
Federal Housing Finance Board

Performance and Accountability Report



Fiscal Year 2006
November 15, 2006

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MESSAGE FROM THE CHAIRMAN

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MESSAGE FROM THE CHAIRMAN

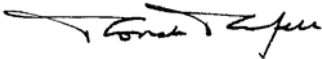
I am pleased to present the Federal Housing Finance Board's (Finance Board) Performance and Accountability Report (Report) for fiscal year 2006 (FY2006). This report summarizes the agency's success in meeting its FY2006 goals and objectives as set forth in the FY2006 Annual Performance Budget and provides Finance Board financial and program performance information.

The primary duty of the Finance Board is to ensure that the Federal Home Loan Banks (FHLBanks) and the Office of Finance (OF) operate safely and soundly. The Finance Board also assesses the FHLBanks' administration of their affordable housing and community investment programs.

FY2006 was a productive year at the Finance Board. The agency met the goals established in the FY2006 Annual Performance Budget. In addition, the Finance Board made substantial progress toward strengthening and positioning the agency to carry out its responsibilities more efficiently and effectively.

The agency's FY2006 financial statements, including an unqualified opinion, are provided in this report. The opinion states that the financial statements are fairly presented and demonstrate accountability in the execution of the agency's responsibilities. This Report also includes a statement of reasonable assurance that the Finance Board's management accountability and internal controls are adequate and effective.

The Finance Board will continue to work to promote the safety and soundness of the Federal Home Loan Banks and build on the agency's accomplishments.



Ronald A. Rosenfeld
Chairman

MANAGEMENT DISCUSSION AND ANALYSIS

ABOUT THE FINANCE BOARD

The Finance Board is an independent agency established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. It is the successor agency to the former Federal Home Loan Bank Board, which was established by the Federal Home Loan Bank Act of 1932 (FHLBank Act). The Finance Board's statutory mandate is to ensure that the Federal Home Loan Banks operate in a financially safe and sound manner, carry out their housing finance mission, and remain adequately capitalized and able to raise funds in the capital markets.

The FHLBanks are privately capitalized, government-sponsored enterprises that provide wholesale credit to members and certain nonmembers to be used for mortgage lending and related activities. In addition, the FHLBanks have a mandate to promote housing and community investment finance. The FHLBanks provide long-term, flexible financing to more than 8,100 member financial institutions around the country. In addition to its supervision of the FHLBanks, the Finance Board also has regulatory authority and supervisory oversight responsibility for the Office of Finance, a joint office of the FHLBanks, which issues FHLBank System debt.

MISSION STATEMENT

The mission of the Federal Housing Finance Board is to ensure that the FHLBanks are safe and sound so they can serve as a reliable source of liquidity and funding for the nation's housing finance and community investment needs.

VISION

To continue to earn the public's trust, the Finance Board is dedicated to the highest professional standards of accountability and independence to carry out its responsibilities for FHLBank supervision and housing finance mission oversight.

VALUES

The core values underlying the mission and vision of the Finance Board, which guide its organizational decisions and actions, are:

- Independence. The Finance Board is the arm's-length regulator of the FHLBanks and the OF.
- Accountability. The Finance Board is a steward of the public's trust and will use its resources efficiently and in the public interest.

- Responsiveness. The Finance Board aligns its actions with its mission and responds promptly, effectively, and creatively to emerging risks and discharges its responsibilities fairly and impartially and adheres to the highest standards of ethical conduct.
- Excellence. The Finance Board strives for excellence in carrying out its responsibilities and recognizes the contributions of employees who demonstrate the highest professional standards in their work.

ORGANIZATION

The Finance Board is governed by a five-member board of directors. Four of the directors are appointed by the President and confirmed by the Senate and must have extensive experience or training in housing finance or a commitment to providing specialized housing credit. The fifth member is the Secretary of the U.S. Department of Housing and Urban Development. No more than three directors may be members of the same political party.

At least one appointed director must be from an organization with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections. The appointed members of the board of directors serve staggered seven-year terms. The President designates the chairperson of the board of directors from among these appointed members.

The Finance Board is organized into five Offices:

The *Office of the Board of Directors* is responsible for setting the agency's strategic direction and approving policies and regulations. By delegation from the full Board of Directors, the chairperson supervises management and policy execution. The Board of Directors generally meets monthly in public sessions. The agency's Chief Information Officer, who is responsible for the Finance Board's technology and information systems, reports to the chairperson.

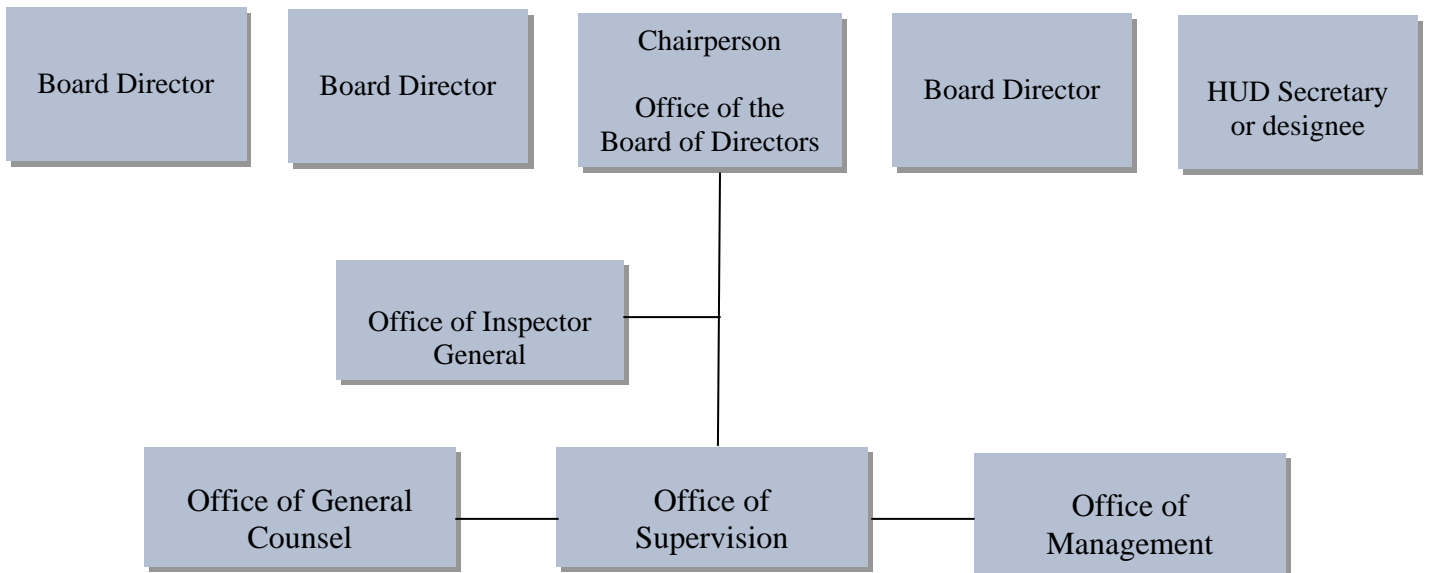
The *Office of Supervision (OS)* is responsible for the supervision and examination of the FHLBanks and the OF. OS performs this function through annual on-site examinations, periodic visitations, and off-site monitoring. Other OS responsibilities include supervisory policy and program development, regulatory analysis and development, and economic research and analysis.

The *Office of General Counsel (OGC)* provides legal support and guidance on interpretations of laws, regulations, and policies to Finance Board officials. OGC prepares legal documents on behalf of the Finance Board and represents the agency in judicial and administrative proceedings. OGC staff manages the Finance Board's ethics and Freedom of Information Act programs, and acts as the Secretary to the Board.

The Office of Management (OM) is responsible for the Finance Board's administrative functions, such as accounting, budgeting, human resources, contracting and procurement, facilities and property management, and records management.

The Office of Inspector General (OIG) operates pursuant to the Inspector General Act of 1978, as amended. OIG conducts and supervises audits and investigations related to Finance Board programs and operations, and recommends policies to promote economy, efficiency, and effectiveness, and to prevent and detect fraud and abuse.

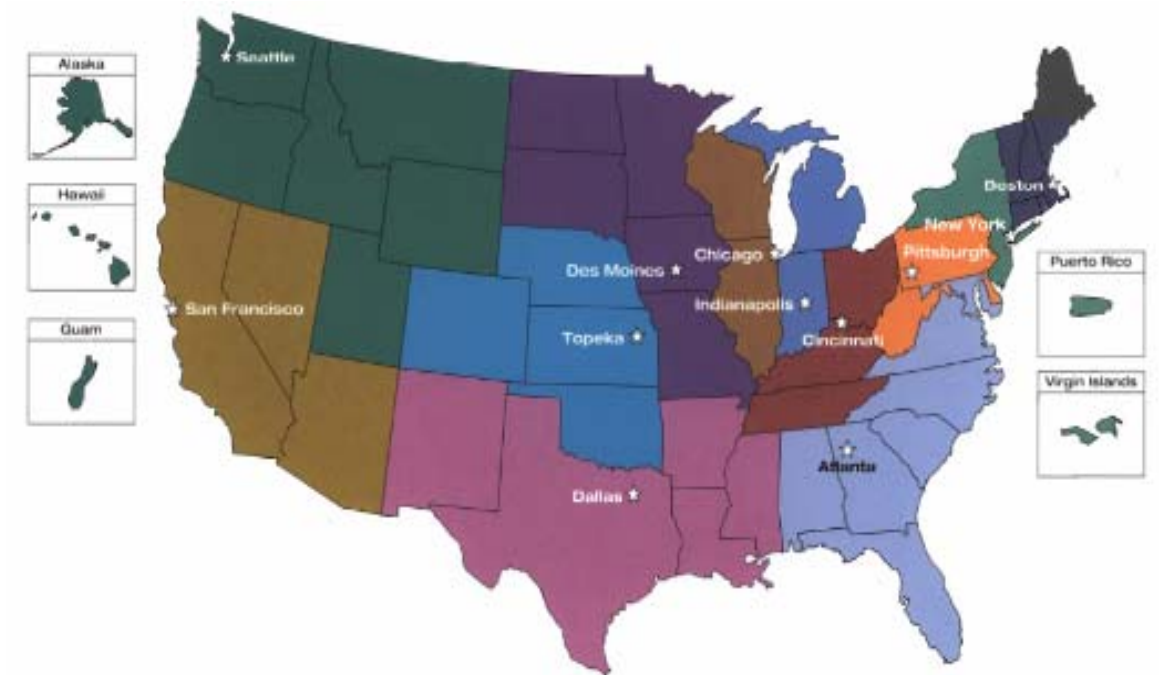
FEDERAL HOUSING FINANCE BOARD ORGANIZATION CHART



THE FEDERAL HOME LOAN BANK SYSTEM

In 1932, Congress authorized the establishment of the FHLBanks to stimulate mortgage finance and provide liquidity to credit markets. Until 1989, FHLBank members consisted primarily of savings and loan associations engaged in home financing. In 1989, Congress extended eligibility for FHLBank membership to commercial banks and federally insured credit unions (subject to a home financing requirement). In 1999, Congress made FHLBank membership voluntary for all types of eligible institutions.

FEDERAL HOME LOAN BANK DISTRICTS



The FHLBanks are privately capitalized, government-sponsored enterprises that provide wholesale credit to members and certain nonmembers to be used for mortgage lending and related activities. In addition, the FHLBanks have a mandate to promote housing and community investment finance. The FHLBanks provide long-term, flexible financing to more than 8,100 member financial institutions around the country. As of September 30, 2006, the FHLBanks had combined assets exceeding one trillion dollars.

The FHLBanks are funded principally by the issuance of consolidated obligations of the FHLBank System. These consolidated obligations consist of bonds (original maturity of one year or longer) and discount notes (original maturity of less than one year). Consolidated obligations are not guaranteed or insured by the U.S. government. However, their status as government sponsored enterprises enables the FHLBanks to raise funds at rates slightly higher than comparable obligations issued by the U.S. Treasury. Debt issued by the FHLBanks through the OF is the joint and several obligation of all 12 FHLBanks.

Members use short and long-term advances (collateralized loans) to fund their lending activities and to maintain liquidity for their operations. Long-term advances may be used only to support residential housing finance and, in the case of a community financial institution, to support lending to small businesses, small farms, and small agricultural businesses. The preponderance of the collateral supporting advances consists of mortgage assets.

In addition to advances, the FHLBanks purchase qualifying mortgage loans from members under various acquired member asset programs. Under these programs, the FHLBank manages the market risk associated with the loans while members bear most of the credit risk through the purchase of mortgage insurance for the loans sold to the FHLBank.

KEY FEDERAL HOME LOAN BANK FINANCIAL STATISTICS
(in millions)

	Sept 30 2006	Dec 31 2005	Dec 31 2004
Advances to Members	\$644,164	\$619,884	\$581,235
Mortgage Loans, Net	99,685	105,015	113,855
Investments	155,557	152,892	152,992
Other Assets	<u>126,087</u>	<u>125,124</u>	<u>85,558</u>
Total Assets	<u>\$1,025,494</u>	<u>\$1,002,915</u>	<u>\$933,639</u>
Consolidated Obligations	\$944,039	\$921,475	\$854,500
Deposits and Borrowings	22,452	23,192	22,326
Other Liabilities	13,445	13,859	14,879
Capital	45,558	44,390	41,934
Net income	\$1,924*	\$2,356	\$2,008

*Reflects income for first 9 months of 2006

Members have access to a broad array of funds to support affordable housing and community investment activities. The Bank Act requires each FHLBank to allocate 10 percent of its annual net income to fund a subsidy program known as the Affordable

Housing Program (AHP). Under the AHP, a member may submit an application to its FHLBank for funds to be used to finance the purchase, construction, or rehabilitation of housing for very low, low, and moderate-income households. AHP funds also are awarded through the homeownership set-aside program in which members obtain AHP funds from the FHLBank to provide grants to eligible low and moderate-income households for down-payment or closing cost assistance and counseling costs in conjunction with a purchase or rehabilitation of owner-occupied units. Since the inception of the AHP in 1990, the FHLBanks have awarded nearly \$2.7 billion in subsidies to assist more than 539,000 housing units.

	Competitive Application Program	Set-Aside Program
Time Period	1990-2006	1995-2005
Units Receiving Assistance (in thousands)	492	48
Total Funds Awarded (\$ in millions)	\$2,477	\$198

THE YEAR IN REVIEW

The Finance Board’s accomplishments in FY2006 were concentrated in five areas:

1. *Safety and Soundness Examination and Supervision.* The Finance Board examination program continues to fulfill its statutory mandate by, among other things, monitoring risks at the FHLBanks. The Finance Board conducted examinations and periodic on-site visitations at all FHLBanks and the OF.

At the conclusion of each examination, OS prepared a Report of Examination that summarized examiners’ findings and assigned a conclusion indicating the level of supervisory concern. OS met with each FHLBank’s board of directors to present the Report of Examination and discuss matters of concern. The Finance Board has written agreements with two FHLBanks that have been effective in achieving remedial action.

2. *Regulatory and Supervisory Policy Initiatives.* In FY2006, the Finance Board issued three final rules, and published a proposed rule and the proposed examination rating system for public comment. The final rule addressing corporate governance improves the FHLBank director election process. Under this rule, at the beginning of the election process, each FHLBank may provide a brief statement describing the skills and experience the FHLBank believes will add strength to its board of directors. In addition,

each ballot may briefly describe a nominee's skills and experience. As a result, members should be better informed when casting their votes. This rule became effective on July 18, 2006.

The final rule addressing the Data Reporting Manual (DRM) consolidates data reporting requirements from individual regulations. The Finance Board finalized the first two chapters of the DRM, which address call report and membership data in FY2005. The agency completed the remaining chapters, which address acquired member asset and AHP data in 2006. This rule became effective on July 21, 2006.

The final rule addressing the AHP removes certain prescriptive requirements, clarifies certain operational requirements, and otherwise streamlines and reorganizes the existing AHP regulation. The rule was published in the *Federal Register* on October 6, 2006, and will become effective on January 1, 2007.

In FY2006, the Finance Board issued a proposed rule for public comment that would require each FHLBank to maintain a minimum level of retained earnings and would restrict an FHLBank's reliance on excess stock. The Finance Board expects to consider a final rule during FY2007.

In FY2006, the Office of Supervision deployed its revised safety and soundness examination manual. The manual, which serves as guidance for examiners during their annual examinations, emphasizes the quality of board governance, risk measurement and management, and financial condition and performance. The revised manual was used by examiners and other examination staff during examinations starting in January 2006. During FY2006, OS held a number of feedback sessions with examiners to solicit suggestions for ways to improve the effectiveness of the manual. A revised examination manual will be published on the Finance Board's web site in FY2007.

Finally, in FY2006, the Finance Board has issued for public comment a proposed examination rating system (Rating System) for the FHLBanks and the OF. Under the proposed Rating System, OS will assign a composite rating to each FHLBank that is based on an evaluation and rating of five key components: corporate governance, market risk, credit risk, operational risk, and financial condition and performance. The Rating System is expected to become effective in 2007.

3. *Risk Monitoring and Risk Modeling.* In FY2006, the Finance Board developed a prototype modeling tool that is intended to facilitate the analysis and assessment of each FHLBank's exposure to interest rate changes, the reliability of its internal reporting, the adequacy of its risk management decisions, the impact of new business strategies and policies, and its earnings capacity. At present, the Finance Board can use this tool to evaluate two FHLBanks. In FY2007, its use will expand to include at least three additional FHLBanks, and the model will be evaluated to determine whether it can be expanded to serve other purposes.

4. *Community Investment and AHP Examination and Supervision.* The Finance Board conducts annual community investment and AHP examinations at each FHLBank. These examinations are designed to assess the overall effectiveness of each FHLBank's AHP, to evaluate whether the FHLBank's AHP databases accurately reflect program operations, to assess the adequacy of governance by the FHLBank's board of directors, to assess the quality and effectiveness of the internal audit program and its coverage, and to assess compliance with the Bank Act and Finance Board regulations. At the conclusion of each examination, examiners summarize results in a Report of Examination presented to the FHLBank's board of directors.

In FY2006, the Finance Board initiated development of an AHP Examination Manual. Selected work programs were revised and used in FY2006. The manual will be completed in FY2007. When completed, the manual will serve as a baseline for examiners to use during their annual AHP examinations.

5. *Organizational Enhancements.* The Finance Board took several actions to enhance the supervisory program in FY2006. New staff and/or positions were added, including senior level executives to oversee the supervision and examination function and supervisory and regulatory policy function, a chief accountant, four economists to conduct financial and housing research, four bank examiners, and two financial analysts.

In light of the recent theft of sensitive personal information from the federal government and in response to Office of Management and Budget memoranda, the Finance Board completed a review of agency practices related to the collection, use, and protection of personally identifiable information. As a result of that review, the information technology staff enhanced the safeguards for sensitive information by adding two-factor authentication and data encryption to the agency's network infrastructure. The agency also is implementing government-wide personal identity verification management standards that will result in issuance of new identification cards for employees and contractors. Finally, the Finance Board issued updates to its Privacy Act implementing rule and systems of records designed to strengthen the agency's ability to protect personally identifiable information.

In FY2006, the Finance Board installed dedicated broadband lines (T1) in all FHLBanks to connect Finance Board examiners to the agency's network via a virtual private network (VPN). This allows examiners to complete work without competing for FHLBank resources, and provides additional security and reliability because the lines are dedicated to the Finance Board and secure.

CHALLENGES

The environment in which the Finance Board and the FHLBanks operate influences the agency's direction, goals, and priorities. The Finance Board is improving its resources and monitoring to provide for the timely assessment of emerging issues and risks. This

effort will inform the agency on issues, and assist in identifying needed supervisory guidance for examiners and the FHLBanks.

KEY EXTERNAL FACTORS

Performance of the Finance Board and the FHLBanks can be affected by conditions beyond their control. For example, macroeconomic developments affecting interest rates, national or regional activity can affect the economic performance of the FHLBanks. Other external factors with the potential to affect the FHLBanks include developments in capital and housing markets. Further, regulatory developments, including developments in accounting standards set by the Financial Accounting Standards Board and disclosure requirements set by the SEC, along with new legislation have the potential to significantly affect the environment in which the FHLBanks must operate. Regardless of the source of the influences on FHLBank performance, the Finance Board must respond promptly to ensure that the FHLBanks meet whatever challenges affect their performance.

Significant events, influences, and risks that may affect the Finance Board are:

Legislation. Congress has been considering legislation to establish a single agency as the regulator for the government sponsored enterprises (GSEs) that support the national housing market. This new agency would oversee the safety, soundness, and housing mission achievement of the FHLBanks, Fannie Mae, and Freddie Mac.

Developments in Banking and Financial Markets. Financial markets continue to evolve with new products and services, particularly hedging activities and their associated accounting. These developments have the potential to influence the demand for FHLBank products and services and the FHLBanks' financial performance. As the industry changes, the supervisory focus of the Finance Board also must change to ensure continuous effective supervision of the FHLBanks. Recent supervisory initiatives have included reviewing of the FHLBanks' anti-predatory lending policies; increased accountability of FHLBank officers and directors as required by the Sarbanes-Oxley Act of 2002; monitoring housing prices and foreclosure activity, particularly in areas affected by natural disasters and economic downturns; monitoring consolidation of the financial services industry and its potential effects on the FHLBanks' membership and business; and reviewing the composition of FHLBank capital and adequacy of retained earnings.

In addition, the rapid pace of technological innovation, especially in telecommunications and electronic data processing, continues to have a substantial affect on U.S. financial services. Harnessing technological innovations will create opportunities to improve the Finance Board's efficiency across organizational units and functions.

Economic Variables. Adverse economic conditions such as high unemployment, softening real estate markets, and sharp or prolonged changes in interest rates have the potential to affect the financial condition of the FHLBanks. The Finance Board is responding by directing the FHLBanks to review and strengthen their risk management practices and business operations vulnerabilities.

Staffing. In the competitive financial services environment, highly skilled personnel are in great demand. This makes recruiting and retaining a highly skilled workforce a continuing challenge. The Finance Board's recruitment and retention efforts have included examiners, economists, accountants, analysts, and attorneys with the requisite financial, legal, and technological skills to model, monitor, and assess the risks undertaken by the FHLBanks and the OF.

Continuity of Operations. Financial institutions must maintain capacity to resume business after a crisis. Ensuring preparedness for a crisis continues to be a priority for the Finance Board both for its own operations and those of the FHLBanks and the OF.

The Finance Board maintains an Emergency Operations Center that has connectivity to all agency systems and provides essential personnel with the necessary resources to continue agency operations. In addition, in case of a natural disaster, staff can access the agency's systems from anywhere in the country.

THE FINANCE BOARD'S MANAGEMENT CHALLENGE

In accordance with Office of Management and Budget (OMB) Circular A-136, the Office of Inspector General has determined that the Finance Board's most serious management and performance challenge is whether the examination and supervisory staff are adequate in number; possesses appropriate abilities, knowledge, and skills; has been provided with adequate guidance; and can adequately monitor the FHLBanks and the OF.

Agency Progress: The OIG believes that the agency has taken appropriate steps to enhance the examination and supervision functions by adopting a risk-based supervisory approach in which staff: (1) identifies risks using common definitions (*i.e.*, market, credit, and operational risks); (2) measures risks using common methods of evaluation; and (3) evaluates risk management to determine whether the FHLBanks' systems and processes enable the board of directors and senior management to manage existing and prospective levels of risk.

OS has committed to developing and issuing a formal strategic plan for fully staffing the examination and supervision functions. In FY2006, the Finance Board hired new staff members who have expertise in management, economics, financial analysis, bank examination, and accounting. In the next two years, the Finance Board plans to continue to hire additional staff with expertise in these areas.

Finally, the Finance Board has revised the safety and soundness examination manual and has made substantial progress in drafting the AHP examination manual.

PROGRAM PERFORMANCE OVERVIEW

The Finance Board evaluates its program performance within a structured planning, budgeting and performance management process. In its FY 2003-2008 Strategic Plan,

the agency established three strategic goals that guide its operation. The strategic plan is available on the agency's website (www.fhfb.gov). For each strategic goal, the agency established strategic objectives that describe how the strategic goal will be accomplished. While some of the objectives are easily measured, e.g., whether or not the FHLBanks meet or exceed their required capital ratios, others are more subjective. Accordingly, the Finance Board has adopted for each objective a number of annual performance goals and accompanying annual performance measures to determine the degree to which the strategic objectives, and ultimately the strategic goals are achieved. The Finance Board's Annual Performance Budget for FY2006 lists the nested structure described above, which is reproduced in the table below.

STRATEGIC GOAL	STRATEGIC OBJECTIVES	ANNUAL PERFORMANCE GOAL	ANNUAL PERFORMANCE MEASURE
1. Supervision program effectively fosters safe and sound operations at each FHLBank.	1.1 The FHLBanks operate safely and soundly.	1.1 Maintain an effective risk-based examination program.	1.1 Conduct all safety and soundness activities, including annual examinations, quarterly reviews, and off-site monitoring on a timely basis.
	1.2 The FHLBanks meet or exceed their minimum capital requirements.	1.2 Each FHLBank satisfies its applicable capital requirements and prudently manages capital and earnings.	1.2 Each FHLBank continuously meets or exceeds its minimum capital requirement.
	1.3 The FHLBanks raise funds efficiently and are role models for transparency and accountability.	1.3a The FHLBanks maintain a triple A credit rating for their consolidated obligations.	1.3a Conduct semi-annual assessment of FHLBank System cost of funds and maintain ratings for consolidated obligations and FHLBank credit ratings at regulatory requirements.
		1.3b Each FHLBank's and the FHLBank System's financial disclosures comply with applicable laws, rules, and regulations.	1.3b Conduct on-site examination of the OF and review annual and quarterly financial reports issued by the FHLBank System and each FHLBank for compliance with disclosure requirements. EICs monitor annual and quarterly financial reports issued by each FHLBank.
2. Ensure that the FHLBanks serve the nation's housing finance and community investment needs.	2.1 The FHLBanks facilitate the housing finance activities of their members.	2.1 The FHLBanks adhere to public policy principles and safety and soundness requirements when making advances and acquiring mortgage assets.	2.1 Review advance and mortgage portfolios of each FHLBank as part of the annual on-site examination for compliance with the Bank Act and Finance Board regulations.
	2.2 The FHLBanks support affordable housing and promote community investment.	2.2 Supervision of the Affordable Housing and Community Investment Programs at each FHLBank.	2.2 Conduct examinations of the Affordable Housing and Community Investment Programs at each FHLBank.
3. Use supervisory, managerial, and legal resources to support effective, efficient, and responsive FHLBank supervision, regulation, and housing oversight.	3.1 The Finance Board takes appropriate and timely regulatory and advisory actions.	3.1a Review, revise, and supplement Finance Board regulations to ensure relevance, transparency, and issue-oriented supervisory guidance.	3.1a Review and revise Finance Board regulations, and supplement regulations with advisory bulletins, examiner guidance bulletins, and regulatory interpretations, where appropriate.
		3.1b Review and respond promptly to new business activity notices filed by the FHLBanks.	3.1b Respond to new business activity notices filed by the FHLBanks within 60 days of receipt.
	3.2 The Finance Board prudently allocates resources to fulfill its mission effectively and efficiently.	3.2a Use fiscal, physical, and human resources efficiently and effectively to fulfill the Finance Board's fiduciary responsibilities.	3.2a Align budgeted resources with projected workloads and business priorities. Recruit, develop, and retain high-achieving professional staff.
		3.2b Maintain and test business continuity and contingency plans.	3.2b Review, update, and test the Finance Board's Continuity of Operations Plan (COOP).

The Finance Board achieved all of its performance goals in FY2006. The agency strengthened its supervisory program through the implementation of risk-based examinations and additional monitoring programs and tools. In addition, the agency issued a final rule to enhance the effectiveness of the AHP. The Finance Board also issued final rules to enhance board governance at the FHLBanks and to improve the quality and timeliness of data collected from the FHLBanks. The Finance Board also issued a notice of proposed rulemaking concerning the composition of FHLBank capital, which would establish a minimum retained earnings requirement and a limit on the use of excess stock at each FHLBank. The following table summarizes a number of the key Finance Board achievements during FY2006.

REPRESENTATIVE ACCOMPLISHMENTS DURING FY2006	
STRATEGIC GOAL 1: SUPERVISION PROGRAM EFFECTIVELY FOSTERS SAFE AND SOUND OPERATIONS AT EACH FHLBANK.	
Strategic Objectives	Accomplishments
1.1 The FHLBanks operate safely and soundly.	<ul style="list-style-type: none"> Completed annual examinations and periodic visitations. Implemented a program to assign an overall examination conclusion that summarizes level of supervisory concern. Amended written agreement with an FHLBank.
1.2. The FHLBanks meet or exceed their minimum capital requirements.	<ul style="list-style-type: none"> Each FHLBank exceeded its minimum regulatory capital requirements. Approved capital plan amendments submitted by two FHLBanks.
1.3. The FHLBanks raise funds efficiently and are role models for corporate transparency and accountability.	<ul style="list-style-type: none"> Every FHLBank registered a class of equity securities with the U.S. Securities and Exchange Commission (SEC) and are now subject to the reporting requirements of the Securities Exchange Act of 1934 (1934 Act).

STRATEGIC GOAL 2: ENSURE THAT THE FHLBANKS SERVE THE NATION’S HOUSING FINANCE AND COMMUNITY INVESTMENT NEEDS.	
Strategic Objectives	Accomplishments
2.1 The FHLBanks facilitate the housing finance activities of their members.	<ul style="list-style-type: none"> Reviewed advance and mortgage portfolios at each FHLBank for compliance with the Bank Act and Finance Board regulations
2.2 The FHLBanks support affordable housing and promote community investment.	<ul style="list-style-type: none"> Completed annual examinations of the Affordable Housing Program at each FHLBank. To date in 2006, the FHLBanks have awarded more than \$135 million in subsidies to assist 20,087 housing units.

STRATEGIC GOAL 3: USE SUPERVISORY, MANAGERIAL, AND LEGAL RESOURCES TO SUPPORT EFFECTIVE, EFFICIENT, AND RESPONSIVE FHLBANK SUPERVISION, REGULATION, AND HOUSING OVERSIGHT.	
Strategic Objectives	Accomplishments
3.1 The Finance Board takes appropriate and timely regulatory and advisory actions.	<ul style="list-style-type: none"> • Adopted corporate governance, AHP, and data quality and timeliness regulations. • Issued for comment a proposed rule to strengthen the capital structure of the FHLBanks. • Requested comments on a proposed FHLBank rating system. • Issued Advisory Bulletins on AHP and Resolution Funding Corporation contributions, model documentation and validation, and disclosure of SEC filings.
3.2 The Finance Board prudently allocates resources to fulfill its mission effectively and efficiently.	<ul style="list-style-type: none"> • Received and responded to all (5) new business activity notices within 60 days of receipt of a complete submission. • Hired 15 additional full-time staff, including a senior executive and chief accountant. • Provided high-speed Internet access to Finance Board staff at the FHLBanks. • Improved security for all agency computers. • Redesigned the Call Report System. • Converted acquired member assets database to a relational database. • Completed testing of Continuity of Operations Plan (COOP).

FINANCIAL PERFORMANCE OVERVIEW

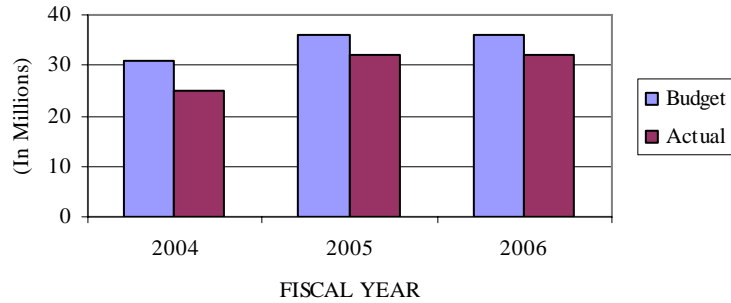
As of September 30, 2006, the financial condition of the Finance Board was sound. There are sufficient funds to meet program needs and adequate controls in place to ensure that obligations do not exceed budget authority.

FINANCIAL HIGHLIGHTS

The Finance Board draws its financial resources from assessments of the twelve FHLBanks. It receives no appropriations, and its funds are not subject to apportionment.

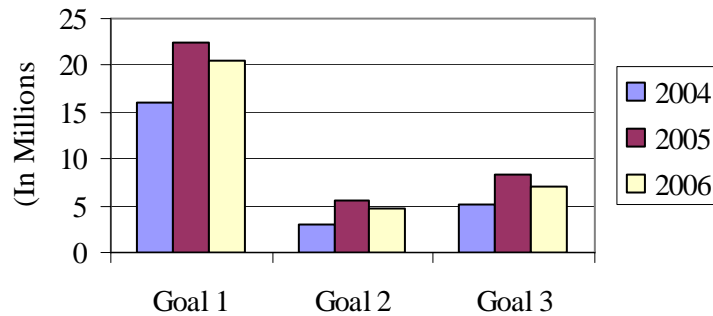
The Finance Board’s budget for FY2006 was approximately \$35.9 million with 153.5 full-time equivalent staff. The FY2006 budget reflected a decrease in budget authority of \$576,000 or 2 percent less than the FY2005 budget.

BUDGET vs. ACTUAL EXPENSES



Actual expenditures in FY2006 were \$32.2 million with 132.5 full-time equivalent staff. As in the past, the Finance Board allocated approximately 80 percent of its budget in FY2006 to supervision of the FHLBanks.

ACTUAL EXPENSES BY STRATEGIC GOAL



FINANCIAL STATEMENT ANALYSIS

A major change in the Net Cost of Operations occurred due to one-time costs associated with the agency’s build-out of new office space in FY2005. FY2006 reflects a significant decrease as a result of the tenant improvement allowance that was applied to rent. In addition, Total Budgetary Resources changed primarily due to an increase in salaries, benefits, and rent.

COMPARISON OF FY2006 TO FY2005
(in Millions)

	<u>2006</u>	<u>2005</u>
Total Assets	\$10.47	\$10.03
Total Liabilities	3.47	3.41
Total Net Position	7.00	6.63
Net Cost of Operations	0.62	3.23
Total Budgetary Resources	\$36.19	\$33.32

The Finance Board has prepared the principal financial statements to report its financial position and results of operations pursuant to the requirements of 31 U.S.C. § 3515(b). The Finance Board prepared the statements from its books and records in accordance with generally accepted accounting principles for Federal entities and the formats prescribed by OMB. The agency's financial statements and reports are prepared from the same books and records, and both are used to monitor and control budgetary resources.

The statements should be read with an understanding that they are for a component of the U.S. Government, a sovereign entity.

MANAGEMENT ASSURANCES

The Finance Board provides reasonable assurance that its systems of internal accounting and administrative control fully comply with applicable requirements of the Federal Managers' Financial Integrity Act of 1982 and OMB Circular A-123 (revised December 21, 2004). The Finance Board also provides reasonable assurance that the agency's management accountability and internal controls are adequate and effective, and there are no material weaknesses to report. The objectives of the system of internal control are to provide reasonable assurance that:

- Programs achieve their intended results;
- Resources are used consistent with agency mission;
- Programs and resources are protected from waste, fraud, and mismanagement;
- Laws and regulations are followed; and
- Reliable and timely information is obtained, maintained, reported, and used for decision making.

The concept of reasonable assurance recognizes that the cost of management control should not exceed the benefits expected to be gained, and that the benefits consist of reductions in the risks of failing to achieve the stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of control procedures. Furthermore, errors or irregularities may occur and not be detected because of inherent limitations in any system of management accountability and control, including limitations resulting from resource constraints and other factors. The statement of assurance and determination is based on the following:

- An independent outside audit of the Finance Board's financial statements, which provided an unqualified opinion and found no weaknesses involving the Finance Board's internal control structure determined to be material.
- An internal evaluation that included input from senior program and management officials and the OIG, covering the period from October 1, 2005, through September 30, 2006, which found no material weaknesses and concluded that the Finance Board's internal controls are achieving their intended objectives.

The Finance Board is committed to a strong internal control program. The agency employs sound financial management techniques, has developed oversight procedures, and emphasizes the importance of a strong risk management and internal control program to meet its statutory, regulatory, and fiduciary responsibilities.

PROGRAM PERFORMANCE

MEASURING AND REPORTING PERFORMANCE

This section presents information on the program-specific performance of the Finance Board during FY2006. This discussion of performance includes an overview of the agency's key initiatives and some of our major accomplishments. Program-specific performance results for Finance Board goals and measures, along with the results of all program evaluations or studies completed during FY2006, are also presented.

PERFORMANCE MEASUREMENT SYSTEM

The Finance Board's performance measurement system centers around three strategic goals for the agency, as outlined in its FY2003-2008 Strategic Plan. The strategic goals represent the agency's mission and reflect the overall outcomes to be achieved. The Finance Board has adopted a number of annual performance goals and accompanying annual performance measures that can be used to determine the degree to which the strategic objectives, and ultimately the strategic goals are achieved. The performance measures, performance goals, and strategic objectives constitute the agency's performance management system.

The Finance Board completed a triennial update of its Strategic Plan and review of its performance measures in 2006. The Finance Board continually seeks additional effective means to measure, report, and ultimately improve its performance. The update of the Strategic Plan for FY2007-2012 was an opportunity to develop and implement effective practices in performance measurement, reporting, and management.

ALIGNING RESOURCES TO GOALS

Collectively, the outcome-based performance goals are the key indicators for successful progress in achieving the agency's strategic goals. The performance goals and their associated measures reflect the agency's move toward more outcome-based performance. The Finance Board plans, manages, and monitors programs and activities based on contributions to the achievement of these performance goals, with the safety and soundness of the FHLBank System as the primary consideration. On-going program evaluations will identify whether existing programs are successfully achieving goals and whether revised or new initiatives are appropriate.

GOALS, OBJECTIVES, AND MEASURES

STRATEGIC GOAL 1: SUPERVISION PROGRAM EFFECTIVELY FOSTERS SAFE AND SOUND OPERATIONS AT EACH FHLBANK.

The Finance Board has identified three strategic objectives to assist in determining whether the agency has met its safety and soundness strategic goal. These objectives define the effectiveness of the Finance Board's oversight of the FHLBanks. The goal of the Finance Board's regulatory efforts is to encourage the events described in the objectives below.

STRATEGIC OBJECTIVES	2002	2003	2004	2005	2006
1.1 The FHLBanks operate safely and soundly.	Achieved	Achieved	Achieved	Achieved	Achieved
1.2 The FHLBanks meet or exceed their minimum capital requirements.	Achieved	Achieved	Achieved	Achieved	Achieved
1.3 The FHLBanks raise funds efficiently, and are role models for transparency and accountability.	Achieved	Achieved	Achieved	Achieved	Achieved

STRATEGIC OBJECTIVE 1.1: THE FHLBANKS OPERATE SAFELY AND SOUNDLY.

The Finance Board's supervisory program focuses on programs, activities, and operations that present the highest risk to the safety and soundness to the FHLBanks. The following processes are central to the agency's application of a risk-based supervisory approach: (1) identification of market, credit, and operational risks; (2) use of common methods of evaluation to measure these risks; and (3) assessment of governance, *e.g.*, the policies, systems, and processes employed by each FHLBank and the OF in managing existing and prospective levels of risk.

STRATEGIC OBJECTIVE 1.2: EACH FHLBANK MEETS OR EXCEEDS ITS MINIMUM CAPITAL REQUIREMENT.

In December 2000, the Finance Board adopted a regulation requiring the FHLBanks to establish a new risk based capital structure that addresses minimum capital standards and establishes the amount of FHLBank stock members must hold.

In 2002, the Finance Board required each FHLBank to submit for approval a plan to establish a new capital structure for the Bank. The Finance Board has approved all of the capital structure plans, and to date, 11 of the 12 FHLBanks have implemented their new capital structure.

STRATEGIC OBJECTIVE 1.3: THE FHLBANKS RAISE FUNDS EFFICIENTLY AND ARE ROLE MODELS FOR TRANSPARENCY AND ACCOUNTABILITY.

As government-sponsored enterprises, FHLBanks can raise funds at interest rates that are slightly higher than the rates on obligations of comparable type and similar maturity issued by the U.S. Treasury.

In 2005, the Finance Board required each FHLBank to file a registration statement covering a class of equity securities with the SEC and ensure its effectiveness under section 12(g) of the 1934 Act. In FY2006, the FHLBanks completed registration with the SEC.

Each FHLBank now is subject to the 1934 Act’s periodic disclosure requirements, which include the periodic preparation and filing of public disclosures relating to their financial condition, results of operations, trends, or uncertainties affecting its business, and management’s assessment of its business and financial condition, including supporting financial information and certifications.

ANNUAL PERFORMANCE GOALS: To support its strategic objectives in meeting strategic goal 1, the Finance Board has four annual performance goals, each with accompanying performance measures to indicate the achievement of those goals.

ANNUAL PERFORMANCE GOAL 1.1: MAINTAIN AN EFFECTIVE RISK-BASED EXAMINATION PROGRAM.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
1.1 Conduct all safety and soundness activities, including annual examinations, quarterly reviews and off-site monitoring on a timely basis.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: To fulfill their housing finance mission, the FHLBanks offer advances, mortgage purchase programs, and other services. As a result of these activities, the FHLBanks assume market, credit, and operational risks. The FHLBanks must evaluate and manage these varied and complex risks in accordance with their condition and earnings. The Finance Board’s supervisory program evaluates and monitors whether the risk management processes at each FHLBank effectively reflect and control the level of risk undertaken by it.

RESULTS: The Finance Board conducted on-site safety and soundness examinations at all 12 FHLBanks. At the end of each examination, staff reached a conclusion of the overall condition of each FHLBank based upon the level of credit, market, and operational risk undertaken, the adequacy of the FHLBank’s risk management practices, its financial condition and operating performance, the adequacy of its capitalization, the quality of its corporate governance, and administration of its affordable housing and community investment programs.

In 2004, the Finance Board entered into written agreements with the boards of directors of two FHLBanks. These agreements address certain deficiencies with the FHLBanks’ risk management, corporate governance, and financial condition that the Finance Board identified through its supervisory program. The agreement with one FHLBank was

amended in October 2005. In the past two years, both of these FHLBanks have made progress toward addressing the Finance Board’s supervisory concerns, but remain subject to the provisions of the written agreements.

ANNUAL PERFORMANCE GOAL 1.2: EACH FHLBANK SATISFIES ITS APPLICABLE CAPITAL REQUIREMENTS AND PRUDENTLY MANAGES CAPITAL AND EARNINGS.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
1.2 Each FHLBank continuously meets or exceeds its minimum capital requirement.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: The FHLBanks must report their risk-based capital, total capital, and permanent capital, at least monthly to the Finance Board. Risk-based capital requirements are imposed upon each FHLBank on the basis of the credit, market, and operations risks it undertakes. If the FHLBank has not implemented a new capital plan, it must adhere to the alternative leverage requirement in 12 C.F.R. § 966.3(a).

RESULTS: In FY2006, all of the FHLBanks exceeded their minimum capital requirements.

In FY2006, the FHLBank of Chicago made significant progress towards implementing its new capital plan.

The Finance Board approved capital plan amendments submitted by two FHLBanks. One FHLBank amended its plan to clarify existing provisions and delete certain transaction-related provisions. The other FHLBank amended its capital plan to authorize the establishment of an excess stock pool and to issue Class A stock.

ANNUAL PERFORMANCE GOAL 1.3A: THE FHLBANKS MAINTAIN A TRIPLE A CREDIT RATING FOR THEIR CONSOLIDATED OBLIGATIONS.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
1.3a Conduct semi-annual assessment of FHLBank System cost of funds and maintain ratings for consolidated obligations and FHLBank credit ratings at regulatory requirements.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: The FHLBanks raise funds in the capital markets through the issuance of consolidated obligations for which they are jointly and severally liable. The FHLBanks

ability to issue consolidated obligations at rates slightly above the rates on comparable U.S. Treasury obligations is important to their ability to efficiently fund their operations.

RESULTS: In FY2006, to measure the efficiency of the FHLBanks in raising funds, the agency conducted two reviews of the FHLBanks’ funding costs relative to those of the U.S. Treasury and other GSEs engaged in housing-related activities. The Finance Board also monitored FHLBank System funding costs relative to interest rate indices such as the London Interbank Offered Rate (LIBOR).

Collectively, the FHLBanks are required to obtain from a nationally recognized statistical rating organization (NRSRO), and at all times maintain, a current credit rating on their consolidated obligations. S&P and Moody’s have rated long-term FHLBank consolidated obligations “AAA” and “Aaa,” respectively, and short-term consolidated obligations “P-1” and “A-1+,” respectively, their highest ratings. Consolidated obligations of the FHLBank System maintained a triple-A rating in FY2006.

**ANNUAL PERFORMANCE GOAL 1.3B: EACH FHLBANK’S AND THE FHLBANK SYSTEM’S
FINANCIAL DISCLOSURES COMPLY WITH
APPLICABLE LAWS, RULES, AND REGULATIONS.**

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
1.3a Conduct on-site examination of the OF, and review annual and periodic financial reports issued by the FHLBank System and each FHLBank..	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: The Finance Board conducts an annual on-site examination of the OF. While on site, examiners: (1) follow up on issues identified through pre-examination analysis and planning; (2) test systems, controls, and reports for adequacy and accuracy, including the internal audit function; (3) assess the risk profile and operational soundness; (4) identify issues that may affect the risk or operating profile; (5) evaluate the quality of corporate governance; and (6) test for compliance with laws, regulations, and policies, including sales suitability practices by participating underwriters and broker-dealers.

RESULTS: The OF prepares the combined financial statements for the entire FHLBank System in accordance with 12 C.F.R. § 985.6(b). The OF currently is preparing the combined FHLBank System financial statements for 2005 and 2004. The Finance Board anticipates that the combined FHLBank System financial statements for 2005 and 2004 will be available by year end 2006, and that the OF will complete the combined FHLBank System financial statements for 2006 on schedule. In addition, by June 30, 2007, the OF plans to provide a single report that presents restated financial information on a combined basis for 2001, 2002, and 2003. Once issued, the Finance Board will assess whether the combined financial statements comply with the agency’s regulations and policies.

All of the FHLBanks have completed registration of a class of equity securities with the SEC and are now subject to the reporting requirements of the 1934 Act.

STRATEGIC GOAL 2: ENSURE THAT THE FHLBANKS SERVE THE NATION’S HOUSING FINANCE AND COMMUNITY INVESTMENT NEEDS.

The Finance Board has identified two strategic objectives that support strategic goal 2, and define the Finance Board’s responsibilities in overseeing the housing finance mission of the FHLBanks. The goal of the Finance Board’s regulatory efforts is to encourage the events described in the objectives below:

STRATEGIC OBJECTIVES	2002	2003	2004	2005	2006
2.1 The FHLBanks facilitate the housing finance activities of their members.	Achieved	Achieved	Achieved	Achieved	Achieved
2.2 The FHLBanks support affordable housing and promote community investment.	Achieved	Achieved	Achieved	Achieved	Achieved

STRATEGIC OBJECTIVE 2.1: THE FHLBANKS FACILITATE THE HOUSING FINANCE ACTIVITIES OF THEIR MEMBERS.

Congress established the FHLBank System in 1932 to restore confidence in the nation’s financial institutions and to improve the supply of funds to local lenders to finance loans for home purchases. In 1989, Congress established the AHP and a Community Investment Program (CIP) through which the FHLBanks provide funding to support the community and economic development activities of their members.

STRATEGIC OBJECTIVE 2.2: THE FHLBANKS SUPPORT AFFORDABLE HOUSING AND PROMOTE COMMUNITY INVESTMENT.

The AHP subsidizes the cost of affordable owner-occupied and rental housing. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an FHLBank advance to a member. The Bank Act requires each FHLBank to contribute at least 10 percent of its net earnings from the previous year to the AHP, subject to a minimum annual combined contribution by all 12 FHLBanks of \$100 million.

ANNUAL PERFORMANCE GOALS: To support its strategic objectives in meeting strategic goal 2, the Finance Board has two annual performance goals, each with accompanying performance measures to indicate the achievement of those goals.

ANNUAL PERFORMANCE GOAL 2.1: THE FHLBANKS ADHERE TO PUBLIC PURPOSE PRINCIPLES AND SAFETY AND SOUNDNESS REQUIREMENTS WHEN MAKING ADVANCES AND ACQUIRING MORTGAGE ASSETS.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
2.1 Review advances and mortgage portfolios of each FHLBank as part of the annual on-site examination for compliance with the FHLBank Act and Finance Board regulations.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: FHLBanks make fully collateralized advances to their members to provide funds for residential housing finance and to community financial institutions for small businesses, small farms, and small agricultural businesses. The Bank Act and Finance Board regulations describe authorized purposes for advances, limitations upon access to advances based upon member capitalization and condition, collateral eligible to secure advances, documentation requirements, required disclosures in the case of convertible advances, transaction fees, lien priority of advances, member borrowing limits, and other matters.

Acquired Member Assets (AMA) is the comprehensive term for programs through which the FHLBanks acquire whole, single-family, residential mortgage loans or loan pools either by purchasing closed loans or funding loans at time of closing. Members originate these loans in transactions that functionally are equivalent to making an advance in purpose and economic substance in that the member or housing associate can access liquidity for additional mission-related lending, and all or a material portion of the credit risk is borne by the member or housing associate.

RESULTS: The Finance Board reviewed the advance portfolio of each FHLBank as part of its 2006 annual on-site examination, and monitored the size and composition of the portfolios on a quarterly basis. The Finance Board completed the annual survey of collateral securing FHLBank advances in the third quarter of 2006.

In 2006, mortgage analysts and examiners evaluated AMA programs and program loans as part of the annual on-site examination of each FHLBank. The examinations focused on: (1) risk exposures to the FHLBanks; (2) operations of the FHLBanks, including governance of the programs and quality control programs; (3) credit enhancement determinations; and (4) data collection coding.

ANNUAL PERFORMANCE GOAL 2.2: SUPERVISION OF THE AFFORDABLE HOUSING AND COMMUNITY INVESTMENT PROGRAMS AT EACH FHLBANK.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
2.2a Conduct examinations of the Affordable Housing and Community Investment Programs at each FHLBank.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: The Finance Board supports the Bank Act’s affordable housing and community investment objectives by maintaining an effective program of annual on-site examinations for the AHP, CIP, and, as applicable, other Community Investment Cash Advance (CICA) programs.

The AHP subsidizes the cost of owner-occupied housing for individuals and families with incomes at or below 80 percent of the area median income, and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of area median income. The subsidy may be in the form of a grant or subsidized interest rate for an advance.

RESULTS: In FY2006, the Finance Board completed on-site reviews of the AHP at all 12 FHLBanks. The purpose of the AHP examination is to assess the overall effectiveness of each FHLBank’s AHP, evaluate the accuracy of the AHP databases, and assess compliance with the Bank Act and AHP regulations. Staff assigned an examination conclusion to each FHLBank based on the effectiveness of its AHP activities.

In FY2006, the Finance Board began to develop the AHP Examination Manual, which it expects to complete in FY2007.

STRATEGIC GOAL 3: USE SUPERVISORY, MANAGERIAL, AND LEGAL RESOURCES TO SUPPORT EFFECTIVE, EFFICIENT, AND RESPONSIVE FHLBANK SUPERVISION, REGULATION, AND HOUSING OVERSIGHT.

The Finance Board has identified two strategic objectives in support of this goal. These are top-level objectives that define the Finance Board’s success in managing its resources to carry out its mission.

STRATEGIC OBJECTIVES	2002	2003	2004	2005	2006
3.1 The Finance Board takes appropriate and timely regulatory and advisory actions.	Achieved	Achieved	Achieved	Achieved	Achieved
3.2 The Finance Board prudently allocates resources to fulfill its mission effectively and efficiently.	Achieved	Achieved	Achieved	Achieved	Achieved

STRATEGIC OBJECTIVE 3.1: THE FINANCE BOARD TAKES APPROPRIATE AND TIMELY REGULATORY AND ADVISORY ACTIONS.

The Finance Board’s highest regulatory priorities are to ensure the safety and soundness of the FHLBank System and to ensure that the FHLBanks fulfill their housing finance mission. In FY2006, the agency continued to reassess and revise its regulatory structure.

STRATEGIC OBJECTIVE 3.2: THE FINANCE BOARD PRUDENTLY ALLOCATES RESOURCES TO FULFILL ITS MISSION EFFECTIVELY AND EFFICIENTLY.

The Finance Board recognizes that it must effectively manage its resources to successfully carry out its mission and achieve its annual performance goals. Two areas that are crucial to the accomplishment of the agency’s mission are human capital and information and systems technology. The Finance Board’s employees are its most important resource. In addition, the Finance Board uses information technology resources to improve the efficiency and effectiveness of its operational processes.

ANNUAL PERFORMANCE GOALS: To support its strategic objectives in meeting strategic goal 3, the Finance Board has four annual performance goals, each with accompanying performance measures to indicate the achievement of those goals.

ANNUAL PERFORMANCE GOAL 3.1A: REVIEW, REVISE, AND SUPPLEMENT FINANCE BOARD REGULATIONS TO ENSURE RELEVANCE, TRANSPARENCY, AND ISSUE-ORIENTED SUPERVISORY GUIDANCE.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
3.1a Review, revise and supplement Finance Board regulations, and supplement regulations with advisory bulletins, examiner guidance bulletins, and regulatory interpretations, where appropriate.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: In FY2006, the Finance Board continued to develop and issue supervisory guidance to the FHLBanks through regulations, advisory bulletins, and regulatory

interpretations. The Finance Board’s guidance incorporates effective practices in response to emerging risks, the evolving activities and operations of the FHLBanks, developments in the financial markets, and new supervisory issues.

RESULTS: In FY2006, the Finance Board adopted rules to: (1) enhance the FHLBanks corporate governance by establishing qualifications for elected members of the FHLBank boards of directors; (2) streamline and reorganize the existing AHP regulation; and (3) consolidate data reporting requirements from individual regulations into a Data Reporting Manual. In FY2006, the Finance Board also issued for comment a proposed rule to strengthen each FHLBank’s capital structure by maintaining a minimum level of retained earnings and restricting the amount of excess stock an FHLBank can have outstanding. In addition, the Finance Board issued the proposed Rating System for public comment. Under the proposed Rating System, each FHLBank would be assigned a composite rating that is based on an evaluation and rating of five key components: corporate governance, market risk, credit risk, operational risk, and financial condition and performance.

The Finance Board also issued advisory bulletins that: (1) clarify how restatement of the FHLBank System’s financial statements will affect contributions to the AHP and Resolution Funding Corporation; (2) require the FHLBanks and the OF to establish policies and procedures to ensure that financial models are documented and validated; and (3) authorize each FHLBank to use or disclose unpublished information that is material to the FHLBank’s financial condition or business operations in its SEC filings.

ANNUAL PERFORMANCE GOAL 3.1B: REVIEW AND RESPOND PROMPTLY TO NEW BUSINESS ACTIVITY NOTICES FILED BY THE FHLBANKS.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
3.1b Respond to new business activity notices filed by the FHLBanks within 60 days of receipt.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: A “new business activity” is any business activity an FHLBank undertakes, transacts, conducts, or engages in that it has not previously undertaken, transacted, conducted, or engaged in, or that it previously undertook, transacted, conducted, or engaged in under materially different terms and conditions. Finance Board regulations require an FHLBank that intends to engage in a new business activity to file a notice with the Finance Board. In its review of a new business activity notice, the Finance Board will assess whether the proposed activity is legally objectionable, the risks of the proposal, and the ability of the FHLBank to manage those risks. After the Finance Board deems a notice to be complete, it must respond to the FHLBank within 60 days.

RESULTS: In FY2006, the Finance Board considered and responded to all 5 new business activity notifications from the FHLBanks within 60 days of receipt of a full and complete FHLBank submission.

ANNUAL PERFORMANCE GOAL 3.2A: USE FISCAL, PHYSICAL, AND HUMAN RESOURCES EFFICIENTLY AND EFFECTIVELY TO FULFILL THE FINANCE BOARD’S FIDUCIARY RESPONSIBILITIES.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
3.2a Align budgeted resources with projected workloads and business priorities. Recruit, develop, and retain high-achieving professional staff.	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: Due to the increasing size and complexity of the FHLBanks, the Finance Board continues to augment and support its workforce with high-achieving professionals in various disciplines.

RESULTS: In FY2006, the Finance Board hired 15 full-time staff, including a senior executive, four economists, four bank examiners, two financial analysts, and two administrative or support staff. The Finance Board also hired a chief accountant.

The Finance Board continues to enhance its data management and information systems. In FY2006, the agency adopted its Data Reporting Manual (DRM), which reorganizes data reporting requirements that previously were in the Finance Board’s regulations or otherwise required by the agency.

In FY2006, the Finance Board redesigned the Call Report System (CRS.net) to provide an integrated framework through which the Finance Board gathers financial and other information from and about the FHLBanks. In addition, the agency converted the AMA database, which captures summary reports on a quarterly basis and loan specific acquired member assets data on a semi-annual basis, to a relational database.

ANNUAL PERFORMANCE GOAL 3.2B: MAINTAIN AND TEST BUSINESS CONTINUITY AND CONTINGENCY PLANS.

ANNUAL PERFORMANCE MEASURE	2002	2003	2004	2005	2006
3.2b Review, update, and test the Finance Board’s Continuity of Operations Plan (COOP).	Achieved	Achieved	Achieved	Achieved	Achieved

DESCRIPTION: The Finance Board designed its Continuity of Operations Plan (COOP) to ensure continuity of essential agency functions under all emergency circumstances. The

COOP identifies the essential functions that must continue under any circumstances, and the policy and procedures for activating the program. The major components of the COOP include identification of essential functions; delegations of authority; orders of succession; communications processes; vital records, files and databases required and available during an emergency; and a testing, training, and exercise program that includes monthly, quarterly, and annual testing of the COOP's different components.

RESULTS: The Finance Board tested the COOP in FY2006 through an exercise using established activation procedures, requiring all emergency personnel to report to the Emergency Operations Center, and testing of programs to ensure that essential functions could be performed. In response to testing in both FY2005 and FY2006, the COOP was updated. In addition, the COOP has been updated to reflect the agency's preparedness for pandemic flu.

PROGRAM EVALUATION

The Finance Board uses program evaluations to improve and enhance its mission performance and support strategic and performance planning efforts. These evaluations take many forms, and are performed by organizations both inside and outside the agency. Staff evaluates and implements recommendations, as appropriate. The principal evaluations include:

SUPERVISORY PROGRAM

Government Accountability Office (GAO) Evaluations: The GAO conducts program- and program-support related evaluations of the agency's supervisory program.

OIG Evaluations: The OIG evaluates the agency's supervisory program and program support operations.

FHLBank Strategic Planning Interview Project: The Finance Board held discussions with senior executives of each FHLBank to gather information about FHLBank practices and experiences in three major areas: (1) risk management and modeling; (2) financial reporting and data collection; and (3) information systems.

Quality Assurance: OS is developing a Quality Assurance (QA) Program that will provide recommendations to facilitate efficient and effective operations. QA also will conduct reviews of all OS programs. These reviews may include ongoing evaluation of work processes, policy development, and decision-making processes.

FINANCIAL MANAGEMENT

Financial Audits: Annually, the OIG contracts with a public accounting firm to audit the Finance Board's financial statements. This audit is conducted in accordance with

generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards.

INFORMATION TECHNOLOGY

Federal Information Security Management Act (FISMA): The OIG annually reviews and evaluates the agency's information technology systems for FISMA compliance. This includes evaluating information technology controls for financial management systems.

Network Penetration: Annually, the Finance Board contracts with an outside company of security experts to perform network penetration testing of our information technology systems.

Customer Satisfaction Survey: Annually, the Finance Board conducts a survey of all end-users to obtain their opinions on the quality of the agency's products and services. This allows a better understanding of user needs and results in improved service.

HUMAN CAPITAL MANAGEMENT

Human Capital Management Survey: Annually, the Finance Board participates in the Office of Personnel Management's Human Capital Management Survey. Recommendations are evaluated and implemented, as appropriate.

Training and Development Program: The Finance Board is committed to training and development of its staff to build, maintain, and improve individual and team competencies to meet current and future demands and challenges in the financial and regulatory arenas. OS has begun a more formalized training and development program to address a variety of training and development opportunities through various activities and forums. Consideration of a particular training or development activity is based on the need to acquire new skills or enhance performance.

Workplace Improvement Committee: Representatives from all offices within the Finance Board meet to identify and pursue improvements to the work environment.

Equal Employment Opportunity (EEO): The Finance Board is committed to equal employment opportunity and the implementation of a strong EEO program to promote employment and advancement opportunities without regard to race, sex, sexual orientation, religion, color, national origin, age, or disability. The Minority and Disabled Recruitment Task Force, comprised of staff from a cross-section of Offices and disciplines within the Finance Board, meets periodically and discusses strategies for enhancing recruitment initiatives to attract a diverse applicant pool. In addition, the Finance Board is committed to continuing to take advantage of employment programs that integrate veterans, disabled, and other populations into the public-sector workforce.

**FEDERAL HOUSING FINANCE BOARD
FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT**

**FOR THE YEARS ENDED
SEPTEMBER 30, 2006 AND 2005**

REPORT NO. 06-A-06-OM

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITOR'S REPORT
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005**

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BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the accompanying balance sheet of the Federal Housing Finance Board (the Finance Board) as of September 30, 2006 and the related statements of net cost, changes in net position, budgetary resources and financing for the year then ended. We also audited the balance sheet as of September 30, 2005 and the related statements of revenue, expenses and changes in net position and cash flows for the year then ended. These financial statements are the responsibility of the Finance Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirement for Federal Financial Statements, as amended*. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Housing Finance Board as of September 30, 2006 and 2005, and its net costs, changes in net position, budgetary resources, and financing for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, certain fiscal year 2005 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with fiscal year 2006 presentation in accordance with OMB Circular A-136, revised. The 2005 financial statements were issued based on an industry type presentation which included balance sheets as of September 30, 2005 and the related statements of revenue, expenses and changes in net position and cash flows. The financial statements for the year ended September 30, 2005, were audited by us and we expressed an unqualified opinion on them in our report dated October 24, 2005, but we have not performed any auditing procedures since that date. For comparative purposes, the 2005 financial information has been restated to be in compliance with OMB A-136 and include statements of net cost, statement of changes in net position, statement of budgetary resources and statement of financing. However, we did not audit these statements as presented, and accordingly, we express no opinion on them.

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As discussed in Note 1 to the financial statements, the Finance Board changed its fixed asset capitalization threshold in 2006.

In accordance with U.S. Government Auditing Standards and OMB Bulletin No. 06-03, as amended, we have also issued a report dated October 24, 2006 on our consideration of the Finance Board's internal control over financial reporting and its compliance with provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with U.S. Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The information in "Management's Discussion & Analysis" is presented for the purpose of additional analysis and is required by OMB Circular No. A-136, revised *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and, accordingly, express no opinion on it.



Largo, Maryland
October 24, 2006



BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

**INDEPENDENT AUDITORS REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Office of Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2006 and have issued our report thereon dated October 24, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the Finance Board's internal control over financial reporting by obtaining an understanding of the Finance Board's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide an opinion on internal control and therefore, we do not express an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants and OMB Bulletin No. 06-03, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control, which could adversely affect the Finance Board's ability to meet the objectives of internal control. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud or noncompliance in amounts that would be material in relation to the financial statements being audited, or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or non-compliance may nevertheless occur and not be detected. However, we noted no matters involving the internal control and its operation that we considered to be material weaknesses as defined above.

In addition, with respect to internal control objective related to the performance measures included in the "Management's Discussion & Analysis," we obtained an understanding of the design of internal controls relating to the existence and completeness assertions, and determined whether they have been placed in operation as required by OMB Bulletin No. 06-03. Our procedures were not designed to

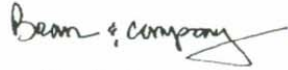
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provide opinion on internal control over reported performance measures, and, accordingly, we do not express an opinion on such controls.

This report is intended solely for the information and use of the management of the Federal Housing Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.



Largo, Maryland
October 24, 2006



BROWN & COMPANY CPAs, PLLC

CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS

**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH LAWS AND REGULATIONS**

Office of the Inspector General
Board of Directors
Federal Housing Finance Board
Washington, D.C.

We have audited the financial statements of the Federal Housing Finance Board (the Finance Board) as of and for the year ended September 30, 2006, and have issued our report thereon dated October 24, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in U.S. Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

The management of the Finance Board is responsible for complying with laws and regulations applicable to the Finance Board. As part of obtaining reasonable assurance about whether the Finance Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 06-03. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the Finance Board.

The results of our tests of compliance disclosed no reportable instances of noncompliance with other laws and regulations discussed in the preceding paragraph that are required to be reported under U.S. Government Auditing Standards or OMB Bulletin No. 06-03.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion. However, we noted no noncompliance with laws and regulations, which could have a direct and material effect on the determination of financial statement amounts.

This report is intended solely for the information and use of the management of the Finance Board, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Largo, Maryland
October 24, 2006

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**FEDERAL HOUSING FINANCE BOARD
BALANCE SHEET
As of September 30, 2006 and 2005
(In Dollars)**

	<u>2006</u>	<u>2005</u>
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	\$ 8,942,840	\$ 7,991,460
Total Intragovernmental	8,942,840	7,991,460
Accounts Receivable (Note 1)	3,358	1,739
General Property, Plant and Equipment, Net (Note 3)	1,498,423	1,994,269
Other	<u>29,030</u>	<u>46,770</u>
Total Assets	<u>\$ 10,473,651</u>	<u>\$ 10,034,238</u>
Liabilities:		
Intragovernmental:		
Accounts Payable (Note 5)	\$ 65,298	\$ 7,505
Other (Note 5)	<u>128,794</u>	<u>123,260</u>
Total Intragovernmental	194,092	130,765
Accounts Payable (Note 5)	778,832	997,879
Other (Note 5)	<u>2,498,611</u>	<u>2,277,419</u>
Total Liabilities	<u>\$ 3,471,535</u>	<u>\$ 3,406,063</u>
Commitments and Contingencies (Note 1)		
Net Position:		
Cumulative Results of Operations - Other Funds	\$ 7,002,116	\$ 6,628,175
Total Net Position	<u>\$ 7,002,116</u>	<u>\$ 6,628,175</u>
Total Liabilities and Net Position	<u>\$ 10,473,651</u>	<u>\$ 10,034,238</u>

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

**FEDERAL HOUSING FINANCE BOARD
STATEMENT OF NET COST
For the Years Ended September 30, 2006 and 2005
(In Dollars)**

	<u>2006</u>	Unaudited (Note 1) <u>2005</u>
Program Costs:		
Program A: Review of Federal Home Loan Banks		
Gross Costs (Note 8)	\$ 32,200,748	\$ 32,720,678
Less: Earned Revenue	<u>31,582,813</u>	<u>29,492,449</u>
Net Program Costs	<u>617,935</u>	<u>3,228,229</u>
 Net Cost of Operations	 <u>\$ 617,935</u>	 <u>\$ 3,228,229</u>

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

FEDERAL HOUSING FINANCE BOARD
STATEMENT OF CHANGES IN NET POSITION
As of September 30, 2006 and 2005
(In Dollars)

	<u>2006</u>	Unaudited
	Total	(Note 1)
		<u>2005</u>
		Total
Cumulative Results of Operations:		
Beginning Balances	\$ <u>6,628,175</u>	\$ <u>8,964,846</u>
Beginning Balances, as Adjusted	\$ <u>6,628,175</u>	\$ <u>8,964,846</u>
Other Financing Sources (Non-Exchange):		
Imputed Financing Sources	\$ <u>991,876</u>	\$ <u>891,558</u>
Total Financing Sources	991,876	891,558
Net Cost of Operations	<u>617,935</u>	<u>3,228,229</u>
Net Changes	\$ <u>373,941</u>	\$ <u>(2,336,671)</u>
Cumulative Results of Operations	\$ <u>7,002,116</u>	\$ <u>6,628,175</u>
Net Position	\$ <u>7,002,116</u>	\$ <u>6,628,175</u>

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

**FEDERAL HOUSING FINANCE BOARD
STATEMENT OF BUDGETARY RESOURCES
For the Years Ended September 30, 2006 and 2005
(In Dollars)**

	<u>2006</u>	Unaudited (Note 1) <u>2005</u>
Budgetary Resources:		
Unobligated Balance Brought Forward, October 1:	\$ 4,307,516	\$ 3,844,154
Recoveries of Prior Year Unpaid Obligations	299,492	929
Budget Authority		
Collected	<u>31,583,288</u>	<u>29,477,431</u>
Total Budgetary Resources	<u>\$ 36,190,296</u>	<u>\$ 33,322,514</u>
Status of Budgetary Resources:		
Obligations Incurred		
Reimbursable	\$ 31,447,727	\$ 29,014,998
Unobligated Balance		
Exempt from Apportionment	<u>4,742,569</u>	<u>4,307,516</u>
Total Status of Budgetary Resources	<u>\$ 36,190,296</u>	<u>\$ 33,322,514</u>
Change in Obligated Balance:		
Obligated Balance, Net		
Unpaid Obligations, Brought Forward, October 1	<u>\$ 3,683,944</u>	<u>\$ 6,286,065</u>
Total Unpaid Obligated Balance, Net	3,683,944	6,286,065
Obligations Incurred Net	31,447,727	29,014,998
Less: Gross Outlays	30,631,908	31,616,190
Less: Recoveries of Prior Year Unpaid		
Obligations, Actual	<u>299,492</u>	<u>929</u>
Obligated Balance, Net, End of Period		
Unpaid Obligations	<u>4,200,271</u>	<u>3,683,944</u>
Total, Unpaid Obligated Balance, Net, End of Period	<u>\$ 4,200,271</u>	<u>\$ 3,683,944</u>
Net Outlays:		
Net Outlays:		
Gross Outlays	\$ 30,631,908	\$ 31,616,190
Less: Offsetting Collections	<u>31,583,288</u>	<u>29,477,431</u>
Net Outlays	<u>\$ (951,380)</u>	<u>\$ 2,138,759</u>

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

**FEDERAL HOUSING FINANCE BOARD
STATEMENT OF FINANCING
For the Years Ended September 30, 2006 and 2005
(In Dollars)**

	<u>2006</u>	<u>Unaudited (Note 1) 2005</u>
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 31,447,727	\$ 29,014,998
Less: Spending Authority from Offsetting Collections and Recoveries	<u>31,882,780</u>	<u>29,478,360</u>
Obligations Net of Offsetting Collections and Recoveries	<u>(435,053)</u>	<u>(463,362)</u>
Net Obligations	<u>(435,053)</u>	<u>(463,362)</u>
Other Resources		
Imputed Financing from Costs Absorbed by Others	<u>991,876</u>	<u>891,558</u>
Net Other Resources Used to Finance Activities	<u>991,876</u>	<u>891,558</u>
Total Resources Used to Finance Activities	<u>\$ 556,823</u>	<u>\$ 428,196</u>
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		
	\$ 433,114	\$ (1,576,248)
Resources That Fund Expenses Recognized in Prior Periods	-	1,118,014
Resources That Finance the Acquisition of Assets	<u>(388)</u>	<u>1,176,076</u>
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	<u>432,726</u>	<u>717,842</u>
Total Resources Used to Finance the Net Cost of Operations	<u>\$ 124,097</u>	<u>\$ (289,646)</u>
Components of the Net Cost of Operations That Will Not Require or Generate Resources in the Current Period		
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	\$ 823,585	\$ 1,154,584
Revaluation of Assets or Liabilities	33,619	85,566
Other	<u>(363,366)</u>	<u>2,277,725</u>
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	<u>493,838</u>	<u>3,517,875</u>
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	<u>493,838</u>	<u>3,517,875</u>
Net Cost of Operations	<u>\$ 617,935</u>	<u>\$ 3,228,229</u>

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

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The financial statements have been prepared to report the financial position, net cost of operations, changes in net position, status and availability of budgetary resources, and the reconciliation between proprietary and budgetary accounts of the Federal Housing Finance Board (Finance Board). The statements are a requirement of the Chief Financial Officers Act of 1990, the Government Management Reform Act of 1994, the Accountability of Tax Dollars Act of 2002, and the Office of Management and Budget (OMB) Bulletin Number 06-03, *Audit Requirements for Federal Financial Statements*. They have been prepared from, and are fully supported by, the books and records of the Finance Board in accordance with the hierarchy of accounting principles generally accepted in the United States of America, standards approved by the principals of the Federal Accounting Standards Advisory Board (FASAB), OMB Circular No. A-136, *Financial Reporting Requirements* and the Finance Board accounting policies, which are summarized in this note. These statements, with the exception of the Statement of Budgetary Resources, are different from financial management reports, which are also prepared pursuant to OMB directives that are used to monitor and control the Finance Board's use of budgetary resources.

The statements consist of the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and the Statement of Financing. In accordance with OMB Circular No. A-136, the financial statements and associated notes are presented on a comparative basis. Unless specified otherwise, all dollar amounts are presented in dollars.

B. Reporting Entity

The Finance Board is an independent non-appropriated funded Agency in the Executive Branch. The Finance Board ensures that Federal Home Loan Banks, which are privately capitalized, government-sponsored enterprises, operate in a safe and sound manner, carry out the housing and community development finance mission, and remain adequately capitalized and able to raise funds in the capital markets. The Federal Home Loan Bank System raises its money through the Office of Finance that acts as the central debt issuance facility for all 12 Federal Home Loan Banks.

The Federal Home Loan Bank System was created in 1932 to promote home ownership and a strong home-finance industry. It is a network of 12 district banks that provide lending, deposit, and other services to mortgage-lending institutions. The members of the Federal Home Loan Bank System originate and hold a significant portion of the nation's home mortgages. Membership includes the thrift institutions, commercial banks, credit unions, and a small number of insurance companies.

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Each Federal Home Loan Bank and the Office of Finance operates with its own staff and funding. Accordingly, the accompanying financial statements summarize only the financial activities of the Finance Board.

The Finance Board is located in Washington, DC, where it operates with a staff of approximately 130 employees under the direction of a five member Board of Directors, four of whom are appointed from the private sector by the President. The fifth is the Secretary of Housing and Urban Development or designee. Operation of the Finance Board is funded by the collection of assessments from each of the Federal Home Loan Banks. These assessments are used to fund the salaries and expenses of staff engaged in supervision and compliance activities, policy development, strategic planning, and administration. These funds are neither appropriated nor subject to apportionment.

C. Basis of Accounting

Transactions are recorded on both an accrual accounting basis, consistent with accounting principles generally accepted in the United States of America, and a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to receipt or disbursement of cash. Budgetary accounting facilitates compliance with legal requirements on the use of federal funds.

D. Revenues & Other Financing Sources

Operating revenues of the Finance Board are obtained through assessments of the 12 Federal Home Loan Banks. The banks are collectively assessed based on amounts needed to fund the Finance Board's annual budget. The agency's Board of Directors, prior to the start of a new fiscal year, approves the budget. Each Federal Home Loan Bank's share is based upon the dollar value of its capital stock relative to the combined dollar value of all Federal Home Loan Banks' capital stock. The Finance Board's expenses are met through assessments paid by the Federal Home Loan Banks, which totaled \$31,224,539 and \$29,474,862 for the fiscal years ended September 30, 2006 and 2005, respectively.

The Finance Board recognizes as an imputed financing source the amount of accrued pension and post-retirement benefit expenses for current employees paid on the Finance Board's behalf by the Office of Personnel Management (OPM).

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Taxes

The Finance Board, as a federal entity, is not subject to federal, state, or local income taxes, and, accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

F. Fund Balance with Treasury

The U.S. Treasury processes cash receipts and disbursements. Funds held at the Treasury are available to pay agency liabilities. The Finance Board does not maintain cash in commercial bank accounts or foreign currency balances.

Significant receipts are transmitted to this account monthly by the 12 Federal Home Loan Banks which are assessed amounts necessary to cover the Finance Board's expected operating needs for the fiscal year.

Disbursements are made as necessary to fund the biweekly payroll and administrative costs of the organization. Due to of the nature of the Finance Board's program, disbursements do not vary significantly from month to month.

Effective July 1, 2005, the Bureau of Public Debt Administrative Resource Center commenced processing operating expenses for the Finance Board. The Finance Board continues to utilize the services of the Department of Agriculture's National Finance Center for payroll related activities.

G. Accounts Receivable

Accounts receivable consists of amounts owed to the Finance Board by other federal agencies and the public. Amounts due from federal agencies are considered fully collectible. Accounts receivable from the public include reimbursements from employees. An allowance for uncollectible accounts receivable from the public is established when either (1) based upon a review of outstanding accounts and the failure of all collection efforts, management determines that collection is unlikely to occur considering the debtor's ability to pay, 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. As of September 30, 2006 and 2005 the balance in accounts receivable from the public was \$3,358 and \$1,739, respectively.

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

H. Property and Equipment, Net

The fixed asset capitalization threshold for the asset acquisitions changed from \$5,000 to \$25,000, effective for fiscal year 2006. Effective fiscal year 2006, equipment acquisitions greater than or equal to \$25,000 are capitalized and depreciated using the straight-line method over the estimated useful life of the asset. Additionally, for bulk purchases of similar items, which individually do not meet the test for capitalization, the acquisition is capitalized and depreciated if the depreciated basis of the bulk purchase is \$100,000 or more. Applicable standard governmental guidelines regulate the disposal and convertibility of agency property, plant and equipment.

The useful life classifications for capitalized assets are as follows:

<u>Description</u>	<u>Useful Life (years)</u>
Furniture, Fixtures, and Equipment	6
Electronic Data Processing Systems	3
Data Handling Equipment (Excluding computers)	6
Software and Computer Programs	3
Real Property Improvements	30

Leasehold Improvement's useful life is equal to the remaining lease term or the estimated useful life of the improvement, whichever is shorter.

I. 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. As of September 30, 2006 and 2005 prepaid expenses were \$29,030 and \$46,770, respectively.

J. Liabilities

Liabilities covered by budgetary or other resources are those liabilities for which funding is available to pay amounts due.

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Intragovernmental liabilities are claims against the Finance Board by other federal agencies. Additionally, the Government, acting in its sovereign capacity, can abrogate liabilities.

K. Accounts Payable

Accounts payable consists of amounts owed to other federal agencies and the public.

L. Employee Leave and Benefits

Accrued Leave: Finance Board employees are entitled to accrue annual leave and sick leave at a rate based on years of federal service. For most employees, annual leave may be accrued up to 240 hours each year. Senior employees may accrue annual leave consistent with the rules for SES level employees. 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 CSRS plan employees is creditable as additional time in service for the purpose of calculating an employee's retirement annuity. For FERS plan employees, unused sick leave is held indefinitely and may be used if rehired.

Health Benefits and Life Insurance: The Finance Board, through programs established for all agencies by the federal government, offers its employees health and life insurance coverage. The cost of each is shared by the Finance Board and its employees. The Finance Board's fiscal year 2006 contribution to health and life insurance coverage was \$967,172. The fiscal year 2005 contribution was \$847,090. In addition, all employees have 1.45% of gross earnings withheld to pay for future Medicare coverage.

M. Accrued Workers' Compensation

A liability is recorded for actual and estimated future payments to be made for workers' compensation pursuant to the Federal Employees' Compensation Act (FECA). The actual costs incurred are reflected as a liability because the Finance Board will reimburse the Department of Labor (DOL) two years after the actual payment of expenses. The liability consists of (1) the net present value of estimated future payments calculated by the DOL, and (2) the unreimbursed cost paid by DOL for compensation to recipients under the FECA.

N. Retirement Plans

Finance Board employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS).

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The employees who participate in CSRS are beneficiaries of Finance Board's matching contribution, equal to 7% of pay, distributed to the employee's annuity account in the Civil Service Retirement and Disability Fund.

FERS went into effect on January 1, 1987. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984 elected to join either FERS and Social Security, or remain in CSRS. FERS offers a savings plan to which the Finance Board automatically contributes 1% of pay and matches any employee contribution up to an additional 4% of pay. For FERS participants, the Finance Board also contributes the employer's matching share of Social Security.

FERS employees and certain CSRS reinstatement employees are eligible to participate in the Social Security program after retirement. In these instances, the Finance Board remits the employer's share of the required contribution.

The Finance Board recognizes the imputed cost of pension and other retirement benefits during the employees' active years of service. OPM actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicate these factors to the Finance Board for current period expense reporting. OPM also provides information regarding the full cost of health and life insurance benefits. The Finance Board recognized the offsetting revenue as imputed financing sources to the extent these expenses will be paid by OPM.

The Finance board 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 the OPM.

The Finance Board's 401(k) is administered by T. Rowe Price. Eligible employees may contribute up to 10% of salary on a pre-tax basis while the Finance Board will match contributions up to 3% of the employee's salary. Qualified employees may participate in both the Federal Thrift Savings Plan and/or the Finance Board's 401(k) Savings Plan, up to the Internal Revenue Code limitations established for salary deferral and annual additions.

O. Use of Estimates

Management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses, and in the note disclosures. Actual results could differ from these estimates.

FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

P. Imputed Costs/Financing Sources

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. The Finance Board recognized imputed costs and financing sources in fiscal years 2006 and 2005 to the extent directed by OMB.

Q. Contingencies

Liabilities are deemed contingent when the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. The Finance Board recognizes contingent liabilities, in the accompanying balance sheet and statement of net cost, when it is both probable and can be reasonably estimated. The Finance Board discloses contingent liabilities in the notes to the financial statements when the conditions for liability recognition are not met or when a loss from the outcome of future events is more than remote.

Equal Employment Opportunity Complaints:

At the Agency: As of the end of the period beginning on October 1, 2005 and ending on September 26, 2006, there were no cases pending before the Finance Board. Agency Case Number 2006-01 was filed on October 13, 2005, and remanded to the Finance Board for processing by a decision of the Office of Federal Operations of the Equal Employment Opportunity Commission (EEOC) dated June 5, 2006. On August 17, 2006, the Finance Board's EEO Director dismissed Case Number 2006-01. The Complainant appealed the dismissal to the EEOC by a form dated August 26, 2006. On September 25, 2006, the Finance Board filed its opposition to the Complainant's appeal of the dismissal. This case has a potential loss ranging from \$0 to \$300,000. An unfavorable outcome is considered unlikely.

At the Equal Employment Opportunity Commission (EEOC): As of the end of the beginning on October 1, 2005 and ending on September 26, 2006, there were two cases pending before the EEOC. In Agency Case Number 2005-01, the Finance Board filed a motion to dismiss the case, or in the alternative, for summary judgment, on January 11, 2006, which has not yet been decided. This case has a potential loss ranging from \$0 to \$300,000. An unfavorable outcome is considered unlikely. In Agency Case Number 2006-01, the Finance Board filed its opposition to the Complainant's appeal of the dismissal of the case on September 25, 2006. This case has a potential loss ranging from \$0 to \$300,000. An unfavorable outcome is considered unlikely.

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

At the United States District Court: As of the end of the nine-month period beginning on October 1, 2005 and ending on September 30, 2006, there was one civil action pending in the U.S. District Court for the District of Columbia. On September 26, 2005, the court granted in part and denied in part the Finance Board's motion to dismiss the case. The Finance Board is awaiting a scheduling order from the court and anticipates filing a motion for summary judgment with regard to the claims that have not already been dismissed. This case has a potential loss ranging from \$0 to \$300,000. An unfavorable outcome is considered unlikely.

Other Cases at the United States District Court: On September 22, 2005, the U.S. District Court for the District of Kansas dismissed the Finance Board as a party in a case filed by a former employee of a Federal Home Loan Bank alleging wrongful discharge based on multiple theories of recovery. On March 13, 2006, the district court judge denied the plaintiff's motion to amend the September 22nd decision, and the 60-day period for appeal has elapsed. The Finance Board no longer is a party to the case.

R. Reclassification

Certain fiscal year 2005 balances have been reclassified, retitled, or combined with other financial statement line items for consistency with current year presentation. The 2005 financial statements were audited and an unqualified opinion was issued based on an industry type format. For comparative purposes, the 2005 financial information has been restated to be in compliance with OMB A-136.

NOTE 2. FUND BALANCE WITH TREASURY

Fund balance with Treasury account balances as of September 30, 2006 and 2005 were:

Fund Balances:

	2006	2005
Total Other Fund Types	\$8,942,840	\$7,991,460

Status of Fund Balance with Treasury:

	2006	2005
Total Unobligated Non-Budgetary FBWT	\$ 8,942,840	\$ 7,991,460

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005**

NOTE 3. GENERAL PROPERTY AND EQUIPMENT

Property and equipment account balances as of September 30, 2006 and 2005 were as follows:

Schedule of Property and Equipment as of September 30, 2006

<u>Description</u>	<u>Acquisition Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Software	\$ 3,325,582	\$ 3,107,491	\$ 218,091
Furniture & Equipment	2,734,985	1,816,400	918,585
Internal-Use Software In Development	361,747		361,747
Total	<u>\$ 6,422,314</u>	<u>\$ 4,923,891</u>	<u>\$ 1,498,423</u>

Schedule of Property and Equipment as of September 30, 2005

<u>Description</u>	<u>Acquisition Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>
Software	\$ 3,325,582	\$ 2,509,278	\$ 816,304
Furniture & Equipment	4,007,539	2,829,574	1,177,965
Total	<u>\$ 7,333,121</u>	<u>\$ 5,338,852</u>	<u>\$ 1,994,269</u>

NOTE 4. LEASES

Capital Leases

The Finance Board leases a copier under lease-to-own agreements. The lease terms range from 54 to 60 months. The minimum future lease payments and the present value of the net minimum lease payments are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 5,951
2008	5,493
2009	458
Total Future Minimum Lease Payments	11,902
Less: Imputed Interest	1,016
Present Value of the Net Minimum Lease Payments	10,886
Less: Current Portion	5,206
Lease Obligation – Long Term	<u>\$ 5,680</u>

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005**

NOTE 4. LEASES (CONTINUED)

Operating Leases

The Finance Board leases office space at 1625 Eye Street, Washington D.C., under a non-cancelable long-term lease that expires on June 30, 2015, and requires monthly payments of \$270,073. Total rental payments for the fiscal years ended September 30, 2006 and 2005 were \$1,601,508 and \$4,168,960, respectively. Fiscal year 2005 disbursements consisted of FHFB's previous office location at F Street regular monthly rents of \$1,447,760, F Street lease buyout of \$1,919,867, and Eye Street monthly rent payments of \$801,333. The rental payments for the fiscal year ending September 30, 2006 were reduced by a tenant improvement allowance in the amount of \$1,613,355. The minimum future payments at 1625 Eye Street, as required by the lease, are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 3,257,103
2008	3,322,310
2009	3,388,799
2010	3,475,652
2011	3,602,273
Thereafter	<u>14,155,278</u>
Total	<u>\$ 35,188,922</u>

NOTE 5. LIABILITIES

The accrued liabilities for the Finance Board are comprised of program expense accruals, payroll accruals, and funded annual leave earned by employees. Program expense accruals represent expenses that were incurred prior to month-end but were not paid. Similarly, payroll accruals represent payroll expenses that were incurred prior to month-end but were not paid.

	<u>2006</u>	<u>2005</u>
Intragovernmental		
Accounts Payable	\$ 65,298	\$ 7,505
Payroll Taxes Payable	<u>128,794</u>	<u>123,260</u>
Total Intragovernmental	<u>194,092</u>	<u>130,765</u>
Accounts Payable	778,832	997,879
Accrued Payroll and Benefits	863,074	728,001
Capital Lease Obligations	10,886	15,306
Funded Annual Leave	<u>1,624,651</u>	<u>1,534,112</u>
Total Liabilities	<u>\$ 3,471,535</u>	<u>\$ 3,406,063</u>

All liabilities are current liabilities.

**FEDERAL HOUSING FINANCE BOARD
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005**

NOTE 6. IMPUTED FINANCING SOURCES

The Finance Board recognizes as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees. The assets and liabilities associated with such benefits are the responsibility of the administering agency, OPM.

For the fiscal years ended September 30, 2006 and 2005, respectively, imputed financing was \$991,876 and \$891,558.

NOTE 7. BUDGETARY RESOURCE COMPARISONS TO THE BUDGET OF THE UNITED STATES GOVERNMENT

The 2008 Budget of the United States Government, with the Actual Column completed for fiscal year 2006, has not yet been published as of the date of these financial statements. The Budget is expected to be published and delivered to Congress in early February 2007. The 2007 Budget of the United States Government, with the Actual Column completed for 2005, has been reconciled.

NOTE 8. OPERATING/PROGRAM COSTS

Costs by major budgetary object classification as of September 30, 2006 and 2005 are as follows:

<u>Budgetary Object Classifications</u>	<u>2006</u>	<u>2005</u>
Personnel Compensation	\$16,197,400	\$14,814,525
Personnel Benefits	5,844,193	5,036,183
Benefits to Former Employees		49,565
Travel	1,586,637	1,075,393
Transportation	16,521	20,283
Rents, Communication & Utilities	2,415,394	5,316,441
Printing and Reproduction	64,415	58,256
Other Services	4,897,619	4,803,871
Supplies and Materials	313,086	247,782
Land & Structures		95,309
Equipment	<u>865,483</u>	<u>1,203,070</u>
Total	<u>\$32,200,748</u>	<u>\$32,720,678</u>