts payable | 554 | 554 | 494 | 494 |

## 10. CONCENTRATIONS

There are no significant concentrations of member share deposits within any region of the United States. Concentrations of member shares do exist within the manufacturing, governmental, and educational industries.

## 11. CONTINGENCIES

*Field of Membership Litigation* - Four North Carolina Banks and the American Bankers Association (ABA) have challenged NCUA's approval of charter amendments granted to AT&T Family Federal Credit Union (FCU). The banks challenged amendments that allowed select employee groups that were unrelated to the original sponsor to join the FCU. Their claim is that the amendments violate the common bond requirements of the FCU Act.

In First National Bank & Trust Co., *et al.* *v.* National Credit Union Administration, the District Court concluded that NCUA's select employee group policy, which permitted more than one distinct employee group to exist in a single credit union, each with its own common bond, was a reasonable interpretation of the FCU Act. The banks appealed. On July 30, 1996, the U.S. Court of Appeals for the D.C. Circuit issued an opinion reversing the District Court. The Court concluded that all groups in a credit union must share a single common bond.

On remand to the District Court, the plaintiffs sought a nationwide injunction barring all federal credit unions from adding select employee groups that did not share a single common bond or adding new members to select employee groups already within their field of membership. NCUA objected, arguing that this relief went far beyond what was sought in the AT&T case. The District Court then permitted the filing of a new lawsuit, ABA *et al.* *v.* NCUA *et al.*, which for the first time directly challenged NCUA's multiple group policy nationwide. The Court then issued a nationwide injunction barring NCUA's group policy nationwide and prohibiting all federal credit unions from adding new select employee groups or new members to existing select employee groups.

On December 24, 1996, the Court of Appeals issued a partial stay whereby credit unions were allowed to admit new members to existing select employee groups but were still prevented from adding new groups. On February 24, 1997, the Supreme Court agreed to hear the case. On February 25, 1998, the Supreme Court issued a decision holding that banks do have standing to challenge NCUA's interpretation of Section 109 of the FCU Act, and that NCUA's interpretation of that section was contrary to the unambiguous intent of Congress. However, in August 1998, Congress passed the Credit Union Membership Access Act (CUMAA), amending the FCU Act in favor of NCUA. The CUMAA allowed federal credit unions to retain their then-existing members and groups and to charter multiple common bond credit unions. CUMAA also authorized the chartering by NCUA of multiple common bond credit unions.

On December 17, 1998, NCUA's Board issued a final rule implementing the CUMAA. In response, on January 8, 1999, the ABA filed a new lawsuit, ABA *v.* NCUA which seeks to challenge and invalidate NCUA's field of membership rule (IRPS 99-1) on the premise that the NCUA Board-approved membership rule unlawfully expands membership in, and eases restrictions on the formation of, federal credit unions.

In the opinion of management, the ultimate resolution of these matters will not be material to NCUA's financial position.

*Office of Personnel Management Action* - In September 1997, the U.S. Office of Personnel Management (OPM) transmitted to NCUA a report entitled "Report of a Delegated Examining Oversight Review, National Credit Union Administration," dated June 16-20, 1997 (the OPM Report). The OPM Report concluded that NCUA had violated merit systems principles and committed prohibited personnel practices. As a result of the OMP Report, NCUA lost its hiring authority and was required to undertake certain remedial actions with respect to its personnel practices. During 1998, NCUA took all corrective actions required by OPM and, on July 31, 1998, OPM returned NCUA's appointing authority.

During 1997, the OPM referred the aforementioned matter to the Office of Special Counsel (OSC) for an investigation of prohibited personnel practices. The OSC has not yet completed its investigation. Once the investigation is complete, the OSC will either take corrective action on its own or order NCUA to do so.

The resolution of these matters may result in claims against NCUA, as well as additional costs related to the remedial personnel actions required. In the opinion of management, the ultimate resolution of these matters will not be material toNCUA's financial position.

*Other Matters* - In addition, NCUA is currently party to a number of other disputes that involve or may involve litigation. In the opinion of management, the ultimate liability with respect to those disputes, if any, will not be material toNCUA's financial position.

# NATIONAL CREDIT UNION ADMINISTRATION CENTRAL LIQUIDITY FACILITY

**Financial Statements for the Years Ended December 31, 1998 and 1997, and Independent Auditors' and Accountants' Reports**

**INDEPENDENT AUDITORS' REPORT**

To the Inspector General of the
National Credit Union Administration:

We have audited the accompanying balance sheets of the National Credit Union Administration Central Liquidity Facility (CLF) as of December 31, 1998 and 1997, and the related statements of operations, members' equity, and cash flows for the years then ended. These financial statements are the responsibility of CLF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Central Liquidity Facility as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 1999, on our examination of the National Credit Union Administration Central Liquidity Facility's assertions as to the effectiveness of its internal control over financial reporting, and our report dated February 26, 1999, on our tests of its compliance with certain provisions of laws and regulations.

February 26, 1999

# NATIONAL CREDIT UNION ADMINISTRATION
# CENTRAL LIQUIDITY FACILITY

## BALANCE SHEETS
## DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| ASSETS | 1998 | 1997 |
|---|---|---|
| Cash | $ 12 | $ 14 |
| Investments with U.S. Central Credit Union (Notes 5 and 8) | 797,405 | 763,332 |
| Accrued interest receivable | 8,233 | 9,718 |
| TOTAL ASSETS | $ 805,650 | $ 773,064 |

### LIABILITIES AND MEMBERS' EQUITY

| | 1998 | 1997 |
|---|---|---|
| LIABILITIES: | | |
| Member deposits (Note 7) | $ 25,782 | $ 25,813 |
| Accounts payable and other liabilities | 59 | 69 |
| Total liabilities | 25,841 | 25,882 |
| MEMBERS' EQUITY: | | |
| Capital stock - required (Note 7) | 768,298 | 735,671 |
| Retained earnings | 11,511 | 11,511 |
| Total members' equity | 779,809 | 747,182 |
| TOTAL LIABILITIES AND MEMBERS' EQUITY | $ 805,650 | $ 773,064 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# CENTRAL LIQUIDITY FACILITY

## STATEMENTS OF OPERATIONS
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| REVENUE - Investment income | $ 40,028 | $ 42,245 |
| EXPENSES: | | |
| Operating expenses: | | |
| Group agent service fee | 1 | 2 |
| Personnel services | 85 | 97 |
| Other services | 26 | 30 |
| Rent, communications and utilities | 14 | 14 |
| Personnel benefits | 19 | 18 |
| Supplies and materials | 2 | 2 |
| Employee travel | 2 | 3 |
| Printing and reproduction | 4 | 6 |
| Total operating expenses | 153 | 172 |
| Interest - member deposits | 449 | 531 |
| Total expenses | 602 | 703 |
| EXCESS OF REVENUE OVER EXPENSES | $ 39,426 | $ 41,542 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# CENTRAL LIQUIDITY FACILITY

## STATEMENTS OF MEMBERS' EQUITY
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | Capital Stock | Retained Earnings |
|---|---|---|
| BALANCE AT JANUARY 1, 1997 | $ 706,214 | $ 11,511 |
| Issuance of required capital stock | 29,730 | - |
| Redemption of required capital stock | (273) | - |
| Dividends | - | (41,542) |
| Excess of revenue over expenses | | 41,542 |
| BALANCE AT DECEMBER 31, 1997 | 735,671 | 11,511 |
| Issuance of required capital stock | 32,627 | - |
| Redemption of required capital stock | - | - |
| Dividends | - | (39,426) |
| Excess of revenue over expenses | - | 39,426 |
| BALANCE AT DECEMBER 31, 1998 | $ 768,298 | $ 11,511 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# CENTRAL LIQUIDITY FACILITY

## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 1998 AND 1997
## (Dollars in Thousands)

| | 1998 | 1997 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Excess of revenue over expenses | $ 39,426 | $ 41,542 |
| Adjustments to reconcile excess of revenue over expenses to net cash provided by operating activities: | | |
| Decrease (increase) in accrued interest receivable | 1,485 | (286) |
| Decrease in accounts payable and other liabilities | (10) | (10) |
| Net cash provided by operating activities | 40,901 | 41,246 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of investments | (34,073) | (38,293) |
| Net cash used in investing activities | (34,073) | (38,293) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Additions to member deposits | 1,506 | 9,486 |
| Issuance of required capital stock | 32,627 | 29,730 |
| Dividends | (39,426) | (41,542) |
| Withdrawal of member deposits | (1,537) | (341) |
| Redemption of required capital stock | - | (273) |
| Net cash used in financing activities | (6,830) | (2,940) |
| NET (DECREASE) INCREASE IN CASH | (2) | 13 |
| CASH, BEGINNING OF YEAR | 14 | 1 |
| CASH, END OF YEAR | $ 12 | $ 14 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# CENTRAL LIQUIDITY FACILITY

## NOTES TO FINANCIAL STATEMENTS
## YEARS ENDED DECEMBER 31, 1998 AND 1997

### 1. ORGANIZATION AND PURPOSE

The National Credit Union Administration Central Liquidity Facility (CLF) was created by the National Credit Union Central Liquidity Facility Act (the Act). The CLF is designated as a mixed-ownership government corporation under the Government Corporation Control Act. The CLF exists within the National Credit Union Administration (NCUA) and is managed by the National Credit Union Administration Board. The CLF became operational on October1, 1979.

The purpose of the CLF is to improve general financial stability by meeting the liquidity needs of credit unions. The CLF is a tax-exempt organization under Section 501(c)(1) of the Internal Revenue Code.

### 2. SIGNIFICANT ACCOUNTING POLICIES

*Basis of Accounting* - The CLF maintains its accounting records on the accrual basis of accounting.

*Allowance for Loan Losses* - Loans to members are made on both a short-term and long-term basis. For all loans, the CLF either obtains a security interest in the assets of the borrower or in some cases receives the guarantee of the NCUA Share Insurance Fund.

The CLF evaluates the collectibility of its loans to members through examination of the financial condition of the individual borrowing credit unions and the credit union industry in general.

*Investments* - The CLF invests in redeposits and share accounts at U.S. Central Credit Union (see Notes 5 and 8). All other investments are short-term with nomaturities in excess of one year. All investments are classified as held-to-maturity under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Accordingly, the CLF records investments at amortized cost.

*Fair Value of Financial Instruments* - The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

a. *Cash* - The carrying amounts for cash approximate fair value.

b. *Investments* - Securities held have maturities of one year or less and, as such, the carrying amounts approximate fair value.

c. *Loans* - For loans advanced to member credit unions, the carrying amounts approximate fair value. There were no loans to members outstanding at December 31, 1998 and 1997.

d. *Member Deposits* - Funds maintained with the CLF in excess of required capital amounts are recorded as member deposits. These deposits are due upon demand and the carrying amounts approximate the fair value.

e. *Other* - Accrued interest receivable and accounts payable and other liabilities are recorded at book values, which approximate the respective fair values.

*Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimates.

*Reclassifications* - Certain reclassifications to 1997 amounts were made to conform to the 1998 presentation.

## 3. GOVERNMENT REGULATIONS

The CLF is subject to various Federal laws and regulations. The CLF's operating budget requires Congressional approval and the CLF may not make loans to members for the purpose of expanding credit union loan portfolios. The CLF's investments are restricted to obligations of the United States Government and its agencies, deposits in Federally insured financial institutions, and shares and deposits in credit unions. Borrowing is Congressionally limited to twelve times equity and capital subscriptions on-call. However, there is a Congressional limitation of $600,000,000 on funds that are borrowed and then loaned out at any one point in time. At December 31, 1998 and 1997, the CLF was in compliance with these Congressional limitations.

## 4. LOANS TO MEMBERS

There were no loans outstanding at December 31, 1998 or 1997. However, the CLF provides members with extended loan commitments and lines of credit. There were no outstanding loan commitments or lines of credit at December 31, 1998.

## 5. FUNDS ON DEPOSIT WITH U.S. CENTRAL CREDIT UNION

Funds not currently required for operations are invested as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 1998 | 1997 |
| U.S. Central Credit Union (see Note 8): | | |
| Redeposit Account | $ 732,320 | $ 705,332 |
| Share accounts | 65,085 | 58,000 |
| | $ 797,405 | $ 763,332 |

## 6. BORROWING AUTHORITY

The Secretary of the Treasury is authorized by the Act to lend up to $500 million to the CLF in the event that the Board certifies to the Secretary that the CLF does not have sufficient funds to meet the liquidity needs of credit unions. This authority to lend is limited to such extent and in such amounts as are provided in advance by Congressional Appropriation Acts. On December23, 1981, President Reagan signed PL 97-101, which provided $100 million of permanent indefinite borrowing authority that may be provided by the Secretary of the Treasury to the CLF to meet emergency liquidity needs of credit unions.

Borrowings would be from the Federal Financing Bank with interest generally payable upon maturity. There were no borrowings outstanding at December 31, 1998 and 1997.

## 7. CAPITAL STOCK AND MEMBER DEPOSITS

The required capital stock account represents subscriptions remitted to the CLF by member credit unions. Regular members' required subscription amounts equal one-half of one percent of their paid-in and unimpaired capital and surplus, one-half of which amount is required to be remitted to the CLF. Agent members' required subscription amounts equal one-half of one percent of the paid-in and unimpaired capital and surplus of all of the credit unions served by the agent member, one-half of which is required to be remitted to the CLF. In both cases, the remaining one-half of the subscription is required to be held in liquid assets by the member credit unions subject to call by the National Credit Union Administration Board. These unremitted subscriptions are not reflected in theCLF's financial statements. Subscriptions are adjusted annually to reflect changes in the member credit unions' paid-in and unimpaired capital and surplus. Dividends are declared and paid on required capital stock.

Member deposits represent amounts remitted by members over and above the amount required for membership. Interest is paid on member deposits at a rate equivalent to the dividend rate paid on required capital stock.

## 8. U.S. CENTRAL CREDIT UNION MEMBERSHIP

During fiscal year 1984, the CLF accepted a membership request from U.S. Central Credit Union (USC) on behalf of 29 of its corporate credit union members. At December 31, 1998 and 1997, $732,320,000 and $705,332,000, respectively, of the required portion of subscribed capital stock was purchased from the CLF by USC on behalf of its member credit unions.

In addition, by accepting the USC membership request, the CLF was initially committed to reinvest all but $50,000,000 of its total share capital in USC at market rates of interest. Beginning April 1, 1996, the CLF reinvests all of its agent member share capital in USC at market rates of interest. At December 31, 1998 and 1997, approximately $797,405,000 and $763,332,000, respectively, were invested in USC share accounts at 4.51% and 5.48%, respective yields.

## 9. CONCENTRATION OF CREDIT RISK

At December 31, 1998 and 1997, the CLF has a concentration of credit risk for its investments on deposit with USC of approximately $797,405,000 and $763,332,000 (see Notes 5 and 8).

## 10. SERVICES PROVIDED BY THE NATIONAL CREDIT UNION ADMINISTRATION

The National Credit Union Administration provides the CLF with data processing and other miscellaneous services and supplies. In addition, the National Credit Union Administration pays CLF's employees' salaries and benefits as well as the CLF's portion of monthly building operating costs. The CLF reimburses the National Credit Union Administration on a monthly basis for these items. Total reimbursements for the years ended December 31, 1998 and 1997, amounted to approximately $151,000 and $171,000, respectively.

## 11. DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the CLF's financial instruments are as follows (in thousands):

| | December 31, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash | $ 12 | $ 12 | $ 14 | $ 14 |
| Investments | 797,405 | 797,405 | 763,332 | 763,332 |
| Accrued interest receivable | 8,233 | 8,233 | 9,718 | 9,718 |
| Member deposits | 25,782 | 25,782 | 25,813 | 25,813 |
| Accounts payable and other liabilities | 59 | 59 | 69 | 69 |

* * * * * *

# NATIONAL CREDIT UNION ADMINISTRATION COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

**Financial Statements for the Years Ended December 31, 1998 and 1997, and Independent Auditors' Reports**

**INDEPENDENT AUDITORS' REPORT**

To the Inspector General of the
National Credit Union Administration:

We have audited the accompanying balance sheets of the National Credit Union Administration Community Development Revolving Loan Program (CDRLP) as of December 31, 1998 and 1997, and the related statements of operations, changes in program balance, and cash flows for the years then ended. These financial statements are the responsibility of the CDRLP's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Community Development Revolving Loan Program as of December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 1999, on our tests of the National Credit Union Administration Community Development Revolving Loan Program's compliance with certain provisions of laws, regulations, contracts, and grants, and on our consideration of its internal control over financial reporting.

February 26, 1999

# NATIONAL CREDIT UNION ADMINISTRATION
# COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

## BALANCE SHEETS
## DECEMBER 31, 1998 AND 1997

| ASSETS | 1998 | 1997 |
|---|---|---|
| Cash and cash equivalents (Note 2) | $ 3,043,631 | $ 2,072,615 |
| Loans - net of allowance (Note 4) | 7,666,977 | 6,688,931 |
| Interest receivable | 62,431 | 55,721 |
| TOTAL ASSETS | $ 10,773,039 | $ 8,817,267 |

## LIABILITIES AND PROGRAM BALANCE

| | | |
|---|---|---|
| LIABILITIES: | | |
| Accrued technical assistance | $ 190,560 | $ 85,245 |
| Total liabilities | 190,560 | 85,245 |
| PROGRAM BALANCE: | | |
| Revolving fund capital (Note 3) | 10,000,000 | 8,000,000 |
| Accumulated earnings | 582,479 | 732,022 |
| Total program balance | 10,582,479 | 8,732,022 |
| TOTAL LIABILITIES AND PROGRAM BALANCE | $ 10,773,039 | $ 8,817,267 |

See notes to financial statements.

## NATIONAL CREDIT UNION ADMINISTRATION
## COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

### STATEMENTS OF OPERATIONS
### YEARS ENDED DECEMBER 31, 1998 AND 1997

| | 1998 | 1997 |
|---|---|---|
| REVENUES: | | |
| Interest on cash equivalents | $ 59,795 | $ 53,147 |
| Interest on loans | 217,972 | 175,475 |
| Provision for loan losses | (21,658) | (17,437) |
| Total | 256,109 | 211,185 |
| EXPENSES: | | |
| Technical assistance | (405,652) | (193,793) |
| Total | (405,652) | (193,793) |
| (DEFICIENCY) EXCESS OF REVENUES OVER EXPENSES | $ (149,543) | $ 17,392 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

## STATEMENTS OF CHANGES IN PROGRAM BALANCE
## YEARS ENDED DECEMBER 31, 1998 AND 1997

| | 1998 | 1997 |
|---|---|---|
| PROGRAM BALANCE, BEGINNING OF YEAR | $ 8,732,022 | $7,714,630 |
| Appropriation - revolving fund capital | 2,000,000 | 1,000,000 |
| (Deficiency) excess of revenues over expenses | (149,543) | 17,392 |
| PROGRAM BALANCE, END OF YEAR | $10,582,479 | $8,732,022 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

## STATEMENTS OF CASH FLOWS
## YEARS ENDED DECEMBER 31, 1998 AND 1997

| | 1998 | 1997 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| (Deficiency) excess of revenues over expenses | $ (149,543) | $ 17,392 |
| Adjustments to reconcile the (deficiency) excess of revenues over expenses to net cash (used in) provided by operating activities: | | |
| Provision for loan losses | 21,658 | 17,437 |
| Increase in interest receivable | (6,710) | (5,106) |
| Increase in accrued technical assistance | 105,315 | 22,660 |
| Net cash (used in) provided by operating activities | (29,280) | 52,383 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Loan principal repayments | 1,965,296 | 1,768,944 |
| Loan disbursements | (2,965,000) | (2,261,000) |
| Net cash used in investing activities | (999,704) | (492,056) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Appropriation - revolving fund capital | 2,000,000 | 1,000,000 |
| Net cash provided by financing activities | 2,000,000 | 1,000,000 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 971,016 | 560,327 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 2,072,615 | 1,512,288 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | $ 3,043,631 | $ 2,072,615 |

See notes to financial statements.

# NATIONAL CREDIT UNION ADMINISTRATION
# COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM

## NOTES TO FINANCIAL STATEMENTS
## YEARS ENDED DECEMBER 31, 1998 AND 1997

### 1. NATURE OF ORGANIZATION

The Community Development Revolving Loan Program for Credit Unions (CDRLP) was established by an act of Congress (Public Law 96-123, November 20, 1979) to stimulate economic development in low-income communities. The National Credit Union Administration (NCUA) and the Community Services Association (CSA) jointly adopted Part 705 of NCUA Rules and Regulations, governing administration of the Program, on February 28, 1980.

Upon the dissolution of CSA in 1983, administration of the CDRLP was transferred to the Department of Health and Human Services (HHS). Because HHS never promulgated final regulations governing the administration of the CDRLP, the program was dormant.

The Community Development Credit Union Transfer Act (Public Law 99-604, November 6, 1986) transferred CDRLP administration back to NCUA. The NCUA Board adopted amendments to Part 705 of NCUA Rules and Regulations on September 16, 1987, and began making loans/deposits to participating credit unions in 1990.

The purpose of the CDRLP is to stimulate economic activities in the communities served by low-income credit unions which will result in increased income, ownership and employment opportunities for low-wealth residents and other economic growth. The policy of NCUA is to revolve the loans to qualifying credit unions as often as practical in order to gain maximum impact on as many participating credit unions as possible.

### 2. SIGNIFICANT ACCOUNTING AND OPERATIONAL POLICIES

*Basis of Accounting* - The CDRLP reports its financial statements on the accrual basis of accounting.

*Cash Equivalents* - The Federal Credit Union Act permits the CDRLP to make investments in United States Government Treasury securities. All investments in 1998 and 1997 were cash equivalents and are stated at cost which approximates market. Cash equivalents are highly liquid investments with original maturities of three months or less.

*Allowance for Loan Losses* - The CDRLP records a provision for estimated loan losses. Loans considered to beuncollectible are charged to the allowance for loan losses. Management continually evaluates the adequacy of the allowance for loan losses based upon prevailing circumstances and an assessment of collectibility risk of the total loan portfolio. Accrual of interest is discontinued on non-performing loans when management believes collectibility is doubtful. At December 31, 1998 and 1997, there were nononaccrual loans.

*Salary and Operating Expenses* - NCUA provides certain general and administrative support to the CDRLP, including office space, salaries, and certain supplies. The value of these contributed services is not allocated to the CDRLP. Consequently, the results of operations would be significantly different if the CDRLP were required to pay these expenses.

*Use of Estimates* - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's estimates.

*Reclassifications* - Certain reclassifications to 1997 amounts were made to conform to the 1998 presentation.

## 3. GOVERNMENT REGULATIONS

The CDRLP is subject to various Federal laws and regulations. Lending is Congressionally limited to a total of the $10,000,000 appropriated for the CDRLP plus accumulated earnings. Included in this $10,000,000 is $1,000,000 that was made available to the CDRLP during 1996 in accordance with Public Law 104-204, and an additional $1,000,000 that was made available to the CDRLP during 1997 in accordance with Public Law 105-65. During 1998, the CDRLP received a supplementary appropriation of $2,000,000 to expand its community loan program. These funds were approved on October 21, 1998, in accordance with Public Law 105-276, which authorizes the use of these funds and includes accumulated earnings that are to remain available until expended. Federally chartered and state-chartered credit unions may participate in the Program. Loans may be made to predominantly low-income credit unions as defined by the NCUA and are recorded in the participant's accounting records as nonmember deposits. As nonmember deposits, the NCUA Share Insurance Fund (NCUSIF) may insure these loans to participating credit unions in an amount not to exceed $100,000 per credit union. The covered amount of loans recorded as nonmember deposits by participating credit unions insured by the NCUSIF totaled approximately $4,956,000 and $4,738,000 at December 31, 1998 and 1997, respectively.

Loans issued prior to June 1993 were limited to a maximum amount of $200,000. Loans issued thereafter are limited to a maximum amount of $300,000. Loans issued prior to January 1, 1995, carry a fixed rate of 2%; loans issued between January 1, 1995, and December 31, 1998, carry a fixed interest rate of 3%; and loans issued after January 1, 1999, carry a fixed rate of 2%. Interest and principal are repaid on a semiannual basis beginning one year after the initial distribution of the loan. The maximum term of each loan is five years. Participating credit unions are required to match the value of the loan within one year of the date of approval of the loan.

## 4. LOANS

Loans outstanding at December 31, 1998, are scheduled to be repaid as follows:

| | |
|---|---|
| 1999 | $2,155,881 |
| 2000 | 1,934,200 |
| 2001 | 1,858,700 |
| 2002 | 1,173,300 |
| 2003 | 712,500 |
| | 7,834,581 |
| Less - allowance for loan losses | (167,604) |
| Net loans outstanding | $7,666,977 |

Changes in the allowance for loan losses are summarized below:

| | **1998** | **1997** |
|---|---|---|
| Balance, beginning of year | $145,946 | $ 70,132 |
| Provision for loan losses | 21,658 | 17,437 |
| Recovery of previously written-off amounts | - | 58,377 |
| Balance, end of year | $167,604 | $145,946 |

There have been no write-offs of outstanding loans for the years ended December 31, 1998 and 1997.

## 5. CONCENTRATION OF CREDIT RISK

At December 31, 1998 and 1997, there are no significant concentrations of credit risk in the loan portfolio. As discussed in Note 1, the CDRLP provides loans to credit unions that serve predominantly low-income communities.

## 6. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosures of the estimated fair value of financial instruments are made in accordance with the requirements of Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments." The methods and assumptions used in estimating the fair value disclosures for financial instruments are as follows:

*Cash and Cash Equivalents* - The carrying amounts for cash and cash equivalents approximate fair values.

*Interest Receivable* and *Accrued Technical Assistance* - Are recorded at book values, which approximate the respective fair values.

*Loans* - The fair value is estimated by discounting projected future cash flows using current market interest rates. For purposes of this calculation, the discount rate used was the prime interest rate plus two percent (9.75% at December 31, 1998, and 10.50% at December 31, 1997).

The carrying amount and the estimated fair value of the CDRLP's financial instruments are as follows:

| | December 31, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Assets: | | | | |
| Cash and cash equivalents | $3,043,631 | $3,043,631 | $2,072,615 | $2,072,615 |
| Interest receivable | $ 62,431 | $ 62,431 | $ 55,721 | $ 55,721 |
| Loans | $7,834,581 | $6,232,368 | $6,834,877 | $5,758,586 |
| Allowance for loan losses | (167,604) | (167,604) | (145,946) | (145,946) |
| Loans, net of allowance | $7,666,977 | $6,064,764 | $6,688,931 | $5,612,640 |
| Liabilities: | | | | |
| Accrued technical assistance | $ 190,560 | $ 190,560 | $ 85,245 | $ 85,245 |

It is the intent of the CDRLP to hold its loans to maturity. The CDRLP anticipates realizing the carrying amount in full.

* * * * * *