United States Government Accountability Office

GAO

Report to Congressional Committees

November 2009

FINANCIAL AUDIT

Federal Housing Finance Agency's Fiscal Year 2009 Financial Statements

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Accountability * Integrity * Reliability

GAO-10-218

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Highlights

Highlights of GAO-10-218, a report to congressional committees

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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 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 year 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 noted the challenges it faced in establishing the new agency while working to stabilize the housing market. It noted that 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-10-218 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 year 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, 2009. GAO found no reportable instances of noncompliance with the laws and regulations it tested.

HERA established FHFA as an independent agency on July 30, 2008, and abolished, effective within 1 year of enactment, the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board (FHFB) – which, together with a mission group within the Department of Housing and Urban Development (HUD), had previous supervisory and oversight responsibilities for Fannie Mae, Freddie Mac, and the 12 federal home loan banks. During fiscal year 2009, OFHEO's and FHFB's personnel, property, and program activities, and certain employees and activities of HUD, were transferred to FHFA, and the assets, liabilities, and financial transactions of OFHEO and FHFB were consolidated into FHFA. While FHFA was in existence prior to the start of fiscal year 2009, this was its first full year of operations and the first year for which it prepared financial statements. Consequently, FHFA's financial statements do not present comparative information for the prior year.

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 year 2009 financial statements, based on determinations by the Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) that they did 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 decision would need to be revisited.

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 issued a report containing a framework for evaluating various options available.

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
HUD	Department of Housing and Urban Development
OFHEO	Office of Federal Housing Enterprise Oversight
OMB	Office of Management and Budget

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

November 16, 2009

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 T. Bachus
Ranking Member
Committee on Financial Services
House of Representatives

This report presents our opinion on whether the financial statements of the Federal Housing Finance Agency (FHFA) are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles for the year ended September 30, 2009—the first full year of FHFA's operation. These financial statements are the responsibility of FHFA. This report also presents (1) our opinion on the effectiveness of FHFA's internal control over financial reporting as of September 30, 2009, and (2) the results of our tests of FHFA's compliance with selected laws and regulations during fiscal year 2009.

The Housing and Economic Recovery Act of 2008[1] established FHFA as an independent agency empowered with supervisory and regulatory oversight of 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, and requires GAO to audit the agency's financial statements and submit to Congress a report on the audit and provide a copy to the President and FHFA. We conducted this audit in accordance with U.S. generally accepted government auditing standards. The accomplishment of this first-ever audit of FHFA's financial statements was made possible by the tremendous dedication of time and effort from FHFA management and staff.

[1]Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008).

FHFA faced significant challenges during fiscal year 2009 in merging the personnel and operations of the former Office of Federal Housing Enterprise Oversight and Federal Housing Finance Board into one regulatory entity. At the same time, FHFA was further challenged with carrying out its responsibilities as conservator of Fannie Mae and Freddie Mac to ensure that these entities continued to meet their mission requirements of providing 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. Treasury to the entities of up to $200 billion each in exchange for the Department of the Treasury's purchase of the entities' senior preferred stock. To date, the entities have received about $96 billion through such purchases. FHFA has maintained that the conservatorship arrangement is not intended to be permanent. Over the longer term, 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.

In a recent report,[2] we analyzed the records of Fannie Mae and Freddie Mac in meeting their housing mission objectives, their organizational structures, and the circumstances that led to the federal government's actions to intercede and stabilize them. In that report, we discussed the need for Congress to reevaluate the roles, structures, and performance of the entities, and to consider various options to facilitate mortgage finance while mitigating safety and soundness and systemic risk concerns. We also provided a framework for identifying the trade-offs associated with the options, and identified potential regulatory and oversight structures, principles, and actions that could help ensure their effective implementation.

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 Chairman of the Securities and Exchange Commission, the Director of the Office of Management and Budget, and other interested parties. This report also is available at no charge on GAO's Web site at http://www.gao.gov.

[2]GAO, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, GAO-09-782 (Washington, D.C.: Sept. 10, 2009).

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 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 audit of FHFA's fiscal year 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, 2009; and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our conclusions on 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, 2009, and its net costs, changes in net position, and budgetary resources for the fiscal year then ended.

As discussed in note 1A of the financial statements, HERA[1] established FHFA on July 30, 2008, and charged it with the supervisory and regulatory oversight of Fannie Mae, Freddie Mac, and the 12 federal home loan banks. These responsibilities were previously assigned to the Office of Federal Housing Enterprise Oversight (OFHEO), the Federal Housing Finance Board (FHFB), and a mission group in the Department of Housing and Urban Development (HUD). HERA abolished OFHEO and FHFB effective no later than 1 year after enactment of the act, or by July 30, 2009. In accordance with HERA, during fiscal year 2009, personnel, property, and program activities of OFHEO and FHFB, and certain HUD employees and activities related to regulation of Fannie Mae and Freddie Mac, were

[1]Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008).

transferred to FHFA, with OFHEO and FHFB ceasing all activity in July 2009. The assets, liabilities, and financial transactions of OFHEO and FHFB were consolidated into FHFA during fiscal year 2009. Because fiscal year 2009 was the first full year of FHFA's operations, this is the first year in which FHFA prepared financial statements. Consequently, the financial statements do not present comparative information for the prior year.

As discussed in note 1A of the financial statements, FHFA's fiscal year 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 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. As announced by the Director, 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. Shortly after Fannie Mae and Freddie Mac were placed in conservatorship, the Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) determined that the finances of these entities would not be included in the financial statements of the federal government. 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 recently reaffirmed this conclusion with respect to fiscal year 2009. FHFA management concurs with this conclusion. Consequently, FHFA did not consolidate Fannie Mae and Freddie Mac into its fiscal year 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, 2009, that 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).

We identified certain deficiencies in FHFA's system of internal control that we consider not to be material weaknesses or significant deficiencies.[2] These deficiencies involve matters related to certain accounting and monitoring procedures, access controls, and information security management. 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 2009 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 contains 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 in the financial statements with U.S. generally accepted accounting principles or OMB Circular No. A-136, *Financial Reporting Requirements*.

[2] 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, 2009, based on the criteria established under FMFIA. FHFA management's assertion 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, 2009. 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; 5 U.S.C. § 5332 and 5343, and 29 U.S.C. § 206 – Pay and Allowance System for Civilian Employees; 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; and 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 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 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 controls over financial reporting. 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, 2009. 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

In commenting on a draft of this report, FHFA stated that it was pleased that the audit found that its fiscal year 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. FHFA noted the challenges it had faced during fiscal year 2009 in trying to stabilize the housing market in the midst of financial market turmoil while creating the new agency and establishing a new financial accounting system, policies, and controls, and noted that the unqualified audit opinion was testimony to the hard work and dedication of its management and staff in building a solid foundation for the agency. FHFA also noted that 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.

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

Steven J. Sebastian
Director
Financial Management and Assurance

November 9, 2009

Management's Discussion and Analysis

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 the Federal Housing Finance Agency (FHFA) and 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 housing-related 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, policymakers 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 (OFHEO), the Federal Housing Finance Board (FHFB), and the Department of Housing and Urban Development's (HUD) mission group to oversee the financial safety and soundness and the housing mission of all the housing-related government-sponsored enterprises (GSEs), also referred to as the regulated entities. These include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank (FHLBank) System, composed of 12 FHLBanks and the Office of Finance.

FHFA employees attend an All Hands Meeting regarding the agency's progress and accomplishments.

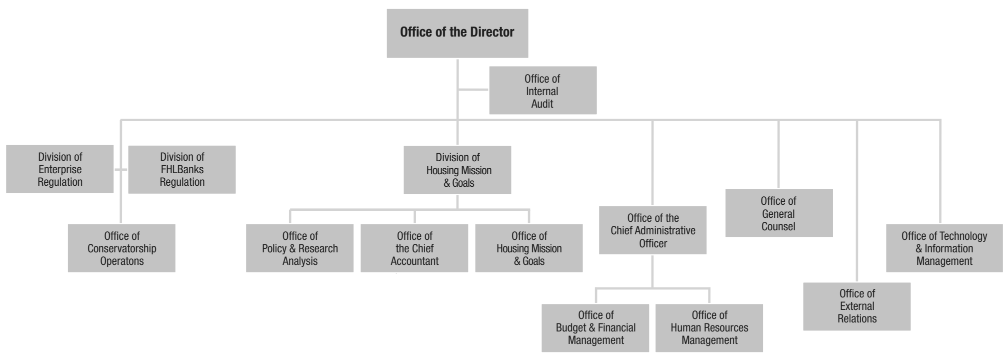
FHFA is a small government agency with a workforce that includes highly skilled economists, market analysts, examiners, subject matter experts, technology specialists, accountants, and attorneys. FHFA had a staff of 428 employees at the end of FY 2009. In FY 2010, the agency plans to add 52 employees.

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 Enterprises). The division conducts annual on-site 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.

Figure 1 • Organization Chart for FHFA



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 Mission and Goals** is responsible for oversight of the housing mission and goals of the Enterprises and the oversight of the housing finance, community, and economic development mission of the 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 and changes in house 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's 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 of Internal Audit** reports directly to the Office of the Director and carries out certain audit functions for FHFA as delegated by the Director. Until FHFA has an Office of Inspector General, the Office of Internal Audit will address reports of violations of any law, rule or regulation; gross mismanagement; gross waste of funds; abuses of authority; or substantial and specific dangers to public safety or complaints regarding the programs and operations of the agency.

The **Office of External Relations** works with FHFA's external stakeholders to effectively communicate information about the agency, respond to public and congressional inquiries, and release pertinent information to the public.

The **Office of the Chief Administrative Officer** provides operational support and services and business solutions to FHFA offices. The office's staff members work in a variety of areas, including human resource management, budget and financial management, performance management, and facilities management.

The **Office of Technology and Information Management** (OTIM) is responsible for ensuring the integrity, confidentiality, and availability of FHFA's information systems and assets. The office maintains the information technology (IT) infrastructure, develops information systems, provides storage and management of the agency's information assets, provides support to FHFA employees on IT systems, manages Freedom of Information Act requests, and ensures information security.

To fulfill its mission, FHFA has available a full range of oversight and regulatory authorities to deal with the regulated entities. These authorities include full scope examinations and enforcement mechanisms, such as cease and desist orders, civil money penalties, removal authority, and independent litigation authority.

Description of Regulated Entities

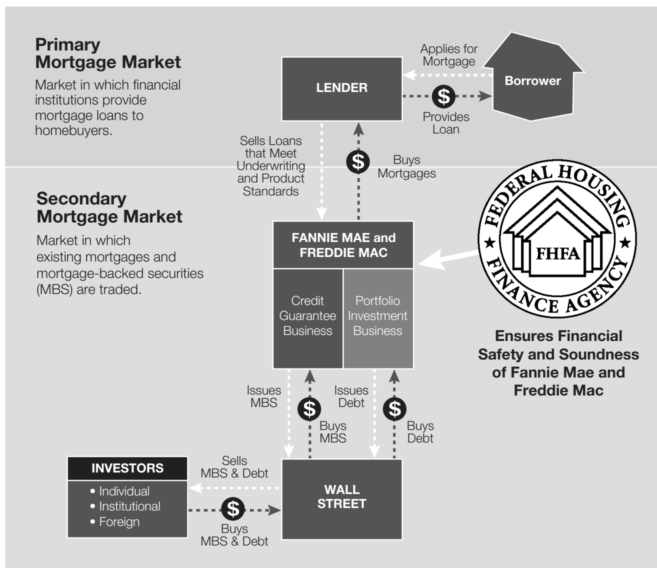
The Enterprises

The primary and secondary mortgage markets work together to finance homeownership opportunities. The secondary market provides liquidity to the primary market and helps establish mortgage interest rates.

In the primary mortgage market, financial institutions make mortgage loans directly to homebuyers. This process begins when the potential homeowner, or borrower, applies for a mortgage loan from a lender. The lender can be a savings bank, credit union, mortgage banking company, commercial bank, savings and loan, or state or local housing finance agency. Once the lender approves the application and the loan is processed, the mortgage lender provides the money to the borrower, who then applies the proceeds of the mortgage to the cost of the home. The lender in the primary market either holds the loan in its own portfolio or sells the loan into the secondary market.

Congress established Fannie Mae and Freddie Mac (the Enterprises) to perform an important role in the nation's housing finance system: providing liquidity, stability, and affordability to the secondary mortgage market. In the secondary mortgage market, the Enterprises make funds readily accessible for

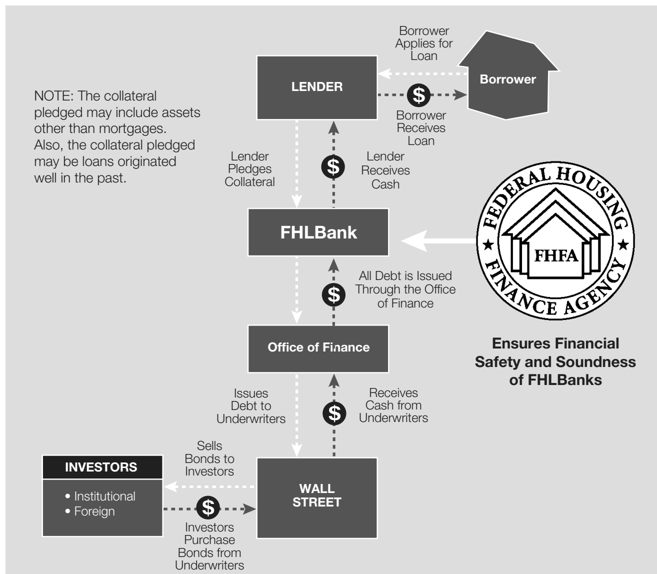
Figure 2 • FHFA's Oversight Role – Fannie Mae & Freddie Mac



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 buy other agency and private-label MBS (PLMBS) for their own portfolios. Lenders can use the cash raised by selling mortgages to the Enterprises to lend more so individuals and families who buy homes and investors who purchase single-family homes or apartment buildings and other multifamily dwellings will have a reliable, stable supply of mortgage money. Roughly half of the mortgages purchased by Fannie Mae and Freddie Mac finance dwelling units that are affordable to low- and moderate-income households. More than one-fourth 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. This process makes the secondary mortgage market more liquid and helps lower the interest rates paid by homeowners and other mortgage borrowers.

Figure 3 • FHFA's Oversight Role – FHLBanks



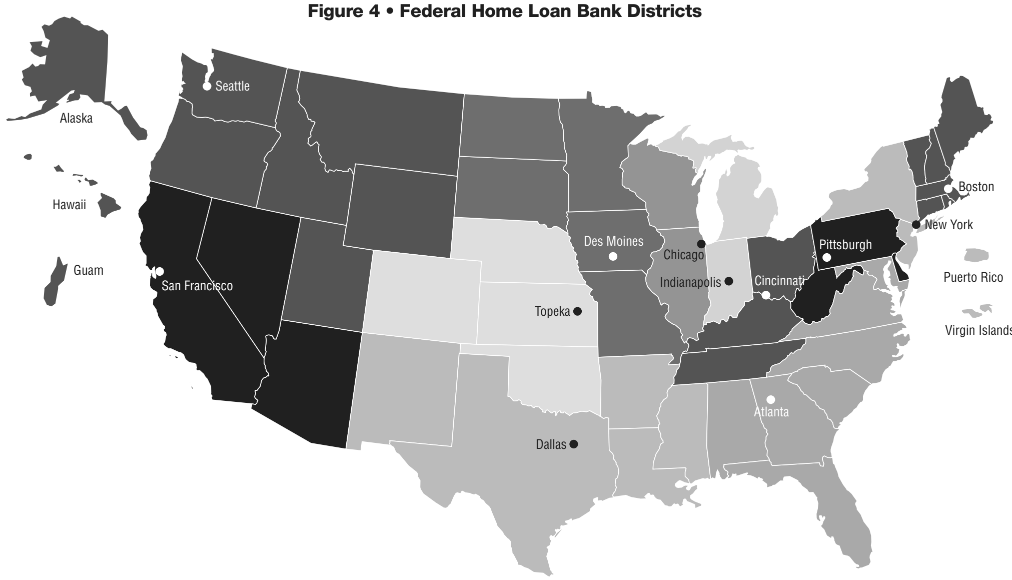
The Federal Home Loan Banks

The fundamental business of the FHLBanks is to provide a readily available, low-cost source of funds in a wide range of maturities to meet the liquidity demands of members. The FHLBanks are cooperatives, which means only members and former members own the capital stock in each FHLBank. Membership is limited to regulated depositories, insurance companies, and community development financial institutions engaged in residential housing finance. As a member-owned cooperative, each FHLBank conducts its credit and mortgage program businesses with its members or eligible housing associates.

The FHLBanks make loans, called advances, to their members and eligible housing associates on the security of mortgages and other collateral pledged by the borrowing member or housing associate. This serves the general public by increasing the availability of credit for residential mortgages and community investments and by making the mortgages and mortgage securities owned by members more liquid. Enhancing the liquidity of mortgages makes members more likely to invest in mortgages and MBS.

Advances are the largest category of assets of the FHLBanks. In addition, some FHLBanks provide members with a means of enhancing liquidity by purchasing or funding home mortgages through mortgage programs developed for their members. Under these programs, members are offered the opportunity to sell qualifying mortgages to, or fund them through, an FHLBank. Members can also

Figure 4 • 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

borrow from an FHLBank to fund low-income housing, helping the 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 assets and operations principally through the sale of debt instruments, known as consolidated obligations, to the public through the Office of Finance. Each FHLBank is jointly and severally liable with the other FHLBanks for all consolidated obligations issued. Consolidated obligations are not obligations of the United States, and the U.S. government does not guarantee them.

Performance Highlights

Establishing FHFA

At the beginning of FY 2009, former OFHEO and FHFB employees were officially transferred to FHFA, less than 90 days after enactment of HERA. Since then, FHFA has worked to integrate the separate administrative and financial systems of the two predecessor agencies.

FHFA contracted with the Treasury Department's Bureau of the Public Debt. Administrative Resource Center to provide accounting services for the agency. The Bureau of the Public Debt is approved by the federal Office of Management and Budget (OMB) as a "Center of Excellence for Financial Management." A new accounting system, which went live on July 1, 2009, provides the agency with a cost-effective integrated system for its accounting, procurement, and travel activities. The project was completed within established timeframes and budget. Combining the financial accounting functions of the predecessor agencies was an important step toward completing the transition to an operationally unified agency.

The Office of Human Resource Management coordinated the programming and systems changes with the National Finance Center to achieve a transition from two separate systems into a unified payroll and processing system for FHFA. The integration was completed in July 2009, on schedule and under budget. With a unified FHFA personnel and payroll system, the agency can move to the next phase of full employee integration: the migration of employees into a combined compensation and benefits package.

OTIM worked to unify FHFA information technology infrastructure operations. The goal throughout the integration effort was to build and operate one IT infrastructure to support FHFA's mission effectively. Specifically, FHFA has

- *Implemented an integrated e-mail messaging system;*
- *Consolidated software licenses and services;*
- *Eliminated duplication of information systems and data sources;*
- *Established the FHFA.gov domain and developed and deployed a new FHFA.gov Web site;*
- *Established an internal employee communication site; and*
- *Unified internal customer service operations.*

Charting the Future

FHFA staff meet to develop the 2009 Agency Strategic Plan in December of 2008.

In its first year, FHFA published its first strategic plan, first human capital plan, and first combined *Performance and Accountability Report*. The combined PAR presented progress and accomplishments of FHFA, FHFB, and OFHEO for FY 2008.

The *FHFA Strategic Plan 2009–2014*, formally approved and adopted in July 2009, established the strategic goals and objectives of FHFA. For those goals to be achieved, it is imperative to restore the financial health of the Enterprises through the conservatorships, enhance the safety and soundness of the FHLBanks and the Enterprises, support efforts to return stability to domestic housing markets, and ensure that the regulated entities contribute to affordable housing and community and economic development.

The strategic plan recognizes Fannie Mae's and Freddie Mac's roles in the Making Home Affordable (MHA) program, which seeks to stabilize mortgage markets by combating preventable foreclosures. The strategic plan also reinforces the strong supervisory framework HERA created for the regulation and oversight of the regulated entities, which is crucial in enhancing the financial safety and soundness of their operations and in financing and otherwise supporting affordable housing and community development activities.

The *FHFA 2009–2011 Strategic Human Capital Plan* links human capital planning to FHFA's mission and strategic goals. The plan describes FHFA's current workforce and business challenges that will affect the management of human capital in the next few years. It also presents a program to ensure that FHFA has the staff needed to meet its performance goals and mission. The human capital plan is premised on the principle that successful human resources management is the foundation of the agency's ability to accomplish performance goals and achieve its mission.

Conducting Examinations and Targeted Supervisory Reviews

The Division of FHLBank Regulation's examination process emphasizes an ongoing supervisory approach involving both off- and on-site activities. Identifying excessive risk exposure through an evaluation of an FHLBank's condition and practices is the primary examination goal. FHFA accomplishes this by conducting risk-based examinations. The scope, depth, and focus of the examinations are based on the results of previous examinations, visitations, or other analyses. During FY 2009, FHFA examiners conducted on-site safety and soundness examinations at all 12 FHLBanks and the Office of Finance. The examination process was enhanced in 2009 to allow an expansion of on-site activities to conduct more rigorous analysis in areas of perceived risk. Significant examination results, known as "matters requiring attention" (MRAs), are reviewed by a committee of senior division staff before discussion with the FHLBanks' Board of Directors.

The Division of Enterprise Regulation (DER) focuses on the safety and soundness of Fannie Mae and Freddie Mac. To this end, FHFA conducted continuous supervision activities and targeted reviews of key areas such as financial performance, credit quality, operational risks, liquidity planning, interest rate risk, retained portfolios, and enterprise risk management. FHFA also strengthened its oversight of

MRAs through ongoing dialogue with management of the Enterprises about corrective actions, additional management reporting for FHFA executives, and establishing an Enforcement Oversight Committee. FHFA will continue to review and revise its formal supervisory strategy for the Enterprises to ensure examinations and targeted reviews reflect a risk-focused approach.

Ensuring Continued Functioning of the Secondary Mortgage Market

Throughout FY 2009, FHFA acted as both conservator of the Enterprises and as the mission and safety and soundness regulator of all the regulated entities. In both capacities, FHFA worked to ensure the regulated entities continued to provide a stable and affordable source of liquidity for the primary mortgage market.

The Department of Treasury's financial support for the Enterprises served as a foundation for those efforts. In conjunction with the establishment of the conservatorships in September 2008, FHFA, acting as conservator, entered into agreements that committed the Treasury to acquire senior preferred stock in each Enterprise to ensure each maintained positive net worth. In February, Treasury doubled the size of these agreements to $200 billion each. The financial support provided through those agreements, FHFA's suspension of all regulatory capital requirements following the conservatorships, and Treasury and the Federal Reserve's purchases of Enterprise debt and MBS enabled the Enterprises to carry out normal secondary mortgage market operations. Those operations included providing liquidity to banks, thrifts, and other mortgage lenders.

Enhancing Foreclosure Prevention Efforts

Throughout the past year, FHFA encouraged the Enterprises to lead foreclosure prevention initiatives to stabilize housing and financial markets. FHFA worked with the Administration, the Enterprises, and other industry participants on a plan to address the economic crisis and keep people in their homes.

FHFA worked with HOPE NOW, an alliance of mortgage market participants, and Treasury, the Federal Housing Administration (FHA), and the Enterprises to design and implement a comprehensive Streamlined Modification Program in November 2008. The streamlined program was designed to reduce preventable foreclosures by transitioning borrowers who were delinquent on their obligations into mortgages they could afford. FHFA also coordinated the actions of the Enterprises to suspend foreclosures of owner-occupied homes from November 26, 2008, until January 31, 2009, and encouraged the Enterprises to update their tenant eviction and foreclosure sale suspension plans.

In early 2009, FHFA helped develop the Administration's MHA program, which is expected to help at-risk homeowners avoid foreclosure by reducing monthly mortgage payments. This program is a major step forward in reducing avoidable foreclosures and stabilizing the housing market. This program will work in tandem with an expanded and improved Hope for Homeowners Program. It builds on both the Federal Deposit Insurance Corporation's (FDIC's) modification initiative and the Streamlined Modification program.

The two principal elements of the MHA program comprise an important step toward achieving a recovery for housing markets and the entire economy.

1. **Home Affordable Refinance Program (HARP).** The Enterprises provide access to low-cost refinancing for loans they own or guarantee. This helps homeowners reduce their monthly payments and avoid foreclosure. It is designed for borrowers who are current in their payments and seek to refinance at a lower rate or into a safer mortgage but who have experienced difficulties because of declining home values and limited availability of mortgage insurance.

2. **Home Affordable Modification Program (HAMP).** This program establishes a national standard for loan modifications. Treasury shares a portion of the costs, which provides financial incentives to borrowers, lenders, and servicers. The Enterprises monitor servicer compliance with the plan's rules. The Enterprises bear the incentive costs of modifications for loans Fannie Mae or Freddie Mac own or guarantee.

FHFA took the lead in coordinating implementation of the MHA loan modification process by the regulated entities, including the coordination of the development of the net present value (NPV) model used to qualify loan modification recipients. The NPV model was a joint collaboration between the Enterprises, FHFA, FDIC, and Treasury. FHFA also oversaw and assisted the Enterprises in their respective roles as agents of the Treasury in implementing the program.

FHFA also actively promoted transparency regarding the results of the Enterprises' foreclosure prevention and refinance activities. In November 2008, FHFA began publishing a monthly *Foreclosure Prevention Report* that provides updates on the Enterprises' loan modification and other foreclosure prevention activities. In August 2009, FHFA began publishing a monthly *Refinance Report* that summarizes the Enterprises mortgage refinance activities, including HARP refinances. These reports together form the key elements of FHFA's monthly *Federal Property Managers Report* to Congress, which FHFA began producing in December 2008 as required by Section 110 of the Emergency Economic Stabilization Act of 2008.

Monitoring and Addressing the Challenges of PLMBS

As high levels of delinquencies triggered ratings downgrades of PLMBS and significant market illiquidity, these MBS presented significant financial challenges for Fannie Mae, Freddie Mac, and the FHLBanks.

Fannie Mae and Freddie Mac incurred significant accounting charges related to other than temporary impairment (OTTI) of residential PLMBS in 2008 and 2009. Through September 30, 2009, the Enterprises had taken a cumulative $16.1 billion of credit-related losses on roughly $160 billion of mostly subprime, Alt-A, and option ARM (adjustable-rate mortgage) PLMBS. Though the overall PLMBS market has slightly improved because of government programs in the third quarter of 2009, prices remain depressed at a weighted average of roughly 60 cents on the dollar mark-to-market value.

FHFA worked with the FHLBanks on the adoption of a common platform for accounting for PLMBS. By the end of FY2009, the common platform had contributed to greater standardization and coordination among the FHLBanks in valuing their PLMBS holdings and determining OTTI.

Exposure to OTTI varies considerably among the FHLBanks. This has affected their retained earnings and accumulated other comprehensive income. Preliminary data indicate the FHLBanks held $51.3 billion in PLMBS as of September 30, 2009. These securities had a fair value of $46.1 billion, or 90 cents on the dollar. Because of the deterioration in the market, the FHLBanks took total OTTI charges in FY 2009 of $12.2 billion. Of that amount, $2 billion was due to credit factors. A total of $8.4 billion was due to noncredit factors, which are recorded as part of their balance sheet capital accounts but do not flow through their income statements.

Providing Accounting Guidance to the Regulated Entities

FHFA General Counsel Alfred Pollard addresses FHFA staff at an agency-wide event.

In light of the changing regulatory landscape, FHFA's Office of the Chief Accountant shared preliminary accounting examination guidance on a range of accounting and auditing issues with the regulated entities. The guidance reflected structural and regulatory differences between the Enterprises and the FHLBanks. The new guidance, when finalized in October 2009, replaced previous accounting guidance applicable only to the Enterprises and supplemented regulations and other guidance applicable only to the FHLBanks.

Several significant events had occurred since the original accounting guidance and FHLBank regulations were issued. The HERA legislation was passed, which created FHFA and made certain Securities and Exchange Commission (SEC) regulations applicable to the regulated entities, and the Enterprises were placed into conservatorship.

The new guidance gives examiners criteria to assess risks posed by an entity's accounting, internal control over financial reporting, and audit functions. One of the primary goals of the new guidance is to promote consistency in implementation of generally accepted accounting principles (GAAP) to enhance transparency. This is achieved in part by establishing the expectation that the regulated entities maintain complete and current accounting policies and procedures.

Another significant element of the new guidance articulates best practices around audit-related governance matters and internal controls. The guidance reinforces SEC, Public Company Accounting Oversight Board, and New York Stock Exchange requirements for audit committees. The updated guidance also reflects the different governance structures of the Enterprises as compared to the FHLBanks. For example, some audit committee independence requirements applicable to the Enterprises will not apply to the FHLBanks because of the cooperative ownership structure of the FHLBanks, which are subject to existing regulations covering the composition of their audit committees.

Another key element of the new guidance relates to external auditor independence at these systemically important institutions. The guidance sets out regular rotation as a best practice for each regulated entity to promote audit independence. The guidance states that regulated entity audit committees should formally consider audit firm rotation after 10 years of audits by the same firm and every five years thereafter until there is a change in auditor. The new guidance also requires examiners to consider the tenure of audit firms in their assessments of auditor independence and related governance matters.

Fulfilling Requirements Established by HERA

During FY 2009, FHFA began a review of existing OFHEO and FHFB regulations as well as regulations required to be issued under HERA. As a result, FHFA issued final and interim final regulations either required by, or in response to, HERA provisions or which adopted, with appropriate revisions, OFHEO or FHFB regulations. The published final or interim final regulations are listed in Figure 5. For those regulations issued as proposed or interim final regulations, FHFA expects to issue final regulations in FY 2010 after considering public comment.

In addition to promulgating regulations, FHFA prepared and issued several reports required by HERA. On July 30, 2009, the agency published the first annual report on guarantee fees charged by the Enterprises for conventional single-family mortgages—loans the federal government does not insure or guarantee that finance properties with four or fewer residential units. The report, issued July 30, 2009, covered single-family fees for loans acquired by the Enterprises in 2007 and 2008. The sample of mortgages used to prepare that report represented 79 percent and 89 percent, respectively, of the unpaid principal balance of single-family mortgages the Enterprises acquired in 2007 and 2008.

Also on July 30, 2009, FHFA published a study on securitization of home mortgage loans purchased, or to be purchased, by the FHLBanks from member financial institutions under the acquired member assets programs. The study focused on the

- *Benefits and risks associated with FHLBank securitization;*
- *Potential effects on liquidity in the mortgage markets and broader credit markets;*
- *Abilities of FHLBanks to manage risk;*
- *Effects of risk management programs on existing activities of the FHLBanks; and*
- *Effects of risk management programs on joint and several liability of the FHLBanks and the cooperative structure of the FHLBank System*

On the basis of the findings of this study and the recent calls for regulatory reform, FHFA did not recommend permitting the FHLBanks to securitize mortgages.

Finally, on July 30, 2009, FHFA published two reports related to collateral securing advances at the FHLBanks. The first report, an annual report required by Section 1212 of HERA, analyzed collateral data as of December 31, 2008, by type and FHLBank district. On January 26, 2009, FHFA published this same report for data as of December 31, 2007. The second report, required by Section 1217 of HERA, studied the extent to which loans and securities used as collateral to support FHLBank advances were consistent with the interagency guidance issued by federal banking regulators on nontraditional mortgage products and subprime lending. The report noted that each FHLBank had adopted policies, procedures, and practices requiring that mortgage loans and securities used as collateral be consistent with interagency guidance as well as policies addressing antipredatory lending.

Figure 5 • Regulations Published in Response to HERA

Proposed	**Golden Parachutes and Indemnification Payments** *(74 FR 30975 Jun. 29, 2009, 12 CFR Part 1231)*
	Federal Home Loan Bank Membership for Community Development Financial Institutions *(74 FR 22848, May 15, 2009, 12 CFR Part 1263)*
	Executive Compensation (Regulated Entities) *(74 FR 26989, Jun. 5, 2009, 12 CFR Part 1230)*
	Reporting of Fraudulent Financial Instruments *(74 FR 28636, Jun. 17, 2009, 12 CFR Part 1233)*
	Board of Directors of FHLBank System Office of Finance *(74 FR 38564, Aug. 4, 2009, 12 CFR Part 1273 and 12 CFR Part 1274)*
Interim	**Portfolio Holdings** *(74 FR 5609, Jan. 20, 2009, 12 CFR Part 1252)*
	Prior Approval for Enterprise Products *(74 FR 31602, Jul. 2, 2009, 12 CFR Part 1253)*
	Federal Home Loan Bank Boards of Directors: Eligibility and Elections *(73 FR 55710, Sep. 26, 2009, 12 CFR Part 1261, Subpart A)*
	Affordable Housing Program Amendments: FHLBank Mortgage Refinancing Authority *(74 FR 38514, Aug. 4, 2009, 12 CFR part 1291)*
Final	**Golden Parachute Payments** *(74 FR 33907, Jul. 14, 2009, 12 CFR Part 1231)*
	Capital Classifications and Prompt Corrective Action *(74 FR 38508, Aug. 4, 2009, 12 CFR Part 1229)*
	2009 Enterprise Transition Affordable Housing Goals *(74 FR 39873, Aug. 10, 2009, 12 CFR Part 1282)*
Adopted with Appropriate Revisions, OFHEO or FHFB Regulations	**Assessments** *(73 FR 56712, Sep. 20, 2008, 12 CFR Part 1206)*
	Freedom of Information Act Implementation *(74 FR 2342, Jan. 15, 2009; 74 FR 18623, Feb. 17, 2009, 12 CFR Part 1202)*
	Flood Insurance *(74 FR 7304, Feb. 17, 2009, 12 CFR 1250)*
	Privacy Act Implementation *(74 FR 33907, Jul. 14, 2009, 12 CFR Part 1204)*

Establishing Affordable Housing Goals

FHFA analyzed detailed loan-level data on the 4.7 million single-family mortgages and 8,900 multifamily mortgages the Enterprises purchased to determine official goal performance for 2008. The agency also analyzed the feasibility of the 2008 housing goals, which were established long before the mortgage market collapse. FHFA determined that in light of market conditions, the 2008 housing goals and home purchase subgoals previously established in the regulation were not feasible and should be adjusted.

Under HERA, the housing goals established for the Enterprises by HUD for 2008 carried over to 2009. In FY 2009, FHFA began evaluating these existing housing goals. Restrictions on the availability of private mortgage insurance for borrowers with lower down payments; a surge in refinancing, particularly by higher income borrowers; the increasingly important role of FHA in the mortgage marketplace; and a slowdown in the multifamily market, among other factors, meant fewer loans in 2009 that qualified under housing goals. Consequently, FHFA proposed adjusting the overall 2009 Enterprise housing goals to lower levels. The final rule was published August 10, 2009.

Developing Duty to Serve Standard for the Enterprises

HERA amended the Safety and Soundness Act of 1992, establishing a duty for the Enterprises to serve three underserved markets—manufactured housing, affordable housing preservation, and rural areas—to increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing in those markets. Congress explicitly required the Enterprises to provide leadership in developing loan products and flexible underwriting guidelines to facilitate the secondary market for these underserved areas.

FHFA published an Advance Notice of Proposed Rulemaking to begin the process of establishing a manner for evaluating and rating whether and to what extent the Enterprises have complied with their duty to serve. The Enterprises must provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages on housing for very low, low-, and moderate-income families with respect to the three underserved markets. FHFA issued the advance notice in August 2009, seeking the broadest possible public comment for its rulemaking. FHFA also sent representatives to Texas, Tennessee, and Wisconsin to learn more about manufactured housing needs. FHFA will report annually to Congress on what the Enterprises have done pursuant to their duty to serve.

Reviewing Executive Compensation at the Regulated Entities

Under HERA, the FHFA Director has the power to approve, disapprove, or modify the executive compensation of the Enterprises and the FHLBanks. The FHFA Director has authority to withhold the compensation of an executive officer during a review for "reasonableness and comparability." It also grants the Director authority to prohibit or limit any golden parachute or indemnification payment.

On January 29, 2009, FHFA published a Golden Parachute Payments final rule that sets forth factors for the FHFA Director's consideration in limiting golden parachute payments to entity-affiliated parties in connection with the Enterprises and the FHLBanks. On June 29, 2009, FHFA published a Golden Parachute and Indemnification Payments Proposed Rule. The proposal amended the Golden

Parachute Payments Final Rule to address in more detail prohibited and permissible golden parachute payments. In addition, on June 5, 2009, FHFA published an Executive Compensation Proposed Rule. The proposed regulation sets forth requirements and processes with respect to compensation provided to executive officers by the Enterprises, the FHLBanks, and the Office of Finance, consistent with FHFA's safety and soundness responsibilities under HERA.

Working with the U.S. Treasury, FHFA designed a forward-looking incentive-based retention plan for the Enterprises. The plan focuses on retention rather than past performance. The retention plan is designed to

- *Retain key officers at a time of increased personnel demands;*
- *Preserve critical institutional knowledge; and*
- *Maintain optimal performance levels until capital levels are restored and credit losses are returned to a normal state.*

As conservator, FHFA did not allow bonuses for 2008 in light of the performance of the two Enterprises.

Management Challenges

The Future of the Secondary Mortgage Market

Conservatorship is not a long-term solution to financial distress at the Enterprises. The Administration, 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. The Administration has announced that it will propose a plan for the long-term future of the Enterprises in February 2010. FHFA personnel are 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 Congress and the Administration as they consider restructuring housing finance and financial regulation and address the secondary mortgage market and the role of the Enterprises. Critical decisions have to be made about the future of the primary mortgage market and the FHLBanks and the appropriate role of the secondary mortgage market, including the roles of government regulation and programs, and what guiding principles will shape the future of the secondary mortgage market.

Though much of the debate will focus on the Enterprises, FHFA expects the discussion to include the future of the FHLBanks. The FHLBanks played a critical role in providing financing to large and small member financial institutions during the second half of 2007, 2008, and the first part of 2009. The FHLBanks' residential mortgage portfolios are small compared to those of the Enterprises and have suffered little in the way of delinquencies or credit losses. FHFA is prepared to discuss the role of the FHLBanks in sustaining the mortgage market.

If Congress restructures the secondary mortgage markets or secondary market institutions, maintaining investor confidence and liquidity in existing and new mortgage products and markets and ensuring the safety and soundness of both old and new institutions will be the most significant challenges. Beyond those challenges are broader issues, such as retaining key employees, identifying valuable elements of the existing Enterprises, and determining the need for certain systems and processes. To prepare for future policy decisions, FHFA is closely monitoring markets and holding discussions with various stakeholders.

Mortgage Delinquencies and Defaults

Rapidly rising levels of serious delinquencies and defaults, further aggravated by high levels of unemployment and severe declines in home prices, continue to stress the Enterprises. As of June 30, 2009, Enterprise serious delinquencies had increased nearly 200 percent year-over-year to 2.89 percent for Freddie Mac and 3.94 percent for Fannie Mae. Real estate owned (REO) acquisitions for the first three quarters of FY 2009 at Fannie Mae were 57,469, an approximate 30 percent increase year-over-year. Freddie Mac had 35,987 REO acquisitions, approximately 60 percent higher than the year before.

To mitigate the impact of continued serious delinquencies and defaults, the Enterprises expanded loan modification efforts and took leadership roles in the MHA Program. The FHLBanks that participate in mortgage purchase programs developed borrower assistance programs that enhance the foreclosure prevention efforts for mortgage loans owned by the FHLBanks.

The Enterprises are recording historic levels of modifications and refinances. For borrowers unable to continue homeownership, the Enterprises offer foreclosure alternatives, including short sales, deeds in lieu of foreclosure, and REO rental programs. The impact of the HAMP and HARP elements remains uncertain as unemployment and house prices continue to deteriorate, interest rates rise from historic lows, other initiatives are set to expire, and operational difficulties in implementing foreclosure prevention programs arise.

Operational Challenges Facing the Enterprises

FHFA placed both Enterprises into conservatorship in September 2008 because deteriorating market conditions threatened the companies' ability to fulfill their mission. The Enterprises continue to be challenged by operational constraints both internally and by counterparties. To handle high numbers of loan modifications, loan servicers are making significant changes in their operational systems. In addition, servicers are increasing personnel to meet the intensive labor demands needed to manage and reduce foreclosures. The Enterprises are working with the government and servicers to accelerate loan modifications and refinancing, but they also must improve systems within their own operations and coordinate changes with servicers.

In 2008 Treasury established three finance facilities (GSE Credit Facility, MBS Purchase Program, and Senior Preferred Stock Purchase Agreement) to support the ongoing business operations of the Enterprises and meet conservatorship objectives. These facilities support the Enterprises' capital and liquidity to provide confidence to investors in the Enterprises' debt and MBS. Some of these facilities expire at the end of this year, so the Enterprises and FHFA are working with Treasury to ensure investor confidence is maintained through appropriate government support coupled with strengthened liquidity and asset liability management within the Enterprises.

Continuing Weaknesses in PLMBS Quality

PLMBS illiquidity and extremely poor collateral performance have challenged investors, including the Enterprises and the FHLBanks, in bonds originally rated triple-A. Credit and pricing weaknesses have demonstrated the need for resources to manage assets backed by riskier collateral and to properly account for current performance and the potential for future disruption to contractual cash flows. The regulated entities, like many other investors, have reallocated staff to assist with loss mitigation efforts on these bonds.

Throughout FY 2009, and likely continuing in FY 2010, earnings have been affected at the Enterprises and some FHLBanks by OTTI of certain securities. For the Enterprises, the actual and expected PLMBS and guarantee fee losses resulted in Department of the Treasury purchases of senior preferred stock. Impairments also have prompted certain FHLBanks to reduce or eliminate dividends and curtail or cease the repurchase or redemption of FHLBank stock.

Housing Goals for 2010

HERA for the first time added affordable housing and mission enforcement to the responsibilities of the safety and soundness regulator. As a result, enforcement of the affordable housing goals established for the Enterprises by Congress, once HUD's responsibility, is now up to FHFA. FHFA must ensure that the Enterprises meet their critical responsibility of making it possible for low- and moderate-income persons and underserved areas to have access to affordable mortgage loans while also ensuring that more prudent lending standards are restored.

HERA requires, beginning in 2010, a wholesale restructuring of the affordable housing goals. The Enterprises will have four single-family goals and one multifamily special affordable goal. For single-family purchase money mortgages, there will be goals for households in two income categories: low-income (income no greater than 80 percent of area median income) and very low income (income no greater than 50 percent of area median income). There will be a goal for refinanced mortgages for low-income families. In the multifamily area, there will be a separate special affordable (low-income) housing goal. FHFA must also finalize standards for the evaluation of the Enterprises' duty to serve certain underserved markets.

Beginning in 2011, HERA also requires FHFA to establish affordable housing goals for the FHLBanks for the first time. 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. Prior to the passage of HERA, the FHLBanks principally supported the provision of affordable housing for low- and moderate-income households through their affordable housing programs.

HERA established a two-year transition period and mandated that FHFA establish interim target affordable housing goals for the FHLBanks during calendar years 2009 and 2010. FHFA will soon propose interim target goals consistent with the low- and moderate-income housing goals and the underserved area housing goal applied to the Enterprises' mortgage purchase activities in 2009 and prior years.

An Economic Capital Model for the Future

FHFA is pursuing the development of a new economic capital model to determine the risk-based capital requirement for the Enterprises. The model would address market, credit, and operational risks as before, but would be different from the prior OFHEO approach. In particular, it would incorporate substantially more stress test scenarios than the previous model did. It could also include a countercyclical adjustment to the credit risk component, designed to require a build-up of capital during an expansion or housing boom well prior to a recession or housing crisis when the capital would be needed to absorb losses.

Acting Director Edward DeMarco addresses FHFA staff at the farewell reception for former Director James Lockhart.

FHFA Leadership

On August 31, 2009, FHFA Director James B. Lockhart III resigned, and FHFA's Chief Operating Officer and Senior Deputy Director for Housing Mission and Goals Edward DeMarco became Acting Director of the agency. Over the past year, DeMarco played an integral role in setting up FHFA, so the President's appointment of DeMarco as Acting Director should provide a measure of stability to the agency. However, the agency continues to face uncertainty about selection of a presidentially appointed and Senate-confirmed Director, the future structure of the Enterprises, the future form of regulation for the Enterprises and the FHLBanks, and the role of FHFA following decisions on the future structure of secondary mortgage markets.

In addition, HERA calls for additional changes, including establishment of an Office of the Inspector General (OIG). FHFA will not have an inspector general, however, until one is approved by the President and confirmed by the Senate. Once an inspector general is appointed by the President and confirmed by the Senate, the agency will need to establish an OIG and provide appropriate staff and infrastructure to support it.

FY 2009 Performance Summary

Strategic Planning at FHFA

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 in greater detail FHFA's results and efforts to achieve its FY 2009 performance goals.

FHFA's 2009 Annual Performance Plan was developed and released in December 2008 and consists of a combination of OFHEO and FHFB strategic goals and performance measures. For FY 2009, FHFA set 17 annual performance goals to reach its strategic goals, 5 annual performance goals to support its resource management strategy, and a total of 60 performance measures. After the release of the 2009 Annual Performance Plan, FHFA revised its performance measures to reflect the new administration's policies. As a result, FHFA added one measure and deleted five measures. This report shows the 61 measures, noting the five that are no longer applicable. This section describes agency performance based on FHFA's FY 2009 Annual Performance Plan, which outlined the means and strategies to achieve the annual performance goals and related measures for the past year.

While FHFA analyzed the allocation of resources, the merging of two accounting systems prevented the agency from tracking FY 2009 obligations by strategic goal. Beginning in FY 2010, FHFA will track resource allocations by strategic goals developed in FHFA's FY 2010 strategic plan, which was published in the last quarter of FY 2009.

FHFA's Strategic Goals

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

1. **Enhance supervision to ensure that Fannie Mae, Freddie Mac, and the FHLBanks operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.**
2. **Promote homeownership and affordable housing and support an efficient secondary mortgage market.**
3. **Through conservatorship, preserve and conserve the assets and property of Fannie Mae and Freddie Mac (the Enterprises) and enhance their ability to fulfill their mission.**

FHFA also has set a resource management strategy to manage effectively FHFA's human capital and resources.

FHFA Met or Exceeded Most of Its Performance Measures

FHFA reported on 61 performance measures in its FY 2009 Performance Plan. The agency exceeded, achieved, or substantially achieved 66 percent of the performance measures in the plan. The performance section outlines in detail 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 "achieved" when targets for all performance measures have been met. "Substantially achieved" indicates that at least one performance measure has not been achieved, although a substantial majority of the measures related to the performance goal were met. In FY 2009, FHFA achieved 63 percent, substantially achieved three percent, and did not achieve 26 percent of its performance measures. Eight percent of the performance measures were not applicable.

FY 2009 was a year of nearly unprecedented disruption in housing and financial markets. In response, the agency had to allocate resources to the conservatorships and to housing stabilization initiatives that it had not envisioned when it developed the FY 2009 Performance Plan was developed. In cases in which FHFA did not achieve performance measures in FY 2009, the reasons stemmed principally from turbulent housing and financial market conditions and challenges encountered in integrating the new agency.

FHFA identified 12 of the 61 FY 2009 performance measures 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 highest priority measures for the agency. The following table summarizes FHFA's achievement of key performance indicators.

Key FHFA Performance Indicators for FY2009

Strategic Goal	Performance Goal	Key Performance Indicator
STRATEGIC GOAL 1 **Enhance supervision to ensure that Fannie Mae, Freddie Mac, and the Federal Home Loan Banks operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.**	**PERFORMANCE GOAL 1.1** **Fannie Mae and Freddie Mac (the Enterprises) comply with safety and soundness standards.**	**PERFORMANCE MEASURE 1.1.1** The percentage of Enterprises with a composite GSE enterprise risk safety and soundness rating of "Limited Concerns" or better. **Not Achieved** Both Enterprises were rated "Critical Concerns" and were in conservatorship.
		PERFORMANCE MEASURE 1.1.2 For both Enterprises, the percentage of GSE enterprise risk categories (governance, solvency, earnings, market, credit, and operational risk) with a safety and soundness rating of "Limited Concerns" or better (1 or 2). **Not Achieved** Ratings for the Enterprises were "Critical Concerns" for earnings, credit risk, and market risk and "Significant Concerns" for governance and operational risk. In conservatorship, the rating for capital was suspended.
	PERFORMANCE GOAL 1. **The FHLBanks comply with safety and soundness standards.**	**PERFORMANCE MEASURE 1.2.1** Percentage of FHLBanks with a composite rating of "1" or "2". **Not Achieved** Sixty-two percent of the FHLBanks (and the Office of Finance) had a composite safety and soundness rating of "1" or "2" at the end of the fiscal year. Heightened concerns about credit risk and governance associated with private-label MBS holdings contributed to the decline in ratings.
	PERFORMANCE GOAL 1.4 **The FHLBanks are adequately capitalized.**	**PERFORMANCE MEASURE 1.4.1** The FHLBanks meet FHFA's determination of capital adequacy. **Substantially Achieved** FHLBanks met all capital requirements at year-end. One FHLBank, failed to meet the risk-based capital requirement for part of the year.

Strategic Goal	Performance Goal	Key Performance Indicator
STRATEGIC GOAL 1 **Enhance supervision to ensure that Fannie Mae, Freddie Mac, and the Federal Home Loan Banks operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements.**	**PERFORMANCE GOAL 1.5** **Fannie Mae and Freddie Mac comply with applicable laws, regulations, directives, and agreements, including executive compensation, corporate responsibility, and disclosure.**	**PERFORMANCE MEASURE 1.5.1** Any identified instances of noncompliance with laws and regulations are resolved to FHFA's satisfaction. **Achieved** Enterprises resolved, or are on schedule to resolve, outstanding supervisory issues arising from laws, regulations, directives, and agreements.
	PERFORMANCE GOAL 1.6 **The FHLBanks comply with applicable laws, regulations, directives, and agreements, including those regarding executive compensation, cor-porate responsibility, and disclosure.**	**PERFORMANCE MEASURE 1.6.3** Establish a matters requiring attention-like measure for tracking follow-up recommendations from annual exams. **Achieved** An MRA tracking tool was developed in 2009 and is being used for FHLBank examinations that commenced in 2009. Tracking tools for each FHLBank were backfilled with outstanding 2008 MRAs to log and document remediation efforts in a consistent manner.
STRATEGIC GOAL 2 **Promote homeownership and affordable housing and support an efficient secondary mortgage market.**	**PERFORMANCE GOAL 2.1** **Develop proposed and final regulations to implement statutory changes in Fannie Mae and Freddie Mac affordable housing goals effective January 1, 2010, while enforcing existing goals.**	**PERFORMANCE MEASURE 2.1.4** Enforce Fannie Mae and Freddie Mac 2009 affordable housing goals. **Achieved** Met monthly with each Enterprise to track progress in meeting housing goals.
	PERFORMANCE GOAL 2.2 **The FHLBanks foster the development of affordable owner-occupied and rental housing for eligible very low-, low-, and moderate-income households.**	**PERFORMANCE MEASURE 2.2.2** The FHLBanks address principal affordable housing program examination findings to FHFA's satisfaction prior to the next examination. **Achieved** Conducted all scheduled affordable housing program exams and visitations, assessed status of principal affordable housing program examination findings from prior exam, and obtained management commitment to correct findings from 2009 examinations.

Strategic Goal	Performance Goal	Key Performance Indicator
STRATEGIC GOAL 2 **Promote homeownership and affordable housing and support an efficient secondary mortgage market.**	**PERFORMANCE GOAL 2.5** **Cooperate with other federal agencies on mortgage markets and the nation's housing finance system and regulatory issues.**	**PERFORMANCE MEASURE 2.5.1** Respond to requests from other Federal agencies for information about housing finance markets and the Enterprises. **Achieved** Thirty-day standard met on requests related to mortgage market conditions, debt issuance, Making Home Affordable, and Housing Finance Agency assistance.
STRATEGIC GOAL 3 **Through conservatorship, FHFA will preserve and conserve the assets and property of Fannie Mae and Freddie Mac and enhance their ability to fulfill their mission.**	**PERFORMANCE GOAL 3.1** **Preserve and conserve each Enterprise's assets and property.**	**PERFORMANCE MEASURE 3.1.1** Financial condition of each enterprise remains liquid and they maintain positive GAAP net worth including Senior Preferred Stock. **Achieved** The Treasury Preferred Stock Agreement continues to support the Enterprises positive net worth and sufficient capacity remains.
	PERFORMANCE GOAL 3.2 **Continue to delegate appropriate authorities to each Enterprise's management to move forward with the business operations.**	**PERFORMANCE MEASURE 3.2.2** Establish new Boards of Directors at each Enterprise. **Achieved** Both Enterprises reconstituted their Boards of Directors in December, 2008.
RESOURCE MANAGEMENT STRATEGY **Manage effectively FHFA's human capital and resources to support our mission.**	**PERFORMANCE GOAL 4.1** **Maintain a diverse workforce that is skilled, flexible, and performance-oriented to fulfill the goals of the agency.**	**PERFORMANCE MEASURE 4.1.3** Percentage of vacancies filled within Office of Personnel Management's 45-day time-to-hire standard. **Achieved** FHFA met the 45-day time-to-hire standard in 73 percent of FY2009 hires.

FY 2009 Financial Summary

Year of Transition

HERA abolished FHFB and OFHEO effective at the end of a one-year period beginning with the signing of the legislation, on July 30, 2008. FHFB and OFHEO existed until then solely for the purpose of winding up their affairs. From a financial standpoint, FHFA changed from three Treasury funds to one, from two accounting systems to one, and from two payroll systems to one, effective July 2009.

Fiscal Year 2009 Financial Results

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

FHFA calculates the assessments for each Enterprise by determining a percentage ratio of each one's assets and off-balance-sheet obligations to the total of both Enterprises. FHFA calculates the assessments for each of the 12 FHLBanks by determining each Bank's share of minimum required regulatory capital as a percentage of the total minimum capital of all the FHLBanks. Assessments are paid semiannually on October 1 and April 1.

In FY 2009, FHFA's operating budget was $120.8 million. During FY 2009, FHFA recovered $6 million in unspent prior year obligations and had a $900,000 reduction in the costs of reimbursable agreements from the legacy agencies. Total budget resources were $125.9 million as a result. FHFA obligated all but $9.7 million of that amount. The $9.7 million unobligated amount included $3 million for the working capital fund.

Net cost represents the gross cost incurred less any revenue earned from activities. For FY 2009, net cost of FHFA operations was $7.1 million. Gross costs include expenses paid and depreciation expense for the year but exclude money paid for capitalized assets. Gross costs also include year-end accruals and unfunded expenses for retirement plans, health benefits, and life insurance paid by the Office of Personnel Management (OPM) for FHFA. Earned revenue consists of assessment, investment, reimbursable, and other miscellaneous revenues.

The agencies highest cost outlay was for payroll expenses. Funded payroll expenses were $77.4 million for FY 2009. This included the full-year cost of 414 full-time equivalents. During FY 2009, FHFA focused on hiring and retaining staff to ensure effective oversight of the regulated entities.

Unqualified Audit Opinion for Fiscal Year 2009

For FY 2009, FHFA received an unqualified audit opinion on its financial statements. The auditor noted no material weaknesses in internal controls and cited no instances of noncompliance with laws and regulations.

Internal Controls

Management Assurances

During FY 2009, 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 Director on the effectiveness of FHFA's internal controls.

Deputy Director of Enterprise Regulation Chris Dickerson meets with management planning staff.

In 2009, the executive committee comprised 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 Performance Improvement Officer, 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 2009, 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 Director, on the basis of a recommendation from the executive committee, issued an unqualified opinion on internal controls over financial reporting as of September 30, 2009. This assurance can be found in the Financial Section of this report and meets the FMFIA reporting requirement for internal controls.

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 United States Government Standard General Ledger at the transaction level. FHFA moved its accounting services to the Bureau of the Public Debt during its first year of operation and now uses 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) a manual 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 agencywide information security program. The program provides the framework to protect the government's information, operations, and assets. FHFA annually reviews the agency's information security program through its internal audit function and reports the results to OMB. The FY 2009 FISMA report is currently in progress.

Significant information security program activities completed during FY 2009 included the development and issuance of the Agency's Breach Notification Policy and Plan for reporting personally identifiable information security incidents. FHFA also published a comprehensive Information

Technology Security Policy Handbook in FY 2009. The agency has begun putting procedures from the handbook in place and will continue this effort into FY 2010. FHFA also addressed security-related weaknesses for systems noted in the prior year OFHEO and FHFB FISMA reviews and completed a review to validate and document system configurations.

FHFA maintained security certification and accreditation on 100 percent of all major systems in production. During the year, FHFA expanded and improved security awareness training, providing a required automated training program to all FHFA employees and contractors. FHFA also upgraded its Security Log Management System to monitor production servers and network device logs and security events. In addition, FHFA implemented comprehensive scanning of production systems on a monthly basis to identify and correct system vulnerabilities as part of a risk management approach to manage IT assets.

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. No erroneous payments were issued by FHFA in FY 2009 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 2009, the dollar amount subject to prompt payment was $28.3 million. The amount of interest penalty paid in FY 2009 was $482 or 0.0017 percent of the total dollars disbursed.

Financial Statement Requirements

FHFA prepares financial statements and submits those statements for annual audit. FHFA has prepared principal financial statements to report the financial position and results of its operations, pursuant to the requirements of 31 U.S.C. 3515(b). FHFA prepared the statements from the books and records of FHFA in accordance with GAAP for federal entities and the formats prescribed by OMB. The statements are also used to monitor and control budget resources that are prepared from the same books and records.

Financial Statements

FHFA Financial Section

Message From The Chief Financial Officer

I am pleased to report that the Federal Housing Finance Agency (FHFA) has received an unqualified "clean" audit opinion from the Government Accountability Office (GAO) in FHFA's first full year of operations. This accomplishment is particularly noteworthy in light of the tremendous amount of change that occurred during the year: The infrastructure for the new agency was developed and brought online and the operations of the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board (FHFB) were wound down.

All of the personnel, property, and program activities of OFHEO and FHFB, and certain employees and activities from the Department of Housing and Urban Development, were transferred to FHFA during FY 2009. At the same time, FHFA worked on developing new accounting, personnel, and information technology systems to operationally unify the new agency. One significant achievement this past year was the successful development and transition to a new, single, integrated accounting system on July 1, 2009. This transition included the decision to outsource the agency's accounting, travel, and charge card management services to an Office of Management and Budget approved service provider. Prior to July 1, 2009, FHFA had been using the legacy accounting systems and processes from OFHEO and FHFB.

Despite the operational challenges of creating a new agency, FHFA remained focused on maintaining a strong internal control environment that helped the agency receive an unqualified audit opinion on its initial financial statements. Senior management set the tone for the agency, continually reinforcing the need to maintain strong internal controls throughout the transition.

During the transition year, FHFA prepared a combined Performance and Accountability Report for FHFA, OFHEO, and FHFB, which received the Certificate for Excellence in Accountability Reporting (CEAR) award for FY 2008 from the Association of Government Accountants. This CEAR award is given for achieving the highest standard of federal fiscal accountability reporting.

I am very proud to work with a highly dedicated group of professionals whose efforts made it possible to successfully stand up the new agency while simultaneously maintaining effective controls over the agency's financial systems and processes. I am confident that FHFA will continue its success in the years to come.

Sincerely,

Mark Kinsey

Mark Kinsey
Chief Financial Officer
November 10, 2009

Federal Housing Finance Agency
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www.fhfa.gov

October 28, 2009

Federal Managers' Financial Integrity Act
Statement of Assurance
Fiscal Year 2009

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, 2009 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 control 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, 2009 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, 2009.

Edward J. DeMarco
Edward J. DeMarco
Acting Director

10/28/2009
Date

FEDERAL HOUSING FINANCE AGENCY

Balance Sheet

As of September 30, 2009
(in Thousands)

		2009
Assets		
Intragovernmental:		
Fund Balance With Treasury (Note 2)	$	29,076
Investments (Note 3)		37,668
Accounts Receivable (Note 4)		3
Total Intragovernmental		**66,747**
Accounts Receivable (Note 4)		3
General Property and Equipment, Net (Note 5)		3,273
Prepaid Expenses		1
Total Assets	**$**	**70,024**
Liabilities		
Intragovernmental:		
Accounts Payable	$	758
Payroll Taxes Payable (Note 7)		652
Total Intragovernmental		**1,410**
Accounts Payable		4,268
Deferred Revenue (Note 6)		35,122
Other (Note 7)		10,813
Total Liabilities	**$**	**51,613**
Net Position		
Cumulative Results of Operations	$	18,411
Total Net Position	$	18,411
Total Liabilities and Net Position	**$**	**70,024**

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

FEDERAL HOUSING FINANCE AGENCY

Statement of Net Cost

for the Year Ended September 30, 2009
(in Thousands)

		2009
Program Costs: (Note 10)		
Gross Costs	$	122,816
Less: Earned Revenue		115,709
Net Program Costs	**$**	**7,107**
Net Cost of Operations	**$**	**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 Year Ended September 30, 2009
(in Thousands)

		2009
Cumulative Results of Operations:		
Beginning Balances	$	9,544
Budgetary Financing Sources:		
Appropriations Used		12,896
Other Financing Sources (Non-Exchange):		
Imputed Financing Sources		3,078
Total Financing Sources		15,974
Net Cost of Operations		7,107
Net Change		8,867
Cumulative Results of Operations	**$**	**18,411**
Unexpended Appropriations:		
Beginning Balances	$	12,896
Budgetary Financing Sources:		
Appropriations Used		12,896
Total Budgetary Financing Sources		**12,896**
Total Unexpended Appropriations	**$**	**-**
Net Position	**$**	**18,411**

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

FEDERAL HOUSING FINANCE AGENCY

Statement of Budgetary Resources

for the Year Ended September 30, 2009
(in Thousands)

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

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

FEDERAL HOUSING FINANCE AGENCY

Notes to the Financial Statements

NOTE 1 • SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Federal Housing Finance Agency 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 12 Federal Home Loan Banks, Fannie Mae, and Freddie Mac (Regulated Entities). 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. FHFA had minimal activity during the agency's two months of existence in fiscal year 2008.

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 determined that the finances of the companies would not be included in financial statements of the federal government. For fiscal year 2008, the Office of Management and Budget (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. Consequently, the assets and liabilities of Fannie Mae and Freddie Mac have not been consolidated into FHFA's financial statements.

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 twice, on September 26, 2008 and May 6, 2009. The Agreements provide for each Enterprise to draw up to $200 billion from Treasury to ensure that they maintain 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 the request for a draw and certifies that the request is within the available amount remaining under the limit contained in 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 (dollars in billions).

Senior Preferred Draws	Fannie Mae	Freddie Mac
September 30, 2008	$ 0.0	$ 13.8
December 31, 2008	15.2	30.8
March 31, 2009	19.0	6.1
June 30, 2009	10.7	0.0
Cumulative Draws	$ 44.9	$ 50.7

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 the Office of Management and Budget (OMB) Circular A-136 "Financial Reporting Requirements," revised June 10, 2009. 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 and associated notes for FHFA for fiscal year 2009 will not be comparative, as this is the agency's first full fiscal year of existence. The balance sheet, statement of net cost, and statement of changes in net position are consolidated statements, whereas the statement of budgetary resources is a combined statement. The statements include consolidated and combined balances for FHFA, FHFB, and OFHEO. Financial transactions were captured in the legacy FHFB and OFHEO systems until the conversion to one system was complete on July 1, 2009. 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 Director, in September 2008 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 Director to be necessary for maintaining a working capital fund.

FHFA develops its annual budget using a 'bottoms 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 costs associated with regulating Fannie Mae and Freddie Mac and the total costs associated with regulating the FHLBanks. These two totals, along with any collection for the working capital fund, equal the fiscal year budget for the agency.

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 Federal Home Loan Bank'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 Federal Home Loan Banks' 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 year 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 is 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.

The Housing and Economic Recovery Act of 2008 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 consist 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 and Equipment, Net

Pursuant to HERA legislation, all Property and Equipment of FHFB and OFHEO were transferred to FHFA at the existing net book value of those assets. Net book value was determined by the capitalization policies in effect at the legacy agencies.

Property and Equipment is recorded at historical cost. It consists of tangible assets and software. As of May 2009, FHFA has adopted a property management policy. Under FHFA's property management policy, equipment acquisitions greater than or equal to $25 thousand 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, 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. For Federal Employees Retirement System (FERS) plan employees, unused sick leave is held indefinitely and may be used if rehired.

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 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. FERS went into effect on January 1, 1987. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984 elected to join either FERS and Social Security or remain in CSRS. FERS offers a Thrift Savings Plan to which FHFA automatically contributes 1% of pay and 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 certain CSRS reinstatement 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.

FHFA's 401(K) is administered by T. Rowe Price. Eligible employees that participate may contribute up to 10% of 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 Federal Thrift Savings Plan 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 year 2009. Fund Balance with Treasury (FBWT) account balances as of September 30, 2009 were as follows:

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

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

NOTE 3 • INVESTMENTS

Intragovernmental Securities
As of September 30, 2009
(In Thousands)

	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Other Adjustments	Market Value Disclosure
Non-Marketable Market Based	$37,668	-	-	$37,668	-	$37,668

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, 2009. Interest earned on investments was $30 thousand for fiscal year 2009.

NOTE 4 • ACCOUNTS RECEIVABLE

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

	2009 (In Thousands)
Accounts Receivable due from the Public	$ 3
Intragovernmental Receivables	3
Total Accounts Receivable	$ 6

As of September 30, 2009 there are no amounts that are deemed uncollectible.

NOTE 5 • GENERAL PROPERTY AND EQUIPMENT

Property and equipment account balances as of September 30, 2009 were as follows:

Schedule of Property and Equipment as of September 30, 2009
(In Thousands)

Description	Acquisition Cost	Accumulated Depreciation	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 consists of $35.1 million 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 rent and unfunded leave. Payroll accruals represent payroll expenses that were incurred prior to month-end but were not paid. Other liabilities not covered by budgetary resources consist of unfunded annual leave which also includes compensation time and deferred rent for a total of $7.4 million. FHFA's other liabilities are classified as current.

	2009 (In Thousands)
Intragovernmental	
Payroll Taxes Payable	$ 652
Total Intragovernmental	$ 652
With the Public	
Accrued Payroll	$ 3,417
Annual Leave	7,256
Deferred Rent	140
Total Public	$ 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, fee, 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 Standards Board Statement No. 13.

1750 Pennsylvania Avenue NW and 1625 Eye Street

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 20, 2011. The lease terms of 1625 Eye Street expire on June 30, 2015. Contingency space at an undisclosed location is also leased, with the lease expiring on October 31, 2009. Total rental payments for the fiscal year ended September 30, 2009 were $4.78 million. The minimum future payments for these leases are as follows:

Fiscal Year	Amount (In Thousands)
2010	$ 4,467
2011	4,107
2012	3,674
2013	3,748
2014	3,823
Thereafter	2,910
Total	$ 22,729

NOTE 9 • COMMITMENTS AND CONTINGENCIES

FHFA does not have any material commitments or contingencies that meet disclosure requirements as of September 30, 2009.

NOTE 10 • PROGRAM COSTS

Pursuant to the Housing and Economic Recovery Act of 2008, FHFA was established to supervise and regulate the 14 regulated entities. The regulated entities include Freddie Mac, Fannie Mae and the 12 Federal Home Loan Banks. FHFA's Program Costs are reflected as one program as defined by HERA Section 1311(b)(1). Fiscal year 2009 resource allocation estimates and actual costs were not tracked by strategic goal due to the priority placed on integrating staff from three agencies; integrating and developing administrative and infrastructure and systems; and establishing a new strategic plan, goals, and objectives. Beginning in fiscal year 2010, FHFA will track resource allocations to the strategic goals developed for FHFA's new strategic plan, which was published in the last quarter of fiscal year 2009.

Program costs are distributed into two categories: Intragovernmental and With the Public. Intragovernmental costs are a result of FHFA 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 the Office of Personnel Management. With the Public costs include expenditures for contracts with the private sector for goods or services, payments for employee salaries, depreciation, annual leave and deferred rent expenses. Revenue is comprised of semi-annual 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. The costs and revenues for the year ended September 30, 2009 were:

	2009 (In Thousands)
Costs:	
Intragovernmental	$ 24,048
With the Public	98,768
Gross Costs	122,816
Less Earned Revenue:	
Assessment Revenue	115,669
Interest Revenue	30
Miscellaneous Revenue	10
Total Revenue	115,709
Net Program Costs	$ 7,107

NOTE 11 • APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

All obligations incurred are characterized as Exempt from apportionment (i.e. not apportioned) on the Statement of Budgetary Resources. Obligations incurred for the year ended September 30, 2009 are:

	2009 (In Thousands)
Direct Obligations – Exempt from Apportionment	$ 111,682
Reimbursable Obligations- Exempt from Apportionment	4,569
Total Obligations – Exempt from Apportionment	$ 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, 2009, the unobligated balance was $44.8 million, of which $35.1 million is deferred revenue which is unavailable. The unobligated available balance of $9.7 million will be credited against the regulated entities' April assessments. (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). However, the President's Budget that will include fiscal year 09 actual budgetary execution information has not yet been published. The President's Budget is scheduled for publication in February 2010 and can be found at the OMB Web site: http://www.whitehouse.gov/omb.

With FHFA being established on July 30, 2008 and FHFB and OFHEO operating as separate agencies for 10 months of the fiscal year, separate financial statements were prepared for FHFB and OFHEO in fiscal year 2008. FHFA had minimal activity during fiscal year 2008 and therefore, did not prepare a Statement of Budgetary Resources or other required financial statements. As a result, the reconciliation of the 2010 Budget of the United States Government, with the Actual column completed for 2008, to the Statement of Budgetary Resources for fiscal year 2008 has not been performed.

NOTE 14 • UNDELIVERED ORDERS AT THE END OF THE PERIOD

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting", states that the amount of budgetary resources obligated for undelivered orders at the end of the period should be disclosed. For the fiscal year ended September 30, 2009 undelivered orders amounted to $12.87 million.

NOTE 15 • CUSTODIAL REVENUES

FHFA's custodial collections primarily consist of Freedom of Information Act requests and civil penalties assessed. 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. A penalty was collected in the amount of $500 thousand from a former executive of Fannie Mae. FHFA's total custodial collections were $500 thousand for the year ended September 30, 2009, all of which were transferred to the Treasury General Fund on September 30, 2009.

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.

	2009 (In Thousands)
Resources Used to Finance Activities:	
Budgetary Resources Obligated	
Obligations Incurred	$ 116,251
Less: Spending Authority From Offsetting Collections and Recoveries	5,077
Obligations Net of Offsetting Collections and Recoveries	111,174
Less: Offsetting Receipts	115,699
Net Obligations	(4,525)
Other Resources	
Imputed Financing From Costs Absorbed by Others	3,078
Total Resources Used to Finance Activities	(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	(2,524)
Resources That Fund Expenses Recognized In Prior Periods	46
Resources That Finance the Acquisition of Assets	974
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(1,504)
Total Resources Used to Finance the Net Cost of Operations	$ 57
Components of 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	3,349
Total Components of Net Cost of Operations That Will Require or Generate Resources In Future Periods	3,349
Components Not Requiring or Generating Resources:	
Depreciation and Amortization	3,697
Revaluation of Assets and Liabilities	4
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	$ 3,701
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	7,050
Net Cost of Operations	$ 7,107

Management's Report on Internal Control over Financial Reporting

Federal Housing Finance Agency

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, 2009, 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, 2009, FHFA's internal control over financial reporting was effective.

Federal Housing Finance Agency

Edward J. DeMarco

Edward J. DeMarco
Acting Director

Mark Kinsey

Mark A. Kinsey
Chief Financial Officer

November 9, 2009

Comments from the Federal Housing Finance Agency

Federal Housing Finance Agency

November 9, 2009

Mr. Steven J. Sebastian
Director, Financial Management and Assurance
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 Year 2009 Financial Statements (GAO-10-218)". I would like to personally thank you and the GAO staff for all of your efforts in working with FHFA to meet the reporting deadline for our audited financial statements.

I am pleased that the audit found that the financial statements are presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles; that FHFA maintained, in all material respects, effective internal control over financial reporting; and that there were no instances of reportable noncompliance with laws and regulations tested by GAO.

Fiscal year 2009 was a tremendously challenging year for FHFA. In addition to our focus on stabilizing the housing market in the midst of financial market turmoil, FHFA was also busy building a new agency, with a new financial accounting system, policies and controls. An unqualified audit opinion is testimony to the hard work and dedication of FHFA management and staff in building a solid foundation for the agency.

As FHFA begins its second year of operations, we 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.

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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