FEDERAL FINANCING BANK

Financial Statements

September 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

FEDERAL FINANCING BANK

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Introduction

The Federal Financing Bank (the Bank) is a government corporation under the general supervision and direction of the Secretary of the Treasury. The Congress created the Bank in 1973, at the request of the U.S. Department of the Treasury (Treasury). The Bank actively borrows from Treasury and lends to Federal agencies and private borrowers that have Federal guarantees. The Bank also has a debt obligation to the Civil Service Retirement and Disability Fund.

Mission

The mission of the Bank is to reduce the costs of Federal and federally assisted borrowings, to coordinate such borrowings with the Government's overall fiscal policy, and to ensure that such borrowings are done in ways that least disrupt private markets. To accomplish this mission, the Bank exercises its broad statutory authority to purchase obligations issued, sold, or guaranteed by Federal agencies.

Objectives

The Bank was formed to be the vehicle through which Federal agencies finance programs involving the sale or placement of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and the sale of assets. This principle is applied in a manner consistent with the Federal Financing Bank Act of 1973 (12 U.S.C. 2281 et seq.) and its legislative history. Guaranteed programs entailing large numbers of relatively small loans in which local origination and servicing are an integral part of the program are excluded.

The Bank makes funds available to Federal agencies and to guaranteed borrowers in accordance with program requirements. The Bank is capable of providing a lending rate for any amount required and for nearly any maturity. The rates charged by the Bank for terms such as prepayment provisions and pass-through of service charges are applied consistently for all borrowers.

The lending policy of the Bank is flexible enough to preclude the need for any accumulation of pools of funds by agencies. This does not exclude the maintenance of liquidity reserves for those agencies that have such a need. In no case will funds provided by the Bank be invested in private credit instruments or be used to speculate in the market for public securities.

Organizational Structure

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. The Board of Directors is comprised of the incumbents of the following Treasury offices: the Secretary of the Treasury, who as provided by law, is the Chairman; the Deputy Secretary; the Under Secretary for Domestic Finance; the General Counsel; and the Fiscal Assistant Secretary.

The officers are incumbents of the following Treasury offices (corresponding Bank positions are in parentheses): the Under Secretary for Domestic Finance (President); the General Counsel (General Counsel); the Assistant Secretary for Financial Markets (Vice President); the Fiscal Assistant Secretary (Vice President); the Deputy Assistant Secretary for Government Financial Policy (Vice President and Treasurer); and the Director, Office of Federal Lending (Secretary and Chief Financial Officer). A delegation by the Bank President authorizes any Bank Vice President, in consultation with any other Bank officer, to exercise the powers of the Presidency.

The staff of the Bank is organized into three units: loan administration, loan accounting, and computer support. The loan administration and accounting managers and the Chief Information Officer (CIO) report to the Chief Financial Officer (CFO). The loan administration manager is responsible for the loan administration unit, which includes the duties and responsibilities associated with credit analysis, loan origination, loan structuring, and customer service. The loan accounting manager heads a team of professionals responsible for loan disbursements, repayments, accounting, and financial reporting. The CIO is responsible for a team of information systems professionals and contractors that conduct in-house software development and maintain the Bank's Oracle®-based, mission-critical enterprise application. That application provides systems support for the loan administration and accounting functions.

Loan Programs Activity

Title XVII of the Energy Policy Act of 2005 created a loan guarantee program to be administered by the Department of Energy (DOE) for innovative technologies. The Bank provides financing commitments for the loan guarantee programs by entering into a Program Financing Agreement with the DOE. In fiscal year 2011, the Bank entered into 31 note purchase agreements that commit the Bank to purchase notes issued by borrowers whose loans will be backed by the full faith and credit of the U.S. Government by the Secretary of Energy. The maximum principal amount of the note purchase agreements are $9,370,560 thousand. One of the new notes, SoloPower, Inc. has not been purchased as of September 30, 2011. The maximum principal amount for SoloPower, Inc. is $184,978 thousand.

The Secretary of Energy is authorized to issue loans under Section 136 of the Energy Independence and Security Act of 2007, as amended by section 129 of Division A of the Consolidated Security, Disaster Assistance, and Continuing Appropriations Act of 2009, through the Advanced Technology Vehicles Manufacturing Loan Program. Under the program, the Secretary of Energy may make loans to automobile and automobile part manufacturers to finance the cost of reequipping, expanding, or establishing manufacturing facilities in the United States to produce advanced technology vehicles or qualified components, and for associated engineering integration costs. In fiscal year 2011, the Bank entered into a note purchase agreement that commits the Bank to purchase notes issued by the Vehicle Production Group, LLC., backed by the full faith and credit of the U.S. Government by the Secretary of Energy. The maximum principal amount of the note is $49,962 thousand.

Under a provision in the 1987 enabling legislation for the U.S. Department of Agriculture's Rural Utilities Services (RUS) Cushion of Credit Payments Program (cushion of credit), the Bank receives considerably less interest each year on certain RUS loans that it holds than it is contractually entitled to receive. The shortfall in interest received by the Bank has resulted in substantial deficits in the past. The cumulative losses from interest credits taken by the RUS, beyond losses that were extinguished by appropriation in a previous year, totaled $1,921,637 thousand through September 30, 2011. The interest shortfall is recorded on the statement of operations and changes in net position as a legislatively mandated interest credit (contra-revenue to interest on loans).

The Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as Gramm-Rudman-Hollings Act, the Consolidated Omnibus Budget Reconciliation Act of 1985, and the Federal Credit Reform Act of 1990 included provisions that have acted as prohibitions and disincentives against the Bank financing certain loans that are 100 percent guaranteed by Federal agencies.

Section 6102 of the Food, Conservation, and Energy Act of 2008 reinstated the direct loan program for the RUS Electric Program, eliminating the borrower's right to have loans financed by the Bank. Eventually, RUS anticipates financing new electric loans through a direct loan program instead of financing the loans through the Bank.

New Borrowing Agreement

Effective in fiscal year 2010, the Bank executed a new agreement with the Secretary of the Treasury to borrow funds used for certain guaranteed loans that require the guaranteeing federal agencies to comply with the Federal Credit Reform Act (FCRA) (2U.S.C. 661(d)(3)). As a result, the interest rate, interest payable, and interest expense for borrowings from Treasury that are used to fund certain guaranteed loans subject to FCRA are determined annually by the borrowing agencies using the FCRA and Office of Management and Budget (OMB) guidelines.

Impact of Economic Conditions

Current economic conditions have had an impact on programs that borrow from the Bank. Certain borrowers have repaid their loans with the Bank early, while other borrowers have increased their borrowing activities with the Bank.

All FFB assets are, or have a commitment to be, full faith and credit obligations of the U.S. Government and economic conditions do not affect repayments to the Bank. Loans backed by the full faith and credit of the U.S. Government are the credit equivalent of Treasury securities. The Bank does not expect to suffer any credit losses from loans backed by the full faith and credit of the U.S. Government.

United States Postal Service

The United States Postal Service (USPS) is an independent establishment of the executive branch of the U.S. Government, which borrows from the Bank to finance its capital improvements and defray operating expenses. USPS is able to borrow up to $3,400 million with a maximum term of up to one year. In addition, USPS can borrow up to $600 million on an overnight basis. The USPS is also limited by statute to net annual debt increases of $3 billion with a total borrowing authority of $15 billion.

The USPS had a fiscal year 2011 deficit due to a decline in mail volume, higher retiree health benefit costs, and cost of living adjustments. The Administration, Congress, and other stakeholders are aware of the current and long-term financial issues of USPS. The USPS provides an essential service to the United States and there are several potential legislative solutions to help ensure the financial liquidity of the USPS.

The Bank has not incurred any credit-related losses on its loans as of the date of these statements, and as stated above, all FFB assets are, or have a commitment to be, full faith and credit obligations of the U.S. Government.

Financial Highlights

Statements of Operations and Changes in Net Position Highlights

The following is a synopsis of the financial performance of the Bank for the fiscal year ended September 30, 2011. Interest on loans of $2,319,867 thousand for the fiscal year ended September 30, 2011 decreased compared to the interest on loans of $2,354,327 thousand for the fiscal year ended September 30, 2010 primarily due to the decrease in the total loans receivable balance despite the increase in total borrowing by RUS and DOE. The legislatively mandated interest credits reduced interest income by $249,813 thousand and $271,461 thousand for the fiscal years ended September 30, 2011 and 2010, respectively, and are related to RUS "cushion of credit" loans. Revenue from servicing loans of $2,120 thousand for the fiscal year ended September 30, 2011 decreased from $2,332 thousand for the fiscal year ended September 30, 2010 due to the maturity of the loans being serviced.

Interest on borrowings of $1,860,498 thousand for the fiscal year ended September 30, 2011 increased from the interest on borrowings of $1,630,511 thousand for the fiscal year ended September 30, 2010 primarily due to the change in repayment structure resulting from the new borrowing agreement with the Secretary of the Treasury. After administrative expenses of $5,399 thousand, net income of $206,769 thousand for the fiscal year ended September 30, 2011 decreased from the net income of $449,496 thousand for the fiscal year ended September 30, 2010. In fiscal year 2011, the Bank prepaid some borrowings from Treasury. The transaction resulted in a prepayment loss of $648 thousand, reported as a loss on extinguishment of borrowings treated as capital transactions.

Statements of Financial Position Highlights

Funds with U.S. Treasury (cash equivalents) amounted to $841,853 thousand at September 30, 2011, which represents a decrease from the September 30, 2010 balance of $1,671,095 thousand. The decrease is due to a prepayment to the Treasury of $902,906 thousand for fiscal year 2011.

The loan portfolio (loans receivable) decreased $2,220,399 thousand from $59,308,291 thousand at September 30, 2010 to $57,087,892 thousand at September 30, 2011. The change is primarily the result of a decrease in short-term loans of $10,100,705 thousand to the National Credit Union Administration's Central Liquidity Facility, partially offset by $2,914,433 thousand increase in loan activity to the Department of Agriculture $3,997,618 thousand increase in new loans to the Department of Energy, and other loan increases. The Bank's net position increased to $3,999,315 thousand at September 30, 2011 from $3,793,194 thousand at September 30, 2010 primarily as a result of positive earnings.

All of the loans in the Bank's portfolio are federally guaranteed or have a commitment to be full faith and credit obligations of the United States. The Bank's borrowings decreased by $3,231,860 thousand due to a decline in lending activities.

Performance Highlights

During fiscal year 2011, the Bank processed 1,443 new loan requests. The interest rate was set or reset on 2,934 loans in fiscal year 2011 for new loans and maturity extensions. The Bank processed 121 prepayments and 31,519 loan payments in fiscal year 2011.

Management Controls

The Bank completed an in-depth testing of its internal accounting and administrative control procedures in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*, as of June 2011. Additionally, in fiscal year 2009, a private contractor performed a certification and accreditation of the Bank's enterprise management system, known as the Loan Management Control System, which is effective for three years.

Accordingly, we believe that the Bank's systems of internal accounting and administrative controls fully comply with the requirements for agency internal accounting and administrative control systems, providing reasonable assurance that they are achieving the intended objectives.

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report

Inspector General, U.S. Department of the Treasury and
the Board of Directors, Federal Financing Bank:

We have audited the accompanying statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2011 and 2010, and the related statements of operations and changes in net position and cash flows for the years then ended (hereinafter referred to as "financial statements"). These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Financing Bank as of September 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information in the Management's Discussion and Analysis and other supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 14, 2011, on our consideration of the Bank's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 14, 2011

FEDERAL FINANCING BANK

Statements of Financial Position

September 30, 2011 and 2010

(Dollars in thousands)

Assets		**2011**	**2010**
Funds with U.S. Treasury	$	841,853	1,671,095
Investments held-to-maturity (notes 3 and 6)		493,254	492,614
Loans receivable (notes 4, 6, and 9)		57,087,892	59,308,291
Accrued interest receivable		151,227	155,689
Advances to others		66	106
Total assets	$	58,574,292	61,627,795
Liabilities and Net Position			
Liabilities:			
Borrowings:			
Principal amount	$	54,250,478	57,440,112
Plus unamortized premium		137,781	180,007
Total borrowings (notes 5, 6, 8, and 9)		54,388,259	57,620,119
Accrued interest payable		186,291	214,275
Other liabilities		427	207
Total liabilities		54,574,977	57,834,601
Loan and interest credit commitments (notes 10 and 1(j))			
Net position (note 7)		3,999,315	3,793,194
Total liabilities and net position	$	58,574,292	61,627,795

See accompanying notes to financial statements.

FEDERAL FINANCING BANK

Statements of Operations and Changes in Net Position

Years ended September 30, 2011 and 2010

(Dollars in thousands)

		2011	2010
Revenue and financing sources:			
Interest on loans	$	2,319,867	2,354,327
Less legislatively mandated interest credit		(249,813)	(271,461)
Net interest on loans		2,070,054	2,082,866
Interest on investments		492	546
Revenue from servicing loans		2,120	2,332
Total revenue		2,072,666	2,085,744
Expenses:			
Interest on borrowings		1,860,498	1,630,511
Administrative expenses		5,399	5,737
Total expenses		1,865,897	1,636,248
Net income	$	206,769	449,496
Net position:			
Beginning of year	$	3,793,194	3,347,933
Net income		206,769	449,496
Loss on extinguishment of borrowings treated as capital transactions (note 8)		(648)	(4,235)
End of year (note 7)	$	3,999,315	3,793,194

See accompanying notes to financial statements.

FEDERAL FINANCING BANK

Statements of Cash Flows

Years ended September 30, 2011 and 2010

(Dollars in thousands)

		2011	2010
Cash flows from operations:			
Net income	$	206,769	449,496
Adjustments to reconcile net income to net cash provided by operations:			
Amortization of premium on borrowings		(42,226)	(48,920)
Capitalization of interest receivable		(9,332)	(1,172)
Capitalization of interest payable		184,037	180,017
Decrease in accrued interest receivable		4,462	70,902
Decrease in advances to others		40	163
Decrease in accrued interest payable		(27,984)	(19,372)
Increase in other liabilities		220	147
Net cash provided by operations		315,986	631,261
Cash flows from investing activities:			
Investment purchases		(640)	(577)
Loan disbursements		(594,804,927)	(227,292,664)
Loan collections		597,034,658	229,550,396
Net cash provided by investing activities		2,229,091	2,257,155
Cash flows from financing activities:			
Borrowings		594,805,568	228,200,921
Repayments of borrowings		(598,179,887)	(230,204,612)
Net cash used in financing activities		(3,374,319)	(2,003,691)
Net (decrease) increase in cash		(829,242)	884,725
Funds with U.S. Treasury – beginning of the period		1,671,095	786,370
Funds with U.S. Treasury – end of the period	$	841,853	1,671,095
Supplemental disclosures of cash flow information:			
Interest paid (net of amount capitalized)	$	1,730,674	1,517,775
Supplemental schedule of noncash investing and financing activities:			
Loss on early extinguishment of borrowings treated as capital transactions (note 8)	$	(648)	(4,235)

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

The Federal Financing Bank (the Bank) was created by the Federal Financing Bank Act of 1973 (12 USC 2281) as an instrumentality of the U.S. Government and a body corporate under the general supervision of the Secretary of the Treasury (the Secretary). The budget and audit provisions of the Government Corporation Control Act are applicable to the Bank in the same manner as they are applied to other wholly owned government corporations.

The Bank was established by Congress at the request of the U.S. Department of the Treasury (Treasury), in order "to assure coordination of Federal and federally assisted borrowing programs with the overall economic and fiscal policies of the U.S. Government, to reduce the cost of Federal and federally assisted borrowing from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions." The Bank was given broad statutory authority to finance obligations issued, sold, or guaranteed by Federal agencies so that the Bank could meet these debt management objectives.

The Bank is authorized to issue obligations to the public in amounts not to exceed $15,000,000 with the approval of the Secretary. Additionally, the Bank is authorized to issue obligations in unlimited amounts to the Secretary and, at the discretion of the Secretary, may agree to purchase any such obligations.

(a) Basis of Presentation

The Bank has historically prepared its financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), based on standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. In October 1999, the American Institute of Certified Public Accountants (AICPA) designated the Federal Accounting Standards Advisory Board (FASAB) as the standards-setting body for the establishment of accounting principles generally accepted in the United States of America with respect to the financial statements of Federal government entities. The FASAB has indicated that financial statements prepared based upon standards promulgated by the FASB may also be regarded as in accordance with GAAP for those Federal entities, such as the Bank, that have issued financial statements based upon FASB standards in the past. Accordingly, consistent with historical reporting, the Bank's financial statements are presented in accordance with accounting and financial reporting standards promulgated by the FASB.

(b) Basis of Accounting

The financial statements are presented on the accrual basis of accounting. The Bank recognizes loans when they are issued and related repayments when they are received. The Bank recognizes investments when they are made and investment redemptions when the proceeds are received. The Bank recognizes borrowings when they are received and repayments when they are made. In addition, the Bank recognizes interest on loans, interest on investments, and revenue from servicing loans when they are earned and recognizes interest on borrowings and expenses when they are incurred.

(c) Funds with U.S. Treasury

As a government corporation, the Bank maintains a Fund Balance with Treasury (fund account 20X4521) and does not hold cash. For the purposes of the statements of cash flows, the funds with Treasury are considered cash.

(d) Investments

The Bank's investments consist of investments in U.S. Treasury securities for the Home Ownership Preservation Entity (HOPE) Fund. The securities are categorized as held to maturity, because the Bank has the ability and intent to hold the securities until maturity. The securities are recorded at par value.

(e) Loans Receivable

The Bank issues loans to Federal agencies for their own use or to private sector borrowers whose loans are guaranteed by a Federal agency. When a Federal agency has to honor a guarantee because a private sector borrower defaults, the Federal agency must obtain an appropriation or use other resources to pay the Bank. All Bank assets are, or have a commitment to be, full faith and credit obligations of the U.S. Government. Accordingly, the Bank has not recorded a reserve for default on any loans receivable.

The Bank has not incurred any credit-related losses on its loans as of the date of these statements.

(f) Interest on Loans

The Bank's general policy is to capture the liquidity premium between Treasury securities and the private sector lending rates, and to charge a rate that reflects the risk inherent in a borrower or transaction, when such a rate will accomplish a broader goal. The income resulting from the interest spread covers the administrative expenses of the Bank. Under amendments to the Federal Credit Reform Act (FCRA), effective October 1, 1998, while the Bank is permitted to charge a spread on new lending arrangements with government-guaranteed borrowers, the margin is not retained by the Bank, but rather is retained by the loan guarantor. In the event that this results in the Bank being unable to fund its administrative expenses related to these loans, the FCRA, as amended, states that the Bank may require reimbursement from loan guarantors.

(g) Capitalized Interest

In accordance with their loan agreements with the Bank, the General Services Administration (GSA), Historically Black Colleges and Universities (HBCU), and Veteran Administration Transitional Housing (VATH) have the option of deferring payments of interest on their loans until future periods. When GSA, HBCU, or VATH elect, in advance, to defer interest payments, the accrued interest is recorded as capitalized interest receivable and added to the respective loan balance by the Bank. The Bank correspondingly capitalizes the interest payable on its related borrowings.

(h) Premium on Borrowings

The Bank amortizes the premium on borrowings using the effective-interest method. The amortization is recorded as part of interest on borrowings on the statements of operations and changes in net position.

(i) Interest on Borrowings from Treasury to Fund Amounts Treated as Lending to Financing Accounts

The interest on borrowings from Treasury is based on the daily Treasury New Issue Curve (TNIC) for all borrowings, except for borrowings used to fund certain guaranteed loans that require the guaranteeing federal agencies to comply with the FCRA (2U.S.C. 661(d)(3)). The interest rate, interest payable, and interest expense for borrowings from Treasury that are used to fund certain guaranteed loans subject to FCRA are determined annually by the borrowing agencies using the FCRA and Office of Management and Budget guidelines.

(j) Legislatively Mandated Interest Credit

In prior years, the Bank purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from the U.S. Department of Agriculture's Rural Utilities Services (RUS). RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (i.e., 7 USC Sec. 940c – Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that private utility companies may reduce the balance of their cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at the higher of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position.

(k) Revenue from Servicing Loans

The Bank charges certain RUS borrowers a loan service fee that is reported as revenue from servicing loans on the statements of operations and changes in net position. The Bank's loan servicing fee is equal to one-eighth of one percent more than the contractual interest rate with Treasury.

(l) Administrative Expenses

The Bank is subject to the general supervision and direction of the Secretary. As provided by law, the Secretary acts as chairman of the Board of Directors. Employees of Treasury's Departmental Offices perform the Bank's management and accounting functions, and its legal counsel is the General Counsel of the Treasury. The Bank reimburses Treasury for the facilities and services it

(Continued)

provides. The amounts of such reimbursements are reported as administrative expenses in the statements of operations and changes in net position.

(m) Net Position

The Bank can borrow from Treasury to meet its immediate cash needs and can also seek appropriations from Congress to make up for accumulated losses that will not be met by income.

(n) Loan Commitments

The Bank recognizes loan commitments when the Bank and the other parties fully execute the promissory notes and reduces loan commitments when the Bank issues loans or when the commitments expire. Most obligations of the Bank give a borrower the contractual right to a loan or loans immediately or at some point in the future. The Bank limits the time available for a loan under an obligation, where applicable.

(o) Management's Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. The significant estimates made by management are the fair value calculations. Actual results could differ from those estimates.

(p) Tax-Exempt Status

The Bank is exempt from tax in accordance with Section 11(a) of the Federal Financing Bank Act of 1973 (12 USC 2281).

(q) Related Parties

The Bank conducts most of its financial transactions with other Federal entities, and therefore, the financial statement balances that represent transactions with other Federal entities include all assets; liabilities, except borrowings from the public of $10 as of September 30, 2011 and 2010; revenues; and expenses.

(2) New Accounting Pronouncements

(a) Newly Implemented Accounting Pronouncements

On October 1, 2010, the Bank implemented FASB issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements*. The ASU requires disclosure of gross activity in Level 3 of the fair value hierarchy and adds a requirement to separately disclose the amounts of significant transfers in and out of Level 1 and 2 of the fair value hierarchy, describing the reasons for the transfers. The ASU also clarifies existing disclosure requirements regarding the level of disaggregation of fair value measurements and inputs, and valuation techniques. The adoption did not have a significant effect on the financial statements.

(Dollars in thousands)

(b) Future Accounting Pronouncements

On May 17, 2011, FASB issued ASU No. 2011-04, FASB ASC 820, *Fair Value Measurement and Disclosures* (precodification FASB SFAS No. 157, *Fair Vaule Measurements*, as amended). The ASU explains how to measure fair value. The disclosures are effective for reporting periods beginning after December 15, 2011. The Bank will adopt the applicable provisions of FASB ASU No. 2011-04 in fiscal year 2012. The adoption is not expected to have a significant effect on the financial statements.

(3) Investments Held to Maturity (the HOPE Bond Transaction)

The Secretary is authorized to issue up to $300,000,000 HOPE bonds under the HOPE for Homeowners Act of 2008, and the Bank will purchase the HOPE bonds issued by the Secretary. The HOPE bonds purchased by the Bank are reported as investments held-to-maturity, and the related interest receivable is reported as accrued interest receivable in the Bank's statements of financial position. The interest rate is 0.010% and 0.153% as of September 30, 2011 and 2010, respectively, with floating interest rates reset quarterly. The bonds have 30-year maturity dates starting on August 27, 2038 and ending on July 15, 2041.

The carrying amount, unrealized holding losses, and fair value of the HOPE bonds at September 30, 2011 and 2010 were as follows:

September 30, 2011		**Carrying amount**	**Unrealized holding losses**	**Fair value**
Investments held to maturity:				
U.S. Treasury Nonmarketable Securities – HOPE Bonds	$	493,254	(60)	493,194
Total	$	493,254	(60)	493,194

September 30, 2010		**Carrying amount**	**Unrealized holding losses**	**Fair value**
Investments held to maturity:				
U.S. Treasury Nonmarketable Securities – HOPE Bonds	$	492,614	(48)	492,566
Total	$	492,614	(48)	492,566

The Bank borrowed funds from Treasury at the same terms to purchase the HOPE bonds.

(4) Loans Receivable

Loans receivable represent the outstanding balances being treated as loans to agencies. The Bank has the ability and intends to hold loans receivable until maturity or payoff. At September 30, 2011, the Bank had outstanding loans receivable of $57,087,892, with interest rates ranging from 0.010% to 13.935%, and maturity dates from October 1, 2011 to January 2, 2046. At September 30, 2010, the Bank had outstanding loans receivable of $59,308,291, with interest rates ranging from 0.152% to 15.325%, and maturity dates from October 1, 2010 to July 17, 2045.

(Dollars in thousands)

Loans receivable at September 30, 2011 and 2010, consist of the following:

Agency		2011	2010
Rural Utilities Service, Department of Agriculture	$	32,503,417	28,905,983
U.S. Postal Service		13,000,000	12,000,000
Credit Liquidity Fund, National Credit Union Administration		—	10,100,705
Department of Energy		6,928,661	2,931,043
Rural Utilities Service, Department of Agriculture certificates of beneficial ownership		1,674,900	2,357,900
General Services Administration		1,898,140	1,973,049
Historically Black Colleges and Universities, Department of Education		781,750	613,870
Foreign Military Sales, Department of Defense		294,429	417,255
Veterans Administration Transitional Housing Program		4,780	4,836
Small Business Administration		578	2,130
Federal Railroad Administration, Department of Transportation		1,237	1,520
Total loans receivable	$	57,087,892	59,308,291

The loans receivable due within one year are $12,555,790 and $20,771,654 as of September 30, 2011 and 2010, respectively.

(5) Borrowings

Under the FFB Act, the Bank may, with the approval of the Secretary, borrow without limit from the Treasury. Repayments on Treasury borrowings match the terms and conditions of corresponding loans made by the Bank and bear interest at the respective rate as determined by the Secretary for all borrowings, except borrowings used to fund certain guaranteed loans based on the FCRA. For certain borrowings based on FCRA, the interest rate is determined annually by the borrowing agencies using the FCRA and Office of Management and Budget guidelines. The Bank's non-FCRA borrowings are repayable at any time, except for loans with fixed-price call options in the no-call period.

At September 30, 2011, the Bank had $36,578,875 of Treasury borrowings for non-FCRA related loans, with interest rates ranging from 0.000% to 8.961%, and maturity dates from October 3, 2011 to January 2, 2046. Additionally, at September 30, 2011, the Bank had $9,230,123 of Treasury borrowings used to fund guaranteed loans based on the FCRA with interest rates ranging from 1.600% to 4.723%, and a maturity date of September 30, 2050.

At September 30, 2010, the Bank had Treasury borrowings for non-FCRA related loans of $44,214,738, with interest rates ranging from 0.081% to 9.376%, and maturity dates from October 1, 2010 to July 17, 2045. At September 30, 2010, the Bank had $2,986,374 of Treasury borrowings used to fund guaranteed loans based on the FCRA with interest rates ranging from 2.680% to 4.723% and a maturity date of September 30, 2050. Finally, at September 30, 2011 and 2010, the Bank had borrowings of $8,441,480 and $10,238,990, respectively, and an associated unamortized premium of $137,781 and $180,007, respectively, from the Civil Service Retirement and Disability Fund, which is administered by the Office of Personnel Management. At September 30, 2011, these borrowings were at a stated interest rate of 4.625%, effective interest rate of 4.625%, and with maturity dates ranging from June 30, 2012 to June 30, 2019. At September 30, 2010, these borrowings were at stated interest rates ranging from 4.625% to 5.250%, effective interest rate of 4.125%, and with maturity dates ranging from June 30, 2011 to June 30, 2019. Borrowing from the public amounted to $10 at September 30, 2011 and 2010.

(Dollars in thousands)

The scheduled principal repayments below reflect maturities of the Bank's borrowings and do not necessarily match the maturities of assets in the Bank's loan portfolio. Scheduled principal repayments of borrowings as of September 30, 2011 are as follows:

Repayment date	Amount
2012	$ 12,757,823
2013	2,996,496
2014	3,291,507
2015	2,450,956
2016	2,981,588
2017 and thereafter	29,772,108
Total principal payments	54,250,478
Plus unamortized premium	137,781
Total borrowings	$ 54,388,259

(6) Fair Value of Financial Instruments and Interest Rate Volatility

(a) Fair Value Hierarchy

The accounting standards establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

(Dollars in thousands)

The Bank does not hold any financial instruments that are measured at fair market value on a recurring basis or for which the fair value option has been elected at September 30, 2011 and 2010.

All the fair values shown in this note are performed using Level 2 inputs at September 30, 2011 and 2010. The Bank's fair value measurements maximize the use of observable inputs and do not use significant unobservable inputs (Level 3).

The financial statements as of and for the year ended September 30, 2011 and 2010 do not include any nonrecurring fair value measurements relating to assets or liabilities for which the Bank has adopted the provisions of FASB ASC 820.

(b) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of the Bank's financial instruments at September 30, 2011 and 2010. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

		2011		2010	
		Carrying amount	Fair value (Level 2 inputs)	Carrying amount	Fair value (Level 2 inputs)
Financial assets:					
Investments held to maturity	$	493,254	493,194	492,614	492,566
Loans receivable		57,087,892	64,744,775	59,308,291	64,470,446
Financial liabilities:					
Borrowings	$	54,388,259	60,595,936	57,620,119	61,525,613

The carrying amounts shown in the table are included in the statements of financial position under the indicated captions.

The fair values of the financial instruments shown in the above table as of September 30, 2011 and 2010 represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Funds with U.S. Treasury: The carrying amount approximates fair value because of the liquid nature of the funds with Treasury.

Loans Receivable and Investments held-to-maturity: The fair value for the majority of the loan portfolio (approximately 99.6%) and investments held-to-maturity is determined using discounted cash flow analyses based on contractual repayment terms. The Bank's loans receivable, investments held-to-maturity, and interest are backed, or have a commitment to be backed, by the full faith and credit of the U.S. Government. As such, the Bank's assets are the equivalent of Treasury securities. The discount rates used in the loans receivable and investment analysis are based on interest rates currently being offered by the Bank on loans of similar maturity and other characteristics, plus 25 basis points added as a factor to account for the liquidity premium. The Bank obtains the discount rates from the daily TNIC, which is created daily with an interest rate for each day from 1 month to 30 years, based on the bid yields that day for Treasury securities traded in the public markets. The TNIC yields represent Treasury's best estimate of its own cost of borrowing for any given term on that business day.

For the rest of the loan portfolio (approximately 0.4%), the Bank's borrowers purchased a call option at the loan origination date. For the loans that have aged past the first available call date, the fair value is determined as the remaining balance plus the fixed call premium in effect at the time of valuation. For the loans with call options that have not reached the first call date, the fair value is determined by evaluating each loan through a call option model using the interest rates from the daily TNIC plus 25 basis points and the same terms in effect for a new comparable loan.

Borrowings: The fair value for all borrowings, except for borrowings used to fund certain guaranteed loans based on the FCRA, is determined using discounted cash flow analyses based on contractual repayment terms. The discount rates used in the borrowings analysis are based on interest rates of current borrowings from Treasury using similar maturity and other characteristics, plus 25 basis points added as a factor to account for the liquidity premium. The Bank obtains the discount rates from the daily TNIC.

Fair value for borrowings used to fund certain guaranteed loans based on the FCRA is determined based on an asset-backed securities model, for which the Bank does not expect to exercise the embedded call option. The asset-backed securities model reflects the cash flow profile of the respective cohorts and is discounted using interest rates from the daily TNIC, plus 25 basis points added as a factor to account for the liquidity premium.

Advances to Others, Accrued Interest Receivable, Accrued Interest Payable, and Other Liabilities: The carrying amount of advances to others, accrued interest receivable, accrued interest payable, and other liabilities approximate fair value as they represent the amounts expected to be realized or paid and are current assets and liabilities.

(c) Interest Rate Volatility

The fair value of the Bank's loans receivable, investments, and borrowings changes in response to the interest rate volatility that results from the current economic conditions, market perception, and expectations. However, because the interest rates and maturities of loans receivable, investments, and borrowings are very similar, the fair market values of both assets and liabilities increase or decrease in the same direction and in similar amounts.

(Dollars in thousands)

(7) Net Position

At September 30, 2011 and 2010, the net position includes the following:

		2011	2010
Transfers to Treasury	$	(1,682,847)	(1,682,847)
Cumulative results of operations and gains/losses on early extinguishment of borrowings treated as capital transactions		5,682,162	5,476,041
Net position	$	3,999,315	3,793,194

Included in the net position activity is income the Bank earned prior to fiscal year 2000 that the Bank transferred to Treasury.

(8) Loss on Extinguishment of Borrowings Treated as Capital Transactions

In fiscal year 2011, the Bank made early repayments to the Treasury totaling $902,906, resulting in a net loss of $648. The repayment represents a capital transaction, and the loss with Treasury is reported as a loss on extinguishment of borrowings treated as capital transaction on the statements of operations and changes in net position. The Bank made an early repayment of debt in fiscal year 2010 for $907,680 and a net loss of $4,235.

(9) Capitalized Interest

Capitalized interest receivable was approximately $12,714 and $8,524, and the related capitalized interest payable was $551,370 and $392,120 as of September 30, 2011 and 2010, respectively. Capitalized interest receivable and payable are reported as part of the loans receivable and borrowing balances, respectively, on the statements of financial position.

(Dollars in thousands)

(10) Loan Commitments

The Bank makes loan commitments to extend credit to Federal program agencies based on the loan agreements executed between the parties. The loan commitments are not reported on the statements of financial position and generally have fixed expiration dates or other termination clauses. Since many of the loan commitments are expected to expire without being completely drawn upon, the total loan commitment amounts do not necessarily represent future cash requirements. The Bank uses the same credit policies in making loan commitments as it does for loans receivable reported on the statements of financial position. The Bank funds the loan commitments with its borrowing authority from the Secretary. There is no exposure or credit risk related to these commitments.

The contract amounts and remaining loan commitments by program agency as of September 30, 2011, are as follows:

Agency		Contract amounts	Remaining loan commitments
Department of Education – FFEL Conduit	$	60,000,000	60,000,000
National Credit Union Administration – CLF		10,000,000	10,000,000
Rural Utilities Service, Department of Agriculture		27,978,809	11,999,600
U.S. Postal Service		13,425,000	2,000,000
Department of Energy		18,109,961	11,351,989
Historically Black Colleges and Universities, Department of Education		692,455	186,997
General Services Administration		163,200	8,289
Total commitments	$	130,369,425	95,546,875

(11) Subsequent Events

The Bank has evaluated subsequent events from the statements of financial position date through November 14, 2011, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

(Dollars in thousands)

In prior years, the Federal Financing Bank (the Bank) purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from the Rural Utilities Service (RUS), a component of the U.S. Department of Agriculture. RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (i.e., 7 USC Sec. 940c Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that a private utility company may reduce the balance of its cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at a rate of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position. As of September 30, 2011, the outstanding principal balance of the nine RUS loans subject to the certificates of beneficial ownership (CBO) legislation totaled $1,674,900, with interest rates ranging from 7.755% to 13.935 %, and maturity dates ranging from 2012 to 2021. In October 1998, the Bank received an appropriation that offset the RUS-CBO interest credits by $917,699.

The interest credits that the Bank has provided RUS-CBO through September 30, 2011 are as follows:

Fiscal year		**Interest credits**
1988–2007	$	2,018,977
2008		97,998
2009		201,087
2010		271,461
2011		249,813
Total interest credits		2,839,336
Less appropriation		(917,699)
Total	$	1,921,637

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Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General, U.S. Department of the Treasury and
the Board of Directors, Federal Financing Bank:

We have audited the statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2011 and 2010 and the related statements of operations and changes in net position and cash flows for the years then ended (hereinafter referred to as "financial statements"), and have issued our report thereon dated November 14, 2011.

We conducted our audits 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Bank is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2011 audit, we considered the Bank's internal control over financial reporting by obtaining an understanding of the design effectiveness of the Bank's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2011 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

We noted a certain matter that we have reported to Bank management in a separate letter dated November 14, 2011.

This report is intended solely for the information and use of the Bank's management, the U.S. Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2011

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2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report on Compliance and Other Matters

Inspector General, U.S. Department of the Treasury and
the Board of Directors, Federal Financing Bank:

We have audited the statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2011 and 2010, and the related statements of operations and changes in net position and cash flows for the years then ended (hereinafter referred to as "financial statements"), and have issued our report thereon dated November 14, 2011.

We conducted our audits 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Bank is responsible for complying with laws, regulations, and contracts applicable to the Bank. As part of obtaining reasonable assurance about whether the Bank's financial statements are free of material misstatement, we performed tests of the Bank's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Bank. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

This report is intended solely for the information and use of the Bank's management, the U.S. Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2011