United States Government Accountability Office

GAO

Report to Congressional Committees

November 2010

FINANCIAL AUDIT

Federal Housing Finance Agency's Fiscal Years 2010 and 2009 Financial Statements

GAO-11-151

GAO

Accountability • Integrity • Reliability

Highlights

Highlights of GAO-11-151, a report to congressional committees

November 2010

FINANCIAL AUDIT

Federal Housing Finance Agency's Fiscal Years 2010 and 2009 Financial Statements

Why GAO Did This Study

The Housing and Economic Recovery Act of 2008 (HERA) created the Federal Housing Finance Agency (FHFA) and gave it responsibility for, among other things, the supervision and oversight of the housing-related government-sponsored enterprises (GSE): Fannie Mae, Freddie Mac, and the 12 federal home loan banks. Specifically, FHFA was assigned responsibility for ensuring that each of the regulated entities operates in a fiscally safe and sound manner, including maintenance of adequate capital and internal controls, and carries out its housing and community development finance mission. HERA also requires FHFA to annually prepare financial statements, and further requires GAO to audit these statements.

Pursuant to HERA's requirement, GAO audited FHFA's fiscal years 2010 and 2009 financial statements to determine whether (1) the financial statements were fairly stated, and (2) FHFA management maintained effective internal control over financial reporting. GAO also tested FHFA's compliance with selected laws and regulations.

GAO is not making any recommendations in this report. In commenting on a draft of this report, FHFA stated that it was pleased with the results of the audit, and it would continue to work to enhance its internal controls and ensure the reliability of its financial reporting, its operational soundness, and public confidence in its mission.

View GAO-11-151 or key components. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.

What GAO Found

In GAO's opinion, FHFA's fiscal years 2010 and 2009 financial statements are fairly presented in all material respects. GAO also concluded that FHFA had effective internal control over financial reporting as of September 30, 2010. GAO found no reportable instances of noncompliance with the laws and regulations it tested.

Because fiscal year 2009 was the first full year of FHFA's operations, fiscal year 2010 is the first year in which FHFA prepared comparative financial statements. As discussed in note 10, the fiscal year 2009 statement of net cost presents costs as one program for fiscal year 2009. For fiscal year 2010, FHFA tracked resource allocations and costs by strategic goal (responsibility segments), consistent with the strategic goals identified in its new strategic plan. Consequently, the fiscal year 2010 statement of net cost presents FHFA's costs by strategic goal.

In early September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the Director of FHFA, with the stated intent to stabilize these entities. The assets, liabilities, and activities of the two entities, Fannie Mae and Freddie Mac, are not reflected in FHFA's fiscal years 2010 and 2009 financial statements, based on determinations by the Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) that they do not meet the criteria for inclusion in the financial statements of the U.S. government or the Treasury under federal accounting concepts. Specifically, OMB and Treasury concluded this because the entities are not currently reflected in the federal government's budget and because the conservatorship arrangement is considered to be temporary. FHFA management concurred with this conclusion. Should circumstances change, this conclusion would need to be revisited.

As of September 30, 2010, Fannie Mae and Freddie Mac have received about $148.2 billion in direct financial support from Treasury in exchange for Treasury's purchase of the entities' senior preferred stock. Over the longer term, Congress and the executive branch face difficult decisions on how to restructure the entities and promote housing opportunities while limiting the risks to taxpayers and the financial markets.

GAO noted other less significant matters involving FHFA's internal controls and will be reporting separately to FHFA management on these matters.

Contents

Abbreviations

FHFA	Federal Housing Finance Agency
FHFB	Federal Housing Finance Board
FMFIA	Federal Managers' Financial Integrity Act of 1982
HERA	Housing and Economic Recovery Act of 2008
HUD	Department of Housing and Urban Development
OFHEO	Office of Federal Housing Enterprise Oversight
OMB	Office of Management and Budget

November 15, 2010

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

This report presents the results of our audits of the financial statements of the Federal Housing Finance Agency (FHFA) as of, and for the fiscal years ending, September 30, 2010 and 2009. These financial statements are the responsibility of FHFA. This report contains our (1) unqualified opinions on FHFA's financial statements, (2) opinion that FHFA's internal control over financial reporting was effective as of September 30, 2010, and (3) conclusion that our tests of FHFA's compliance with selected laws and regulations disclosed no instances of reportable noncompliance during fiscal year 2010.

The Housing and Economic Recovery Act of 2008 (HERA)[1] established FHFA as an independent agency empowered with supervisory and regulatory oversight of the housing-related, government-sponsored enterprises (GSE): Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks. The act requires FHFA to annually prepare and submit financial statements to the Director of the Office of Management and Budget (OMB), and requires GAO to audit the agency's financial statements. We conducted this audit in accordance with U.S. generally accepted government auditing standards.

FHFA continues to be challenged with carrying out its responsibilities as conservator of Fannie Mae and Freddie Mac to ensure that these entities continue to meet their mission requirements of providing liquidity and

[1]Public Law 110-289, 122 Stat. 2654, signed into law on July 30, 2008.

stability to the secondary market for residential mortgages and serving the needs of certain targeted groups. FHFA placed both entities into conservatorship in September 2008 in the wake of their deteriorating financial conditions with the objective of stabilizing them. These stabilization efforts included direct financial support from the U.S. Department of the Treasury (Treasury) to each entity of up to the greater of (1) $200 billion; or (2) $200 billion plus the cumulative net worth deficits experienced during 2010, 2011, and 2012 less any amount by which the assets of each entity exceed its liabilities on December 31, 2012 in exchange for Treasury's purchase of the entities' senior preferred stock. As of September 30, 2010, the entities have received about $148.2 billion through such purchases. FHFA, OMB, and Treasury maintain that the conservatorship arrangement is not intended to be permanent. Over the longer term, particularly with continuing uncertainty about future economic conditions, Congress and the executive branch will face difficult decisions on how to restructure Fannie Mae and Freddie Mac and promote housing opportunities while limiting the risks to taxpayers and ensuring the stability of the financial markets. It will be necessary for Congress to reevaluate the roles, structures, and performance of Fannie Mae and Freddie Mac and to consider options to facilitate mortgage finance while mitigating safety and soundness and systemic risk concerns.

We are sending copies of this report to the Chairman of the Federal Housing Finance Oversight Board; the Secretary of the Treasury; the Secretary of Housing and Urban Development; the Chairperson of the Securities and Exchange Commission; the Director of the Office of Management and Budget; and other interested parties. In addition, this report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you have any questions concerning this report, please contact me at (202) 512-3406 or sebastians@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Steven J. Sebastian
Director
Financial Management and Assurance

United States Government Accountability Office
Washington, D.C. 20548

To the Acting Director of the Federal Housing Finance Agency

In accordance with the Housing and Economic Recovery Act of 2008 (HERA), we are responsible for conducting audits of the financial statements of the Federal Housing Finance Agency (FHFA). In our audits of FHFA's fiscal years 2010 and 2009 financial statements, we found

- the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles,
- FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010, and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our conclusions on FHFA's Management's Discussion and Analysis; (3) our audit objectives, scope, and methodology; and (4) agency comments and our evaluation.

Opinion on Financial Statements

FHFA's financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, its assets, liabilities, and net position as of September 30, 2010 and 2009; and its net costs, changes in net position, and budgetary resources for the fiscal years then ended.

Because fiscal year 2009 was the first full year of FHFA's operations, fiscal year 2010 is the first year in which FHFA prepared comparative financial statements. As discussed in note 10, the statement of net cost presents costs as one program for fiscal year 2009. For fiscal year 2010, consistent with its new strategic plan, FHFA tracked and reported resource allocations and costs by strategic goal (responsibility segment). Consequently, the fiscal year 2010 statement of net cost presents FHFA's costs by strategic goal.

As discussed in note 1A of the financial statements, FHFA's fiscal years 2010 and 2009 financial statements do not include the assets, liabilities, and activities associated with Fannie Mae and Freddie Mac. In early September 2008, less than 2 months after FHFA's establishment, the then-Director of FHFA placed Fannie Mae and Freddie Mac into conservatorship under the authority of the Federal Housing Enterprises Financial Safety and

Soundness Act of 1992, as amended by HERA. FHFA's goal in placing the two entities into conservatorship was to stabilize them with the objective of maintaining normal business operations and restoring safety and soundness. As of September 30, 2010, about $148.2 billion in direct financial support from Treasury has been provided to Fannie Mae and Freddie Mac. Shortly after Fannie Mae and Freddie Mac were placed in conservatorship, OMB and Treasury determined that the assets, liabilities, and activities of these entities would not be included in the financial statements of the federal government or those of the Treasury, although Treasury records an asset for its investment in Fannie Mae and Freddie Mac and a liability for future payments to the two entities in its financial statements. In making this determination, OMB and Treasury reviewed the criteria contained in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*. They concluded that because the entities were not listed in the section of the federal government's budget, entitled "Federal Programs by Agency and Account," and because the nature of the conservatorships and the federal government's ownership and control of the entities were considered to be temporary, the entities did not meet the conclusive or indicative criteria in Concept Statement No. 2 for consolidation. OMB and Treasury reaffirmed this conclusion with respect to both fiscal years 2009 and 2010. FHFA management concurred with this conclusion. Consequently, FHFA did not consolidate Fannie Mae and Freddie Mac into its fiscal years 2010 and 2009 financial statements. Should circumstances change, such as the inclusion of Fannie Mae and Freddie Mac in the federal budget or a determination that the current degree of federal control and ownership of the entities is other than temporary, this decision would need to be revisited.

Opinion on Internal Control

FHFA maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010, which provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

During our audit of FHFA's fiscal year 2009 financial statements, we identified certain deficiencies in FHFA's system of internal control that we did not consider to be material weaknesses or significant deficiencies.[1] These deficiencies involved matters related to certain accounting and monitoring procedures, access controls, and information security management. FHFA has made progress in addressing these deficiencies during fiscal year 2010. However, not all actions were completed as of the completion of our fiscal year 2010 audit. During our fiscal year 2010 audit, we also identified additional deficiencies in accounting procedures. We do not consider the deficiencies found during our fiscal year 2009 and 2010 audits, individually or in the aggregate, to be material weaknesses or significant deficiencies. We have communicated these matters to management and, where appropriate, will report on them separately.

Compliance with Laws and Regulations

Our tests of FHFA's compliance with selected provisions of laws and regulations for fiscal year 2010 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

FHFA's Management's Discussion and Analysis and other accompanying information contain a wide range of information, some of which is not directly related to the financial statements. We did not audit and we do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with FHFA officials. On the basis of this limited work, we found no material inconsistencies with the financial statements, with U.S. generally accepted accounting principles, or with OMB Circular No. A-136, *Financial Reporting Requirements*.

[1] A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

Objectives, Scope, and Methodology

FHFA management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles, (2) establishing and maintaining effective internal control over financial reporting and evaluating its effectiveness, and (3) complying with applicable laws and regulations. FHFA management evaluated the effectiveness of FHFA's internal control over financial reporting as of September 30, 2010, based on the criteria established under FMFIA. FHFA management's assertion based on its evaluation is included in appendix I.

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) FHFA's financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, and (2) FHFA management maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010. We are also responsible for (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and (2) performing limited procedures with respect to certain other information accompanying the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of the entity and its operations, including its internal control over financial reporting;
- considered FHFA's process for evaluating and reporting on internal control over financial reporting that FHFA is required to perform by FMFIA;
- assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;

- evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;

- tested relevant internal control over financial reporting;

- tested compliance with selected provisions of the following laws and their related regulations: 31 U.S.C. § 3902 (a), (b), (f)—Interest penalties under the Prompt Payment Act; 31 U.S.C. § 3904—Limitations on Discount Payments Under the Prompt Payment Act; 12 U.S.C. § 4515—Personnel; Federal Employees' Retirement System Act of 1986, as amended; Social Security Act of 1935, as amended; Federal Employees Health Benefits Act of 1959, as amended; 12 U.S.C. § 4516 (g)(4), which makes applicable 31 U.S.C. § 3512 (c), Federal Managers' Financial Integrity Act of 1982; and Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008; and

- performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process affected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness. Because of inherent limitations, internal control may not prevent or detect and correct misstatements due to error or fraud, losses, or noncompliance. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to FHFA. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements for the fiscal year ended September 30, 2010. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions and other conclusions.

Agency Comments and Our Evaluation

In commenting on a draft of this report, FHFA stated that it was pleased that the audit found that its fiscal year 2010 and 2009 financial statements were presented fairly, that it maintained effective internal control over financial reporting, and that there had been no instances of reportable noncompliance with laws and regulations we tested. FHFA noted that it would continue to work to enhance its internal controls and ensure the reliability of its financial reporting, its soundness of operations, and public confidence in its mission.

The complete text of FHFA's response is reprinted in appendix II.

Steven J. Sebastian
Director
Financial Management and Assurance

November 9, 2010

FHFA'S MISSION

Provide effective supervision, regulation, and housing mission oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market.

FHFA's Values

- ***Accountability***
  We foster responsibility on the part of individual employees and divisions through defined delegations of authority. We align our actions and resources with our mission and respond promptly and proactively to emerging risks. We adhere to a predictable, risk-based supervision program. We use agency resources and authorities efficiently and effectively to achieve our mission and goals.
- ***Responsiveness***
  We cooperate, collaborate, and communicate within FHFA, with other government agencies, Congress, and the public. We respond promptly to external requests and regularly disseminate information about the housing industry and markets. We promptly address and clearly communicate issues, decisions, and conclusions to the regulated entities.
- ***Independence***
  We are the independent regulator of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Our evaluations of the regulated entities are unbiased and remain free from external influence.
- ***Integrity***
  We adhere to the highest ethical and professional standards. We treat the regulated entities, the public, policy makers and other stakeholders fairly with impartiality and respect. We apply consistent treatment to and among the housing regulated entities and base our decisions on the merits of their current actions and conditions.
- ***Professionalism***
  We maintain a highly skilled, dedicated, and diverse workforce. We promote equal opportunity and advancement on the basis of merit. We recognize employees who demonstrate competence and effectiveness in their decisions and actions and whose results serve the agency's mission and the public interest. We judge the regulated entities against defined industry standards through a disciplined examination approach.

Description of FHFA

The Housing and Economic Recovery Act of 2008 (HERA) established FHFA by merging the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board, and certain Department of Housing and Urban Development's (HUD) staff, to oversee the financial safety and soundness and the housing mission compliance of the housing-related government-sponsored enterprises (GSEs or regulated entities). These include Fannie Mae, Freddie Mac, and the FHLB System, comprised of 12 Federal Home Loan Banks.

FHFA is an independent government agency with a workforce that includes highly skilled economists, analysts, examiners, subject matter experts, technology specialists, accountants, and attorneys. FHFA had a staff of 453 employees at the end of FY 2010. In FY 2011, the agency plans to add 103 employees, in addition to staff in the Office of Inspector General following the appointment in September 2010, of the agency's first Inspector General. FHFA's Director sets the direction for the agency to achieve its mission. FHFA divisions and offices have specific responsibilities and work together to ensure effective execution of the agency's mission.

The **Division of Federal Home Loan Bank Regulation** is responsible for the supervision and examination of the FHLBanks and the Office of Finance. The division conducts annual on-site examinations, periodic visitations, and off-site monitoring. Other division responsibilities include supervisory policy and program development, regulatory analysis and developments, and economic research and analysis in support of FHLBank regulation.

The **Division of Enterprise Regulation** is responsible for the supervision and examination of Fannie Mae and Freddie Mac. The division conducts on-site continuous supervision, targeted examinations, and off-site monitoring. The division provides oversight and ensures coordination among all FHFA mission-critical supervisory functions, including programs for capital adequacy, compliance, examination, financial analysis, and quality assurance in support of the Enterprises.

The **Division of Housing Mission and Goals** is composed of the following three offices, each with responsibilities that span all of the regulated entities:

- The **Office of Housing and Community Investment** is responsible for regulatory policy relating to community investment, affordable

FHFA staff assembled for Town Hall Meeting at the National Press Club, April 19, 2010 housing, certain new business activities, and housing goals of the Enterprises and FHLBanks.

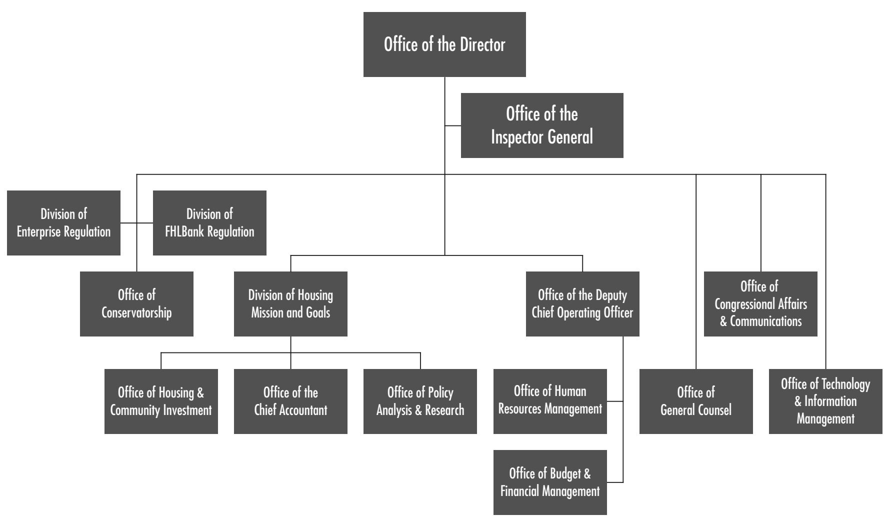
- The **Office of the Chief Accountant** develops safety and soundness guidance and policies related to accounting, auditing, and financial reporting and disclosure at the regulated entities. The office monitors the compliance of the regulated entities with such policies and also promotes the application of consistent accounting policies across the regulated entities.
- The **Office of Policy Analysis and Research** conducts research and policy analysis to assess the short- and long-term effect of trends and issues in the activities of the regulated entities, housing finance, and financial regulation on the regulatory and supervisory functions of FHFA. The office also prepares data series and publications that inform the public about the housing finance system, changes in housing prices, and helps support development of FHFA regulatory policies.

The **Office of Conservatorship Operations** assists the FHFA Director, as conservator, in preserving and conserving Fannie Mae and Freddie Mac's assets and property. The office ensures the Enterprises appropriately focus on their mission, including the stability, liquidity, and affordability of the housing market.

The **Office of the General Counsel** advises and supports the Director and all FHFA staff on legal matters related to the functions, activities, and operations of FHFA and the regulated entities, specifically providing support for supervision functions, promulgation of regulations, and enforcement actions. The Office also manages the Freedom of Information and Privacy Act programs. In addition, the agency ethics official provides advice, counseling and training to FHFA employees concerning ethical standards and conflicts of interest, and manages the agency's financial disclosure program.

The **Office of Inspector General (OIG)** conducts independent and objective audits, evaluations, and investigations to assist FHFA in meeting its mission;

Figure 1. Organization Chart for FHFA



keeps the FHFA Director, Congress, and the American public up to date and fully informed of problems and deficiencies relating to FHFA programs and operations; and works collaboratively with FHFA staff and program participants to ensure success of the agency's program goals. This office came into being upon the confirmation of Steve A. Linick by the U.S. Senate on September 29, 2010.

The **Office of Internal Audit** through FY 2010, until the appointment of the FHFA Inspector General, reported directly to the FHFA Director and carried out a variety of audit functions for FHFA as delegated by the Director.

The **Office of Congressional Affairs and Communications** is responsible for the public affairs and congressional relations functions at FHFA and is the primary point of contact for the external and internal communications of the agency. OCAC prepares and disseminates pertinent public information and responds to inquiries from Congress, the media, industry, and the public at large.

The **Office of the Deputy Chief Operating Officer** provides operational support and services to the agency in the areas of human resources, budget and financial management, performance management, emergency preparedness, and facilities.

The **Office of Technology and Information Management** is responsible for ensuring the integrity, confidentiality, and availability of FHFA's information systems and assets. The office maintains the agency's information technology (IT) infrastructure; oversees the IT security program; develops and maintains custom applications and data repositories; manages technology resources, investments, and assets; establishes IT strategic plans, policies and procedures; supports business partners; and manages the agency's records and information management program.

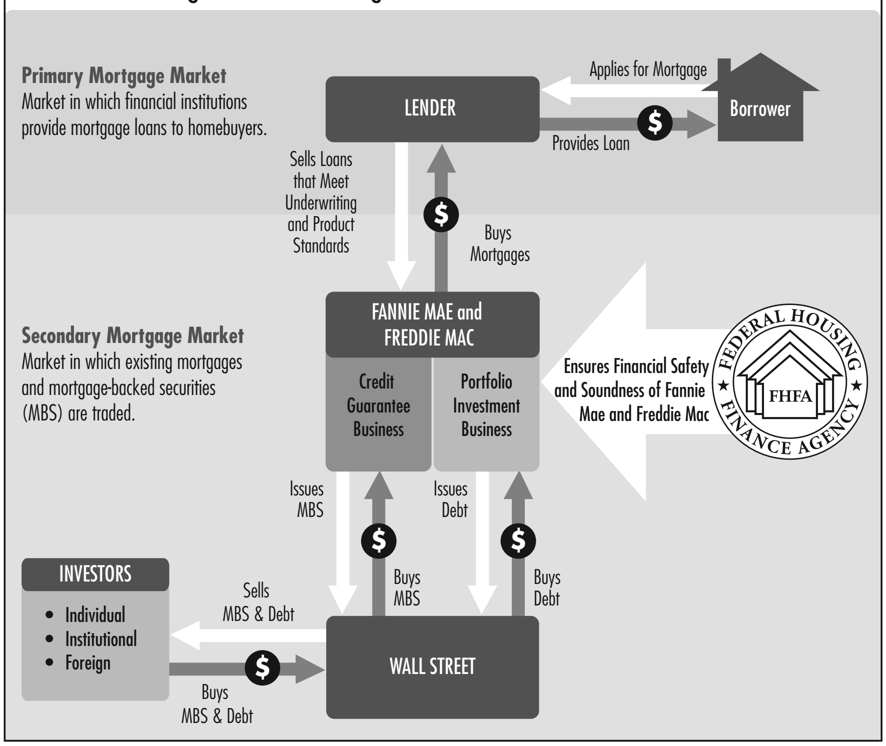
The Enterprises

In the primary mortgage market, financial institutions make mortgage loans directly to homebuyers. This process begins when a potential homeowner or borrower applies for a mortgage loan from a lender. For example, the lender may be a savings bank, credit union, mortgage banking company, commercial bank, savings and loan, or state or local housing finance agency. Once the loan is originated, the lender either holds the loan in its own portfolio or sells the loan. The secondary mortgage market is the market in which mortgages or mortgage-backed securities are traded. The Enterprises acquire mortgages and issue mortgage-backed securities in the secondary mortgage market (See Figure 2).

Congress established the Enterprises to provide liquidity, stability, and affordability to the secondary mortgage market. In the secondary mortgage market, the Enterprises make funds readily accessible to banks, savings and loans, and mortgage companies that make loans in the primary mortgage market to finance housing. Fannie Mae and Freddie Mac are the largest buyers of mortgages in the secondary market. They hold the mortgages they purchase in their portfolios or package the loans into mortgage-backed securities (MBS). The Enterprises also have the authority to buy other agency and private-label MBS for their own portfolios. Lenders may use the cash raised by selling mortgages to the Enterprises to lend to other homebuyers and real estate investors. Roughly half of the mortgages purchased by Fannie Mae and Freddie Mac finance dwelling units that are affordable to households with income at or below 80 percent of the area median income. More than one-fourth of the mortgages are located in geographic areas designated as underserved.

MBS are traded in the secondary mortgage market. Because Fannie Mae and Freddie Mac package mortgages as MBS and guarantee timely payment of principal and interest on the underlying mortgages, investors who might not otherwise invest in mortgages enter the secondary mortgage market, which expands the pool of funds available for housing. Such capital makes the secondary mortgage market more liquid and helps lower the interest rates paid by homeowners and other mortgage borrowers.

Figure 2. FHFA's Oversight Role – Fannie Mae and Freddie Mac



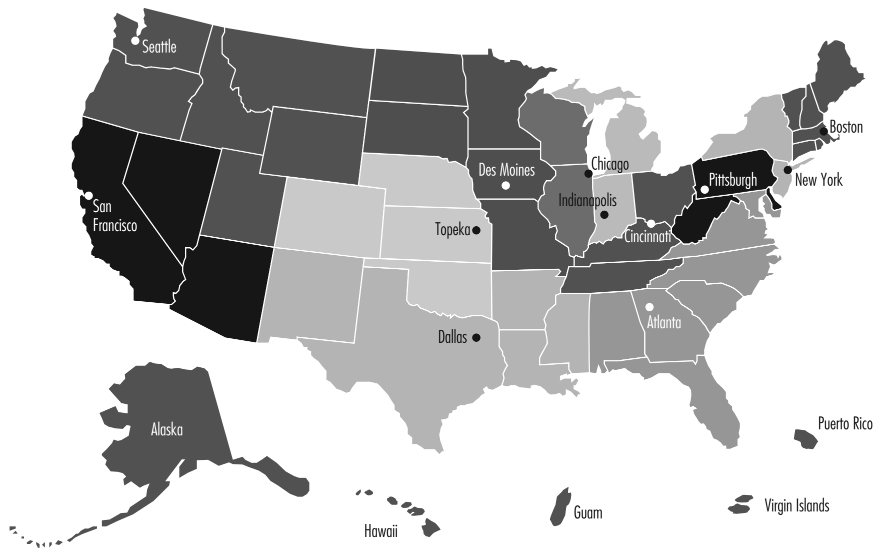
The Federal Home Loan Banks

The FHLBanks provide a readily available, low-cost source of funds to support housing finance and member liquidity. The FHLBanks are member-owned cooperatives. Only members own the capital stock in each FHLBank, and only members can borrow from an FHLBank. Membership is limited to regulated depository institutions (banks, thrifts, and credit unions), insurance companies, and community development financial institutions (CDFIs) engaged in residential housing finance (See Figure 3). The regions comprise combinations of whole states.

Each FHLBank conducts the majority of its credit and mortgage program businesses exclusively with its members or eligible housing associates.

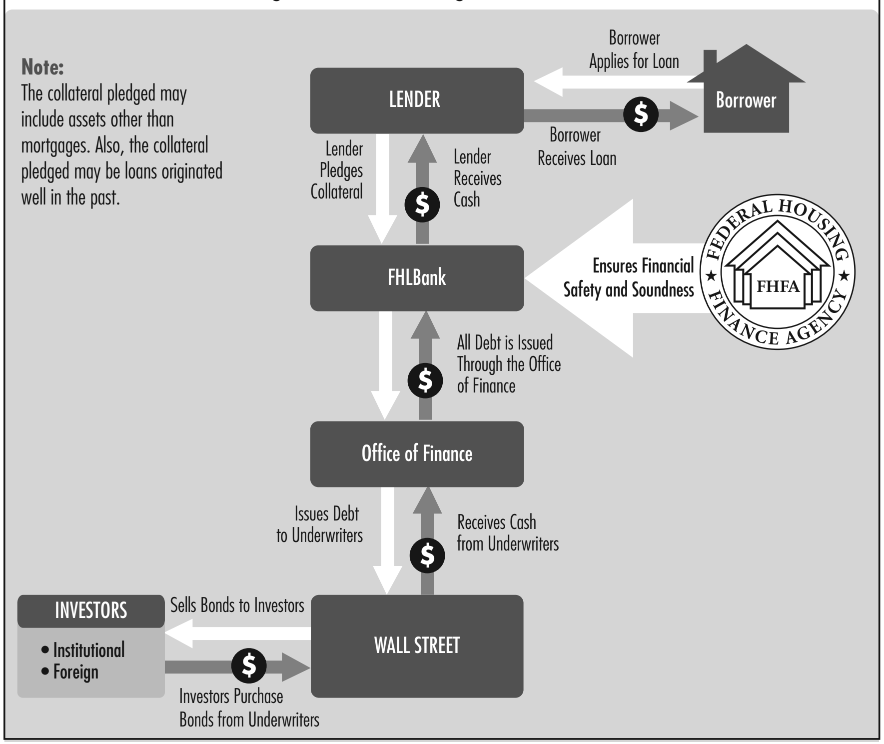
The FHLBanks offer credit and credit-related products, including loans (advances), letters of credit, and lines of credit to their members and eligible housing associates. All advances must be fully collateralized by mortgages and other eligible collateral pledged by the borrowing member or housing associates. Advances are the largest category of FHLBank assets. By providing

Figure 3. Federal Home Loan Bank Districts



Atlanta	Alabama, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia
Boston	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont
Chicago	Illinois, Wisconsin
Cincinnati	Kentucky, Ohio, Tennessee
Dallas	Arkansas, Louisiana, Mississippi, New Mexico, Texas
Des Moines	Iowa, Minnesota, Missouri, North Dakota, South Dakota
Indianapolis	Indiana, Michigan
New York	New Jersey, New York, Puerto Rico, Virgin Islands
Pittsburgh	Delaware, Pennsylvania, West Virginia
San Francisco	Arizona, California, Nevada
Seattle	Alaska, Guam, Hawaii, Idaho, Montana, Oregon, Utah, Washington, Wyoming
Topeka	Colorado, Kansas, Nebraska, Oklahoma

Figure 4. FHFA's Oversight Role – FHLBanks



advances and other credit-related products to their members, FHLBanks increase the availability of credit for residential mortgages.

In addition, some FHLBanks have an Acquired Member Assets (AMA) program to purchase mortgages from their members. Under these programs, members may sell qualifying mortgages to, or fund them through, an FHLBank. Members also may borrow from an FHLBank to fund low-income housing, helping members satisfy their regulatory requirements under the Community Reinvestment Act.
Finally, some FHLBanks offer their members a variety of services, such as correspondent banking, which includes security safekeeping, wire transfers and settlements, cash management, letters of credit, and derivative intermediation.

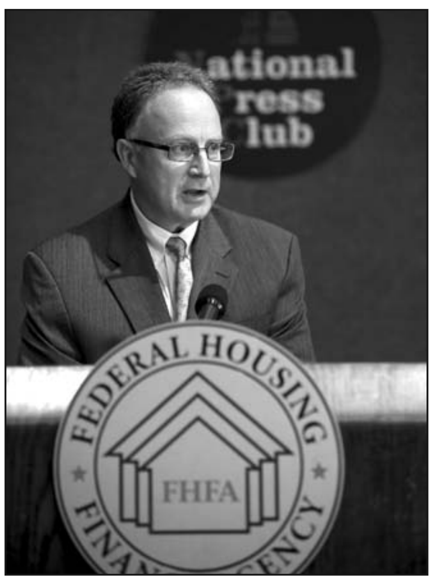
The FHLBanks fund their operations principally through the sale of debt instruments known as consolidated obligations, which are joint and severable obligations of the 12 FHLBanks. These debt instruments are sold to the public through the Office of Finance. Consolidated obligations are not obligations of the United States, and the U.S. Government does not guarantee them (Figure 4).

Performance Highlights

Changes in the Housing and Mortgage Markets During FY 2010

Housing prices declined at a slower rate in 2010 than in 2009. For the 12 months ending in August 2010, housing prices fell 2.4 percent, based on FHFA's monthly House Price Index. At the end of August 2010, the index was 13.6 percent below its peak, which occurred in April 2007.

Mortgage rates generally declined during FY 2010. In September 2010, the average interest rate on conventional 30-year, fixed rate mortgage loans of $417,000 or less was 4.58 percent, compared to 5.23 percent in September 2009. Recovery in the housing and mortgage markets has generally been slowed by several economic factors, including unemployment, but there are signs of progress.



Stephen Cross, Acting Chief Operating Officer, addresses FHFA staff at an FHFA Town Hall meeting on April 19, 2010.

In July 2010, Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or the Act), designed to correct problems that led to the financial crisis. Among other things, the Dodd-Frank Act, provides that taxpayers will not be called upon to bail out failing financial companies or cover the cost of their liquidation. The Act also strengthens regulatory oversight and enhances regulators' authority to pursue financial fraud. The Act does not address the future of the Enterprises, the secondary mortgage market or of the housing finance system.

During FY 2010, FHFA carried out its mission against this backdrop of financial regulatory reform and changing conditions in the housing market. The agency accomplished a number of important goals as both conservator of the Enterprises and safety and soundness regulator of the 14 housing GSEs.

Preserving and Conserving the Assets of the Enterprises

Since September 2008, when both Enterprises were placed into conservatorship, FHFA has worked to preserve and conserve their assets. As conservator, FHFA assumed the powers of each Enterprise's management, board, and shareholders. FHFA provides approvals and guidance for the Enterprises as they conduct their business activities and day-to-day operations.

During FY 2010, FHFA prohibited the Enterprises from developing and offering new products to eliminate the operational challenges and risks inherent in such offerings. This restriction, standard for troubled financial institutions, directs focus of the Enterprises on existing core businesses while minimizing credit losses and remediating internal control weaknesses.

During FY 2010, FHFA also directed the Enterprises and the FHLBanks to undertake prudential actions to address significant safety and soundness concerns presented by energy retrofit lending programs denominated as Property Assessed Clean Energy (PACE). PACE loans foster lending for retrofits of residential or commercial properties through a county or city's tax assessment. In some states, such loans have a priority lien over existing mortgages, which could result in an alteration of lien priorities, thereby posing credit risk to lenders and secondary market entities. The actions required by FHFA were designed to mitigate risks posed by those PACE programs that altered lien priorities and failed to operate with sound underwriting guidelines and consumer protections.

In July 2010, exercising broad authority granted under HERA, FHFA issued 64 subpoenas to various entities seeking documents related to private-label MBS in which the Enterprises had invested. Information obtained from the subpoenas will aid FHFA in determining whether private-label MBS issuers and others are liable to the Enterprises for losses sustained on these securities, and enable the Enterprises to assess any claims arising from the failure of the loans or their servicing to meet required standards. Before FHFA issued the subpoenas, the Enterprises had been unsuccessful in their attempts to obtain such information.

FHLBank Corporate Governance

In April 2010, FHFA sent to the *Federal Register* a final rule that restructures the board of directors of the FHLBank System's Office of Finance and enhances the responsibility of the Office of Finance board of directors audit committee for the System's combined financial reports. The Office of Finance is responsible for issuing consolidated obligations on behalf of the 12 Federal Home Loan Banks, serves as their fiscal agent, and prepares disclosure materials associated with the marketing and sale of that debt, including the System's quarterly and annual combined financial reports.

Under the new rule, the Office of Finance board of directors expanded from three to 17 members. The new board of directors is composed of the president of each of the 12 Federal Home Loan Banks and five independent directors, each of whom must be a U.S. citizen with no material financial relationship to the System. The rule also provides that the five independent directors serve as the audit committee for the Office of Finance, and gives the audit committee increased authority over the form and content of the information that the FHLBanks provide to the Office of Finance for use in the System's combined financial reports.

The FHLBanks' Resolution Funding Corporation Obligations

Recent trends indicate that the FHLBanks will, within the next two fiscal years, fulfill their obligation to pay their portion of the interest on bonds issued by the Resolution Funding Corporation (REFCORP) as part of the savings and loan cleanup of 1989.

Currently, each FHLBank's REFCORP obligation is 20 percent of its net earnings. When the REFCORP obligation is satisfied, FHFA will expect the FHLBanks to allocate a commensurate sum each quarter to retained earnings. By increasing retained earnings, the FHLBanks will be in a better position to support par value repurchases and redemptions of member capital stock and will otherwise enhance their safety and soundness.

Responding to the Administration, Congress, and the Public

Addressing the financial crisis required a collaborative effort among the Administration, Congress, regulators, the public, and other industry stakeholders. FHFA responded promptly to inquiries, published reports and data pertaining to the secondary mortgage market, and met regularly with industry stakeholders. FHFA also gave a series of presentations regarding affordable housing and community investment activities for participants of the NeighborWorks Training Institutes.

In FY 2010, FHFA's Acting Director testified before Congressional committees on five occasions. Throughout 2010, FHFA responded promptly to numerous Congressional inquiries. FHFA received 253 Congressional inquiries and responded to 88 percent of them within 15 business days. FHFA participated in the President's Working Group on Financial Markets to help coordinate regulatory activities. FHFA also held meetings with representatives from U.S. Department of the Treasury (Treasury), HUD, the Council of Economic Advisers, the National Economic Council, and the Enterprises to discuss ways to improve the performance of the Enterprises and increase the stability of the secondary mortgage market.

FHFA provided information on the regulated entities and other housing-related topics through the FHFA website and several published papers and reports. In FY 2010, FHFA published two working papers: *Estimating Median House Prices* and *Automatic Recapitalization Alternatives*. FHFA also published five new research papers: *Revisions to FHFA's House Price Index in the Recent National House Price Boom and Bust*; *Housing and Mortgage Markets and the Housing Government-Sponsored Enterprises in 2008*; *Market Estimation Model for the 2010 and 2011 Enterprise Single-Family Housing Goals*; *Data on the Characteristics and Performance of Single-Family Mortgages Originated in 2001-2008 and Financed in the Secondary Market*; and *An Approach for Calculating Reliable State and National House Price Statistics*. A mortgage market note was titled *The Housing Goals of Fannie Mae and Freddie Mac in the Context of the Mortgage Market: 1996-2009*. In addition to this mortgage market note, FHFA published two mortgage market note updates. In August 2010, FHFA released its first *Conservator's Report on the Enterprises' Financial Condition*, which provided an overview of various aspects of the financial condition of the Enterprises during conservatorship. FHFA also published a monthly *Federal Property Managers Report*, described further in the next section.

Foreclosure Alternatives and Loss Mitigation

The Enterprises have long had programs to mitigate losses. These programs typically consisted of repayment plans and modest changes to loan terms, rather than any substantial modification to reduce the borrowers' monthly payments to an affordable level.

As the housing crisis persisted, it was clear that a more aggressive and broader approach to loss mitigation—one that included mortgages securitized in private-label securities, mortgages held as whole loans in bank portfolios, and mortgages owned or guaranteed by the Enterprises—was needed. This recognition led to the Enterprises' participation in the Administration's Making Home Affordable (MHA) program, including the Home Affordable Modification Program (HAMP) and the Home Affordable Refinance Program (HARP). MHA is a plan developed by the Administration to stabilize the housing market and help struggling homeowners get relief and avoid foreclosure. HAMP provides mortgage servicers a single, consistent program to modify mortgage payments for borrowers with delinquent mortgages or in imminent default to make them more affordable. FHFA oversees Fannie Mae and Freddie Mac's participation as financial agents for HAMP, as well as their efforts to carry out these and other loss mitigation strategies.

Fannie Mae and Freddie Mac have played key roles in the development and implementation of HAMP. A well-designed loan modification is often a lower cost resolution to a delinquent mortgage than foreclosure, and these alternatives to foreclosure lower Enterprise costs and save taxpayers money. Loan modification programs also can offer benefits beyond reducing losses directly on the Enterprises' resolutions of their delinquent mortgages, by improving stability in housing markets and reducing credit exposure.

During FY 2010, FHFA published a monthly *Foreclosure Prevention and Refinance Report* to publicize the progress of MHA, promote transparency in the Enterprises' foreclosure prevention activities, and provide data on the Enterprises' mortgage refinance and loan modification activities. In addition, FHFA published a monthly *Federal Property Managers Report*, which detailed the number and types of loan modifications and the number of foreclosures during the reporting period.

Housing Mission Compliance

On September 2, 2010, FHFA sent a final rule to the *Federal Register*, establishing new housing goals for the Enterprises for calendar years 2010 and 2011. The final rule establishes three, single-family, owner-occupied home purchase mortgage goals for low-income families, very low-income families, and families living in geographical areas with lower-income populations, areas with high concentrations of minority residents, and federally-declared disaster areas. The latter goal also includes a specialized subgoal to ensure that the Enterprises address housing needs in lower-income and minority areas. The final rule also contains a goal for single-family, owner-occupied refinance mortgages for low-income families.

While the Enterprises are in conservatorships, FHFA expects them to continue to fulfill their core statutory purposes, which includes their support for affordable housing. One set of measures of the Enterprises' support for affordable housing comes through the housing goals, which Congress revised significantly in HERA.

FHFA does not intend for the Enterprises to undertake imprudent or high-risk activities in support of the goals, nor does it intend conservatorship to be a justification for withdrawing support from these market segments. Under the conservatorships, the Enterprises have tightened their underwriting standards to avoid poor quality mortgages, such as those that contributed so much to their losses. Through FHFA oversight, the Enterprises will be expected to maintain this type of sound underwriting discipline going forward.

As before enactment of HERA, the FHLBanks will continue to support affordable housing for low- and moderate-income households principally through the Affordable Housing Program (AHP). Beginning in 2011, HERA also requires FHFA to establish affordable housing goals for the FHLBanks. The affordable housing goals for the FHLBanks must be consistent with those for the Enterprises and take into consideration the unique mission and ownership structure of the FHLBanks.

On May 27, 2010, FHFA published in the *Federal Register* a proposed rule to establish a framework for affordable housing goals for the FHLBanks. Under the proposed rule, an FHLBank would be subject to the proposed housing goals if its AMA-approved mortgage purchases in a given year exceed a volume threshold of $2.5 billion. FHFA received public comments on the establishment of three purchase money mortgage goals and one refinancing mortgage goal applicable to the FHLBanks' purchases of mortgages on owner-occupied single-family housing under their AMA programs.

Under the AMA programs, the FHLBanks purchase only single-family, fixed-rate mortgages below the conforming loan limit. While at one time, all FHLBanks offered AMA programs, several no longer offer the program, and mortgage loan balances are stable or declining at most of the FHLBanks. As of September 30, 2010, the combined value of the AMA mortgage loans in the FHLBanks' portfolios was $64 billion.

Executive Compensation

During FY 2010, FHFA established a new executive compensation program for the Enterprises as part of its oversight responsibilities as conservator. FHFA designed the new compensation structure in consultation with the Special Master for Troubled Asset Relief Program (TARP) Executive Compensation.

In addition, FHFA also lowered executive officer pay at the Enterprises by an average of 40 percent from pre-conservatorship levels. The significant salary structure changes implemented during FY 2010 include the following:

- No executive officers will receive perquisites exceeding $25,000 without FHFA approval in consultation with the U.S. Department of the Treasury.
- No retirement plans for executives may use more generous formulas than plans for lower-ranking employees.
- No expense reimbursements to executives will include "tax gross-ups," which are reimbursements to an employee for taxes owed on relocation expense payments.
- Deferred salary and incentive pay for all executive officers will be subject to "claw backs" by the Enterprises in the event of gross misconduct, gross negligence, conviction of a felony, or erroneous performance metrics. Claw backs allow FHFA to reclaim previously given monies or benefits, if it is later determined that management fell short through either adverse action or inaction.

The agency also issued the final rule, *FHLBank Board of Directors Eligibility, Elections, Compensation, and Expenses*. HERA repealed the statutory caps on the annual compensation an FHLBank may pay its directors. The final rule allows each FHLBank to pay its directors reasonable compensation and expenses, subject to the authority of the FHFA Director to prohibit compensation determined to be unreasonable. This is consistent with the authority the FHFA Director has used to reform compensation practices at Fannie Mae and Freddie Mac.

FHLBank Membership

On January 5, 2010, FHFA published a final rule that authorizes CDFIs, that have been certified by the CDFI Fund of the U.S. Department of the Treasury, to become members of the FHLBanks. Congress provided for such membership in the FHLBanks to enable CDFIs with increased access to long-term funding to increase their capacity to promote economic growth and stability in low- and moderate-income communities.

Figure 5. Regulations Published in FY 2010	
Proposed	**Minority and Women Inclusion** (75 FR 1289, January 11, 2010, 12 CFR Part 1207)
	Minimum Capital Temporary Increase (75 FR 6151, February 8, 2010, 12 CFR 1225)
	Use of Community Development Loans by Community Financial Institutions to Secure Advances, Secured Lending by Federal Home Loan Banks to Members and their Affiliates; Transfer of Advances and New Business Activity Regulations (75 FR 7990, February 23, 2010, 12 CFR 1266, 1272)
	Equal Access to Justice Act Implementation (75 FR 17622, April 7, 2010, 12 CFR 1203)
	Federal Home Loan Bank Investments (75 FR 23631, May 4, 2010, 12 CFR 1267)
	Federal Home Loan Bank Housing Goals (75 FR 29947, May 28, 2010, 12 CFR 1281)
	Enterprise Duty to Serve Underserved Markets (75 FR 32099, June 7, 2010, 12 CFR 1282)
	Conservatorship and Receivership (75 FR 39462, July 9, 2010, 12 CFR 1237)
	Office of Ombudsman (75 FR 47495, August 6, 2010, 12 CFR 1213)
	Rules on Practice and Procedure (75 FR 49313, August 12, 2010, 12 CFR Parts 1209)
	Private Transfer Fee Covenants (74 FR 49932, August 16, 2010)
	Information Sharing among Federal Home Loan Banks (75 FR 60347, September 30, 2010, 12 CFR Part 1260)
Final	**Post-Employment Restriction for Senior Examiners** (74 FR 51073, October 5, 2009, 12 CFR 1212)
	Federal Home Loan Bank Membership for Community Development Financial Institutions (75 FR 677, January 5, 2010, 12 CFR Parts 1263, 1290)
	Reporting of Fraudulent Financial Instruments (75 FR 4255, January 27, 2010, 12 CFR 1233)
	Federal Home Loan Bank Housing Associates, Core Mission Activities and Standby Letters of Credit (75 FR 8239, February 24, 2010, 12 CFR 1264, 1265, 1269)
	Federal Home Loan Bank Director's Eligibility, Elections, Compensation and Expenses (75 FR 17037, April 5, 2010, 12 CFR 1261)
	Board of Directors of Federal Home Loan Bank System Office of Finance (75 FR 23152, May 3, 2010, 12 CFR Parts 1273, 1274)
	Affordable Housing Program Amendments: Federal Home Loan Bank Mortgage Refinancing Authority (75 FR 29877, May 28, 2010, 12 CFR 1291)
	Supplemental Standards of Ethical Conduct for Employees of the Federal Housing Finance Agency (75 FR 52607, August 27, 2010, 5 CFR 9001)
	2010 - 2011 Enterprise Affordable Housing Goals; Enterprise Book-entry Procedures (75 FR 55892, September 14, 2010, 12 CFR Parts 1249, 1282)

An FHFA meeting wherein FHFA operating as conservator of Fannie Mae and Freddie Mac is carrying out the assumed powers of the Board and management of the two Enterprises.

The final rule sets forth eligibility and procedural requirements for CDFIs to become members of the FHLBanks. The eligible CDFIs include community development loan funds, certain venture capital funds, and state-chartered credit unions without federal insurance.

Providing Regulatory Guidance

In addition to the rulemaking described above, FHFA issued an array of other rules, some to implement new authorities provided in HERA and some to update or change regulations previously issued by one of FHFA's predecessor agencies. Figure 5 lists the proposed and final regulations issued by FHFA during FY 2010. Importantly, FHFA finalized a rule on post-employment restrictions for senior examiners, which restricts senior examiners from taking a job with a regulated entity for one year after leaving FHFA.

Management Challenges

FHFA as Conservator

Conservatorship cannot be a permanent state for the Enterprises. As debate continues over the future design of the housing finance system, FHFA remains focused on the fundamental purposes of the conservatorships: conserving the Enterprises' assets and maintaining their activities in the secondary mortgage market.

The statutory role of FHFA as conservator also requires the agency to take actions to preserve the assets of the Enterprises and restore them to a financially safe and sound condition. In the conservator role, FHFA has consistently emphasized that the Enterprises will continue to be responsible for normal business activities and day-to-day operations, seeking conservator approval and guidance as needed; in FY 2010, the companies focused on these principles. Pursuant to FHFA's mandate, the Enterprises, while they are in conservatorship, are not permitted to engage in new lines of business.

Managing and Reporting on the Conservatorship

During 2009, Treasury and the Federal Reserve provided unprecedented support to the mortgage markets via the Enterprises. Treasury established three support mechanisms: the GSE Credit Facility, the GSE Mortgage-Backed Securities (GSE MBS) Purchase Facility, and the Senior Preferred Stock Purchase Agreements. As required by law, the GSE Credit Facility and GSE MBS Purchase Facility terminated at the end of 2009. The GSE Credit Facility was never used. However, Treasury used the GSE MBS Purchase Facility to buy $221 billion of Fannie Mae and Freddie Mac MBS from September 2008 through December 2009. In addition, the Federal Reserve completed its commitment to purchase $1.25 trillion of Enterprise and the Government National Mortgage Association (Ginnie Mae) MBS as of March 31, 2010.

Treasury reaffirmed its commitment to the stability and liquidity of the mortgage market through the Senior Preferred Stock Purchase Agreements with two modifications in 2009 to the original agreements. First, Treasury announced an increase in the financial commitment to each company from $100 billion to $200 billion in February 2009, a move that emphasized the importance of the agreements in maintaining market confidence in the Enterprises. Legal authority to commit additional funds was set to expire at year-end, so Treasury reaffirmed its commitment on December 24, 2009, by amending the agreements to provide funding for each Enterprise up to the greater of: (1) $200 billion; or (2) $200 billion plus the cumulative total of draws for each calendar quarter in 2010, 2011 and 2012, minus any amount by which the assets of the Enterprise exceed its liabilities on December 31, 2012. This funding is to ensure that each Enterprise maintains a non-negative net worth, thereby avoiding a statutory requirement that an Enterprise be put in receivership following an extended period of negative net worth.

The December 2009 amendment was designed to quell market uncertainty by assuring investors of the soundness of Enterprise securities. That December amendment allows the Enterprises to be able to serve as a stable source of funds for new home purchases and refinancing of existing mortgages. This amendment also assures capital market investors that Enterprise securities are sound investments.

Although the Enterprises' substantial market presence has been a key step to restoring market stability, neither company would be capable of serving the mortgage market today without the ongoing financial support provided by Treasury. Losses at the Enterprises have totaled $226 billion since year-end 2007. At the end of FY 2010, Fannie Mae had drawn $85.1 billion and Freddie Mac $63.1 billion in Treasury support from the Senior Preferred Stock Purchase Agreements, nearly $148.2 billion in total. To provide the public with clear information about the Enterprises, FHFA began posting on its website in August 2010, quarterly data on the Enterprises' financial performance in conservatorship.

FHFA previously determined that capital classifications would be suspended during conservatorship. Both Enterprises have depleted all of their shareholders' equity, with the negative balances of those accounts offset by Treasury's investments under the Senior Preferred Stock Purchase Agreements. Consequently, levels of capital and capital adequacy, key measures of safety and soundness, cannot be measured for the Enterprises while operating under conservatorship with financial support from Treasury. Reliance on the U.S. Department of Treasury's backing will continue until legislation produces a final resolution of the Enterprises' future.

Each Enterprise continues to realize credit losses from mortgages originated in the years prior to conservatorship. Between 2004 and 2007, the Enterprises increased the amount of their exposure in nontraditional and high-risk mortgages, including Alt-A and interest only loans, which resulted in substantial losses. For example, during the first quarter of calendar year 2010, Alt-A loans accounted for 37 percent of Fannie Mae's losses for the quarter and 42 percent of Freddie Mac's. Figure 6 shows the characteristics of the Enterprises' single-family mortgage acquisitions since 2006.

Past business decisions cannot be undone; however, with the oversight and guidance of FHFA as conservator and regulator, the Enterprises are actively seeking ways to minimize these credit losses and ensure that new business generated during conservatorship is profitable. During the first quarter of 2010, less than 2 percent of Fannie Mae's purchases were interest only loans. Freddie Mac did not purchase any interest only loans. Alt-A loans were less than 1 percent of acquisitions for both Enterprises during the first quarter of 2010.

Operational challenges remain a critical concern at each Enterprise. In conservatorship, the Enterprises can continue their existing core business activities and take actions necessary to advance the goals of the conservatorship. They cannot commence new products or lines of business.

FHFA will work with the Administration and Congress on a complete review of, and legislative action on, the future of the housing finance system and of the Enterprises beyond conservatorship. Also, FHFA is looking at possible changes in the way the Enterprises do business that may be desirable in the interim period, as Congress contemplates and debates statutory options.

For example, this year FHFA directed the two Enterprises to work collectively to expand and enhance the data submitted by loan sellers. The goal of this initiative is to raise the quality and consistency of key mortgage and property information, which in turn should improve the Enterprises' risk management capabilities. The changes should also improve the functioning of the mortgage market and be beneficial regardless of what course the larger-scale restructuring of the housing finance system takes.

FHFA as Regulator

FHFA has the statutory responsibility of conducting an annual examination program for the Enterprises, the FHLBanks, and the Office of Finance. FHFA's annual examination program assesses the regulated entities' financial safety and soundness and overall risk management practices.

FHFA examiners use a risk-based approach to supervision. Through examinations, data analysis, and risk monitoring activities, FHFA identifies matters requiring corrective action by the regulated entities and monitors their efforts to correct deficiencies.

Setting Expectations for the FHLBank System

The FHLBanks face challenges. In FY 2010, the FHLBanks incurred aggregate credit-related impairment charges of more than $900 million on their holdings of private-label MBS. However, all but one of the 12 FHLBanks was adequately capitalized at the end of FY 2010, and the 12th FHLBank met regulatory minimum capital requirements but FHFA used its discretionary authority to deem it "undercapitalized" because of losses associated with its holdings of private-label MBS.

Four FHLBanks have negative accumulated other comprehensive income (AOCI) in excess of retained earnings. The negative AOCI principally reflects non-credit impairment in private-label MBS for which OTTI has been taken. The excess of negative AOCI over retained earnings is large at two FHLBanks, both with significant exposure to private-label MBS backed by non-traditional mortgages originated in 2005-08.

During FY 2010, the FHLBanks worked collectively to improve the rigor and consistency of their analytical framework for valuing their holding of private-label MBS. FHFA conducted two reviews of the "common platform" for FHLBank OTTI analyses and separately evaluated their OTTI modeling. FHFA offered recommendations for improvement, but concluded that the FHLBanks' methodology was generally sound.

A key objective of FHFA is to return the focus of FHLBank operations to providing advances to member institutions and to establish stability at each FHLBank to permit repurchases and redemptions of member stock at par. FHFA expects advances to represent an increasing share of total FHLBank assets over time. FHFA also expects Banks to achieve and maintain a market value of equity equal to or greater than the par value of their capital stock.

In recent years, FHLBank investment portfolios had grown beyond levels needed for liquidity and mission achievement at some FHLBanks. In some cases, interest rate exposures and credit risk rose significantly. Several FHLBanks experienced sharp declines in net asset values, which in turn led to restrictions on dividend payments, stock repurchases, and stock redemptions. Some of those restrictions have been voluntary, while others have stemmed directly from supervisory action. But, in either case, the restrictions disrupt the normal operations of the FHLBanks and affect the value proposition of membership.

Against this backdrop, FHFA expects all the FHLBanks to review, rethink and reformulate their business strategies with an increased emphasis on mission achievement and a focus on the traditional business of making advances to member institutions, while de-emphasizing investment portfolios not needed to support core activities.

Source of Losses

Enterprises

In its annual *Report of Examinations* for each Enterprise, FHFA rated both Fannie Mae and Freddie Mac as critical supervisory concerns, mainly due to credit-related expenses and forecasted credit losses yet to be recognized on purchases and guarantees of mortgages originated in 2006 and 2007. FHFA expects the high delinquency rates to continue for these vintage mortgages because of uncertainty about the overall economy, housing prices, and unemployment rates.

Both Enterprises also face a high degree of operational risk and limitations in their operational capacity. Constraints on operational capacity are also a concern for mortgage servicers, many of whom received incentives to keep costs low during the housing boom and subsequently have been strained by record mortgage defaults.

Both Enterprises have been working to develop alternative servicing solutions for high-risk mortgage portfolios because of rapidly rising inventories of real estate owned. Not only do large volumes of foreclosed houses present operational challenges, but these properties must be liquidated in a manner that does not needlessly exacerbate weaknesses in housing markets.

Each Enterprise funds more than $700 billion in mortgage-related assets through the issuance of debt securities. The interest rate risk of mortgage portfolios of this size is inherently large, but the challenges of managing this portfolio have become even larger because of the difficulty of estimating prepayments.

The need to carefully manage the interest rate risk of these portfolios is heightened by the fact that many of the new mortgages in the Enterprises' portfolios were originated at historically low rates. In an environment of rising interest rates, the average duration of these investments would significantly extend. If interest rate risk is not properly managed in the present, such a situation could lead to significant future funding challenges. Furthermore, the retained portfolio mix is changing with a much larger concentration of distressed assets that have cash flows that are difficult to model and may not be as sensitive to changes in rates. Finally, the asset mix within the retained portfolios is becoming less liquid.

Figure 6. Characteristics of the Enterprises' Single-Family Mortgage Acquisitions

Percent of New Single-Family Business *(Categories overlap and are not additive)*

	Fannie Mae				YTD	Freddie Mac				YTD
	2006	2007	2008	2009	June '10	2006	2007	2008	2009	June '10
Alt-A	22%	17%	3%	0%	0%	18%	22%	7%	0%	1%
Interest-only	15%	15%	6%	1%	2%	17%	21%	6%	0%	0%
Credit Score < 620	6%	6%	3%	0%	1%	5%	6%	3%	1%	1%
LTV > 90 Percent	10%	16%	10%	4%	8%	6%	11%	9%	4%	9%
Average LTV	73%	75%	72%	67%	69%	73%	74%	71%	67%	70%
Average Credit Score	716	716	738	761	758	720	718	734	756	750

Notes:

1. New business is defined as issuance of MBS plus purchases of whole loans and does not include purchases of mortgage-related securities.
2. For Fannie Mae, Alt-A generally refers to a mortgage loan that may be underwritten with reduced or alternative documentation than that required for a full documentation mortgage loan but may also include other alternative product features. In reporting Alt-A exposure, Fannie Mae classified mortgage loans as Alt-A if the lenders that delivered the mortgage loans to them classified the loans as Alt-A based on documentation or other product features. Fannie Mae classified private-label mortgage related securities held in its investment portfolio as Alt-A if the securities were labeled as such when issued.
3. In determining Alt-A exposure on loans underlying its single-family credit guarantee portfolio, Freddie Mac classified mortgage loans as Alt-A if the lender that delivered the mortgage loans classified the loans as Alt-A, or if the loans had reduced documentation requirements, as well as a combination of certain credit characteristics and expected performance characteristics at acquisition which, when compared to full documentation loans in Freddie Mac's portfolio, indicate that the loan should be classified as Alt-A. Freddie Mac's year-to-date figures include Alt-A purchases of $1.5 billion due to a long-term standby commitment termination and a subsequent participation certificate issuance. There was no change to the Alt-A exposure on these mortgages as a result of these transactions.
4. The years in the heading of this table are calendar years.

Sources:
Enterprises' Forms 10-K, credit supplements to SEC disclosures, and management reports.

Federal Home Loan Banks

Risk management deficiencies are present at some individual FHLBanks. Also, FHLBanks with substantial investments in private-label MBS have seen a decline in their market value of equity compared to the par value of capital stock, which has resulted in a reduction or suspension of dividends and limits on their ability to repurchase or redeem stock.

By the end of FY 2010, FHLBank advances had declined to the lowest level for the System since the third quarter of 2004. Advances accounted for less than 60 percent of total assets for the first time since the first quarter of 1998. The decline in advances reflects continuing deposit growth and members' tepid loan demand, which reduces their need for wholesale funding. In addition, ongoing consolidation in the financial services industry has resulted in some large borrowers being acquired by firms with a lower historical use of advances.

The FHLBanks' AHP continues to be a source of funding for national and local affordable housing initiatives supported by member institutions. However, the decline in FHLBank income has reduced program contributions from $331 million in 2007 to $258 million in 2009.

Participating in Regulatory Reform

The Dodd-Frank Act requires new rules for mortgages and mortgage securitizations. Among other things, the Act requires FHFA to work with other federal regulators and agencies to define low-risk, "qualified residential mortgage." Such mortgages will be exempt from certain risk-retention requirements related to their securitization.

In addition, the Act establishes the Consumer Financial Protection Bureau, which will be responsible for regulations governing certain disclosures and mortgage lending practices. FHFA expects to work with the Bureau on mortgage-related consumer protection matters.

Future of the Housing Finance System

Numerous ideas about the future of the housing finance system have been proposed in the past two years. Large-scale restructuring of the housing finance system that would provide an explicit federal guarantee of any kind, assign the functions of the Enterprises to a federal agency or corporation, or establish more than two federally chartered secondary market firms would require new legislation.

The Administration, Congressional Budget Office, U.S. Government Accountability Office (GAO), trade associations, academics, and others have identified a variety of approaches related to the future structure and functions of the Enterprises or their successors. FHFA is participating in internal and multiagency efforts to review and evaluate the strengths, weaknesses, and risks of the various options. FHFA's experience with, and understanding of, secondary mortgage markets and institutions will be valuable to the Administration and Congress as they consider restructuring housing finance and financial regulation and address the secondary mortgage market and the role of the Enterprises.

Though much of the debate will focus on the Enterprises or their successors in the secondary mortgage market, FHFA expects the discussion to include the future of the FHLBanks. The FHLBanks have played a critical role in providing financing to large and small member financial institutions through advances, but their residential mortgage portfolios are small compared to those of the Enterprises. To prepare for future policy decisions, FHFA is closely monitoring markets and holding discussions with various stakeholders.

Challenges for the Housing GSEs and FHFA as the Policy Debate Commences

The upcoming national debate on the future of the country's housing finance system will pose unique challenges for the housing GSEs and FHFA. As the debate progresses, the Enterprises will be expected to continue providing an active, stable secondary mortgage market so that mortgage lending may continue uninterrupted and unimpeded by policy debates. Yet the management and staff at each Enterprise will be sensitive to the terms and course of the debate, as it will include discussions of whether and how the Enterprises may exist in the future. The ongoing policy debate poses challenges for Enterprise management as well as for FHFA in ensuring the continued staffing and efficient operations at each Enterprise.

As the FHLBanks are an important part of the country's housing finance system, the policy debate may soon include consideration of possible new or changing roles and responsibilities for the FHLBanks. As with the Enterprises, the FHLBanks will be challenged with maintaining ongoing operations as policy discussions about the FHLBank System take place.

For FHFA, the broad Administration and congressional review of the country's housing finance system also poses challenges and opportunities. Since its creation two years ago, FHFA has worked to realize HERA's purpose in having a single housing finance regulator capable of a broad view of wholesale mortgage financing and of the liquidity of the nation's mortgage market. Internally, FHFA continues to make strides in how it organizes and manages its responsibilities so as to realize the benefits of being a single, unified housing GSE regulator. In FY 2011, FHFA will continue to develop its internal management structure to more fully realize the benefits of combining its three predecessor agencies. It will also be active in supporting the policy debate on the future of housing finance, while remaining focused on the difficult challenges facing the country's housing finance system and its institutions today.

FY 2010 Performance Summary

FHFA's Strategic Planning

FHFA sets long-term and annual goals and monitors progress throughout the year to produce results using strategic and performance planning. The second section of this report describes FHFA's results and their relation to the agency's FY 2010 performance goals.

FHFA's *FY 2010 Annual Performance Plan* was developed and released in January 2010, and includes a total of 26 performance measures: 20 annual performance goals in support of three strategic goals and objectives; and six annual performance goals in support of FHFA's resource management strategy. This section describes the agency's performance against its *FY 2010 Annual Performance Plan*, which outlined the means and strategies to achieve the annual performance goals and related measures for the past year.

FHFA plans to refine and update the agency's strategic plan in time for the FY 2012 budget development, in response to OMB's directive. Consistent with OMB guidance and sound strategic planning practices, FHFA will update its FY 2011 targets and set FY 2012 performance targets in advance of preparing its FY 2012 budget.

In FY 2010, FHFA began tracking resource allocations and program costs by strategic goals that are outlined in the agency's strategic plan.

FHFA's Strategic Goals

To achieve FHFA's mission, the agency established three strategic goals:

1. The housing GSEs operate in a safe and sound manner and comply with legal requirements.
2. The housing GSEs support a stable, liquid, and efficient mortgage market, including sustainable homeownership and affordable housing.
3. FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.

FHFA also has set a resource management strategy which states that FHFA has the personnel, resources, and infrastructure to effectively and efficiently achieve its mission and goals.

FHFA FY 2010 Performance

The performance section describes the agency's performance goals for each strategic goal and FHFA's accomplishments related to each performance goal and its associated performance measures. Performance goals are counted as *met* when targets for all performance measures have been achieved. FHFA reported on 26 performance measures in its *FY 2010 Annual Performance Plan*. The agency met or exceeded 12 of the performance measures in the plan. It failed to meet 14 of the performance measures.

The agency is not satisfied with that performance record. However, in a number of cases in which a goal was not fully satisfied, the agency did achieve a substantial degree of progress toward the goal. For example, one measure relating to the safety and soundness would require an improvement in at least one component examination rating for each of the two Enterprises. The objective was satisfied in one Enterprise, but not the other. In the other, progress was made in a number of component areas, but not enough progress to warrant a higher component rating. As such, the performance measure was not achieved, but the agency and the Enterprises made clear progress toward the measure's satisfaction.

Another example relates to the FHLBanks achieving a composite examination rating of "2" or better or operating under an approved remediation plan. Of the three FHLBanks that were not operating under an approved remediation plan within 90 days of the downgrade, one subsequently adopted a plan acceptable to FHFA during FY 2010. The other two FHLBanks adopted plans acceptable to FHFA during the first quarter of FY 2011.

In another case, a new examination documentation and retrieval tool was tested during the fiscal year, but the tool's specifications were not yet final. Certain key decisions had been made, but a final decision will be made in FY 2011, rather than in FY 2010. Similarly, the agency's housing goals and duty to serve rules for the Enterprises were delayed, but ultimately published for comment during the fiscal year. The associated performance measures were not met because the rulemakings did not meet their target dates.

Therefore, in preparing the agency's *FY 2011 Annual Performance Plan*, FHFA will look to refine its performance measures in light of progress made to date. Also, the FY 2011 performance measures will more clearly tie to measurable progress in the supervision of the Enterprises and the FHLBanks and enhancements to internal controls at FHFA.

Further, FHFA identified six of the 26 performance measures for FY 2010 as key performance indicators critical to its achievement of its strategic goals and objectives. Those key performance indicators represent each of the agency's three strategic goals and its resource management strategy, and represent the

Figure 7. Key FHFA Performance Indicators for FY 2010

Strategic Goal	Performance Goal	Key Performance Indicator
STRATEGIC GOAL 1 **The housing GSEs operate in a safe and sound manner and comply with legal requirements.**	**PERFORMANCE GOAL 1.1** **Fannie Mae and Freddie Mac (the Enterprises) comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.**	**PERFORMANCE MEASURE 1.1.1** Each Enterprise improves in one or more component ratings TARGET: September 30, 2010 **Not Met** Freddie Mac's market risk rating improved from critical concerns to significant concerns at the end of the second quarter. Fannie Mae did not improve in any component ratings during the fiscal year. Although most of Fannie Mae and Freddie Mac's component ratings did not improve, improvements were made in several areas, increasing the likelihood that some component ratings will improve in the next fiscal year.
	PERFORMANCE GOAL 1.2 **The FHLBanks and the Office of Finance comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.**	**PERFORMANCE MEASURE 1.2.1** Each FHLBank is rated 2 or better or operates under a performance improvement plan acceptable to FHFA within 90 calendar days of a downgrade below a rating of 2. TARGET: Quarterly, beginning June 30, 2010 **Not Met** In FY 2010, 7 FHLBanks were assigned a rating below "2", and 3 of those were not operating under an acceptable performance improvement plan within 90 days.

Strategic Goal	Performance Goal	Key Performance Indicator
STRATEGIC GOAL 2 **The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing.**	**PERFORMANCE GOAL 2.1** **FHFA ensures the housing GSEs support a stable, liquid, and efficient mortgage market.**	**PERFORMANCE MEASURE 2.1.2** Absent a revival of the private market in FY 2010, each Enterprise's share of single-family mortgage purchases and originations does not decline by more than 10 percent of the share obtained in FY 2009. TARGET: Annually **Met** For Fannie Mae, the share of single-family mortgage purchases and originations decreased from 40.04 percent in FY 2009 to 36.26 percent in FY 2010. For Freddie Mac, the share of single-family mortgage purchases and originations decreased from 25.61 percent in FY 2009 to 23.75 percent in FY 2010.
	PERFORMANCE GOAL 2.2 **FHFA ensures the housing GSEs provide leadership in housing finance and affordable housing by operating these programs in an effective and efficient manner, developing products, establishing partnerships, and financing homes for very low-, low-, and moderate-income households.**	**PERFORMANCE MEASURE 2.1.2** The FHLBanks' Affordable Housing Program (AHP) funds are awarded in compliance with laws and regulations. TARGET: Annually **Met** FHFA conducted AHP examinations at all 12 FHLBanks. No substantive issues were found regarding compliance with laws and regulations.
STRATEGIC GOAL 3 **FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.**	**PERFORMANCE GOAL 3.2** **Delegate appropriate authorities to each Enterprise's management to continue with or improve upon the Enterprises' mission and their business operations.**	**PERFORMANCE MEASURE 3.2.1** FHFA provides approvals and guidance to the Enterprises on conservatorship-related issues within 30 business days. TARGET: 80 percent per quarter **Not Met** FHFA provided approvals and guidance to the Enterprises on conservatorship-related issues within 30 business days for 54 percent of the time in the fourth quarter, reflecting both improved ability to track performance and improved performance over prior period results. Early data problems with this measure are described later in this report.
RESOURCE MANAGEMENT STRATEGY **FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals.**	**PERFORMANCE GOAL 4.4** **FHFA has the information technology and physical infra-structure needed to achieve its mission and goals.**	**PERFORMANCE MEASURE 4.4.2** FHFA completes its internal review of Examiner Workstation and finalizes a new strategic plan for Examiner Workstation. TARGET: September 30, 2010 **Not Met** Although the target deadline was missed, substantial development of the Proof of Concept was achieved. Feedback from ongoing testing was positive and will result in a more robust strategic plan.

highest priority measures for the agency. See Figure 7 above for a summary of FHFA's achievement of those six key performance indicators.

The data for FHFA's performance measures are complete and reliable. Data for FHFA's performance measures are created internally, reported in the agency's performance tracking system, and reviewed by senior management quarterly. Data related to supervision activities are collected through FHFA's supervision process and reviewed by FHFA quality assurance staff and agency management.

Program Evaluation

Because FHFA's Inspector General was not confirmed until the end of FY 2010, no program evaluations were conducted at FHFA during the fiscal year.

FHFA received, for the second consecutive year, the Certificate of Excellence in Accountability Reporting award for its FY 2009 Performance and Accountability Report from the Association of Government Accountants.

FY 2010 Financial Summary

For FY 2009 and FY 2010, its first and second year as a new agency, FHFA achieved an unqualified (clean) opinion from the GAO on its annual financial statements. GAO noted no material weaknesses or significant deficiencies in FHFA's internal controls and cited no instances of noncompliance with laws and regulations. In accordance with the Office of Management and Budget's (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, FHFA continued to assess the effectiveness of its internal controls annually. FHFA received, for the second consecutive year, the Certificate of Excellence in Accountability Reporting (CEAR) award for its *FY 2009 Performance and Accountability Report* (PAR) from the Association of Government Accountants (AGA). The CEAR is awarded to agencies that have demonstrated excellence in integrating performance and accountability reporting. FHFA also received a CEAR Best-In-Class award for providing the most comprehensive and candid presentation of forward-looking information in its FY 2009 PAR.

Source of Funds

HERA authorizes FHFA to collect annual assessments from its regulated entities to pay its costs and expenses and maintain a working capital fund. Under HERA, annual assessments are levied against the Enterprises and the FHLBanks to cover the cost and expenses of the agency's operations for supervision of the regulated entities.

FHFA calculates the assessments for each Enterprise by determining the proportion of each Enterprise's assets and off-balance sheet obligations to the total for both Enterprises and then applying each of the Enterprise's proportion (expressed as a percentage) to the total budgeted costs for regulating the Enterprises. FHFA calculates the assessments for each of the 12 FHLBanks by determining each FHLBank's share of minimum required regulatory capital as a percentage of the total minimum capital of all the FHLBanks and applying this percentage to the total budgeted costs for regulating the banks. Assessments are paid semiannually on October 1 and April 1. FHFA collected assessments of $143 million during FY 2010, which included a $10.4 million special assessment on the Enterprises related to conservatorship activities.

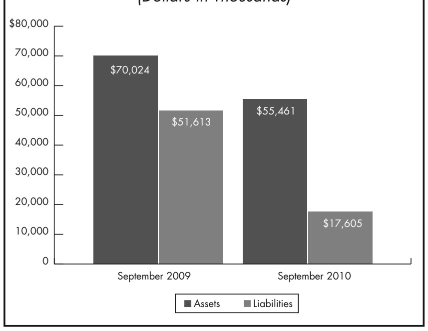
Analysis of Financial Statements

The principal financial statements present FHFA's financial position, net cost of operations, changes in net position, and budgetary resources for fiscal years 2010 and 2009. Financial statements and notes for fiscal years 2010 and 2009 appear on pages 70-86. Highlights of the financial information presented in the principal financial statements are shown below.

Balance Sheet

The Balance Sheet presents, as of the end of the fiscal year, the recorded value of assets and liabilities retained or managed by FHFA. The difference between the assets and liabilities represents FHFA's net position. The Balance Sheet reflects total assets of $55.5 million, a 21-percent decrease over FY 2009. The decrease is primarily due to FY 2010 assessment payments received during FY 2009 and increased cash outlays during FY 2010. FHFA's total liabilities decreased by $34 million, a 66-percent decrease over FY 2009. The decrease is primarily due to the decrease in deferred revenue. FHFA deferred revenue to reflect FY 2010 assessments that were received at the end of FY 2009. As a result, FHFA's net position as of September 30, 2010 was $37.9 million, a $19.5 million increase over the $18.4 million net position as of September 30, 2009.

Figure 8. Assets and Liabilities
(Dollars in Thousands)

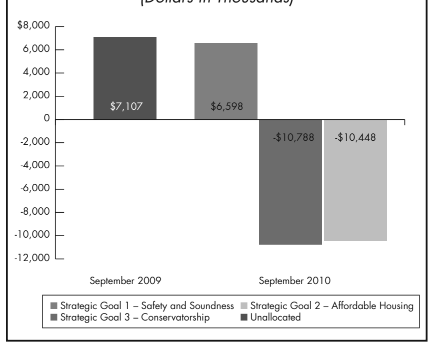


Statement of Net Cost

The Statement of Net Cost presents the components of FHFA's net cost, which is the gross cost incurred less any revenues earned. FHFA's total program net costs, as reflected on the Statement of Net Cost, were -$14.6 million (or net revenue) as compared to the $7.1 million net cost in FY 2009. This change reflects the increase in gross costs and earned revenue needed to carry out its mission as reflected in its FY 2010 operating budget. The operating budget increase between fiscal years is the result of increased mission costs and a special assessment levied on the Enterprises related to conservatorship activities. However, during the course of the year, FHFA was unable to fully expend its FY 2010 earned revenue, thereby resulting in an excess of revenue over cost. FHFA's costs for FY 2010 were less than expected and budgeted for, resulting in a surplus. FHFA issues a credit for unobligated funds as of September 30, 2010 against next year's assessment.

Consistent with the Government Performance and Results Act of 1993, the Statement of Net Cost is reported by FHFA's strategic goals. FHFA's program costs were reflected as one program for FY 2009, as defined by HERA Section 1311(b)(1). Beginning in FY 2010, FHFA tracked resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's new strategic plan, which became effective for FY 2010. Strategic Goals, 1 – Safety and Soundness; 2 – Affordable Housing; and 3 – Conservatorship, guide program offices to carry out FHFA's vision and mission. FHFA has a Resource Management Strategy, which is distributed proportionately to Strategic Goals 1-3 based on the percentage of direct costs of each goal to the total direct costs for FHFA. Strategic Goal 1, Safety and Soundness, comprises the major portion of the total program costs.

Figure 9. Total Net Cost of Operations
(Dollars in Thousands)

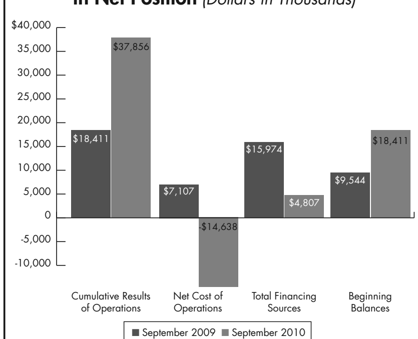


Statement of Changes in Net Position

The Statement of Changes in Net Position presents those accounting items that caused the net position section of the Balance Sheet to change from the beginning to the end of the reporting period. Financing sources increase net position. FHFA's financing source is imputed financing from costs absorbed on FHFA's behalf by other Federal agencies. Net cost of/income from operations impacts net position.

FHFA's cumulative results of operations for the period ending September 30, 2010 increased $19.5 million, due primarily to a combination of a decrease in net costs of $21.7 million and an increase in beginning balances of $8.9 million. Total financing sources decreased $11.2 million as a result of having no appropriation in FY 2010.

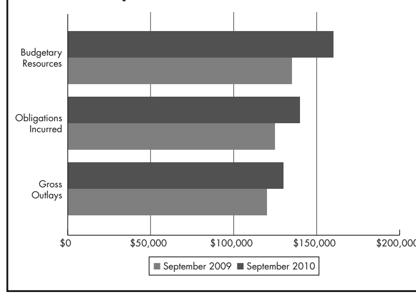
Figure 10. Statement of Changes in Net Position *(Dollars in Thousands)*



Statement of Budgetary Resources

This statement provides information about the provision of budgetary resources and their status as of the end of the reporting period. The statement shows that FHFA had $155.6 million in total budgetary resources for the 12 months ended September 30, 2010. These budgetary resources were composed of $143 million in assessments, $9.7 million in unobligated balance brought forward from FY 2009, and $2.7 million in recoveries of prior year unpaid obligations. Obligations incurred increased $16.6 million to $132.8 million in FY 2010. Gross outlays increased $5.5 million to $122.9 million in FY 2010.

Figure 11. Statement of Budgetary Resources Comparisons *(Dollars in Thousands)*



Limitations of the Financial Statements

FHFA management has prepared its fiscal years 2010 and 2009 financial statements from the books and records of the agency in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, as amended. The financial statements represent the financial position and results of operations of the agency pursuant to the requirements of Chapter 31 of the U.S. Code section 3515 (b). While these statements have been prepared from the agency's books in accordance with the formats prescribed by the OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. These statements should be read with the understanding that they are for a component of the U.S. government, a sovereign entity.

Management Assurances

During FY 2010, FHFA adhered to the internal control requirements of the Federal Managers Financial Integrity Act of 1982 (FMFIA) and the guidance provided by OMB Circular A-123. FHFA's Executive Committee on Internal Controls met quarterly to oversee internal controls and provide recommendations to the Acting Director on the effectiveness of FHFA's internal controls.

In 2010, the executive committee members were the Senior Deputy Director/Chief Operating Officer who served as the Chairman, the Chief Administrative

Officer who served as the Vice-Chairman, the Chief Information Officer, the Chief Financial Officer, the Deputy Director for Enterprise Regulation, the Deputy Director for FHLBank Regulation, the General Counsel, and the Associate Director, Office of Supervision Infrastructure. The Chairman and Vice Chairman invited other FHFA executives when appropriate. The executive committee also established senior assessment teams to review specific areas when needed.

During FY 2010, pursuant to its obligations under OMB Circular A-123, FHFA monitored and assessed the following three areas:

- **Reliability over Financial Reporting**
  FHFA's Office of Budget and Financial Management assessed the agency's financial reporting controls according to the requirements outlined in OMB Circular A-123, Appendix A.
- **Compliance with Laws and Regulations**
  Assessment teams from FHFA divisions and offices identified the significant laws and regulations that relate to the operations for their respective offices. Assessment teams documented the actions that demonstrated compliance, and the agency's Office of General Counsel reviewed all submissions.
- **Effectiveness and Efficiency of Operations**
  Assessment teams from FHFA divisions and offices reviewed controls over operations using the criteria outlined in the GAO Internal Control Management and Evaluation Tool. Division and office managers and the Office of Budget and Financial Management reviewed the reports of the assessment teams.

The Executive Committee on Internal Controls reviewed documentation from all three areas. In compliance with the FMFIA requirements, the Acting Director, on the basis of a recommendation from the executive committee, provided reasonable assurance that internal controls over financial reporting as of September 30, 2010, were operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting. This assurance can be found in the "Management's Discussion and Analysis" of this report and meets the FMFIA reporting requirement for internal controls.

Federal Management System and Strategy

Section 1106(g)(3) of HERA requires FHFA to implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. FHFA uses the Bureau of the Public Debt for its accounting services and that agency's financial management system (FMS) which includes (1) a core accounting system—Oracle Federal Financials; (2) three feeder systems—PRISM (procurement), GovTrip (travel), and Citidirect (charge card); (3) a reporting system—Discoverer; and (4) an inventory tracking system. FHFA is responsible for overseeing the Bureau of the Public Debt's performance of accounting services for the agency. A financial oversight document outlines the assignment of activities between FHFA and the Bureau of the Public Debt. FMS includes manual and automatic procedures and processes from the point at which a transaction is initiated to issuance of financial reports. FMS meets the requirements of HERA Section 1106(g)(3). FHFA also uses the National Finance Center, a service provider within the Department of Agriculture, for its payroll and personnel processing. FHFA has streamlined accounting processes by electronically interfacing data from charge cards, investment activities, the GovTrip travel system, the PRISM procurement system, and the National Finance Center payroll system to FMS.

Federal Information Security Management Act

Title III of the Electronic Government Act of 2002, titled the Federal Information Security Management Act (FISMA), requires all federal agencies to develop and implement an agency-wide information security program. The program provides the framework to protect the agency's information, operations, and assets. During FY 2010, OMB issued guidance requiring federal agencies to continuously monitor the security posture of information systems to enable timely decision making regarding identified vulnerabilities and threats. To accomplish this, agencies must automate security-related activities and acquire tools that correlate and analyze security-related information.

FHFA annually reviews the agency's information security program through its internal audit function and reports the results to OMB as required by FISMA. FHFA's information security program activities during FY 2010 reflect efforts in bringing the agency into compliance with the government-wide continuous monitoring requirement. Such compliance requires FHFA to proactively monitor the security posture of its information technology infrastructure through the implementation of automated security tools and supplemental resources for monitoring activities. The tools and activities include system log review and configuration management tools, and periodic vulnerability scans.

Other FY 2010 information security program activities included implementing an updated information security policy, comprehensive security procedures, and performing annual security control assessments. FHFA maintained security certification and accreditation on 100 percent of all major systems in production and provided security awareness training through an automated program to all FHFA employees and contractors. FHFA also addressed security-related weaknesses for systems noted in the prior year FISMA review.

The FY 2010 FISMA review concluded that FHFA had an effective information security program. The review disclosed weaknesses pertaining to monitoring of contractor systems, control and disposal of storage media for peripheral equipment such as copiers, noncompliance of the organizational structure of FHFA's information security program with FISMA, lack of completion of updates to the FHFA information security policy and related information security procedures, and vulnerabilities identified by network scans. All of the findings have been addressed and remediation efforts are underway. None of the weaknesses were classified as significant deficiencies.

Erroneous Payments

The Improper Payments Information Act of 2002 requires that agencies (1) review activities susceptible to significant erroneous payments; (2) estimate the amount of annual erroneous payments; (3) implement a plan to reduce erroneous payments; and (4) report the estimated amount of erroneous payments and the progress to reduce them. The Act defines significant erroneous payments as the greater of 2.5 percent of program activities or $10 million.

FHFA has implemented and maintains internal control procedures that ensure disbursement of federal funds for valid obligations. FHFA made no erroneous payments in FY 2010 that met the Act's thresholds.

Prompt Pay

The Prompt Payment Act requires federal agencies to make timely payments to vendors and improve the cash management practices of the government by encouraging the use of discounts when they are justified. This also means that FHFA must pay its bills within a narrow window of time. In FY 2010, the dollar amount subject to prompt payment was $28.7 million. The amount of interest penalty paid in FY 2010 was $126 or 0.00044 percent of the total dollars disbursed.

Financial Statements

Message from the Chief Financial Officer

Mark Kinsey, Chief Financial Officer
Federal Housing Finance Agency

I am pleased to report that, in its second full year of operations, the Federal Housing Finance Agency (FHFA) once again received an unqualified 'clean' audit opinion on its financial statements from the Government Accountability Office (GAO). In its financial audit report, GAO concluded that 1) FHFA's FY 2010 financial statements are fairly presented in all material respects; 2) FHFA had effective internal control over financial reporting; and 3) there were no reportable instances of noncompliance with the laws and regulations it tested.

In addition to its clean financial audits, FHFA received the Certificate for Excellence in Accountability Reporting (CEAR) award for FY 2009 from the Association of Government Accountants. This is the second straight year FHFA received this prestigious award. The CEAR award is given to government agencies that received unqualified audit opinions on their financial statements and produced Performance and Accountability Reports (PARs) that achieved the highest standards in communicating results and demonstrating accountability.

These impressive accomplishments could not have been achieved with out the commitment from management and staff to maintain effective programs of internal control over important agency activities. FHFA's Executive Committee on Internal Controls works to establish a strong control environment for the agency and meets at least quarterly to monitor and evaluate the effectiveness of the agency's internal control programs.

As always, I am very proud to work with a highly dedicated group of professionals whose efforts contributed significantly to these accomplishments.

Sincerely,

Mark Kinsey
Chief Financial Officer
November 10, 2010

Federal Housing Finance Agency
1625 Eye Street, N.W., Washington, D.C. 20006-4065
Telephone: (202) 408-2500
Facsimile: (202) 408-1435
www.fhfa.gov

October 15, 2010

Federal Managers' Financial Integrity Act
Statement of Assurance
Fiscal Year 2010

The Federal Housing Finance Agency (FHFA) management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA).

FHFA conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, Management's Responsibility for Internal Control. Based on the results of this evaluation, FHFA can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2010 was operating effectively and that no material weaknesses were found in the design or operation of the internal controls.

In addition, FHFA conducted its assessment of the effectiveness of internal controls over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, FHFA can provide reasonable assurance that its internal controls over financial reporting as of September 30, 2010 were operating effectively and no material weaknesses were found in the design or operation of the internal controls over financial reporting.

In accordance with the requirements of FMFIA, FHFA's financial management systems are substantially in compliance with the requirements for federal financial management systems as presented in A-127, Financial Management Systems as of September 30, 2010.

Edward J. DeMarco
Edward J. DeMarco
Acting Director

10-10-10
Date

FEDERAL HOUSING FINANCE AGENCY

Balance Sheet

As of September 30, 2010 and 2009
(In Thousands)

	2010	2009
Assets:		
Intragovernmental		
Fund Balance With Treasury (Note 2)	$ 1,000	$ 29,076
Investments (Note 3)	50,878	37,668
Accounts Receivable (Note 4)	-	3
Prepaid Expenses	307	-
Total Intragovernmental	**52,185**	**66,747**
Accounts Receivable (Note 4)	6	3
Property, Equipment, and Software, Net (Note 5)	2,397	3,273
Prepaid Expenses	873	1
Total Assets	**$ 55,461**	**$ 70,024**
Liabilities:		
Intragovernmental		
Accounts Payable	$ 430	$ 758
Payroll Taxes Payable (Note 7)	799	652
Total Intragovernmental	**1,229**	**1,410**
Accounts Payable	4,358	4,268
Deferred Revenue (Note 6)	-	35,122
Other (Note 7)	12,018	10,813
Total Liabilities	**$ 17,605**	**$ 51,613**
Net Position:		
Cumulative Results of Operations	$ 37,856	$ 18,411
Total Net Position	$ 37,856	$ 18,411
Total Liabilities and Net Position	**$ 55,461**	**$ 70,024**

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

FEDERAL HOUSING FINANCE AGENCY

Statement of Net Cost

For the Fiscal Years Ended September 30, 2010 and 2009
(In Thousands)

	2010	2009
Program Costs by Strategic Goal: (Note 10)		
Safety and Soundness:		
Gross Costs	$ 95,870	$ -
Less: Earned Revenue	(89,272)	-
Net Safety and Soundness Costs/(Income)	**$ 6,598**	**$ -**
Affordable Housing:		
Gross Costs	$ 16,031	-
Less: Earned Revenue	(26,819)	-
Net Affordable Housing Costs/(Income)	**$ (10,788)**	**$ -**
Conservatorship:		
Gross Costs	$ 16,663	$ -
Less: Earned Revenue	(27,111)	-
Net Conservatorship Costs/(Income)	**$ (10,448)**	**$ -**
Total Gross Program Costs	$ 128,564	$ 122,816
Less: Total Earned Revenue	(143,202)	(115,709)
Net (Income from)/Cost of Operations	**$ (14,638)**	**$ 7,107**

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

FEDERAL HOUSING FINANCE AGENCY

Statement of Changes in Net Position

For the Fiscal Years Ended September 30, 2010 and 2009
(In Thousands)

	2010	2009
Cumulative Results of Operations:		
Beginning Balances	$ 18,411	$ 9,544
Budgetary Financing Sources:		
Appropriations Used	-	12,896
Other Financing Sources (Non-Exchange):		
Imputed Financing Sources	4,807	3,078
Total Financing Sources	4,807	15,974
Net Income From/(Cost of) Operations	14,638	(7,107)
Net Change	19,445	8,867
Cumulative Results of Operations	$ 37,856	$ 18,411
Unexpended Appropriations:		
Beginning Balances	$ -	$ 12,896
Budgetary Financing Sources:		
Appropriations Used	-	(12,896)
Total Budgetary Financing Sources	-	(12,896)
Total Unexpended Appropriations	$ -	$ -
Net Position	**$ 37,856**	**$ 18,411**

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

FEDERAL HOUSING FINANCE AGENCY

Statement of Budgetary Resources

For the Fiscal Years Ended September 30, 2010 and 2009

(In Thousands)

	2010	2009
Budgetary Resources:		
Unobligated Balance:		
Unobligated Balance, Brought Forward, October 1	$ 9,657	$ 5,132
Recoveries of Prior Year Unpaid Obligations	2,693	6,002
Budget Authority		
Appropriation - Assessments	143,028	115,669
Appropriation - Investment Interest	72	30
Spending Authority From Offsetting Collections		
Earned		
Collected	104	4,572
Change In Receivables From Federal Sources	(3)	(1,459)
Change In Unfilled Customer Orders		
Without Advance From Federal Sources	-	(4,038)
Subtotal	143,201	114,774
Total Budgetary Resources	**$ 155,551**	**$ 125,908**
Status of Budgetary Resources:		
Obligations Incurred (Note 11)		
Direct	$ 132,707	$ 111,682
Reimbursable	101	4,569
Subtotal	132,808	116,251
Unobligated Balance		
Exempt From Apportionment	22,743	9,657
Total Status of Budgetary Resources	**$ 155,551**	**$ 125,908**
Change in Obligated Balance:		
Obligated Balance, Net		
Unpaid Obligations, Brought Forward, October 1	$ 21,968	$ 29,146
Uncollected Customer Payments From		
Federal Sources, Brought Forward, October 1	(3)	(5,500)
Total Unpaid Obligated Balance, Net	**21,965**	**23,646**
Obligations Incurred Net	132,808	116,251
Gross Outlays	(122,948)	(117,427)
Recoveries of Prior Year Unpaid		
Obligations, Actual	(2,693)	(6,002)
Change In Uncollected Customer Payments		
From Federal Sources	3	5,497
Obligated Balance, Net, End of Period		
Unpaid Obligations	29,135	21,968
Uncollected Customer Payments From		
Federal Sources	-	(3)
Total Unpaid Obligated Balance, Net, End of Period	**$ 29,135**	**$ 21,965**
Net Outlays:		
Gross Outlays	$ 122,948	$ 117,427
Offsetting Collections	(104)	(4,572)
Distributed Offsetting Receipts	(143,100)	(115,699)
Net Outlays	**$ (20,256)**	**$ (2,844)**

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

FEDERAL HOUSING FINANCE AGENCY

Notes to the Financial Statements

for the Years Ended September 30, 2010 and 2009

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Federal Housing Finance Agency (FHFA) was established on July 30, 2008, when the President signed into law the Housing and Economic Recovery Act of 2008 (HERA). FHFA is an independent agency in the Executive branch empowered with supervisory and regulatory oversight of the twelve Federal Home Loan Banks (FHLBanks), Federal National Mortgage Association (Fannie Mae), and Federal Home Loan Mortgage Corporation (Freddie Mac), all of which are referred to as regulated entities within this document. FHFA is responsible for ensuring that each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls, and carries out their housing and community development finance missions.

HERA abolished the Federal Housing Finance Board (FHFB) and Office of Federal Housing Enterprise Oversight (OFHEO) effective at the end of the 1-year period beginning on July 30, 2008. FHFB and OFHEO existed until then solely for the purpose of winding up their affairs. During fiscal year 2009, in accordance with HERA, the transfer of personnel, property, and program activities of FHFB, OFHEO, and certain employees and activities of the Department of Housing and Urban Development related to the regulation of the mission of Fannie Mae and Freddie Mac were made to FHFA.

Under the authority of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by HERA, FHFA placed Fannie Mae and Freddie Mac under conservatorship on September 6, 2008, to stabilize the two entities with the objective of maintaining normal business operations and restoring safety and soundness. FHFA, as conservator, assumed the power of stockholders, boards, and management. FHFA delegated to Fannie Mae and Freddie Mac certain business and operational authority. FHFA personnel monitor the operations of the enterprises.

In September 2008, after Fannie Mae and Freddie Mac were placed in conservatorship under the FHFA, the Office of Management and Budget (OMB) determined that the assets, liabilities and activities of the companies would not be included in the financial statements of the federal government. For fiscal year 2008, OMB and the Department of the Treasury (Treasury) concluded that Fannie Mae and Freddie Mac did not meet the conclusive or indicative criteria for a federal entity contained in OMB Circular A-136 and Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display* because they are not listed in the section of the federal government's budget entitled "Federal Programs by Agency and Account," and because the nature of FHFA's conservatorships over Fannie Mae and Freddie Mac and the federal government's ownership and control of the entities is considered to be temporary. Treasury reaffirmed this position for fiscal year 2009, with which FHFA concurs. OMB continued to hold this view in the President's fiscal year 2010 and fiscal year 2011 budget submissions to Congress. Consequently, the assets, liabilities, and activities of Fannie Mae and Freddie Mac have not been consolidated into FHFA's financial statements. However, Treasury records the value of the federal government's investments in Fannie Mae and Freddie Mac in its financial statements as a General Fund asset.

Both Fannie Mae and Freddie Mac, as represented by FHFA as their Conservator, entered into separate agreements with Treasury known as the Senior Preferred Stock Purchase Agreements (Agreements) on September 7, 2008. These two Agreements are identical and have since been amended three times, on September 26, 2008, May 6, 2009 and December 24, 2009. The Agreements commit Treasury to provide funding for each Enterprise up to the greater of: (1) $200 billion; or (2) $200 billion plus the cumulative total of draws for each calendar quarter in 2010, 2011 and 2012 minus any amount by which the assets of the Enterprise exceed its liabilities on December 31, 2012. This funding is to ensure that each Enterprise maintains a non-negative net worth, thereby avoiding a statutory requirement that an Enterprise be put in receivership following an extended period of negative net worth. Under the Agreements, each Enterprise submits a request for any needed draw amount once their financials (to be published in their 10-K or 10-Q) are finalized. The Enterprise also submits a statement certifying compliance with Agreement covenants, which include limits on portfolio size and indebtedness. FHFA, in its role as Conservator, reviews any request for a draw and certifies that the request is available for funding under the agreement. FHFA then sends a letter to Treasury requesting the draw amount prior to the end of the current quarter. FHFA as Conservator also issues an order to the Enterprises each quarter requiring each Enterprise to pay dividends to Treasury as required by the Agreements. Additionally, the Agreements require each Enterprise to obtain Treasury approval for the disposition of assets, except under certain circumstances. FHFA as Conservator reviews these requests. Fannie Mae and Freddie Mac draws on their Agreements with Treasury are summarized below. Such draws are reported in Treasury's financial statements.

Enterprise Draws on Treasury Agreements
(Dollars in Billions)

Draw Dates	Fannie Mae	Freddie Mac
September 30, 2008	$ -	$ 13.8
December 31, 2008	15.2	30.8
March 31, 2009	19.0	6.1
June 30, 2009	10.7	-
September 30, 2009	15.0	-
December 31, 2009	15.3	-
March 31, 2010	8.4	10.6
June 30, 2010	1.5	1.8
Cumulative Draws	$ 85.1	$ 63.1

B. Basis of Presentation

FHFA's principal statements were prepared from its official financial records and general ledger in conformity with accounting principles generally accepted in the United States and follow the presentation guidance established by OMB Circular A-136 "Financial Reporting Requirements," revised September 29, 2010. The statements are a requirement of the Government Management Reform Act of 1994, the Accountability of Tax Dollars Act of 2002, and HERA. These financial statements are in addition to the financial reports prepared by FHFA, pursuant to OMB directives, which are used to monitor and control budgetary resources. As required by HERA, the financial statements of FHFA are audited by the U.S. Government Accountability Office (GAO). The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and the status and availability of budgetary resources of FHFA. Unless specified otherwise, all amounts are presented in thousands.

C. Basis of Accounting

Transactions are recorded on both an accrual accounting basis, and a budgetary basis. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of federal funds. FHFA conforms to accounting principles generally accepted in the United States for federal entities as prescribed by the standards set forth by the Federal Accounting Standards Advisory Board (FASAB). FASAB is recognized by the American Institute of Certified Public Accountants as the body designated to establish generally accepted accounting principles for federal entities. Certain assets, liabilities, earned revenues, and costs have been classified as intragovernmental throughout the financial statements and notes. Intragovernmental is defined as exchange transactions made between two reporting entities within the federal government.

D. Revenues, Imputed & Other Financing Sources

Operating revenues of FHFA are obtained through assessments of the regulated entities. The agency's acting Director, in September 2009, approved the annual budget. By law, FHFA is required to charge semi-annual assessments to the entities. Assessments collected shall not exceed the amount sufficient to provide for the reasonable costs associated with overseeing the entities, plus amounts determined by the acting Director to be necessary for maintaining a working capital fund.

FHFA develops its annual budget using a 'bottom up' approach. Each office within the agency is asked to bifurcate their budget request between the amount of resources needed for the regulation of Fannie Mae and Freddie Mac and the resources needed for the regulation of the twelve FHLBanks. The office requests are then aggregated (with overhead costs distributed proportionately) to determine the total expected costs associated with regulating Fannie Mae and Freddie Mac and the total expected costs associated with regulating the FHLBanks. These two totals, along with any expected collection for the working capital fund, comprise the fiscal year budget for the agency. Additionally, FHFA levied a special assessment for conservatorship activities on Fannie Mae and Freddie Mac during fiscal year 2010.

Fannie Mae and Freddie Mac pay a pro rata share of their portion of the total assessment based on the combined assets and off-balance sheet obligations of each enterprise. Each FHLBank's share of their portion of the total assessment is based on the dollar value of its capital stock relative to the combined dollar value of all FHLBanks' capital stock. Assessment letters are sent to the entities 30 days prior to the assessment due dates of October 1st and April 1st. Assessments received prior to due dates are available for investment but are unavailable for obligation. These assessments are recorded as deferred revenue.

Federal government entities often receive goods and services from other federal government entities without reimbursing the providing entity for all the related costs. In addition, federal government entities also incur costs that are paid in total or in part by other entities. An imputed financing source is recognized by the receiving entity for costs that are paid by other entities. FHFA recognized imputed costs and financing sources in fiscal years 2010 and 2009 as prescribed by accounting standards. FHFA recognizes as an imputed financing source the amount of pension and post-retirement benefit expenses for current employees accrued on FHFA's behalf by the Office of Personnel Management (OPM).

E. Use of Estimates

The preparation of the accompanying financial statements in accordance with U.S. generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results could differ from those estimates.

F. Earmarked Funds

FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 27 "Identifying and Reporting Earmarked Funds" established certain disclosure requirements for funds defined as "earmarked." SFFAS No. 27 states that "(e)armarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the Government's general revenues." The standard also presents three required criteria for an earmarked fund. Based on the standard's criteria, FHFA determined that it has no earmarked funds.

G. Fund Balance with Treasury

The U.S. Treasury (Treasury) processes cash receipts and disbursements on FHFA's behalf. Funds held at the Treasury are available to pay agency liabilities and finance authorized purchase obligations. FHFA does not maintain cash in commercial bank accounts or foreign currency balances.

During the year, increases to FHFA's Fund Balance with Treasury are comprised of semi-annual assessments, investment interest, collections on reimbursable agreements, civil penalty monies, and Freedom of Information Act (FOIA) request fees. FHFA is not authorized to retain civil penalty monies or FOIA fees, and as such, records these as custodial liabilities (See Note 15. Incidental Custodial Collections).

HERA provides authority for FHFA to maintain a working capital fund. The working capital fund is defined in FHFA's Assessment Regulation as an account for amounts collected from the regulated entities to establish an operating reserve that is intended to provide for the payment of large or multiyear capital and operating expenditures, as well as unanticipated expenses. The balance in the working capital fund will be evaluated annually.

H. Investments

FHFA has the authority to invest in U.S. Treasury securities with maturities suitable to FHFA's needs. FHFA invests solely in U.S. Treasury securities, which are normally held to maturity and carried at cost. Investments are adjusted for unamortized premiums or discounts. Premiums and discounts are amortized and interest is accrued using the level-yield, scientific method of effective interest amortization over the term of the respective issues.

I. Accounts Receivable

Accounts receivable consists of amounts owed to FHFA by other federal agencies and the public. Amounts due from federal agencies are considered fully collectible and consist of interagency agreements. Accounts receivable from the public include reimbursements from employees, civil penalty assessments and FOIA request fees. An allowance for uncollectible accounts receivable from the public is established when either (1) management determines that collection is unlikely to occur after a review of outstanding accounts and the failure of all collection efforts, or (2) an account for which no allowance has been established is submitted to the Department of the Treasury for collection, which takes place when it becomes 180 days delinquent. Historical experience has indicated that the majority of the receivables are collectible.

J. Property, Equipment, and Software, Net

Property, Equipment, and Software is recorded at historical cost. It consists of tangible assets and software. Under FHFA's property management policy, equipment acquisitions of $25 thousand or more are capitalized and depreciated using the straight-line method over the estimated useful life of the asset. Additionally, for bulk purchases of similar items, which individually do not meet the test for capitalization, the acquisition is capitalized and depreciated if the depreciated basis of the bulk purchase is $250 thousand or more. Applicable standard governmental guidelines regulate the disposal and convertibility of agency property and equipment. The useful life classifications for capitalized assets are as follows:

Description	Useful Life (years)
Furniture, Fixtures, and Equipment	3
Automated Filing Storage Systems	15
Internal Use Software	3

A leasehold improvement's useful life is equal to the remaining lease term or the estimated useful life of the improvement, whichever is shorter. FHFA has no real property holdings or stewardship or heritage assets. Other property items, normal repairs and maintenance are charged to expense as incurred.

K. Advances and Prepaid Charges

Advance payments are generally prohibited by law. There are some exceptions, such as reimbursable agreements, subscriptions and payments to contractors and employees. Payments made in advance of the receipt of goods and services are recorded as advances or prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received.

L. Liabilities

Liabilities represent the amount of funds that are likely to be paid by FHFA as the result of a transaction or event that has already occurred.

FHFA reports its liabilities under two categories, Intragovernmental and With the Public. Intragovernmental liabilities represent funds owed to another government agency. Liabilities With the Public represent funds owed to any entity or person that is not a federal agency, including private sector firms and federal employees. Each of these categories may include liabilities that are covered by budgetary resources and liabilities not covered by budgetary resources.

Liabilities covered by budgetary resources are liabilities funded by a current appropriation or other funding source. These consist of accounts payable and accrued payroll and benefits. Accounts payable represent amounts owed to another entity for goods ordered and received and for services rendered except for employees. Accrued payroll and benefits represent payroll costs earned by employees during the fiscal year which are not paid until the next fiscal year.

Liabilities not covered by budgetary resources are liabilities that are not funded by any current appropriation or other funding source. These liabilities consist of accrued annual leave, deferred rent, and the amounts due to Treasury for collection and accounts receivable of civil penalties and FOIA request fees. Annual leave is earned throughout the fiscal year and is paid when leave is taken by the employee; the accrued liability for annual leave represents the balance earned but not yet taken. The Department of Labor (DOL) is the central paying agent for all workman compensation claims filed under the Federal Employees Compensation Act (FECA). Accrued FECA represents the amount FHFA is to reimburse DOL for claims paid to FHFA employees. No liability is recorded for future workman compensation as of September 30, 2010 and 2009, as FHFA's methodology for estimating the future workman compensation as prescribed by DOL determined that the liability would be negligible. Deferred rent is the difference at year-end between the sum of monthly cash disbursements paid to date for rent and the sum of the average monthly rent calculated based on the term of the lease. This determination and recording of deferred rent is applicable only to the lease agreement on the property at 1750 Pennsylvania Avenue that commenced in 2005 (See Note 8. Leases).

M. Employee Leave and Benefits

FHFA employees are entitled to accrue annual leave and sick leave at a rate based on years of federal service. For most employees, annual leave may be accrued up to 240 hours each year. The FHFA executive employees equivalent to the Senior Executive Service (SES) employees may accrue annual leave consistent with the rules for SES level employees. Accrued annual leave is treated as an unfunded expense with an offsetting liability when earned. The accrued liability is reduced when the annual leave is taken. Any unused annual leave balance is paid to the employee upon leaving federal service, based on the employee's earnings per hour. There is no maximum limit on the amount of sick leave that may be accrued. Upon separation, any unused sick leave of Civil Service Retirement System (CSRS) plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. Credit is given for sick leave balances in the computation of annuities upon the retirement of Federal Employees Retirement System (FERS)-covered employees effective at 50% beginning in fiscal year 2010 and 100% beginning in fiscal year 2014.

Health Benefits and Life Insurance: FHFA, through programs established for all agencies by the federal government, offers its employees health and life insurance coverage through the Federal Employees Health Benefits Program and Federal Employees Group Life Insurance Program. The cost of each is shared by FHFA and its employees. In addition, all employees have 1.45% of gross earnings withheld to pay for future Medicare coverage.

N. Retirement Plans

FHFA employees participate in the retirement plans offered by OPM, which consist of CSRS, CSRS – Offset, or FERS. The employees who participate in CSRS are beneficiaries of FHFA's contribution, equal to 7% of pay, distributed to the employee's annuity account in the Civil Service Retirement and Disability Fund. Prior to December 31, 1983, all employees were covered under the CSRS program. From January 1, 1984 through December 31, 1986, employees had the option of remaining under CSRS or joining FERS and Social Security. Employees hired as of January 1, 1987 are automatically covered by the FERS program. Both CSRS and FERS employees may participate in the federal Thrift Savings Plan (TSP). FERS employees receive an automatic Agency contribution equal to 1% of pay and FHFA matches any employee contribution up to an additional 4% of pay. For FERS participants, FHFA also contributes the employer's matching share of Social Security.

FERS employees and CSRS – Offset employees are eligible to participate in the Social Security program after retirement. In these instances, FHFA remits the employer's share of the required contribution, which is 11.2% for FERS and 7% for CSRS.

FHFA expenses its contributions to the retirement plans of covered employees as the expenses are incurred. FHFA reports imputed (unfunded) costs with respect to retirement plans, health benefits and life insurance pursuant to guidance received from OPM. These costs are paid by OPM and not by FHFA. Disclosure is intended to provide information regarding the full cost of FHFA's program in conformity with generally accepted accounting principles.

FHFA does not report on its financial statements information pertaining to the retirement plans covering its employees. Reporting amounts such as plan assets, accumulated plan benefits, and related unfunded liabilities, if any, is the responsibility of OPM as the administrator.

In addition to the TSP, FHFA offers a supplemental 401(K) plan that is administered by T. Rowe Price. All CSRS employees are eligible to contribute to the 401(K). Only FERS employees contributing at least 3% to the TSP are eligible to participate in the 401(K). All eligible employees that participate may contribute up to 10% of their bi-weekly salary on a pre-tax basis while FHFA will match contributions up to 3% of the employee's salary. Qualified employees may participate in the TSP and/or FHFA's 401(K) Savings Plan, up to the Internal Revenue Code limitations established for salary deferral and annual additions.

O. Contingencies

Liabilities are deemed contingent when the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. FHFA recognizes contingent liabilities, in the accompanying balance sheet and statement of net cost, when they are both probable and can be reasonably estimated. FHFA discloses contingent liabilities in the notes to the financial statements when a loss from the outcome of future events is more than remote but less than probable or when the liability is probable but cannot be reasonably estimated.

NOTE 2. FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of an Operating Fund and a Working Capital Fund. FHFA did not use the funds in the Working Capital Fund during fiscal years 2010 or 2009. In fiscal year 2010, the funds in the Working Capital Fund were fully invested. Fund Balance with Treasury (FBWT) account balances as of September 30, 2010 and 2009 were as follows:

(Dollars in Thousands)	2010	2009
Fund Balances:		
Operating Fund	$ 1,000	$ 26,076
Working Capital Fund	-	3,000
Total	**$ 1,000**	**$ 29,076**
Status of Fund Balance with Treasury:		
Unobligated Balance		
Available	$ 22,743	$ 9,657
Unavailable (See Note 6. Deferred Revenue)	-	35,122
Total Unobligated Balance	22,743	44,779
Obligated Balance Not Yet Disbursed	29,135	21,968
Investments	(50,878)	(37,668)
Uncollected Customer Payment Earned	-	(3)
Total	**$ 1,000**	**$ 29,076**

(See Note 12. Legal Arrangements Affecting Use of Unobligated Balances)

NOTE 3. INVESTMENTS

Investments as of September 30, 2010 consist of the following:

(Dollars in Thousands)	Cost	Amortized (Premium) Discount	Interest Receivable	Investments Net	Market Value Disclosure
Intragovernmental Securities:					
Non-Marketable Market-Based	$ 50,878	$ -	$ -	$ 50,878	$ 50,878

Investments as of September 30, 2009 consist of the following:

(Dollars in Thousands)	Cost	Amortized (Premium) Discount	Interest Receivable	Investments Net	Market Value Disclosure
Intragovernmental Securities:					
Non-Marketable Market-Based	$ 37,668	$ -	$ -	$ 37,668	$ 37,668

Non-marketable, market-based securities are Treasury notes and bills issued to governmental accounts that are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms. FHFA is currently investing in one-day certificates issued by the U.S. Treasury. There were no amortized premiums/discounts or interest receivable on investments as of September 30, 2010 or 2009. Interest earned on investments was $72 thousand and $30 thousand for fiscal years 2010 and 2009, respectively.

NOTE 4. ACCOUNTS RECEIVABLE

Accounts Receivable balances as of September 30, 2010 and 2009 were as follows:

(Dollars in Thousands)	2010	2009
Intragovernmental		
Accounts Receivable	$ -	$ 3
With the Public		
Accounts Receivable	6	3
Total Accounts Receivable	**$ 6**	**$ 6**

There are no amounts that are deemed uncollectible as of September 30, 2010 and 2009.

NOTE 5. PROPERTY, EQUIPMENT, AND SOFTWARE, NET

Schedule of Property, Equipment, and Software as of September 30, 2010 *(Dollars in Thousands)*

Major Class	Acquisition Cost	Accumulated Amortization/Depreciation	Net Book Value
Equipment	$ 10,844	$ 9,975	$ 869
Leasehold Improvements	6,940	6,674	266
Capital Lease	22	22	-
Internal-Use Software	29,267	28,521	746
Internal-Use Software-in-Development	370	-	370
Construction-in-Progress	146	-	146
Total	**$ 47,589**	**$ 45,192**	**$ 2,397**

Schedule of Property, Equipment, and Software as of September 30, 2009 *(Dollars in Thousands)*

Major Class	Acquisition Cost	Accumulated Amortization/Depreciation	Net Book Value
Equipment	$ 10,303	$ 9,526	$ 777
Leasehold Improvements	6,881	6,270	611
Capital Lease	22	22	-
Internal-Use Software	29,093	27,280	1,813
Internal-Use Software-in-Development	61	-	61
Construction-in-Progress	11	-	11
Total	**$ 46,371**	**$ 43,098**	**$ 3,273**

NOTE 6. DEFERRED REVENUE

Deferred revenue for fiscal 2009 consists of $35.1 million and is classified as with the public for assessments received from the regulated entities prior to the due date of October 1st. These assessments are available for investment but unavailable for obligation. (See Note 2. Fund Balance With Treasury)

NOTE 7. OTHER LIABILITIES

The other liabilities for FHFA are comprised of payroll accruals, deferred lease liability and unfunded leave. Payroll accruals represent payroll expenses that were incurred prior to year-end but were not paid. Other liabilities not covered by budgetary resources consist of unfunded annual leave, compensatory time, and deferred lease liability.

As of September 30, 2010 and 2009 other liabilities not covered by budgetary resources were $7.9 million and $7.4 million, respectively. FHFA's other liabilities are classified as current.

(Dollars in Thousands)	2010	2009
Intragovernmental Liabilities		
Payroll Taxes Payable	$ 799	$ 652
Total Intragovernmental Liabilities	**$ 799**	**$ 652**
With the Public		
Accrued Funded Payroll	$ 4,124	$ 3,417
Unfunded Leave	7,837	7,256
Deferred Lease Liabilities	57	140
Total Public Liabilities	**$ 12,018**	**$ 10,813**

NOTE 8. LEASES

Operating Leases

1700 G Street NW

FHFA has an occupancy lease with the Office of Thrift Supervision (OTS) at 1700 G Street NW, Washington, DC, that covers office space and building services, including utilities, security guards, janitorial services, mail delivery, use of the loading dock, garage parking and building operation and maintenance. The initial term of the lease was for five years beginning in 1993, with the option to renew for three 5-year terms with OFHEO. This lease was transferred to FHFA with its creation. FHFA has exercised the third of the three option terms.

FHFA may terminate the lease agreement with OTS in whole or in part. In the event of termination at FHFA's discretion, FHFA would be required to pay two months' rent. If either party ceases to exist or merges with another entity by operation of law, either party may terminate the rental agreement. In the event of termination under this provision, neither party is liable for further costs, fees, damages or other monies due to the termination, except for payments through the date of the termination. Because of this termination clause, no deferred rent is established for this lease, nor is disclosure of minimum future lease payments required under Financial Accounting Standard Board Statement No. 13.

1750 Pennsylvania Avenue NW and 1625 Eye Street NW

FHFA leases office space in Washington, DC at 1750 Pennsylvania Avenue NW and 1625 Eye Street NW. The lease terms of 1750 Pennsylvania Avenue NW expire on March 30, 2011. The lease terms of 1625 Eye Street NW expire on June 30, 2015. Contingency space at an undisclosed location is also leased, with the lease expiring on March 31, 2011. Total rental payments for the fiscal years ended September 30, 2010 and 2009 were $4.91 million and $4.78 million, respectively. The minimum future payments for these leases are as follows:

Fiscal Year	Amount (Dollars in Thousands)
2011	$ 4,123
2012	3,674
2013	3,748
2014	3,823
2015	2,910
Thereafter	-
Total Future Payments	**$ 18,278**

NOTE 9. COMMITMENTS AND CONTINGENCIES

FHFA did not have any material commitments or contingencies that met disclosure requirements as of September 30, 2010 and 2009.

NOTE 10. PROGRAM COSTS

Pursuant to HERA, FHFA was established to supervise and regulate the fourteen regulated entities. The regulated entities include Freddie Mac, Fannie Mae and the twelve FHLBanks. FHFA's Program Costs were reflected as one program for fiscal year 2009 as defined by HERA Section 1311(b)(1). For fiscal year 2010, FHFA tracked resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's new strategic plan, which was published in the last quarter of fiscal year 2009. The table below reflects the reporting change from fiscal year 2009 to 2010.

Program costs are broken out into two categories – "Intragovernmental" and "With the Public". Intragovernmental costs are costs FHFA incurs through contracting with other federal agencies for goods and/or services, such as rent paid to OTS, payroll processing services received from the Department of Agriculture and imputed financing costs for post-retirement benefits with OPM. With the Public costs are costs FHFA incurs through contracting with the private sector for goods or services, payments for employee salaries, depreciation, annual leave and deferred rent expenses. Revenue is comprised of assessments, investment interest, and miscellaneous revenue. Intragovernmental expenses relate to the source of goods and services purchased by the agency and not to the classification of related revenue. Such costs and revenue are summarized as follows:

(Dollars in Thousands)	2010	2009
Safety and Soundness		
Intragovernmental Costs	$ 21,703	$ -
Public Costs	74,167	-
Total Costs	95,870	-
Less: Intragovernmental Earned Revenue	108	-
Less: Public Earned Revenue	89,164	-
Net Safety and Soundness Costs	**6,598**	**-**
Affordable Housing		
Intragovernmental Costs	3,759	-
Public Costs	12,272	-
Total Costs	16,031	-
Less: Intragovernmental Earned Revenue	33	-
Less: Public Earned Revenue	26,786	-
Net Affordable Housing (Income)/Costs	**(10,788)**	**-**
Conservatorship		
Intragovernmental Costs	1,926	-
Public Costs	14,737	-
Total Costs	16,663	-
Less: Intragovernmental Earned Revenue	33	-
Less: Public Earned Revenue	27,078	-
Net Conservatorship (Income)/Costs	**(10,448)**	**-**
Total Intragovernmental costs	27,388	24,048
Total Public costs	101,176	98,768
Total Program Costs	128,564	122,816
Less: Total Intragovernmental Earned Revenue	174	33
Less: Total Public Earned Revenue	143,028	115,676
Total Program Net (Income)/Costs	**$ (14,638)**	**$ 7,107**

NOTE 11. APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

All obligations incurred are characterized as Category C, Exempt from apportionment (i.e. not apportioned), on the Statement of Budgetary Resources. Obligations incurred and reported in the Statement of Budgetary Resources in fiscal years 2010 and 2009 consisted of the following:

(Dollars in Thousands)	2010	2009
Direct Obligations, Category C	$ 132,707	$ 111,682
Reimbursable Obligations, Category C	101	4,569
Total Obligations Incurred	**$ 132,808**	**$ 116,251**

NOTE 12. LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

HERA requires that any balance that remains unobligated at the end of the fiscal year, except for amounts assessed for contribution to FHFA's working capital fund, must be credited against the next year's assessment to the regulated entities. As of September 30, 2010 and 2009, the unobligated balance was $22.7 million and $44.8 million, of which $35.1 million of the balance at September 30, 2009 was deferred revenue, which was unavailable. The portion of the fiscal year 2010 unobligated available balance that will be credited against the regulated entities' April assessments is $16.7 million with the remaining $6.0 million retained in the working capital fund. (See Note 2. Fund Balance With Treasury)

NOTE 13. BUDGETARY RESOURCE COMPARISONS TO THE BUDGET OF THE UNITED STATES GOVERNMENT

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting", calls for explanations of material differences between amounts reported in the Statement of Budgetary Resources and the actual balances published in the Budget of the United States Government (President's Budget). The President's Budget that will include fiscal year 2010 actual budgetary execution information has not yet been published. The President's Budget is scheduled for publication in February 2012 and can be found at the OMB Web site: **http://www.whitehouse.gov/omb/**. The 2011 Budget of the United States Government, with the "Actual" column completed for 2009, has been reconciled to the Statement of Budgetary Resources and there were no material differences.

NOTE 14. UNDELIVERED ORDERS AT THE END OF THE PERIOD

For the fiscal years ended September 30, 2010 and 2009, undelivered orders amounted to $20.60 million and $12.87 million, respectively.

NOTE 15. INCIDENTAL CUSTODIAL COLLECTIONS

FHFA's custodial collections primarily consist of Freedom of Information Act requests and civil penalties assessed. Custodial collections will be reflected in the Fund Balance with Treasury amount on the Balance Sheet. While these collections are considered custodial, they are neither primary to the mission of the agency nor material to the overall financial statements. FHFA also collects civil penalties assessed against the regulated entities. FHFA's custodial collections are $288 for the year ended September 30, 2010. Custodial collections totaled $500 thousand for the year ended September 30, 2009 which resulted from a penalty collected from a former executive of Freddie Mac . There were no civil penalties assessed or collected in fiscal year 2010. Custodial collections are transferred to the Treasury General Fund on September 30 and are not reflected in the financial statements of the Agency.

NOTE 16. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

FHFA has reconciled its budgetary obligations and non-budgetary resources available to its net cost of operations.

(Dollars In Thousands)	2010	2009
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 132,808	$ 116,251
Less: Spending Authority from Offsetting Collections and Recoveries	2,794	5,077
Obligations Net of Offsetting Collections and Recoveries	130,014	111,174
Less: Offsetting Receipts	143,100	115,699
Net Obligations	(13,086)	(4,525)
Other Resources		
Imputed Financing from Costs Absorbed by Others	4,807	3,078
Total Resources Used to Finance Activities	**(8,279)**	**(1,447)**
Resources Used to Finance Items Not Part of the Net Cost of Operations:		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	7,729	(2,524)
Resources That Fund Expenses Recognized in Prior Periods	84	46
Resources That Finance the Acquisition of Assets	975	974
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	8,788	(1,504)
Total Resources Used to Finance the Net Cost of Operations	**(17,067)**	**57**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	581	3,349
Other	1	-
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	582	3,349
Components Not Requiring or Generating Resources		
Depreciation and Amortization	2,200	3,697
Other	(353)	4
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	1,847	3,701
Total Components of Net Cost of Operations That Will Not Generate Resources in the Current Period	2,429	7,050
Net (Income from)/Cost of Operations	**$ (14,638)**	**$ 7,107**

NOTE 17. SUBSEQUENT EVENT

Subsequent events have been evaluated through November 15, 2010, the date the financial statements are available to be issued.

On October 25, 2010, the FHLBank of Seattle's Board of Directors agreed to a set of stipulations made by FHFA and consented to an FHFA order that set forth a comprehensive set of actions and requirements for the Bank. This was in response to investment decisions made in 2006 and 2007 and a series of supervisory determinations beginning in November 2009, when FHFA used its Prompt Corrective Action authority to make the discretionary determination that the FHLBank of Seattle was undercapitalized based on depreciation in the value of the Bank's investments in private-label MBS. The decline in value of private-label MBS investments and related shortcomings in its retained earnings made it inadvisable for the FHLBank of Seattle to honor pending requests for stock redemptions by member institutions. In response to the FHFA determination that the Seattle Bank was undercapitalized, the Bank submitted to FHFA a capital restoration plan in December 2009. In April 2010, FHFA directed the Bank to provide a business plan supplement to its capital restoration plan to address how the Bank would move toward more normal FHLBank functioning, including a greater balance sheet focus on advances and a return of capital at par to members. The Bank submitted the business plan supplement to FHFA on August 16, 2010, which was deemed complete upon a meeting at FHFA offices on August 31, 2010. FHFA responded to the Bank's capital restoration plan and business supplement in a meeting with the Bank's Board of Directors on October 22, 2010. The consent order and associated agreement with the Board constitute the Bank's approved capital restoration plan. The Bank also announced on October 25, 2010, that its President was stepping down and the current Chief Operating Officer would serve as the Bank's Acting President and Chief Executive Officer.

Management's Report on Internal Control over Financial Reporting

Federal Housing Finance Agency
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Management's Report on Internal Control over Financial Reporting

The Federal Housing Finance Agency's (FHFA) internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

FHFA management is responsible for establishing and maintaining effective internal control over financial reporting. FHFA management evaluated the effectiveness of the agency's internal control over financial reporting as of September 30, 2010, based on the criteria established under 31 U.S.C. sec. 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we conclude that, as of September 30, 2010, FHFA's internal control over financial reporting was effective.

Federal Housing Finance Agency

Edward J. DeMarco
Edward J. DeMarco
Acting Director

Mark A. Kinsey
Mark A. Kinsey
Chief Financial Officer

November 5, 2010

Comments from the Federal Housing Finance Agency

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

November 8, 2010

Mr. Steven J. Sebastian
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Sebastian:

Thank you for the opportunity to respond to the Government Accountability Office's (GAO) draft audit report titled, Financial Audit: Federal Housing Finance Agency's Fiscal Years 2010 and 2009 Financial Statements, GAO-11-151. This report presents GAO's opinion on the fiscal years 2010 and 2009 financial statements of the Federal Housing Finance Agency (FHFA). The report also presents GAO's opinion on the effectiveness of FHFA's internal controls as of September 30, 2010 and GAO's evaluation of FHFA's compliance with laws and regulations.

I am pleased to accept GAO's unqualified opinion on the FHFA financial statements and to note that there were no materials weaknesses or significant deficiencies identified during the fiscal year 2010 audit. The GAO reported that: the statements and notes were presented fairly, in all material respects; FHFA had effective internal controls over financial reporting; and there were no reportable instances of noncompliance with laws and regulations tested by GAO.

FHFA will continue to work to enhance our internal controls and ensure the reliability of our financial reporting, soundness of operations, and public confidence in the agency's mission. We appreciate your support of these efforts. In addition, we would like to acknowledge the dedicated GAO staff that worked with FHFA to meet the reporting deadline for our audited financial statements and notes.

If you have any questions relating to our response, please contact Mark Kinsey, Chief Financial Officer, at (202) 414-3811.

Sincerely,

Edward J. DeMarco

Edward J. DeMarco
Acting, Director

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