

2002
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 statement of financial position of the U.S. Department of the Treasury, Office of Thrift Supervision (OTS) as of September 30, 2002, and the related statements of operations and changes in net position, and cash flows for the year 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 audit 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 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 audit provides 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, 2002, and the results of its operations and its cash flows for the year 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 8, 2002, on our consideration of OTS' internal control over financial reporting and a report dated November 8, 2002, 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.



Certified Public Accountants

November 8, 2002

UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENT OF FINANCIAL POSITION
As of September 30, 2002
(In thousands)

Assets

Cash and cash equivalents (Note 3)	\$ 67,312
Accrued interest receivable	1,366
Accounts receivable	1,405
Investments held to maturity (Note 4)	92,973
Property and equipment, net (Note 5)	36,738
Other assets (Note 11)	<u>2,240</u>
Total Assets	\$ <u>202,034</u>

Liabilities and Net Position

Liabilities:

Accrued annual leave	\$ 8,356
Workers' compensation liability (Note 6)	4,728
Deferred compensation liability (Note 11)	739
Deferred assessment revenue	37,556
Deferred rent credit	1,476
Post-retirement benefit liability (Note 8)	11,651
Payroll, benefits, and withholding	4,628
Other accrued liabilities (Note 7)	<u>6,273</u>
Total Liabilities	\$ <u>75,407</u>

Net Position:

Assumed capital (Note 2)	\$ 41,037
Retained earnings	<u>85,590</u>
Total Net Position	\$ <u>126,627</u>
Total Liabilities and Net Position	\$ <u>202,034</u>

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

UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
For the Year Ended September 30, 2002
(In thousands)

Revenues

Industry assessments	\$ 147,410
Examination, application, and security filing fees	4,944
Interest	4,788
Rental income (Note 9)	3,805
Other	<u>2,697</u>
 Total Revenues	 <u>\$ 163,644</u>

Expenses

Personnel compensation	\$ 89,304
Benefits	31,880
Rent, communication, and utilities	8,424
Travel and transportation	10,840
Services	2,626
Data processing	2,102
Building expenditures	4,074
Office equipment and software	1,876
Miscellaneous	2,431
Depreciation	<u>2,192</u>
 Total Expenses	 <u>\$ 155,749</u>

Excess of Revenues over Expenses \$ 7,895

Net Position, Beginning Balance 118,732

Net Position, Ending Balance \$ 126,627

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

UNITED STATES DEPARTMENT OF THE TREASURY
OFFICE OF THRIFT SUPERVISION
STATEMENT OF CASH FLOWS
For the Year Ended September 30, 2002
(In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES

Excess of Revenues over Expenses	\$ 7,895
Adjustments to reconcile excess of Revenues over Expenses to net cash provided by operating activities:	
Amortization of net bond premium	869
Depreciation and amortization	2,257
Changes in assets and liabilities:	
Decrease in receivables	164
Decrease in other assets	344
Decrease in accounts payable	(646)
Increase in other liabilities	<u>2,332</u>
Net cash provided by operating activities	<u>\$ 13,215</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchases of investments	\$ (60,684)
Maturities of investments	31,000
Purchases of equipment	<u>(2,367)</u>
Net cash used in investing activities	<u>\$ (32,051)</u>
Net cash used in operating and investing activities	\$ (18,836)
Cash and cash equivalents, beginning of year	<u>86,148</u>
Cash and cash equivalents, end of year	<u><u>\$ 67,312</u></u>

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

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

NOTES TO FINANCIAL STATEMENTS

1. REPORTING ENTITY

The Office of Thrift Supervision (OTS) was created when the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) abolished the Federal Home Loan Bank Board (FHLBB) and transferred all examination and supervisory activities to OTS under the Department of the Treasury. 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 based on the OTS budget and 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 Federal Accounting Standards Advisory Board (FASAB) was designated by the American Institute of Certified Public Accountants 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 (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 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 U.S. Treasury obligations. OTS has the intent and ability to hold these investments to maturity. Therefore, all investments are classified as held to maturity and are stated at amortized cost. Premiums and discounts are amortized over the term of the investments using the straight-line method, which approximates 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 Financial Accounting Standards Board (FASB) Statement No. 106 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, the OTS expensed its share of the costs as claims were incurred by the retirees and as premiums were paid by OTS. Pursuant to an agreement with the Office of Personnel Management (OPM) in 1994, OTS agreed to pay a one-time fee to OPM in consideration of OPM assuming the health care portion of the post-retirement plan liability.

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

NOTES TO FINANCIAL STATEMENTS

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 Statement of Financial Position.

INCOME TAXES

As an agency of the U.S. Department of the Treasury, OTS is exempt from all federal and state taxes based on income. The Office of Thrift Supervision 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):

Cash	\$ 1,012
Overnight investment with Treasury	<u>66,300</u>
Total cash and cash equivalents	<u>\$ 67,312</u>

Interest earned on overnight investments totaled \$1,322,298.

4. INVESTMENTS HELD TO MATURITY

Investment securities held at September 30, 2002 are marketable Treasury securities maturing through May 2007. The amortized cost and market value of these securities are summarized as follows (in thousands):

Face value	\$ 92,000
Unamortized premium, net of unamortized discount	<u>973</u>
Book value of investments held to maturity	<u>\$ 92,973</u>
Market value	<u>\$ 95,627</u>

Effective interest rates range from 3.20% to 5.62%. Interest earned on these investments totaled \$3,465,266.

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NOTES TO FINANCIAL STATEMENTS

5. PROPERTY AND EQUIPMENT (in thousands)

The following table summarizes the fixed asset balances:

Land	\$ 7,101
Building	49,188
Furniture, fixtures, and equipment	<u>9,233</u>
Total cost	<u>\$ 65,522</u>
Accumulated depreciation, building	\$ (22,334)
Accumulated depreciation, furniture, fixtures, and equipment	<u>(6,450)</u>
Total accumulated depreciation	<u>\$ (28,784)</u>
Property and equipment, net	<u><u>\$ 36,738</u></u>

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. The liability is determined using the paid losses extrapolation method calculated over the next 37 years. 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 U.S. Department of the Treasury, OTS estimates that its FECA liability as of September 30, 2002 was \$4,727,954. Actual FECA expenses currently payable are included in other accrued liabilities and totaled \$663,843 as of September 30, 2002. 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)

Post-employment benefits payable	\$ 2,930
Relocation	477
Goods and services	<u>2,866</u>
Total other accrued liabilities	<u><u>\$ 6,273</u></u>

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.

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

NOTES TO FINANCIAL STATEMENTS

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 FASB 106, the agreement with OPM constitutes a settlement and, accordingly, OTS recognized a gain on the settlement of approximately \$16,694,000 in 1994. Such gain includes the health portion of the transition obligation that OTS elected to initially recognize over 20 years in 1993. The post-retirement liability of \$11,650,639 in the Statement of Financial Position 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 for the year ended September 30, 2002 (in thousands):

Service cost - current year	\$ 227
Interest on accumulated post-retirement benefit obligation	884
Amortization of transition obligation	<u>298</u>
Net post-retirement benefit expense	<u>\$ 1,409</u>

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

Accumulated post-retirement benefit obligation:	
Retirees	\$ 6,356
Other fully eligible participants	5,464
Other active participants	<u>1,874</u>
Accumulated post-retirement benefit obligation	13,694
Unrecognized transition obligation	(2,590)
Unrecognized net gain	<u>547</u>
Total post-retirement benefit liability	<u>\$ 11,651</u>

The weighted average discount rate used in estimating the accumulated post-retirement benefit obligations at September 30, 2002 was 7%.

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.

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NOTES TO FINANCIAL STATEMENTS

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

<u>Years ending September 30</u>	<u>Leases</u>	<u>Subleases</u>	<u>Total</u>
2003	\$ 3,548	\$ 714	\$ 4,262
2004	454	723	1,177
2005	359	476	835
2006	333	0	333
2007	287	0	287
Thereafter	<u>1,105</u>	<u>0</u>	<u>1,105</u>
	<u>\$ 6,086</u>	<u>\$ 1,913</u>	<u>\$ 7,999</u>

Rental income totaled \$3,805,436.

10. RETIREMENT PLANS

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

The Civil Service Retirement System (CSRS) is two-tiered. For employees hired prior to January 1, 1984, OTS withholds 7.0 percent of regular earnings. OTS contributed 7.5 percent of regular earnings in 2002 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 7.5 percent of regular earnings in 2002 for each employee in this tier. When regular earnings exceed the FICA maximum wages (\$84,900 for 2002), employees covered under this tier of CSRS are required to have 7.0 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 2002. The agency contributed 10.7 percent of regular earnings in 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 ORA's retirement system, which is part of FIRF. Under this private retirement system, 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 of active FIRF employees, the number of people who have retired, the benefits paid out, and adjustments to the actuarial gain or loss. Prior to the close of fiscal year 2002, the FIRF Fund Administrator notified OTS that the retirement plan's Unfunded Accrued Liability (UAL) is projected to total approximately \$9,249,000 for the plan year beginning July 1, 2002, and projected the plan's Normal Cost for OTS to be \$6,100,000 for the plan year. The UAL primarily resulted from investment performance in recent years falling below actuarial assumptions for the plan. OTS will amortize the UAL over approximately five years (\$1.9 million per year) in

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

NOTES TO FINANCIAL STATEMENTS

conformance with IRS rules. Accordingly, OTS recognized expenses of \$2,000,000 relating to FIRF for the fourth quarter of fiscal year 2002.

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. Civil Service Retirement System and Federal Employee Retirement System 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 retirement expenses for all OTS plans, included in benefits expense in the accompanying Statement of Operations and Changes in Net Position, are as follows (in thousands):

CSRS	\$ 1,201
FERS	2,278
FIRF	2,027
TSP	966
FITP	<u>4,325</u>
Total	<u>\$ 10,797</u>

11. DEFERRED COMPENSATION LIABILITY

As part of FIRREA, OTS assumed the Deferred Compensation Plans of the employees working for the Federal Home Loan Banks of Dallas and San Francisco. These plans allowed employees to defer a portion of their income and provided for employer matching contributions. OTS froze these plans and discontinued all plan deferrals or employer matches effective January 1, 1991. Benefits under the assumed plans were intended to be provided by cash value of life insurance policies issued by Mutual Benefit Life that went into rehabilitation on July 16, 1991. Under the rehabilitation plan, withdrawal of cash value prior to December 31, 1999 was restricted and subject to substantial withdrawal penalties. Current plan withdrawals have been funded by OTS. The cash value of those policies, included in other assets in the accompanying Statement of Financial Position, is approximately \$2,004,131 in 2002.

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 Statement of Operations and Changes in Net Position reflects rent expense on a straight-line basis over the lives of the leases.

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OFFICE OF THRIFT SUPERVISION**

NOTES TO FINANCIAL STATEMENTS

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

Years ending <u>September 30</u>	
2003	\$ 5,981
2004	5,754
2005	4,947
2006	2,756
2007	2,610
Thereafter	<u>7,044</u>
Total	\$ <u><u>29,092</u></u>

Rent expense under noncancellable operating leases totaled \$5,914,262.

13. COMMITMENTS AND CONTINGENCIES

There are approximately one hundred lawsuits pending against the United States in the U.S. Court of Federal Claims and the U.S. 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 the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The U.S. Department of Justice is defending these cases on behalf of the United States, and OTS is supporting the Justice Department 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 U.S. 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 the other cases, the claims are either pending in the U.S. 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.

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, 2002, and have issued our report thereon dated November 8, 2002. 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.

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 8, 2002

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, 2002, and have issued our report thereon dated November 8, 2002. 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.

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November 8, 2002