United States Government Accountability Office

GAO

Report to Congressional Committees

November 2011

FINANCIAL AUDIT

Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements

U.S. Government Accountability Office

GAO 90 YEARS 1921-2011

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GAO-12-161

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Highlights

Highlights of GAO-12-161, a report to congressional committees

November 2011

FINANCIAL AUDIT

Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements

Why GAO Did This Study

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

Pursuant to HERA's requirement, GAO audited FHFA's fiscal years 2011 and 2010 financial statements to determine whether (1) the financial statements were fairly presented and (2) FHFA management maintained effective internal control over financial reporting. GAO also tested FHFA's compliance with selected laws and regulations.

What GAO Recommends

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

View GAO-12-161. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.

What GAO Found

In GAO's opinion, FHFA's fiscal years 2011 and 2010 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, 2011. GAO found no reportable instances of noncompliance with the laws and regulations it tested.

FHFA's fiscal year 2011 financial statements include costs for the FHFA Office of Inspector General (OIG), which make up approximately 10 percent of FHFA's fiscal year 2011 costs. While the OIG was established in 2008 by the enactment of HERA, the Inspector General was not confirmed by the U.S. Senate until October 2010. Therefore, there were no OIG costs to be reported in FHFA's fiscal year 2010 financial statements.

In early September 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the Director of FHFA, with the stated intent to stabilize these entities. The assets, liabilities, and activities of the two entities, Fannie Mae and Freddie Mac, are not reflected in FHFA's fiscal years 2011 and 2010 financial statements, based on determinations by the Office of Management and Budget (OMB) and the Department of the Treasury (Treasury) that they do not meet the criteria for inclusion in the financial statements of the U.S. government or the Treasury under federal accounting concepts, though Treasury records an asset for its investments in the two entities and a liability for future payments to these entities on its financial statements. Specifically, OMB and Treasury concluded this because the entities are not currently reflected in the federal government's budget and because the conservatorship arrangement is considered to be temporary. FHFA management concurred with this conclusion. Should circumstances change, this conclusion would need to be revisited.

From early September 2008 through September 30, 2011, Fannie Mae and Freddie Mac have received about $169 billion in direct financial support from Treasury in exchange for Treasury's purchase of the entities' senior preferred stock. Additionally, Fannie Mae and Freddie Mac are requesting $7.8 billion and $6.0 billion, respectively, in additional support from Treasury due to losses sustained for the quarter ended September 30, 2011. Over the longer term, Congress and the executive branch face difficult decisions on how to restructure the entities and promote housing opportunities while limiting the risks to taxpayers and the financial markets.

GAO noted matters involving FHFA's internal control that were less significant than a material weakness or significant deficiency, but which nonetheless merit management's attention. GAO will be reporting separately to FHFA management on these matters.

Contents

Abbreviations

FHFA	Federal Housing Finance Agency
FMFIA	Federal Manager's Financial Integrity Act of 1982
HERA	Housing and Economic Recovery Act of 2008
OIG	Office of Inspector General
OMB	Office of Management and Budget

United States Government Accountability Office
Washington, DC 20548

November 15, 2011

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

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

This report presents the results of our audits of the financial statements of the Federal Housing Finance Agency (FHFA) as of, and for the fiscal years ending, September 30, 2011 and 2010. These financial statements are the responsibility of FHFA. This report contains our (1) unqualified opinions on FHFA's financial statements, (2) opinion that FHFA's internal control over financial reporting was effective as of September 30, 2011, and (3) conclusion that our tests of FHFA's compliance with selected provisions of laws and regulations disclosed no instances of reportable noncompliance during fiscal year 2011.

The Housing and Economic Recovery Act of 2008[1] established FHFA as an independent agency empowered with supervisory and regulatory oversight of the housing-related government-sponsored enterprises: Fannie Mae, Freddie Mac, the 12 federal home loan banks, and the Office of Finance. The Act requires FHFA to annually prepare and submit financial statements to the Director of the Office of Management and Budget (OMB) and requires GAO to audit the agency's financial statements.

[1] Pub. L. No. 110-289, 122 Stat. 2654 (July 30, 2008). The law gave the Director of the FHFA authority over Fannie Mae, Freddie Mac, the federal home loan banks, and the Office of Finance. The 12 federal home loan banks and the Office of Finance, whose primary function is to issue and service all debt securities for the banks, make up the Federal Home Loan Bank System.

FHFA continues to carry out its responsibilities as conservator of Fannie Mae and Freddie Mac to ensure that these entities continue to meet their mission requirements of providing liquidity and stability to the secondary market for residential mortgages, participate in programs such as the Home Affordable Modification Program to help borrowers at risk of foreclosures, and take actions to reduce costs to taxpayers and attain solvency. FHFA placed both entities into conservatorship in September 2008 in the wake of their deteriorating financial conditions with the objective of stabilizing them. From September 2008 through September 30, 2011, the entities have received about $169 billion of direct financial support from the Department of the Treasury (Treasury). Additionally, Fannie Mae and Freddie Mac are requesting $7.8 billion and $6.0 billion, respectively, in additional support from Treasury due to losses sustained for the quarter ended September 30, 2011. FHFA, OMB, and Treasury maintain that the conservatorship arrangement is not intended to be permanent. Over the longer term, particularly with continuing uncertainty about future economic conditions, Congress and the executive branch will face difficult decisions on how to restructure Fannie Mae and Freddie Mac and promote housing opportunities, while limiting the risks to taxpayers and ensuring the stability of the financial markets. It will be necessary for Congress to reevaluate the roles, structures, and performance of Fannie Mae and Freddie Mac and to consider options to facilitate mortgage finance while mitigating safety and soundness and systemic risk concerns.

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

If you or your staff 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, DC 20548

To the Acting Director of the Federal Housing Finance Agency

In accordance with the Housing and Economic Recovery Act of 2008 (HERA), we are responsible for conducting audits of the financial statements of the Federal Housing Finance Agency (FHFA). In our audits of FHFA's fiscal years 2011 and 2010 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, 2011; and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions; (2) our conclusions on FHFA's Management's Discussion and Analysis and other accompanying information; (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, 2011 and 2010, and its net costs, changes in net position, and budgetary resources for the fiscal years then ended.

As discussed in note 1B of the financial statements, FHFA's fiscal year 2011 financial statements include, for the first time, the activities and transactions of the FHFA Office of Inspector General (OIG). While HERA established an OIG for FHFA, the Inspector General was not confirmed by the U.S. Senate until October 2010. Therefore, FHFA's fiscal year 2010 financial statements do not include costs for the OIG. The activities and transactions of the OIG represented approximately 10 percent of FHFA's fiscal year 2011 costs.

As discussed in note 1A of the financial statements, FHFA's fiscal years 2011 and 2010 financial statements do not include the assets, liabilities, and activities associated with Fannie Mae and Freddie Mac. In early September 2008, less than 2 months after FHFA's establishment, the then Director of FHFA placed Fannie Mae and Freddie Mac into conservatorship under the authority of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by HERA.

FHFA's goal in placing the two entities into conservatorship was to stabilize them with the objective of maintaining normal business operations and restoring safety and soundness. From early September 2008 through September 30, 2011, about $169 billion in direct financial support from the Department of the Treasury (Treasury) has been provided to Fannie Mae and Freddie Mac. Additionally, Fannie Mae and Freddie Mac are requesting $7.8 billion and $6.0 billion, respectively, in additional support from Treasury due to losses sustained for the quarter ended September 30, 2011. Shortly after Fannie Mae and Freddie Mac were placed in conservatorship, the Office of Management and Budget (OMB) and Treasury determined that the assets, liabilities, and activities of these entities would not be included in the consolidated financial statements of the federal government or those of the Treasury, although Treasury records an asset for its investment in Fannie Mae and Freddie Mac and a liability for future payments to the two entities in its financial statements. In making this determination, OMB and Treasury 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 for inclusion in the federal government's or Treasury's financial statements.[1] OMB reaffirmed this conclusion with respect to fiscal years 2009, 2010 and 2011. FHFA management concurred with this conclusion. Consequently, FHFA did not include the assets, liabilities, and activities of Fannie Mae and Freddie Mac in its fiscal years 2011 and 2010 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, 2011, 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

[1] The conclusive and indicative criteria used in deciding what to include as part of a financial reporting entity is included in Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

During fiscal year 2011, FHFA made progress in addressing internal control deficiencies that we noted during our audits of FHFA's fiscal year 2009 and 2010 financial statements. These deficiencies involved matters related to accounting and monitoring procedures, access controls, and information security management that remained unresolved at the conclusion of our fiscal year 2010 audit. Although FHFA has made progress in addressing those deficiencies, not all actions were completed as of the completion of our fiscal year 2011 audit. During our fiscal year 2011 audit, we also identified additional deficiencies in accounting procedures and controls over FHFA's information security. We do not consider the remaining deficiencies from our fiscal years 2009 and 2010 financial audits, and those found during our fiscal year 2011 audit, individually or in the aggregate, to constitute material weaknesses or significant deficiencies.[2] 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 2011 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

FHFA's Management's Discussion and Analysis and other accompanying information contain a wide range of information, some of which is not directly related to the financial statements. We did not audit and we do not express an opinion on this information. However, we compared this

[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.

information for consistency with the financial statements and discussed the methods of measurement and presentation with FHFA officials. On the basis of this limited work, we found no material inconsistencies with the financial statements, with U.S. generally accepted accounting principles, or with OMB Circular No. A-136, *Financial Reporting Requirements*.

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, 2011, based on the criteria established under FMFIA. FHFA management's assertion based on its evaluation is included in appendix I.

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) FHFA's financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, and (2) FHFA management maintained, in all material respects, effective internal control over financial reporting as of September 30, 2011. 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. § 5313 – Positions at level II; 12 U.S.C. § 4515 – Personnel; 12 U.S.C. § 4517(h) – Appointment of accountants, economists, and examiners; Continuing Appropriations Act, 2011, as amended by Continuing Appropriations and Surface Transportation Extensions Act, 2011; Presidential Memorandum on Freezing Federal Employee Pay Schedules and Rates That Are Set by Administrative Discretion, 75 Fed. Reg. 81829 (Dec. 29, 2010); Federal Employees' Retirement System Act of 1986, as amended; Social Security Act of 1935, as amended; Federal Employees Health Benefits Act of 1959, as amended; 12 C.F.R. Part 1206 – Assessments; and Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended by the Housing and Economic Recovery Act of 2008; and
- performed such other procedures as we considered necessary in the circumstances.

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

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

We did not test compliance with all laws and regulations applicable to FHFA. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements for the fiscal year ended September 30, 2011. 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, the acting Director of FHFA stated that he was pleased to accept the audit findings that FHFA's fiscal years 2011 and 2010 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 tested. The acting Director also commented the agency would continue to work to enhance its internal controls and ensure the reliability of its financial reporting, its soundness of operations, and public confidence in its mission.

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

Steven J. Sebastian
Director
Financial Management and Assurance

November 9, 2011

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 Values

ACCOUNTABILITY

We foster responsibility on the part of individual employees and divisions through defined delegations of authority. We align our actions and resources with our mission and respond promptly and proactively to emerging risks. We adhere to a predictable, risk-based supervision program. We use agency resources and authorities efficiently and effectively to achieve our mission and goals.

RESPONSIVENESS

We cooperate, collaborate, and communicate within FHFA, with other government agencies, Congress, and the public. We respond promptly to external requests and regularly disseminate information about the housing industry and markets. We promptly address and clearly communicate issues, decisions, and conclusions to the regulated entities.

INDEPENDENCE

We are the independent regulator of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Our evaluations of the regulated entities are unbiased and free from external influence.

INTEGRITY

We adhere to the highest ethical and professional standards. We treat the regulated entities, the public, policy makers, and other stakeholders fairly with impartiality and respect. We apply consistent treatment to and among the housing regulated entities and base our decisions on the merits of their current actions and conditions.

PROFESSIONALISM

We maintain a highly skilled, dedicated, and diverse workforce. We promote equal opportunity and advancement on the basis of merit. We recognize employees who demonstrate competence and effectiveness in their decisions and actions and whose results serve the agency's mission and the public interest. We judge the regulated entities against defined industry standards through a disciplined examination approach.

Strategic Goals and Resource Management Strategy

STRATEGIC GOAL 1 - SAFETY AND SOUNDNESS	The housing government-sponsored enterprises (GSEs) — Fannie Mae, Freddie Mac, and the FHLBanks — operate in a safe and sound manner and comply with legal requirements
STRATEGIC GOAL 2 - HOUSING MISSION	The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing
STRATEGIC GOAL 3 - CONSERVATORSHIP	FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship
RESOURCE MANAGEMENT STRATEGY	FHFA has the personnel, resources, and infrastructure to manage effectively and efficiently to achieve its mission and goals

Alignment of Resource Allocation with Strategic Goals

In FY 2010, FHFA began tracking resource allocations and program costs according to strategic goals. Figure 1 illustrates the costs that FHFA expended during FYs 2010 - 2011 to accomplish its three strategic goals. Figure 2 shows the number of full-time equivalent employees working on each goal. Resources associated with the Resource Management Strategy were allocated across the strategic goals proportionately.

Figure 1 • Actual Dollars FYs 2010 and 2011 (in Millions)

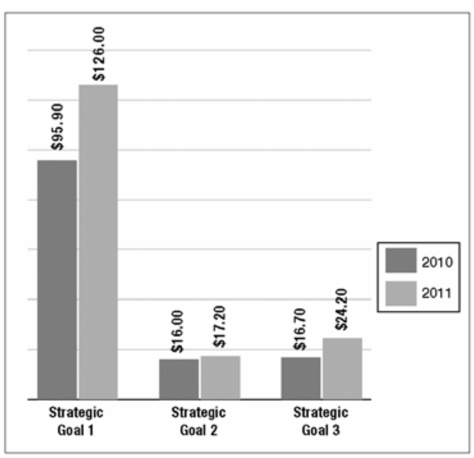
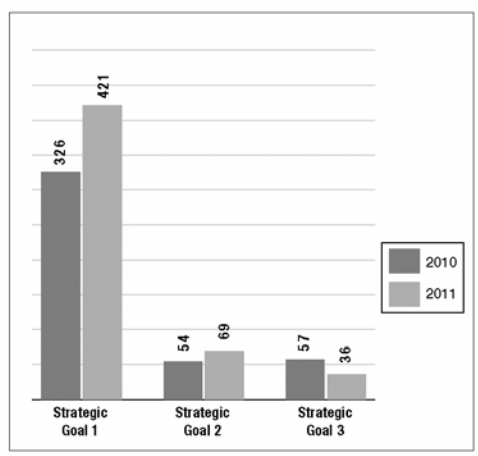


Figure 2 • Actual Full-Time Equivalent FYs 2010 and 2011



Note: Full-time equivalent is the total number of hours worked (or to be worked) divided by the number of compensable hours applicable to each fiscal year.

FHFA at a Glance

HISTORY

The Housing and Economic Recovery Act of 2008 (HERA) merged the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board, and certain staff from the Department of Housing and Urban Development (HUD) to create the Federal Housing Finance Agency (FHFA). FHFA is responsible for overseeing the financial safety and soundness and housing mission compliance of the housing government-sponsored enterprises (GSEs). The GSEs include Fannie Mae, Freddie Mac, the 12 FHLBanks and their joint Office of Finance.

FHFA participates in a number of interagency initiatives to improve the effectiveness of financial market oversight, including the Financial Stability Oversight Council (FSOC) and the Financial Stability Oversight Board. The FHFA Director is appointed by the President, subject to Senate approval. The Director represents the agency on the FSOC and chairs the Federal Housing Finance Oversight Board. Currently, FHFA is headed by Acting Director Edward J. DeMarco.

LEGISLATION

In accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 as amended by HERA, FHFA was appointed conservator of Fannie Mae and Freddie Mac (the Enterprises) on September 6, 2008. Legislation authorizing conservatorship of the Enterprises and FHFA's regulatory powers for the FHLBanks is described below.

Federal Home Loan Bank Act

In 1932, the conditions in the housing sector and the closely related savings and loan industry were dire. President Herbert Hoover responded with the first federal regulation of the housing and savings and loan industry—the Federal Home Loan Bank Act.

The FHLBank System was created by the Act to support mortgage lending and related community investment. The System is now composed of 12 FHLBanks, more than 8,000 member financial institutions, and the System's fiscal agent, the Office of Finance. Each FHLBank is a separate, government-chartered, member-owned corporation. The 12 FHLBanks are jointly and severable liable for system debt and obligations. The Act was amended by HERA, and the System is under the supervision of its mission and safety and soundness regulator, FHFA.

Safety and Soundness Act as amended by HERA

The Safety and Soundness Act, as amended by HERA, specifies two conservator powers, stating that the agency may "take such action as may be:

(i) Necessary to put the regulated entity in a sound and solvent condition; and

(ii) Appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."

As conservator, FHFA holds authority over the management, boards, and shareholders of the Enterprises. However, the Enterprises continue to operate as business corporations. For example, they have chief executive officers and boards of directors, and must follow the laws and regulations governing financial disclosure, including requirements of the Securities Exchange Commission. Like other corporate executives, the Enterprises' executive officers have legal responsibility to use sound and prudent business judgment in their stewardship of their companies.

While FHFA has very broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations. Instead, FHFA reconstituted the boards of directors and charged them with ensuring that normal corporate governance practices and procedures are in place. The boards are responsible for carrying out normal board functions, but they are subject to FHFA review and approval on critical matters. This division of responsibilities represents the most efficient structure for carrying out FHFA's responsibilities as conservator.

FHFA is working with management to determine the strategic direction for each of the Enterprises. To fulfill its obligations as conservator, the agency has final decision-making authority in areas that have significant effects on operational, market, or credit risk; major accounting determinations, including policy changes, significant mergers or acquisitions; and any other matters FHFA believes are strategic or crucial to the Enterprises.

Emergency Economic Stabilization Act of 2008

FHFA also operates under a statutory mandate in the Emergency Economic Stabilization Act of 2008. This legislation established the Troubled Asset Relief Program (TARP) to maximize assistance for homeowners and minimize foreclosures. That mandate specified loan modifications and tenant protections, and established a monthly reporting requirement for FHFA.

2011 PROFILE

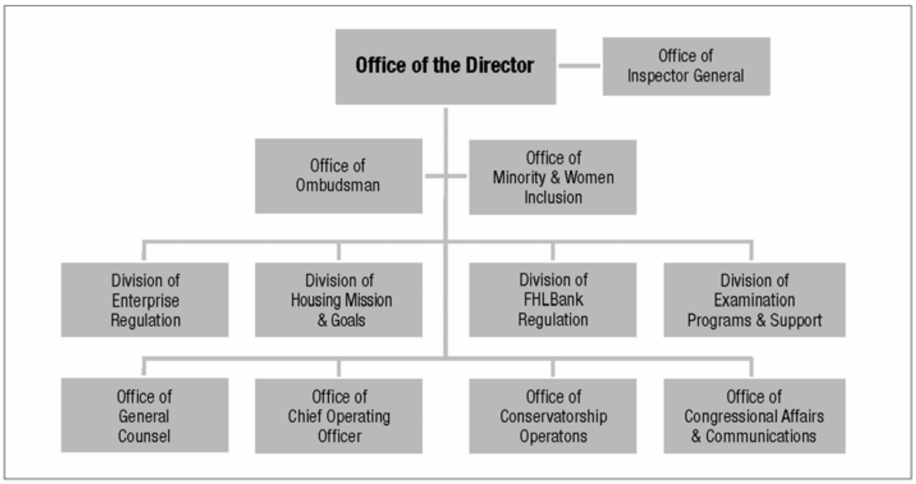
- During each calendar year (CY), FHFA completes reports of examination for Fannie Mae, Freddie Mac, each of the 12 FHLBanks, and the Office of Finance, and presents these reports of examination to the respective boards of directors. The scheduling of examination fieldwork and the reviews of the reports of examination may vary from year to year.
- FHFA restructured its examination and policy staff in FY 2011 to enhance consistency and collaboration in the examination and supervision of the FHLBanks and the Enterprises and to consolidate principal policy, research, and analysis functions into the Division of Housing Mission and Goals. Certain key positions were filled throughout FY 2011; the new structure should be fully operational for the next examination cycle.
- To consolidate its entire Washington, D.C.-based staff under one roof, FHFA has signed a lease for a new headquarters building. Currently, FHFA personnel are housed in three separate buildings. Build-out of the new office space began in FY 2011 and will be completed in FY 2012. FHFA plans to move to the new headquarters in January 2012.
- The Office of Congressional Affairs and Communications handled 229 congressional inquiries, 1,602 nonconsumer general public inquiries, and 1,200 consumer inquiries in FY 2011.
- FHFA had 453 employees in FY 2010 and 519 employees at the end of FY 2011. In FY 2012, the agency is budgeted to fill approximately 100 positions.
- The total budget for FY 2011 was $167.4 million in lieu of $169.4; the FY 2010 budget was $128.6 million.

FHFA Employees (By Specialized Areas)

	2011		2012
	Budgeted	Year End	Budgeted
Examinations	284	241	292
Other Mission	47	110	129
Office of the Director	23	23	30
Legal	38	39	42
Information Technology	50	47	55
Infrastructure*	106	59	72
TOTALS	**548**	**519**	**620**

** Includes 45 positions that were allocated after the planned reorganization of the mission areas.*

Figure 3 • FHFA Principal Organization Units



Organization

FHFA is an independent government agency with a workforce that includes highly skilled examiners, economists, financial and policy analysts, attorneys, and subject matter experts in banking, technology, accounting, and legal matters. In FY 2011, FHFA restructured its examination, examination policy, and housing and regulatory policy functions to enhance the efficiency and effectiveness of its supervision of the regulated entities and improve coordination and consistency in examination and policy functions throughout the agency (see Figure 3).

The organizational changes allow FHFA to carry out a financial institution supervision program that is more uniform and consistent across the 14 regulated entities. The changes include the establishment of a Division of Examination Programs and Support to provide services (including specialized risk assessments) to the core examination and supervision teams in the Division of Enterprise Regulation and the Division of Federal Home Loan Bank Regulation. The expanded Division of Housing Mission and Goals focuses on regulatory policy matters involving the supervision of the regulated entities, the Enterprise conservatorships, loss mitigation activities and foreclosure alternatives, public reporting on the activities of FHFA's regulated entities, affordable housing, the state of the secondary mortgage market, and activities required by statutory changes, including HERA and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

These changes allow FHFA to build on the strengths of examination programs for both the Enterprises and the FHLBanks by integrating examination resources and standards. The changes place the agency in a better position to monitor safety and soundness at each regulated entity and to provide critical support to FSOC, Congress, and the Administration on matters involving the country's housing finance system and possible changes to that system.

The **Office of Inspector General (OIG)** is responsible for conducting independent and objective audits, evaluations, and investigations to help FHFA fulfill its mission; keeping the FHFA Director, Congress, and the American public up-to-date and fully informed about problems and deficiencies relating to FHFA programs and operations; and working collaboratively with FHFA staff and program participants to ensure the success of the agency's program goals. OIG was established by HERA and commenced operation in October 2010.

The **Office of Ombudsman** is responsible for considering complaints and appeals from any regulated entity, the Office of Finance, or any person who has a business relationship with a regulated entity or the Office of Finance concerning any matter relating to FHFA's regulation and supervision of that entity or the Office of Finance. Neither FHFA nor any of its employees may retaliate against a regulated entity, the Office of Finance, or a person for submitting a complaint or appeal to the ombudsman. The office was created by regulation under HERA and commenced operation in March 2011.

The **Office of Minority and Women Inclusion (OMWI)** is responsible for all matters of diversity in employment, management, and business activities at FHFA. OMWI ensures that FHFA is in compliance with Equal Employment Opportunity and protects against illegal work place discrimination. OMWI ensures that minorities, women, service-disabled veterans, and persons with disabilities are fully included in any and all job and business opportunities created as a part of the federal government's efforts to reform and strengthen the banking system and the financial services industry.

The **Division of Enterprise Regulation** is responsible for supervising the Enterprises to promote their safe and sound operation. The division oversees and directs all Enterprise examination activities, develops examination findings, and prepares the sections of the *Annual Report to Congress* that describes the condition and performance of each Enterprise. By means of annual examinations and a continuous on-site presence, the division monitors and assesses the amount of risk the Enterprise assume, the quality of risk management, and compliance with regulations.

The **Division of Housing Mission and Goals** is responsible for FHFA policy development and analysis, oversight of housing and regulatory policy, and oversight of the mission and goals of the Enterprises, and the housing finance and community and economic development mission of the FHLBanks. In support of FHFA's mission and the Director's responsibilities as a member of the Federal Housing Finance Oversight Board, the Financial Stability Oversight Board, and FSOC, the division also oversees and coordinates FHFA activities that involve data analysis, market surveillance, systemic risk monitoring, and analysis affecting housing finance and financial markets.

The **Division of FHLBank Regulation** is responsible for supervising the FHLBanks and the Office of Finance to promote their safe and sound operation. The division oversees and directs all FHLBank examination activities, develops examination findings, prepares reports of examination, and prepares portions of the annual report to Congress on the condition and performance of the FHLBanks. The division monitors and assesses the financial condition and performance of the FHLBanks and the Office of Finance and tests their compliance with regulations and the quality of their risk management through annual on-site examinations, periodic visits, and ongoing off-site monitoring and analysis.

The **Division of Examination Programs and Support** is responsible for supporting FHFA examination activities across all its regulated entities and for developing and maintaining a consistent examination program that is applied by all supervision offices. The division develops examination policy and provides management oversight and support for the risk area exam teams (credit, market, operational risk, and risk modeling) and the Office of the Chief Accountant. The division also has lead responsibility for examiner training, including development of an examiner accreditation program for FHFA examiners.

The **Office of the General Counsel** advises and supports the Director and FHFA staff on legal matters related to the functions, activities, and operations of FHFA and the regulated entities; it supports supervision functions, regulations writing, and enforcement actions, when warranted. The office also manages the Freedom of Information and Privacy Act programs. The ethics official advises, counsels, and trains FHFA employees on ethical standards and conflicts of interest, and manages the agency's financial disclosure program.

The **Office of Chief Operating Officer** oversees the agency's day-to-day operations, including facilities management, contingency planning, continuity of operations, financial and strategic planning and budgeting, hiring and human resources management, information technology, quality assurance, internal and external communications, and coordination with the FHFA Office of Inspector General. This office is responsible for overseeing the agency's relocation to new office space in 2012. The office leads preparation of reports on strategic planning and accountability, and develops recommendations for long-term improvements in agency operations.

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

The **Office of Congressional Affairs and Communications** is the liaison and coordinator of all communications between Congress and FHFA, and is responsible for coordinating contact and communication with all external parties, including the public, media, trade associations and other regulators. The office coordinates legislative analysis within the agency, conducts outreach to congressional offices on legislative matters, and monitors legislative activity; it coordinates some FHFA activities with arms of Congress such as the Congressional Budget Office and the Government Accountability Office; and it coordinates the communications activities of Fannie Mae and Freddie Mac while they are under conservatorship. The office also coordinates with internal offices to draft, edit, and produce the *Annual Report to Congress* and other agency publications; produces the House Price Index (HPI) report in conjunction with the Office of Policy Analysis and Research and handles HPI-related media and public inquiries; and maintains FHFA's website and intranet.

The Housing Government-Sponsored Enterprises

FANNIE MAE AND FREDDIE MAC

In the primary mortgage market, financial institutions make mortgage loans directly to homebuyers. This process begins when a potential homeowner or borrower applies for a mortgage loan from a lender. Once the loan is originated, the lender either holds the loan in its own portfolio or sells it.

Mortgage-backed securities (MBS) are traded in the secondary mortgage market. Fannie Mae and Freddie Mac (the Enterprises) acquire mortgages and issue MBS in the secondary market (see Figure 4).

Since 2008, the Enterprises have operated under conservatorship. The FHFA Director is the conservator, aided by the FHFA Office of Conservatorship Operations. The Department of the Treasury support the Enterprises through preferred stock purchase agreements established when the Enterprises entered conservatorship; they are designed to ensure that each Enterprise maintains a positive net worth. The stock purchase agreements require a 10 percent reduction in the Enterprises' retained portfolios each year. At the inception of the conservatorships, FHFA made clear that the Enterprises would continue to be responsible for normal business activities and day-to-day operations. FHFA exercise oversight as safety and soundness regulator while serving a more active role as conservator.

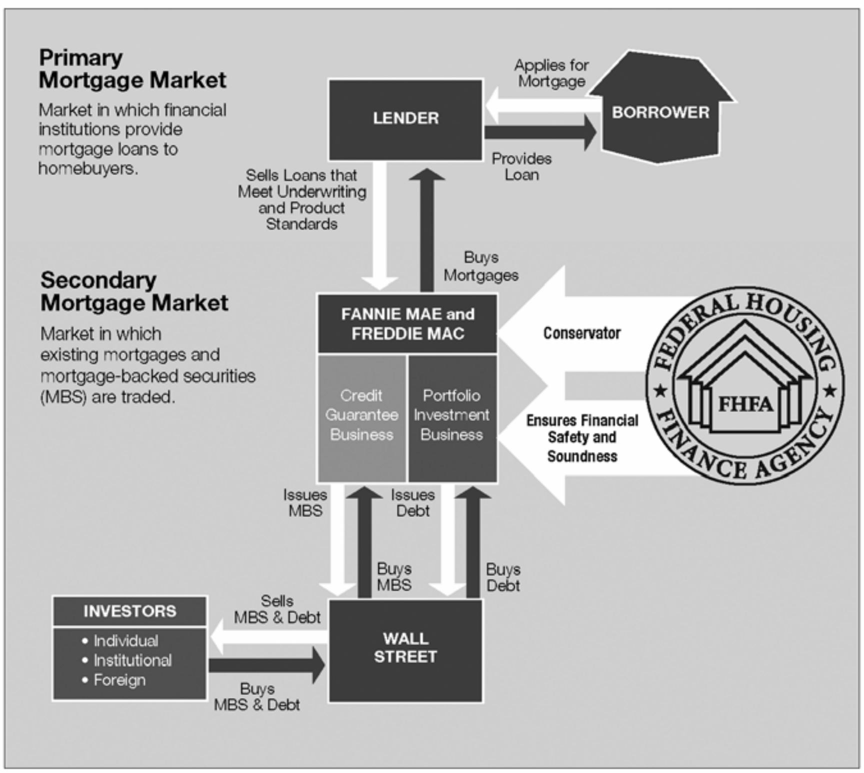
Although FHFA has very broad authority, the focus of the conservatorships is not to manage each aspect of the Enterprises' daily operations. Instead, FHFA reconstituted the boards of directors at each Enterprise and charged the boards with ensuring that normal corporate governance practices and procedures are in place. The boards are responsible for carrying out normal board functions, subject to FHFA review and approval on critical matters. To manage the work of overseeing the Enterprises' conservatorships and to assist the FHFA Director, FHFA created the Office of Conservatorship Operations in 2008.

FEDERAL HOME LOAN BANKS

The FHLBanks were created by Congress in 1932. The System includes 12 district banks, each serving a designated geographic area of the United States, and the Office of Finance, which issues consolidated obligations to fund the banks. The FHLBanks are member-owned cooperatives; they provide a reliable source of liquidity to member financial institutions that demonstrate a commitment to housing finance. FHLBanks make loans, known as advances, to member institutions and housing associates, such as state housing agencies. Those loans are underwritten on the basis of the borrower's ability to repay and are collateralized by whole mortgage loans, securities, and other real estate related collateral. Advances are the largest category of FHLBank assets. By providing advances and other credit-related products to their members, FHLBanks increase the availability of credit for residential mortgages.

The FHLBanks offer members certain other services as well, such as letters of credit, lines of credit, correspondent banking (which includes security safekeeping, wire transfers, and settlements), cash management, and derivative intermediation. Some FHLBanks have an acquired member assets program to purchase mortgages from their members. The volume of loan purchases is low relative to advances, and acquired member assets balances have generally declined over the past five to seven years. The FHLBanks also offer their members several housing and community investment programs, such as the Affordable Housing Program, under which a member receives a subsidy from an FHLBank that is used, typically in conjunction with an affordable housing sponsor, for the purchase, construction, or rehabilitation of housing for low- and moderate-income households. Support is provided under

Figure 4 • FHFA Oversight and Conservatorship Roles – Fannie Mae and Freddie Mac



the Affordable Housing Program for both multifamily rental properties and single-family home ownership projects.

The FHLBanks fund their operations mainly through the sale of debt instruments known as consolidated obligations; these are joint and several obligations sold to the public through the Office of Finance. Consolidated obligations are not obligations of the United States, and the U.S. government does not explicitly guarantee them.

As a condition of membership in an FHLBank or to obtain an advance, an institution purchases capital stock in that bank. Only member institutions can purchase the capital stock in an FHLBank, and, with the exception of certain housing associates, only member institutions can borrow from an FHLBank. Membership is limited to regulated depository institutions (banks, thrifts, and credit unions), insurance companies, and community development financial institutions engaged in residential housing finance (see Figure 5). Each FHLBank district comprises whole contiguous states, including the District of Columbia and U.S. territories; the districts range in size from two to nine states (see Figure 6).

Figure 5 • FHFA Oversight Role – FHLBanks

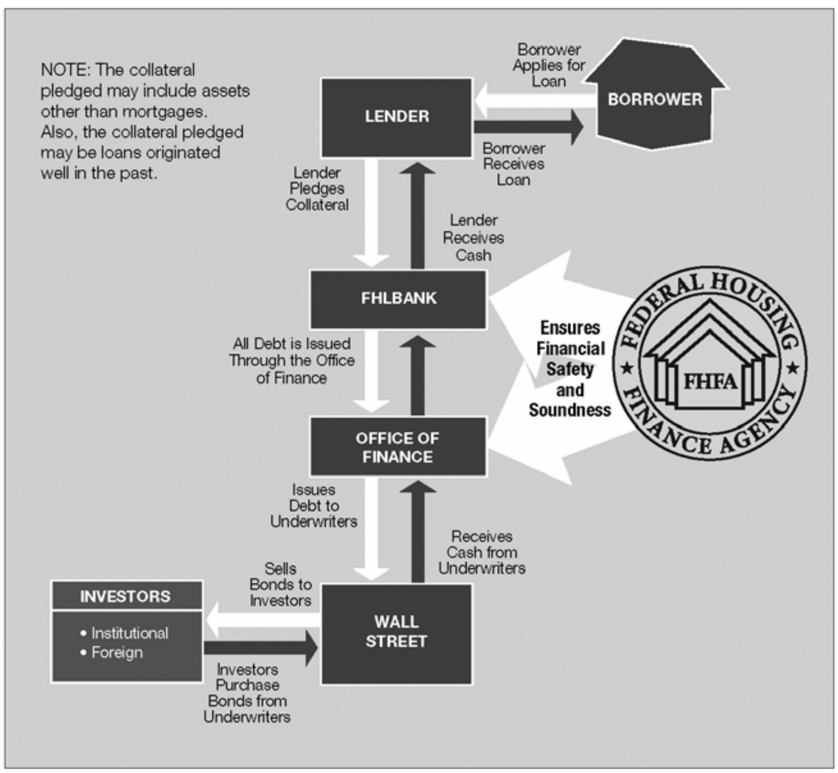
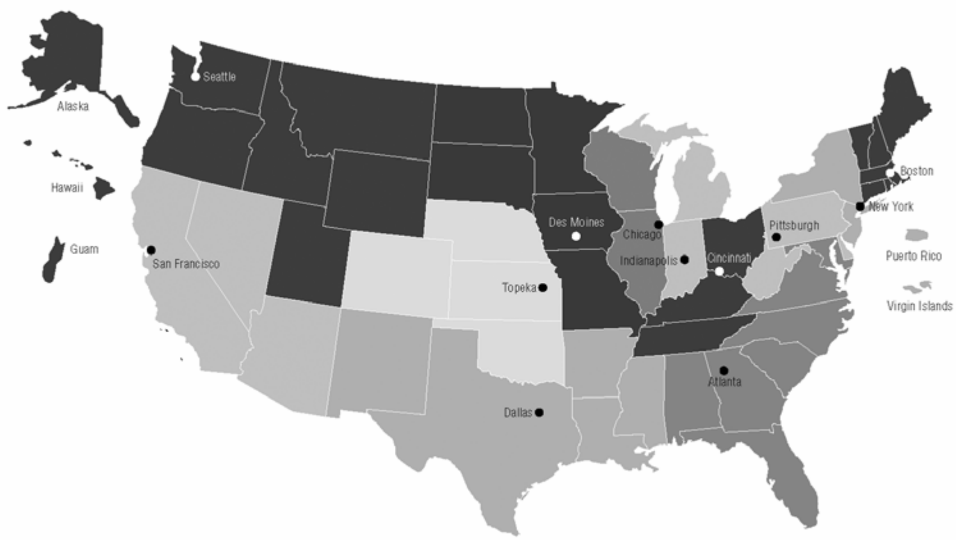


Figure 6 • Federal Home Loan Bank Districts



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

Performance Highlights by Strategic Goal

STRATEGIC GOAL 1

The housing government-sponsored enterprises (GSEs) operate in a safe and sound manner and comply with legal requirements

Safety and Soundness Examinations

On-site safety and soundness examinations are the primary tool used to assess the financial condition, performance and operations of the regulated entities. During FY 2011, FHFA completed safety and soundness examinations of each regulated entity and delivered a report of examination to each entity's board of directors. The report of examination contains the agency's examination findings, a composite rating for the regulated entity, and component ratings for principal areas of risk and risk management, and highlights issues that require the board's attention.

On-site examinations are supported by off-site monitoring and analysis conducted by FHFA financial analysts, economists, and accountants. These analyses complement the on-site examinations through simultaneous structured analyses across a group of entities, which help identify trends across multiple institutions or anomalies in the activities of one relative to the others. Off-site monitoring and analysis help set the scope of examinations and assessments of the entities' safety and soundness.

In FY 2011, FHFA began restructuring its examination divisions to unify and standardize its supervisory approach. The restructuring will result in a unified supervision program with guidelines, examination standards, and a common rating system; this will establish a common language to describe the risk and condition of the GSEs. FHFA also expanded its efforts to attract and hire additional supervision staff to increase examination resources.

Restructuring FHFA Safety and Soundness and Mission Offices

During FY 2011, FHFA announced a restructuring of the agency's safety and soundness and mission offices, including the establishment of an integrated supervision structure and a revamped housing mission and policy division.

Changes in the supervision program structure were designed to promote greater uniformity and consistency in the examinations of Fannie Mae, Freddie Mac, and the FHLBanks. The new housing mission team is focused on policy matters involving the Enterprise conservatorships, including loss mitigation activities, public reporting on the activities of FHFA's regulated entities, affordable housing, the state of the secondary mortgage market, and activities related to the Dodd-Frank Act.

With these changes, FHFA is building on the strengths of its examination programs by integrating resources and standards. The integration and realignment of FHFA's supervision and examination resources including core teams headed by examiners-in-charge for the two Enterprises, specialized risk teams for the Enterprises and the FHLBanks, and a dedicated housing mission and policy team will enhance FHFA's consistency in monitoring safety and soundness at each regulated entity and will enable the agency to deploy examiners to areas of greatest need. The changes will also provide critical policy, research, and analytical support to FSOC, the Federal Housing Finance Oversight Board, Congress, and the Administration on matters involving the country's housing finance system.

Acting Director Edward J. DeMarco addresses FHFA's full staff at an "all hands" meeting held in April.

The new structure is designed to improve the efficiency and effectiveness of operations agency-wide and to ensure a clear alignment of the agency's supervisory and housing mission and its policy responsibilities. HERA requires FHFA to have two statutorily designated supervision positions: the Deputy Director of the Division of Federal Home Loan Bank Regulation and the Deputy Director of the Division of Enterprise Regulation as well as a Deputy Director for Housing Mission and Goals. The restructuring adds another supervisory position: Deputy Director for Examination Programs and Support. The Supervision Committee (composed of the four deputy directors) will coordinate and monitor implementation of FHFA's annual examination programs and mission oversight.

FHFA has also enhanced its quality assurance programs for examination and supervision of the Enterprises and FHLBanks. The restructuring created an integrated Office of Quality Assurance that reports directly to the chief operating officer. This office will provide independent, internal review of the supervision offices' activities to ensure compliance with FHFA's examination standards and work plans.

Creation of the Office of Ombudsman

FHFA's Office of Ombudsman, created by regulation pursuant to requirements in HERA, commenced operation in March 2011. The office ensures that complaints and appeals are considered in a fair and timely manner; conducts independent inquiries and acts as a neutral facilitator or mediator to help resolve complaints and appeals; and submits findings of fact and recommendations to the FHFA Director on complaints and appeals that have not been resolved through facilitation or mediation.

During FY 2011, the Office of Ombudsman received 132 complaints, of which 106 were individual consumer complaints referred to the Office of Congressional Affairs and Communications. Five alleged fraud were referred to the Inspector General. Eleven were against institutions not regulated by FHFA; they were referred to the appropriate federal regulators of those institutions, such as the U.S. Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC). Of the 10 remaining complaints, 6 are under review by the ombudsman and 4 have been closed out.

Resolution Funding Corporation Obligations Completed

In August 2011, FHFA certified that the FHLBanks had satisfied their obligation to make payments related to the Resolution Funding Corporation (REFCORP). The FHLBanks were paying 20 percent of their net earnings to REFCORP for bonds issued from 1989 to 1991 to help pay for the costs associated with an earlier resolution of failures of savings and loan institutions.

RESTRICTED RETAINED EARNINGS ACCOUNT

The July 2011 payment to REFCORP successfully completed the FHLBanks' statutorily required payments ahead of the original schedule. The completion of these payments prompted the FHLBanks to amend their capital structure plans pursuant to a joint capital enhancement agreement announced at the end of February. The purpose of this agreement is to strengthen the capital position of the FHLBanks by reallocating income to build restricted retained earnings at each FHLBank.

Under the agreement, each FHLBank will allocate 20 percent of its net quarterly income (approximately equal to the previous REFCORP obligation) to a separate restricted retained earnings account. Each FHLBank will build a separate restricted retained earnings account in this fashion until that account equals 1 percent of the outstanding consolidated obligations for which it is the primary obligor. The banks may not pay dividends out of these special accounts until the accounts reach a specified level.

FHFA approved each of the FHLBanks' modified capital plans, allowing them to implement the provisions of the agreement. These capital plans should enhance the banks' capital by building retained earnings which will, in turn, enhance the safety and soundness of the individual banks and of the FHLBank system.

Supervisory Enforcement Actions

During FY 2011, two FHLBanks were subject to formal enforcement actions. The Chicago FHLBank addressed certain requirements in a cease and desist order previously imposed by FHFA. The FHLBank of Seattle agreed to a new consent order. FHFA's actions with regard to these orders are described below.

FHLBANK OF CHICAGO C&D ORDER

On September 23, 2010, the Chicago FHLBank submitted a proposed market risk management and hedging framework, the *Income and Market Value Risk Framework: Income Guidelines and Market Value Limits and Guidelines*. FHFA did not object to the bank's implementing this proposed framework. FHFA's non-objection satisfied Article III – the final article that required affirmative action by the bank – of the October 10, 2007, consent order.

The Chicago FHLBank must satisfy the remaining outstanding operating articles until FHFA terminates the order. These include complying with Article II, which prohibits the bank from repurchasing or redeeming capital stock and Article V, which prohibits the bank from declaring or paying dividends without prior written approval. On September 30, 2011, FHFA terminated Article I of the order, which had required the bank to maintain (1) a capital-to-asset ratio of 4.5 percent, and (2) capital stock plus subordinated debt of at least $3.6 billion, effective as of the date the bank implements its capital structure plan on January 1, 2012. The bank previously satisfied Article III, as noted above, and Article IV by submitting a capital structure plan within 120 days of the effective date of the order.

Acting Deputy Director Steve Cross talks to members of FHLBank advisory councils from around the country who attended an FHFA outreach conference in December 2010.

FHLBANK OF SEATTLE CONSENT ORDER

The Seattle FHLBank has been classified as undercapitalized since March 31, 2009, based on FHFA rules subpart A of part 1229 Capital Classifications and Prompt Corrective Action and under authority of section 1364(c)(1)(A) of the Safety and Soundness Act of 1992. The Seattle FHLBank board of directors stipulated to and FHFA issued a consent order on October 25, 2010, to resolve outstanding capital and supervisory issues. The order prohibits the bank from paying dividends and repurchasing or redeeming capital stock without prior FHFA approval. It requires the bank to develop plans to mitigate risk posed by its devalued private-label MBS portfolio; increase advances as a percentage of bank assets; improve collateral risk management; equitably repurchase capital stock; revise its compensation practices; and remediate examination findings.

The consent order also prohibits the Seattle FHLBank from purchasing loans under its acquired member asset program and requires the bank to meet time-tables and requirements mandated by FHFA. The consent order requires the bank to meet timetables and requirements mandated by FHFA. The consent order and associated supervisory mandates constitute the bank's capital restoration plan and fulfill FHFA's April 19, 2010, requirement (imposed pursuant to the prompt corrective action rule) that the bank develop a plan acceptable to FHFA. The requirement called for a business plan with steps the bank would take to resume timely repurchases and redemptions of member capital stock and to refocus its business on advances that support housing finance and community development. FHFA staff closely monitors and evaluates the Seattle FHLBank's progress under the plan.

Credit Characteristics of the Enterprises' New Single-Family Business

The credit quality of new single-family business remained high during FY 2011, after changes in underwriting required by FHFA as conservator. Enterprise purchases of non-traditional and higher risk mortgages were very low during the period, and the average Fair Isaac Corporation (FICO) credit score remained high compared with the preconservatorship period. For example, average FICOs for new business in the first half of CY 2011 were 760 at Fannie Mae and 753 at Freddie Mac; this compares favorably with average scores in CY 2007 of 716 and 718 respectively.

The percentage of new business with loan-to-value ratios greater than 90 percent increased to 9 percent in the first half of CY 2011, from 7 percent in CY 2010. Much of this increase can be attributed to refinance activity, including refinancing of loans with loan-to-value ratios above 100 percent as part of the Home Affordable Refinance Program (HARP).

For details on the credit characteristics of the Enterprises' new single-family business, see FHFA's *Conservator's Report on the Enterprises' Financial Performance*.

Refinement to Executive Incentive-based Compensation

During FY 2011, FHFA reviewed and provided feedback to the 12 FHLBanks on their 2011 incentive compensation plans and payouts on the 2010 plans. Consistent with Advisory Bulletin 2009-AB-02, Principles for Executive Compensation at the Federal Home Loan Banks and the Office of Finance, and FHFA feedback on earlier ICPs, many FHLBanks have made significant improvements to their incentive compensation plans. These include the following:

- Increased percentage of incentive-based compensation that is deferred and contingent on performance over several years.
- Eliminated performance measures tied directly to dividend payment.
- Reduced weight and refined performance measures related to income and profitability.
- Increased weight on performance measures related to risk management and mitigation.
- Increased use of outcome-oriented performance measures.
- Increased use of target performance levels that reflect a reasonable assessment of the entity's financial condition and prospects.
- Design and implementation of separate incentive compensation structure for staff engaged in risk management and compliance and audit functions.
- Explicitly stated requirements for "clawback" or reduction in incentive compensation.

HERA requires FHFA to ensure that compensation at the regulated entities is reasonable and comparable to compensation for employment in similar businesses involving similar duties and responsibilities. In response to FHFA feedback in 2011, the boards of directors at two FHLBanks lowered incentive-based payouts for their executives. FHFA feedback also resulted in the board of directors at another FHLBank lowering potential incentive awards for their executives.

STRATEGIC GOAL 2

The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing

Loss Mitigation Efforts

Reducing the Enterprises' losses through foreclosure prevention activities has been an important priority for FHFA. Foreclosure prevention activities include home retention programs and foreclosure alternatives that allow borrowers a graceful exit when they cannot or do not want to remain in the home. Foreclosure prevention activities are intended to reduce the Enterprises' losses resulting from borrower defaults and minimize the effect of foreclosures on borrowers, communities, and neighborhoods. Since the first full quarter in conservatorship, the combined completed foreclosure prevention actions totaled nearly 1.9 million for the Enterprises as of August 2011.

Home retention programs aimed at helping borrowers stay in their homes include workout activities such as loan modifications, repayment plans, and forbearance plans. During FY 2011, the majority of foreclosure prevention activities focused on home retention solutions. As of August 2011, loan modifications total 345,888; repayment plans, 171,898; and forbearance plans, 35,475.

Foreclosure prevention activities offer alternatives such as short sales and deeds in lieu of foreclosure. A short sale involves the sale of a mortgaged property at a price that nets less than the amount due on the mortgage. A deed in lieu of foreclosure involves a loan for which the borrower voluntarily conveys the property to the lender to avoid a foreclosure proceeding. During FY 2011, the number of short sales was 99,344, and deeds in lieu of foreclosure were 8,038 as of August 2011.

FHFA has required the Enterprises to pursue the Home Affordable Modification Program (HAMP), designed to help homeowners avoid foreclosures by modifying loans to a level that is affordable now and sustainable over the long term. If HAMP modifications are not available, proprietary loan modifications that reduce interest rates, extend mortgage terms, and provide for principal forbearance to help borrowers who are having difficulty affording mortgage payments, can be an option.

HARP is another home retention program. HARP focuses on mortgages that Fannie Mae and Freddie Mac already hold in their portfolios or guarantee through their MBS; it provides unique flexibilities around the level of credit enhancement required on loans with loan-to-values greater than 80 percent. Borrowers who are current on their mortgages can refinance into a lower mortgage payment or a more sustainable mortgage without requiring additional credit enhancement (generally private mortgage insurance) to refinance. Without these credit enhancement flexibilities, borrowers whose home equity has declined and who have current loan-to-value in excess of 80 percent would be unable to refinance. In March 2011, FHFA extended HARP from June 2011 to June 2012.

FHFA is carefully reviewing the mechanics of the program to identify possible enhancements that would reduce barriers for borrowers already eligible to refinance using HARP. Loan- level price adjustments, representations and warranties, and valuation requirements are being considered.

Since HARP's inception, the Enterprises had completed approximately 1.6 million streamlined refinances outside of HARP and 6 million standard "rate and term" refinances as of August 2011. These efforts represent loss mitigation efforts consistent with the goals of the conservatorships and with helping families retain their homes. As of August 2011, the number of HARP refinances since inception was 893,755.

FHFA Contributions to Dodd-Frank Act Implementation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010requires changes that, among other things, affect the oversight and supervision of financial institutions. The Act does not directly address broader issues associated with housing finance reform, such as the future role of Fannie Mae and Freddie Mac. However, key provisions affect Fannie Mae, Freddie Mac, the FHLBanks and FHFA's oversight functions; and the structure and workings of mortgage finance and securitization. Others add to the agency's responsibilities in other areas.

One set of activities associated with implementing the Dodd-Frank Act involves the Financial Stability Oversight Council. The Act created FSOC to provide coordinated oversight of the U.S. financial system. The council is chaired by the Secretary of the Treasury and includes the nation's top financial regulators including the FHFA Director. As a voting member of this key interagency regulatory and coordinating body, the FHFA Director ensures the agency's important role in discussions involving the workings of, and risk to, the U.S. financial system. FSOC is organized under a committee structure and FHFA participates on all the committees.

Financial Stability Oversight Council

The Financial Stability Oversight Council (FSOC) is chaired by the Secretary of the Treasury, and includes 10 voting members at the forefront of financial regulation. Voting members include leaders from the following organizations:

- U.S. Department of Treasury,
- Federal Housing Finance Agency,
- Federal Reserve Board,
- Office of the Comptroller of the Currency,
- Federal Deposit Insurance Corporation,
- National Credit Union Association,
- Securities and Exchange Commission,
- U.S. Commodity Futures Trading Commission,
- Consumer Financial Protection Bureau,
- An independent, presidentially appointed member with expertise in insurance.

The FSOC also includes five non-voting members: the Director of the Office of Financial Research, Director of the Federal Insurance Office, a state banking supervisor, a state securities commissioner, and a state insurance commissioner.

In FY 2011, FHFA created the Office of Systemic Risk and Market Surveillance to help the FHFA Director carry out ongoing FSOC responsibilities. FHFA's support to FSOC during FY 2011 included the following:

- Assisting with the completion of FSOC's first annual report;
- Analyzing emerging threats to financial institutions and markets;
- Issuing proposed rules and further consideration of the process for designating systemically important nonbank financial companies;
- Issuing final rules on designating systemically important financial market utilities;
- Consulting on forthcoming heightened prudential standards;
- Consulting on FDIC and Federal Reserve Board orderly liquidation rules; and
- Participating in the completion of FSOC studies on the Volcker Rule, concentration limits, and secured creditor haircuts.[1]

The Dodd-Frank Act required a number of agencies, including FHFA, to establish an Office of Minority and Women Inclusion (OMWI) that, is responsible for all agency matters related to diversity in management, employment and business activities, including contracting. FHFA established its OMWI in February 2011. The implementation of the Dodd-Frank Act has brought about many challenges for FHFA over the past year. However, it has also provided FHFA with a direct opportunity to participate in many important policy issues that will shape the future of financial regulation and has further

[1] In financial terms, a haircut is a discount of a percentage of the par value of a financial asset used as collateral or a discount on the value that the creditor would receive on resolution of the institution.

integrated the work of FHFA with that of the other federal financial regulators.

Joint Studies and Relationships

FHFA has participated in the many joint studies, joint rulemakings, and consultations required by the Dodd-Frank Act, including several that resulted from FHFA's role as a voting member of FSOC. In addition, FHFA has participated in joint studies focused on housing finance reform and efforts to resolve continuing market distress generated by the financial crisis. During FY 2011, FHFA participated in major studies mandated by the Dodd-Frank Act and coordinated and published by FSOC. As a voting member of FSOC, FHFA provided staff to participate in drafting and evaluating each of these studies. In addition, FHFA participated in the preparation of FSOC's 2011 annual report.

Section 619 of the Dodd-Frank Act mandated a study on the 'Volcker Rule,' which restricts the activities of federally insured financial firms with respect to proprietary trading and ownership of hedge funds or private equity funds. Those prohibitions are intended to reduce conflicts of interest, exposure to high-risk assets or high-risk trading strategies, and threats to the safety and soundness of individual banking entities or the financial stability of the United States. The study includes 10 recommendations to the banking agencies for full implementation of the Volcker Rule.

Section 622 of the Dodd-Frank Act establishes a concentration limit that generally prohibits a financial company from merging or consolidating with or acquiring another company if the resulting company's consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies at the end of the calendar year preceding the transaction. The study highlights FSOC's consensus that the concentration limit will reduce the risk to U.S. financial stability created by increased concentration arising from mergers, consolidations, and acquisitions involving the largest U.S. financial companies. Like the Volcker Rule study, the concentration limit study includes recommendations for its effective implementation. Section 215 of the Dodd-Frank Act required FSOC to determine whether allowing regulators in a resolution proceeding to treat a portion of fully secured creditors' claims as unsecured ("secured creditor haircuts") would promote market discipline and taxpayer protection. The report evaluated arguments for and against such haircuts and concluded that the combination of the orderly liquidation authority in Title II and the new supervisory framework in Title I of the Dodd-Frank Act can effectively be used to achieve the goals of market discipline and taxpayer protection without instituting secured creditor haircuts.

FHFA also helped produce FSOC's first annual report, which was released in July 2011. The report cites real estate related exposures among the significant risks for many financial institutions and recommends continued efforts to strengthen and encourage the return of private capital to the housing finance system.

FHFA worked with HUD, the Department of the Treasury, the National Credit Union Administration, FDIC, and Fannie Mae, and Freddie Mac to publish a study of the standardized net present value model central to HAMP. That model was developed to identify troubled loans that would likely gain value from payment-reducing modifications. The study discusses the development and structure of the model; describes the responsiveness of the model to key characteristics, such as loan-to-value ratio and the borrower's credit score; and gives new evidence on the relationship between HAMP modification performance and key borrower and modification characteristics. The study concludes with a discussion of model limitations and suggestions for further refinement of the model.

Joint Rulemakings Associated with the Dodd-Frank Act

FHFA participated in three joint rulemakings required by the Dodd-Frank Act, each of which resulted in a Notice of Proposed Rulemaking published in the *Federal Register*. These proposed rules are intended to address sources of risk that contributed to the recent financial crisis.

The agency proposed a credit risk retention rule jointly with HUD, FDIC, the Federal Reserve System, and OCC.

FHFA Regulations Published in FY 2011	
PROPOSED	**Proposed Voluntary FHLBank Mergers** *75 FR 72751 (Nov. 26, 2010) 12 CFR Part 1278, Subchapter D*
	Private Transfer Fees *76 FR 6702 (Feb. 8, 2011) 12 CFR Part 1228*
	Incentive-Based Compensation Arrangements (joint Dodd-Frank Act rulemaking) *76 FR 21170 (Apr. 14, 2011) 12 CFR Part 1232*
	Credit Risk Retention for Asset-Backed Securities (joint Dodd-Frank Act rulemaking) *76 FR 24090 (Apr. 29, 2011) 76 FR 34010 (Jun. 10, 2011) 12 CFR Part 1234*
	Margin and Capital Requirements for Covered Swap Entities (joint Dodd-Frank Act rulemaking) *76 FR 27564 (May 11, 2011) 76 FR 37029 (Jun. 24, 2011) 12 CFR Part 1221*
	Prudential Management and Operations Standards *76 FR 35791 (Jun. 20, 2011) 12 CFR Part 1236*
ADVANCE NOTICES OF PROPOSED RULEMAKING	**Advance Notices of Proposed Rulemaking Members of Federal Home Loan Banks** *75 FR 81145 (Dec. 27,2010) 12 CFR Part 1263*
	Alternatives to Use of Credit Ratings in Regulations *76 FR 5292 (Jan. 31, 2011) 12 CFR Parts 1220, 1266, 1267, 1269, 1270, 1273*
FINAL	**Use of Community Development Loans by Community Financial Institutions To Secure Advances; Secured Lending by Federal Home Loan Banks to Members and Their Affiliates; Transfer of Advances and New Business Activity Regulations** *75 FR 76617 (Dec. 9, 2010) 12 CFR Parts 1264, 1266, 1269, and 1272*
	Federal Home Loan Bank Housing Goals *75 FR 81096 (Dec. 27, 2010) 12 CFR Part 1281*
	Minority and Women Inclusion *75 FR 81395 (Dec. 28, 2010) 12 CFR Part 1207*
	Portfolio Holdings *75 FR 81405 (Dec. 28, 2010) 12 CFR Part 1252*
	Office of the Ombudsman *76 FR 7479 (Feb. 10, 2011) 12 CFR Part 1213*
	Minimum Capital *76 FR 11668 (Mar. 3, 2011) 12 CFR Part 1225*
	Debt Collection *76 FR 17331 (Mar. 29, 2011) 12 CFR Part 1208*
	Federal Home Loan Bank Liabilities *76 FR 18366 (Apr. 4, 2011) 12 CFR Part 1270*
	Federal Home Loan Bank Investments *76 FR 29147 (May 20, 2011) 12 CFR Part 1267*
	Record Retention for Regulated Entities and Office of Finance *76 FR 33121 (Jun. 8, 2011) 12 CFR Part 1235*
	Conservatorship and Receivership *76 FR 35724 (Jun. 20, 2011) 12 CFR Parts 1229 and 1237*
	Freedom of Information Act Implementation (Interim final) *76 FR 29633 (May 23, 2011) 12 CFR Part 1202*
	Privacy Act Implementation (Interim final) *74 FR 33907 (Jul. 14, 2011) 12 CFR Part 1209*
	Rules of Practice and Procedures *76 FR 53596 (Aug. 26, 2011) 12 CFR Part 1209*

Among other things, the proposed rule defines a "qualified residential mortgage." Qualified residential mortgages are exempt by law from an otherwise mandatory requirement that sponsors of MBS retain at least 5 percent of the credit risk associated with any securitization pool.

The second proposed rule would establish margin and capital requirements for swap dealers and major swap participants regulated by a prudential regulator,[2] defined as the Federal Reserve System, OCC, FDIC, FHFA, and the Farm Credit Administration.

The third proposed rule would require the reporting of incentive-based compensation arrangements by a covered financial institution and would prohibit certain arrangements. A covered financial institution would be barred from providing excessive incentive-based compensation or incentive-based compensation that could expose the institution to inappropriate risks and to material financial loss. FHFA proposed the rule jointly with OCC, FDIC, the Federal Reserve System, the Office of Thrift Supervision, the National Credit Union Administration, and the Securities and Exchange Commission.

The Dodd-Frank Act also calls for extensive consultations among regulatory agencies, either directly or through FSOC. FHFA has participated in numerous consultations about proposed rules to implement various sections of the Act. FHFA continues to consult with HUD and Treasury on such issues as the future of the U.S. housing finance system, conforming loan limits, and protecting taxpayers.

[2] Section 721 of the Dodd Frank Act provides a long, complex definition of the term "swap" and section 712 charges the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission with further refining that term and related terms.

STRATEGIC GOAL 3

FHFA preserves and conserves the assets and property of the Enterprises, ensuring focus on their housing mission, and facilities their financial stability and emergence from conservatorship.

Enhancing Public Understanding of Financial Performance

In October 2010, FHFA released projections of the financial performance of Fannie Mae and Freddie Mac. The purpose of this report was to alert the public to possible future Treasury draws by the Enterprises under specified scenarios, using consistent assumptions for both Enterprises. The projected credit losses in each scenario reflect possible further losses on the Enterprises' pre-conservatorship mortgage business.

These projections are intended to give policymakers and the public useful snapshots of potential outcomes for the taxpayer support of the Enterprises. The results of these projections reflect the potential effects of a limited set of hypothetical changes in house prices, a key variable driving credit losses for the Enterprises. As of June 2011, the Enterprises have drawn $169 billion from the U.S. Department of the Treasury under the terms of the preferred stock purchase agreements, as amended, between Treasury and each of the Enterprises. Since releasing the projections, FHFA has reported actual performance against the projections in its quarterly conservatorship reports. FHFA updated the projections themselves in a report released in October 2011.

Joint Servicing Compensation Initiative

FHFA announced a joint servicing compensation Initiative in January 2011. FHFA directed Fannie Mae and Freddie Mac, in coordination with FHFA and HUD, to consider alternatives for future mortgage servicing compensation for their single-family mortgage loans. The goals of the joint initiative are to improve service for borrowers, reduce financial risk to servicers, and provide flexibility for guarantors to better manage nonperforming loans, while promoting continued liquidity in the mortgage securities market. Part of the goal of this initiative is to consider changes to the compensation structure that would improve competition and liquidity in the market for mortgage servicing. On September 27, 2011, FHFA released the Alternative Mortgage Servicing Compensation Discussion Paper. The agency is seeking public comment on two alternative mortgage servicing compensation structures detailed in the paper.

Servicing Alignment Initiative

FHFA announced a servicing alignment initiative in April 2011. This initiative is designed to produce a single, consistent set of protocols for servicing Enterprise mortgages from the moment they first become delinquent. The initiative responds to recent problems with the servicing of delinquent mortgages and simplifies the procedures for mortgage servicers by giving them just one set of procedures to follow, whether the mortgage is owned by Fannie Mae or Freddie Mac.

Portfolio Reductions—Preferred Stock Purchase Agreements

In 2008, when FHFA placed Fannie Mae and Freddie Mac in conservatorship, the agency entered into separate senior preferred stock purchase agreements with the Department of the Treasury. Under the agreements, the Treasury agreed to acquire preferred stock from each Enterprise in amounts that will ensure each Enterprise maintains a positive net worth and avoids a statutory requirement that it be put in receivership following an extended period of negative net worth. One of the conditions attached to Treasury's funding commitment under the preferred stock agreement was that each Enterprise reduces its holdings of mortgage assets, starting in 2010, by 10 percent each year until those holdings reach a balance of $250 billion.

The preferred stock agreement originally limited Treasury's financial commitment to the Enterprises to $100 billion each. In May 2009, Treasury amended the agreement to increase the amount of its financial commitment to each Enterprise to $200 billion. Later that year, the Treasury reaffirmed its financial commitment to the Enterprises by agreeing to provide for each Enterprise, as of any determination date, the greater of:

- $200 billion; or
- $200 billion plus the cumulative total of deficiency amounts determined for calendar quarters in calendar years 2010, 2011, and 2012, less any surplus amount determined as of December 31, 2012, and, in the case of either (a) or (b), less the aggregate amount of funding under the commitment before this date.

The preferred stock agreement initially limited the size of each Enterprise's mortgage asset portfolio to a maximum balance of $850 billion at year end 2009. A later amendment increased the amount to $900 billion for that year and changed the portfolio reduction requirement so that the 10 percent reduction is based on the maximum allowable size of the portfolios rather than the actual size of an Enterprise's portfolio.

HERA required FHFA to establish criteria, by regulation, governing the portfolio holdings of the Enterprises. The regulation aims to ensure consistent safe and sound operations of the Enterprises and to ensure that the portfolio holdings are backed by sufficient capital. FHFA's final regulation, issued December 28, 2010, adopted the portfolio holdings criteria established by the preferred stock purchase agreements, which may be amended from time to time, as the standard that governs the Enterprises' holdings of mortgage assets.

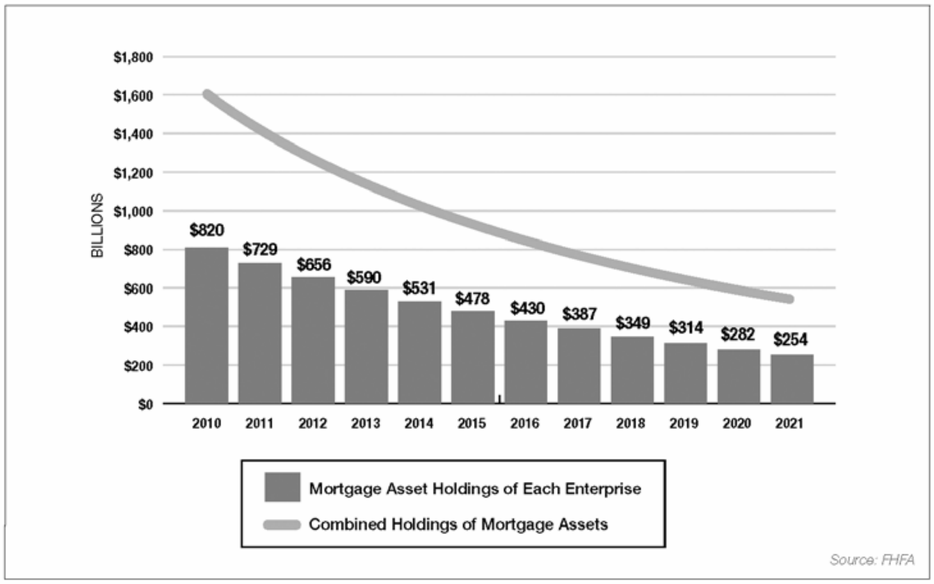
The maximum allowable amount of mortgage assets each Enterprise could own as of December 31, 2010, was $810 billion. Despite large purchases of delinquent loans from their respective MBS trusts in 2010, the portfolio balances of both Enterprises were below the maximum level. At year end 2010, Fannie Mae had mortgage assets of $789 billion and Freddie Mac had $697 billion. As of September 2011, Fannie Mae's mortgage assets totaled $720 billion and Freddie Mac's totaled $685 billion. The portfolio limit for each Enterprise as of the end of CY for 2011 was $729 billion (see Figure 7).

The final regulatory criteria incorporate preferred stock agreement portfolio limits agreed to by the U.S. Department of the Treasury and FHFA as conservator. The Safety and Soundness Act requires the FHFA Director to monitor the portfolio of each Enterprise and order an Enterprise to dispose of or acquire any asset under terms and conditions determined by the Director to be consistent with the Safety and Soundness Act or the authorizing statute of the Enterprise. FHFA's portfolio holdings regulation will remain in effect until it is amended or until the Enterprises are no longer subject to the preferred stock purchase agreements. Changes to the portfolio limits or to criteria related to the limits can be made by amending the agreements.

Request for Information on Real Estate Owned Properties

In August 2011, FHFA, Treasury, and HUD issued a request for information on ways to dispose of real estate owned properties. While the Enterprises have considered various approaches to disposing of these properties, the request for information represents an opportunity to consider new approaches, including those that include both the Enterprises and FHA. By taking this collaborative approach, the three agencies are seeking ways to improve returns to taxpayers and bring greater stability to local housing markets. FHFA is currently reviewing the nearly 4,000 submissions in response to the RFI to determine how they meet the needs and economic conditions of local communities. FHFA is encouraged by the apparent collaboration among for-profit and not-for-profit organizations in submitting proposals. FHFA expects the public responses to help form the basis for strategies that would be implemented in FY 2012.

Figure 7 • Maximum Allowable Enterprise Mortgage Asset Holdings (Year-End 2010-2021)



Management Challenges

FHFA and the Enterprises are facing challenging times as the housing market continues to struggle. FHFA will continue to work with the Enterprises to support a stable and liquid housing finance market. Implementation of the Dodd-Frank Act presented both challenges and opportunities for FHFA during FY 2011. The agency had to reallocate staff and consider various structural issues to meet its responsibilities. The Dodd-Frank Act gave FHFA the opportunity to participate directly in many important policy issues that will shape the future of financial regulation, and it has more closely integrated the work of FHFA with other federal financial regulators.

The following challenges that FHFA faced in 2011 included:

Enhancing Examinations

RESTRUCTURING

Since FHFA's establishment in 2008, its examination divisions had operated under policies and practices in place in predecessor agencies. During FY 2011, FHFA restructured its examination divisions to unify and standardize its supervisory approach for the regulated entities, while meeting the statutory requirements for separate divisions of Enterprise regulation and FHLBank regulation. The restructuring has allowed the agency to respond to the unique characteristics of the FHLBanks and to develop a unified supervision program, supervision guidelines, examination standards, and a common rating system.

Standardization allows FHFA to establish consistent standards for assessing the risk and financial performance of the Enterprises and the FHLBanks and allows for a degree of integration among staff responsible for examining the Enterprises and those responsible for examining the FHLBanks. The restructuring will help FHFA meet its core supervisory responsibilities in a consistent and efficient fashion while supporting cross-training of staff and increased flexibility to deploy resources in areas of greatest need.

INCREASED CAPACITY

FHFA's examination program is the primary means by which the agency monitors the GSE's financial condition and operations. Currently, the program faces many challenges, particularly with respect to its capacity to meet multiple responsibilities as the regulator of the GSEs, conservator of the Enterprises, and a participant in efforts to respond to the housing crisis and prepare for the future of housing finance.

To enhance its capacity in this area, FHFA has undertaken numerous initiatives, including restructuring its examination program and using personnel with diverse skills and backgrounds to work collaboratively on examinations and to bring new insights, different thought processes, and a wider range of analytical approaches to examination and supervision. FHFA has attracted and recruited examiners, accountants, financial analysts, and economists to overcome any examination capacity constraints and augmented its capacity by using expert contractor support on two horizontal exams (the Real Estate Owned Contractor Risk Assessment and the Home Affordable Modification Program Operational Risk Assessment). The agency is also expanding the use of out-stationed examiners and telework to fill critical positions with as much hiring flexibility as possible. FHFA has advertised in financial periodicals, posted hiring information on websites, and conducted outreach with organizations representing minorities, women, and veterans.

FHFA has also begun enhancements to staff training and development, including development of an examiner accreditation program. The agency's accreditation program will leverage other federal financial regulatory agency programs, which consist of classroom training, on-the-job training, and practical examination experience.

Fulfilling FHFA's Role as Conservator

As conservator of the Enterprises, FHFA holds the powers of the management, boards, and shareholders, while each Enterprise handles its own day-to-day business. FHFA reconstituted the boards of directors at each Enterprise in 2008 and charged them with ensuring that normal corporate governance practices and procedures are in place. The boards are responsible for carrying out normal board functions, subject to FHFA review and approval on critical matters.

A challenge for FHFA is to minimize executive management turnover while also recruiting new senior leadership as warranted. Key positions are filled with competent, skilled professionals who have the experience to help the agency meet the goal of conserving Enterprise assets.

REDUCING LOSSES

As conservator, FHFA must conserve and preserve the assets of the Enterprises; for example, by decreasing credit losses from delinquent mortgages and expanding the pool of eligible businesses. To accomplish this, FHFA has implemented the Making Homes Affordable (MHA) program, which includes HAMP and HARP. These programs help borrowers refinance into more affordable mortgages that enable them to stay in their homes while also directly benefiting the enterprises by reducing credit exposure.

HAMP allows a borrower's payment to be reduced to a more affordable amount through an interest rate reduction (down to 2 percent), a term extension (up to 480 months), or principal forbearance. In addition, incentives are offered to borrowers, servicers, and investors for program participation and for successful payment history.

Enterprise participation in HAMP and HARP are consistent with conserving and preserving assets to the extent that loan refinancing and modification (particularly on underwater or delinquent loans) can offer lower cost alternatives to foreclosure. Foreclosure prevention stabilizes the housing market and decreases risk for the Enterprises. Since the first full quarter in conservatorship in 2008, the combined completed foreclosure prevention actions total nearly 1.9 million loans for the Enterprises as of August 2011. These programs have provided options for families to avoid foreclosure, although not to the extent originally anticipated.

FILING SUIT TO RECOVER LOSSES

In September 2011, FHFA filed lawsuits against 17 banks after concluding that a portion of the losses incurred by the Enterprises on private-label MBS was attributable to misrepresentation and other improper actions by certain named firms and individuals.

Over a period of several years before conservatorship, each Enterprise bought hundreds of billions of dollars worth of MBS packaged and sold by large financial institutions. FHFA has found that the mortgages backing many of these securities had characteristics that differ from representations in securities filings.

Under securities laws, the seller has a legal responsibility to accurately represent the characteristics of the loans backing securities. The Enterprises did not have access to the loans underlying these securities and relied on the security issuer to accurately describe the mortgages backing the security in sales materials.

FHFA has consistently made clear its intention to seek recovery for losses that are the legal responsibility of others, but it previously sought informal remedies short of filing legal complaints. The agency has now taken formal action to carry out its responsibility as conservator under the broad authority granted by HERA. The U.S. legal system addresses alleged securities misrepresentations through securities laws and traditional common law. FHFA is pursing these legal remedies. Any dollar recovery will reduce taxpayers' ultimate losses from the Enterprises' financial difficulties.

Remediating Weaknesses at the Housing GSEs in a Weak Housing Market

FHFA continues to face challenges in remediating weaknesses at the housing GSEs, particularly in a housing market that has yet to stabilize. External factors such as the economy, the job market, and consumer confidence are plaguing the housing market and impeding its growth.

To remediate weaknesses at the GSEs, FHFA has worked with the Enterprises to greatly strengthen their underwriting standards and improve the risk sensitivity of their pricing. FHFA also announced a joint servicing compensation initiative that will improve service for borrowers and reduce financial risk to servicers and a servicing alignment initiative that will simplify the process for mortgage servicers by giving them just one set of procedures to follow. (For additional information on these initiatives, see the Performance Highlights section on page 26.) FHFA has also participated in numerous joint studies and relationships with the Treasury, HUD, the Federal Reserve, FDIC, and OCC to prepare rulemakings and studies to strengthen the housing market. (For specific information on these various joint studies, see the Performance Highlights section on page 23.)

The housing GSEs have also faced challenges in correcting identified weaknesses and strengthening various aspects of their operations and risk management practices. As financial institutions focused on housing finance, each has direct and indirect exposure to a record level of serious mortgage delinquencies. FHFA's challenge is to promote financially safe and sound operations at the Enterprises and the FHLBanks while overseeing activities that provide affordable housing and sound housing finance practices.

Achieving the Agency's Housing Mission

As supervisor of the regulated entities, FHFA is responsible for ensuring that the Enterprises and the FHLBanks fulfill their housing finance missions. Several issues affect the regulated entities' ability to carry out their mission:

- Uncertainty about the future of the Enterprises in conservatorship;
- Board and management turnover at the Enterprises;
- Quarterly operating losses at the Enterprises;
- Limited private securitizations of mortgage-related securities and the expanded role of the Federal Housing Administration;
- Investment losses among certain FHLBanks; and
- Declining demand for advances at all FHLBanks.

Support for affordable housing is a core statutory requirement for the Enterprises and the FHLBanks. However, this mandate should reflect the Enterprises' current conservatorship status and the depressed state of housing markets in much of the country. FHFA has tied affordable housing goals to the amount of affordable housing actually produced in the primary market. FHFA intends for the Enterprises and the FHLBanks to reflect the overall market, not to undertake economically adverse or high-risk activities in support of a particular housing goal.

FHFA does not intend to use the conservatorships to justify withdrawing support from important affordable housing responsibilities or certain housing market segments. However, the agency believes that creating conditions conducive to a more stable and sustainable system of housing finance will contribute to mission achievement while supporting safety and soundness for the regulated entities.

Encouraging the Recovery of Housing and Housing Finance

FHFA is currently constrained by law to conserve and protect Enterprise assets. Conservatorship allows the Enterprises to continue serving their public purpose while lawmakers determine the ultimate resolution of the conservatorships and the future legal structure for housing finance. After three years, there is still no clear indication as to what institutional structures will replace the Enterprises and their position in housing finance. This provides a challenge for FHFA regarding the Enterprises' ongoing activities and future business strategies.

FHFA is taking several steps to encourage the return of the private sector to housing finance. For example, FHFA has directed the Enterprises to work on initiatives to improve their internal operations, mitigate credit losses, and ensure continued liquidity in the market. FHFA has also announced several initiatives such as the Uniform Mortgage Data Program, joint servicing compensation, and servicing alignment. These initiatives should improve liquidity in the housing finance market.

FHFA hopes to encourage the return of the private sector and establish an environment for the return of deep liquid markets for borrowers, lenders, and investors. With improved transparency, standardization, and accountability, American families will have greater access to simple, straightforward products that will protect them from sudden financial shocks and help them build equity in their homes.

Housing Finance Reform

In February 2011, the U.S. Department of the Treasury issued a white paper that described three options for housing finance reform – they were among the first to be widely discussed that addressed the future structure of housing finance. The first option proposed that the nation's housing should rely mostly on the private sector, except for federal assistance targeted at creditworthy low-and middle-income borrowers. The second option proposed government assistance for certain borrowers but included a "backstop mechanism" in case additional credit was needed during a housing crisis. The third option proposed federal assistance for certain borrowers and federal reinsurance for some private mortgage securities (the U.S. government would pay shareholders of those securities if private guarantors went bankrupt).

FHFA is continuing to contribute expertise on housing finance reform proposals through congressional testimony, speeches, and public documents. In addition, FHFA has collaborated with Executive Branch departments, congressional staff, industry participants, and other financial regulatory agencies to identify and develop ideas and options that would redefine the structure of housing finance.

FHFA will continue to adhere to the goals of conservatorship, focusing on programs that can promote the recovery of the housing market and developing conditions that encourage a more stable system of housing finance.

Pricing and Risk Sharing

During FY 2011, FHFA submitted its third Report to Congress on the single-family guarantee fees charged by the Enterprises. That report noted that in recent years the Enterprises have steadily increased guarantee fees and reduced the extent of cross-subsidization in their pricing of credit risk. FHFA anticipates that the Enterprises will continue the gradual process of increasing single-family guarantee fees in FY 2012, which will place them in a more stable and sound financial condition and move their pricing closer to levels that would likely exist in a private, competitive market. Changes in Enterprise pricing in FY 2012 may address issues of cross-subsidization, geographic differences in credit costs, and pricing differentials among lenders.

FHFA is considering ways the Enterprises can share single-family mortgage credit risk with the private sector, in support of the goals of reducing the Enterprises' long-term risk exposure and strengthening their financial condition. Possible approaches include expanded use of mortgage insurance and securities structures that would allow a portion of the credit risk of mortgages acquired by the Enterprises to be sold off. Execution of such transactions would have the added benefit of providing feedback on the Enterprises' guarantee fee pricing decisions. If the market price to absorb a portion of the Enterprises' risk exposure was greater than the guarantee fee they charged, that would suggest how much their guarantee fees would have to rise to attract private capital and align their pricing with the private sector.

FY 2011 Performance Summary

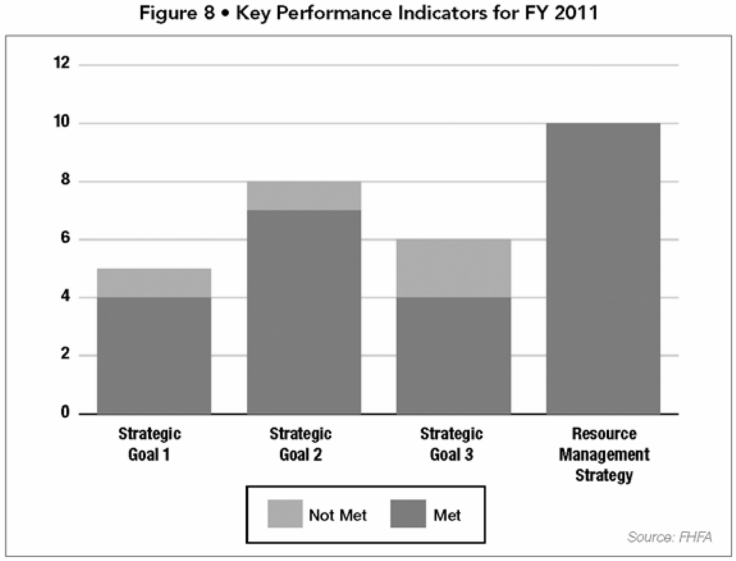
This section describes FHFA's strategic and performance planning framework as well as the seven key performance measures that most closely reflect the agency's achievements and desired outcomes by strategic and performance goal. (For a comprehensive list of performance measures, see pages 53 through 73.) FHFA's performance measures are rated as:

- Target Met; or
- Target Not Met.

FHFA determines performance goals to be met if targets for all performance measures have been achieved. Goals are counted as not met if at least one target performance measure has not been achieved. In FY 2011, FHFA had 29 performance measures. The agency met or exceeded 25 of its measures and failed to meet 4 performance measures. Figure 8 shows the overall results.

Although the agency met over 80 percent of its performance measures, FHFA did not meet 4 performance measures in FY 2011. Specifically, performance measure 1.1.1, relating to safety and soundness, requires an improvement in at least one component examination rating for each of the two Enterprises. The objective was not satisfied at either Fannie Mae or Freddie Mac. The stressed economy and poor performance in the mortgage market continue to hinder the Enterprise's operations. Additionally, because of the uncertainty regarding the future of the Enterprise, they are faced with turnover in key areas, particularly risk

Figure 8 • Key Performance Indicators for FY 2011



management. FHFA will continue to monitor remediation activities but will increase examination ratings only for sustainable and material improvements in their operations.

Performance measure 2.2.3 was not met. This target pertains to finalizing rules that require the Enterprises to serve the manufactured housing and rural housing segments of the market and to preserve multi-family affordable housing. This measure was not met because the rulemaking did not meet the target date of July 15, 2011. However, the final rule has completed the internal clearance process and is under management review.

FHFA also did not meet performance measure 3.1.1, although it made progress. Specifically, FHFA required the Enterprises to submit plans to reduce the size of their mortgage portfolios. While both Fannie Mae and Freddie Mac submitted plans, those submissions did not meet FHFA standards. FHFA will continue to work with the Enterprises to submit plans that target the specific requirements to FHFA's satisfaction. FHFA continued its review of miscellaneous other assets on the Enterprises' books, assessing quarterly asset inventory submissions. FHFA has not yet identified specific disposition plans as a result of these quarterly inventories. Fannie Mae did submit an acceptable plan for assets identified for disposition owing to charter compliance questions.

Finally, FHFA did not meet performance measure 3.1.2, which required the agency to review Enterprise assets, partnerships, contracts, and litigation activities. Although the measure was partially completed, FHFA received the third quarter's inventory report this reporting period, completed an analysis of non mission assets, and reviewed litigation activities for the third quarter. Upon completion of the review, FHFA determined that further procedures and analysis would be needed to comprehensively review all aspects of this performance measure. As a result, FHFA is beginning the process of automating the transmission of the inventory report and performing other procedures to analyze the inventory.

FHFA significantly improved its performance during FY 2011, despite continued disruption in the housing and financial markets. In addition, the agency's forthcoming strategic plan for FY 2012-2016 will further refine its performance goals and measures to better represent the organizational and legislative changes that have affected the agency over the past few years. (See the Other Accompanying Information section, page 104 for a list of our performance measures that were either changed or deleted for FY 2011.)

Strategic Planning Process

FHFA sets long-term and annual goals and monitors progress throughout the year. The agency assesses its record in meeting its performance measures through quarterly performance tracking meetings, which include the senior executive leadership team. These quarterly meetings are normally chaired by the Acting Director. FHFA staff prepare performance reports and discuss the agency's record relative to its performance measures. The meetings highlight the agency's record to date and the challenges for the future, with a focus on how to meet targets and ensure successful performance in support of the mission.

FHFA's FY 2011 Annual Performance Plan was developed and released in March 2011. It includes 29 performance measures and 14 performance goals to support 3 strategic goals and 1 resource management strategy. This section describes the agency's performance against its FY 2011 Annual Performance Plan, which outlined the means and strategies to achieve the annual performance goals and related measures for the past year.

FHFA is in the process of updating the current strategic plan for 2009-2014. The FY 2012-2016 strategic plan aligns with FHFA's major reorganization as well as the requirements of the Dodd-Frank Act and the Government Performance and Results Modernization Act of 2010. The plan sets out the agency's mission, vision, values, and strategic goals through FY 2016. It details the outcomes the agency is seeking to achieve, the means and strategies that will be used to accomplish those outcomes, and the performance measures that will be used to gauge the agency's progress.

Overview of FHFA's Seven Key Performance Measures

FHFA identified seven of the 29 FY 2011 performance measures as **key performance measures** – these are measures that are critical to the achievement of our strategic goals and objectives. These key performance measures represent each of the agency's three strategic goals and the resource management strategy. The following tables summarize FHFA's actual performance during FY 2011 as compared to established targets for our seven key performance measures. The tables for FHFA's seven key performance measures organized by strategic and performance goal show FHFA's accomplishments as they relate to each performance goal and measure. For FY 2011, FHFA met or exceeded six of the seven key performance measures.

STRATEGIC GOAL 1

The housing GSEs operate in a safe and sound manner and comply with legal requirements.

The focus of Strategic Goal 1 is to promote the safety and soundness of housing government-sponsored enterprises (GSEs) through prudential supervision and regulation. (The Performance section of this report includes a list of all measures associated with this goal.)

Table 1 summarizes the key performance measures for safety and soundness of the housing GSEs. During FY 2011, FHFA conducted risk-based supervision and examinations on the housing GSEs to evaluate condition and performance, risk, risk management, governance, and planning. The purpose of the examinations is to ensure that the regulated entities operate in a financially safe and sound manner and take appropriate steps to remediate any deficiencies. One key performance measure was an improvement in one or more component examination ratings at each Enterprise. This measure was not met. One reason for the failure was that both Enterprises operated in a mortgage market that was under profound and continued stress as a result of earlier underwriting shortcomings that have led to mortgage delinquencies and foreclosures unprecedented in more than 75 years.

TABLE 1 • Key Performance Measures for Safety and Soundness of the Housing GSEs

Performance Goal	Key Performance Measure
PERFORMANCE GOAL 1.1 Fannie Mae and Freddie Mac (the Enterprises) comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.	**KEY PERFORMANCE MEASURE 1.1.1** Each Enterprise improves in one or more component ratings. TARGET: September 30, 2011 NOT MET
PERFORMANCE GOAL 1.2 The FHLBanks and the Office of Finance comply with legal requirements and operate in a safe and sound manner with adequate capital and access to funds and capital.	**KEY PERFORMANCE MEASURE 1.2.1** Each FHLBank is rated "2" or better or, operating under an acceptable performance improvement plan within 180 days of a rating downgrade to below "2". TARGET: Quarterly MET

STRATEGIC GOAL 2

The housing GSEs support a stable, liquid, and efficient mortgage market including sustainable homeownership and affordable housing.

The focus of the second strategic goal is the housing mission of FHFA. As the supervisor for the housing GSEs, FHFA has a critical responsibility to foster a well-functioning, stable, and liquid housing finance system. Only through effective supervision can FHFA ensure that the entities serve as a source of liquidity to homeowner and rental housing markets at an efficient and reasonable price.

See Table 2 which summarizes the key performance measures for the housing mission. During FY 2011, the housing GSEs met or exceeded the required liquidity levels. Fannie Mae was not in compliance at the end of the last fiscal year, but came into compliance during the first quarter of FY 2011 and has maintained its standing. FHFA continued to provide information, such as the House Price Index, to promote an efficient secondary mortgage market. The performance section of this report includes a list of all measures associated with Strategic Goal 2.

TABLE 2 • Key Performance Measures for the Housing Mission

Performance Goal	Key Performance Measure
PERFORMANCE GOAL 2.1 FHFA ensures the housing GSEs support a stable, liquid and efficient mortgage market.	**KEY PERFORMANCE MEASURE 2.1.1** Liquidity levels at Fannie Mae and Freddie Mac meet or exceeds required levels or is brought into compliance within five business days. TARGET: Quarterly MET
	KEY PERFORMANCE MEASURE 2.1.2 Liquidity levels at FHLBanks meet or exceeds required levels or is brought into compliance within five business days. TARGET: Quarterly MET
PERFORMANCE GOAL 2.3 FHFA supports an efficient secondary mortgage market through research that increases transparency of the housing GSEs' risks and activities and improves understanding of mortgage market developments.	**KEY PERFORMANCE MEASURE 2.3.1** Each FHLBank is rated "2" or better or, operating under an acceptable performance improvement plan within 180 days of a rating downgrade to below "2". TARGET: Quarterly MET

STRATEGIC GOAL 3

FHFA preserves and conserves the assets and property of the Enterprises, ensures focus on their housing mission, and facilitates their financial stability and emergence from conservatorship.

The focus of Strategic Goal 3 is on conservatorship of the Enterprises. As conservator, FHFA's role is to foster improvement in the Enterprise financial condition, underwriting practices, and operational capacity so they can fulfill their role in the nation's housing finance system.

Table 3 summarizes the key performance measure that demonstrates FHFA's goal to preserve and conserve the Enterprise assets while preparing for future housing finance markets under conditions different from those of the past. To accomplish this overall goal, FHFA continued to pursue loan modification activities and other loss mitigation strategies designed to reduce preventable foreclosure. The performance section of this report include a list of all measures associated with Strategic Goal 3.

TABLE 3 • Key Performance Measure Demonstrating FHFA's Goal of Preserving and Conserving Enterprise Assets

PERFORMANCE GOAL 3.3	KEY PERFORMANCE MEASURE 3.3.1
Ensure the Enterprises have effective programs that respond to problems in mortgage markets by reducing preventable foreclosures.	Number of loan modifications and foreclosure alternatives completed by the Enterprises. TARGET: 400,000 MET

RESOURCE MANAGEMENT STRATEGY

FHFA has the personnel, resources and infrastructure to manage effectively and efficiently to achieve its mission and goals.

The focus of the Resource Management Strategy is to anticipate what is required to create and sustain an infrastructure that is responsive to mission-critical program management. FHFA ensures effectiveness and efficiency in this area through the recruitment, retention, and rewarding of a diverse, highly skilled staff.

Table 4 summarizes the key performance measure that demonstrates FHFA's use of its resources. The performance section of this report includes a list of all measures associated with the Resource Management Strategy.

TABLE 4 • Key Performance Measure Demonstrating FHFA's Use of Resources

PERFORMANCE GOAL 4.3	KEY PERFORMANCE MEASURE 4.3.2
FHFA has effective financial and risk management programs.	Total FHFA resources allocated directly to supervision of the housing GSEs - Strategic Goals 1 and 2.
	TARGET: 100% per quarter MET

Program Evaluations

FHFA reviews its strategic plan annually to ensure that strategic and outcome goals are being met. Through quarterly performance tracking meetings with senior leadership, FHFA reviews the progress of its performance measures and verifies and validates performance data to ensure reliability and accuracy. FHFA did not have an independent external evaluation conducted this fiscal year.

FHFA's OIG began operations in October 2010. OIG conducted an FY 2011 assessment addressing the Acting Director's most serious management issues. (See the Other Accompanying Information section of this report.) As of September 2011, OIG had completed the following evaluations of FHFA:

Program Evaluations

EVALUATION	SUMMARY	SUMMARY OF FHFA'S RESPONSE
Evaluation of FHFA's Oversight of Fannie Mae's and Freddie Mac's Executive Compensation Programs – March 2011	FHFA coordinated with the U.S. Department of Treasury and outside consultants to develop the Enterprises' compensation programs. FHFA lacks key controls necessary to monitor the Enterprises' ongoing executive compensation decisions under the approved package, and FHFA has not been sufficiently transparent to the public on the Enterprises' executive compensation programs, but it does report relevant information in public securities filings.	FHFA agreed to (1) study how federal support for the Enterprises and their conservatorship status may facilitate their capacity to meet certain performance goals; (2) regularly monitor and evaluate metrics associated with recruitment and retention of employees and consider appropriate compensation levels; (3) establish formal approach for reviewing the Enterprises' performance measures and self-assessment data; (4) strengthen its executive compensation document storage systems; and (5) consider options for improving executive compensation transparency. FHFA did not agree to assess disparities in compensation among the Enterprises and government personnel because private sector compensation scales are most useful for comparison.
Evaluation of FHFA's Exit Strategy and Planning Process for the Enterprises' Structural Reform – March 2011	The Administration's February 11, 2011, proposal recommends that FHFA implement several steps under its regulatory authority in the short to medium term to significantly reduce the Enterprises' dominant position in the housing finance system. OIG views FHFA's potential implementation of its regulatory authorities under this proposal in the short- to medium-term as an area of significant risk if not managed effectively.	FHFA agreed with the draft evaluation's recommendations in its written comments. The Administration's white paper recommends a gradual transition to greater private capital participation in housing finance. FHFA has already begun implementing several options to help this transition.
Evaluation of FHFA's Role in Negotiating Fannie Mae's and Freddie Mac's Responsibilities in U.S. Department of Treasury's MHA Program – August 2011	OIG found no evidence that, in developing and implementing MHA programs. Treasury has compromised FHFA's independence as the Enterprises' conservator and regulator. Since FHFA did not play an active role in reviewing and negotiating Treasury's Financial Accounting & Advisory Services (FAAS) with the Enterprises. OIG found that FHFA's conservatorship interests would have been better served if FHFA had played a greater role during the negotiation and review of the FAASs.	FHFA agreed to engage the Enterprises and the U.S. Department of Treasury in discussions aimed at establishing more specific resolution procedures.
Evaluation of FHFA's Examination Capacity – September 2011	OIG identified shortfalls in FHFA's examination coverage, particularly in the areas of Real Estate Owned and default-related legal services. FHFA has too few examiners overall to ensure the efficiency and effectiveness of its examination program. It sometimes has to scale back planned examination work and require additional time to complete examinations. FHFA has sought to address these challenges.	FHFA concurs with OIG's recommendations to (1) assess examination shortfalls/ quality; (2) monitor development/ implementation of an examiner accreditation program; (3) consider using details; and (4) report externally on its progress/status. FHFA does not-concur with any references to its quality of examinations and states that the report does not provide any proof to support OIG's comment. FHFA also does not concur with the report's reference to the quality of its examination staff.

FY 2011 Financial Summary

For FY 2010 and FY 2011, FHFA achieved an unqualified (clean) opinion from the GAO on its annual financial statements. GAO noted no material weaknesses or significant deficiencies in FHFA's internal controls and cited no instances of noncompliance with laws and regulations. In accordance with the Office of Management and Budget's (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* FHFA continued to assess the effectiveness of its internal controls annually. FHFA received, for the third consecutive year, the Certificate of Excellence in Accountability Reporting (CEAR) award for its *FY 2010 Performance and Accountability Report* from the Association of Government Accountants. The CEAR is awarded presented to agencies that have demonstrated excellence in integrating performance and accountability reporting.

FHFA received, for the third consecutive year, the Certificate of Excellence in Accountability Reporting award for its FY 2010 Performance and Accountability Report from the Association of Government Accountants

Source of Funds

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

FHFA calculates the assessments for each Enterprise by determining the proportion of each Enterprise's assets and off-balance sheet obligations to the total for both Enterprises and then applying each of the Enterprise's proportion (expressed as a percentage) to the total budgeted costs for regulating the Enterprises. FHFA calculates the assessments for each of the 12 FHLBanks by determining each FHLBank's share of minimum required regulatory capital as a percentage of the total minimum capital of all the FHLBanks and applying this percentage to the total budgeted costs for regulating the banks. Assessments are paid semiannually on October 1 and April 1. FHFA collected assessments of $200.6 million during FY 2011, which included a $9.5 million special assessment on the Enterprises related to conservatorship activities and a $29 million assessment for costs related to the establishment and operations of an Office of Inspector General.

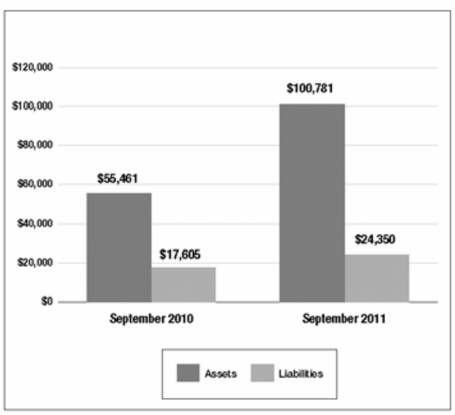
Analysis of Financial Statements

The principal financial statements present FHFA's financial position, net cost of operations, changes in net position, and budgetary resources for fiscal years 2011 and 2010. Financial statements and notes for fiscal years 2011 and 2010 appear on pages 75-101. Highlights of the financial information presented in the principal financial statements follow.

BALANCE SHEET

The Balance Sheet presents, as of the end of the fiscal year, the recorded value of assets and liabilities retained or managed by FHFA. The difference between the assets and liabilities represents FHFA's net position. The Balance Sheet reflects total assets of $100.8 million, an 82 percent increase over FY 2010. The increase is primarily due to a $15.4 million increase in Fund Balance With Treasury due to the collection of assessment funds related to the establishment and operations of an Office of Inspector General and a $27.4 million increase in Investments due to an increase in assessments for a larger FY 2011 operating budget. FHFA's total liabilities increased by $6.7 million, a 38 percent increase over FY 2010. The increase is primarily due to an increase in unfunded leave and accounts payable associated with the establishment of an Office of Inspector General. As a result, FHFA's net position as of September 30, 2011, was $76.4 million, a $38.5 million increase over the $37.9 million net position as of September 30, 2010. The increase in net position is due to FHFA collecting funds in excess of operating costs for the year (see Figure 9).

Figure 9 • Assets and Liabilities (Dollars in Thousands)



STATEMENT OF NET COST

The Statement of Net Cost presents the components of FHFA's net cost, which is the gross cost incurred less any revenues earned. FHFA's FY 2011 total program net (income)/costs, as reflected on the Statement of Net Cost, were -$33.4 million (or net revenue) as compared to the -$14.6 million in FY 2010. This change reflects the increase in gross costs and earned revenue needed to carry out its mission as reflected in its FY 2011 operating budget. The operating budget increase between fiscal years is the result of increased mission costs and the establishment and operations of an Office of Inspector General. However, during the course of the year, FHFA did not fully expend its FY 2011 earned revenue, thereby resulting in an excess of revenue over cost. FHFA's costs for FY 2011 were less than expected and budgeted for, resulting in a surplus. FHFA issues a credit for unobligated funds as of September 30, 2011, against next year's assessment to the regulated entities (see Figure 10).

Consistent with the Government Performance and Results Act of 1993, the Statement of Net Cost is reported by FHFA's strategic goals. FHFA tracked resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's strategic plan. Strategic Goals, 1 – Safety and Soundness; 2 – Affordable Housing; and 3 – Conservatorship, guide program offices to carry out FHFA's vision and mission. FHFA has a Resource Management Strategy, which is distributed proportionately to Strategic Goals 1-3 based on the percentage of direct costs of each goal to the total direct costs for FHFA. FHFA places a significant emphasis on Strategic Goal 1, Safety and Soundness, which comprises a major portion of the total program costs. FHFA-OIG allocated their costs to FHFA's Resource Management Strategy.

Figure 10 • Total Net (Income from)/Cost of Operations (Dollars in Thousands)

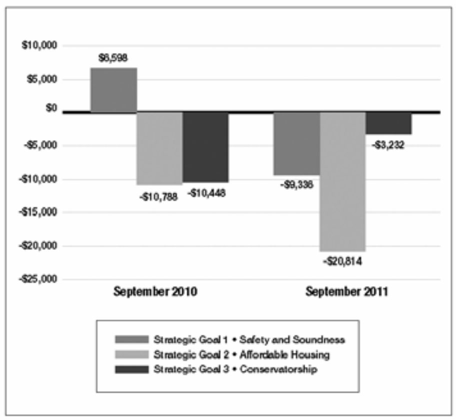
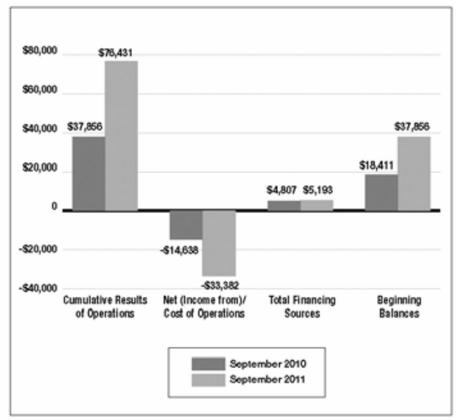


Figure 11 • Statement of Changes in Net Position (Dollars in Thousands)



STATEMENT OF CHANGES IN NET POSITION

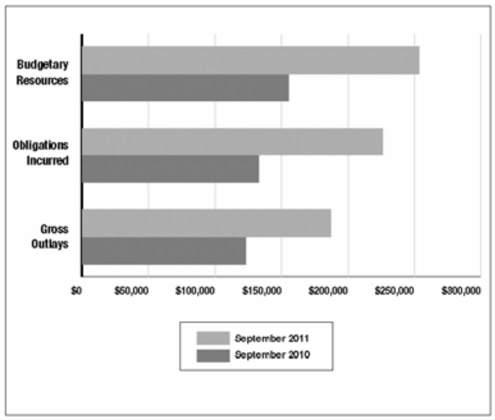
The Statement of Changes in Net Position presents those accounting items that caused the net position section of the Balance Sheet to change from the beginning to the end of the reporting period. Financing sources increase net position. FHFA's financing source is imputed financing from costs absorbed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

FHFA's net position as of September 30, 2011, was $76.4 million, a $38.5 million increase over the $37.9 million net position as of September 30, 2010. The increase in net position is due to FHFA collecting funds in excess of operating costs for the year. FHFA's cumulative results of operations for the period ending September 30, 2011, increased $38.6 million, due primarily to net income from operations of $33.4 million (see Figure 11).

STATEMENT OF BUDGETARY RESOURCES

This statement provides information about the provision of budgetary resources and their status as of the end of the reporting period. FHFA's total budgetary resources as of September 30, 2011, was $253.6 million, a $98 million increase over the $155.6 million total budgetary resources as of September 30, 2010 The 2011 budgetary resources were primarily comprised of $200.6 million in assessments, $29 million in spending authority from offsetting collections, $22.7 million in unobligated balance brought forward from FY 2010, and $1 million in recoveries of prior year unpaid obligations. The increase in budgetary resources is the result of increased mission costs and the establishment and operations of an Office of Inspector General. Obligations incurred increased $93.1 million to $225.9 million in FY 2011. Gross outlays increased $64 million to $186.9 million in FY 2011 (see Figure 12).

Figure 12 • Statement of Budgetary Resources Comparisons (Dollars in Thousands)



Limitations of the Financial Statements

FHFA management has prepared its fiscal years 2011 and 2010 financial statements from the books and records of the agency in accordance with the requirements of the Office of Management and Budget Circular A-136, *Financial Reporting Requirements*, as amended. The financial statements represent the financial position and results of operations of the agency pursuant to the requirements of Chapter 31 of the U.S. Code section 3515 (b). While these statements have been prepared from the agency's books in accordance with the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. These statements should be read with the understanding that they are for a component of the U.S. government, a sovereign entity.

Internal Controls

During FY 2011, FHFA adhered to the internal control requirements of the Federal Managers Financial Integrity Act of 1982 and the guidance provided by OMB Circular A-123. FHFA's Executive Committee on Internal Controls (ECIC) met quarterly to oversee internal controls and provide recommendations to the FHFA Acting Director on the effectiveness of FHFA's internal controls.

In 2011, the ECIC members were the Deputy Chief Operating Officer who served as the Chairman, the Chief Financial Officer who served as the Vice-Chairman, the Chief Information Officer, the Deputy Director for Enterprise Regulation, the Deputy Director for Bank Regulation, the Deputy Director for Examination Programs and Support, the Deputy Director for Housing Mission and Goals, the General Counsel, and the Associate Director Office of Quality Assurance. The Chairman and Vice Chairman invited other FHFA executives when appropriate. ECIC also established senior assessment teams to review specific areas when needed.

During FY 2011, 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.

ECIC reviewed documentation from all three areas. In compliance with the FMFIA requirements, the Acting Director, on the basis of a recommendation from ECIC, provided reasonable assurance that internal controls over the effectiveness and efficiency of operations, compliance with applicable laws and regulations, and financial reporting as of September 30, 2011 were operating effectively and that no material weaknesses or significant deficiencies were found in the design or operation of the internal controls. This assurance can be found in the "Management's Discussion and Analysis" section of this report and meets the FMFIA reporting requirement for internal controls.

The FHFA-OIG began operation in mid-October 2010 and adhered to the internal control requirements of FMFIA and the guidance provided by OMB Circular A-123. In order to ensure compliance, the FHFA-OIG formed an ECIC and established a senior assessment team headed by the Chief of Staff to assess the internal controls of the OIG. The assessment team included participants from each office within the FHFA-OIG. Based on its review of the internal control assessments, OIG's ECIC provided reasonable assurance that OIG offices have developed and maintained effective internal controls for FY 2011, and no significant deficiencies or material weaknesses have been identified.

The Office of Counsel, under the Chief Counsel's direction, is FHFA-OIG's principal authority on legal matters pertaining to FHFA-OIG activities, duties, and authorities. The Office of Counsel works to ensure that all FHFA-OIG activities are conducted in accordance with applicable legal requirements. Starting with the creation of FHFA-OIG in mid-October 2010, the Office of Counsel has developed rules, policies, and procedures to ensure full FHFA-OIG compliance with such requirements. Although these efforts continue, no FHFA-OIG office identified substantive deviations from full compliance with those legal authorities to which it is subject. Based on these factors and the controls assessments performed at each OIG office, the FHFA-OIG ECIC members determined that the FHFA-OIG's A-123 efforts provide reasonable assurance that FHFA-OIG complies with laws and regulations applicable to FHFA generally, and to FHFA-OIG specifically. The FHFA-OIG ECIC recommended the Inspector General sign an assurance statement to the FHFA Acting Director recommending an unqualified statement of assurance relative to the two areas assessed by the OIG; effectiveness and efficiency of operations, and compliance with laws and regulations.

Federal Management System and Strategy

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

Federal Information Security Management Act

Title III of the Electronic Government Act of 2002, titled the Federal Information Security Management Act (FISMA), requires all federal agencies to develop and implement an agency-wide information security program. The program provides the framework to protect the agency's information, operations, and assets. During FY 2011, OMB issued guidance requiring federal agencies to continuously monitor the security posture of information systems to enable timely decision making regarding identified vulnerabilities and threats. To accomplish this, agencies automate security-related activities and acquire tools that correlate and analyze security-related information.

The FHFA-OIG is required to review the agency's information security program annually and report the results to OMB as required by FISMA. FHFA's information security program activities during FY 2011 reflect efforts focused on enhancing the agency's continuous monitoring compliance program. Such compliance requires FHFA to proactively monitor the security posture of its information technology infrastructure through the implementation of operational, management, and technical controls, including automated security tools and supplemental resources for monitoring activities. The tools and activities include certifying and accrediting information systems before they become operational, reviewing system logs and configuration management activities, and performing periodic vulnerability scans.

Other FY 2011 information security program activities included implementing a new intrusion detection system, updating information security policy with comprehensive procedures, and performing annual security control assessments of FHFA information systems, including FMS. FHFA maintained security certification and accreditation on 100 percent of all major systems in production and provided security awareness training through a new automated learning management information system to all FHFA employees and contractors. FHFA also addressed security-related weaknesses for systems noted in the prior year FISMA review as well as mitigating vulnerabilities identified during certification and accreditation.

The FY 2011 FISMA review concluded that FHFA generally has a sound risk management framework for its information security program. Although FHFA's information security program had a number of strengths, including but not limited to its information system security training, system-level planning, risk assessment, access authorization, and continuous control monitoring, the audit identified security practices that can be improved.

Specifically, FHFA had not:

- Finalized, disseminated, and implemented an organization-wide information security program plan that defines such key requirements as security-related roles and responsibilities and security program controls;
- Updated the agency's policies and procedures to address completely all of the NIST-recommended components within the control families applicable to FHFA information systems;
- Developed, disseminated, and implemented an information categorization policy and methodology;
- Implemented adequate procedures for tracking and monitoring correction of weaknesses or deficiencies through Plan of Action and Milestones;
- Implemented adequate procedures for ensuring remediation of weaknesses noted in network vulnerability assessments.

All of the findings have been addressed and remediation efforts are underway.

Management Report on Final Action

As required under amended Section 5 of the Inspector General Act of 1978, FHFA must report information on final action taken by management on certain audit reports. FHFA-OIG has not identified any disallowed costs or funds put to better use for FY 2011. Additionally, FHFA does not have any audit reports without final actions but with management decisions over one year old for FY 2011.

Erroneous Payments

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

FHFA has implemented and maintains internal control procedures that ensure disbursement of federal funds for valid obligations. FHFA has identified no activities susceptible to significant erroneous payments that meet 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 2011, the dollar amount subject to prompt payment was $44.2 million. The amount of interest penalty paid in FY 2011 was $222, or 0.00050 percent, of the total dollars disbursed.

Figure 13 • Summary of Financial Statement Audit and Management Assurances

Table 1: Summary of Financial Statement Audit

AUDIT OPINION	UNQUALIFIED				
RESTATEMENT	NO				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weaknesses	0	0	0	0	0

Table 2: Summary of Management Assurances

Effectiveness of Internal Control Over Financial Reporting (Federal Management Financial Integrity Act Paragraph 2)						
STATEMENT OF ASSURANCE	UNQUALIFIED					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0

Effectiveness of Internal Control Over Operations (Federal Management Financial Integrity Act Paragraph 2)						
STATEMENT OF ASSURANCE	UNQUALIFIED					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Material Weaknesses	0	0	0	0	0	0

Conformance with Financial Management System Requirements (Federal Management Financial Integrity Act Paragraph 4)						
STATEMENT OF ASSURANCE	SYSTEMS CONFORM TO FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-Conformances	0	0	0	0	0	0

Message From The Chief Financial Officer

Fiscal year 2011 has been a very challenging but rewarding year. The Federal Housing Finance Agency (FHFA) continued to grow to match its responsibilities for regulating the Housing GSEs and to manage the conservatorships of Fannie Mae and Freddie Mac. A significant part of FHFA's growth has been the creation and rapid growth of the Office of Inspector General (OIG). Since OIG is an independent entity of FHFA with a budget of $29 million, FHFA is required to prepare a set of consolidated financial statements for FY 2011.

Even with this added complexity, I am pleased to report that FHFA once again received an unqualified audit opinion on its financial statements from Government Accountability Office (GAO). In its financial audit report, GAO concluded that 1) FHFA's Fiscal Year 2011 financial statements are fairly presented in all material respects; 2) FHFA had effective internal control over financial reporting; and 3) there were no reportable instances of noncompliance with the laws and regulations it tested.

In addition to a clean audit opinion, FHFA received the Certificate for Excellence in Accountability Reporting (CEAR) award for its *Fiscal Year 2010 Performance and Accountability Report* (PAR) from the Association of Government Accountants, the third straight year FHFA has received this prestigious award. The CEAR award is given to government agencies that received unqualified audit opinions on their financial statements and produced PARs that achieved the highest standards in communicating results and demonstrating accountability.

We are very proud of our accomplishments and are constantly striving to improve how we communicate financial and performance information to the public. For example, in this year's PAR we organize our highlights and accomplishments by strategic goal. This will make it easier for the public to associate our activities to the achievement of our strategic plan. To make the document itself more user friendly, we have provided hyperlinks directly to documents referred to in the text, and a reader can go directly from the table of contents to any section of the PAR with a simple click of the mouse.

Finally, the commitment of senior management and staff to maintain effective programs of internal control over agency activities provides the solid foundation necessary for the continued successes achieved by the agency.

Sincerely,

Mark Kinsey

Mark Kinsey
Chief Financial Officer
November 10, 2011

FEDERAL HOUSING FINANCE AGENCY

Consolidated Balance Sheets

As of September 30, 2011 and 2010
(in Thousands)

	2011	2010
Assets:		
Intragovernmental		
Fund Balance With Treasury (Note 2)	$ 16,445	$ 1,000
Investments (Note 3)	78,252	50,878
Accounts Receivable (Note 4)	19	-
Prepaid Expenses	-	307
Total Intragovernmental	**94,716**	**52,185**
Accounts Receivable (Note 4)	5	6
Property, Equipment, and Software, Net (Note 5)	5,569	2,397
Prepaid Expenses	491	873
Total Assets	**$ 100,781**	**$ 55,461**
Liabilities:		
Intragovernmental		
Accounts Payable	$ 1,221	$ 430
Payroll Taxes Payable (Note 6)	1,219	799
Total Intragovernmental	**2,440**	**1,229**
Accounts Payable	6,601	4,358
Other (Note 6)	15,309	12,018
Total Liabilities	**$ 24,350**	**$ 17,605**
Net Position:		
Cumulative Results of Operations	$ 76,431	$ 37,856
Total Net Position	$ 76,431	$ 37,856
Total Liabilities and Net Position	**$ 100,781**	**$ 55,461**

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

FEDERAL HOUSING FINANCE AGENCY

Consolidated Statements of Net Cost/(Income)

For the Fiscal Years Ended September 30, 2011 and 2010
(in Thousands)

	2011	2010
Program Costs by Strategic Goal :		
Safety and Soundness:		
Gross Costs	$ 125,961	$ 95,870
Less: Earned Revenue	(135,297)	(89,272)
Net Safety and Soundness (Income from)/Cost of Operations	**$ (9,336)**	**$ 6,598**
Affordable Housing:		
Gross Costs	$ 17,240	$ 16,031
Less: Earned Revenue	(38,054)	(26,819)
Net Affordable Housing (Income from)/Cost of Operations	**$ (20,814)**	**$ (10,788)**
Conservatorship:		
Gross Costs	$ 24,200	$ 16,663
Less: Earned Revenue	(27,432)	(27,111)
Net Conservatorship (Income from)/Cost of Operations	**$ (3,232)**	**$ (10,448)**
Total Gross Program Costs	$ 167,401	$ 128,564
Less:Total Earned Revenue	(200,783)	(143,202)
Net (Income from)/Cost of Operations	**$ (33,382)**	**$ (14,638)**

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

FEDERAL HOUSING FINANCE AGENCY

Consolidated Statements of Changes in Net Position

For the Fiscal Years Ended September 30, 2011 and 2010 (in Thousands)

	2011	2010
Cumulative Results of Operations:		
Beginning Balances	**$ 37,856**	**$ 18,411**
Other Financing Sources (Non-Exchange):		
Imputed Financing Sources	5,193	4,807
Total Financing Sources	5,193	4,807
Net Income from/(Cost) of Operations	33,382	14,638
Net Change	38,575	19,445
Cumulative Results of Operations	**$ 76,431**	**$ 37,856**
Net Position	**$ 76,431**	**$ 37,856**

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

FEDERAL HOUSING FINANCE AGENCY

Combined Statements of Budgetary Resources

For the Fiscal Years Ended September 30, 2011 and 2010
(in Thousands)

	2011	2010
Budgetary Resources:		
Unobligated Balance:		
Unobligated Balance Brought Forward, October 1	$ 22,743	$ 9,657
Recoveries of Prior Year Unpaid Obligations	1,033	2,693
Budget Authority		
Appropriation - Assessments	200,623	143,028
Appropriation - Investment Interest	66	72
Spending Authority From Offsetting Collections		
Collected	29,075	104
Change In Receivables From Federal Sources	19	(3)
Change In Unfilled Customer Orders Without Advance From Federal Sources	9	-
Subtotal	229,792	143,201
Total Budgetary Resources	**$ 253,568**	**$ 155,551**
Status of Budgetary Resources:		
Obligations Incurred (Note 10)		
Direct	$ 225,802	$ 132,707
Reimbursable	94	101
Subtotal	225,896	132,808
Unobligated Balance		
Exempt From Apportionment	27,672	22,743
Total Status of Budgetary Resources	**$ 253,568**	**$ 155,551**
Change in Obligated Balance:		
Unpaid Obligations, Brought Forward, October 1	$ 29,135	$ 21,968
Uncollected Customer Payments From Federal Sources, Brought Forward, October 1	-	(3)
Total Unpaid Obligated Balance, Net	**29,135**	**21,965**
Obligations Incurred Net	225,896	132,808
Gross Outlays	(186,945)	(122,948)
Recoveries of Prior Year Unpaid Obligations, Actual	(1,033)	(2,693)
Change In Uncollected Customer Payments From Federal Sources	(28)	3
Obligated Balance, Net, End of Period		
Unpaid Obligations	67,053	29,135
Uncollected Customer Payments From Federal Sources	(28)	-
Total, Unpaid Obligated Balance, Net, End of Period	**$ 67,025**	**$ 29,135**
Net Outlays:		
Gross Outlays	$ 186,945	$ 122,948
Offsetting Collections	(29,075)	(104)
Distributed Offsetting Receipts	(200,689)	(143,100)
Net Outlays	**$ (42,819)**	**$ (20,256)**

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

FEDERAL HOUSING FINANCE AGENCY

Notes to the Financial Statements

For the Years Ended September 30, 2011 and 2010

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

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

HERA provided for a FHFA Office of the Inspector General (FHFA-OIG). As of April 2011, the FHFA-OIG maintained its own Agency Location Code and set of books. The Inspector General Act of 1978, as amended, sets forth the functions and authorities of the FHFA-OIG. The reporting entity for purposes of financial statements includes FHFA and FHFA-OIG.

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

In September 2008, after Fannie Mae and Freddie Mac were placed in conservatorship under the FHFA, the Office of Management and Budget (OMB) determined that the assets, liabilities and activities of the companies would not be included in the financial statements of the federal government. For fiscal year 2008, OMB and the Department of the Treasury (Treasury) concluded that Fannie Mae and Freddie Mac did not meet the conclusive or indicative criteria for a federal entity contained in OMB Circular A-136, *Financial Reporting Requirements*, and Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*, because they are not listed in the section of the federal government's budget entitled "Federal Programs by Agency and Account," and because the nature of FHFA's conservatorships over Fannie Mae and Freddie Mac and the federal government's ownership and control of the entities is considered to be temporary. Treasury reaffirmed this position for fiscal year 2009, with which FHFA concurs. OMB continued to hold this view in the President's fiscal year 2010, 2011 and 2012 budget submissions to Congress. Consequently, the assets, liabilities, and activities of Fannie Mae and Freddie Mac have not been consolidated into FHFA's financial statements. However, Treasury records the value of the federal government's investments in Fannie Mae and Freddie Mac in its financial statements as a General Fund asset.

Both Fannie Mae and Freddie Mac, as represented by FHFA as their Conservator, entered into separate agreements with Treasury known as the Senior Preferred Stock Purchase Agreements (Agreements) on September 7, 2008. These two Agreements are identical and have since been amended three times, on September 26, 2008, May 6, 2009 and December 24, 2009. The Agreements commit Treasury to provide funding for each Enterprise up to the greater of: (1) $200 billion; or (2) $200 billion plus the cumulative total of draws for each calendar quarter in 2010, 2011 and 2012 minus any amount by which the assets of the Enterprise exceed its liabilities on December 31, 2012. This funding is to ensure that each Enterprise maintains a non-negative Net Worth, thereby avoiding a statutory requirement that an Enterprise be put in receivership following an extended period of negative Net Worth. Under the Agreements, each Enterprise submits a request for any needed draw amount once their financials (to be published in their 10-K or 10-Q) are finalized. The Enterprise also submits a statement certifying compliance with Agreement covenants, which include limits on portfolio size and indebtedness. FHFA, in its role as Conservator, reviews any request for a draw and certifies that the request is available for funding under the agreement. FHFA then sends a letter to Treasury requesting the draw amount prior to the end of the current quarter. Because of third quarter losses announced in early November 2011, Fannie Mae is requesting $7.8 billion and Freddie Mac is requesting $6.0 billion in additional draws on their Agreements with Treasury.

FHFA as Conservator also issues an order to the Enterprises each quarter requiring each Enterprise to pay dividends to Treasury as required by the Agreements. Additionally, the Agreements require each Enterprise to obtain Treasury approval for the disposition of assets, except under certain circumstances. FHFA as Conservator reviews these requests. Fannie Mae and Freddie Mac draws on their Agreements with Treasury are summarized below. Such draws are reported in Treasury's financial statements.

Enterprise Draws on Treasury Agreements
(Dollars in Billions)

Quarter	Fannie Mae	Freddie Mac
September 30, 2008	$ -	$ 13.8
December 31, 2008	15.2	30.8
March 31, 2009	19.0	6.1
June 30, 2009	10.7	-
September 30, 2009	15.0	-
December 31, 2009	15.3	-
March 31, 2010	8.4	10.6
June 30, 2010	1.5	1.8
September 30, 2010	2.5	0.1
December 31, 2010	2.6	0.5
March 31, 2011	8.5	-
June 30, 2011	5.1	1.5
Cumulative Draws	**$ 103.8**	**$ 65.2**

B. Basis of Presentation

FHFA's principal statements were prepared from its official financial records and general ledger in conformity with accounting principles generally accepted in the United States and follow the presentation guidance established by OMB Circular A-136 "Financial Reporting Requirements," as amended. 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 include the activities and transactions of the FHFA-OIG. The total columns reflect consolidated totals net of intra-entity transactions, except for the Statement of Budgetary Resources (SBR), which is presented on a combined basis. While HERA established the FHFA-OIG in July 2008, the first FHFA Inspector General was appointed in October 2010. Therefore, fiscal year 2010 does not include FHFA-OIG activity. The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, and the status and availability of budgetary resources of FHFA. Unless specified otherwise, all amounts are presented in thousands.

C. Basis of Accounting

Transactions are recorded on both an accrual accounting basis, and a budgetary basis. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal requirements and controls over the use of federal funds. FHFA's financial statements conform 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 transactions made between two reporting entities within the federal government.

D. Revenues, Imputed & Other Financing Sources

Operating revenues of FHFA are obtained through assessments of the regulated entities. The agency's acting Director approved the annual budget in August 2011 and 2010. By law, FHFA is required to charge semi-annual assessments to the entities. Assessments collected shall not exceed the amount sufficient to provide for the reasonable costs associated with overseeing the entities, plus amounts determined by the acting Director to be necessary for maintaining a working capital fund.

FHFA develops its annual budget using a 'bottom up' approach. Each office within the agency is asked to bifurcate their budget request between the amount of resources needed for the regulation of Fannie Mae and Freddie Mac and the resources needed for the regulation of the twelve FHLBanks. The office requests are then aggregated (with overhead costs distributed proportionately) to determine the total expected costs associated with regulating Fannie Mae and Freddie Mac and the total expected costs associated with regulating the FHLBanks. These two totals, along with any expected collection for the working capital fund, comprise the fiscal year budget for the agency. Additionally, FHFA levied a special assessment for conservatorship activities on Fannie Mae and Freddie Mac during fiscal year 2011.

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

Additionally, the FHFA Inspector General was appointed in October 2010. The FHFA-OIG developed budget estimates for Fiscal Year 2011 and FHFA assessed the Regulated Entities in January 2011 and April 2011 to cover the costs of the OIG operations. OIG costs were allocated between the regulated entities and were based on the same percentages used for FHFA's assessment notifications.

Federal government entities often receive goods and services from other federal government entities without reimbursing the providing entity for all the related costs. In addition, federal government entities also incur costs that are paid in total or in part by other entities. An imputed financing source is recognized by the receiving entity for costs that are paid by other entities. FHFA recognized imputed costs and financing sources in fiscal years 2011 and 2010 as prescribed by accounting standards. FHFA recognizes as an imputed financing source the amount of pension and post-retirement benefit expenses for current employees accrued on FHFA's behalf by the Office of Personnel Management (OPM).

E. Use of Estimates

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

F. Earmarked Funds

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

G. Fund Balance with Treasury

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

During the year, increases to FHFA's Fund Balance with Treasury are comprised of semi-annual assessments, investment interest, collections on reimbursable agreements, civil penalty monies, and Freedom of Information Act (FOIA) request fees. FHFA is not authorized to retain civil penalty monies or FOIA fees, and as such, records these as custodial liabilities (see Note 14. Incidental Custodial Collections).

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

H. Investments

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

I. Accounts Receivable

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

J. Property, Equipment, and Software, Net

Property, Equipment and Software is recorded at historical cost. It consists of tangible assets and software. Based on a review of capitalization policy thresholds of 22 other agencies, FHFA implemented new capitalization thresholds beginning in June 2011. The new capitalization thresholds are being applied prospectively.

Under FHFA's Oversight Procedures for the Identification of Capitalized Assets, revised June 2011, the following are the capitalization thresholds:

Description	Threshold
Furniture and Equipment	$ 50,000
Leasehold Improvements	$ 250,000
Software: Internally Developed	$ 500,000
Software: Off-the-Shelf	$ 200,000
Capitalized Leases	$ 250,000
Bulk Purchases	$ 250,000

Prior to the revision in June 2011, the capitalization thresholds were as follows:

Description	Threshold
Furniture and Equipment	$ 25,000
Leasehold Improvements	$ 25,000
Internal Use Software	$ 25,000
Capitalized Leases	$ 25,000
Bulk Purchases	$ 250,000

Depreciation is calculated using the straight-line method over the estimated useful life of the asset. 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, 2011 and 2010, 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 7. Leases).

M. Employee Leave and Benefits

All full-time FHFA employees are entitled to accrue sick leave at a rate of four hours per pay period. Annual leave is accrued based on years of creditable federal service and military service, with the following exceptions: Former Office of Federal Housing Enterprise Oversight (OFHEO) employees hired between April 25, 2005 and July 30, 2008 accrue annual leave based on years of creditable federal and military service as well as years of relevant private sector experience (HERA abolished OFHEO when FHFA was established in July 2008). Additionally, FHFA employees hired into mission critical positions after May 2011 accrue annual leave under this same formula. For most employees, annual leave may be accrued up to 240 hours each year. The FHFA executive employees equivalent to the Senior Executive Service (SES) employees may accrue annual leave consistent with the rules for SES level employees. Accrued annual leave is treated as an unfunded expense with an offsetting liability when earned. The accrued liability is reduced when the annual leave is taken. Any unused annual leave balance is paid to the employee upon leaving federal service, based on the employee's earnings per hour. There is no maximum limit on the amount of sick leave that may be accrued. Upon separation, any unused sick leave of Civil Service Retirement System (CSRS) plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. Credit is given for sick leave balances in the computation of annuities upon the retirement of Federal Employees Retirement System (FERS)-covered employees effective at 50% beginning in fiscal year 2010 and 100% beginning in fiscal year 2014.

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

N. Retirement Plans

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

FERS employees and CSRS - Offset employees are eligible to participate in the Social Security program after retirement. In these instances, FHFA remits the employer's share of the required contribution, which is 11.7% for FERS and 7% for CSRS.

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

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

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

O. Contingencies

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

NOTE 2. FUND BALANCE WITH TREASURY

Fund Balance with Treasury consists of an Operating Fund and a Working Capital Fund. FHFA did not use the funds in the Working Capital Fund during fiscal years 2010 or 2011. Beginning in fiscal year 2010, the funds in the Working Capital Fund were fully invested. Fund Balance with Treasury (FBWT) account balances as of September 30, 2011 and 2010 were as follows:

(Dollars in Thousands)	2011	2010
Fund Balances:		
Operating Fund	16,445	1,000
Total	**$ 16,445**	**$ 1,000**
Status of Fund Balance With Treasury:		
Unobligated Balance		
Available	27,672	22,743
Obligated Balance Not Yet Disbursed	67,025	29,135
Investments	(78,252)	(50,878)
Total	**$ 16,445**	**$ 1,000**

(See Note 11. Legal Arrangements Affecting Use of Unobligated Balances)

NOTE 3. INVESTMENTS

Investments as of September 30, 2011 consist of the following:

(Dollars in Thousands)	Cost	Amortized (Premium) Discount	Interest Receivable	Investments Net	Market Value Disclosure
Intragovernmental Securities:					
Non-Marketable					
Market-Based	$ 78,252	-	-	$ 78,252	$ 78,252

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

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

Non-marketable, market-based securities are Treasury notes and bills issued to governmental accounts that are not traded on any securities exchange, but mirror the prices of marketable securities with similar terms. FHFA is currently investing in one-day certificates issued by the U.S. Treasury. There were no amortized premiums/discounts or interest receivable on investments as of September 30, 2011 or 2010. Interest earned on investments was $66 thousand and $72 thousand for fiscal years 2011 and 2010, respectively.

NOTE 4. ACCOUNTS RECEIVABLE

Accounts Receivable balances as of September 30, 2011 and 2010 were as follows:

(Dollars in Thousands)	2011	2010
Intragovernmental		
Acounts Receivable	$ 19	$ -
With the Public		
Accounts Receivable	5	6
Total Accounts Receivable	**$ 24**	**$ 6**

There are no amounts that are deemed uncollectible as of September 30, 2011 and 2010.

NOTE 5. PROPERTY, EQUIPMENT, AND SOFTWARE, NET

Schedule of Property, Equipment, and Software as of September 30, 2011 (Dollars in Thousands):

Major Class	Acquisition Cost	Accumulated Amortization/ Depreciation	Net Book Value
Equipment	$ 13,958	$ 10,874	$ 3,084
Leasehold Improvements	6,974	6,902	72
Capital Lease	22	22	-
Internal-Use Software	30,316	29,286	1,030
Software-in-Development	-	-	-
Construction-in-Progress	1,383	-	1,383
Total	**$ 52,653**	**$ 47,084**	**$ 5,569**

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

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

The change in capitalization threshold resulted in an immaterial change to the fiscal year 2011 financial statements.

NOTE 6. OTHER LIABILITIES

The other liabilities for FHFA are comprised of FECA liability, unemployment insurance liability, payroll accruals, deferred lease liability and unfunded leave. Payroll accruals represent payroll expenses that were incurred prior to year-end but were not paid. Other liabilities not covered by budgetary resources consist of unfunded annual leave, compensatory time, and deferred lease liability. As of September 30, 2011 and 2010, other liabilities not covered by budgetary resources were $9.5 million and $7.9 million, respectively. Intragovernmental liabilities not covered by budgetary resources were $1,408 for unfunded Federal Employees' Compensation Act (FECA) liabilities in Fiscal Year 2011, and $0 in Fiscal Year 2010.

Other Liabilities as of September 30, 2011 consist of the following:

(Dollars in Thousands)	Current	Non Current	Total
Intragovernmental Liabilities			
Payroll Taxes Payable	$ 799	$ -	$ 799
Total Intragovernmental Other Liabilities	**$ 799**	**$ -**	**$ 799**
With the Public			
Accrued Funded Payroll and Unfunded Leave	$ 11,961	$ -	$ 11,961
Deferred Lease Liabilities	57		57
Total Public Other Liabilities	**$ 12,018**	**$ -**	**$ 12,018**

Other Liabilities as of September 30, 2010 consist of the following:

(Dollars in Thousands)	Current	Non Current	Total
Intragovernmental Liabilities			
Funded and Unfunded FECA Liability	$ 3	$ -	$ 3
Payroll Taxes Payable	$ 1,216	-	$ 1,216
Total Intragovernmental Other Liabilities	**$ 1,219**	**$ -**	**$ 1,219**
With the Public			
Accrued Funded Payroll and Unfunded Leave	$ 15,309	$ -	$ 15,309
Total Public Other Liabilities	**$ 15,309**	**$ -**	**$ 15,309**

NOTE 7. LEASES

Operating Leases

1700 G Street NW

FHFA has an occupancy lease with the Office of the Comptroller of the Currency (OCC) 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 provided notification of its intent to terminate the lease.

FHFA may terminate the lease agreement with OCC 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 Standard 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 January 31, 2012. The lease terms of 1625 Eye Street expire on June 30, 2015. FHFA-OIG also leases office space in 1625 Eye Street NW. The FHFA-OIG lease terms at 1625 Eye Street NW expire one year after the occupation date, January 24, 2011, with optional renewal periods for up to two years. Leases at both locations are non cancellable. Contingency space at an undisclosed location is also leased, with the lease expiring on March 31, 2012. Total rental payments for the fiscal years ended September 30, 2011 and 2010 were $6.1 million and $4.9 million, respectively.

400 7th Street SW – Constitution Center

FHFA entered into a lease for office space at 400 7th Street SW Constitution Center on January 31, 2011. FHFA will take occupancy in January 2012. FHFA does not have the right to terminate the lease for the convenience of the government. FHFA may only exercise a one-time early termination at the end of the 10th year, contingent upon FHFA having less than 400 employees in the Washington DC area and representing that it reasonably believes it will have less than 400 employees in the DC area in the future.

The minimum future payments for these leases (except for 1700 G Street, NW and 1750 Pennsylvania Avenue) are as follows:

(Dollars in Thousands) Fiscal Year	Amount
2012	$ 15,286
2013	19,462
2014	19,852
2015	19,260
2016	16,676
Thereafter	93,143
Total Future Payments	**$ 183,679**

NOTE 8. COMMITMENTS AND CONTINGENCIES

FHFA did not have any material commitments or contingencies that met disclosure requirements as of September 30, 2011 and 2010.

NOTE 9. PROGRAM COSTS

Pursuant to HERA, FHFA was established to supervise and regulate the fourteen regulated entities. The regulated entities include Freddie Mac, Fannie Mae and the twelve FHLBanks. FHFA tracks resource allocations and program costs to the strategic goals (responsibility segments) developed for FHFA's strategic plan. Strategic Goals, 1 – Safety and Soundness; 2 – Affordable Housing; and 3 – Conservatorship, guide program offices to carry out FHFA's vision and mission. FHFA has a Resource Management Strategy, which is distributed proportionately to Strategic Goals 1 – 3 based on the percentage of direct costs of each goal to the total direct costs for FHFA. FHFA-OIG allocated their costs to FHFA's Resource Management Strategy. FHFA's revenue was provided by the Regulated Entities through assessments. FHFA-OIG received their funding through a $29 million expenditure transfer from FHFA. FHFA-OIG's revenues for fiscal year 2011 were $0 and total expenses were $17.3 million.

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

(Dollars in Thousands)	2011	2010
Safety and Soundness		
Intragovernmental Costs	$ 27,364	$ 21,703
Public Costs	98,597	74,167
Total Program Costs	125,961	95,870
Less: Intragovernmental Earned Revenue	108	108
Less: Public Earned Revenue	135,189	89,164
Net Safety and Soundness Program (Income)/Costs	**(9,336)**	**6,598**
Affordable Housing		
Intragovernmental Costs	4,216	3,759
Public Costs	13,024	12,272
Total Program Costs	17,240	16,031
Less: Intragovernmental Earned Revenue	30	33
Less: Public Earned Revenue	38,024	26,786
Net Affordable Housing Program (Income)/Costs	**(20,814)**	**(10,788)**
Conservatorship		
Intragovernmental Costs	2,683	1,926
Public Costs	21,517	14,737
Total Program Costs	24,200	16,663
Less: Intragovernmental Earned Revenue	22	33
Less: Public Earned Revenue	27,410	27,078
Net Conservatorship Program (Income)/Costs	**(3,232)**	**(10,448)**
Total Intragovernmental costs	34,263	27,388
Total Public costs	133,138	101,176
Total Costs	167,401	128,564
Less: Total Intragovernmental Earned Revenue	160	174
Less: Total Public Earned Revenue	200,623	143,028
Total Net (Income)/Cost	**$ (33,382)**	**$ (14,638)**

NOTE 10. APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

All obligations incurred are characterized as Category C, Exempt from apportionment (i.e. not apportioned), on the Statement of Budgetary Resources. Obligations incurred and reported in the Statement of Budgetary Resources in fiscal years 2011 and 2010 consisted of the following:

(Dollars in Thousands)	2011	2010
Direct Obligations, Category C	$ 225,802	$ 132,707
Reimbursable Obligations, Category C	94	101
Total Obligations Incurred	**$ 225,896**	**$ 132,808**

NOTE 11. 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, 2011 and 2010, the unobligated balance was $27.7 million and $22.7 million. The portion of the fiscal year 2011 unobligated available balance that will be credited against the regulated entities' April assessments is $14.7 million with the remaining $9 million retained in the working capital fund and $4 million retained in the FHFA-OIG account. (see Note 2. Fund Balance With Treasury)

NOTE 12. BUDGETARY RESOURCE COMPARISONS TO THE BUDGET OF THE UNITED STATES GOVERNMENT

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting", calls for explanations of material differences between amounts reported in the Statement of Budgetary Resources and the actual balances published in the Budget of the United States Government (President's Budget). The President's Budget that will include fiscal year 2011 actual budgetary execution information has not yet been published. The President's Budget is scheduled for publication in February 2013 and can be found at the OMB Web site: *http://www.whitehouse.gov/omb/*. The 2012 Budget of the United States Government, with the "Actual" column completed for 2010, has been reconciled to the Statement of Budgetary Resources and there were no material differences.

NOTE 13. UNDELIVERED ORDERS AT THE END OF THE PERIOD

For the fiscal years ended September 30, 2011 and 2010, budgetary resources obligated for undelivered orders amounted to $52.7 million and $20.6 million, respectively.

NOTE 14. INCIDENTAL CUSTODIAL COLLECTIONS

FHFA's custodial collections primarily consist of Freedom of Information Act requests and civil penalties assessed. Custodial collections are reflected in Fund Balance with Treasury during the year. While these collections are considered custodial, they are neither primary to the mission of the agency nor material to the overall financial statements. FHFA also collects civil penalties assessed against the regulated entities. FHFA's custodial collections are $3,385 for the year ended September 30, 2011. Custodial collections totaled $288 for the year ended September 30, 2010. There were no civil penalties assessed or collected in fiscal year 2010 or 2011. Custodial collections are transferred to the Treasury General Fund on September 30 and are not reflected in the financial statements of the agency.

NOTE 15. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

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

(Dollars in Thousands)	2011	2010
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	$ 225,896	$ 132,808
Spending Authority From Offsetting Collections and Recoveries	(30,136)	(2,794)
Obligations Net of Offsetting Collections and Recoveries	195,760	130,014
Offsetting Receipts	(200,689)	(143,100)
Net Obligations	(4,929)	(13,086)
Other Resources		
Imputed Financing From Costs Absorbed By Others	5,193	4,807
Net Other Resources Used to Finance Activities	5,193	4,807
Total Resources Used to Finance Activities	**264**	**(8,279)**
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	(32,083)	(7,729)
Resources That Fund Expenses Recognized In Prior Periods	(55)	(84)
Resources That Finance the Acquisition of Assets	(5,226)	(975)
Total Resources Used to Finance Items Not Part of Net Cost of Operations	(37,364)	(8,788)
Total Resources Used to Finance the Net Cost of Operations	**(37,100)**	**(17,067)**
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase In Annual Leave Liability	1,662	581
Other	2	1
Total Components of Net Cost of Operations That Will Require or Generate Resources In Future Periods	1,664	582
Components Not Requiring or Generating Resources		
Depreciation and Amortization	2,164	2,200
Other	(110)	(353)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	2,054	1,847
Total Components of Net Cost of Operations That Will Not Require or Generate Resources In The Current Period	3,718	2,429
Net (Income from)/Cost of Operations	**$ (33,382)**	**$ (14,638)**

Appendix I: Management's Report on Internal Control over Financial Reporting

Federal Housing Finance Agency
1625 Eye Street, N.W., Washington, D.C. 20006-4065
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Management's Report on Internal Control over Financial Reporting

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

FHFA management is responsible for establishing and maintaining effective internal control over financial reporting. FHFA management evaluated the effectiveness of the agency's internal control over financial reporting as of September 30, 2011, 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, 2011, FHFA's internal control over financial reporting was effective.

Federal Housing Finance Agency

Edward J. DeMarco
Acting Director

Mark A. Kinsey
Chief Financial Officer

October 12, 2011

Appendix II: Comments from the Federal Housing Finance Agency

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

November 9, 2011

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

Dear Mr. Sebastian:

Thank you for the opportunity to respond to the Government Accountability Office's (GAO) draft audit report titled, Financial Audit: Federal Housing Finance Agency's Fiscal Years 2011 and 2010 Financial Statements, GAO-12-161. This report presents GAO's opinion on the fiscal years 2011 and 2010 financial statements of the Federal Housing Finance Agency (FHFA). The report also presents GAO's opinion on the effectiveness of FHFA's internal controls as of September 30, 2011 and GAO's evaluation of FHFA's compliance with laws and regulations.

I am pleased to accept GAO's unqualified opinion on the FHFA financial statements and to note that there were no material weaknesses or significant deficiencies identified during the fiscal year 2011 audit. The GAO reported that: the statements and notes were presented fairly, in all material respects; FHFA had effective internal controls over financial reporting; and there were no reportable instances of noncompliance with laws and regulations tested by GAO.

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

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

Sincerely,

Edward J. DeMarco

Edward J. DeMarco
Acting, Director

1700 G Street, N.W., Washington, D.C. 20552-0003 • 202-414-3800 • 202-414-3823 (fax)

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