Audit Report

OIG 04-011

Audit of the Office of Thrift Supervision Fiscal Years 2003 and 2002 Financial Statements

December 3, 2003

Office of Inspector General

Department of the Treasury

OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEC 3 2003

MEMORANDUM FOR JAMES E. GILLERAN, DIRECTOR
OFFICE OF THRIFT SUPERVISION

FROM: William H. Pugh
Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT: Audit of the Office of Thrift Supervision Fiscal Years 2003 and 2002 Financial Statements

I am pleased to transmit the attached audited Office of Thrift Supervision (OTS) financial statements for fiscal years 2003 and 2002. We contracted with the independent certified public accounting firm of Deva & Associates, P.C. (DEVA), an Independent Public Accountant (IPA), to audit the financial statements of OTS as of September 30, 2003 and 2002 for the years then ended. The contract required that the audits be performed in accordance with generally accepted government auditing standards; applicable provisions of OMB's bulletin, *Audit Requirements for Federal Financial Statements;* and the GAO/PCIE *Financial Audit Manual.*

The IPA issued the following reports, which are incorporated in the attachment:

- Independent Auditors' Report;
- Independent Auditors' Report on Internal Control over Financial Reporting; and
- Independent Auditors' Report on Compliance with Laws and Regulations.

In its audit of OTS, DEVA found:

- that the financial statements were fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America,
- no matters involving internal control and its operations that are considered material weaknesses, and
- no instances of reportable noncompliance with laws and regulations tested.

The IPA also issued a management letter dated November 3, 2003, discussing various issues that were identified during the audit, but were not required to be included in the audit reports.

In connection with the contract, we reviewed DEVA's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control; or a conclusion on compliance with laws and regulations. DEVA is responsible for the attached auditors' reports dated November 3, 2003 and the conclusions expressed in the reports. However, our review disclosed no instances where DEVA did not comply, in all material respects, with generally accepted government auditing standards.

Should you have any questions, please contact me at (202) 927-5430, or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits at (202) 927-5789.

Attachment

2003
Financial Report

Office of Thrift Supervision

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of financial position of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of September 30, 2003 and 2002, and the related statements of operations and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of OTS' management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of OTS as of September 30, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued a report dated November 3, 2003, on our consideration of OTS' internal control over financial reporting and a report dated November 3, 2003, on its compliance with laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deva & Associates, P.C.

Certified Public Accountants

November 3, 2003

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

	As of September 30	
	2003	**2002**
Assets		
Cash and cash equivalents (Note 3)	$ 87,431	$ 67,312
Accrued interest receivable	794	1,366
Accounts receivable	1,005	1,405
Investments held to maturity (Note 4)	95,846	92,973
Property and equipment, net (Note 5)	35,262	36,738
Other assets (Note 11)	378	2,240
Total Assets	$ 220,716	$ 202,034
Liabilities and Net Position		
Liabilities:		
Accounts payable	$ 998	$ -
Accrued annual leave	8,882	8,356
Workers' compensation liability (Note 6)	4,469	4,728
Deferred compensation liability (Note 11)	754	739
Deferred assessment revenue	39,197	37,556
Deferred rent credit	1,269	1,476
Post-retirement benefit liability (Note 8)	12,607	11,651
Payroll, benefits, and withholding	3,333	4,628
Other accrued liabilities (Note 7)	6,555	6,273
Total Liabilities	$ 78,064	$ 75,407
Net Position:		
Assumed capital (Note 2)	$ 41,037	$ 41,037
Retained earnings	101,615	85,590
Total Net Position	$ 142,652	$ 126,627
Total Liabilities and Net Position	$ 220,716	$ 202,034

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

UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENTS OF OPERATIONS AND CHANGES IN NET POSITION
For the Years Ended September 30
(In thousands)

	2003	2002
Revenues		
Industry assessments	$ 152,724	$ 147,410
Examination, application, and security filing fees	6,389	4,944
Interest	4,110	4,788
Rental income (Note 9)	4,374	3,805
Other	1,880	2,697
Total Revenues	$ 169,477	$ 163,644
Expenses		
Personnel compensation	$ 85,297	$ 89,304
Benefits	35,414	31,880
Rent, communication, and utilities	7,930	8,424
Travel and transportation	10,002	10,840
Services	3,335	2,626
Data processing	1,851	2,102
Building expenditures	4,003	4,074
Office equipment and software	1,555	1,876
Miscellaneous	2,032	2,431
Depreciation	2,033	2,192
Total Expenses	$ 153,452	$ 155,749
Excess of Revenues over Expenses	$ 16,025	$ 7,895
Net Position, Beginning Balance	126,627	118,732
Net Position, Ending Balance	$ 142,652	$ 126,627

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

UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENTS OF CASH FLOWS
For the Years Ended September 30
(In thousands)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Excess of Revenues over Expenses	$ 16,025	$ 7,895
Adjustments to reconcile Excess of Revenues over Expenses to net cash provided by operating activities:		
Amortization of net bond premium	318	869
Depreciation and amortization	2,098	2,257
Changes in assets and liabilities:		
Decrease in receivables	972	164
Decrease in other assets	1,862	344
Increase/(decrease) in accounts payable	998	(646)
Increase in other liabilities	1,659	2,332
Net cash provided by operating activities	$ 23,932	$ 13,215
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	$ (35,191)	$ (60,684)
Maturities of investments	32,000	31,000
Purchases of equipment	(622)	(2,367)
Net cash used in investing activities	$ (3,813)	$ (32,051)
Net cash provided by/(used in) operating and investing activities	$ 20,119	$ (18,836)
Cash and cash equivalents, beginning of year	67,312	86,148
Cash and cash equivalents, end of year	$ 87,431	$ 67,312

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

NOTES TO FINANCIAL STATEMENTS

1. REPORTING ENTITY

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

OTS has historically prepared its financial statements in accordance with generally accepted accounting principles based upon accounting standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. In October 1999, the American Institute of Certified Public Accountants designated the Federal Accounting Standards Advisory Board (FASAB) as the standards-setting body for financial statements of federal government entities with respect to the establishment of generally accepted accounting principles. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as being in accordance with generally accepted accounting principles for those federal entities such as OTS that have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, OTS financial statements are presented in accordance with accounting standards published by FASB.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of OTS's account at the Department of the Treasury and funds invested overnight by Treasury on behalf of OTS.

INVESTMENTS HELD TO MATURITY

Effective January 1, 1994, OTS adopted Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Investments in Certain Debt and Equity Securities." Under the statement, OTS is required to classify investment securities under three categories: (1) trading, (2) available for sale, and (3) held to maturity. All of the agency's investments consist of Treasury obligations. OTS has the intent and ability to hold these investments to maturity. Therefore, all investments are classified as held to maturity and are stated at amortized cost. Certain Treasury securities are purchased at a discount or premium. Prior to October 1, 2002, these premiums and discounts were amortized over the term of the investments using the straight-line method, which approximates the interest method. Effective October 1, 2002, premiums and discounts are amortized over the term of the security using the interest method.

POST-RETIREMENT BENEFITS

OTS provides certain health and life benefits for all retired employees that meet eligibility requirements. Effective January 1, 1993, OTS adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," to account for its share of the costs of those benefits. Under this statement, OTS's share of the estimated costs that will be paid after retirement is being accrued by charges to expense over the employees' 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 twenty (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 the retirees incurred claims and as OTS paid premiums. 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

Fixed assets acquired by OTS are capitalized at cost. Individual fixed assets in excess of $50,000 and bulk purchases in excess of $250,000 are capitalized. The building owned by OTS is being depreciated over 50 years. The agency's furniture, fixtures and equipment are depreciated over 3 to 5 years. Depreciation is computed on a straight-line basis.

ASSUMED CAPITAL

The land and building owned by FHLBB were transferred to OTS under FIRREA. OTS also assumed all furniture, fixtures and equipment previously owned by FHLBB. These assets were recorded at their existing book values established in FHLBB's accounting records. Their value is reported as Assumed Capital in the Net Position section of the comparative Statements of Financial Position.

INCOME TAXES

As an agency of the 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.

3. CASH AND CASH EQUIVALENTS

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

	September 30	
	2003	2002
Cash	$ 998	$ 1,012
Overnight investment with Treasury	86,433	66,300
Total cash and cash equivalents	$ 87,431	$ 67,312

Interest earned on cash and overnight investments totaled $843,572 and $1,322,298 for 2003 and 2002, respectively.

4. INVESTMENTS HELD TO MATURITY

Investment securities held at September 30, 2003 and 2002 are marketable Treasury securities maturing through August 2008. The amortized cost and market value of these securities are summarized as follows (in thousands):

	September 30	
	2003	2002
Face value	$ 95,000	$ 92,000
Unamortized premium, net of unamortized discount	846	973
Book value of investments held to maturity	$ 95,846	$ 92,973
Market value	$ 98,298	$ 95,627

Effective interest yields range from 2.83% to 4.16%. Interest earned on these investments totaled $3,266,162 and $3,465,266 for 2003 and 2002, respectively. Interest earned in 2003 includes $21,181 resulting from the change in method for amortizing premiums and discounts discussed in Note 2.

5. PROPERTY AND EQUIPMENT (in thousands)

The following table summarizes the fixed asset balances:

	September 30	
	2003	2002
Land	$ 7,101	$ 7,101
Building	49,188	49,188
Furniture, fixtures, and equipment	7,095	9,233
Total cost	$ 63,384	$ 65,522
Accumulated depreciation, building	$ (23,387)	$ (22,334)
Accumulated depreciation, furniture, fixtures, and equipment	(4,735)	(6,450)
Total accumulated depreciation	$ (28,122)	$ (28,784)
Property and equipment, net	$ 35,262	$ 36,738

6. WORKERS' COMPENSATION LIABILITY

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. Benefit claims incurred for active and former employees of OTS and its predecessor, the Federal Home Loan Bank Board, are administered by the U.S. Department of Labor (DOL) and are ultimately paid by OTS. Actuarial estimates of future workers' compensation estimates are generated by DOL. The estimated actuarial liability for FECA benefits includes

the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. The annual benefit payments have been discounted to present value using OMB's economic assumptions for 10-year Treasury notes and bonds. Based on information provided by DOL and the Department of the Treasury, OTS estimates that its FECA liability as of September 30, 2003 and September 30, 2002 was $4,469,127 and $4,727,954, respectively. Actual FECA expenses currently payable are included in other accrued liabilities and totaled $722,076 as of September 30, 2003. Changes in the actuarial liability and payments related to FECA are reflected as reductions or increases in benefits expense in the appropriate year.

7. OTHER ACCRUED LIABILITIES (in thousands)

	September 30	
	2003	2002
Post-employment benefits payable	$ 722	$ 2,930
Relocation	622	477
Goods and services	5,211	2,866
Total other accrued liabilities	$ 6,555	$ 6,273

8. POST-RETIREMENT BENEFIT LIABILITY

OTS sponsors a life insurance plan (the Plan) for all employees that meet eligibility requirements. The agency funds benefit costs principally on a pay-as-you-go basis, with retiree contributions that are adjusted annually based on certain factors, some of which are discretionary. The Plan is unfunded, with participants paying a portion of the costs. As stated in the Significant Accounting Policies, OTS changed its accounting policy with respect to the Plan as of January 1, 1993. OTS elected to defer recognition of the Plan's transition obligation, and amortize such obligation over twenty (20) years on a straight-line basis.

A Memorandum of Understanding (MOU) was signed in December 1994 between OPM and OTS. The purpose of the MOU was to implement legislation permitting annuitants who retired from OTS prior to January 1995, and who were enrolled in the OTS health plan, to enroll in the Federal Employees Health Benefits Program (FEHB) for coverage effective on or after January 8, 1995.

OTS agreed to pay a one-time fee to OPM of approximately $10,993,000 in consideration of OPM assuming the health portion of the post-retirement plan liability. In accordance with SFAS No. 106, the agreement with OPM constitutes a settlement and, accordingly, OTS recognized a gain on the settlement of approximately $16,694,000 in 1994. Such gain includes the health portion of the transition obligation that OTS elected to initially recognize over 20 years in 1993. The post-retirement liability of $12,607,304 in the Statements of Financial Position at September 30, 2003 and $11,650,639 at September 30, 2002 represents OTS's recognized portion of the remaining liability for participants' future life insurance benefits.

Net periodic post-retirement benefit cost for life insurance provisions under the Plan included the following components in 2003 and 2002 (in thousands):

	For the Years Ended September 30	
	2003	2002
Service cost - current year	$ 184	$ 227
Interest on accumulated post-retirement benefit obligation	944	884
Amortization of transition obligation	253	298
Net post-retirement benefit expense	$ 1,381	$ 1,409

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

	September 30	
	2003	2002
Accumulated post-retirement benefit obligation:		
Retirees	$ 7,214	$ 6,356
Other fully eligible participants	5,127	5,464
Other active participants	2,335	1,874
Accumulated post-retirement benefit obligation	14,676	13,694
Unrecognized transition obligation	(2,337)	(2,590)
Unrecognized net gain	268	547
Total post-retirement benefit liability	$ 12,607	$ 11,651

The weighted average discount rates used in estimating the accumulated post-retirement benefit obligations at September 30, 2003 and September 30, 2002 were 6.35% and 7.0%, respectively.

9. RENTAL INCOME

OTS leases a portion of its building space to retailers under noncancellable operating leases expiring at various dates through 2011. Some of the leases provide renewal options. The leases provide for annual base rent, some 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.

The future minimum rentals to be received under both types of noncancellable operating lease arrangements, not including renewals, are as follows (in thousands):

Years ending September 30	Leases	Subleases	Total
2004	$ 645	$ 742	$ 1,387
2005	262	486	748
2006	226	-	226
2007	165	-	165
2008	165	-	165
Thereafter	426	-	426
	$ 1,889	$ 1,228	$ 3,117

Rental income totaled $4,374,107 and $3,805,436 for 2003 and 2002, respectively.

10. RETIREMENT PLANS

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

The Civil Service Retirement System (CSRS) is two-tiered. For employees hired prior to January 1, 1984, OTS withholds 7.0 percent of regular earnings. OTS contributed 7.0 percent and 7.5 percent of regular earnings in 2003 and 2002, respectively, for each employee in this tier. The sum is transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits. Employees do not contribute to, or receive benefits from, the Social Security System.

For employees with more than five years of (not necessarily continuous) service, hired on or after January 1, 1984, OTS withholds 0.8 percent of regular earnings, in addition to Social Security withholding. OTS also contributed 7.0 percent and 7.5 percent of regular earnings in 2003 and 2002, respectively, for each employee in this tier. When regular earnings exceed the FICA maximum wages ($87,000 for 2003 and $84,900 for 2002), employees covered under this tier of CSRS are required to have 7.0 percent of their earnings withheld. This employee group will receive retirement benefits from both CSRS and the Social Security System.

Beginning in January 1987, all employees hired since January 1, 1984, either as new employees or having less than five years of accumulated service (with a break in service over one year) are included in the Federal Employee Retirement System (FERS). For these employees, OTS withheld 0.8 percent of regular earnings in 2003 and 2002. The agency contributed 10.7 percent of regular earnings in 2003 and 2002 for FERS employees. This group of employees will receive benefits from FERS as well as the Social Security System, to which they concurrently contribute.

Pursuant to FIRREA, the Office of Regulatory Activities (ORA) and its twelve examination districts became part of OTS. OTS assumed the cost of their retirement system, which is part of FIRF. OTS contributes a percentage of total FIRF salary. The percentage varies from year to year. Employees do not contribute to FIRF but do contribute to the Social Security System.

Changes in percentages are based on the number and average age of active FIRF employees, the number of people who have retired, the benefits paid out, and adjustments to the actuarial gain or loss. The estimated FIRF plan contributions for the plan years beginning July 1, 2003 and July 1, 2002 consist of two components: (1) Normal Cost and (2) amortization of the retirement plan's Unfunded Accrued Liability (UAL) for the plan year. The UAL totaled $38,548,115 (estimate) and $11,843,239 (actual) for the plan years beginning July 1, 2003 and July 1, 2002, respectively. The plan year UAL is amortized over approximately five years in conformance with IRS Rules.

The FIRF Fund Administrator provides an estimate of the expected contribution for the plan year prior to OTS's fiscal year closing. The actual contribution request is provided in November after the actuarial valuation process is completed. OTS recognizes one-fourth of the estimated expected contribution in current fiscal year expense and the remainder in the next fiscal year based on the actual contribution request. For the fourth quarter of fiscal year 2002, OTS recognized $2.0 million of the estimated $8.0 million expected contribution as expense; the actual contribution totaled $9,398,210 and the $7,398,210 remainder was recognized in fiscal 2003. The estimated expected contribution for the plan year begun July 1, 2003 is $16,043,401. Accordingly, OTS recognized $4,010,853 in expense for the fourth quarter of fiscal year 2003, and this amount is included in other accrued liabilities.

OTS funds either all FIRF or a portion of CSRS and FERS pension benefits under any of the aforementioned retirement systems relating to its employees and makes the necessary payroll withholdings. However, OTS does not account for the assets of either government 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 OPM for both government retirement systems and are not allocated to the individual agencies.

In addition to the retirement plans described above, OTS employees have the option of participating in retirement savings plans. Employees covered under CSRS or FERS may participate in the OPM-sponsored Thrift Savings Plan (TSP), a plan with characteristics similar to a private-sector 401(k) plan. CSRS and FERS covered employees may also participate in the Financial Institutions Thrift Plan (FITP), a 401(k) plan. Employees covered under FIRF may participate in FITP only. All employees may contribute up to 15% of their earnings to the plans. OTS makes matching contributions of up to 7% to the plans for FERS and FIRF participants and up to 2 % for CSRS participants.

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

	For the Years Ended September 30	
	2003	2002
CSRS	$ 950	$ 1,201
FERS	2,220	2,278
FIRF	11,411	2,027
TSP	980	966
FITP	4,155	4,325
Total	$ 19,716	$ 10,797

11. DEFERRED COMPENSATION LIABILITY

Under provisions of FIRREA, OTS assumed the Deferred Compensation Plans of the employees transferred from 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 all plan deferrals or employer matches effective January 1, 1991. Under the assumed plans, benefits were intended to be provided by cash value life insurance policies issued by Mutual Benefit Life; Mutual Benefit went into rehabilitation on July 16, 1991. OTS surrendered all but two of these policies in 1994 and retained the full cash values on deposit with Mutual Benefit. Under the rehabilitation plan, withdrawal of cash value prior to December 31, 1999, was restricted and subject to substantial withdrawal penalties. The cash value of the surrendered policies, included in other assets in the accompanying Statements of Financial Position, is approximately $5,685 in 2003 and $2,004,131 in 2002. In 2003, OTS elected to receive the cash values for surrendered policies and invest the funds with Treasury. Plan payments are funded by OTS.

12. LEASE COMMITMENTS

OTS conducts most of its regional operations in leased facilities under noncancellable operating leases expiring at various dates through 2011. 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 comparative 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 (in thousands):

Years ending September 30	
2004	$ 5,990
2005	5,175
2006	2,907
2007	2,752
2008	2,280
Thereafter	5,027
Total	$ 24,131

Rent expense under noncancellable operating leases totaled $6,113,203 and $5,914,262 for 2003 and 2002, respectively.

13. COMMITMENTS AND CONTINGENCIES

There are approximately sixty-one lawsuits pending against the United States in the Court of Federal Claims and the Court of Appeals for the Federal Circuit, in connection with Congress's elimination of the capital treatment of supervisory goodwill or other intangible assets of certain thrift institutions. These cases arise from the enactment of FIRREA. The U.S. Department of Justice (Department of Justice) is defending these cases on behalf of the United States, and OTS is supporting the Department of Justice in its defense efforts. The Department of Justice Appropriations

Act, 1999, provides a specific appropriation to pay judgments and compromise settlements in these supervisory goodwill cases. Further, 28 U.S.C. § 2517 provides that any judgment issued by the Court of Federal Claims must be paid from appropriated funds. Therefore, OTS funds, which are non-appropriated, cannot be used to pay judgments in these cases.

OTS is also supporting the Department of Justice in its defense of seven "tax benefits" lawsuits pending against the United States in the Court of Federal Claims, concerning Congress's elimination of tax benefits that were granted in connection with certain thrift acquisitions in the late 1980s. Although there is no specific appropriation for payment of judgments in these tax benefits cases, OTS funds cannot be used to pay judgments in these cases because, as noted above, 28 U.S.C. § 2517 requires that any judgment issued by the Court of Federal Claims must be paid from appropriated funds, and OTS funds are non-appropriated.

OTS is also defending or supporting the Department of Justice in defending several other lawsuits in which the plaintiffs seek damages in excess of $100,000. In one of these cases, the claims against OTS have been dismissed, and OTS believes it is more likely than not that this dismissal would be affirmed in the event of an appeal. In another case, which is at a preliminary stage, OTS expects to prevail. And in the other cases, the claims are either pending in the Court of Federal Claims, where any possible judgment must come from appropriated (non-OTS) funds, and/or OTS and the Department of Justice believe the likelihood of an unfavorable outcome is minimal or remote.

OTS is also involved in several actions at the administrative level. In some of these matters, OTS believes it has substantial legal and factual defenses to the claims asserted, and believes it is more likely than not that the agency will prevail. The remaining matters are at a preliminary stage and OTS is not able at present to estimate the likelihood of success or make an estimate of potential loss.

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INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING

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

We have audited the financial statements of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of and for the year ended September 30, 2003, and have issued our report thereon dated November 3, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable Office of Management and Budget (OMB) guidance for audits of federal financial statements.

In planning and performing our audit, we considered OTS' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control and its operation that we have reported to the management of OTS in a separate letter dated November 3, 2003.

This report is intended solely for the information and use of the Inspector General of the U.S. Department of the Treasury, the management of OTS, OMB and Congress and is not intended to be and should not be used by anyone other than those specified parties.

Deva & Associates, P.C.

Certified Public Accountants

November 3, 2003

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

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

We have audited the financial statements of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of and for the year ended September 30, 2003, and have issued our report thereon dated November 3, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable Office of Management and Budget (OMB) guidance for audits of federal financial statements. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

As part of obtaining reasonable assurance about whether OTS' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of applicable laws and regulations, noncompliance with which could have a direct material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Inspector General of the U.S. Department of the Treasury, the management of OTS, OMB and Congress and is not intended to be and should not be used by anyone other than those specified parties.

Deva & Associates, P.C

Certified Public Accountants

November 3, 2003