# FEDERAL FINANCING BANK

Financial Statements

September 30, 2013 and 2012

(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 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 four units: accounting, information technology, lending and operations. Each area of functional unit is headed by a Director that reports to the Chief Financial Officer. The Director of Accounting is responsible for the loan transactions, including but not limited to overseeing loan disbursements and repayments as well as managing the accounting and financial reporting. The Director of Information Technology is responsible for management and oversight of the IT infrastructure, including but not limited to software development, and maintenance of mission critical enterprise applications that provide support for lending and accounting functions. The Director of Lending is responsible for loan administration function, including but not limited to loan origination, loan structuring, and managing customer relationships. The Director of Operations is responsible for coordinating the general management functions including but not limited to budgeting, procurement, human resources, strategic planning and facilities.

**Loan Programs Activity**

The Community Development Financial Institution Fund (CDFI Fund) was created by the Riegle Community Development and Regulatory Improvement Act of 1994, to promote economic revitalization and community development through investment in and assistance to community development financial institutions. On September 19, 2013, the Bank and CDFI entered into a program financing agreement totaling $1.5 billion to support CDFI's mission for community development. The Secretary may guarantee up to $500 million of the bonds in fiscal year 2013 and $1 billion in fiscal year 2014.

On September 24, 2013, the Bank entered into a $10 billion note purchase agreement with the Farm Credit System Insurance Corporation (FCSIC) for the purpose of establishing a standby line of credit. FCSIC was established by the Agricultural Credit Act of 1987 to ensure the timely payment of principal and interest on insured notes, bonds and other obligations issued on behalf of the System Banks.

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 $2,180,432 thousand through September 30, 2013. 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 Bank has paid off all debt used to finance this program.

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 prohibited or limited the Bank's financing of certain loans that are 100 percent guaranteed by Federal agencies.

## Impact of Economic Conditions

All Bank 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. Certain borrowers have repaid their loans with the Bank early, while other borrowers have increased their borrowing activities with 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. The USPS has a total borrowing authority of $15 billion. The USPS borrowed up to the maximum debt ceiling on September 30, 2013. The USPS repaid $4 billion of the outstanding amount on October 1, 2013. The outstanding balance was further reduced to $11 billion on October 7, 2013. The USPS can be expected to borrow up to the ceiling amount at different times in the coming year.

The USPS had a fiscal year 2013 deficit due to a decline in mail volume. As a result, the USPS was unable to make payments for legislatively mandated prefunding of retiree health benefits. However, relieving USPS of the obligation to prefund retiree health benefits will not, in and of itself, resolve the current and long-term financial issues of the USPS. The Administration, Congress, and other stakeholders are aware of the current and long-term financial issues of USPS. Congress is considering legislative solutions to return the USPS to financial stability.

The Bank has not incurred any credit-related losses on its loans as of the date of these statements, and as stated above, all Bank 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, 2013. Interest on loans of $2,613,634 thousand for the fiscal year ended September 30, 2013 decreased compared to the interest on loans of $2,642,121 thousand for the fiscal year ended September 30, 2012, due to the prepayments for certain borrowers which were made in fiscal year 2012 which ultimately affected the Bank's interest income. The legislatively mandated interest credits reduced interest income by $100,001 thousand and $158,794 thousand for the fiscal years ended September 30, 2013 and 2012, respectively, and are related to RUS's "cushion of credit" loans. Revenue from servicing loans of $2,275 thousand for the fiscal year ended September 30, 2013 increased from $1,493 thousand for the fiscal year ended September 30, 2012 due to the timing of RUS's quarterly payments.

Interest on borrowings of $2,210,538 thousand for the fiscal year ended September 30, 2013 increased from the interest on borrowings of $2,176,933 thousand for the fiscal year ended September 30, 2012 primarily due to the change in repayment structure resulting from the borrowing agreement with the

Secretary of the Treasury. After administrative expenses of $5,406 thousand, net income of $300,343 thousand for the fiscal year ended September 30, 2013 decreased from the net income of $302,788 thousand for the fiscal year ended September 30, 2012.

**Statements of Financial Position Highlights**

Funds with U.S. Treasury (cash equivalents) amounted to $912,186 thousand at September 30, 2013, which represents an increase from the September 30, 2012 balance of $716,258 thousand.

The loan portfolio (loans receivable) increased $4,761,596 thousand from $67,862,609 thousand at September 30, 2012 to $72,624,205 thousand at September 30, 2013. The change is primarily the result of a $2,888,023 thousand increase in loan activity to RUS, $1,747,843 thousand increase in new loans to the Department of Energy (DOE), and other loan activity. The Bank's net position increased to $4,602,446 thousand at September 30, 2013 from $4,302,103 thousand at September 30, 2012 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 increased by $4,575,030 thousand due to increased lending activities.

**Performance Highlights**

During fiscal year 2013, the Bank processed 1,410 new loan requests. The interest rate was set or reset on 3,989 loans in fiscal year 2013 for new loans and maturity extensions. The Bank processed 137 prepayments and 44,545 loan repayments in fiscal year 2013.

**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 2013. 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 (LMCS), which was effective for three years. The recertification was due in 2012, when the LMCS was anticipated to be migrated to a new computer platform (Integrity). A certification was completed for Treasury's Departmental Offices (DO) Integrity platform and the Bank's LMCS combined. However, due to a delay in fully installing the Integrity computers, the migration was postponed. On June 29, 2012, DO issued an "Authority to Operate for LMCS" memo to bridge the operation of the LMCS on its current computer platform (Alpha) until the migration to the Integrity platform is completed. Future LMCS certifications will be included with Treasury's certifications.

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.

**FEDERAL FINANCING BANK**

Statements of Financial Position

September 30, 2013 and 2012

(Dollars in thousands)

| **Assets** | | **2013** | **2012** |
|---|---|---|---|
| Funds with U.S. Treasury | $ | 912,186 | 716,258 |
| Investments held-to-maturity (note 3) | | 493,887 | 493,446 |
| Loans receivable (note 4) | | 72,624,205 | 67,862,609 |
| Accrued interest receivable | | 161,876 | 466,149 |
| Advances to others | | 18 | 55 |
| Total assets | $ | 74,192,172 | 69,538,517 |
| **Liabilities and Net Position** | | | |
| Liabilities: | | | |
| Borrowings: | | | |
| Principal amount | $ | 69,381,532 | 64,776,632 |
| Plus unamortized premium | | 72,584 | 102,454 |
| Total borrowings (note 5) | | 69,454,116 | 64,879,086 |
| Accrued interest payable | | 135,209 | 357,163 |
| Other liabilities | | 401 | 165 |
| Total liabilities | | 69,589,726 | 65,236,414 |
| Loan and interest credit commitments (notes 8 and 1(j)) | | | |
| Net position (note 6) | | 4,602,446 | 4,302,103 |
| Total liabilities and net position | $ | 74,192,172 | 69,538,517 |

See accompanying notes to financial statements.

**FEDERAL FINANCING BANK**

Statements of Operations and Changes in Net Position

Years ended September 30, 2013 and 2012

(Dollars in thousands)

| | | 2013 | 2012 |
|---|---|---|---|
| Revenue and financing sources: | | | |
| Interest on loans | $ | 2,613,634 | 2,642,121 |
| Less legislatively mandated interest credit | | (100,001) | (158,794) |
| Net interest on loans | | 2,513,633 | 2,483,327 |
| Interest on investments | | 379 | 288 |
| Revenue from servicing loans | | 2,275 | 1,493 |
| Total revenue | | 2,516,287 | 2,485,108 |
| Expenses: | | | |
| Interest on borrowings | | 2,210,538 | 2,176,933 |
| Administrative expenses | | 5,406 | 5,387 |
| Total expenses | | 2,215,944 | 2,182,320 |
| Net income | $ | 300,343 | 302,788 |
| Net position: | | | |
| Beginning of year | $ | 4,302,103 | 3,999,315 |
| Net income | | 300,343 | 302,788 |
| End of year (note 6) | $ | 4,602,446 | 4,302,103 |

See accompanying notes to financial statements.

**FEDERAL FINANCING BANK**

Statements of Cash Flows

Years ended September 30, 2013 and 2012

(Dollars in thousands)

| | | 2013 | 2012 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ | 300,343 | 302,788 |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Amortization of premium on borrowings | | (29,870) | (35,327) |
| Capitalization of interest receivable | | (122,067) | (58,345) |
| Capitalization of interest payable | | 200,410 | 129,344 |
| Decrease (Increase) in accrued interest receivable | | 304,273 | (314,922) |
| Decrease in advances to others | | 37 | 11 |
| (Decrease) Increase in accrued interest payable | | (221,954) | 170,872 |
| Increase (Decrease) in other liabilities | | 236 | (262) |
| Net cash provided by operating activities | | 431,408 | 194,159 |
| Cash flows from investing activities: | | | |
| Investment purchases | | (441) | (192) |
| Loan disbursements | | (244,257,891) | (654,980,692) |
| Loan collections | | 239,618,362 | 644,264,320 |
| Net cash (used in) provided by investing activities | | (4,639,970) | (10,716,564) |
| Cash flows from financing activities: | | | |
| Borrowings | | 244,258,332 | 654,980,885 |
| Repayments of borrowings | | (239,853,842) | (644,584,075) |
| Net cash provided by financing activities | | 4,404,490 | 10,396,810 |
| Net increase (decrease) in cash | | 195,928 | (125,595) |
| Funds with U.S. Treasury – beginning of the period | | 716,258 | 841,853 |
| Funds with U.S. Treasury – end of the period | $ | 912,186 | 716,258 |
| Supplemental disclosures of cash flow information: | | | |
| Interest paid (net of amount capitalized) | $ | 2,249,157 | 1,876,620 |

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. The Federal Accounting Standards Advisory Board (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 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 Historically Black Colleges and Universities (HBCU) and the Department of Energy (DOE) have the option of deferring payments of interest on their loans until future periods. When HBCU or DOE 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 non-FCRA 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 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; revenues; and expenses.

**(2) Accounting Pronouncement**

On February 7, 2013, FASB issued ASU No. 2013-03, FAS ASC 825, *Financial Instruments (Topic 825),Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities* that amends ASU No. 2011-04, *Fair Value Measurement and Disclosure Requirements.* FASB ASC 825 added paragraph 825-10-50-3A stating that "A nonpublic entity is not required to provide the disclosure in paragraph 825-10-50-10(d) for items disclosed at fair value but not measured at fair value in the statement of financial position". The amendment affects nonpublic entities that have total assets of $100 million or more or that have one or more derivative instruments. Amendment ASU No. 2013-03 is effective upon issuance, so it is applicable to the Bank's fiscal year 2013 financial statements. The Bank is not required to provide fair value measurement disclosure in the notes to the financial statements. Therefore, the Bank elected not to present the fair value of its assets and liabilities.

**(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 carrying amount for the HOPE bond at September 30, 2013 is $493,887 and for September 30, 2012 it was $493,446. The interest rate is 0.042% and 0.103% as of September 30, 2013 and 2012, respectively, with floating interest rates reset quarterly. The bonds have 30-year maturity dates starting on August 27, 2039 and ending on July 15, 2043.

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, 2013, the Bank had outstanding loans receivable of $72,624,205. Certain of these loans were funded using FCRA borrowing procedures. The outstanding amount of loans funded using FCRA borrowing procedures was $22,861,597 with interest rates ranging from .002% to 4.687% and maturity dates ranging from December 16, 2013 to December 31, 2047. The remaining non-FCRA loans receivable of $49,762,608 had interest rates ranging from .020% to 12.405% and maturity dates ranging from October 1, 2013 to July 17, 2045.

At September 30, 2012, the Bank had outstanding loans receivable of $67,862,609. The outstanding amount of loans funded using FCRA borrowing procedures was $17,184,592 with interest rates ranging from .095% to 4.707% and maturity dates ranging from October 1, 2012 to December 31, 2046. The remaining non-FCRA loans receivable of $50,678,017 had interest rates ranging from 0.95% to 12.405% and maturity dates ranging from October 1, 2012 to July 17, 2045.

(Dollars in thousands)

Loans receivable at September 30, 2013 and 2012, consist of the following:

| Agency | | 2013 | 2012 |
|---|---|---|---|
| Rural Utilities Service, Department of Agriculture | $ | 39,835,663 | 36,603,840 |
| U.S. Postal Service | | 14,999,600 | 14,999,600 |
| Department of Energy | | 14,034,442 | 12,170,688 |
| Rural Utilities Service, Department of Agriculture certificates of beneficial ownership | | 802,700 | 1,146,500 |
| General Services Administration | | 1,733,015 | 1,819,153 |
| Historically Black Colleges and Universities, Department of Education | | 1,133,378 | 928,712 |
| Foreign Military Sales, Department of Defense | | 80,131 | 188,397 |
| Veterans Administration Transitional Housing Program | | 4,662 | 4,723 |
| Small Business Administration | | — | 60 |
| Federal Railroad Administration, Department of Transportation | | 614 | 936 |
| Total loans receivable | $ | 72,624,205 | 67,862,609 |

The loans receivable due within one year are $16,083,555 and $16,040,021 as of September 30, 2013 and 2012, respectively.

## (5) Borrowings

Under the FFB Act, the Bank may, with the approval of the Secretary, borrow without limit from the Treasury.

For certain borrowings used to fund certain guaranteed loans based on FCRA, the interest rate is determined annually by the borrowing agencies using FCRA and Office of Management and Budget guidelines. At September 30, 2013, the Bank had $22,683,060 of Treasury borrowings used to fund guaranteed loans based on FCRA with interest rates ranging from 1.000% to 4.723%, and a maturity date of September 30, 2053. Under FCRA borrowing procedures, borrowings from Treasury do not capitalize interest.

For the Bank's non-FCRA borrowings, repayments on Treasury borrowings generally match the terms and conditions of corresponding loans made by the Bank and bear interest at the respective rate, as determined by the Secretary, and are repayable at any time, except for loans with fixed-price call options in the no-call period. In November 2004, certain borrowings from Treasury were refinanced under a debt limit transaction. At September 30, 2013, the Bank had $41,003,355 of Treasury borrowings for non-FCRA related loans, with interest rates ranging from .002% to 8.961%, and maturity dates from October 1, 2013 to December 31, 2047.

At September 30, 2012, the Bank had $17,121,965 of Treasury borrowings used to fund guaranteed loans based on FCRA with interest rates ranging from 1.000% to 4.723% and a maturity date of September 30, 2050. Treasury borrowings for non-FCRA related loans of $40,543,098, with interest rates ranging from 0.051% to 8.961%, and maturity dates from October 1, 2012 to December 31, 2046.

(Dollars in thousands)

Finally, at September 30, 2013 and 2012, the Bank had borrowings of $5,695,107 and $7,111,559, respectively, and an associated unamortized premium of $72,584 and $102,454, respectively, from the Civil Service Retirement and Disability Fund (CSR&DF), which is administered by the Office of Personnel Management. At September 30, 2013, 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, 2014 to June 30, 2019. At September 30, 2012, these borrowings were at stated interest rates 4.625%, effective interest rate of 4.625%, and with maturity dates ranging from June 30, 2012 to June 30, 2019. Borrowing from the public amounted to $10 at September 30, 2013 and 2012.

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, 2013 are as follows:

| **Repayment date** | | **Amount** |
|---|---|---|
| 2014 | $ | 16,567,758 |
| 2015 | | 3,026,213 |
| 2016 | | 3,764,650 |
| 2017 | | 2,607,789 |
| 2018 | | 2,505,805 |
| 2019 and thereafter | | 40,909,317 |
| Total principal payments | | 69,381,532 |
| Plus unamortized premium | | 72,584 |
| Total borrowings | $ | 69,454,116 |

## (6) Net Position

At September 30, 2013 and 2012, the net position includes the following:

| | | **2013** | **2012** |
|---|---|---|---|
| Beginning of year | $ | 4,302,103 | 3,999,315 |
| Net Income | | 300,343 | 302,788 |
| Net position | $ | 4,602,446 | 4,302,103 |

(Dollars in thousands)

### (7) Capitalized Interest

Capitalized interest receivable was approximately $183,306 and $68,588, and the related capitalized interest payable was $624,833 and $530,176 as of September 30, 2013 and 2012, respectively. Capitalized interest receivable and payable are reported as part of the loans receivable and borrowing balances, respectively, on the statements of financial position. The large difference between capitalized interest receivable and capitalized interest payable is due to the effects of a debt limit transaction on November 15, 2004. This transaction altered the structure of existing debt and caused capitalized interest to accrue.

### (8) 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, 2013, 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 | | 2,000,000 | 2,000,000 |
| Rural Utilities Service, Department of Agriculture | | 27,028,744 | 9,943,979 |
| U.S. Postal Service | | 10,600,000 | 400 |
| Department of Energy | | 8,417,383 | 1,487,368 |
| Historically Black Colleges and Universities, Department of Education | | 327,500 | 183,461 |
| Secretary of the Treasury-SOT HOPE | | 3,000 | 3,000 |
| Total commitments | $ | 108,376,627 | 73,618,208 |

## (9) Subsequent Events

On October 1, 2013, the Bank issued a debt obligation of $9,304,883 under section 9(a) of the FFB Act to the CSR&DF in exchange for certain special-issue Treasury debt obligations ("Specified Treasury Specials") issued by the Treasury and presently held by the Civil Service Fund. The Bank's 9(a) Obligations will match the coupon rates, the payment dates, the maturity dates and the redemption terms of the Specified Treasury Specials that the Bank receives from the Civil Service Fund.

On October 1, 2013 the Bank exchanged the Specified Treasury Specials received from the Civil Service Fund of $9,304,883 to extinguish borrowings from the Treasury of $8,296,609; related capitalized interest of $483,235 and related accrued interest payable of $2,517 for certain debt obligations issued by the Bank under section 9(b) of the FFB Act (such obligations of the Bank being the Bank's "9(b) Obligations"), and held by the Treasury. Additionally, FFB received $71,201 in related interest which will be paid to the CSR&DF on December 31, 2013.

On the statement of financial position, funds with Treasury increased by $71,201, borrowings increased by $525,039 and accrued interest payable increased by $68,684. The transactions resulted in the Bank owing debt to the CSR&DF instead of the Treasury Department and resulted in a loss of $522,522 which represents a capital transaction with Treasury.

**FEDERAL FINANCING BANK**

Other Information – Schedule 1

Unaudited – See Accompanying Auditors' Report

September 30, 2013 and 2012

(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, 2013, the outstanding principal balance of the five RUS loans subject to the certificates of beneficial ownership (CBO) legislation totaled $802,700, with interest rates ranging from 7.755% to 12.405 %, and maturity dates ranging from 2014 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, 2013 are as follows:

| **Fiscal year** | | **Interest credits** |
|---|---|---|
| 1988–2009 | $ | 2,318,062 |
| 2010 | | 271,461 |
| 2011 | | 249,813 |
| 2012 | | 158,794 |
| 2013 | | 100,001 |
| Total interest credits | | 3,098,131 |
| Less appropriation | | (917,699) |
| Total | $ | 2,180,432 |

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## Independent Auditors' Report

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

### Report on the Financial Statements

We have audited the accompanying financial statements of the Federal Financing Bank (the Bank), which comprise the Statements of Financial Position as of September 30, 2013 and 2012, and the related Statements of Operations and Changes in Net Position and Cash Flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion on the Financial Statements*

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, 2013 and 2012, and the results of its operations, changes in net position, and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

### *Other Matters*

*Other Information*

Our audits were conducted for the purpose of forming an opinion on the basic financial statements 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 a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 9, 2013 on our consideration of the Bank's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and 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* in considering the Bank's internal control over financial reporting and compliance.

KPMG LLP

December 9, 2013

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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, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Federal Financing Bank (the Bank), which comprise the Statements of Financial Position as of September 30, 2013 and 2012, and the related Statements of Operations and Changes in Net Position and Cash Flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 9, 2013.

### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2013, we considered the Bank's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control. 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the Bank's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bank's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 9, 2013

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## 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, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of Federal Financing Bank (the Bank), which comprise the Statements of Financial Position as of September 30, 2013 and 2012, and the related Statements of Operations and Changes in Net Position and Cash Flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 9, 2013.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Bank’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. 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 disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 14-02.

### Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the Bank’s compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Bank’s compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 9, 2013