2004
Financial Report

OFFICE OF THRIFT SUPERVISION
1989

Office of Thrift Supervision

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Deva & Associates, P.C.

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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, 2004 and 2003, 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, 2004 and 2003, 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 1, 2004, on our consideration of OTS' internal control over financial reporting and a report dated November 1, 2004, 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 1, 2004

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

	As of September 30	
	2004	**2003**
Assets		
Cash and cash equivalents (Note 3)	$ 86,407	$ 87,431
Accrued interest receivable	1,076	794
Accounts receivable	365	1,005
Investments held to maturity (Note 4)	110,794	95,846
Property and equipment, net (Note 5)	34,707	35,262
Other assets	689	378
Total Assets	$ 234,038	$ 220,716
Liabilities and Net Position		
Liabilities:		
Accounts payable	$ 416	$ 998
Accrued annual leave	9,299	8,882
Workers' compensation liability (Note 6)	4,536	4,469
Deferred compensation liability (Note 11)	567	754
Deferred assessment revenue	42,538	39,197
Deferred rent credit	2,266	1,269
Post-retirement benefit liability (Note 8)	13,535	12,607
Payroll, benefits, and withholding	4,190	3,333
Other accrued liabilities (Note 7)	10,987	6,555
Total Liabilities	$ 88,334	$ 78,064
Net Position:		
Assumed capital (Note 2)	$ 41,037	$ 41,037
Retained earnings	104,667	101,615
Total Net Position	$ 145,704	$ 142,652
Total Liabilities and Net Position	$ 234,038	$ 220,716

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
(In thousands)

	For the Years Ended September 30 2004	2003
Revenues		
Industry assessments	$ 164,809	$ 152,724
Examination, application, and security filing fees	6,575	6,389
Interest	4,192	4,110
Rental income (Note 9)	4,923	4,374
Other	1,267	1,880
Total Revenues	$ 181,766	$ 169,477
Expenses		
Personnel compensation	$ 90,067	$ 85,297
Benefits	52,405	35,414
Rent, communication, and utilities	9,474	7,930
Travel and transportation	10,182	10,002
Services	4,980	3,335
Data processing	2,141	1,851
Building expenditures	4,049	4,003
Office equipment and software	1,971	1,555
Miscellaneous	1,782	2,032
Depreciation	1,663	2,033
Total Expenses	$ 178,714	$ 153,452
Excess of Revenues over Expenses	$ 3,052	$ 16,025
Net Position, Beginning Balance	142,652	126,627
Net Position, Ending Balance	$ 145,704	$ 142,652

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
(In thousands)

	For the Years Ended September 30 2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Excess of revenues over expenses	$ 3,052	$ 16,025
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Amortization of net bond premium	242	318
Depreciation and amortization	1,753	2,098
Loss on disposed assets	6	-
Changes in assets and liabilities:		
Decrease in receivables	358	972
(Increase)/decrease in other assets	(311)	1,862
(Decrease)/increase in accounts payable	(582)	998
Increase in other liabilities	10,852	1,659
Net cash provided by operating activities	$ 15,370	$ 23,932
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	$ (45,190)	$ (35,191)
Maturities of investments	30,000	32,000
Capitalized leasehold improvements	(1,204)	-
Purchases of equipment	-	(622)
Net cash used in investing activities	$ (16,394)	$ (3,813)
Net cash (used in)/provided by operating and investing activities	$ (1,024)	$ 20,119
Cash and cash equivalents, beginning of year	87,431	67,312
Cash and cash equivalents, end of year	$ 86,407	$ 87,431

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 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. Premiums and discounts are amortized over the term of the security using the interest method.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

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 thousand and bulk purchases in excess of $250 thousand are capitalized. Aggregate purchases of multiple items directly related to a specific project (for example, leasehold improvements) are capitalized when the total cost exceeds a minimum threshold of $250 thousand, and the annual amortization amount exceeds $50 thousand. 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 the 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 the 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 2004	September 30 2003
Cash	$ 1,019	$ 998
Overnight investment with Treasury	85,388	86,433
Total cash and cash equivalents	$ 86,407	$ 87,431

Interest earned on cash and overnight investments totaled $782 thousand and $844 thousand for 2004 and 2003, respectively.

4. INVESTMENTS HELD TO MATURITY

Investment securities held at September 30, 2004 and 2003 are marketable Treasury securities maturing through March 2009. The amortized cost and market value of these securities are summarized as follows (in thousands):

	September 30 2004	September 30 2003
Face value	$ 110,000	$ 95,000
Unamortized premium, net of unamortized discount	794	846
Book value of investments held to maturity	$ 110,794	$ 95,846
Market value	$ 111,038	$ 98,298

Effective interest yields range from 2.21% to 4.16%. Interest earned on these investments totaled $3.4 million and $3.3 million for 2004 and 2003, respectively.

5. PROPERTY AND EQUIPMENT

The following table summarizes the fixed asset balances (in thousands):

	September 30	
	2004	2003
Land	$ 7,101	$ 7,101
Building	49,188	49,188
Furniture, fixtures, and equipment	5,623	6,443
Leasehold Improvements	1,856	652
Total cost	$ 63,768	$ 63,384
Accumulated depreciation, building	$ (24,440)	$ (23,387)
Accumulated depreciation, furniture, fixtures, and equipment	(4,401)	(4,605)
Accumulated amortization, leasehold improvements	(220)	(130)
Total accumulated depreciation and amortization	$ (29,061)	$ (28,122)
Property and equipment, net	$ 34,707	$ 35,262

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 was $4.5 million as of September 30, 2004 and September 30, 2003. Actual FECA expenses currently payable are included in other accrued liabilities and totaled $735 thousand and $722 thousand as of September 30, 2004 and September 30, 2003, respectively. 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 2004	September 30 2003
Post-employment benefits payable	$ 740	$ 722
Relocation	741	622
Retirement plan	6,720	4,011
Goods and services	2,786	1,200
Total other accrued liabilities	$ 10,987	$ 6,555

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 Note 2, 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 $11.0 million 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 $16.7 million 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 $13.5 million in the Statements of Financial Position at September 30, 2004 and $12.6 million at September 30, 2003 represents OTS's recognized portion of the remaining liability for participants' future life insurance benefits.

8. POST-RETIREMENT BENEFIT LIABILITY (continued)

Net periodic post-retirement benefit cost for life insurance provisions under the Plan included the following components in 2004 and 2003 (in thousands):

	For the Years Ended September 30 2004	2003
Service cost - current year	$ 206	$ 184
Interest on accumulated post-retirement benefit obligation	918	944
Amortization of transition obligation	253	253
Net post-retirement benefit expense	$ 1,377	$ 1,381

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 2004	2003
Accumulated post-retirement benefit obligation:		
Retirees	$ 8,446	$ 7,214
Other fully eligible participants	6,326	5,127
Other active participants	2,588	2,335
Accumulated post-retirement benefit obligation	17,360	14,676
Unrecognized transition obligation	(2,084)	(2,337)
Unrecognized net gain or (loss)	(1,741)	268
Total post-retirement benefit liability	$ 13,535	$ 12,607

The weighted average discount rates used in estimating the accumulated post-retirement benefit obligations at September 30, 2004 and September 30, 2003 were 5.81% and 6.35%, respectively.

9. RENTAL INCOME

OTS leases a portion of its building as office and retail space under noncancellable operating leases expiring at various dates through 2014. Some of the leases provide renewal options. The leases provide for annual base rent. Some leases 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 office space in some of its existing unused leased facilities under similar terms.

9. RENTAL INCOME (continued)

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
2005	$ 4,115	$ 438	$ 4,553
2006	4,239	-	4,239
2007	4,286	-	4,286
2008	4,402	-	4,402
2009	652	-	652
Thereafter	721	-	721
	$ 18,415	$ 438	$ 18,853

Rental income totaled $4.9 million and $4.4 million for 2004 and 2003, 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 also contributed 7.0 percent of regular earnings during 2004 and 2003 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 of regular earnings during 2004 and 2003 for each employee in this tier. When regular earnings exceed the FICA maximum wages, 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 2004 and 2003. The agency contributed 10.7 percent of regular earnings during 2004 and 2003 for FERS employees. This group of employees will receive benefits from FERS as well as the Social Security System, to which they concurrently contribute.

10. RETIREMENT PLANS (continued)

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, 2004 and July 1, 2003 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 $53.6 million and $34.1 million for the plan years beginning July 1, 2004 and July 1, 2003, respectively. The plan year UAL is amortized over approximately five years in conformance with IRS Rules.

Prior to OTS's fiscal year closing, the FIRF Fund Administrator provides an estimate of the expected contribution for the plan year. 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 2003, OTS recognized $4.0 million of the estimated $16.0 million expected contribution as expense. The estimated expected contribution for the plan year begun July 1, 2004 is $19.2 million. Accordingly, OTS accrued $4.8 million in expense for the fourth quarter of fiscal year 2004. The fiscal year 2004 FIRF expense also includes $1.9 million to increase the plan's funded status to 80 percent as of July 1, 2004. The total $6.7 million 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 administered by Pentegra Retirement Services (Pentegra). 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.

In 2004, OTS implemented a new Employee Savings Plan (ESP). The ESP is administered by Pentegra and has characteristics similar to the FITP 401(k) plan described above, except all contributions are funded by OTS and vesting begins in year four of participation in the plan. Participating employees are eligible to withdraw the vested amount of their accounts upon terminating employment with OTS. For the plan year ending September 30, 2004, OTS contributed $10.1 million to the ESP.

10. RETIREMENT PLANS (continued)

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 2004	2003
CSRS	$ 918	$ 950
FERS	2,393	2,220
FIRF	17,953	11,411
TSP	1,050	980
FITP	4,375	4,155
ESP	10,090	-
Total	$ 36,779	$ 19,716

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 one remaining policy, included in other assets in the accompanying Statements of Financial Position, is approximately $8 thousand in 2004 and $6 thousand in 2003. 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 2020. 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.

12. LEASE COMMITMENTS (continued)

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

Years ending September 30		
2005	$	4,221
2006		3,011
2007		2,873
2008		2,411
2009		1,991
Thereafter		10,509
Total	$	25,016

Rent expense under noncancellable operating leases totaled $5.8 million and $6.1 million for 2004 and 2003, respectively.

13. COMMITMENTS AND CONTINGENCIES

There are approximately fifty-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. Under 28 U.S.C. § 2517, 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. These cases concern Congress's elimination of tax benefits that it granted in connection with certain thrift acquisitions in the late 1980s. 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 three other lawsuits in which the plaintiffs seek damages in excess of $100,000. In one of these cases, the claims are pending in the Court of Federal Claims, where any possible judgment must come from appropriated (non-OTS) funds. In the second case, 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. That lawsuit also asserted claims against certain current and former OTS employees. All but one of these claims have been dismissed. An unfavorable outcome appears unlikely at this point, but if there is a judgment against one or more of the employees, OTS may be called upon to indemnify such employee(s) under the agency's indemnification policy, which provides for indemnification under certain specified conditions. In the third case, OTS believes the likelihood of an unfavorable outcome is minimal or remote.

OTS is involved in one active and one potential matter at the administrative level. The active matter is currently in mediation and a negotiated resolution appears likely at this time. Such resolution is not expected to be material to the financial position of OTS. In the event mediation is unsuccessful, OTS anticipates that it will litigate the matter vigorously and expects to ultimately prevail. In the potential matter, several claimants have asked the Federal Trade Commission to take action against OTS based on allegations that the courts have previously rejected. OTS does not anticipate any loss from this matter.

Deva & Associates, P.C.

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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, 2004, and have issued our report thereon dated November 1, 2004. 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. However, this report is available as a matter of public record.

Deva & Associates, P.C.

Certified Public Accountants

November 1, 2004

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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, 2004, and have issued our report thereon dated November 1, 2004. 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. However, this report is available as a matter of public record.

Deva & Associates, P.C.

Certified Public Accountants

November 1, 2004