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November 07, 2005
Audit Case Number
2006-FO-0002

TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing Commissioner, H

Randy W McGinnis

FROM: Randy W. McGinnis, Director, Financial Audits Division. GAF

SUBJECT: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2005 and 2004

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Urbach, Kahn, and Werlin LLP to audit the fiscal year 2005 financial statements of the Federal Housing Administration (FHA). The fiscal year 2004 financial statements were audited by KPMG LLP whose report dated November 8, 2004 expressed an unqualified opinion on those statements. The contract required that the audit be performed according to generally accepted government auditing standards.

Urbach, Kahn, and Werlin LLP is responsible for the attached auditor's report dated October 28, 2005 and the conclusions expressed in the report. We do not express an opinion on FHA's financial statements or conclusions on FHA's internal controls or compliance with laws and regulations.

This report includes both the Independent Auditors' Report and FHA's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general- purpose federal financial report should include as required supplementary information a section devoted to management's discussion and analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. FHA plans to separately publish an annual report for fiscal year 2005 that conforms to FASAB standards.

Recommendation 1a in this year's report substantially repeats a recommendation made in the fiscal year 2004 report on FHA's financial statements. FHA has established corrective action plans for this recommendation and, in accordance with the department's audit management system; they will continue to track the resolution of this prior year audit recommendation. Twelve recommendations are new to this year's report. Based on the information provided in management's response to Urbach, Kahn, and Werlin's audit, we will record management decisions in the department's Audit Resolution and Corrective Action Tracking System for these twelve new recommendations.

We appreciate the courtesies and cooperation extended to the Urbach, Kahn, and Werlin and OIG audit staffs during the conduct of the audit.

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INDEPENDENT AUDITOR'S REPORT

Inspector General
US Department of Housing and Urban Development

Commissioner
Federal Housing Administration

We have audited the accompanying consolidated balance sheet of the Federal Housing Administration (FHA), a wholly owned government corporation within the United States Department of Housing and Urban Development (HUD), as of September 30, 2005, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statement of budgetary resources (Principal Financial Statements) for the year then ended. The objective of our audit was to express an opinion on the fair presentation of the fiscal year 2005 Principal Financial Statements. The fiscal year 2004 Principal Financial Statements were audited by other auditors whose report dated November 8, 2004 expressed an unqualified opinion on those statements. These financial statements are the responsibility of the management of FHA. In connection with our audit, we also considered FHA's internal control over financial reporting and tested FHA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on its financial statements.

Introduction

We concluded that FHA's fiscal year 2005 Principal Financial Statements are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

Our consideration of internal control over financial reporting resulted in the following matters being identified as reportable conditions, and with respect to the first two items, material weaknesses:

- FHA must incorporate better risk factors and monitoring tools into its single family insured mortgage program risk analysis and loan liability estimation process

- FHA management must continue to improve its review over the Credit Reform estimation process

- FHA must continue to enhance the management of controls over its portfolio of integrated insurance and financial systems

We found no reportable instances of noncompliance with certain provisions of applicable laws, regulations, contracts and grant agreements.

These results and our key findings are discussed more fully in the following sections.

Auditor Responsibilities

Our responsibility is to express an opinion on these Principal Financial Statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements,* as amended. These standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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 our audit provides a reasonable basis for our opinion.

Opinion on the Principal Financial Statements

In our opinion, the Principal Financial Statements referred to above present fairly, in all material respects, the financial position of FHA as of September 30, 2005, and its net costs, changes in net position, combined budgetary resources, and reconciliation of budgetary obligations to net costs for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the Principal Financial Statements, FHA has identified certain multifamily projects and single family properties (owned and insured) that were affected by the September Gulf Coast disasters. However, the accompanying financial statements do not include any additional liabilities for future claims because FHA is unable to accurately estimate the number and amount of claims that will be attributed to these disasters.

The information in the Management's Discussion and Analysis and Required Supplementary Information sections is not a required part of the Principal Financial Statements, but is supplementary information required by the Federal Accounting Standards Advisory Board and OMB Circular A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Internal Control over Financial Reporting

In planning and performing our audit, we considered FHA's internal control over financial reporting by obtaining an understanding of FHA's internal control, determined whether internal controls had been placed into operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-

02 and *Government Auditing Standards*. 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 assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of 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, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect FHA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the Principal Financial Statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may occur and not be detected.

However, we noted certain matters, summarized below and more fully described in Appendix A, involving the internal control and its operation that we consider to be reportable conditions and, with respect to the first two items, material weaknesses:

- ***FHA must incorporate better risk factors and monitoring tools into its single family insured mortgage program risk analysis and the loan liability estimation process***

  Due to significant changes in the home mortgage-lending environment in recent years, the composition and credit worthiness of borrowers in FHA's single family insured loan portfolio has changed. The result has been significant increases in the rate of mortgage insurance defaults and claims. However, FHA has not developed a formal process to effectively evaluate the impact of certain loan attributes that impact the risk of future losses, such as borrower credit scores, down payment assistance sources, delinquency rates and other portfolio characteristics on FHA's overall program performance. Timely incorporation of these factors into the insured loan guarantee liability calculation will help FHA more accurately evaluate the program's future performance.

  FHA does have a number of initiatives under way that are intended to improve FHA's ability to identify changes in future insured loan portfolio performance. One initiative is the Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard (the Scorecard) to evaluate the risk of loans submitted for FHA underwriting. The Scorecard not only captures certain data such as credit bureau scores, but also allows FHA to examine individual lender loan portfolios, various product offerings, identify high risk mortgages, and better estimate default and claim assumptions.

In response to prior audit findings regarding the effectiveness of its lender underwriting review process, FHA established and implemented new policies and procedures for its Post Endorsement Technical Review process during fiscal year 2005. However, FHA's Homeownership Center quality control reviews performed on this new process have identified incorrect loan ratings caused by unclear guidance on the revised process. As a result, FHA does not yet have reliable information on the effectiveness of the direct lender loan underwriting process.

- ***FHA management must continue to improve its review over the Credit Reform estimation process***

  FHA continues to improve the cash flow models used to estimate the net present value of future premiums, claims and recoveries, and the resulting Loan Guarantee Liability. During fiscal year 2005, FHA implemented a model validation review process where the projected fiscal year 2004 cash flows in the FY2003 models were compared to actual 2004 data. During the fiscal year 2005 audit, we identified the management review process over the year-end estimate was insufficient to identify material errors in both the Mark-to-Market program and Home Equity Conversion Model (reverse mortgage) cash flow calculations.

- ***FHA must continue to enhance the management of controls over its portfolio of integrated insurance and financial systems***

  As FHA's implementation of its new core financial management system (FHASL) project moves into its final phases, we found that the remaining portfolio of various insurance and financial application systems that support the financial reporting process are not effectively managed. This resulted in general control weaknesses with respect to FHASL's contingency planning, risk assessments, disaster recovery planning, and other components of system security.

Additional detail and the related recommendations for these findings are provided in Appendix A of this report. The full text of management's response is included in Appendix B. Our assessment of management's response is included in Appendix C. The current status of prior year findings and recommendations is included in Appendix D.

With respect to certain key performance measures reported in Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls related to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We also noted other less significant matters involving the internal control and its operation, which we have reported to the management of FHA and HUD in a separate letter, dated October 28, 2005.

Compliance with Laws and Regulations

The management of FHA is responsible for complying with laws, regulations, and provisions of contracts and grant agreements applicable to FHA. As part of obtaining reasonable assurance about whether FHA's fiscal year 2005 financial statements are free of material misstatement, we performed tests of FHA's compliance with certain provisions of applicable laws, regulations, contracts and grant agreements, 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. 01-02.

Our audit procedures were not designed to test the requirements of OMB Bulletin No. 01-02 relating to the Federal Financial Management Improvement Act of 1996 (FFMIA), which are not applicable to FHA. Compliance with FFMIA will be evaluated and reported on by the HUD Office of Inspector General (OIG) in connection with their audit of the consolidated financial statements of HUD. We limited our tests of compliance to the provisions described above and we did not test compliance with all laws, regulations, contracts and grants applicable to FHA. Providing an opinion on compliance with certain provisions of laws, regulations, contracts and grants was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws, regulations, contracts and grants described above, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Distribution

This report is intended solely for the information and use of the HUD OIG, the management of HUD and FHA, OMB, the Government Accountability Office and Congress and is not intended to be used by anyone other than these parties.

Urbach Kahn & Werlin LLP

Washington, DC
October 28, 2005

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Appendix A
Reportable Conditions and Material Weaknesses

The following internal control matters are considered Material Weaknesses:

1. FHA must incorporate better risk factors and monitoring tools into its single-family insured mortgage program risk analysis and liability estimation process

Due to significant changes in the home mortgage-lending environment in recent years, the composition and credit worthiness of borrowers in FHA's single family insured loan portfolio has changed. The result has been a significant increase in mortgage defaults and insurance claims. However, FHA has not developed a formal process to effectively evaluate the impact in its portfolio of certain loan factors, such as borrower credit scores, down payment assistance sources, and other portfolio characteristics. The impact of certain loan factors such as loan-to-value ratios, non-gift down payment assistance sources, loan size and product type is evaluated as part of the legislatively mandated actuarial review of the Mutual Mortgage Insurance (MMI) fund. However, sufficient historical data is required for these factors to be effectively identified and analyzed, resulting in delays between when these changes occur and their impact on the portfolio is identified and assessed. The effects of these factors are aggregated for purposes of determining one overall conditional claim rate table which is used in management's insured loan guarantee liability calculation. Separate and timely identification of the impact of each of these loan factors should be incorporated in the insured loan guarantee liability calculation to help FHA management better estimate and manage the MMI fund's future performance.

FHA does not currently use borrower credit scores as a risk indicator for purposes of estimating the insured loan guarantee liability. Recent growth in the home mortgage lending industry has reduced FHA's market share, leading to concerns over changes in the credit worthiness of FHA's remaining market. The commercial mortgage lending industry has accepted credit scores as a primary leading indicator of future loan performance. Management has indicated some sensitivity to focusing solely on credit scores because of the risk of discouraging lenders from underwriting loans to some of FHA's target borrowers who may have low credit scores. Without adequate data on borrower credit scores, FHA is unable to determine whether the average credit score of its insured borrowers has changed and whether declining borrower credit scores have contributed to significant unexpected upward reestimates of its insured loan guarantee liability in recent year. FHA also cannot determine current risk trends in its active insured mortgage portfolio.

For example, in connection with the fiscal year 2005 actuarial review of the MMI fund, FHA's independent actuary determined that the claim rates for loans where the borrowers received assistance from certain entities for the initial loan down payment was as high as three times those that did not receive assistance. Although these types of loans have been a growing part of the FHA portfolio for several years, FHA has not had sufficient data to segregate these loans into a separate risk category for loss estimation purposes.

FHA does have a number of initiatives under way that are intended to improve FHA's ability to identify changes in future insured loan portfolio performance, such as the Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard (the Scorecard) to evaluate the risk of loans submitted for FHA underwriting. The Scorecard not only captures certain data such as credit bureau scores, but also allows FHA to examine individual lenders loan portfolios, various product offerings, identify high risk mortgages, and better estimate default and claim assumptions.

An additional initiative implemented by FHA during 2005 is a revised risk-based loan underwriting review process. FHA currently has contractors performing reviews on 5 percent to 10 percent of new endorsements underwritten by direct endorsement lenders. The objective of these reviews is to rate an underwriter's ability to properly evaluate loan applications and to comply with FHA underwriting requirements. Previous audits have identified that one potential source of increasing claims is the ineffectiveness of the contracted Post Endorsement Technical Review (PETR) program for monitoring underwriting errors during loan origination. The revised process is designed to simplify FHA's evaluation process and focus more on substantive risks, thus allowing FHA to seek indemnification from lenders for future claims during the first five years that were caused by underwriting errors.

In its early implementation of the revised process, quality control testing by FHA's Homeownership Center Processing and Underwriting Division staff found errors and inconsistencies in the ratings made by its PETR contractors as a result of insufficient implementation guidance. Until FHA is satisfied that the PETR contractor ratings are both consistently determined and fully comply with appropriate underwriting guidelines, FHA is unable to use the information from the revised PETR process to effectively evaluate the adequacy of the direct endorsement process and the effect on the portfolio of the risks assumed.

Recommendations to address the above include:

1a. The Director of the FHA Office of Evaluation should evaluate the information provided from the TOTAL scorecard process and the current actuarial review relating to downpayment assistance and determine the impact of incorporating these additional loan risk attributes directly into the MMI fund cash flow modeling process to ensure future changes to the composition of borrowers result in a corresponding timely change in projected claim rates. (Updated)

1b. The Director for the Housing Office of Single Family Program Development, in coordination with the Director of the Office of Evaluation, should determine whether poor underwriting ratings correlate to higher claim rates for those lenders under the revised PETR monitoring process. (New)

2. FHA management must continue to improve its review over the Credit Reform estimation process

Federal accounting standards requires agency management to estimate the net present value of future cash flows (subsidies) related to loan guarantee programs, such as FHA's mortgage insurance programs. This estimate of future losses, net of fees and recoveries, is recorded in the financial statements as the Loan Guarantee Liability. The FHA Office of Evaluation, under the direction of the Office of Finance and Budget, is responsible for calculating management's estimate of the year-end liability for future claims and losses, net of estimated premiums to be collected and future recoveries. These estimates are based on complex calculations of discounted future cash flows using a combination of various system data and management assumptions.

Each September, the key assumptions and resulting calculated liabilities are summarized and, along with the models, are presented to senior FHA management officials for their review and approval.

During fiscal year 2005, we noted FHA continued to make improvements to the cash flow models used to estimate the resulting Loan Guarantee Liability. Most notably was the development of a data validation process where fiscal year 2004 actual transaction data was compared to the fiscal year 2004 projected data from the fiscal year 2003 model. However, FHA management did not effectively perform sufficient analytical reviews of the various model calculations to identify anomalous data relationships for the Home Equity Conversion Mortgage (HECM) and Mark-to-Market restructuring program model outputs.

In addition, the briefing information provided to management on the results of the calculated liability for restructured loans through the Mark-to-Market program was not sufficient to allow the management officials responsible for approving the estimate to efficiently evaluate the reasonableness of the data inputs, the propriety of the model calculations, and the reasonableness of the resulting outputs. Consequently, management did not detect a $500 million error in the resulting liability caused by a formula error in the calculation of the net present value of future Mark-to-Market claims.

The review of the HECM model calculation by the approving officials was also insufficient to detect gross overstatements in cash flows for assignments and recoveries caused by a formula error in the calculation of assignments. Management also did not identify an unusual increase in the type I conditional claim rate that overstated the liability by $20 million.

Federal Financial Accounting and Auditing Technical Release 6 (TR6), *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act, Amendments to Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*, issued January 2004, states, "Preparing reliable and timely direct loan and loan guarantee subsidy estimates must be a joint effort between the budget, CFO, and program offices at each agency. These offices should work together to ensure that the procedures and internal control are implemented and operating as designed."

Recommendations to address the above include:

2a. The FHA Director of the Office of Evaluation should expand the validation process developed in 2005 to use the prior year comparisons of projected and actual cash flows to develop management's independent expectations for gross cash flows and other key ratios to be produced by the upcoming reestimation process. (New)

2b. The FHA Director of the Office of Evaluation should expand the information on the results of the Mark-to-Market modeling process provided to approving officials to improve their ability to evaluate the reasonableness of the resulting calculations. At a minimum, such information should include: (a) the number and unpaid principal balance of projects eligible for Mark-to-Market restructuring, (b) the number and amount of projects resulting in full or partial claims, (c) the net present value of those claims, (d) the related premium and recovery amounts that make up the net liability and (e) key ratios to assist management in evaluating the reasonableness of the components of the calculated liability as well as the net balance. (New)

2c. The FHA Director of the Office of Evaluation should expand the information on the results of the HECM modeling process provided to approving officials to improve their ability to evaluate the reasonableness of the resulting calculations. At a minimum, such information should include: (a) summary information on each type of cash flow, (b) the effect of changes in sensitive model assumptions on each type of cash flow, (c) the net present value of each of these types of cash flows, and (d) key ratios to assist management in evaluating the reasonableness of the components of the calculated liability as well as the net balance. (New)

2d. The FHA Director of the Office of Evaluation, in coordination with the Deputy Assistant Secretary for Finance and Budget, should expand the year-end model review process to include a comparison and analysis of management's expectations developed above with the results of the current year modeling process and prior year cash flow calculations. This, would, at a minimum, include reviewing the effect of current year changes to the data model, sensitive assumptions, gross cash flow information and results and documentation of management's explanation for any significant variances between the expected balances and the current model calculations. (New)

We consider the following matter a Reportable Condition:

3. FHA must continue to enhance the management of controls over its portfolio of integrated insurance and financial systems

To manage its complex mortgage insurance business, FHA requires large amounts of financial and non-financial data from lenders, borrowers and trading partners such as multifamily project owners, vendors, agents, etc. FHA's Office of Housing maintains 11 separate application systems for managing its Single Family insurance programs and four Multifamily insurance application systems. Some of the business processes and related systems used in FHA's day-to-day business are also shared by other HUD programs. Several of these applications are interfaced with FHA's core financial management system, the FHA Subsidiary Ledger (FHASL). This structure requires a complex portfolio of business and financial systems to support FHA's financial management requirements.

In connection with our audit, we found that the Single Family and Multifamily insurance and related financial systems (principally FHASL) are not effectively managed as a "unified set of systems", resulting in control weaknesses with FHASL's disaster recovery planning, risk assessment and contingency planning processes, and other components of system security. Specifically, we found:

- FHASL is not included as a mission critical system in HUD's disaster recovery facility backup plan

  During fiscal year 2005, HUD awarded a new contract for data center management, which included disaster recovery management and system operations maintenance. Under the new contract, FHASL is not listed as a HUD mission critical system, and accordingly, is not included in the disaster recovery backup plans for mission critical systems covered by the data center contract. This omission was caused by an ineffective process at the HUD level for maintaining and prioritizing an accurate listing of critical system applications. As a result, the FHASL application system and data are not being replicated and may not be recovered in a timely manner in the event of a data center or data communications disruption. HUD's Chief Information Officer (CIO) has since awarded a contract for the development of a methodology for defining the criticality of HUD's portfolio of systems.

- <u>The FHASL Security Plan did not meet current standards</u>.

  The FHASL Security Plan, *PeopleSoft System Security Plan and Enterprise Architecture Update*, did not have appropriate data integrity, availability and confidentiality classifications as required by current standards published by the National Institute of Standards and Technology (NIST). An updated version of the Security Plan was provided to UKW in September 2005.

- <u>No FHASL formal Risk Assessment document exists.</u>

  FHA has not drafted a formal written Risk Assessment document in accordance with NIST standards, as required by HUD and OMB policy.

- <u>FHA management has not developed a written contingency plan or back-up policies for FHASL.</u>

  Documented contingency plans and operational, tested back-up policies and procedures are critical to ensuring the continued operation of the system in the event of a disaster or interruption. Although regular back-up procedures for FHASL appear to be performed, inadequate documentation increases the risk that the back-up process may be unreliable.

- <u>The HUD Information Technology Services (HITS) data center did not have an updated Security Plan during fiscal year 2005.</u>

  HUD's primary data center responsible for maintaining daily operations of its critical application systems did not have a security plan in place that reflects the current operating environment.

- <u>System logs under the HITS contract are not properly reviewed at the operating system, application, and database levels.</u>

  The security logs that track various system activities managed by the HITS data center that maintains HUD's primary information system applications and data (including FHASL) are not reviewed properly. Documentation of management's review of these logs is critical to ensure the integrity of system operations.

- <u>The Certification and Accreditation (C&A) package for FHASL was incomplete.</u>

The Certification & Accreditation package for FHASL was approved by the HUD CIO, the application system owner and the authorizing official without a contingency plan or risk assessment.

As noted in prior audits, one of the contributing causes to these issues is continuing weaknesses in HUD's certification and accreditation (C&A) program. The C&A program is designed to ensure that system and application information security controls are in place and operating effectively (certification), and that the appropriate management official has formally accepted any security risks of the system (accreditation).

Portfolio management: FHA is in the process of continuing to upgrade and integrate its various insurance and business systems in compliance with HUD's Enterprise Architecture Plan. FHASL was a critical component of this plan and a number of application systems were eliminated or integrated into other applications in connection with the FHASL implementation in recent years. FHA has a project plan to replace one multifamily and three single family insurance systems and upgrade the system interfaces for six other insurance systems in 2006 (three single family, one multifamily and two Title I systems). As part of this process, certain financial business processes will be migrated into FHASL. However, FHA and HUD have not yet developed a strategic plan or risk assessment for the future of FHA business systems that will ensure these system changes are coordinated or integrated as a "unified set of systems". To manage this process, HUD has appointed a Deputy CIO for Enterprise Architecture responsible for developing a strategic plan for system integration. In addition, FHA recently appointed a Director for Single Family Portfolio Management. FHA has also started developing a blueprint for the future multifamily systems architecture. FHA is also implementing a comprehensive business process reengineering review process for both Single Family and Multifamily business programs.

The Joint Financial Management Improvement Program's *Framework for Federal Financial Management Systems* requires agencies to have a "unified set of financial systems and the financial portion of mixed systems that are planned for and managed together, operated in an integrated fashion, and linked together electronically in an efficient and effective manner…".

Recommendations to address the above issue include:

3a. The FHASL Project Director, in conjunction with the HUD Chief Information Officer (CIO), should ensure the HUD Information Technology Services contract is updated to include FHASL as a mission critical application covered under the disaster recovery backup plan. (New)

3b. The FHA Director, Office of Financial Analysis and Reporting should ensure the updated Security Plan for FHASL contains appropriate data integrity, availability and confidentiality classifications as required by Office of Management and Budget and NIST standards and document the process for determining the classifications. (New)

3c. The FHA Director, Office of Financial Analysis and Reporting should develop an FHASL Risk Assessment document in compliance with NIST guidance as required by HUD's Certification and Accreditation process. (New)

3d. The FHA Director, Office of Financial Analysis and Reporting should develop a contingency plan for the FHASL application and test the contingency plan on an annual basis or after any significant change is made to the system environment. (New)

3e. The HUD Chief Information Security Officer (CISO) should ensure the data center security plan is updated to reflect the current operating environment. (New)

3f. The HUD Chief Information Security Officer (CISO) should ensure the security logs for systems managed under the HITS contract are reviewed and that these reviews are properly documented. (New)

3g. The Deputy Chief Information Officer (DCIO) for Business and IT modernization, the FHA Director, Office of Financial Analysis and Reporting and the FHASL Project Director should ensure the FY2006 FHA systems project plan is consistent with the HUD Enterprise Architecture integration and consolidation plan. (New)

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U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

October 26, 2005

MEMORANDUM FOR: Urbach Kahn & Werlin LLP

Ronald Y. Spraker

FROM: Ronald Y. Spraker, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to UKW's Fiscal Year 2005 FHA Audit Report

I am pleased to present Federal Housing Administration (FHA) management's responses to your audit report on the fiscal year 2005 FHA financial statements.

General Comments

FHA is pleased that UKW has noted progress in many areas, especially in regards to the improvements made to FHA's financial systems. However, we believe that in the areas of risk assessment and Loan Guarantee Liability estimation processes, that the addition of a new material weakness is unwarranted. FHA has taken considerable steps to enhance the quality of these processes and will continue to make additional improvements.

Report on Internal Controls – Material Weaknesses

1. FHA must incorporate better risk factors and monitoring tools into its single family insured mortgage program risk analysis and liability estimation process.

FHA non-concurs with the finding of a material weakness with regard to the quality of its risk assessment and monitoring of its single family insured mortgage program.

The Internal Control Report states that "FHA has not developed a formal process to effectively evaluate the impact of certain loan attributes that impact the risk of future losses, such as borrower credit scores, down payment assistance sources, delinquency rates and other portfolio characteristics on FHA's overall program performance."

FHA does in fact have a formal process for assessing the risk profile of its mortgage insurance business. The formal process consists of a mandated annual independent actuarial review of the Mutual Mortgage Insurance Fund (MMIF) and the use of cash flow models to estimate the remaining liability of its existing books of business for the FHA audit and the FHA budget. In

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addition, the FHA Office of Evaluation has permanent staff that monitors and reports on FHA business activities on a full-time basis.

Regarding recommendation 1.a., the MMI fund cash flow models use conditional claim and prepayment rates directly from the annual actuarial review. This year the actuarial review contractor used source of downpayment along with other variables in estimating these rates. They will continue to evaluate information from the TOTAL scorecard process and assess whether it would be possible to incorporate credit scores into statistical models of claim and prepayment.

Regarding recommendation 1.b., FHA respectfully non-concurs with the auditor's findings and recommendation on the Post Endorsement Technical Review (PETR) process. All sustained unacceptable ratings issued result in the issuance of an indemnification agreement to HUD/FHA by the lender. Upon execution of the agreement and depending on the term of the agreement, the Department will not pay a claim to that lender if the loan goes into claim status after foreclosure. Further, the PETR process is completed within a specified time after insurance endorsement and the loan may not go to immediate claim status. It may be difficult to correlate an Unacceptable rating to the payment of a claim as the borrower(s) default for many reasons, which may be unrelated to the initial underwriting of the loan.

2. FHA management should strengthen its review over the Loan Guarantee Liability Credit Reform estimation process.

FHA has state-of-the-art cash flow models for modeling the estimation of the liability for loan guarantee for the FHA audit and credit subsidy for the FHA budget. Data extraction and population of cash flow model tables is automated to reduce the likelihood of human error. Calculation of assumptions and cash flows are controlled by Visual Basic code that is carefully documented. One model is used for the principal single family risk categories—the Section 203(b) program in the MMIF and the Section 234(c) and Section 203(k) programs in the General Insurance Fund; and one model is used for the 18 multifamily risk categories, minimizing the opportunity for error. Finally, the same models are used for both liability for loan guarantee and credit subsidy estimation, assuring the maximum continuity in assumptions used for these separate analyses.

In addition, FHA has a process governed by a very extensive configuration management plan first implemented in 2003 for controlling and accounting for every change made to a model, treating the prior year's final model as the new baseline. In addition to documenting every change, the Office of Evaluation meets with program, accounting, and budget staff to discuss modeling and assumption changes. The configuration management plan requires all changes to the cash flow models be approved by FHA management, the appropriate program offices, and specifically by the Deputy Assistance Secretary for Finance and Budget.

However, FHA agrees that further oversight of the models is essential due to the complexity of the calculations and the models and the accelerated time period relating to the audited financial statements.

Regarding recommendation 2.a, FHA will expand the validation report to include management's independent expectations for gross cash flows and other key ratios to be produced by the upcoming reestimation process.

Regarding recommendation 2.b., FHA will expand the information on the results of the Mark-to-Market modeling process provided to approving officials to improve their ability to evaluate the reasonableness of the resulting calculations.

Regarding recommendation 2.c., FHA will expand the information on the results of the HECM modeling process provided to approving officials to improve their ability to evaluate the reasonableness of the resulting calculations.

Regarding recommendation 2.d., FHA will expand the year-end model review process to include a comparison and analysis of management's expectations with the results of the current year modeling process and prior year cash flow calculations.

Report on Internal Controls – Reportable Condition

3. FHA must continue to enhance the management of controls over its portfolio of integrated insurance and financial systems.

FHA agrees with this finding and associated recommendations. In FY 2006, FHA is consolidating management of its investments in financial and mixed systems under three major programs: the FHA Subsidiary Ledger, Single Family Integration, and Multifamily Integration. This consolidation will help FHA plan system improvements and operations more effectively in terms of overall FHA objectives and priorities. In addition, FHA will take the management actions identified below to address the specific conditions and recommendations of this reportable condition:

Regarding recommendation 3.a., The FHASL Project Director, in conjunction with the Office of Chief Information Officer (OCIO), will ensure that the HUD Information Technology Services (HITS) contract is updated to provide the FHASL with backup and recovery services, including support for an interim contingency plan, while the Office of the Chief Information Officer and the Office of Housing plan the acquisition of adequate FHASL hosting services.

Regarding recommendation 3.b., The FHA Director, Office of Financial Analysis and Reporting will ensure that by December 31, 2005, the FHASL Security Plan is updated to align with HUD and NIST standards. FHA will also complete a Security Risk Assessment that will evaluate the data integrity, availability, and confidentiality classifications as required by Office of Management and Budget and NIST standard and update the Security Plan again to assure consistency with the final Security Risk Assessment.

Regarding recommendation 3.c., The FHA Director, Office of Financial Analysis and Reporting will ensure that a FHASL Risk Assessment document is developed in compliance with NIST guidance as required by HUD's Certification and Accreditation process.

Regarding recommendation 3.d., The FHA Director, Office of Financial Analysis and Reporting will ensure that a contingency plan for the FHASL application is developed and tested.

Regarding recommendation 3.e., The Office of the Chief Information Officer does not agree that FISMA, OMB Circular A-130, or NIST require a security plan for a facility or a data center as recommended in the auditor's report. However, the HITS contract does call for the contractor to provide a security plan for the data center. An updated security plan is scheduled to be delivered to OCIO by October 31, 2005.

Regarding recommendation 3.f., The Chief Information Officer will ensure the security logs for systems managed under the HITS contract are reviewed and that these reviews are documented. In addition, this recommendation is already documented in the Plan of Action & Milestones for the General Support System (LAN) on which the FHASL resides.

Regarding recommendation 3.g., FHA, in conjunction with the Office of the Chief Information Officer will ensure the FY2006 FHA systems project plan is consistent with the HUD Enterprise Architecture integration and consolidation plan.

Appendix C
UKW's Assessment of Management's Response to Recommendations

UKW has obtained and reviewed FHA management's response to the findings and recommendations made in connection with our audit of FHA's 2005 Principal Financial Statements, which is included as Appendix B. Our assessment of management's responses is discussed below.

Assessment of management's response to material weakness No. 1:

FHA management does not concur with UKW's assessment of their methodology for assessing the risk profile and liability estimation process as a material weakness.

We acknowledge that the requirement for an independent actuarial review lends credibility to the effectiveness and reliability of the calculations from the cash flow models as to the remaining liability to be recorded in the financial statements. However, a key limitation, as acknowledged in the actuarial report, is its ability to reflect current changes in the risk of the portfolio, as follows:

> *"…the model coefficients are reliable only when the existing market and policy regimes remain unchanged. Therefore, the forecasts presented in this study are long term in nature as is appropriate given the long-term cash flows modeled.*
>
> *Short-term variations in MMI Fund claim or prepayment rates are not predicted by these models nor are other variables, such as delinquencies. It is not clear what conditions would cause such short-term variations to have a significant influence on the long-term forecasts. Further study in such short term variations is challenged by a lack of data availability and data consistency."*

Federal Financial Accounting and Auditing Technical Release 6 (TR6), *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act, Amendments to Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*, issued January 2004, also states:

> *"In certain limited instances, informed opinion may be used to support cash flow projections in the absence of historical data. Informed opinion refers to the judgment of agency staff or others who make subsidy estimates based on their programmatic knowledge and/or experience without using a fully satisfactory information store and in some cases, without using an econometric or other statistical model. Informed opinion may be used only as a last resort when relevant historical data and/or modeling capabilities are not available."*

Such informed opinion was incorporated into the FY2004 actuarial review to partially account for the impact of the increasing use of downpayment assistance because of the lack of historical data. Given the dramatic changes within the FHA program in recent years, we believe that reliance on long-term historical data and macroeconomic national trends will be insufficient to ensure the reliability and accuracy of management's estimates of the Loan Guarantee Liability will be reliable and accurate. Until additional sufficient data can be evaluated from certain "leading indicators" such as the TOTAL scorecard, we continue to believe management should formalize its review of the sufficiency of the objective long-term historical data to effectively predict future cash flows and document its conclusions.

With regard to our reported recommendation 1b, management has indicated its non-concurrence with our recommendation. In its response to the fiscal year 2004 audit recommendation, management stated that the new Post Endorsement Technical Review (PETR) process “will identify risk to the FHA insurance fund.” We agree that those loans assigned a rating of unacceptable will result in an indemnification agreement. However, only 5% to 10% of the direct endorsement loans are reviewed under the PETR process. We continue to believe that management must improve its response to the revised PETR process to ensure direct endorsement lenders correct non-compliant endorsement practices. Moreover, FHA should evaluate the potential impact of the rate of “unacceptable” loans in the 90-95% of direct endorsements not subjected to the PETR process on future claim rates.

Assessment of management’s response to material weakness No. 2:

Management agrees with this finding and our recommendations. We concur with management’s response.

Assessment of management’s response to reportable condition No. 3:

Management agrees with this finding and our recommendations. We concur with management’s response.

With respect to recommendation 3e, we concur with management’s comment and have revised this report to show the amended criteria.

Appendix D
Status of Prior Audit Findings and Recommendations

Our assessment of the current status of reportable conditions and material weaknesses identified in prior year audits is presented below:

Prior Finding/Recommendation	*Type*	*Fiscal Year 2005 Status*
1. HUD/FHA's ADP system environment must be enhanced to more effectively support FHA's business and budget processes.	2003-2004 Material Weakness 2005 Reportable Condition	See 2005 Reportable Condition Finding No. 3
1a. Continue to ensure that the FHASL implementation follows FFMIA requirements and HUD's System Development Life Cycle Methodology.		Partially Resolved. FHA continues to migrate financial functionality from its numerous insurance systems to FHASL.
1b. Ensure all critical manual FHA financial processes, including the budgetary execution process, are enhanced.		Partially resolved. FHA has migrated all budgetary control functions to FHASL with the exception of certain obligations still maintained within the Single Family Asset Management System (SAMS).
1c. Ensure the FHASL project system design and specifications continue to be consistent with and reflected in the planned HUD IT enterprise architecture.		Partially resolved. The FHA Systems Strategic Plan is in process under the direction of the Deputy CIO for Enterprise Architecture.
2. FHA management must improve its review over the Credit Reform estimation process.	2004 Material Weakness 2005 Material Weakness	See Updated Finding – While FHA continues to make enhancements to its cash flow models, weaknesses in the management review process over the Loan Guarantee Liability reestimation process resulted in material errors in the gross cash flow calculations.
2a. Ensure there is an effective review of the completeness and accuracy of the underlying data supporting the assumptions used in the Single Family and Multifamily cash flow models.		See updated recommendations Nos. 2a through 2d.

Prior Finding/Recommendation	*Type*	*Fiscal Year 2005 Status*
2b. Further develop the process to review the LLR/LLG estimates each year and compare them with actual experience to determine whether projected cash flows are representative of actual cash flows.		Partially resolved. FHA performed validation testing using FY2004 data to support the assumptions and results. FHA has not yet compiled sufficient historical data to validate the reliability of its estimate for Mark-to-Market claims.
3. HUD/FHA can more effectively manage controls over the FHA ADP system portfolio	2003 - 2004 Reportable Condition 2005 Reportable Condition	FHA was able to resolve most of the individual application control weaknesses identified in FHA's feeder systems. The current audit identified security and other weaknesses in FHASL, FHA's core financial management system.
3a. Ensure the application controls for the Underwriting Reporting System are enhanced		Resolved.
3b. Ensure the application security controls for FHA Connection are enhanced.		Resolved
3c. Ensure the application security controls for the Lender Approval Subsystem (LASS) and the Institution Master File are enhanced.		Resolved.
3d. Ensure the FHASL application control weaknesses are addressed.		Resolved – See Recommendation Nos. 3a – 3d for FHASL general control weaknesses noted in current year report.
3e. Ensure the planned Single Family and Multifamily business reengineering efforts are performed.		Not yet resolved. See current year finding No.3 and discussion on planned FHASL, Multifamily and Single Family application system integration efforts.
3f. Include all FHA systems in the Certification & Accreditation process.		Resolved. See current year OIG report No. 2005-DP-0007 on the results of the HUD Certification & Accreditation process.

Appendix D
Status of Prior Audit Findings and Recommendations

Prior Finding/Recommendation	*Type*	*Fiscal Year 2005 Status*
4. FHA must place more emphasis on monitoring lender underwriting and continue to improve early warning and loss prevention for Single Family insured mortgages.	2003 -2004 Reportable Condition 2005 Material Weakness	See Finding No 1 – FHA has made substantial improvements to the Post Endorsement Technical Review process. However, the quality control over the revised methodology for management review purposes appears unreliable. FHA has now begun collecting certain data through its TOTAL Scorecard process; however, this data is not yet being used to effectively identify categories of different risks within the Single Family insured mortgage portfolio.
4a. Continue to redesign the Post Endorsement Technical Review process as an effective early warning control that better predicts loan performance so that the process can be used as a lender-monitoring tool and also as an effective risk assessment tool.		Partially Resolved. See recommendation No. 1b to address the effectiveness of the revised methodology.
4b. Develop and implement a formal process to analyze certain loan data such as borrower credit scores to better identify high risk loans, to better monitor the performance of direct endorsement lenders, and assist management in evaluating the claim assumptions in the Liability for Loan Guarantee estimation model with greater precision.		In process. FHA's actuarial contractor is evaluating a sample of scores and loans to assess the viability of adopting this risk category. See Recommendation No. 1a for evaluating the results of current year actuarial review and data compiled through the TOTAL scorecard to determine whether current characteristics of the FHA Single Family loan portfolio can be used to stratify the claim risks to better predict the impact on future cash flows.

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PRINCIPAL FINANCIAL STATEMENTS

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FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2005 and 2004
(Dollars in Millions)

	2005	2004
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$9,705	$7,898
Investments (Note 4)	22,745	23,430
Other Assets (Note 7)	54	64
Total Intragovernmental	32,504	31,392
Investments (Note 4)	201	122
Accounts Receivable, Net (Note 5)	302	234
Loans Receivable and Related Foreclosed Property, Net (Note 6)	4,057	3,947
Other Assets (Note 7)	97	120
TOTAL ASSETS	**$ 37,161**	**$ 35,815**
LIABILITIES		
Intragovernmental		
Borrowings from U.S. Treasury (Note 9)	$ 7,548	$ 7,635
Other Liabilities (Note 10)	772	627
Total Intragovernmental	8,320	8,262
Accounts Payable (Note 8)	597	533
Loan Guarantee Liability (Note 6)	4,584	5,074
Debentures Issued to Claimants (Note 9)	132	187
Other Liabilities (Note 10)	373	590
TOTAL LIABILITIES	**14,006**	**14,646**
NET POSITION		
Unexpended Appropriations (Note 16)	609	699
Cumulative Results of Operations	22,546	20,470
TOTAL NET POSITION	23,155	21,169
TOTAL LIABILITIES AND NET POSITION	**$ 37,161**	**$ 35,815**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET COST
For the periods ended September 30, 2005 and 2004
(Dollars in Millions)

	2005	2004
MMI/CMHI PROGRAM COSTS		
Intragovernmental Gross Costs (Note 12)	$ 405	$ 631
Less: Intragovernmental Earned Revenue (Note 13)	1,344	1,459
Intragovernmental Net Costs	(939)	(828)
Gross Costs with the Public (Note 12)	1,243	(436)
Less: Earned Revenue from the Public (Note 13)	41	64
Net Costs with the Public	1,202	(500)
NET MMI/CMHI PROGRAM COST (SURPLUS)	**263**	**(1,328)**
GI/SRI PROGRAM COSTS		
Intragovernmental Gross Costs (Note 12)	127	88
Less: Intragovernmental Earned Revenue (Note 13)	147	93
Intragovernmental Net Costs	(20)	(5)
Gross Costs with the Public (Note 12)	(989)	(231)
Less: Earned Revenue from the Public (Note 13)	322	186
Net Costs with the Public	(1,311)	(417)
NET GI/SRI PROGRAM COST (SURPLUS)	**(1,331)**	**(422)**
NET COST (SURPLUS) OF OPERATIONS	**$ (1,068)**	**$ (1,750)**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
For the periods ended September 30, 2005 and 2004
(Dollars in Millions)

	2005 Cumulative Results of Operations	2005 Unexpended Appropriations	2004 Cumulative Results of Operations	2004 Unexpended Appropriations
BEGINNING BALANCES	**$ 20,470**	**$ 699**	**$ 17,659**	**$ 576**
BUDGETARY FINANCING SOURCES				
Appropriations Received (Note 16)	-	1,987	-	2,023
Other Adjustments (Note 16)	-	(81)	-	(4)
Appropriations Used (Note 16)	1,859	(1,859)	1,812	(1,812)
Transfers-Out (Note 15 and 16)	(577)	(137)	(555)	(84)
OTHER FINANCING SOURCES				
Transfers-Out (Note 15)	(297)	-	(208)	-
Imputed Financing (Note 12)	23	-	14	-
Other (Note 15)	-	-	(2)	-
TOTAL FINANCING SOURCES	**1,008**	**(90)**	**1,061**	**123**
NET (COST) SURPLUS OF OPERATIONS	**1,068**	-	**1,750**	-
ENDING BALANCES	**$ 22,546**	**$ 609**	**$ 20,470**	**$ 699**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENTS OF BUDGETARY RESOURCES
For the periods ended September 30, 2005 and 2004
(Dollars in Millions)

	2005 Budgetary	2005 Non-Budgetary	2004 Budgetary	2004 Non-Budgetary
BUDGETARY RESOURCES (Note 17)				
Budget Authority:				
Appropriations	$ 1,987	$ -	$ 2,023	$ -
Borrowing Authority	(9)	1,175	130	3,400
Unobligated Balance Carried Forward	23,978	4,609	27,111	1,061
Spending Authority from Offsetting Collections:				
Earned:				
Collected	2,757	11,722	4,432	17,303
Receivable from Federal Sources	13	(87)	(29)	119
Change in Unfilled Customer Orders	-	-	-	5
Recoveries of Prior Year Obligations	20	39	36	12
Permanently Not Available	(311)	(1,215)	(298)	(4,559)
TOTAL BUDGETARY RESOURCES	**$ 28,435**	**$ 16,243**	**$ 33,405**	**$ 17,341**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 4,833	$ 10,352	$ 9,427	$ 12,732
Unobligated Balance-Apportioned	77	2,649	152	2,586
Unobligated Balance Not Available	23,525	3,242	23,826	2,023
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 28,435**	**$ 16,243**	**$ 33,405**	**$ 17,341**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Obligated Balance, Net, Beginning of Period	$ 743	$ 1,125	$ 938	$ 941
Obligated Balance, Net, End of Period:				
Accounts Receivable	(261)	(47)	(248)	(134)
Unfilled Customer Orders from Federal Sources	-	(5)	-	(5)
Undelivered Orders	552	571	537	520
Accounts Payable	515	692	454	744
Outlays:				
Disbursements	4,737	10,314	9,615	12,412
Collections	(2,757)	(11,722)	(4,432)	(17,303)

Subtotal	1,980	(1,408)	5,183	(4,891)
Less: Offsetting Receipts	474	-	419	-
NET OUTLAYS	**$ 1,506**	**$ (1,408)**	**$ 4,764**	**$ (4,891)**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENT OF FINANCING
For the periods ended September 30, 2005 and 2004
(Dollars in Millions)

	2005	2004
RESOURCES USED TO FINANCE ACTIVITIES		
Obligations Incurred	$ 15,185	$22,159
Spending Authority from Offsetting Collections and Recoveries	(14,464)	(21,878)
Offsetting Receipts	(474)	(419)
Transfers Out	(297)	(208)
Imputed Financing from Costs Absorbed by Others	23	14
Other	-	(2)
TOTAL RESOURCES USED TO FINANCE ACTIVITIES	**$ (27)**	**$ (334)**
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST (SURPLUS) OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods and Services Ordered but not yet Provided	$ (57)	$ (340)
Resources that Fund Expenses Recognized in Prior Periods	(3,161)	(7,546)
Budgetary Offsetting Collections and Receipts that Do Not Affect the Net Cost (Surplus) of Operations	13,158	20,371
Resources that Finance the Acquisition of Assets	(10,114)	(12,630)
Transfer Out to HUD without Reimbursement Related to Salary and Expense Payments	(233)	(274)
Other Resources or Adjustments that do not Affect the Net Cost (Surplus) of Operations	(165)	138
TOTAL RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST (SURPLUS) OF OPERATIONS	**$ (572)**	**$ (281)**
TOTAL RESOURCES USED TO FINANCE THE NET COST (SURPLUS) OF OPERATIONS	**$ (599)**	**$ (615)**
COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Upward Reestimate of Credit Subsidy Expense	$ 2,552	$ 3,129
Downward Reestimate of Credit Subsidy Expense	(402)	(262)
Changes in Loan Loss Reserve Expense	(1,138)	(1,082)
Changes in Bad Debt Expenses Related to Uncollectible Pre-Credit Reform Receivables	(200)	(351)
Reduction of Credit Subsidy Expense from Endorsements and Modifications of Loan Guarantees	(1,304)	(2,945)
Gains or Losses on Sales of Credit Program Assets	276	605

Other	(253)	(229)
TOTAL COMPONENTS OF THE NET COST (SURPLUS) OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD	**$ (469)**	**$(1,135)**
NET COST (SURPLUS) OF OPERATIONS	**$ (1,068)**	**$(1,750)**

The accompanying notes are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS
September 30, 2005

Note 1. Significant Accounting Policies

Entity and Mission

The Federal Housing Administration (FHA) was established under the National Housing Act of 1934 and became a wholly owned government corporation in 1948 subject to the Government Corporation Control Act, as amended. While FHA was established as a separate Federal entity, it was subsequently merged into the Department of Housing and Urban Development (HUD) when that department was created in 1965. FHA does not maintain a separate staff or facilities; its operations are conducted, along with other Housing activities, by HUD organizations. FHA is headed by HUD's Assistant Secretary for Housing/Federal Housing Commissioner, who reports to the Secretary of HUD. FHA's activities are included in the Housing section of the HUD budget.

FHA administers a wide range of activities to make mortgage financing more accessible to the home-buying public and to increase the availability of affordable housing to families and individuals, particularly to the nation's poor and disadvantaged. FHA insures private lenders against loss on mortgages, which finance Single Family homes, Multifamily projects, health care facilities, property improvements, and manufactured homes. The objectives of the activities carried out by FHA relate directly to developing affordable housing.

FHA categorizes its activities as Single Family, Multifamily, or Title I. Single Family activities support basic home ownership; Multifamily activities support high-density housing and medical facilities; Title I activities support manufactured housing and property improvement.

FHA organizes its operations into two overall program types – MMI/CMHI and GI/SRI. These program types are composed of four major funds. The Mutual Mortgage Insurance fund (MMI), FHA's largest fund, provides basic Single Family mortgage insurance and is a mutual insurance fund, whereby mortgagors, upon non-claim termination of their mortgages, share surplus premiums paid into the MMI fund that are not required for operating expenses and losses or to build equity. The Cooperative Management Housing Insurance fund (CMHI), another mutual fund, provides mortgage insurance for management-type cooperatives. The General Insurance fund (GI), provides a large number of specialized mortgage insurance activities, including insurance of loans for property improvements, cooperatives, condominiums, housing for the elderly, land development, group practice medical facilities and nonprofit hospitals. The Special Risk Insurance fund (SRI) provides mortgage insurance on behalf of mortgagors eligible for interest reduction payments who otherwise would not be eligible for mortgage insurance.

Basis of Accounting

The principal financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to Federal agencies as promulgated by the Federal Accounting Standards Advisory Board (FASAB). The recognition and measurement of budgetary resources and their status for purposes of preparing the Combined Statement of Budgetary Resources, is based on concepts and guidance provided by the Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission, and Execution of the Budget*.

Basis of Consolidation

The accompanying principal financial statements include all Treasury Account Fund Symbols (TAFSs) designated to FHA, which consist of two principal general program funds, six revolving funds, two general funds and an escrow fund. All inter-fund accounts receivable, accounts payable, transfers in and transfers out within these TAFSs have been eliminated to prepare the consolidated balance sheets, statements of net cost, statements of changes in net position and statements of financing. The statements of budgetary resources are prepared on a combined basis as allowed by *Form and Content of Agency Financial Statements*, OMB Circular A-136.

Use of Estimates

The preparation of the principal financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Amounts reported for net loans receivable and related foreclosed property and the loan guarantee liability represent FHA's best estimates based on pertinent information available.

To estimate the allowance for subsidy (AFS) associated with loans receivable and related to foreclosed property and the liability for loan guarantees (LLG), FHA uses cash flow model assumptions associated with loan guarantee cases subject to the Federal Credit Reform Act of 1990 (FCRA), as described in Note 6, to estimate the cash flows associated with future loan performance. To make reasonable projections of future loan performance, FHA develops assumptions, as described in Note 6, based on historical data, current and forecasted program and economic assumptions.

Certain programs have higher risks due to increased chances of fraudulent activities perpetrated against FHA. FHA accounts for these risks through the assumptions used in the liabilities for loan guarantee estimates. FHA develops the assumptions based on historical performance and management's judgments about future loan performance.

Fund Balance with U.S. Treasury

Fund balance with U.S. Treasury consists of amounts collected and available to fund payments for expenses and of amounts collected but unavailable until authorizing legislation is enacted (see Notes 2 and 3).

Credit Reform Accounting

The FCRA establishes the use of the program, financing, general fund receipt and capital reserve accounts for loan guarantees committed and direct loans obligated after September 30, 1991 (Credit Reform). It also establishes the liquidating account for activity relating to any loan guarantees committed and direct loans obligated before October 1, 1991 (pre-Credit Reform). These accounts are classified as either budgetary or non-budgetary in the Combined Statements of Budgetary Resources. The budgetary accounts include the program, capital reserve and liquidating accounts. The non-budgetary accounts consist of the credit reform financing accounts.

The program account is a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. The program account also receives appropriations for administrative expenses. The financing account is a non-budgetary account that is used to record all of the cash flows resulting from Credit Reform direct loans or loan guarantees. It includes loan disbursements, loan repayments and fees, claim payments, , borrowing from the U.S. Treasury, interest, negative subsidy and the subsidy cost received from the program account.

The general fund receipt account is a budget account used for the receipt of amounts paid from the financing account when there is a negative subsidy from the original estimate or a downward reestimate. In most cases, the receipt account is a general fund receipt account and amounts are not earmarked for the FHA's credit programs.

They are available for appropriations only in the sense that all general fund receipts are available for appropriations. Any assets in this account are non-entity assets and are offset by intragovernmental liabilities. At the beginning of the following fiscal year, the fund balance in the general fund receipt account is transferred to the U.S. Treasury general fund. The FHA general fund receipt account of the GI and SRI funds are in this category.

In order to resolve the different requirements between the FCRA and the National Affordable Housing Act of 1990 (NAHA), OMB instructed FHA to create the capital reserve account to record the MMI/CMHI negative subsidy and subsequent downward reestimates. Specifically, the NAHA required that FHA's MMI fund achieve a Capital Ratio of 2.0 percent by fiscal year 2000. The Capital Ratio is defined as the ratio of economic net worth (current cash plus the present value of all future net cash flows) of the MMI fund to unamortized insurance in force (the unpaid balance of insured mortgages). Therefore, to ensure that the calculated Capital Ratio reflects the actual strength of the MMI fund, the resources of the capital reserve account, which are considered FHA assets, are included in the calculation of the MMI fund's economic net worth. At the end of fiscal year 1995, FHA met and has since maintained the Capital Ratio requirement. FHA's actuary estimated the September 30, 2005 Capital Ratio to be 6.02 percent. The fiscal year 2004 estimated Capital Ratio was 5.53 percent.

The liquidating account is a budget account that is used to record all cash flows to and from FHA resulting from pre-Credit Reform direct loans or loan guarantees. Liquidating account collections in any year are available only for obligations incurred during that year or to repay debt. Unobligated balances remaining in the GI and SRI liquidating funds at year-end are transferred to the U.S. Treasury's general fund. Consequently, in the event that resources in the GI/SRI liquidating account are otherwise insufficient to cover the payments for obligations or commitments, the FCRA provides that the GI/SRI liquidating account can receive permanent indefinite authority to cover any resource shortages.

Investments

FHA investments include investments in U.S. Treasury securities and investments in private-sector entities where FHA is a member with other parties under the Accelerated Claims Disposition Demonstration program (see Note 4).

Under current legislation, FHA invests available resources in excess of its current needs (in MMI/CMHI funds) in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of unamortized premium or discount. Amortization of the premium or discount is recognized monthly in interest income on investments in U.S. Treasury securities on the effective interest rate basis.

The Departments of Veterans Affairs and Housing and Urban Development Appropriations Act of 1999 and Section 601 of the Independent Agencies Act of 1999 provide FHA with new flexibility in reforming its single family claims and property disposition activities. In accordance with these Acts, FHA implemented the Accelerated Claims Disposition Demonstration program (the 601 program) to shorten the claim filing process, obtain higher recoveries from its defaulted guaranteed loans, and support the Office of Housing's mission of keeping homeowners in their home. To achieve these objectives, FHA transfers assigned mortgage notes to private-sector entities in exchange for cash and equity interest. The servicing and disposition of the mortgage notes are performed by the private-sector entities whose primary mission is dedicated to these types of activity.

With the transfer of assigned mortgage notes under the 601 program, FHA obtains ownership interest in the private-sector entities. This level of ownership interest enables FHA to exercise significant influence over the operating and financial policies of the entities. Accordingly, to comply with the requirement of Opinion No. 18 issued by the Accounting Principles Board (APB 18), FHA uses the equity method of accounting to measure the value of its investments in these entities. The equity method of accounting requires FHA to record its investments in the entities at cost initially. Periodically, the carrying amount of the investments is adjusted for cash distributions to FHA and for FHA's share of the entities' earnings or losses.

Loans Receivable and Related Foreclosed Property, Net

FHA's loans receivable include mortgage notes assigned (MNA), also described as Secretary-held notes, and purchase money mortgages (PMM). Under the requirements of the FCRA, PMM notes are considered to be direct loans while MNA notes are considered to be defaulted guaranteed loans. The PMM loans are generated from the sales on credit of FHA's foreclosed properties to qualified non-profit organizations. The MNA notes are created when FHA pays the lenders for claims on defaulted guaranteed loans and takes assignment of the defaulted loans for direct collections. In addition, Multifamily and Single Family performing notes insured pursuant to Section 221(g)(4) of the National Housing Act may be assigned automatically to FHA at a pre-determined point.

In accordance with the FCRA and Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees,* Credit Reform direct loans, defaulted guaranteed loans and foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily estimated proceeds less selling and mainteanance costs. The difference between the cost of these loans and property and the net present value is called the allowance for subsidy cost. Pre-Credit Reform loans receivable and foreclosed property in inventory are recorded at net realizable value, which is based on historical recovery rates net of any selling expenses (see Note 6).

General Property, Plant and Equipment

FHA does not maintain separate facilities. HUD purchases and maintains all property, plant and equipment used by FHA, along with other Office of Housing activities.

Current HUD policy concerning SFFAS No. 10 *Accounting for Internal Use Software* indicates that HUD will either own the software or the functionality provided by the software in the case of licensed or leased software. This includes "commercial off-the-shelf" (COTS) software, contractor-developed software, and internally developed software. FHA had several procurement actions in place and had incurred expenses for software development. FHA identified and transferred those expenses to HUD to comply with departmental policy.

Loan Guarantee Liability

The net potential future losses related to FHA's central business of providing mortgage insurance are reflected in the Loan Guarantee Liability in the consolidated balance sheets. As required by SFFAS No. 2, the Loan Guarantee Liability includes the Credit Reform related Liabilities for Loan Guarantees (LLG) and the pre-Credit Reform Loan Loss Reserve (LLR) (see Note 6).

The LLG is calculated as the net present value of anticipated cash outflows and cash inflows. Anticipated cash outflows include lender claims arising from borrower defaults, (i.e., claim payments), premium refunds, property costs to maintain foreclosed properties arising from future defaults and selling costs for the properties. Anticipated cash inflows include premium receipts, proceeds from asset sales and principal and interest on Secretary-held notes.

FHA records loss estimates for its single family LLR (includes MMI and GI/SRI) to provide for anticipated losses incurred (e.g., claims on insured mortgages where defaults have taken place but claims have not yet been filed). Using the net cash flows (cash inflows less cash outflows), FHA computes an estimate based on conditional claim rates and loss experience data, and adjusts the estimate to incorporate management assumptions about current economic factors.

FHA records loss estimates for its multifamily LLR (includes CMHI and GI/SRI) to provide for anticipated outflows less anticipated inflows. Using the net present value of claims less premiums, fees, and recoveries, FHA computes an estimate based on conditional claim rates, prepayment rates, and recovery assumptions based on historical experience.

Unearned Premiums

Unearned premiums are recognized for pre-Credit Reform loan guarantee premiums collected but not yet earned in the liquidating account. Premiums charged by FHA's MMI fund include up-front and annual risk-based premiums. Up-front risk-based premiums are recorded as unearned revenue upon collection and are recognized as revenue over the period in which losses and insurance costs are expected to occur. Annual risk-based premiums are recognized as revenue on a straight-line basis throughout the year. FHA's other funds charge periodic insurance premiums over the mortgage insurance term. Premiums on annual installment policies are recognized for the liquidating account on a straight-line basis throughout the year. Premiums associated with Credit Reform loan guarantees are included in the calculation of the LLG and are not included in the unearned premium amounts reported in the consolidated balance sheets.

Appropriations and Monies Received from Other HUD Programs

The National Housing Act of 1990, as amended, provides for appropriations from Congress to finance the operations of GI and SRI funds. For Credit Reform loan guarantees, appropriations to the GI and SRI funds are provided at the beginning of each fiscal year to cover estimated losses on insured loans during the year. For pre-Credit Reform loan guarantees, FHA has permanent indefinite appropriation authority to finance any shortages of resources needed for operations.

Monies received from other HUD programs, such as interest subsidies and rent supplements are recorded as revenue for the liquidating accounts when services are rendered. Monies received for the financing accounts are recorded as additions to the LLG or the AFS when collected.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, requires that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. For purposes of HUD's consolidated financial statements, HUD identifies each responsibility segment's share of the program costs or resources provided by other Federal agencies. As a responsibility segment of HUD, FHA's portion of these costs for fiscal years 2005 and 2004 was $23 million and $14 million, respectively and are included in FHA's financial statements as an imputed cost in the Consolidated Statements of Net Cost, and an imputed financing in the Consolidated Statements of Changes in Net Position and the Consolidated Statements of Financing.

In a separate effort, FHA conducts time allocation surveys of all Office of Housing operational managers. These surveys determine FHA's direct personnel costs associated with the Housing Salaries and Expenses (S&E) transfer to HUD and where to allocate these costs between the MMI/CMHI and GI/SRI programs. The HUD Chief Financial Officer (CFO) office also conducts surveys to determine how the department's fiscal year overhead, Office of Inspector General, and Working Capital Fund costs, which are paid for by S&E transfer, should be accounted for by responsibility segments. This data is an integral part of the FHA direct cost S&E allocation prepared for financial statement reporting.

Distributive Shares

As mutual funds, excess revenues in the MMI Fund and CMHI Fund may be distributed to mortgagors at the discretion of the Secretary of HUD. Such distributions are determined based on the funds' financial positions and their projected revenues and costs. As previously discussed, in November 1990, Congress passed the NAHA, which effectively suspended payment of distributive shares from the MMI fund, other than those already declared by the Secretary, until the fund meets certain Capital Ratio requirements. Although the Capital Ratio requirement has been met since September 30, 1995, no distributive shares have been declared from the MMI fund because legislation is not yet enacted.

Liabilities Covered by Budgetary Resources

Liabilities of federal agencies are required to be classified as those covered and not covered by budgetary resources, as defined by OMB Circular A-136, and in accordance with SFFAS No. 1, *Selected Assets and Liabilities*. In the event that available resources are insufficient to cover liabilities due at a point in time, FHA has authority to borrow monies from the U.S. Treasury (for post-1991 loan guarantees) or to draw on permanent indefinite appropriations (for pre-1992 loan guarantees) to satisfy the liabilities. Thus, all of FHA's liabilities are considered covered by budgetary resources.

Note 2. Non-entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2005 and 2004 are as follows:

(Dollars in millions)

	2005	2004
Intragovernmental:		
Fund Balance with U.S. Treasury	$ 1,272	$ 790
Investments in U.S. Treasury Securities	4	4
Total Intragovernmental	1,276	794
Other Assets	95	114
Total Non-entity Assets	1,371	908
Total Entity Assets	35,790	34,907
Total Assets	**$ 37,161**	**$ 35,815**

FHA's non-entity assets consist of FHA's U.S. Treasury deposit of negative credit subsidy in the GI/SRI general fund receipt account and of escrow monies collected by FHA from the borrowers of its loans.

According to the FCRA, FHA transfers negative credit subsidy from new endorsements and downward credit subsidy reestimates from the GI/SRI financing account to the GI/SRI general fund receipt account. At the beginning of each fiscal year, fund balance in the GI/SRI general fund receipt account is transferred into the U.S. Treasury's general fund.

Other assets consisting of escrow monies collected from FHA borrowers are either deposited at the U.S. Treasury or Minority-owned banks or invested in U.S. Treasury securities. Subsequently, FHA disburses these escrow monies to pay for property taxes, property insurance or maintenance expenses on behalf of the borrowers.

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was composed of the following as of September 30, 2005 and 2004:

(Dollars in millions)

	2005	2004
Fund Balances:		
Revolving Funds	$ 8,044	$ 6,697
Appropriated Funds	460	481
Other Funds	1,201	720
Total	**$ 9,705**	**$ 7,898**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance:		
Available	$ 2,724	$ 2,738
Unavailable	4,651	2,905
Obligated Balance not yet Disbursed	2,330	2,255
Total	**$ 9,705**	**$ 7,898**

Revolving Funds

FHA's revolving funds include the liquidating and financing accounts as required by the FCRA. These funds are created to finance a continuing cycle of business-like operations in which the fund charges for the sale of products or services. These funds also use the proceeds to finance spending, usually without requirement of annual appropriations.

Appropriated Funds

FHA's appropriated funds consist of the program accounts created by the FCRA. Annual or multi-year program accounts expire at the end of the time period specified in the authorizing legislation. For the subsequent five fiscal years after expiration, the resources are available only to liquidate valid obligations incurred during the unexpired period. Adjustments are allowed to increase or decrease valid obligations incurred during the unexpired period that were not previously reported. At the end of the fifth expired year, the annual and multi-year program accounts are cancelled and any remaining resources are returned to the U.S. Treasury.

Other Funds

FHA's other funds include the general fund receipt accounts established under the FCRA and an escrow fund. Additionally, included with these funds is the capital reserve account that is used to retain the MMI/CMHI negative subsidy and downward credit subsidy reestimates transferred from the financing account. If subsequent upward credit subsidy reestimates are calculated in the financing account or there is shortage of budgetary resources in the liquidating account, the capital reserve account will return the retained negative subsidy to the financing account or transfer the needed funds to the liquidating account, respectively.

Status of Fund Balance with U.S. Treasury

Unobligated Fund Balance with U.S. Treasury represents Fund Balance with U.S. Treasury that has not been obligated to purchase goods or services either because FHA has not received apportionment authority from OMB to use the resources (unavailable unobligated balance) or because FHA has not obligated the apportioned resources (available unobligated balance). Fund Balance with U.S. Treasury that is obligated, but not yet disbursed, consists of resources that have been obligated for goods or services but not yet disbursed either because the ordered goods or services have not been delivered or because FHA has not yet paid for goods or services received by the end of the fiscal year.

Note 4. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30. The cost, par value, net unamortized discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2005 were as follows:

(Dollars in millions)	Cost	Par Value	Unamortized Premium (Discount), Net	Investment, Net	Market Value
MMI/CMHI Investments	$ 22,346	$ 22,642	$ (161)	$ 22,481	$ 22,957
GI/SRI Investments	4	4	-	4	4
Subtotal	22,350	22,646	(161)	22,485	22,961
MMI/CMHI Accrued Interest	-	-	-	260	-
Total	**$ 22,350**	**$ 22,646**	**$ (161)**	**$ 22,745**	**$ 22,961**

The cost, par value, net unamortized discount, net investment, and market values as of September 30, 2004 were as follows:

(Dollars in millions)	Cost	Par Value	Unamortized Premium (Discount), Net	Investment, Net	Market Value
MMI/CMHI Investments	$ 23,066	$ 23,321	$ (143)	$ 23,178	$ 24,162
GI/SRI Investments	4	4	-	4	4
Subtotal	23,070	23,325	(143)	23,182	24,166
MMI/CMHI Accrued Interest	-	-	-	248	-
Total	**$ 23,070**	**$ 23,325**	**$ (143)**	**$ 23,430**	**$ 24,166**

Investments in Private-Sector Entities

The following table presents financial data on FHA's investments in private-sector entities as of September 30, 2005 and 2004:

(Dollars in millions)

	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Return of Investment	Other Adjustments	Ending Balance
FY 2005	$ 122	$ 252	$ 58	$ (231)	$ -	$ 201
FY 2004	$ 123	$ 123	$ 62	$ (185)	$ (1)	$ 122

The condensed, audited financial information related to these private-sector entities as of December 31, 2004 and 2003 are as follows:

(Dollars in millions)	2005	2004
Total assets, primarily mortgage loans	$ 499	$ 349
Liabilities	3	2
Partners' capital	496	347
Total liabilities and partners' capital	$ 499	$ 349
Revenues	$ 235	$ 62
Expenses	(31)	(11)
Net Income	$ 204	$ 51

Note 5. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2005 and 2004 are as follows:

	Gross		Allowance		Net	
(Dollars in millions)	2005	2004	2005	2004	2005	2004
From the Public:						
Receivables related to credit program assets	$ 30	$ 34	$ (4)	$ (4)	$ 26	$ 30
Premiums receivable	119	50	-	-	119	50
Miscellaneous receivables	235	232	(78)	(78)	157	154
Total	**$ 384**	**$ 316**	**$ (82)**	**$ (82)**	**$ 302**	**$ 234**

Receivables Related to Credit Program Assets

These receivables include sale proceeds receivable and rents receivable from FHA's foreclosed properties. The sale proceeds receivable should be differentiated from the PMM notes receivables, which are created by the sales of

FHA's foreclosed properties on credit to qualifying non-profit organizations.

Premiums Receivable

These amounts consist of the up-front and periodic premiums due to FHA from the mortgagors at the end of the reporting period. The details of FHA premium structure are discussed in Note 13 – Earned Revenue/Premium Revenue.

Miscellaneous Receivables

Miscellaneous receivables include late charges and penalties receivable on premiums receivable, generic debt receivables, refunds receivable from overpayments of claims and distributive shares and other immaterial receivables.

Allowance for Loss

The allowance for loss for these receivables is calculated based on FHA's historical loss experience and management's judgment concerning current economic factors.

Note 6. Direct Loans and Loan Guarantees, Non-Federal Borrowers

FHA Direct Loan and Loan Guarantee Programs and the related loans receivable, foreclosed property, and loan guarantee liability as of September 30, 2005 and 2004 are as follows:

Direct Loan and Loan Guarantee Programs Administered by FHA Include:
MMI/CMHI Direct Loan Program
GI/SRI Direct Loan Program
MMI/CMHI Loan Guarantee Program
GI/SRI Loan Guarantee Program

Direct Loans Obligated Prior to Fiscal Year 1992 (Allowance for Loss Method):

(Dollars in millions)

Direct Loan Programs	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Direct Loans
FY 2005:					
MMI/CMHI	$ 3	$ -	$ (1)	$ -	$ 2
GI/SRI	14	3	(6)	-	11
Total	**$ 17**	**$ 3**	**$ (7)**	**$ -**	**$ 13**
FY 2004:					
MMI/CMHI	$ 3	$ -	$ (2)	$ -	$ 1
GI/SRI	19	2	(10)	-	11
Total	**$ 22**	**$ 2**	**$ (12)**	**$ -**	**$ 12**

Direct Loans Obligated After Fiscal Year 1991:

(Dollars in millions)

Direct Loan Programs	Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost	Value of Assets Related to Direct Loans
FY 2005:					
MMI/CMHI	$ 1	$ -	$ -	$ (3)	$ (2)
GI/SRI	-	-	-	-	-
Total	**$ 1**	**$ -**	**$ -**	**$ (3)**	**$ (2)**
FY 2004:					
MMI/CMHI	$ -	$ -	$ -	$ (3)	$ (3)
GI/SRI	-	-	-	-	-
Total	**$ -**	**$ -**	**$ -**	**$ (3)**	**$ (3)**

Defaulted Guaranteed Loans from Pre-1992 Guarantees (Allowance for Loss Method):

(Dollars in millions)

Loan Guarantee Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Foreclosed Property	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FY 2005:					
MMI/CMHI	$ 5	$ -	$ (1)	$ 16	$ 20
GI/SRI	2,968	140	(845)	8	2,271
Total	**$ 2,973**	**$ 140**	**$ (846)**	**$ 24**	**$ 2,291**
FY 2004:					
MMI/CMHI	$ 6	$ -	$ (1)	$ 14	$ 19
GI/SRI	2,755	135	(905)	1	1,986
Total	**$ 2,761**	**$ 135**	**$ (906)**	**$ 15**	**$ 2,005**

Defaulted Guaranteed Loans from Post-1991 Guarantees:

(Dollars in millions)

Loan Guarantee Programs	Defaulted Guaranteed Loans Receivable, Gross	Interest Receivable	Foreclosed Property	Allowance for Subsidy Cost	Value of Assets Related to Defaulted Guaranteed Loans Receivable, Net
FY 2005:					
MMI/CMHI	$ 343	$ 1	$ 2,405	$ (1,441)	$ 1,308
GI/SRI	655	60	387	(655)	447
Total	**$ 998**	**$ 61**	**$ 2,792**	**$ (2,096)**	**$ 1,755**
FY 2004:					
MMI/CMHI	$ 340	$ 2	$ 2,095	$ (993)	$ 1,444
GI/SRI	704	73	394	(682)	489
Total	**$ 1,044**	**$ 75**	**$ 2,489**	**$ (1,675)**	**$ 1,933**

Guaranteed Loans Outstanding:

(Dollars in millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
FY 2005		
Guaranteed Loans Outstanding:		
MMI/CMHI	$ 364,444	$ 335,568
GI/SRI	89,928	80,893
Total	**$ 454,372**	**$ 416,461**
FY 2004		
Guaranteed Loans Outstanding:		
MMI/CMHI	$ 412,404	$ 383,548
GI/SRI	94,711	85,248
Total	**$ 507,115**	**$ 468,796**
FY 2005		
New Guaranteed Loans Disbursed:		
MMI/CMHI	$ 55,287	$ 54,823
GI/SRI	11,004	10,950
Total	**$ 66,291**	**$ 65,773**
FY 2004		
New Guaranteed Loans Disbursed:		
MMI/CMHI	$ 101,632	$ 100,625
GI/SRI	15,749	15,515
Total	**$ 117,381**	**$ 116,140**

Loan Guarantee Liability, Net:

(Dollars in millions)

Loan Guarantee Programs	Liabilities for Losses on Pre-1992 Guarantees, Estimated Future Default Claims (LLR)	Liabilities for Loan Guarantees for Post-1991 Guarantees (LLG)	Total Loan Guarantee Liability, Net
FY 2005:			
MMI/CMHI	$ 53	$ 1,803	$ 1,856
GI/SRI	1,164	1,564	2,728
Total	**$ 1,217**	**$ 3,367**	**$ 4,584**
FY 2004:			
MMI/CMHI	$ 85	$ 1,316	$ 1,401
GI/SRI	2,264	1,409	3,673
Total	**$ 2,349**	**$ 2,725**	**$ 5,074**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions) **Subsidy Expense for New Loan Guarantees**	**Defaults**	**Fees and Other Collections**	**Other**	**Total**
FY 2005:				
MMI/CMHI	$ 1,201	$ (2,516)	$ 271	$ (1,044)
GI/SRI	709	(891)	-	(182)
Total	**$ 1,910**	**$ (3,407)**	**$ 271**	**$ (1,226)**
FY 2004:				
MMI/CMHI	$ 1,454	$ (4,502)	$ 388	$ (2,660)
GI/SRI	798	(1,076)	-	(278)
Total	**$ 2,252**	**$ (5,578)**	**$ 388**	**$ (2,938)**

(Dollars in millions) **Subsidy Expense for Modifications and Reestimates**	**Total Modifications**	**Technical Reestimates**
FY 2005:		
MMI/CMHI	$ -	$ 1,933
GI/SRI	(78)	(12)
Total	**$ (78)**	**$ 1,921**
FY 2004:		
MMI/CMHI	$ -	$ 1,986
GI/SRI	-	508
Total	**$ -**	**$ 2,494**

(Dollars in millions) **Total Loan Guarantee Subsidy Expense**	**2005**	**2004**
MMI/CMHI	$ 889	$ (674)
GI/SRI	(271)	230
Total	**$ 618**	**$ (444)**

Subsidy Rates for Loan Guarantees by Program and Component:

(Percentage)	**Defaults**	**Fees and Other Collections**	**Other**	**Total**
Budget Subsidy Rates for Loan Guarantees of FY 2005 Cohort:				
MMI/CMHI	2.05	(4.30)	.46	(1.79)
GI/SRI	3.51	(4.41)	-	(0.90)
Budget Subsidy Rates for Loan Guarantees of FY 2004 Cohort:				
MMI/CMHI	1.35	(4.18)	.36	(2.47)

GI/SRI	3.19	(4.27)	-	(1.08)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in millions)	2005		2004	
	LLR	LLG	LLR	LLG
Beginning Balance of the Loan Guarantee Liability	**$ 2,349**	**$ 2,725**	**$ 3,435**	**$ 2,816**
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	1,910	-	2,252
Fees and Other Collections	-	(3,407)	-	(5,578)
Other Subsidy Costs	-	271	-	388
Total of the above subsidy expense components	**-**	**(1,226)**	**-**	**(2,938)**
Adjustments:				
Fees Received	-	2,483	-	2,914
Foreclosed Property and Loans Acquired	-	5,753	-	6,367
Claim Payments to Lenders	-	(8,503)	-	(9,116)
Interest Accumulation on the Liability Balance	-	(57)	-	(227)
Other	-	42	-	43
Ending Balance before Reestimates	**2,349**	**1,217**	**3,435**	**(141)**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate:				
Subsidy Expense Component	(1,132)	1,921	-	2,494
Interest Expense Component	-	199	-	372
Adjustment of prior years' credit subsidy reestimates		30		-
Total Technical/Default Reestimate	**(1,132)**	**2,150**	**(1,086)**	**2,866**
Ending Balance of the Loan Guarantee Liability	**$ 1,217**	**$ 3,367**	**$ 2,349**	**$ 2,725**

Administrative Expense:

(Dollars in millions)	2005	2004
MMI/CMHI	$ 208	$ 198
GI/SRI	265	228
Total	**$ 473**	**$ 426**

Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2005 and 2004 is as follows:

	2005	2004
Number of property in foreclosure process	30	47
Number of property held	26,751	25,307
Average holding period for property held	6 months	5 months

Pre-Credit Reform Valuation Methodology

FHA values its pre-Credit Reform related notes and properties in inventory at net realizable value, determined on the basis of net cash flows. To value these items, FHA uses historical claim data, revenues from premiums and recoveries, and expenses of selling and maintaining property.

FHA records loss estimates for its single family LLR (includes MMI and GI/SRI) to provide for anticipated losses incurred (e.g., claims on insured mortgages where defaults have taken place but claims have not yet been filed). Using the net cash flows (cash inflows less cash outflows), FHA computes an estimate based on conditional claim rates and loss experience data, and adjusts the estimate to incorporate management assumptions about current economic factors.

FHA records loss estimates for its multifamily LLR (includes CMHI and GI/SRI) to provide for anticipated outflows less anticipated inflows. Using the net present value of claims less premiums, fees, and recoveries, FHA computes an estimate based on conditional claim rates, prepayment rates, and recovery assumptions are based on historical experience.

A separate analysis was conducted to adjust the loan loss estimate for planned reductions in project-based Section 8 rental assistance subsidies administered by the Office of Affordable Housing Preservation (OAHP). All projects that submitted annual financial statements, received Section 8 assistance and had contract rents exceeding 90 percent of fair market value were included. In the analysis, the gross rent for these projects was reduced to bring the contract rent for assisted units to fair market levels. The effects of this rent reduction on projects' financial health was assessed and the projects were grouped into the following three categories:

No action: Projects that could continue to pay their operating expenses and mortgage payment.

Partial claim: Projects that could pay their operating expenses but could not make a full mortgage payment.

Full Claim: Projects that could no longer meet their mortgage payment and operating expenses.

Based on this analysis, appropriate adjustments were made to each project's loan loss estimate. No changes were made for projects requiring no action. For those classified as a partial claim, a new sustainable mortgage amount was calculated. The loss estimated on loans classified as partial claims was based on the amount of the claim payment. For loans classified as full claim, the loss estimate was set to 100 percent of the project's unpaid principal balance.

Credit Reform Valuation Methodology

FHA values its Credit Reform LLG and related receivables on notes and properties in inventory at the net present value of their estimated future cash flows. The disbursement weighted interest rate on U.S. Treasury securities of maturity comparable to the guaranteed loan term is the discount factor used in the present value calculation for cohorts 1992 to 2000. For the 2001 and future cohorts, the rate on U.S. Treasury securities of maturity comparable to the term of each cash flow for the loan guarantee is used in the present value calculation. This methodology is referred to as the basket of zeros discounting methodology. OMB provides these rates to all Federal agencies for use in preparing credit subsidy estimates and requires their use under OMB Circular A-11, Part 4, "Instructions on Budget Execution." The basket of zeros discount factors are also disbursement weighted.

To apply the present value computations, FHA divides the loans into cohorts. Individual cohorts are defined by year of insurance activity and program type. Multifamily cohorts are defined based on the year in which loan guarantee commitments are made. Single Family mortgages are grouped into cohorts based on loan endorsement dates for the GI/SRI fund and commitment dates for the MMI fund. A loan can be disbursed in a year after the one in which it was obligated. Within each cohort year, loans are subdivided by risk categories. Each risk category has characteristics that distinguish it from others, including risk profile, premium structure, and the type and quality of collateral underlying the loan.

The cash flow estimates that underlie the present value calculations are determined using the significant assumptions detailed below.

Significant Assumptions – FHA developed financial models in order to estimate the present value of future program cash flows. The models incorporate information on the cash flows' expected magnitude and timing. The models rely heavily on the following loan performance assumptions:

- Conditional Termination Rates: The estimated probability of an insurance policy claim or non-claim termination in each year of the loan guarantee's term.

- Recovery Rates: The estimated percentage of a claim payment that is recovered through disposition of a mortgage note or underlying property.

- Claim Amount: The estimated amount of the claim payment relative to the unpaid principal balance at the time the claim occurs.

Additional information about loan performance assumptions is provided below:

Sources of data: FHA developed assumptions for claim rates, prepayment rates, claim amounts, and recoveries based on historical data obtained from its systems.

Economic assumptions: Forecasts of economic conditions used in conjunction with loan-level data to generate Single Family and Multifamily claim and prepayment rates were obtained from Global Insights (formerly DRI) forecasts of U.S. annual economic figures. The liability for loan guarantee estimate is likely to change depending on the time at which the economic forecasts are collected. OMB provides other economic assumptions used, such as discount rates.

Reliance on historical performance: FHA relies on the average historical performance of its insured portfolio to forecast future performance of that portfolio. Changes in legislation, subsidy programs, tax treatment and economic factors all influence loan performance. FHA assumes that similar events may occur during the remaining life of existing mortgage guarantees, which can be as long as 40 years for Multifamily programs and affect loan performance accordingly.

Current legislation and regulatory structure: FHA's future plans allowed under current legislative authority have been taken into account in formulating assumptions when relevant. In contrast, future changes in legislative authority may affect the cash flows associated with FHA insurance programs. These changes cannot be reflected in LLG calculations because of uncertainty over their nature and outcome.

Because of uncertainties inherent in the loan performance assumptions underlying the LLG and related receivables on notes and properties in inventory, actual cash flows will vary from the estimates over time. A reestimate process each year allows for estimates to be adjusted.

Discussion of Change in the Liability for Loan Guarantees

FHA has estimated and applied credit subsidy rates to each FHA loan guarantee program since fiscal year 1992. Over this time FHA's credit subsidy rates have varied. The variance is caused by three factors: (1) additional loan performance data underlying the credit subsidy rate estimates, (2) revisions to the calculation methodology used to estimate the credit subsidy rates, and (3) revisions on expected claims and prepayments derived from the revised Actuarial Review of the MMI Fund as of FY 2005. Loan performance data, which reflect mortgage market performance and FHA policy direction, are added as they become available. Revisions to the estimation methodology result from legislative direction and technical enhancements.

FHA estimated the credit subsidy rates for the 2005 cohort in fiscal year 2003. At the time of budget submission, the rates reflected prevailing policy and loan performance assumptions based on the most recent information available. These credit subsidy rates can be compared to the credit subsidy rates estimated at the end of 2005. The two rates can be reconciled through credit subsidy reestimates, which allow FHA to adjust the LLG and subsidy expense to reflect the most current and accurate credit subsidy rate.

Described below are the programs that comprise the majority of FHA's fiscal year 2005 new business. In addition, the Hospital Insurance program is also described. These descriptions highlight the factors that contributed to changing credit subsidy rates and the credit subsidy reestimate. Overall, FHA's liability decreased by $490 million from the fiscal year 2004 values.

Mutual Mortgage Insurance (MMI) - The MMI fund provides insurance for private lenders against losses on Single Family mortgages. The fund protects lenders against loan default on mortgages for properties that meet certain minimum requirements. This allows lenders to provide credit to borrowers who might not meet conventional underwriting requirements.

Due to the magnitude of the MMI fund, program changes can significantly affect the overall LLG and subsidy expense recorded in the financial statements. During fiscal year 2005, recent data, expected claims and prepayments estimated by the *Actuarial Review of MMI Fund as of FY 2005*, and changing assumptions increased the liability of the MMI fund. The majority of this change is due to the revised claims being predicted by the claim and prepayment rates taken from the *Actuarial Review of the MMI Fund as of FY 2005.*

GI/SRI Section 221(d)(4) - The Section 221(d)(4) program was established to provide mortgage insurance for the construction or substantial rehabilitation of Multifamily rental properties with five or more units. Under this program, HUD may insure up to 90 percent of the total project cost and is prohibited from insuring loans with HUD-subsidized interest rates. The Section 221(d)(4) program is the largest Multifamily program in the GI/SRI fund. The Section 221(d)(4) liability decreased in FY 2005 and was impacted by two major changes.

First, since 1991, FHA has realized a decrease in the length of time assets are held in inventory after assignment and acquisition. In FY 2005, FHA reduced the holding period assumption for assets recovered via paid in full disposition, with the approval of the Office of Management and Budget (OMB), which resulted in a decrease to the 221(d)(4) liability estimate.

Second, with clarification from the MF program offices, all of the tax credit loans identified in the Development

Application Processing system (DAP) were assigned to the Tax Credit risk category. Many 221(d)(4) loans receive tax credit benefits, and thus tax credit liabilities previously calculated in the 221(d)(4) risk category are now captured in the Tax Credit risk category. This resulted in a decrease to the 221(d)(4) liability estimate.

GI/SRI Section 234(c) - The Section 234(c) program insures a loan for as many as 30 years to purchase a unit in a condominium building. One of the many purposes of FHA's mortgage insurance programs is to encourage lenders to make affordable mortgage credit available for non-conventional forms of ownership. Condominium ownership, in which the separate owners of the individual units jointly own the development's common areas and facilities, is one particularly popular alternative. Historically, the program generates a reduction in credit subsidy expense.

GI/SRI Section 203(k) - The section 203(k) program allows a homebuyer to finance the purchase and rehabilitation of a Single Family property with a single mortgage loan insured by FHA. In the past, this program encountered incidents of fraud and FHA explicitly accounts for these risks through its LLG estimates. Based on management's judgments on claim costs and the additional rehabilitation costs associated with these fraud cases, the LLG increased by $111 million.

Note 7. Other Assets

The following table presents the composition of other assets held by FHA as of September 30:

(Dollars in millions)

	2005	2004
Intragovernmental:		
Advances to HUD for Working Capital Fund Expenses	$ 54	$ 64
Total	**$ 54**	**$ 64**
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 95	$ 114
Undistributed Charges	2	6
Total	**$ 97**	**$ 120**

Advances to HUD for Working Capital Fund Expenses

The Working Capital Fund was established by HUD to consolidate, at the department level, the acquisition of certain property and equipment to be used by different organizations within HUD. Advances to HUD for Working Capital Fund expenses represent the amount of payments made by FHA to reimburse the HUD Working Capital Fund for its share of the fund’s expenses prior to the receipt of goods or services from this fund.

Escrow Monies Deposited at Minority-Owned Banks

FHA holds in trust escrow monies received from the borrowers of its Multifamily mortgage notes to cover property repairs and renovations expenses. These escrow monies are deposited at the U.S. Treasury (see Note 2), invested in U.S. Treasury securities (see Note 4 - GI/SRI Investments) or deposited at minority-owned banks.

Undistributed Charges

Undistributed charges include FHA disbursements processed by the U.S. Treasury but the identification of the specific FHA operating area associated with the disbursement has not been determined by the end of the reporting period. When the FHA operating area that initiated the disbursement is identified, the undistributed charges are reclassified by recognizing new expenses or by liquidating previously established accounts payable.

Note 8. Accounts Payable

Accounts payable as of September 30 are as follows:

(Dollars in millions)		2005		2004
With the Public:				
Claims Payable	$	281	$	231
Premium Refunds and Distributive Shares Payable		112		78
Disbursements in Transit		41		64
Miscellaneous Payables		163		160
Total	**$**	**597**	**$**	**533**

Claims Payable

Claims payable represents the amount of claims that have been processed by FHA, but the disbursement of payment to lenders has not taken place at the end of the reporting period.

Premium Refunds and Distributive Shares Payable

Premium refunds payable are refunds of previously collected Single Family premiums that will be returned to the borrowers resulting from prepayment of the insured mortgages. Distributive shares payable represents the amount of excess revenues in the liquidating account of the CMHI fund that is to be distributed to the mortgagors at the discretion of the Secretary of HUD.

Disbursements in Transit

Disbursements in transit represent the payments recorded in FHA financial systems that have not been processed by the U.S. Treasury. The disbursements in transit will be reclassified into the reductions of the Fund Balance with U.S. Treasury once the disbursements are confirmed as paid by the U.S. Treasury.

Miscellaneous Payables

Miscellaneous payables include interest enhancement payables, interest penalty payables for late payment of claims, generic debt payables and other payables related to various operating areas within FHA.

Note 9. Debt

The following tables describe the composition of debt held by FHA as of September 30:

(Dollars in millions)	2004			2005	
	Beginning Balance	Net Borrowing	Ending Balance	Net Borrowing	Ending Balance
Agency Debt:					
Debentures Issued to Claimants	$ 270	$ (83)	$ 187	$ (55)	$ 132
Other Debt:					
Borrowings from U.S. Treasury	8,794	(1,159)	7,635	(87)	7,548
Total	**$ 9,064**	**$ (1,242)**	**$ 7,822**	**$ (142)**	**$ 7,680**

	2005	2004
Classification of Debt:		
Intragovernmental Debt	$ 7,548	$ 7,635
Debt held by the Public	132	187
Total	**$ 7,680**	**$ 7,822**

Debentures Issued to Public

The National Housing Act authorizes FHA, in certain cases, to issue debentures in lieu of cash to settle claims. FHA-issued debentures bear interest at rates established by the U.S. Treasury. Interest rates related to the outstanding debentures ranged from 4.00 percent to 12.875 percent in fiscal years 2005 and 2004. FHA debentures may be redeemed by lenders prior to maturity to pay mortgage insurance premiums to FHA, or they may be called with the approval of the Secretary of the U.S. Treasury.

The par value of debentures outstanding at September 30 was $129 million in fiscal year 2005 and $183 million in fiscal year 2004. The fair values for fiscal years 2005 and 2004 were $181 and $265 million, respectively.

Borrowings from U.S. Treasury

In accordance with Credit Reform accounting, FHA borrows from the U.S. Treasury when cash is needed in its financing accounts. Usually, the need for cash arises when FHA has to transfer the negative credit subsidy amounts related to new loan disbursements, and existing loan modifications from the financing accounts to the general fund receipt account (for cases in GI/SRI funds) or to the liquidating account (for cases in MMI/CMHI funds). In some instances, borrowings are also needed to transfer the credit subsidy related to downward reestimates from the GI/SRI financing account to the GI/SRI receipt account or when available cash is less than claim payments due.

During fiscal year 2005, FHA's U.S. Treasury borrowings carried interest rates ranging from 2.41 percent to 7.34 percent. In fiscal year 2004 the carried interest rates ranged from 3.71 percent to 7.34 percent. Fiscal year 2005 maturity dates occur from September 2009 – September 2024. Loans may be repaid in whole or in part without penalty at any time prior to maturity.

Note 10. Other Liabilities

The following table describes the composition of other liabilities as of September 30, 2005 and 2004:

(Dollars in millions)	Current		Non-Current		Total	
	2005	2004	2005	2004	2005	2004
Intragovernmental:						
Special Receipt Account Liability	$ 772	$ 627	$ -	$ -	$ 772	$ 627
Total	**$ 772**	**$ 627**	**$ -**	**$ -**	**$ 772**	**$ 627**
With the Public:						
Trust and Deposit Liabilities	$ 170	$ 189	$ -	$ -	$ 170	$ 189
Unearned Premiums	27	35	(50)	137	(23)	172
Undistributed Credits	58	75	-	-	58	75
Miscellaneous Liabilities	168	154	-	-	168	154
Total	**$ 423**	**$ 453**	**$ (50)**	**$ 137**	**$ 373**	**$ 590**

Special Receipt Account Liability

The special receipt account liability is created from negative subsidy endorsements and downward credit subsidy in the GI/SRI special receipt account.

Trust and Deposit Liabilities

Trust and deposit liabilities include mainly escrow monies received by FHA for the borrowers of its mortgage notes and earnest money received from potential purchasers of the FHA foreclosed properties. The escrow monies are eventually disbursed to pay for insurance, property taxes, and maintenance expenses on behalf of the borrowers. The earnest money becomes part of the sale proceeds or is returned to any unsuccessful bidders.

Unearned Premiums

As discussed in Note 1, unearned premiums represent premiums collected for the pre-1992 loan guarantees, but not recognized as revenue because the earning process has not been completed.

Undistributed Credits

Undistributed credits represent FHA collections processed by U.S. Treasury, but the identification of the specific operating area associated with the collections has not been determined at the end of the reporting period. When the FHA operating area that is entitled to the collections is identified, the undistributed credits are reclassified by recognizing revenue or by liquidating previously established accounts receivable.

Miscellaneous Liabilities

Miscellaneous liabilities include mainly other unearned revenue from Single Family and Multifamily operations.

Note 11. Commitments and Contingencies

Impact of Hurricane Katrina

As a result of damage incurred by hurricane Katrina in the Gulf Coast and Southeast, FHA expects claims and losses in those areas. While immediate department efforts have been focused on providing relief to displaced residents, HUD is continuing to assess what impact the storm will have on FHA's financial position.

The Federal Emergency Management Agency (FEMA) has designated the areas that were directly affected by the hurricane in the states of Alabama, Florida, Louisiana and Mississippi. There was minimal damage in the state of Florida. For the states of Alabama, Mississippi and Louisiana, FHA has identified approximately 528 multifamily projects and 106,400 single family properties in the areas affected by Katrina. In response to a greatly diminished communication infrastructure immediately following the devastating storm, and the initial inability to conduct physical inspections, HUD quickly established the HUD Recovery and Response Center (HRRC). This emergency management task force serves as a command post to coordinate responses and attend to the needs of both residents and property owners.

HUD has implemented several policies and programs to assist lenders, property owners and residents. For the Multifamily portfolio, the HUD Notice 04-22 and Mortgagee letter 2004-38 are in effect and address waivers of Handbooks and Notices. They set priorities for permanent rental housing, allow multiple occupants in a unit and establish other guidance on Section 8 assisted housing. For the Single Family portfolio, HUD issued Mortgage letter 2005-33, reminding lenders and servicers that a 90-day moratorium on foreclosures is in effect and to consider hurricane damage in requests for loss mitigation assistance. As HUD assesses the status of each project and case with lenders, additional guidance may be issued and legislative relief may be sought, if necessary, to mitigate the claims and losses against the insurance funds.

At this time, the expected loss from the damage caused by hurricane Katrina cannot be reasonably estimated. The HRRC, comprised of Single family, Multifamily and FEMA program managers, is managing and coordinating assessments of the affected areas. Currently, damage assessments of affected areas in both Alabama and Florida are complete. Assessments in Louisiana and Mississippi are still ongoing. The level of damage ranges from undamaged to severely damaged.

Based on the assessments completed to date, of the 528 multifamily projects in the impacted areas of Alabama, Louisiana and Mississippi, there are 416 with minor to no damage. However, many properties remain inaccessible due to blocked roads or the lack of infrastructure allowing assessment teams to reach the affected areas. While FHA has identified over 79,200 single family properties that fall into the category of severely damaged, the amount of FHA's loss is dependent on several factors, including the amount of hazard insurance, flood insurance, Federal assistance received by the property owners, and FHA's claim submission requirements.

Litigation

FHA is party in various legal actions and claims brought by or against it. In the opinion of management and general counsel, the ultimate resolution of the majority of these legal actions and claims will not materially affect FHA's consolidated financial statements as of, and for, the period ending September 30, 2005 and 2004. There are 7 cases where judgment against FHA is considered reasonably possible with a potential loss estimated at $65 million.

Note 12. Gross Costs

Gross costs incurred by FHA for the fiscal years ended on September 30 are as follows:

(Dollars in millions)	2005		2004	
	MMI/CMHI	**GI/SRI**	**MMI/CMHI**	**GI/SRI**
Intragovernmental:				
Interest Expense	$ 373	$ 94	$ 604	$ 66
Imputed Costs	10	13	6	8
Other Expenses	22	20	21	14
Total	**$ 405**	**$ 127**	**$ 631**	**$ 88**
With the Public:				
Salary and Administrative Expenses	$ 186	$ 245	$ 177	$ 214
Subsidy Expense	889	(271)	(674)	230
Interest Expense	178	14	63	111
Bad Debt Expense	(37)	(163)	(14)	(337)
Loan Loss Reserve Expense	(32)	(1,106)	(25)	(1,057)
Other Expenses	59	292	37	608
Total	**$ 1,243**	**$ (989)**	**$ (436)**	**$ (231)**

Interest Expense

Intragovernmental interest expense includes interest expense on borrowings from the U.S. Treasury in the financing account. Interest expense is calculated annually for each cohort using the interest rates provided by the U.S Treasury. Interest expense with the public consists of interest expense on debentures issued to claimants to settle claim payments and interest expense on the annual credit subsidy reestimates.

Imputed Costs/Imputed Financing

Imputed costs represent FHA's share of the departmental imputed cost calculated and allocated to FHA by the HUD CFO office. Federal agencies are required by SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards*, to account for costs assumed by other Federal organizations on their behalf. The HUD CFO receives its imputed cost data from the Office of Personnel Management (OPM) for pension costs, federal employee health benefits (FEHB) and life insurance costs. It also receives Federal Employees' Compensation Act (FECA) costs from the Department of Labor (DOL). Subsequently, using its internally developed allocation basis, HUD CFO allocates the imputed cost data to each of its reporting offices. The imputed costs reported by FHA in its Statements of Net Cost are equal to the amounts of imputed financing in its Statements of Changes in Net Position.

Salary and Administrative Expenses

Salary and administrative expenses include FHA's reimbursement to HUD for FHA personnel costs and FHA's payments to third party contractors for administrative contract expenses.

Subsidy Expense

Subsidy expense, positive and negative, consists of credit subsidy expense from new endorsements, modifications, and annual credit subsidy reestimates and the subsidy expense incurred by the Church Arson program. Credit subsidy expense is the estimated long-term cost to the U.S. Government of a direct loan or loan guarantee, calculated on a net present value basis of the estimated future cash flows associated with the direct loan or loan guarantee. Subsidy expense incurred by the Church Arson program is the expense of a HUD program administered by the Office of Community Planning and Development (CPD) even though its cost is funded through a FHA program account.

Bad Debt Expense

Bad debt expense represents the provision for loss recorded for uncollectible amounts related to FHA's pre-1992 accounts receivable and credit program assets. FHA calculates its bad debt expense based on the estimated change of these assets' historical loss experience and FHA management's judgment concerning current economic factors.

Loan Loss Reserve Expense

Loan loss reserve expense is recorded to account for the change in the balance of the loan loss reserve liabilities associated with FHA's pre-1992 loan guarantees. The loan loss reserve is provided for the estimated losses incurred by FHA to pay claims on its pre-1992 insured mortgages when defaults have taken place but the claims have not yet been filed with FHA.

Other Expenses

Other expenses with the public include only those associated with the FHA pre-1992 loan guarantees. They consist of net losses or gains on sales of FHA credit program assets, insurance claim expenses, fee expenses, and other miscellaneous expenses incurred to carry out FHA operations. Other intragovernmental expenses include FHA's share of HUD expenses incurred in the Working Capital Fund and expenses from intra-agency agreements.

Note 13. Earned Revenue

Earned revenue generated by FHA for the fiscal years ended on September 30 are as follows:

(Dollars in millions)	2005		2004	
	MMI/CMHI	**GI/SRI**	**MMI/CMHI**	**GI/SRI**
Intragovernmental:				
Interest Revenue from Deposits at U.S. Treasury	$ 265	$ 147	$ 346	$ 93
Interest Revenue from MMI/CMHI Investments	1,079	-	1,113	-
Total	**$ 1,344**	**$ 147**	**$ 1,459**	**$ 93**
With the Public:				
Premium Revenue	$ 40	$ 56	$ 54	$ 67
Interest Revenue	-	76	8	(34)
Other Revenue	1	190	2	153
Total	**$ 41**	**$ 322**	**$ 64**	**$ 186**

Interest Revenue

Intragovernmental interest revenue includes interest revenue from deposits at the U.S. Treasury and investments in U.S. Treasury securities. FHA's U.S. Treasury deposits are generated from post-1991 loan guarantees and direct loans in the financing accounts. FHA's investments in U.S. Treasury securities consist of investments of surplus resources in the MMI/CMHI liquidating accounts and of escrow monies collected from borrowers in the GI/SRI liquidating accounts.

Interest revenue with the public is generated mainly from FHA's acquisition of pre-1992 performing MNA notes from payments to lenders for defaulted guaranteed loans. Interest revenue associated with the post-1991 MNA notes is included in the Allowance for Subsidy balance.

Premium Revenue

According to the FCRA accounting, FHA's premium revenue includes only premiums associated with the pre-1992 loan guarantee business. Premium revenue for post-1991 loan guarantee cases is included in the balance of the LLG. The FHA premium structure, set by the National Affordable Housing Act and published in the Code of Federal Regulations, which became effective July 1991, includes both up-front premiums and annual periodic premiums.

Up-front Premiums

The up-front premium rates, which are set by legislation, vary according to the mortgage type and the year of origination. The pre-1992 up-front premiums in the MMI fund were recorded as unearned revenue upon collection and are recognized as revenue over the period in which losses and insurance costs are expected to occur. Other FHA funds' unearned revenue is recognized monthly as revenue on a straight-line basis.

The FHA up-front premium rates in fiscal year 2005 were:

	Premium Rate
Single Family	1.50%
Multifamily	.45%, 50%, .57%, .61%, .80%, or 1.0%

Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums receivable. These rates, which are also legislated, vary by mortgage type and program. The FHA periodic premium rate in fiscal year 2005 for Single Family and Multifamily were:

	Mortgage Term 15 Years or Less	Mortgage Term More Than 15 Years
Single Family	.25%	.50%
Multifamily	.45%, .50%, .57%, .61%, or .80%	.45%, .50%, .57%, .61%, or .80%

For Title I, the maximum insurance premium paid for guaranteed cases endorsed in years 1992 through 2001 is equal to 0.50 percent of the loan amount multiplied by the number of years of the loan term. The annual insurance premium for a Title I Property Improvement loan is 0.50 percent of the loan amount until the maximum insurance charge is paid. The annual insurance premium of a Title I Manufactured Housing loan is calculated in tiers by loan term until the maximum insurance charge is paid. For guaranteed cases endorsed in fiscal years 2004 and 2005, the Title I annual insurance premium is 1.00 percent of the loan amount until maturity.

Other Revenue

Other revenue includes revenue associated with FHA pre-1992 loan guarantees. FHA's other revenue consists of late charges and penalty revenue, fee income, and miscellaneous income generated from FHA operations.

Note 14. Gross Cost and Earned Revenue by Budget Functional Classification

FHA cost and earned revenue reported on the Statements of Net Cost is categorized under the budget functional classification (BFC) for Mortgage Credit (371). All FHA U.S. Treasury account symbols found under the department code "86" for Department of Housing and Urban Development appear with the Mortgage Credit BFC.

Note 15. Transfers Out

Transfers out incurred by FHA for the fiscal years ended on September 30 are as follows:

(Dollars in millions)	U.S. Treasury	HUD	Total
Budgetary Financing Sources	$ 481	$ 233	$ 714
Other Financing Sources	297	-	297
FY 2005 Total	**$ 778**	**$ 233**	**$ 1,011**
Budgetary Financing Sources	$ 365	$ 274	$ 639
Other Financing Sources	208	-	208
Other	-	2	2
FY 2004 Total	**$ 573**	**$ 276**	**$ 849**

Transfers Out to U.S. Treasury

Transfers out to U.S. Treasury consists of negative subsidy from new endorsements, modifications and downward credit subsidy reestimates in the GI/SRI general fund receipt account, and the prior year unobligated balance of budgetary resources in the GI/SRI liquidating account.

Transfers Out to HUD

Transfers out to HUD include a certain portion of FHA's monthly payments to HUD for salaries and expenses as well as amounts related to FHA's share in the departmental Working Capital Fund capitalized expense.

Note 16. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2005 and 2004 are as follows:

(Dollars in millions)	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Transfers-Out	Ending Balance
Positive Subsidy	$ 84	$ 10	$ (30)	$ (6)	$ -	$ 58
Administrative Expenses	458	748	(51)	(705)	-	450
Reestimates	-	767	-	(767)	-	-
GI/SRI Liquidating	157	462	-	(381)	(137)	101
FY 2005 Total	**$ 699**	**$ 1,987**	**$ (81)**	**$ (1,859)**	**$ (137)**	**$ 609**
Positive Subsidy	$ 72	$ 15	$ -	$ (3)	$ -	$ 84
Administrative Expenses	394	767	(4)	(699)	-	458
Reestimates	-	517	-	(517)	-	-
GI/SRI Liquidating	110	724	-	(593)	(84)	157
FY 2004 Total	**$ 576**	**$ 2,023**	**$ (4)**	**$ (1,812)**	**$ (84)**	**$ 699**

As required under FCRA, FHA receives appropriations to cover expenses or fund shortages related to its loan guarantee and direct loan operations.

FHA receives appropriations in the annual program accounts for administrative and contract expenses. The GI/SRI no-year program account also receives appropriations for positive credit subsidy and upward reestimates. Additionally, FHA obtains permanent indefinite appropriations to cover any shortfalls for its GI/SRI pre-1992 loan guarantee operations.

When appropriations are first received, they are reported as unexpended appropriations. As these appropriations are expended, appropriations used are increased and unexpended appropriations are decreased. Additionally, unexpended appropriations are decreased when: the year-end unobligated balance in the GI/SRI liquidating account is returned to the U.S. Treasury; appropriations are rescinded; or other miscellaneous adjustments are required.

Note 17. Budgetary Resources

FHA has two program, two liquidating, and four financing appropriations. The Statement of Budgetary Resources has been prepared as a combined statement and as such, intra-entity transactions have not been eliminated.

Budget authority is the authorization provided by law to enter into obligations to carry out the guaranteed and direct loan programs and their associated administrative costs, which would result in immediate or future outlays of federal funds. FHA's budgetary resources include current budgetary authority (i.e., appropriations and borrowing authority) and unobligated balances brought forward from multi-year and no-year budget authority received in prior years, and recoveries of prior year obligations. Budgetary resources also include spending authority from offsetting collections credited to an appropriation or fund account.

Unobligated balances associated with appropriations that expire at the end of the fiscal year remain available for obligation adjustments, but not for new obligations, until that account is canceled. When accounts are canceled, five years after they expire, amounts are not available for obligations or expenditure for any purpose.

FHA funds its programs through borrowings from the U.S. Treasury and debentures issued to the public. These borrowings and debentures are authorized through a permanent indefinite authority at interest rates set each year by the U.S. Treasury and the prevailing market rates.

Financing sources for repayments are from premiums earned, and the maturity dates on these borrowings are generally 20 years or more. The balances of the Permanently Not Available line item in the Statements of Budgetary Resources as of September 30, 2005 and year 2004 are $1,526 million and $4,857 million respectively. In fiscal year 2005, the $1,526 million amount is composed of a repayment of $128 million for debentures, repayment of $1,180 million for borrowing from the U.S. Treasury, a return to U.S. Treasury of $81 million for rescinded and cancelled appropriations, and a transfer to the U.S. Treasury of $137 million of unobligated balances that remained in the GI/SRI liquidating account at the end of fiscal year 2004.

The SF-133 and the Statement of Budgetary Resources for fiscal year 2004 has been reconciled to the fiscal year 2004 actual amounts included in the P&F Schedules presented in the Budget of the United States Government. There were no significant reconciling items. Information from the fiscal year 2005 Statement of Budgetary Resources will be presented in the fiscal year 2007 Budget of the U.S. Government. The Budget will be transmitted to Congress on the first Monday in February 2007 and will be available from the Government Printing Office at that time.

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's intragovernmental assets, by federal entity, are as follows on September 30, 2005 and 2004:

(Dollars in millions)

Agency	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Other Assets
U.S. Treasury	$ 9,705	$ 22,745	$ -
HUD	-	-	54
FY 2005 Total	**$ 9,705**	**$ 22,745**	**$ 54**
U.S. Treasury	$ 7,898	$ 23,430	$ -
HUD	-	-	64
FY 2004 Total	**$ 7,898**	**$ 23,430**	**$ 64**

Schedule B: Intragovernmental Liabilities

FHA's intragovernmental liabilities, by federal entity, are as follows on September 30, 2005 and 2004:

(Dollars in millions)

Agency	Borrowings from U.S. Treasury	Other Liabilities
U.S. Treasury	$ 7,548	$ 772
FY 2005 Total	**$ 7,548**	**$ 772**
U.S. Treasury	$ 7,635	$ 627
FY 2004 Total	**$ 7,635**	**$ 627**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program

(Dollars in millions)	MMI/CMHI 2005	MMI/CMHI 2004	GI/SRI 2005	GI/SRI 2004	Total 2005	Total 2004
BUDGETARY RESOURCES						
Budget Authority:						
Appropriations received	$ 434	$ 444	$ 1,553	$ 1,579	$ 1,987	$ 2,023
Borrowing Authority	403	3,000	763	530	1,166	3,530
Unobligated Balance Carried Forward						
Beginning of period	27,041	27,116	1,546	1,056	28,587	28,172
Net Transfers						
Spending Authority from Offsetting Collections:						
Earned						
Collected	11,587	19,312	2,892	2,423	14,479	21,735
Receivable from Federal Sources	(119)	104	45	(14)	(74)	90
Unfilled Customer Orders	-	-	-	5	-	5
Recoveries of Prior Year Obligations	47	12	12	36	59	48
Permanently Not Available	(1,015)	(4,303)	(511)	(554)	(1,526)	(4,857)
TOTAL BUDGETARY RESOURCES	**$ 38,378**	**$ 45,685**	**$ 6,300**	**$ 5,061**	**$ 44,678**	**$ 50,746**
STATUS OF BUDGETARY RESOURCES						
Obligations Incurred	$ 11,633	$ 18,643	$ 3,552	$ 3,516	$ 15,185	$ 22,159
Unobligated Balance-Apportioned	2,222	2,317	504	421	2,726	2,738
Unobligated Balance Not Available	24,523	24,725	2,244	1,124	26,767	25,849
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 38,378**	**$ 45,685**	**$ 6,300**	**$ 5,061**	**$ 44,678**	**$ 50,746**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS						
Obligated Balance, Net, Beginning of Period	$ 949	$ 1,083	$ 919	$ 796	$ 1,868	$ 1,879
Obligated Balance, Net, End of Period:						
Accounts Receivable	(262)	(381)	(46)	(1)	(308)	(382)
Unfilled Customer Orders	-	-	(5)	(5)	(5)	(5)
Undelivered Orders	563	500	560	557	1,123	1,057
Accounts Payable	879	830	329	368	1,208	1,198
Outlays:						
Disbursements	11,475	18,662	3,576	3,365	15,051	22,027
Collections	(11,587)	(19,312)	(2,892)	(2,423)	(14,479)	(21,735)
Subtotal	(112)	(650)	684	942	572	292
Less: Offsetting Receipts	-	-	474	419	474	419
NET OUTLAYS	**$ (112)**	**$ (650)**	**$ 210**	**$ 523**	**$ 98**	**$ (127)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by Appropriation for the MMI/CMHI Program–Fiscal Year 2005

(Dollars in millions)

	Program 86 0183	Liquidating 86x4070	Financing 86x4587 & 86x4242	Capital Reserve 86x0236	MMI/CMHI Total
BUDGETARY RESOURCES					
Budget Authority:					
Appropriations received	$ 434	$ -	$ -	$ -	$ 434
Borrowing Authority	-	-	403	-	403
Unobligated Balance Carried Forward					
Beginning of period	49	12	3,461	23,519	27,041
Net Transfers	2,394	44	-	(2,438)	-
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	81	9,338	2,168	11,587
Receivable from Federal Sources	-	-	(132)	13	(119)
Unfilled Customer Orders	-	-	-	-	-
Recoveries of Prior Year Obligations	8	2	37	-	47
Permanently Not Available	(15)	-	(1,000)	-	(1,015)
TOTAL BUDGETARY RESOURCES	**$ 2,870**	**$ 139**	**$ 12,107**	**$ 23,262**	**$ 38,378**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 2,820	$ 101	$ 8,712	$ -	$ 11,633
Unobligated Balance-Apportioned	5	36	2,181	-	2,222
Unobligated Balance Not Available	45	2	1,214	23,262	24,523
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 2,870**	**$ 139**	**$ 12,107**	**$ 23,262**	**$ 38,378**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS					
Obligated Balance, Net, Beginning of Period	$ 81	$ 276	$ 840	$ (248)	$ 949
Obligated Balance, Net, End of Period:					
Accounts Receivable	-	-	(2)	(260)	(262)
Unfilled Customer Orders	-	-	-	-	-
Undelivered Orders	91	25	447	-	563
Accounts Payable	2	242	635	-	879
Outlays:					
Disbursements	2,800	109	8,566	-	11,475
Collections	-	(81)	(9,338)	(2,168)	(11,587)
Subtotal	2,800	28	(772)	(2,168)	(112)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 2,800**	**$ 28**	**$ (772)**	**$ (2,168)**	**$ (112)**

Schedule D: Comparative Combining Budgetary Resources by Appropriation for the MMI/CMHI Program–Fiscal Year 2004

(Dollars in millions)

	Program 86 0183	Liquidating 86x4070	Financing 86x4587 & 86x4242	Capital Reserve 86x0236	MMI/CMHI Total
BUDGETARY RESOURCES					
Budget Authority:					
Appropriations received	$ 444	$ -	$ -	$ -	$ 444
Borrowing Authority	-	-	3,000	-	3,000
Unobligated Balance Carried Forward					
Beginning of period	39	583	311	26,183	27,116
Net Transfers	7,029	(583)	-	(6,446)	-
Spending Authority from Offsetting Collections:					
Earned					
Collected	-	138	15,362	3,812	19,312
Receivable from Federal Sources	-	-	133	(29)	104
Unfilled Customer Orders	-	-	-	-	-
Recoveries of Prior Year Obligations	-	1	11	-	12
Permanently Not Available	(3)	-	(4,300)	-	(4,303)
TOTAL BUDGETARY RESOURCES	**$ 7,509**	**$ 139**	**$ 14,517**	**$ 23,520**	**$ 45,685**
STATUS OF BUDGETARY RESOURCES					
Obligations Incurred	$ 7,460	$ 127	$ 11,056	$ -	$ 18,643
Unobligated Balance-Apportioned	10	11	2,296	-	2,317
Unobligated Balance Not Available	39	1	1,165	23,520	24,725
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 7,509**	**$ 139**	**$ 14,517**	**$ 23,520**	**$ 45,685**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS					
Obligated Balance, Net, Beginning of Period	$ 72	$ 456	$ 832	$ (277)	$ 1,083
Obligated Balance, Net, End of Period:					
Accounts Receivable	-	-	(133)	(248)	(381)
Unfilled Customer Orders	-	-	-	-	-
Undelivered Orders	79	25	396	-	500
Accounts Payable	2	251	577	-	830
Outlays:					
Disbursements	7,452	306	10,904	-	18,662
Collections	-	(138)	(15,362)	(3,812)	(19,312)
Subtotal	7,452	168	(4,458)	(3,812)	(650)
Less: Offsetting Receipts	-	-	-	-	-
NET OUTLAYS	**$ 7,452**	**$ 168**	**$ (4,458)**	**$ (3,812)**	**$ (650)**

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program–Fiscal Year 2005

(Dollars in millions)

	Program 86 0200	Liquidating 86x4072	Capital Reserve 86x4077 & 86x4105	GI/SRI Total
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$ 1,091	$ 462	$ -	$ 1,553
Borrowing Authority	-	(9)	772	763
Unobligated Balance Carried Forward				
Beginning of period	261	138	1,147	1,546
Net Transfers	-	-	-	-
Spending Authority from Offsetting Collections:				
Earned				
Collected	-	507	2,385	2,892
Receivable from Federal Sources	-	-	45	45
Unfilled Customer Orders	-	-	-	-
Recoveries of Prior Year Obligations	8	2	2	12
Permanently Not Available	(66)	(231)	(214)	(511)
TOTAL BUDGETARY RESOURCES	**$ 1,294**	**$ 869**	**$ 4,137**	**$ 6,300**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 1,078	$ 834	$ 1,640	$ 3,552
Unobligated Balance-Apportioned	19	16	469	504
Unobligated Balance Not Available	197	19	2,028	2,244
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 1,294**	**$ 869**	**$ 4,137**	**$ 6,300**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Obligated Balance, Net, Beginning of Period	$ 91	$ 543	$ 285	$ 919
Obligated Balance, Net, End of Period:				
Accounts Receivable	-	(1)	(45)	(46)
Unfilled Customer Orders	-	-	(5)	(5)
Undelivered Orders	97	339	124	560
Accounts Payable	3	269	57	329
Outlays:				
Disbursements	1,060	768	1,748	3,576
Collections	-	(507)	(2,385)	(2,892)
Subtotal	1,060	261	(637)	684
Less: Offsetting Receipts	-	-	-	474
NET OUTLAYS	**$ 1,060**	**$ 261**	**$ (637)**	**$ 210**

Required Supplementary Information

Schedule E: Comparative Combining Budgetary Resources by Appropriation for the GI/SRI Program–Fiscal Year 2004

(Dollars in millions)

	Program 86 0200	Liquidating 86x4072	Capital Reserve 86x4077 & 86x4105	GI/SRI Total
BUDGETARY RESOURCES				
Budget Authority:				
Appropriations received	$ 855	$ 724	$ -	$ 1,579
Borrowing Authority	-	130	400	530
Unobligated Balance Carried Forward				
Beginning of period	221	84	751	1,056
Net Transfers	-	-	-	-
Spending Authority from Offsetting Collections:				
Earned				
Collected	-	483	1,940	2,423
Receivable from Federal Sources	-	-	(14)	(14)
Unfilled Customer Orders	-	-	5	5
Recoveries of Prior Year Obligations	4	31	1	36
Permanently Not Available	(2)	(293)	(259)	(554)
TOTAL BUDGETARY RESOURCES	**$ 1,078**	**$ 1,159**	**$ 2,824**	**$ 5,061**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred	$ 818	$ 1,021	$ 1,677	$ 3,516
Unobligated Balance-Apportioned	61	70	290	421
Unobligated Balance Not Available	199	68	857	1,124
TOTAL STATUS OF BUDGETARY RESOURCES	**$ 1,078**	**$ 1,159**	**$ 2,824**	**$ 5,061**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Obligated Balance, Net, Beginning of Period	$ 88	$ 600	$ 108	$ 796
Obligated Balance, Net, End of Period:				
Accounts Receivable	-	(1)	-	(1)
Unfilled Customer Orders	-	-	(5)	(5)
Undelivered Orders	90	343	124	557
Accounts Payable	1	200	167	368
Outlays:				
Disbursements	810	1,047	1,508	3,365
Collections	-	(483)	(1,940)	(2,423)
Subtotal	810	564	(432)	942
Less: Offsetting Receipts	-	-	-	419
NET OUTLAYS	**$ 810**	**$ 564**	**$ (432)**	**$ 523**

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