Federal Housing Administration, Washington, DC

Fiscal Years 2018 and 2017 (Restated)

Financial Statements Audit

Office of Audit, Financial Audits Division
Washington, DC

Audit Report Number: 2019-FO-0002
November 14, 2018

To: Brian Montgomery, Assistant Secretary for Housing, H

//signed//

From: Thomas R. McEnanly, Director, Financial Audits Division, GAF

Subject: Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2018 and 2017 (Restated)

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of the Federal Housing Administration's fiscal years 2018 and 2017 (restated) financial statements.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 202-402-8216.

Audit Report Number: 2019-FO-0002
Date: November 14, 2018

Audit of the Federal Housing Administration's Financial Statements for Fiscal Years 2018 and 2017 (Restated)

Highlights

What We Audited and Why

The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the Office of Inspector General to audit the financial statements of the Federal Housing Administration (FHA) annually. We audited the accompanying financial statements and notes of FHA as of and for the fiscal years ending September 30, 2018 and 2017 (restated), which are comprised of the balance sheets, related statements of net cost and changes in net position, and combined statements of budgetary resources for the years then ended. Additionally, we audited the restatement adjustments made by FHA in fiscal year 2018 to restate its fiscal year 2017 financial statements and notes. We conducted these audits in accordance with U.S. generally accepted government auditing standards.

What We Found

In our opinion, FHA's fiscal years 2018 and 2017 financial statements were presented fairly, in all material respects, in accordance with the U.S. generally accepted accounting principles for the Federal Government. Our opinion is reported in FHA's Fiscal Year 2018 Annual Management Report. The results of our audit of FHA's principal financial statements and notes for the fiscal years ending September 30, 2018 and 2017, including our report on FHA's internal control and test of compliance with selected provisions of laws and regulations applicable to FHA, are presented in this report. Our audit disclosed one material weaknesses, three significant deficiencies in internal controls, and no instances of noncompliance with applicable laws and regulations, which are discussed further in the body of this report.

What We Recommend

To support reliable financial reporting, we recommend that FHA strengthen its existing system of internal control processes, policies, procedures, and information systems to (1) ensure effective model governance implementation and (2) prevent material misstatements from occurring in the financial statements and notes or detect such mistakes in a timely manner. Additionally, we recommend that FHA deobligate $399 million to recapture funds with invalid obligations.

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U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

Independent Auditor's Report

General Deputy Assistant Secretary
Federal Housing Administration

In our audits of the fiscal years 2018 and 2017 (restated) financial statements of the Federal Housing Administration (FHA), a component of the U.S. Department of Housing and Urban Development (HUD), we found

- That FHA's financial statements as of and for the fiscal years ending September 30, 2018 and 2017, were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles.
- One material weaknesses in internal control over financial reporting.
- Three significant deficiencies in internal control over financial reporting.
- No instances of reportable noncompliance for fiscal year 2018 with certain provisions of applicable laws and regulations we tested.

The following sections and appendixes discuss in more detail (1) our report on the financial statements, which includes emphasis-of-matter paragraphs related to the loan guarantee liability (LGL) and restatement of the fiscal year 2017 financial statements and notes, required supplementary information (RSI), and other information included with the financial statements; (2) our report on internal control over financial reporting; (3) our report on compliance with laws and regulations; (4) agency comments and Office of Inspector General (OIG) evaluation; (5) the current status of prior-year findings; and (6) a schedule of funds to be put to better use.

Report on the Financial Statements

In accordance with U.S. generally accepted auditing standards, we audited FHA's financial statements. FHA's financial statements comprise the balance sheets as of September 30, 2018 and 2017 (restated), the related statements of net cost, changes in net position, the combined statements of budgetary resources for the fiscal years then ended, and the related notes to the financial statements.

We conducted our audits in accordance with U.S. generally accepted auditing standards. We believe that the audit evidence we have obtained was sufficient and appropriate to provide a basis for our audit opinion.

Management's Responsibility

FHA's management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting

principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report and ensuring the consistency of that information with the audited financial statements and the RSI; and (4) maintaining effective internal control over financial reporting, including 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. We also conducted our audits in accordance with Office of Management and Budget (OMB) Bulletin 19-01, Audit Requirements for Federal Financial Statements. We are further responsible for applying certain limited procedures to the RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's 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 FHA's preparation and fair presentation of the financial statements 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 of financial statements also involves 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. Our audits also included performing such other procedures we considered necessary in the circumstances.

Opinion on Financial Statements

In our opinion, FHA's financial statements referred to above presented fairly, in all material respects, the financial position of FHA as of September 30, 2018 and 2017 (restated), and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in notes 1 and 7 to the financial statements, the LGL is an estimate of the net present value of future claims, net of future premiums, and future recoveries from loans insured as of the end of the fiscal year. This estimate is developed using econometric models that integrate historical loan-level program and economic data with regional house price appreciation forecasts to develop assumptions about future portfolio performance. In fiscal year 2018, FHA changed its discounting period to allocate the reestimate expense from the middle-of-year discount period assumption to the beginning-of-year discount period assumption. The LGL is discussed further in note 7 to the financial statements. Our opinion was not modified with respect to this matter.

Other Matters

Fiscal Year 2017 Financial Statements and Notes

In our report, dated November 15, 2017, we expressed an opinion that FHA's financial statements for fiscal year 2017 fairly presented the financial position of FHA's financial statements as of September 30, 2017, and its net costs, changes in net position, and budgetary resources for the years then ended in accordance with generally accepted accounting principles. However, in fiscal year 2018, as discussed in note 22 to the financial statements, errors were identified in the 2017 financial statements and notes, which required correction of the balances in fiscal year 2018. FHA made restatements to (1) the balance sheet, statement of net cost, and statement of changes in net position, as well as Note 2 – Non-Entity Assets, Note 7 – Direct Loan and Loan Guarantees, Note 11 – Other Liabilities, Note 13 – Gross Costs, and Note 16 – Transfers In and Other Financing Sources, due to a material discounting error in the home equity conversion mortgage (HECM) return on assets (ROA) cash flow model; (2) Note 3 – Fund Balance with U.S. Treasury to correct the classification of the status of fund balance with the U.S. Department of the Treasury; (3) the statement of net cost, the statement of changes in net position, Note 13 – Gross Costs, and Note 16 – Transfers in and Other Financing Sources to correct an error in the cost allocation related to salaries and administrative expenses; (4) Note 7 – Direct Loans and Loan Guarantees to correct reporting the loan loss reserve (LLR) as an LLR technical-default reestimate instead of an LLR adjustment; and (5) Note 5 – Investments to remove the inclusion of accrued interest from the market value of investments. For these reasons, the opinion expressed in the 2017 audited financial statements was no longer appropriate because the financial statements and accompanying notes, as published at that time, contained material misstatements. Accordingly, our opinion on the audited financial statements for 2017 is withdrawn because it can no longer be relied upon and is replaced by the auditor's report on the restated financial statements. Additional details regarding the material weakness related to the discounting error in the HECM ROA cash flow model can be found in finding 1. Additional details regarding the significant deficiency in financial reporting internal controls for the other errors reported can be found in finding 2.

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. The RSI consists of "Management's Discussion and Analysis" and the "Combining Statement of Budgetary Resources," which are included with the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

FHA's other information contains a wide range of information, some of which is not directly related to the financial statements and consists of information included with the financial statements, other than the RSI and the auditor's report. This information, including the message from the FHA Commissioner, is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on FHA's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Report on Internal Control Over Financial Reporting

In connection with our audits of FHA's financial statements, we considered FHA's internal control over financial reporting, consistent with our auditor's responsibility discussed below. We performed our procedures related to FHA's internal control over financial reporting in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

FHA management is responsible for maintaining effective internal control over financial reporting, including 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.

Auditor's Responsibility

In planning and performing our audit of FHA's financial statements as of and for the year ending September 30, 2018, in accordance with U.S. generally accepted government auditing standards, we considered FHA's internal control over financial reporting as a basis for designing 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 FHA's internal control over financial reporting. Accordingly, we do not express an opinion on FHA's internal control over financial reporting. We are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses. We did not consider all internal controls relevant to operating objectives, such as those controls relevant to preparing performance information and ensuring efficient operations.

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 FHA's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the

preparation of financial statements in accordance with U.S. generally accepted accounting principles and assets are safeguarded against loss from unauthorized acquisition, use, or disposition and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements due to fraud or error.

Results of Our Consideration of Internal Control Over Financial Reporting

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be material weaknesses and significant deficiencies or to express an opinion on the effectiveness of FHA's internal control over financial reporting. Therefore, other deficiencies in internal control that might be material weaknesses or significant deficiencies may exist that were not identified.

During our 2018 audit, we identified four deficiencies in FHA's internal control over financial reporting described below. We consider one to be a material weakness and three to be significant deficiencies. We have communicated these matters to FHA management.

Weaknesses Continued in FHA's Modeling Processes

FHA had addressed some previous-year modeling weaknesses, but improvements are still needed. While FHA had corrected the specific modeling errors cited in our fiscal year 2017 audit report, new modeling errors were identified during our fiscal year 2018 audit. For example, in fiscal year 2018, FHA discovered that cash flows were improperly discounted in the fiscal year 2017 HECM ROA model. Errors were also identified in the HECM and multifamily liabilities for loan guarantees (LLG) cash flow models. In addition, FHA continued to face challenges with its model governance and model practices and failed to test or consider the impact of assumptions used in its HECM models. These conditions were due to ineffective oversight and FHA's failure to follow its established guidelines. As a result of improperly discounting cash flows in the HECM ROA model, the loans receivable and related foreclosed-on property line item was understated by $1.7 billion on the fiscal year 2017 financial statements. Further, there were additional errors totaling $19.1 million in the fiscal year 2018 models, and FHA remained susceptible to modeling errors due to its model governance and practices and its failure to test or consider the impact of assumptions.

FHA's Controls Over Financial Reporting Had Weaknesses

In fiscal year 2018, some of the control deficiencies in financial reporting identified in 2017 continued, and new control deficiencies were identified. Specifically, these new control deficiencies included issues related to the lack of subsidiary ledger systems or inadequate designs within subsidiary ledger systems and incorrect assumptions and inadequate controls used for financial statement reporting. These conditions occurred because FHA did not have effective monitoring and processes in place to ensure (1) that subsidiary ledger systems were implemented and accurately designed to record accounting events and (2) the accuracy of data reported in the financial statements. As a result, $588 million in expenses was incorrectly reported in the financial statement note disclosures, and $461.5 million was restated in fiscal year 2017 financial statement notes. Additionally, FHA may have missed

an opportunity to put $399 million of its unobligated funds to better use because invalid obligations were not always deobligated on time.

FHA's Controls Related to Partial Claims Had Improved, but Weaknesses Remained
While FHA made progress on resolving unsupported partial claims in fiscal year 2018, it did not follow up with the Office of Program Enforcement (OPE) to determine whether it should refer seriously noncompliant lenders to the Mortgagee Review Board (MRB) for temporary suspension or termination. These lenders did not provide required supporting documentation, did not reimburse FHA for the partial claim plus incentive fee, or did not reach a settlement in a timely manner. The cases remained unresolved an average of 591 days after the execution of the partial claim. FHA is no longer waiting until 6 months after execution of partial claims to begin requesting payment from lenders that do not provide the supporting promissory note, and it is sending requests for payments more frequently and on average, in a timely manner and in accordance with its newly implemented process. However, for lenders that have not sent the recorded mortgage within 6 months, letters requesting reimbursement in the amount of the partial claim plus the incentive fee were sent between 33 and 62 days after the expiration of the 6-month period and on average, 48 days after the expiration of the 6-month period. Failure to collect from noncompliant lenders with unsupported partial claims is a deficient cash management practice and does not help improve the health of the Mutual Mortgage Insurance fund.

Weaknesses Were Identified in Select FHA Information Technology Systems
FHA had security vulnerabilities within the management of the Computerized Homes Underwriting Management System (CHUMS) application. These conditions occurred because of a lack of oversight. As a result, the confidentiality, integrity, and availability of critical information may have been negatively impacted. We also determined that weaknesses previously reported with selected FHA information systems and the credit reform estimation and reestimation process had not been fully remediated.

Intended Purpose of Report on Internal Control Over Financial Reporting
The purpose of this report is solely to describe the scope of our consideration of FHA's internal control over financial reporting and the results of our procedures and not to provide an opinion on the effectiveness of FHA's internal control over financial reporting. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering internal control over financial reporting. Accordingly, this report on internal control over financial reporting is not suitable for any other purpose. In addition to this report and providing specific recommendations to FHA management, we noted other matters involving internal control over financial reporting and FHA's operation that we are reporting to FHA management in a separate management letter.

Report on Compliance With Laws and Regulations

In connection with our audits of FHA's financial statements, we tested compliance with selected provisions of applicable laws and regulations consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility
FHA management is responsible for complying with laws and regulations applicable to FHA.

Auditor's Responsibility
Our responsibility is to test compliance with selected provisions of applicable laws and regulations applicable to FHA that have a direct effect on the determination of material amounts and disclosures in FHA's financial statements and perform certain other limited procedures. Accordingly, we did not test compliance with all laws and regulations applicable to FHA.

Results of Our Tests for Compliance With Laws and Regulations
Our tests for compliance with selected provisions of applicable laws and regulations disclosed no instances of noncompliance for fiscal year 2018 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws and regulations applicable to FHA. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance With Laws and Regulations
The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws and regulations and the results of that testing and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws and regulations is not suitable for any other purpose. In addition to this report and providing specific recommendations to FHA management, we noted other compliance issues and issues with FHA's operation that we are reporting to FHA management in a separate management letter.

Agency Comments and Our Evaluation

In commenting on a draft of this report, FHA generally concurred with the findings and recommendations. Efforts have been made to address recommendations from prior years and FHA has already implemented recommendations based upon the current year audit. FHA's continued efforts in improving and strengthening its controls over the modeling process, financial reporting, partial claims and information systems will improve the reliability of the financial statements. OIG looks forward to working with FHA to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process. The complete text of FHA's response is reprinted in appendix B.

Kimberly R. Randall
Acting Assistant Inspector General for Audit
Washington, DC

November 14, 2018

Material Weaknesses

Finding 1: Weaknesses Continued in FHA's Modeling Processes

FHA had addressed some previous-year modeling weaknesses, but improvements are still needed. While FHA had corrected the specific modeling errors cited in our fiscal year 2017 audit report, new modeling errors were identified during our fiscal year 2018 audit. For example, in fiscal year 2018, FHA discovered that cash flows were improperly discounted in the fiscal year 2017 HECM ROA model. Errors were also identified in the HECM and multifamily liabilities for LLG cash flow models. In addition, FHA continued to face challenges with its model governance and model practices and failed to test or consider the impact of assumptions used in its HECM models. These conditions were due to ineffective oversight and FHA's failure to follow its established guidelines. As a result of improperly discounting cash flows in the HECM ROA model, the loans receivable and related foreclosed-on property line item was understated by $1.7 billion on the fiscal year 2017 financial statements. Further, there were additional errors totaling $19.1 million in the fiscal year 2018 models, and FHA remained susceptible to modeling errors due to its model governance and practices and its failure to test or consider the impact of assumptions.

Modeling Errors Not Prevented or Detected in a Timely Manner

In our fiscal year 2017 audit report, we identified a number of modeling errors for the single-family, HECM, and multifamily programs. Although FHA corrected the specific errors identified in the fiscal year 2017 audit report, additional errors were identified during our fiscal year 2018 audit. Errors were identified in the HECM ROA model and the HECM and multifamily LLG cash flow models. OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, requires agencies to establish and maintain internal control to ensure the reliability of financial reporting. The errors in the fiscal year 2018 models illustrate the need for FHA to strengthen its controls over modeling processes.

Improper discounting of cash flows in the HECM ROA model. In September 2018, FHA notified us that it improperly discounted cash flows in the HECM ROA model in fiscal year 2017. Cash flows were improperly discounted back to the cohort date[1] instead of being discounted to fiscal year 2017. Discounting back to the cohort date rather than to the year of forecast caused the rates for the return on notes and ROA to be lower than they should have been.

FHA stated that it discovered the error in August 2018 through its internal review process. During its review of the HECM ROA model results, FHA analyzed the nominal and discounted recoveries on a cohort-level basis and noted a linear trend between the recovery rate and the age of the cohort in the return on notes component of the ROA model. This trend suggested the use of the incorrect discount dates. FHA attributed the error to an oversight and credited its internal controls with detecting the error. Although FHA credits its internal controls with detecting the error, FHA's controls were not effective enough to detect the error before the preparation of the

[1] The cohort date refers to the year when FHA endorsed the mortgages.

fiscal year 2017 financial statements. This error resulted in a $1.7 billion understatement of the loans receivable and related foreclosed-on property line item on the fiscal year 2017 financial statements. In addition, the receipt account liability was understated by $61 million, and the reestimate was overstated by $1.7 billion. FHA properly discounted the cash flows in the HECM ROA model in fiscal year 2018.

Cash flows were excluded from some HECM cohorts. FHA excluded cash flows from some HECM cohorts in its interim LLG cash flow model for fiscal year 2018. FHA forecasted 35 years of cash flows for cohorts before 2015, while it forecasted 70 years of cash flows for cohorts 2015 and later. FHA changed the forecasting methodology for cohorts before 2015 to 50 years to avoid excluding cash flows for any cohort in the final LLG cash flow model. If FHA had excluded the cash flows in the final LLG cash flow model, the LLG would have been overstated by $17.8 million in fiscal year 2018. FHA declined to test the impact of this error on the LLG for fiscal year 2017.

Coding error in the multifamily models impacted the cash flow projections. A statistical analysis system software coding error in the multifamily LLG cash flow and ROA models for fiscal years 2017 and 2018 resulted in some expenses and payables not being included in the cash flow projections. After we brought this error to FHA's attention, FHA corrected the error in the fiscal year 2018 cash flow model. If FHA had not made this correction, the multifamily LLG would have been overstated by $1.3 million in fiscal year 2018. The impact of this error on the fiscal year 2017 LLG was $0.88 million.

Weaknesses in Controls Over Model Governance

We first reported on model governance in fiscal year 2016, and since that time, FHA has addressed some of the weaknesses in its model governance. For example, FHA finalized its Credit Reform Board charter and Model Risk Management Guidelines in fiscal year 2017 and established a policy for its model risk rating and policies and procedures for data management and validation. Although FHA had improved its model governance, it did not always follow its established guidance in fiscal year 2018. Specifically, FHA did not (1) perform important data validation steps, (2) use the loan limits established by policy when modeling the HECM program, and (3) update the final single-family and HECM ROA models with the most recently available data.

Policies and procedures for data validation were not fully implemented. FHA established a policy for its model risk rating and policies and procedures for data management and validation in fiscal year 2017, but it did not fully implement these policies and procedures. In fiscal year 2018, we were unable to determine whether FHA's data validation steps included a quantitative process to validate row counts and discard outliers during the model execution phase. In addition, FHA did not validate the interim HECM model output. If FHA had validated the interim HECM model output, it would have detected that some HECM cash flows were excluded.[2] Further, FHA did not perform necessary steps to improve its predictions over time by comparing predicted versus actual results for the HECM program, and it did not provide evidence of a model inventory system for the single-family and HECM programs.

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[2] See "Cash flows were excluded from some HECM cohorts" under the section, Modeling Errors Not Prevented or Detected in a Timely Manner.

Established loan limits were not used in the HECM LLG cash flow model. FHA did not consider the loan limits established by mortgagee letters during its modeling for the HECM program. Each year, FHA issues a mortgagee letter that specifies the loan limit for reverse mortgages, based on geographic location. Instead of using the established loan limits, FHA (1) developed a formula to determine the loan limit to use in the LLG cash flow model for cohorts before 2009 and (2) set the loan limit at $625,500 for cohorts 2009 and later, although this was not the loan limit for each of those years. We estimated that the LLG for fiscal year 2018 could be understated by $38.5 million because FHA did not use the loan limits established by the mortgagee letters.[3] In its final fiscal year 2018 model, FHA corrected the loan limit for the 2017 cohort but did not correct the limits for the other years. According to the FHA modeling team, it did not have the data to correct the limits for these years. However, we were able to obtain the correct loan limits from the Office of Single Family Program Development.

Final ROA models were not updated with the final LLG and return on notes cash flow results. When FHA determined the cash flow forecast from the final LLG and return on notes cash flow models for the single-family and HECM programs, it did not update the final ROA models. The cash flow forecast produced by the single-family LLG cash flow model and HECM return on notes cash flow model are an input to the ROA models. Updating the ROA model results with the final LLG cash flow and HECM return on notes cash flow results will ensure that consistent cash flows are used for the LLG and ROA estimates.[4] Table 1 shows the impact of not using the final LLG and return on notes cash flow model results in the final ROA model.

Table 1: Impact of not updating the final ROA models

Program and fund	ROA percentage using interim LLG and return on notes cash flow results	ROA percentage using final LLG and return on notes cash flow results	Increase (decrease)	Impact on allowance amount if the final LLG and return on notes cash flow results were used
Single-family Mutual Mortgage Insurance fund	55.61	56.60	.99	Increase of $127 million
HECM General Insurance-Special Risk Insurance fund	55.98	54.76	(1.22)	Decrease of $78 million
HECM Mutual Mortgage Insurance fund	69.16	67.97	(1.19)	Decrease of $201 million

[3] Our estimate is based on using the less granular historical national loan limits, which is a conservative measure of the understatement.

[4] The final ROA model uses March 2018 data, while the final LLG cash flow and HECM return on notes models use June 2018 data.

FHA stated that it could not update the final ROA models because the Credit Reform Board had not granted approval.[5] According to FHA, the Credit Reform Board has to approve all assumptions in the models, and the Board approved the use of the assumptions (which were based on March 2018 data) in the interim ROA models at its August 2018 meeting. Because the board did not meet again after the August 2018 meeting, the final ROA models could not be updated with the cash flow results from the final LLG and return on notes cash flow models (which were based on June 2018 data). It is unclear why data for June 2018 could not have been used for the August 2018 meeting or why the Board could not have been notified when the June data were available.

Susceptibility to Modeling Errors Due to Ineffective Modeling Practices

We identified ineffective modeling practices during our fiscal year 2016 and 2017 audits. These ineffective practices were related to FHA's model documentation and coding. Specifically, model documentation contained errors and inconsistent information and did not include necessary information. In addition, FHA had not adopted some industry best model coding practices. In fiscal year 2018, FHA took steps to improve its documentation and adopt best practices. However, its model documentation remained deficient, and some coding practices were still contrary to industry best practices. As in fiscal year 2017, we had difficulties initially replicating the single-family model results. Improving its model documentation and adopting additional industry best coding practices can further reduce the risk of errors and reduce FHA's maintenance of its programming code.

Weaknesses in model documentation remained. In our fiscal years 2016 and 2017 audit reports, we reported on the weaknesses in FHA's model documentation for the single-family and HECM program. Model documentation remained a concern for both of these programs in fiscal year 2018. FASAB Technical Release 6 requires model documentation to be complete and stand on its own so that an independent person could perform the same steps and replicate the results with little or no outside explanation or assistance. While we were able to replicate the model results in fiscal year 2018 with fewer problems than in the previous 2 fiscal years, FHA model documentation needs improvement. HECM program documentation weaknesses included (1) assumptions that were not adequately addressed in the documentation, (2) formulas that were not consistent with the formulas in the model, and (3) outdated codes in the documentation. For the single-family program, we noted that FHA did not include in its model documentation (1) a justification for incorporating an override factor for prepayment rates into the model, (2) its analysis on how it accounted for a significant policy change, and (3) which operating system needed to be used to replicate the model results. After we brought the documentation weaknesses to FHA's attention, FHA revised its documentation to address some of the weaknesses.

Additional industry best model coding practices need to be adopted. During our fiscal year 2017 audit, we identified a number of modeling code practices and techniques, which significantly

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[5] The Credit Reform Board consists of HUD management and includes the (1) General Deputy Assistant Secretary for Housing (2) Deputy Assistant Secretary for Finance and Budget, (3) Deputy Assistant Secretary for Single Family Housing, (4) Deputy Assistant Secretary for Multifamily Housing, (5) Deputy Assistant Secretary for Healthcare Programs, (6) Deputy Assistant Secretary for Risk Management and Regulatory Affairs, and (7) Assistant Secretary for Policy Development and Research.

increased FHA's risk of modeling errors for the single-family and HECM programs. For example, there were large sections of duplicated code in the single-family and HECM programs, and FHA did not assign "global"[6] values and references in the single-family and HECM programs. FHA made improvements in its coding practices in fiscal year 2018 and addressed many of the high-risk practices identified during our fiscal year 2017 audit. However, additional steps need to be taken to further reduce the risk of modeling errors. During our review of the 2018 single-family and HECM models, we again found duplicated sections of codes in the HECM program and hard-coded variables in the single-family and HECM models. These coding practices increased the risk of susceptibility of the code to error.

Assumptions or Impact of Assumptions Not Tested

In fiscal years 2016 and 2017, we reported that FHA did not perform a sensitivity analysis on some assumptions in the LLG cash flow models and on the assumptions in the ROA models. In fiscal year 2018, FHA performed a sensitivity analysis on assumptions used in the fiscal year 2018 LLG and ROA models for the single-family, HECM, and multifamily programs. FASAB Technical Release 6 states that agencies should test assumptions to identify which assumptions have the greatest impact on LLG estimates and have a rationale for selecting specific methodologies. Although FHA performed a sensitivity analysis for assumptions in the fiscal year 2018 models, it did not perform a sensitivity analysis on the assumptions in the fiscal year 2017 multifamily ROA model until October 2018. In addition, FHA had not tested the impact of assumptions used in the HECM LLG cash flow and ROA models. These assumptions were related to FHA's prediction on the number of HECM mortgages that would be assigned to HUD and the maintenance risk discount rate.

A sensitivity analysis on assumptions in the fiscal year 2017 multifamily ROA model was not performed until October 2018. Although FHA performed a sensitivity analysis for assumptions used in the fiscal year 2018 multifamily ROA model, it did not perform a sensitivity analysis on the fiscal year 2017 assumptions in the model until after we suggested it. Performing sensitivity analyses annually guides the inherent risk assessment of the underlying assumptions. FHA should analyze the individual assumptions to determine the marginal impact of changes to each assumption. The ability to change the sensitivity for critical assumptions each year allows the reviewer to determine bias in the model.

Impact of assumptions related to HECM assignments was not tested or considered. When performing its modeling, FHA relies on actual data for a portion of the year and projects data for the remainder of the forecast. One of the things that FHA must project for the HECM program is the number of the mortgages that will be eligible to be assigned to HUD during the remainder of the year and the number of mortgages that will not be eligible. The cash flows related to assignments are significant in the HECM models. When a mortgage is assigned to HUD by the end of the fiscal year, the cash flows for the assigned mortgage are captured in the ROA model. The cash flows for mortgages not assigned to HUD are captured in the LLG. When a mortgage is projected to be eligible to be assigned by the end of the fiscal year but is not assigned, the recovery stage cash flows are excluded from the LLG estimate. According to FHA, this was a model design choice implemented to avoid double counting the same mortgage in both models.

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[6] A global variable can be used across software code.

During our review, we determined that FHA did not fully evaluate the risks associated with assignment assumptions or consider alternatives to avoid double counting.

- An assignment-eligible status was not projected for mortgages with an unpaid principal balance greater than the maximum claim amount. This no assignment status remains in effect for all projected future cash flows. FHA did not provide analysis or documentation to support its rationale for not projecting an assignment status for any portion of mortgages with an unpaid principal balance greater than the maximum claim amount or assess the impact of not projecting an assignment-eligible status for these mortgages. According to FHA, there are several reasons why mortgages may not be eligible to be assigned to HUD, and it did not project an eligible assignment status for these mortgages based on the principle of conservativism since assignments reduce the LLG. The LLG cash flow model uses only a subset of several reasons that FHA provides for a mortgage to be eligible to be assigned.

  For fiscal year 2018, there were 27,829 mortgages with an unpaid principal balance greater than the maximum claim amount that were deemed ineligible to be assigned by FHA's model. To quantify the possible impact of FHA's assumption, we assumed that all of these mortgages were assigned to HUD in fiscal year 2019. Based on our assumption, the LLG balance for fiscal year 2018 would be overstated as much as $300.8 million. We acknowledge that all of these mortgages may not be eligible or likely to be assigned. However, because FHA did not provide us with the historical assignment data for mortgages with an unpaid principal balance greater than the maximum claim amount, we were unable to evaluate the reasonableness of FHA's assignment assumption.

- Cash flows were mistakenly excluded from the LLG cash flow and the ROA models because FHA adjusts the ROA model using the unpaid principal balance of the actual assigned HECM portfolio at yearend. Specifically, if a mortgage is predicted to be eligible to be assigned during the remainder of the year but is not assigned, the LLG balance increases since the cash flows for these mortgages were excluded from both the LLG cash flow and the ROA models.

  After we identified this issue, FHA acknowledged that cash flows were excluded. FHA maintains that there are instances in which an eligible assignment status was not predicted to occur but an assignment occurred, thereby reducing the LLG balance. In these instances, the cash flows are double counted when they are predicted to be assigned later in the projections. This is the double counting situation that FHA had intended to avoid with its model design. FHA asserted that the incorrectly excluded and incorrectly included cash flows basically offset each other over the long term. FHA acknowledged that in any given quarter, one could demonstrate instances in which exclusions outnumbered inclusions but argued that there were other quarters in which inclusions outnumbered exclusions. However, FHA did not provide an analysis to support its assertion until prompted. In addition, FHA did not provide an analysis to support why this assumption was adopted as opposed to alternative methods that may satisfy FHA's double counting concerns without introducing these increased model risks. FHA maintained its view that its analysis for the model, as a whole, demonstrates that there is no bias over the long term.

We requested that FHA's modeling team provide the necessary data for us to independently perform a back-testing analysis of FHA's assignment projection, but FHA did not provide the data. Therefore, as an alternative, we used the HECM Exposure Report[7] to conduct our analysis of FHA's assumption. We identified 23,586[8] instances in which FHA incorrectly excluded cash flows and one instance in which FHA incorrectly included cash flows. While we acknowledge that our limited testing is relevant only to the current period, this asymmetric impact increases our concerns regarding the unknown risk that FHA introduced with this model assumption. Based on our analysis, the LLG could be potentially understated as much as $1.1 billion in fiscal year 2018. We also noted that there was an $847.2 million variance between the HECM LLG for the Mutual Mortgage Insurance fund and the net present value of cash flows, using actual data instead of projected data, for the fourth quarter of fiscal year 2018. We acknowledge that there could be other factors, such endorsements and terminations, that potentially introduce forecast risk and cause an offsetting effect on the $1.1 billion.

Risk of not resetting the HECM maintenance risk discount rate assumption was not assessed. FHA had not assessed the risk of not resetting the maintenance risk discount rate in the HECM LLG cash flow model. FHA calculates the maintenance risk discount to capture the sales value changes of HECM homes depending on the loan age and the relative value of the homes to the market median. The maintenance risk discount rate is a significant factor in the LLG cash flow model, and FHA had not reset the rate since it was implemented in 2009.

Conclusion

While FHA has addressed some of the modeling weaknesses reported in fiscal years 2016 and 2017, it should continue to improve its modeling processes to ensure the reliability of the LLG estimates. These improvements should focus on minimizing the risk of modeling errors to the extent possible and detecting modeling errors in a timely manner. Although FHA has made notable progress with its model governance, it needs to improve its data validation procedures and take additional measures to ensure that the most accurate and up-to-date data are used in its models. FHA also needs to continue to improve its modeling documentation and follow best coding practices to reduce the risk of error. Further, FHA can benefit from testing assumptions used in its models in a timely manner and testing or considering the impact of its assumptions.

Recommendations

We recommend that the Director of the Office of Evaluation

1A. Correct the impact of all of the modeling errors identified in this report.

1B. Revise the modeling policies and procedures to use the established HECM loan limits in the HECM LLG cash flow model.

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[7] The HECM Exposure Report is a report that shows the HECM mortgages in FHA's assigned inventory. This report is used by the FHA General Ledger Division so it can determine the line of credit payments due to HECM borrowers at the end of each quarter.

[8] Of the 23,586 mortgages that were predicted to be eligible to be assigned, 383 were terminated.

1C. Develop alternative policies and procedures that would enable the use of the final single-family LLG cash flow model results and HECM return on notes cash flow model results in the final ROA models.

1D. Reassess the HECM assumption that mortgages with an unpaid principal balance greater than the maximum claim amount will not be assigned to HUD and perform the following: (1) compare this assumption to historical experience, (2) document the basis for selecting the assumption as opposed to alternative assumptions, and (3) determine the impact of this assumption and the associated risk.

1E. Reassess the model design that was implemented to avoid the double counting of the cash flows for HECM mortgages in the LLG cash flow and ROA models and perform the following: (1) determine whether there are alternative methodologies that will not result in the exclusion of cash flows in both models, (2) document the basis of the selected methodology, and (3) determine the impact and risk of the selected methodology.

We recommend that the Deputy Assistant Secretary of Finance and Budget

1F. Restate the fiscal year 2017 financial statements to correct the impact of using the improper discounting methodology in the HECM ROA model in fiscal year 2017.

Significant Deficiencies

Finding 2: FHA's Controls Over Financial Reporting Had Weaknesses

In fiscal year 2018, some of the control deficiencies in financial reporting identified in 2017 continued, and new control deficiencies were identified. Specifically, these new control deficiencies included issues related to the lack of subsidiary ledger systems or inadequate designs within subsidiary ledger systems and incorrect assumptions and inadequate controls used for financial statement reporting. These conditions occurred because FHA did not have effective monitoring and processes in place to ensure (1) that subsidiary ledger systems were implemented and accurately designed to record accounting events and (2) the accuracy of data reported in the financial statements. As a result, $588 million in expenses was incorrectly reported in the financial statement note disclosures,[9] and $461.5 million[10] was restated in fiscal year 2017 financial statement notes. Additionally, FHA may have missed an opportunity to put $399 million of its unobligated funds to better use because invalid obligations were not always deobligated on time.

No Subsidiary Ledger for the Federal Financing Bank Direct Loan Program

FHA did not have a subsidiary ledger system in place with the capability of generating reliable and detailed loan-level accounting reports for the life of its $1.7 billion portfolio of 133 direct loans and related borrowings. FHA used data from Treasury and Federal Financing Bank (FFB)[11] reports to manually record journal entries for all principal and interest on the direct loans and related borrowings directly into the general ledger system. While FHA was able to support the total $1.7 billion portfolio recorded in the general ledger with summarized Treasury and FFB reports, it used a manual process to enter loan-level data from approved Schedule 1-B forms (payment schedule) to an Excel spreadsheet and did not include FHA's accrued interest on the related borrowings for each direct loan. Additionally, FHA did not have comprehensive policies and procedures in place for the manual accounting of FFB direct loans and related borrowings.

Manual transactions were recorded in the general ledger due to the lack of a subsidiary ledger system. In fiscal year 2015, FHA began an FFB Risk Share program, an interagency partnership among HUD, FFB, and various housing finance authorities (HFA). Under this program, FHA

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[9] The $588 million (absolute value of $294 million) was due to the interest expense on reestimates being understated by $294 million and the subsidy reestimates expense being overstated by the same amount. However, due to a change in presentation for fiscal year 2018 and the comparative fiscal year 2017 financial statements and notes for the reestimate expense, the effects of the overstatement and understatement of $294 million is not presented in the financial statement notes.

[10] The restatements included $174 million related to salaries and administrative expenses, $233 million related to borrowing authority carried forward, $1.5 million related to Unfilled Customer Orders Without Advance, $7 million related to the LLR, and $46 million related to accrued interest for investments.

[11] FFB is a government corporation and an instrumentality of the United States under the general supervision and direction of the Secretary of the Treasury. FFB provides financing to help Federal agencies manage their borrowing and lending programs and to ensure that all Federal Government borrowing from the public is conducted through the Treasury and not through program agencies.

records a direct loan with the public as an asset on its balance sheet and, conversely, borrowing from FFB as a liability. The borrowing that FHA records requires it to also pay interest. FHA entered into an agreement with FFB, and FFB entered into agreements with the HFA and the HFA's custodian as part of the FFB Risk Share program. The HFA is required to pay principal and interest to FFB as determined in the approved payment schedule (Schedule 1-B). The approved Schedule 1-B lists the amounts of principal and interest to be paid at each payment date until the loan is fully repaid. FHA's direct loans outstanding had increased from just $14 million in 2014 to approximately $1.7 billion as of September 30, 2018. The amount of direct loans outstanding began to increase with the introduction of the FFB Risk Share program in 2015. FHA did not anticipate the rapid expansion of the program. FHA was in the process of awarding a contract to establish a subsidiary system to account for the loan level transactions, however, contract award protests have delayed the implementation of a system. As a result, it did not have a subsidiary ledger system in place to account for the loan-level transactions.

In 2017, FHA awarded a contract to service and account for FFB direct loans, however, due to the multiple protests related to the award, the contract was not ratified. FHA stated it is in the process of re-procuring this contract and will update the requirements for the new FFB subsidiary system as a result. The contract required the contractor to receive funds from FFB directly, ensure that the amounts had been paid according to the amortization schedule, and provide a separate category for the management and monitoring of the loans. The contract also required the contractor to include a system that interfaced with the general ledger, FHA Subsidiary Ledger, and Pay.gov (including the capability to upload to Treasury and download from Treasury). Although FHA awarded the contract, it had not been implemented.

Since FHA lacked a subsidiary ledger system, it used the monthly Treasury Governmentwide Accounting report to manually record the direct loan receivable and the related borrowing for the disbursed direct loan directly into the general ledger. The HFA is required to pay the principal and interest to FFB according to the preapproved payment schedule; however, FFB did not provide loan-level information regarding the principal or interest transactions on the direct loan or the related borrowing, instead FHA used the same Schedule 1-Bs, as those provided to FFB, to manually record the principal and interest amounts. FHA then used a summarized report from FFB to adjust the direct loan principal and interest balances directly in the general ledger. Reports that FHA received from FFB on the related borrowings were summarized either by fund or by the United States Government Standard General Ledger. When the accrued interest in FHA's general ledger, which was based on monthly FFB reports, did not match the quarterly FFB reports, FHA recorded a "true-up" journal entry to match the general ledger balance with FFB records, without understanding why the monthly and quarterly reports did not agree. FHA relied on FFB records since it did not have a subsidiary ledger system in place to determine the correct amount of accrued interest. FHA did not document comprehensive policies and procedures for accounting for all of the principal and interest on the direct loans and related borrowings and made entries to reflect the reports received.

Weaknesses in Processing of Recorded HECM Assignments

FHA had weaknesses in the processing of recorded HECM assignments. Specifically, there were processing delays for recorded assignments, and not all key dates were tracked on the assignment timeline. These conditions were attributed to (1) the increased volume of assignments, (2) the absence of a billing and sanctioning process to address servicers' delays in providing recorded

assignments, and (3) the design of the assignment timeline in the Home Equity Reverse Mortgage Information Technology (HERMIT) system.[12] As a result, there is a risk that recorded assignments may not have been properly recorded, and FHA was unable to determine the status of the assignments.

When the loan balance of reverse mortgages reaches 98 percent of the maximum claim amount, servicers are allowed to assign the mortgages to HUD. Servicers are required to send the assignments to the appropriate counties for recording and send the recorded assignments to FHA's loan servicing contractor. Once the loan servicing contractor receives the recorded assignments, the contractor reviews the assignments and issues final title approval if it determines that the assignments have been properly recorded. We identified two weaknesses in this process: (1) there were delays in the processing of recorded assignments, and (2) key dates were not tracked on the assignment timeline.

Delays in the processing of recorded assignments. As of September 2018, FHA had 2,594 mortgages in its loans receivable inventory that had been sent for recording from February 2014 to March 2018, but final title approval had not been issued.[13] The loans receivable balance for these 2,594 mortgages totaled $729 million. According to FHA, either (1) the loan-servicing contractor had not received the recorded assignments from the servicers, or (2) the loan-servicing contractor had received but had not yet reviewed the recorded assignments.

FHA attributed loan-servicing contractor delays in processing recorded assignments to an increase in recorded assignments. We believe the absence of a billing and sanctioning process may have contributed to the servicers' delay in providing recorded assignments in a timely manner.[14] According to the Office of Single Family Asset Management, servicers are notified monthly of their overdue assignments, but the Office had not taken additional action beyond this notification. In September 2018, the Office of Single Family Asset Management informed us that it was finalizing a process with OPE and the Office of General Counsel to add a billing and sanctioning process for servicers with overdue assignments.

The U.S. Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government, Principle 10, states that management should design control activities to achieve objectives and respond to risks. Because there were weaknesses in the processing of recorded assignments, there was a risk that mortgages in the loans receivable inventory may have not been properly recorded in HUD's name.

Key dates were not tracked on the assignment timeline. FHA tracks many key dates on the HERMIT system assignment timeline. However, FHA did not track other key dates on the assignment timeline, which could assist in tracking the status of an assignment, such as the date on which the servicer received the recorded assignment back from the counties' recorder of

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[12] HERMIT is the online system of record for HECMs.

[13] FHA's loan-servicing contractor issues final title approval when it receives the recorded assignments from the servicers and verifies that the assignments have been properly recorded in HUD's name.

[14] Mortgagee Letter 2017-05 states that lenders must forward the recorded assignment to the loan-servicing contractor once received but no later than 6 months after the claim has been paid. If the recorded assignment is not received within 6 months of claim payment, the lender will be responsible for reimbursing the agency for any costs incurred to obtain copies of the recorded assignment and will be referred to the appropriate office(s) for sanctioning.

deeds office and the date on which the servicer mailed the recorded assignments to the loan-servicing contractor. These dates were not included because the HERMIT assignment timeline was not designed to track all of the key dates between the time when the servicer sends the recorded assignment to the county for recording and the time when the loan-servicing contractor issues final title approval. As a result of not tracking the key dates on the HERMIT assignment timeline, FHA was unable to determine how many assignments had yet to be recorded and how many had been recorded but not yet received or reviewed by the loan-servicing contractor.

Incorrect Discount Period Assumption Used To Allocate the Liquidating Reestimate

FHA used the incorrect discount period assumption in allocating the liquidating reestimate in fiscal years 2017 and 2018. This error occurred because FHA's Office of Financial Analysis and Reporting (OFAR) relied on information provided by FHA's Office of Budget and Field Resources (OBFR) to determine the allocation between the subsidy reestimate and interest expense and OFAR incorrectly believed that OBFR used the same discount period assumption it intended to use for the reestimates. As a result, the interest expense on reestimates was overstated by $190 million, and the subsidy reestimate expense was understated by the same amount on the third quarter fiscal year 2018 financial statements. On the fiscal year 2017 financial statements, the interest expense on reestimates was understated by $294 million, and the subsidy reestimates expense was overstated by the same amount.

In June 2018, we found that for the fiscal years 2017 and 2018 liquidating reestimates, FHA used the incorrect discount period assumption in allocating the reestimate between the subsidy reestimate and interest expense on reestimates. In fiscal year 2017 and at the beginning of fiscal year 2018, FHA management decided that FHA should use the middle-of-year discount period for both the annual reestimates and the liquidating reestimates. However, FHA used the beginning-of-year discount period instead of the middle-of-year discount period for the liquidating reestimate in fiscal years 2017 and 2018. FHA used the intended discount period (middle-of-year) for the annual estimates.

GAO's Standards for Internal Control in the Federal Government states that management should design control activities to ensure that transactions are accurately recorded to maintain their relevance and value to management in controlling operations and making decisions. OFAR relied on information provided by OBFR to determine the liquidating reestimates for fiscal years 2017 and 2018 and incorrectly believed that the OBFR office used the same discount period assumption (middle-of-year) as that used for the annual reestimates. After we notified FHA that different discount period assumptions were used for the annual and liquidating reestimates, FHA met with the OBFR and learned that the budget office used the beginning-of-year discount period and not the middle-of-year discount period in fiscal years 2017 and 2018.

Because FHA used the beginning-of-year discount period instead of the middle-of-year discount period for the liquidating estimates as it had intended, the interest expense on reestimates was overstated by $190 million, and the subsidy reestimate expense was understated by the same amount on the third quarter fiscal year 2018 financial statements.[15] On the fiscal year 2017

[15] The gross costs note to the financial statements refers to interest expense on reestimates as interest expense and refers to the subsidy reestimate as the reestimate expense.

financial statements, the interest expense on reestimates was understated by $294 million, and the subsidy reestimates expense was overstated by the same amount.

In September 2018, FHA notified us that it planned to use the beginning-of-year discount period for the annual and liquidating reestimates instead of the middle-of-year discount period starting with this fiscal year. In addition, FHA informed us that it planned to combine the interest expense on reestimates and the subsidy reestimate expense on the notes to the financial statements starting in fiscal year 2018. Only the total reestimates amount will be shown on the financial statements. Combining the interest expense on reestimates and the subsidy reestimate expense does not change the total reestimates amount.

Ineffective Controls Over Calculating Salaries and Administrative Expenses

In 2018, FHA determined that the salaries and administrative expenses reported on the fiscal year 2017 statement of net cost (SNC) understated FHA's personnel-related costs by $31 million as a result of FHA's using an incomplete payroll report. In addition, FHA was informed that HUD's Office of the Chief Financial Officer (OCFO) provided FHA with an allocation of imputed, direct, and indirect salaries and expenses (S&E) costs, which was understated by $143 million as a result of a miscalculation and was also included in FHA's fiscal year 2017 salaries and administrative expenses reported on the SNC. To that end, FHA's total salaries and administrative expenses of $523 million reported on the fiscal year 2017 SNC were understated by $174 million.

FHA and HUD OCFO are responsible for the allocation of the Office of Housing's salaries and expenses. FHA must accurately report full cost on its financial statements in accordance with FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting. SFFAS No. 4 requires that transferred costs be accurately reported by program, activity, or output. FHA's funding activities are included in the Office of Housing section of the HUD's budget, and its salary and expense cost allocation accounting entries are calculated by HUD employees. Annually, FHA records a transfer in and expense for the Office of Housing's S&E costs to cover personnel costs, information technology expenditures, overhead expenses, OIG costs, and working Capital Fund costs. Personnel costs constitute most of the S&E.

Every 3 years, FHA conducts a cost allocation survey to estimate and determine the allocation of payroll-related expenditures for each of its major programs on its SNC.

Administrative and overhead costs (such as S&E or imputed costs) are reported separately and not allocated to specific FHA programs. FHA separates non-FHA activity costs from Office of Housing's personnel costs to accurately reflect administrative and overhead costs in FHA's SNC.

Annually, at fiscal yearend, FHA uses a payroll report to determine the total personnel-related costs for the year. Based upon the report, FHA will determine the direct personnel-related cost that will be charged to the FHA and non-FHA programs within the Office of Housing by applying the percentages from the cost allocation survey. FHA then provides HUD OCFO with a personnel report that separates the Office of Housing's FHA and non-FHA personnel costs. At fiscal yearend, HUD OCFO uses the personnel report from FHA to calculate other imputed, direct, and indirect S&E costs attributable to FHA activities and provides FHA with a

spreadsheet of its attributable costs. The total of the actual imputed, direct, and indirect S&E costs attributable to FHA, calculated by FHA and HUD OCFO, is reported in FHA's SNC.

FHA and HUD OCFO Did Not Have Adequate Controls To Ensure That the Calculations Were Accurate. FHA did not communicate to HUD OCFO that it used a payroll report outside HUD's general ledger system to determine FHA personnel costs. FHA and HUD OCFO did not have controls in place to ensure that FHA used complete and accurate yearend payroll information. FHA used an incomplete yearend payroll report to determine FHA's allocation of personnel, compensation, and benefits related costs for the year. HUD OCFO miscalculated FHA's portion of imputed, direct, and indirect S&E costs and provided the costs to FHA. FHA did not have a review process to ensure that S&E cost information obtained from HUD OCFO was accurate and complete. HUD OCFO had not provided an explanation for what caused the miscalculation that was provided to FHA.

Financial Statement Note Errors Not Prevented or Detected in a Timely Manner

FHA incorrectly reported several items in the fiscal year 2017 financial statement notes and failed to detect the errors until fiscal year 2018. FHA restated (1) Note 3 – Fund Balance with U.S. Treasury to correct the classification of $233 million in borrowing authority carried forward and $1.5 million related to unfilled customer orders without advance, as an unavailable resource instead of as an available resource, (2) Note 7 – Direct Loans and Loan Guarantees to correct reporting the LLR of $7 million as an LLR technical-default reestimate instead of LLR adjustments other, and (3) Note 5 – Investments to remove the inclusion of $46 million in accrued interest from the market value of investments. In addition, the interest accumulation expense was improperly calculated and reported in fiscal year 2017 by $13 million and as a result of the improper calculation of interest accumulation expense, interest expense was incorrectly reported by $6.5 million. We reported the error in the calculation of the interest accumulation expense in the fiscal year 2017 management letter. In fiscal year 2018, FHA provided new policies and procedures for calculating and recording interest accumulation expense and calculated and recorded the interest accumulation expense correctly. However, we identified that the interest accumulation expense of $10.8 million for the FFB program was improperly crosswalked and reported as other expenses instead of interest accumulation expense in the fiscal year 2018 financial statement notes.[16] While the U.S. Treasury provides crosswalks from general ledger accounts to financial statement line items, it does not provide crosswalks to financial statement notes. The errors occurred because FHA did not have adequate policies and procedures to ensure that it used accurate crosswalks to various financial statement note line items. The financial statement review process did not ensure that the general ledger accounts were crosswalked to the correct financial statement note line items. Although FHA detected the errors in fiscal year 2018, FHA's controls were not adequate to detect the errors before the preparation of the fiscal years 2017 and 2018 financial statements.

Current-Year Status of Prior-Year Audit Matters

Challenges with deobligating invalid obligations. As in fiscal year 2017, FHA continued to face challenges in deobligating invalid obligations in fiscal year 2018. While FHA reported that it

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[16] Restatements were not made to the interest accumulation and interest expenses in the fiscal year 2017 financial statement notes. The crosswalk of the $10.8 million was corrected before the issuance of the fiscal year 2018 financial statement notes.

had made significant progress in deobligating the invalid obligations identified during our fiscal years 2016 and 2017 audits, FHA's efforts to deobligate invalid obligations in a timely manner remained a challenge. Of the $399.1 million in invalid obligations identified in May and June of this fiscal year, FHA reported that only $169.5 million had been deobligated by the end of September 2018. Table 2 shows the remaining amount of funds that needs to be deobligated according to FHA.

Table 2. Status of deobligating invalid obligations (in millions)

Year	Amount to be deobligated	Amount deobligated as of fiscal year 2018	Remaining amount to be deobligated as of fiscal year 2018
Fiscal year 2016	$276.5	$266.1	$ 10.4
Fiscal year 2017	270.7	165.8	104.9
Fiscal year 2018	399.1	169.5	229.6

Discrepancies in the undelivered order balances for management and marketing contracts. In fiscal year 2016, we reported that FHA's individual contract undelivered order balances for single-family management and marketing contracts were not accurate on the report used for financial reporting.[17] There was a $2.3 million difference between the total undelivered order balance on the report used for financial reporting and the report that FHA identified as containing the correct balances. During our fiscal year 2017 audit, FHA reported that it had made significant progress in correcting the discrepancies on the report used for financial reporting and there was a difference of only about $138,000. At fiscal yearend 2018, FHA's documentation showed that the difference had decreased even further to about $31,000. We plan to review source documentation to verify the accuracy of the report used for financial reporting during our fiscal year 2019 audit.

Discrepancies identified in FHA systems loan endorsement amounts. In our fiscal year 2017 audit report, we reported that for the HECM and single-family forward programs, there were discrepancies in the current-year loan endorsement amounts between the systems that FHA used for financial reporting and CHUMS, which is the system where endorsements are initially recorded for these two loan programs. In fiscal year 2018, FHA began taking steps to identify discrepancies in the loan endorsements in its various systems. Since early fiscal year 2018, FHA has been performing reconciliations between CHUMS and the HERMIT system used to report the HECM loan endorsement amount in the financial statement notes. However, FHA only recently (August 2018) started performing reconciliations between CHUMS and the Single Family Insurance System for the single-family program. We did not test the control for the HECM or single-family program during our fiscal year 2018 audit because reconciliations were not fully implemented for both programs in fiscal year 2018. During our fiscal year 2019 audit, we will review FHA's reconciliations to determine the effectiveness of this control.

[17] The undelivered order balance is the difference between the obligated amount and the expenditure amount.

Conclusion

While efforts have been made to address the lack of a subsidiary system and the errors that were previously reported were restated, FHA should continue striving to improve its controls over financial reporting to minimize the risk of material misstatements in its financial reporting. Additionally, FHA should continue to implement the management decisions for the recommendations that remain open from prior-year findings.

Recommendations

We recommend that the Deputy Assistant Secretary for Finance and Budget

2A. Implement an automated subsidiary ledger system with the capability of obtaining loan-level transaction data from FHA, Treasury, and FFB source systems.

2B. Work with Treasury and FFB to receive monthly loan-level transaction reports.

2C. Identify the cause for the accrued interest differences and determine the correct accounting treatment.

2D. Establish policies and procedures for recording and accounting for manual transactions, including the accounting rationale for the principal and interest on the direct loans and accrued interest on the borrowings.

2E. Correct the error related to the allocation of the liquidating reestimates in fiscal years 2017 and 2018.

2F. Restate salary and administrative costs on FHA's fiscal year 2017 statement of net cost, statement of net position, and footnote disclosures.

2G. Require FHA and HUD OCFO to work together to determine a policy and procedure to ensure that both parties receive and provide complete information related to salaries and administrative costs.

2H. Establish and implement a review process for salary and administrative cost information that is received from HUD OCFO to ensure that the information is complete and accurate.

2I. Ensure that $399.1 million identified as invalid obligations in fiscal year 2018 is deobligated as appropriate.

2J. Document the rationale and policy for the crosswalks used to prepare the financial statement note line items.

2K. Document and implement policies and procedures, which include a review process to ensure that the general ledger accounts are correctly crosswalked to financial statement note line items.

2L. Restate the fiscal year 2017 financial statement notes to correct inaccurate classifications, expenses, and market value balances reported by FHA.

We recommend that the Director of the Office of Single Family Asset Management

2M. In conjunction with the loan-servicing contractor, determine what actions can be taken to ensure that recorded assignments are reviewed in a timely manner after receipt.

2N. Develop and implement a billing and sanctioning process to ensure that FHA bills servicers for the costs incurred to obtain recorded assignments from the counties' recorder's offices and sanctions the servicers when they do not provide the recorded assignments within 6 months of claim payment.

2O. Improve the tracking of recording assignments by modifying the HERMIT assignment timeline to include date fields for servicers' (1) receipt of recorded assignments from counties and (2) mailing of recorded assignments to the loan-servicing contractor.

Finding 3: FHA's Controls Related to Partial Claims Had Improved, but Weaknesses Remained

While FHA made progress on resolving unsupported partial claims in fiscal year 2018, it did not follow up with OPE to determine whether it should refer seriously noncompliant lenders to the MRB for temporary suspension or termination. These lenders did not provide required supporting documentation, did not reimburse FHA for the partial claim plus incentive fee, or did not reach a settlement in a timely manner. The cases remained unresolved an average of 591 days after the execution of the partial claim. FHA is no longer waiting until 6 months after execution of partial claims to begin requesting payment from lenders that do not provide the supporting promissory note, and it is sending requests for payments more frequently and on average, in a timely manner and in accordance with its newly implemented process. However, for lenders that have not sent the recorded mortgage within 6 months, letters requesting reimbursement in the amount of the partial claim plus the incentive fee were sent between 33 and 62 days after the expiration of the 6-month period and on average, 48 days after the expiration of the 6 month period. Failure to collect from noncompliant lenders with unsupported partial claims is a deficient cash management practice and does not help improve the health of the Mutual Mortgage Insurance fund.

FHA Had Made Considerable Improvement in Pursuing Partial Claim Promissory Notes

During the audit resolution process for fiscal year 2016, FHA management agreed in fiscal year 2017 to send notices for missing promissory notes 61 and 91 days after execution of the partial claim. It also agreed to send reimbursement letters for the amount of the claim plus the incentive fee 181 and 211 days after the execution of the partial claim if the lender had not provided the promissory note or recorded mortgage. FHA also changed its referral process for noncompliant lenders. If noncompliant lenders were not responsive to the letters sent, it would now refer the lenders to OPE instead of the MRB. OPE would then notify the Office of Single Family Housing if it did not receive the funds or documents, and the Office of Single Family Housing would then refer these noncompliant lenders to the MRB within 14 business days for temporary suspension or termination. FHA began this new process in May 2017 and, therefore, had not fully implemented the process at the close of the 2017 fiscal year.

The amount of partial claims not supported by second mortgage notes within 60 days after the date of execution has drastically decreased over the 5-year period as noted in table 3.

Table 3: Partial claims not supported by second mortgage notes 60 days after execution

Fiscal year ended	Number of partial claims not supported	Gross loans receivable balance
September 30, 2018	422	$10.7 million
September 30, 2017	695	8 million
September 30, 2016	2,798	76 million
September 30, 2015	12,057	376 million
September 30, 2014	57,164	1.5 billion

Policies and Procedures for Pursuing Partial Claim Promissory Notes Changed Over Time

In response to our fiscal year 2014 audit recommendations, FHA developed a number of policies and procedures and updated Mortgagee Letter 2015-18[18] with the goal of identifying partial claims with missing promissory notes beyond the prescribed submission period and appropriately billing noncompliant lenders for the amount of partial claims paid plus the incentive fee for failure to submit the required documentation to FHA. Based on FHA's policy under the Mortgagee Letter and the regulatory requirements, FHA is to send the first reimbursement letter to a noncompliant lender if the promissory note has not been provided within 60 days of partial claim execution. However, this process did not ensure that FHA sent a reimbursement letter until 6 months after execution of the partial claim.

As the issue continued to exist in fiscal year 2015, four causes were reported in our finding in the fiscal year 2015 audit report under Finding 1: Controls To Prevent Misclassification of the Receivables Had Not Been Fully Implemented. One cause related to the untimely document processing by FHA's loan-servicing contractor. The other three causes were related to the timely billing of and collection from noncompliant lenders.

In our review for fiscal year 2016, we determined that none of the four causes reported in the fiscal year 2015 audit report had been fully addressed. The cause that related to FHA's contractors' not processing documents in a timely manner continued to be a problem. FHA planned to resolve the issue in fiscal year 2017 by procuring three new contracts in place of a single contract. The other three causes related to billing and collection efforts toward noncompliant lenders also continued in fiscal year 2016. When testing the designed process in fiscal year 2016, we noted additional delays in implementation. We identified two factors that led to delays in collecting partial claims with missing documents. One factor was that FHA made changes to its billing and collection process during fiscal year 2016; therefore, the new process had not been fully implemented as of the end of fiscal year 2016. The other factor was

[18] Mortgagee Letter 2015-18 has been superseded by Housing Handbook 4000.1, FHA Single Family Housing Policy Handbook, which was effective September 30, 2016.

that FHA sent an extension letter to lenders at the request of the HUD Office of General Counsel and the FHA Commissioner following the issuance of the two reimbursement letters, which further delayed the process. Because of the delays embedded into the process, there was a need to strengthen controls to ensure timely referral for collection of loans receivable with missing promissory notes.

In our review for fiscal year 2017, FHA had begun billing noncompliant lenders between 2 and 59 days after the 60-day expiration period. Although FHA sent the letters relatively close to 30 days after the 61-day letters, the 91-day letters were sent between 24 and 71 days after the 90 days expired. Lastly, the 181-day letters sent to lenders that did not send the promissory note, payment, or recorded mortgage to FHA within 6 months were sent between 29 and 45 days after the expiration dates noted in the letter. Although it was requested, FHA did not provide evidence to show that it had fully implemented the new process and that it had sent the 211-day letters or referred noncompliant lenders to OPE under the new process.

While this was a marked improvement from waiting until 6 months after the expiration period, letters were not always immediately sent after the expiration period, as we had previously recommended, or in accordance with the new process implemented.

Policies and Procedures That More Closely Align With Regulatory Requirements Had Been Implemented

In fiscal year 2017, FHA improved its policies and procedures for the partial claim promissory note process. FHA implemented a process to send letters to lenders requesting reimbursement in the amount of the partial claim plus the incentive fee if the lenders had not provided to FHA (1) partial claim promissory notes within 60 days of executing the partial claim or (2) the recorded secondary mortgage within 6 months of executing the partial claim. FHA was to send these letters to noncompliant lenders at 61-, 91-, 181-, and 211-day intervals, and each letter specified that the lender had 30 days to send the missing information or remit payment. After the expiration of the 211-day letter, FHA would refer the lender to OPE within 14 business days if the lender did not provide the missing promissory note or recorded mortgage or if the lender failed to respond to the letter. If OPE was unable to obtain the funds or documents from the lender, it was to notify FHA, and FHA would refer the noncompliant lenders to the MRB within 14 business days for temporary suspension or termination.

In fiscal year 2018, we reviewed a total of 45 partial claim cases, which as of June 30, 2018, had been referred to OPE for either not providing FHA with partial claim promissory notes or the recorded secondary mortgage more than 30 days after the 211-day noncompliance letter. We reviewed 12 letters that were to be sent at the 61-day interval, noting that the letters requested payment in the amount of the claim plus the incentive fee and were sent on average, 31 days after the 60 days expired. We also reviewed letters at the 91-day, 181-day, and 211-day intervals. These letters were sent in a timely manner on average. However, we noted 3 of 15 181-day letters reviewed that were sent 114 days after the 91-day letter and 1 letter that was sent 117 days after the 91-day letter.

We also reviewed 37 of the 181-day interval letters sent to lenders that did not send the recorded mortgage or payment to FHA within 6 months. Of the 37 letters sent, 25 lenders had not received any previous letters from FHA requesting reimbursement, as they had sent their partial claim promissory note within 60 days of claim payment. The 25 initial letters requesting

reimbursement in the amount of the partial claim plus the incentive fee were sent between 33 and 62 days after the expiration of the 6 months and on average, 48 days after the expiration of the 6 months, which was not in a timely manner. We reviewed 37 of the 211-day letters sent to lenders that did not send the recorded mortgage or payment and determined that they were sent in a timely manner on average.

All 45 of the partial claim cases reviewed were referred to OPE. None of the 45 cases was referred to the MRB. We obtained the settlement status for 14 of the 45 cases. Of the 14 cases, settlement was pending for 9 cases. Of the nine cases, eight had been referred to OPE for more than 237 days, and one had been referred to OPE for more than 153 days as of September 30, 2018. The partial claims for those nine cases were executed between 530 and 632 days, with an average of 591 days, before September 30, 2018, and the lender still had not either sent the promissory note, recorded mortgage, or payment or reached a settlement. FHA reported that the remaining five cases sent either a settlement payment or the missing documentation.

Conclusion

FHA has experienced a significant decrease in noncompliant lenders. FHA is no longer waiting until 6 months after execution of partial claims to begin requesting payment from lenders that do not provide the supporting promissory note, and it is sending requests for payment more frequently and in a more timely manner on average. However, for lenders that have not sent the recorded mortgage within 6 months, letters requesting reimbursement in the amount of the partial claim plus the incentive fee were sent between 33 and 62 days after the expiration of the 6 months and on average, 48 days after the expiration of the 6 months. Additionally, resolution is taking more than 591 days on average for some noncompliant lenders, and FHA is not executing its option to refer lenders to the MRB.

Internal controls to rectify the weaknesses in FHA's controls related to claims, which were originally identified in fiscal year 2014, were fully implemented in fiscal year 2018. As of yearend 2018, 422 collectible partial claims with a total claim amount of $10.7 million were missing promissory notes at least 60 days after the partial claim was executed. Collecting the amounts for unsupported partial claims in a timely manner improves the status of the Mutual Mortgage Insurance fund by restoring funds paid out as loss mitigation claims.

Recommendations

We recommend that HUD's Associate General Counsel for Program Enforcement

3A. Establish a timeframe and process to notify the Office of Single Family Housing that funds or documents were not received so noncompliant lenders can be referred to the MRB within 14 business days for temporary suspension or termination and notify FHA of any noncompliant lenders accordingly.

Finding 4: Weaknesses Were Identified in Selected FHA Information Technology Systems

FHA had security vulnerabilities within the management of the CHUMS[19] application. These conditions occurred because of a lack of oversight. As a result, the confidentiality, integrity, and availability of critical information may have been negatively impacted. We also determined that weaknesses previously reported with selected FHA information systems and the credit reform estimation and reestimation process had not been fully remediated.

Interface Control Agreements for CHUMS Were Incomplete, and Security Documents Contained Inconsistent Information

FHA did not maintain complete and accurate information on the interfaces for the CHUMS application. Specifically, (1) one interface control agreement (ICA) document was not signed by both involved parties, and (2) CHUMS security documentation contained inconsistent information regarding the number of active CHUMS interfaces. The ICA was not signed because the system owner did not follow up with the office that the ICA was sent to for review and concurrence on the changes to the submitted documents. The inconsistencies in the reporting of active interfaces among the various security documents occurred because when changes were made to one source, the program office did not ensure that those changes were consistent among all of the other sources. If the interconnections between CHUMS and other applications are not properly defined, FHA has limited assurance that security controls will be in place and properly configured; the interconnection could expose FHA systems to access by unauthorized personnel; and the data that they store, process, or transmit could be compromised. Incomplete documentation could also lead to the insufficient protection of sensitive or critical resources. To be effective, the security documentation should be consistent and maintained to reflect current conditions, including interconnections. It should be periodically reviewed and if appropriate, updated and reissued to reflect changes due to factors, such as changes in entity mission or the types and configuration of computer resources in use. Revisions to policies, plans, or interconnected systems should be reviewed, approved, and documented in the relevant security documents.

Rules of Behavior Were Not in Place for External CHUMS Users

FHA did not establish and maintain rules of behavior for external[20] users of CHUMS. This condition occurred because before fiscal year 2014, the program office had no system security administrators or system compliance monitors for CHUMS. Although there is now a systems team in place addressing National Institute of Standards and Technology compliance requirements, this task had not been completed. The rules of behavior document is important as it describes the users' responsibilities with regard to the information and information system use. Not having rules of behavior in place or not requiring a user sign the rules of behavior to

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[19] CHUMS' mission is to support HUD employees, contractors, and external business partners with processing, underwriting, and quality control reviews of applications for single-family mortgage insurance. CHUMS is the primary system for operational information on all single-family mortgage insurance application and endorsement activity.

[20] External users are able to access the functionality of CHUMS only through FHA Connection.

acknowledge receipt and understanding of the rules in place could result in a user's misusing the information maintained within the system or the information system itself.

CHUMS Users Performed Security and Nonsecurity Functions Using the Same Identifier

CHUMS users with privileged access to security relevant functions also performed nonsecurity functions using the same user identifier. The user identifier is an identification number that is assigned to CHUMS users, which allows them to perform functions[21] within CHUMS. This condition occurred because FHA did not have a detailed process in place requiring the creation of a separate administrator ID for the staff assigned to perform privileged duties in accordance with HUD information technology security policy. Separation of duties addresses the potential for abuse of authorized privileges and helps to reduce the risk of malevolent activity without collusion. Least privilege limits exposure when operating from within privileged accounts or roles. Inadequately segregated duties increase the risk that erroneous or fraudulent transactions could be processed, that improper program changes could be implemented, and that computer resources could be damaged or destroyed. Misuse of privileged functions, either intentionally or unintentionally, by authorized users or by unauthorized external entities that have compromised information system accounts is a serious and ongoing concern and can have significant adverse impacts on organizations.

CHUMS Logging of Mainframe Processed Transactions Was Insufficient

FHA did not implement sufficient audit logging within CHUMS at the application level for transactions processed through the mainframe. Specifically, FHA (1) did not have adequate audit logs implemented until March 2018 and (2) did not develop policies and procedures for the regular review and maintenance of the audit logs produced. The lack of audit logs was initially identified during an authorization to operate (ATO) assessment[22] that occurred during fiscal year 2017. In March 2018, FHA completed actions to inherit the audit-logging capability from the Unisys mainframe. As a result of that action, CHUMS events are now included in the audit logs generated by the mainframe. However, FHA did not request or review the reports or logs that were produced using that capability until we requested the reports. This condition occurred because FHA took actions necessary to address a finding from the ATO assessor but failed to apply the management controls necessary to fully implement the change. Without timely and consistent review of the audit logs, FHA would be unable to reconstruct events if the system were compromised or a malfunction occurred or was suspected. In addition, FHA could not conduct reviews for indications of inappropriate or unusual activity.

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[21] This includes both nonsecurity and security functions, depending upon the user's role and need to access CHUMS. Nonsecurity functions include data entry related to single-family mortgage insurance applications and endorsement activity, ad hoc reporting requests, report transmission to homeownership centers, and overnight creation of output reports. Security functions include assigning, maintaining, and updating user access privileges and the ability to access all users' information.

[22] A review of the security and privacy controls within CHUMS to ensure the completeness and adequacy of CHUMS security and privacy documentation

Information System Control Weaknesses Previously Identified in Selected FHA Information Systems and the Credit Reform Estimation and Reestimation Process Were Being Addressed

In an audit we conducted in fiscal year 2017,[23] we identified instances in which controls over FHA's information systems did not fully comply with HUD information technology policies and Federal information system security and financial management requirements. FHA did not ensure adequate software maintenance support for its Asset Disposition and Management System. Specifically, the contractor used one software product that is no longer supported and two different versions of another software product. In addition, it did not properly maintain a list of the system components in the system security documentation. Lastly, the multifamily and single-family data sources for the credit reform estimation and reestimation were not properly protected.

We followed up on the status of these weaknesses during fiscal year 2018. HUD was addressing the weaknesses identified during the audit and implementing appropriate corrective actions. These actions are scheduled to be completed by January 31, 2019.

Information System Control Weaknesses Previously Identified in FHA's SFPCS-P and SAMS Systems Had Not Been Fully Remediated

In an audit we conducted in fiscal year 2016,[24] we found that the general and application controls over the Single Family Premiums Collection System - Periodic (SFPCS-P) and Single Family Acquired Asset Management System (SAMS) did not fully comply with Federal requirements and HUD's own security policies. SFPCS-P was classified as a low-impact instead of a moderate-impact system, and some software used by SFPCS-P was outdated. In addition, some interface reconciliations of the data between the source system and SFPCS-P and SAMS were insufficient, and SFPCS-P application release documents were not processed and maintained properly by the HUD Application Release Tracking System. We found that SFPCS-P had not participated in HUD's disaster recovery exercise for more than 4 years. Also, segregation of duties for SFPCS-P developers and least privilege and segregation of duties requirements for SAMS users were not fully implemented, and SFPCS-P security documents were inaccurate.

We followed up on the status of these weaknesses during fiscal year 2018. HUD was addressing the weaknesses identified during the audit and implementing appropriate corrective actions. These actions have not been fully remediated.

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[23] Audit Report 2018-DP-0002, Review of Information Systems Controls Over FHA, issued February 13, 2018. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

[24] Audit Report 2017-DP-0002, Review of Information Systems Controls Over FHA's Single Family Premiums Collection Subsystem – Periodic and the Single Family Acquired Asset Management System, issued February 9, 2017. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

Information System Control Weaknesses Previously Identified in FHA's SFIS and Claims Systems Had Not Been Fully Remediated

In an audit we conducted in fiscal year 2015,[25] we found that improvements were needed to ensure that information security controls over the Single Family Insurance System (SFIS) and the Single Family Insurance Claims Subsystem (Claims) fully complied with Federal requirements and HUD's own security policies. Some of the personally identifiable information retained in Claims' postmaintenance database files was not encrypted. In addition, five of nine vulnerabilities identified during the fiscal year 2015 vulnerability scan were identified during the fiscal year 2014 scan but had not been corrected. The remaining four vulnerabilities identified had remained uncorrected for longer than 90 days. In addition, SFIS had not implemented an effective application contingency planning practice. Further, the risk assessment prepared for SFIS did not accurately document whether SFIS was operating with an acceptable level of risk to information technology resources; information processed, stored, and transmitted in the application; and SFIS' connections to other systems.

An additional audit report[26] resulting from the fiscal year 2015 audit found that the general and application controls over SFIS and Claims did not fully comply with Federal requirements and HUD's own security policies. There were inconsistencies between soft error codes identified for claims submitted in May 2015 and the soft error code list maintained by FHA. In addition, for claims reported in the June 2015 suspense report, there were inconsistencies in 341 claims with errors in the initial case data and 2,018 claims with errors in the fiscal data of the application for single-family insurance benefits. The Office of the Chief Information Officer also did not retain the history of software modifications, including the related approvals, made throughout the development and life of the Claims system for more than 5 years. User access controls for SFIS and Claims were not adequately managed. SFIS and Claims management did not adequately implement effective application configuration management for the SFIS and Claims systems.

We followed up on the status of these weaknesses during fiscal year 2018. HUD was addressing the weaknesses identified during the audit and implementing appropriate corrective actions. These actions have not been fully remediated.

Conclusion

FHA must improve its information security controls over CHUMS to comply with Federal requirements and its own security policies to prevent an increased risk of unauthorized disclosure or modification of FHA system data.

Recommendations

Recommendations are included in a separate OIG audit report. Therefore, no recommendations are reported here.

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[25] Audit Report 2016-DP-0002, Review of Information System Controls Over SFIS and Claims, issued December 21, 2015. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

[26] Audit Report 2016-DP-0003, Additional Review of Information System Controls over FHA Information Systems, issued August 31, 2016. This was a limited distribution report because of the sensitive nature of the information reported and was not made available to the public.

Scope and Methodology

In accordance with the Chief Financial Officers Act of 1990, as amended, OIG is responsible for conducting the annual financial statement audit of FHA. The scope of this work includes the audit of FHA's balance sheets as of September 30, 2018 and 2017, and the related statements of net costs and changes in net position, the combined statements of budgetary resources for the years then ended, and the related notes to the financial statements. We conducted this audit in accordance with U.S. generally accepted government auditing standards and OMB Bulletin 19-01, Audit Requirements for Federal Financial Statements. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To fulfill these responsibilities, we

- Examined, on a test basis, evidence supporting the amounts and disclosures in the principal financial statements.
- Assessed the accounting principles used and the significant estimates made by management.
- Evaluated the overall presentation of the principal financial statements.
- Obtained an understanding of internal controls over financial reporting (including safeguarding assets) and compliance with laws and regulations (including the execution of transactions in accordance with budget authority).
- Tested and evaluated the design and operating effectiveness of relevant internal controls over significant cycles, classes of transactions, and account balances.
- Tested FHA's compliance with certain provisions of laws and regulations; governmentwide policies, noncompliance with which could have a direct and material effect on the determination of financial statement amounts; and certain other laws and regulations specified in OMB Bulletin 19-01, including the requirements referred to in the Federal Managers' Financial Integrity Act of 1982 (FMFIA).
- Considered compliance with the process required by FMFIA for evaluating and reporting on internal controls and accounting systems.
- Performed other procedures we considered necessary in the circumstances.

We considered internal controls over financial reporting by obtaining an understanding of the design of FHA's internal controls, determined whether these internal controls had been placed into operation, assessed control risk, and performed tests of controls to determine our auditing procedures for expressing our opinion on the principal financial statements. We also tested compliance with selected provisions of applicable laws, regulations, and government policies that may materially affect the principal financial statements.

With respect to internal controls related to performance measures to be reported in FHA's Fiscal Year 2018 Annual Management Report, we obtained an understanding of the design of significant internal controls as described in OMB Bulletin 19-01. We performed limited testing

procedures as required by the American Institute of Certified Public Accountants' auditing standards at AU-C, section 730, Required Supplementary Information, and OMB Bulletin 19-01. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We did not evaluate the internal controls relevant to operating objectives as broadly defined by FMFIA. We limited our internal controls testing to those controls that are material in relation to FHA's financial statements. Because of inherent limitations in any internal control structure, misstatements may occur and not be detected. We also caution that projection of any evaluation of the structure to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls over financial reporting that might be significant deficiencies. We noted certain matters in the internal control structure and its operation that we consider material weaknesses and significant deficiencies under OMB Bulletin 19-01.

Followup on Prior Audits

The current fiscal yearend status of open recommendations from prior-year reports on FHA's financial statements are provided below. Specifically, we identified 13 unimplemented recommendations from prior-year reports. FHA should continue to track these recommendations under the prior-year report numbers in accordance with departmental procedures. Each of these open recommendations and its status is shown below.

Federal Housing Administration Fiscal Years 2017 and 2016 Financial Statements Audit, 2018-FO-0003

With respect to FHA's not having effective model documentation, model governance, and modeling practices, we recommended that the Deputy Assistant for Finance and Budget

1.a. Establish and implement an effective quality control process to prevent or detect model processing errors cited in our report and prevent other similar model processing errors in the future. (Final action target date was August 31, 2018; reported in the Audit Resolution and Corrective Actions Tracking System (ARCATS) as 2018-FO-0003-001-A.)

1.b. Reevaluate FHA's existing model documentation for single-family, HECM, and multifamily models to determine whether their current state is acceptable, so that it provides the intended users a thorough understanding of how the model works and also allows new users to assume responsibility for the model's use (operational procedures). Based on this review, FHA should make adjustments as needed to the model documentation. At a minimum, these adjustments should include appropriate actions taken to address model documentation deficiencies cited in our report. (Final action target date was July 31, 2018; reported in ARCATS as 2018-FO-0003-001-B.)

1.c. Review FHA's existing model coding for single-family, HECM, and multifamily models and make necessary changes to make them consistent with industry's best practices in model coding. At a minimum, FHA should implement actions to address model coding deficiencies cited in our report. (Final action target date was July 31, 2018; reported in ARCATS as 2018-FO-0003-001-C.)

1.d. Establish and implement policies and procedures for assessing and monitoring the reliability of the work performed by FHA's modeling contractors. (Final action target date was August 31, 2018; reported in ARCATS as 2018-FO-0003-001-D.)

1.e. Revisit the model's ability to predict future performance of the single-family portfolio, based on our concerns expressed in this report regarding relationships of certain variables (such as loan-to-value ratio and FICO scores to prepayment) that are not consistent with our expectations. FHA should provide us an analysis to support its position if it believes that a model design change is not warranted. (Final action target date was July 31, 2018; reported in ARCATS as 2018-FO-0003-001-E.)

With respect to FHA's not having effective monitoring and processing controls over its unliquidated obligation balances, recording subsidy expense in a timely manner, and using inaccurate data to report on its loan guarantees, we recommended that the Deputy Assistant for Finance and Budget

1.f. Ensure that the $270.7 million identified as invalid obligations in fiscal year 2017 is deobligated as appropriate. (Final action target date was August 31, 2018; reported in ARCATS as 2018-FO-0003-002-A.)

1.g. Develop and implement a reconciliation process to ensure that the information in various systems is consistent for all accounting events. (Final action target date was September 30, 2018; reported in ARCATS as 2018-FO-0003-002-C, closed November 2, 2018.)

1.h. Develop and implement policies, procedures, and controls to ensure that the reported current-year endorsements in HERMIT and SFHEDW [Single Family Housing Enterprise Data Warehouse] agree with the current-year endorsements in CHUMS. (Final action target date was September 30, 2018; reported in ARCATS as 2018-FO-0003-002-F.)

Federal Housing Administration Fiscal Years 2016 and 2015 Financial Statements Audit, 2017-FO-0002

With respect to FHA's not having effective monitoring and processing controls over its unliquidated obligation balances and using inaccurate data to report on its undelivered orders, we recommended that the Acting FHA Comptroller

2.a. Establish and implement policies and procedures to ensure that accurate data are used to report the undelivered order balances for management and marketing contracts. (Final action target date was November 30, 2017; reported in ARCATS as 2017-FO-0002-002-C.)

2.b. Ensure that the $276.5 million identified as invalid obligations in fiscal years 2015 and 2016 are deobligated as appropriate. (Final action target date was November 30, 2017; reported in ARCATS as 2017-FO-0002-002-D.)

With respect to FHA's not fully implementing controls to collect the amounts for unsupported partial claims, we recommended that the Office of Single Family Housing

2.c. Request payment in the amount of the claims paid, plus incentive, from mortgagees that have not provided the original note within the prescribed deadline for the $55.3 million. (Final action target date was June 20, 2018; reported in ARCATS as 2017-FO-0002-003-C.)

Federal Housing Administration Fiscal Years 2015 and 2014 Financial Statements Audit, 2016-FO-0002

With respect to FHA's not fully implementing controls to prevent misclassification of the receivables, we recommended that the Office of Single Family Housing

3.a. Start the billing process for the claims paid, plus incentive, in which the lender has not provided the original note and security instrument within the prescribed deadlines for the

$291 million. (Final action target date was November 30, 2016; reported in ARCATS as 2016-FO-0002-001-C.)

Federal Housing Administration Fiscal Years 2014 and 2013 Financial Statements Audit, 2015-FO-0001

With respect to FHA's not establishing appropriate receivables for legal settlements and partial claims notes, we recommended that the Director of Single Family Asset Management

4.a. Initiate the billing process for the claims paid, plus incentive, where the lender has not provided the original of the note and security instrument within the prescribed deadlines for the $1.5 billion. (Final action target date was October 31, 2015; reported in ARCATS as 2015-FO-0001-001-F.)

Appendixes

Appendix A

Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
2.I.	$399,090,727
Totals	**399,090,727**

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

OFFICE OF HOUSING

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

November 14, 2018

MEMORANDUM FOR: Thomas R. McEnanly, Director, Financial Audits Division, GAF

FROM: Susan A. Betts, Housing, Deputy Assistant Secretary for Finance and Budget, HW

SUBJECT: Response to Fiscal Years 2018 and 2017 (Restated) Financial Statements Audit

Thank you for providing us with the opportunity to respond to FHA's Independent Auditor's Report.

We appreciate that the OIG is committed to FHA's mission, and is working to help provide us with actionable recommendations. FHA is committed to making the changes necessary to strengthen controls. This is a priority for FHA and the entire team is engaging to undertake these efforts. Working collaboratively with OIG, FHA will continue to identify and implement changes needed to address the internal control findings identified.

Report on Internal Control

Finding 1: Weaknesses Continued in FHA's Modeling Processes

Comment 1

FHA is committed to the principle of constant improvement over FHA's modeling processes. The Fiscal Year (FY) 2017 audit report made important observations about the need to improve the quality control of out modeling processes. We appreciate those findings. While we continue to improve, we believe the audit deliverables we provided this year evidence strong improvement.

During FY 2018, FHA and its contractors made enormous efforts to improve oversight and quality control procedures. These efforts include:

1. A complete re-drafting of the "FHA Oversight and Quality Control of the Single-Family Forward/HECM Liability for Loan Guarantees Models" oversight governance document to include specific principles and practices.
2. The contractor's development of a comprehensive quality control plan that includes 38 distinct controls, the documentation alone of which covers 38 pages.
3. The execution of these controls results in over 500 pages of diagnostic output.
4. A comprehensive re-coding of the statistical scripts to implement 23 model coding best practices. This is documented in flow charts and side-by-side comparisons totaling 125

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Ref to OIG Evaluation

Auditee Comments

pages. FHA reviewed these changes in detail for over 11 hours during code review with its contractors.

5. Numerous enhancements to model documentation including user guide changes to support easy replication of results.

Based on the above, we believe that the material weakness was remediated.

We would like to address the primary deficiency identified in this audit finding, which concerns the FHA-identified and corrected issue of the $1.7 billion in FY 2017 Return on Assets discounting. The FHA Audit Report states that "Although FHA credits its internal controls with detecting the error, FHA's controls were not effective enough to detect the error prior to the preparation of the FY 2017 financial statements." While true that formulation and review by all responsible entities during the FY 2017 audit cycle did not prevent this error, FHA's detection and correction of this error in FY 2018 is strong evidence of FHA's oversight abilities *in FY 2018 and FHA's improvements in this area from FY 2017 practices*. Nonetheless, we will continue to address this matter through enhanced diagnostic methods.

While we value the OIG's feedback, we have several concerns with the methodologies the OIG used. For some findings we believe there is a misunderstanding of how FHA program terms are applied in our models. For other findings (lack of documentation for policy changes and documentation not sufficient for external replication), we believe we provided evidence to support our position.

We would welcome the opportunity to meet with your office to detail our concerns with the findings identified.

Comment 2

Finding 2: FHA's Controls Over Financial Reporting Had Weaknesses

FHA has already implemented several of the recommendations identified in the finding relating to FHA's controls over financial reporting had weaknesses and will continue to complete the implementation of remaining recommendations in FY 2019.

As recommended by the OIG, FHA will focus on improved controls surrounding the Federal Financing Bank program in the coming year. In addition, FHA continues to make progress deobligating the invalid obligations identified. As part of the resolution process, FHA will collaborate with our partners, including the Chief Procurement Office, whom we are dependent upon to resolve this recommendation.

Regarding the OIG's concerns surrounding the processing of recorded HECM assignments, FHA has implemented process improvements to ensure that all recorded assignments are reviewed timely after receipt. Further, FHA is implementing a plan to obtain recorded assignments from county recorders' offices and bill servicers for the associated costs and working on a modification to its HERMIT systems to improve date tracking.

Ref to OIG Evaluation	Auditee Comments
Comment 3	**Finding 3: FHA's Controls Related to Partial Claims Had Improved, but Weaknesses Remain** FHA has made and will continue to make further changes to strengthen controls related to partial claims. The Office of Single Family Asset Management is working to establish a time frame and process for notification to the Office of Single Family Housing when cases are not resolved. Strengthened partial claim controls have generated case referrals to the Office of Program Enforcement providing resolution without the need to utilize the Mortgagee Review Board process for resolution.
Comment 4	**Finding 4: Weaknesses Were Identified in Selected FHA Information Technology Systems** FHA is working to address the OIG's recommendations relating to the CHUMS system, several of which have been addressed. FHA will continue to support the OCIO's office to resolve current and prior year recommendations.

OIG Evaluation of Auditee Comments

Comment 1 OIG accepts the response of concurrence with the recommendations. FHA's continued efforts in improving its controls over the modeling process will improve the reliability of the estimation process and reliability of financial information related to the loan guarantee liability. OIG looks forward to working with FHA to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process.

Comment 2 OIG accepts the response of concurrence with the recommendations. FHA should continue their efforts to improve their internal controls over financial reporting in order to improve the reliability of the financial statements. OIG looks forward to working with FHA to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process.

Comment 3 OIG accepts the response of concurrence with the recommendations. FHA's continued efforts to strengthen partial claim controls will continue to improve the status of the MMI fund. OIG looks forward to working with FHA to reach a mutually acceptable management decision to close out the recommendations during the audit resolution process.

Comment 4 OIG looks forward to working with FHA to reach mutually acceptable management decisions during the audit resolution process to resolve the current recommendations. OIG also looks forward to the closure of the prior year recommendations.

Appendix C

FHA's Fiscal Years 2018 and 2017 Financial Statements and Notes

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED BALANCE SHEETS
As of September 30, 2018, and 2017
(Dollars in Millions)

	FY 2018	Restated FY 2017
ASSETS		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 33,690	$ 29,112
Investments (Note 5)	26,697	30,841
Total Intragovernmental	$ 60,387	$ 59,953
Cash and Other Monetary Assets (Note 4)	$ 34	40
Investments (Note 5)	$ 8	44
Accounts Receivable, Net (Note 6)	137	220
Loans Receivable and Related Foreclosed Property, Net (Note 7)	26,059	20,515
TOTAL ASSETS	**$ 86,625**	**$ 80,772**
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 8)	$ 2	$ 2
Borrowings (Note 9)	26,379	29,141
Other Liabilities (Note 10)	2,787	1,734
Total Intragovernmental	$ 29,168	$ 30,877
Accounts Payable (Note 8)	$ 555	$ 514
Loan Guarantee Liability (Note 7)	19,107	20,616
Other Liabilities (Note 10)	582	636
TOTAL LIABILITIES	**$ 49,412**	**$ 52,643**
NET POSITION		
Unexpended Appropriations (Note 16)	$ 463	$ 459
Cumulative Results of Operations	36,750	27,670
TOTAL NET POSITION	**$ 37,213**	**$ 28,129**
TOTAL LIABILITIES AND NET POSITION	**$ 86,625**	**$ 80,772**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET COST
For the Periods Ended September 30, 2018, and 2017
(Dollars in Millions)

		FY 2018		Restated FY 2017
Single Family Forward				
Intragovernmental Gross Costs	$	671	$	765
Less: Intragovernmental Earned Revenue		1,177		805
Intragovernmental Net Costs	$	(506)	$	(40)
Gross Costs With the Public	$	(6,958)	$	(919)
Less: Earned Revenues		7		10
Net Costs With the Public	$	(6,965)	$	(929)
Single Family Forward Net Cost (Surplus)	$	(7,471)	$	(969)
HECM				
Intragovernmental Gross Costs	$	264	$	235
Less: Intragovernmental Earned Revenue		724		830
Intragovernmental Net Costs	$	(460)	$	(595)
Gross Costs With the Public	$	(986)	$	20,211
Less: Earned Revenues		-		-
Net Costs With the Public	$	(986)	$	20,211
HECM Net Cost (Surplus)	$	(1,446)	$	19,616
Multifamily				
Intragovernmental Gross Costs	$	146	$	114
Less: Intragovernmental Earned Revenue		29		23
Intragovernmental Net Costs	$	117	$	91
Gross Costs With the Public	$	(536)	$	(1,512)
Less: Earned Revenues		133		67
Net Costs With the Public	$	(669)	$	(1,579)
Multifamily Net Cost (Surplus)	$	(552)	$	(1,488)
Healthcare				
Intragovernmental Gross Costs	$	43	$	40
Less: Intragovernmental Earned Revenue		10		16
Intragovernmental Net Costs	$	33	$	24
Gross Costs With the Public	$	(91)	$	(322)
Less: Earned Revenues	$	-	$	1
Net Costs With the Public	$	(91)	$	(323)
Healthcare Net Cost (Surplus)	$	(58)	$	(299)
Salaries and Administrative Expenses				
Intragovernmental Gross Costs	$	174	$	101
Less: Intragovernmental Earned Revenue		-		-
Intragovernmental Net Costs	$	174	$	101
Gross Costs With the Public	$	566	$	623
Less: Earned Revenues		-		-
Net Costs With the Public	$	566	$	623
Adminstrative and Contracts Net Cost (Surplus)	$	740	$	724
Net Cost of Operations	**$**	**(8,787)**	**$**	**17,584**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
CONSOLIDATED STATEMENTS OF NET POSITION
For the Periods Ended September 30, 2018, and 2017
(Dollars in Millions)

	2018	Restated 2017
Unexpended Appropriations (Note 17)		
Collections	459	415
Budgetary Financing Sources:		
Appropriations Received	2,078	4,473
Other Adjustments (Recissions, etc)	(39)	-
Appropriations Used	(2,035)	(4,429)
Total Budgetary Financing Sources	4	44
Total Unexpended Appropriations	463	459
Cumulative Results of Operations (Note 17)		
Beginning Balance	**$ 27,670**	**$ 40,682**
Beginning Balance, As Adjusted	**$ 27,670**	**$ 40,682**
Budgetary Financing Sources:		
Appropriations Used	2,035	4,429
NonExchange Revenue	-	2
Other Financing Sources (Nonexchange):		
Transfers In/Out Without Reimbursement	611	600
Imputed Financing From Costs	18	13
Other	(2,373)	(473)
Total Financing Sources	291	4,571
Net Cost of Operations	8,787	(17,584)
Net Change	9,080	(13,012)
Cummulative Results of Operation	36,750	27,670
Net Position	**$ 37,213**	**$ 28,129**

The accompanying notes are an integral part of these statements.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2018
(Dollars in Millions)

	FY 2018 Budgetary	FY 2018 Non-Budgetary	FY 2018 Total
Budgetary Resources:			
Unobligated balance from prior year budget authority, net	$ 31,750	$ 25,255	$ 57,005
Appropriations (discretionary and mandatory)	2,078	-	2,078
Borrowing authority (discretionary and mandatory)	-	8,204	8,204
Spending authority from offsetting collections (discretionary and mandatory)	8,157	23,677	31,834
Total budgetary resources	**$ 41,985**	**$ 57,136**	**$ 99,121**
Memorandum (non-add) entries:			
Net Adjustments to unobligated balance brought forward, Oct. 1	$ (137)	$ 463	326
Status of Budgetary Resources:			
Obligations incurred	14,753	27,357	42,110
Unobligated balance, end of year:			
Apportioned	57	10,486	10,543
Unapportioned	27,140	19,293	46,433
Unexpired unobligated balance, end of year	27,198	29,779	56,977
Expired unobligated balance, end of year	34	-	34
Total unobligated balance, end of year	27,232	29,779	57,011
Total budgetary resources	**$ 41,985**	**$ 57,136**	**$ 99,121**
Budget Authority and Outlays, Net:			
Outlays, net (discretionary and mandatory)	$ 6,499	$ (7,665)	$ (1,166)
Less Distributed offsetting receipts (-)	(1,183)	-	(1,183)
Agency outlays, net (discretionary and mandatory)	**$ 5,316**	**$ (7,665)**	**$ (2,349)**

The accompanying notes are an integral part of these statements

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
COMBINED STATEMENT OF BUDGETARY RESOURCES
For the Period Ended September 30, 2017
(Dollars in Millions)

	FY 2017 Budgetary	FY 2017 Non-Budgetary	FY 2017 Total
Budgetary Resources:			
Unobligated balance from prior year budget authority, net	$ 37,343	$ 16,727	54,070
Appropriations (discretionary and mandatory)	4,473	-	4,473
Borrowing authority (discretionary and mandatory)	-	8,376	8,376
Contract authority (discretionary and mandatory)	-	-	-
Spending authority from offsetting collections (discretionary and mandatory)	13,289	34,665	47,954
Total budgetary resources	**$ 55,105**	**$ 59,768**	**$ 114,873**
Memorandum (non-add) entries:			
Net Adjustments to unobligated balance brought forward, Oct. 1	$ (415)	$ 316	(99)
Status of Budgetary Resources:			
Obligations incurred	23,217	34,975	58,192
Unobligated balance, end of year:			
Apportioned	69	6,272	6,341
Exempt from apportionment	-	-	-
Unapportioned	31,761	18,521	50,282
Unexpired unobligated balance, end of year	31,830	24,793	56,623
Expired unobligated balance, end of year	58	-	58
Total unobligated balance, end of year	31,888	24,793	56,681
Total budgetary resources	**$ 55,105**	**$ 59,768**	**$ 114,873**
Budget Authority and Outlays, Net:			
Outlays, net (discretionary and mandatory)	$ 9,885	$ (10,288)	(403)
Less Distributed offsetting receipts (-)	(1,078)	-	(1,078)
Agency outlays, net (discretionary and mandatory)	**$ 8,807**	**$ (10,288)**	**$ (1,481)**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS
September 30, 2018

Note 1. Significant Accounting Policies

Entity and Mission

The Federal Housing Administration (FHA) was established under the National Housing Act of 1934 and became a wholly owned government corporation in 1948 subject to the Government Corporation Control Act (31 U.S.C. § 9101 et seq.), as amended. While FHA was established as a separate federal entity, it was subsequently merged into the Department of Housing and Urban Development (HUD), when that department was created in 1965. FHA does not maintain a separate staff or facilities; its operations are conducted, along with other Housing activities, by HUD organizations. FHA is headed by HUD's Assistant Secretary for Housing/Federal Housing Commissioner, who reports to the Secretary of HUD.

FHA administers a wide range of activities to make mortgage financing more accessible to the home-buying public and to increase the availability of affordable housing to families and individuals, particularly to the nation's poor and disadvantaged. FHA insures private lenders against loss on mortgages, which finance single family homes, multifamily projects, healthcare facilities, property improvements, manufactured homes, and reverse mortgages, also referred to as Home Equity Conversion Mortgages (HECM). The objectives of activities carried out by FHA relate directly to the development of affordable housing.

FHA categorizes its insurance programs as Single Family (including Title 1), Multifamily, Healthcare, and HECM. Single Family activities support initial or continued home ownership; Title I activities support manufactured housing and property improvement. Multifamily and Healthcare activities support high-density housing and medical facilities. HECM activities support reverse mortgages, which allow homeowners 62 years of age or older to convert the equity in their homes into lump sum or monthly cash payments without having to repay the loan until the loan terminates.

FHA supports its insurance operations through five funds. The Mutual Mortgage Insurance fund (MMI), FHA's largest fund, provides basic Single Family mortgage insurance and is a mutual insurance fund, whereby mortgagors, upon non-claim termination of their mortgages, share surplus premiums paid into the MMI fund that are not required for operating expenses and losses or to build equity. The Cooperative Management Housing Insurance fund (CMHI), another mutual fund, provides mortgage insurance for management-type cooperatives. The General Insurance fund (GI), provides a large number of specialized mortgage insurance activities, including insurance of loans for property improvements, cooperatives, condominiums, housing for the elderly, land development, group practice medical facilities, nonprofit hospitals, and reverse mortgages. The Special Risk Insurance fund (SRI) provides mortgage insurance on behalf of mortgagors eligible for interest reduction payments who otherwise would not be eligible for mortgage insurance. To comply with the FHA Modernization Act of 2008, activities related to most Single Family programs, including HECM, endorsed in Fiscal Year 2009 and going forward, are in the MMI fund. The Single Family activities in the GI fund from Fiscal Year 2008 and prior remain in the GI fund. The Hope for Homeowners (H4H) program began on October 1, 2008 for Fiscal Year 2009 as a result of *The Housing and Economic Recovery Act of 2008*. This legislation required FHA to modify existing programs and initiated the H4H program and fund, which guaranteed loans for three years. No new H4H loans have been guaranteed since FY 2011.

For the Loan Guarantee Program at FHA, there are Single Family and Multifamily activities in both the MMI/CMHI and GI/SRI funds. The H4H fund only contains Single Family activity.

The following table illustrates how the primary Single Family program activities for FHA are now distributed between MMI/CMHI and GI/SRI funds based on the year of endorsement:

Fund	Loans Endorsed in Fiscal Years 2008 and Prior	Loans Endorsed in Fiscal Years 2009 and Onward
GI/SRI	234(c), HECM	N/A
MMI	203(b)	203(b), 234(c), HECM

In fiscal year 2010, FHA received appropriations for the Energy Innovation and Transformation Initiative programs. The Energy Innovation program is intended to catalyze innovations in the residential energy efficiency sector that have the ability to be replicated and to help create a standardized home energy efficient retrofit market. The appropriation for the Transformation Initiative was for combating mortgage fraud.

Basis of Accounting

The principal financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to federal agencies, as promulgated by the Federal Accounting Standards Advisory Board (FASAB). The recognition and measurement of budgetary resources and their status for purposes of preparing the Combined Statement of Budgetary Resources (SBR), is based on concepts and guidance provided by the Office of Management and Budget (OMB) Circular A-11, *Preparation, Submission, and Execution of the Budget* and the Federal Credit Reform Act of 1990. The format of the SBR is based on the SF 133, *Report on Budget Execution and Budgetary Resources*.

Basis of Consolidation

The accompanying principal financial statements include all Treasury Account Fund Symbols (TAFSs) designated to FHA, which consist of principal program funds, revolving funds, general funds and a deposit fund. All inter-fund accounts receivable, accounts payable, transfers in and transfers out within these TAFSs have been eliminated to prepare the consolidated balance sheet, statement of net cost, and statements of changes in net position. The SBR is prepared on a combined basis as required by OMB Circular A-136, *Financial Reporting Requirements, Revised*.

Fund Balance with U.S. Treasury

Fund balance with U.S. Treasury consists of amounts collected from premiums, interest earned from Treasury, recoveries and appropriations. The balance is available to fund payments for claims, property and operating expenses and of amounts collected but unavailable until authorizing legislation is enacted (see Notes 2 and 3).

Investments

FHA investments include investments in U.S. Treasury securities and Multifamily Risk Sharing debentures. Under current legislation, FHA invests available MMI/CMHI capital reserve fund resources, in excess of its current needs, in non-marketable market-based U.S. Treasury securities. These U.S. Treasury securities may not be sold on public securities exchanges, but do reflect prices and interest rates of similar marketable U.S. Treasury securities. Investments are presented at acquisition cost net of the amortized premium or discount. Amortization of the premium or discount is recognized monthly on investments in U.S. Treasury securities using the interest method in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 *Accounting for Selected Assets and Liabilities*, paragraph 71.

Multifamily Risk Sharing Debentures [Section 542(c)] is a program available to lenders where the lender shares the risk in a property by issuing debentures for the claim amount paid by FHA on defaulted insured loans. In FY 2017,

FHA reported Securities Held Outside of Treasury, marketable stock, received as part of a settlement and held outside of the U.S. Treasury by a broker authorized by the Treasury. The stocks were liquidated this fiscal year.

Credit Reform Accounting

The Federal Credit Reform Act (FCRA) established the use of program, financing, general fund receipt and capital reserve accounts to separately account for transactions that are not controlled by the Congressional budget process. It also established the liquidating account for activity relating to any loan guarantees committed and direct loans obligated before October 1, 1991 (pre-Credit Reform). These accounts are classified as either Budgetary or Non-Budgetary in the Combined Statement of Budgetary Resources. The Budgetary accounts include the program, capital reserve and liquidating accounts. The Non-Budgetary accounts consist of the credit reform financing accounts.

In accordance with the SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees,* the program account receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. The program account also receives appropriations for administrative expenses. The financing account is a Non-Budgetary account that is used to record all the cash flows resulting from Credit Reform direct loans, assigned loans, loan guarantees and related foreclosed property. It includes loan disbursements, loan repayments and fees, claim payments, recoveries on sold collateral, borrowing from the U.S. Treasury, interest, negative subsidy and the subsidy cost received from the program account.

FHA has two general fund receipt accounts. FHA's receipt accounts are general fund receipt accounts and these amounts are not earmarked for the FHA's credit programs. The first is used for the receipt of amounts paid from the GI/SRI financing account when there is negative subsidy from the original estimate or a downward reestimate. They are available for appropriations only in the sense that all general fund receipts are available for appropriations. Any assets in these accounts are non-entity assets and are offset by intragovernmental liabilities. At the end of the fiscal year, the fund balance in this general fund receipt account is transferred to the U.S. Treasury general fund.

The second general fund receipt account is used for the unobligated balance transferred from GI/SRI liquidating account and loan modifications. Similar to the general fund receipt account used for the GI/SRI negative subsidy and downward reestimates, the amounts in this account are not earmarked for FHA's credit programs and are returned to Treasury at the end of the fiscal year. Any assets in this account are non-entity assets and are offset by intragovernmental liabilities.

Negative subsidy and downward reestimates in the MMI/CMHI fund are transferred to the Capital Reserve account. Capital Reserve balances are accumulated for unanticipated losses.

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

Loans Receivable and Related Foreclosed Property, Net

FHA's loan receivables includes mortgage notes assigned (MNA), also described as Secretary-held notes, purchase money mortgages (PMM), notes related to partial claims, and direct loans relating to the Federal Financing Bank Risk Share program. Under the requirements of the FCRA, PMM notes are considered to be direct loans while

MNA notes are considered to be defaulted guaranteed loans. The PMM loans are generated from the sales on credit of FHA's foreclosed properties to qualified non-profit organizations. The MNA notes are created when FHA pays the lenders for claims on defaulted guaranteed loans and takes assignment of the defaulted loans for direct collections. The majority of MNAs are HECM notes. HECM loans, while not in default, are assigned to HUD when they reach 98% of their maximum claim amount. In addition, Multifamily and Single Family performing notes insured pursuant to Section 221(g)(4) of the National Housing Act may be assigned automatically to FHA at a pre-determined point. Partial claims notes arise when FHA pays a loss mitigation amount to keep a borrower current on their loan. FHA, in turn, records a loan receivable which takes a second position to the primary mortgage.

In accordance with the FCRA and SFFAS No. 2, Credit Reform direct loans, defaulted guaranteed loans and related foreclosed property are reported at the net present value of expected cash flows associated with these assets, primarily from estimated proceeds less selling and maintenance costs. The difference between the cost of these loans and property and the net present value is called the Allowance for Subsidy. Pre-Credit Reform loans receivable and related foreclosed property in inventory are recorded at net realizable value which is based on recovery rates net of any selling expenses (see Note 7).

Loan Guarantee Liability

The net potential future losses related to FHA's central business of providing mortgage insurance are reflected in the Loan Guarantee Liability in the consolidated balance sheet. As required by SFFAS No. 2, the Loan Guarantee Liability includes the Credit Reform-related Liabilities for Loan Guarantees (LLG) and the pre-Credit Reform Loan Loss Reserve (LLR) (see Note 7).

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

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

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

Use of Estimates

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

Amounts reported for net loans receivable and related foreclosed property and the Loan Guarantee Liability represent FHA's best estimates based on pertinent information available.

To estimate the Allowance for Subsidy associated with loan receivables and related foreclosed property, and the Liability for Loan Guarantees (LLG), FHA uses cash flow model assumptions associated with loan guarantee cases subject to the Federal Credit Reform Act of 1990 (FCRA), as described in Note 7, to estimate the cash flows associated with future loan performance. To make reasonable projections of future loan performance, FHA develops assumptions, as described in Note 7, based on historical data, current and forecasted program and economic assumptions.

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

General Property, Plant and Equipment

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

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

Appropriations

FHA receives appropriations for certain operating expenses for its program activities. Additionally, FHA receives appropriations for GI/SRI positive subsidy, upward reestimates, and permanent indefinite authority to cover any shortage of resources in the liquidating account.

Full Cost Reporting

SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards* and SFFAS No. 55, *Amending Inter-Entity Cost Provisions* to account for costs assumed by other Federal organizations on their behalf, require that Federal agencies report the full cost of program outputs in the financial statements. Full cost reporting includes all direct, indirect, and inter-entity costs. HUD allocates each responsibility segment's share of the program costs or resources provided by other federal agencies. As a responsibility segment of HUD, FHA's portion of these costs was $18 million for fiscal year 2018 and $13 million for fiscal year 2017, and it was included in FHA's financial statements as an imputed cost in the Consolidated Statement of Net Cost, and as imputed financing in the Consolidated Statement of Changes in Net Position.

Distributive Shares

As mutual funds, excess revenues in the MMI/CMHI Fund may be distributed to mortgagors at the discretion of the Secretary of HUD. Such distributions are determined based on the funds' financial positions and their projected revenues and costs. No distributive share distributions have been declared from the MMI fund since the enactment of the National Affordable Housing Act (NAHA) in 1990.

Liabilities Covered by Budgetary Resources

Liabilities of Federal agencies are required to be classified as those covered and not covered by budgetary resources, as defined by OMB Circular A-136, and in accordance with SFFAS No. 1. In the event that available resources are insufficient to cover liabilities due at a point in time, FHA has authority to borrow monies from the U.S. Treasury

(for post-1991 loan guarantees) or to draw on permanent indefinite appropriations (for pre-1992 loan guarantees) to satisfy the liabilities.

Liabilities Not Requiring Budgetary Resources

Liabilities that have not previously, nor will in the future, require the use of budgetary resources. These include clearing accounts, non-fiduciary deposit funds, custodial accounts and unearned revenue. FHA's General Fund receipt accounts also fall into this category.

Statement of Budgetary Resources

The Statement of Budgetary Resources has been prepared as a combined statement and as such, intra-entity transactions have not been eliminated. Budget authority is the authorization provided by law to enter into obligations to carry out the guaranteed and direct loan programs and their associated administrative costs, which would result in immediate or future outlays of federal funds. FHA's budgetary resources include current budgetary authority (i.e., appropriations and borrowing authority) and unobligated balances brought forward from multi-year and no-year budget authority received in prior years, and recoveries of prior year obligations. Budgetary resources also include spending authority from offsetting collections credited to an appropriation or fund account.

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

Note 2. Non-Entity Assets

Non-entity assets consist of assets that belong to other entities but are included in FHA's consolidated balance sheets. To reflect FHA's net position accurately, these non-entity assets are offset by various liabilities. FHA's non-entity assets as of September 30, 2018 and 2017 are as follows:

(Dollars in millions)		FY 2018		Restated FY 2017
Intragovernmental:				
Fund Balance with Treasury	$	17	$	19
Total Intragovernmental		17		19
Cash and Other Monetary Assets		22		26
Total Non-Entity Assets		39		45
Total Entity Assets		86,586		80,727
Total Assets	**$**	**86,625**	**$**	**80,772**

FHA's non-entity assets consist of escrow monies collected by FHA from the borrowers of its loans.

Cash and other monetary assets that are collected from FHA borrowers consist of escrow monies that are either deposited at the U.S. Treasury or minority-owned banks or invested in U.S. Treasury securities. Subsequently, FHA disburses these escrow monies to pay for maintenance expenses on behalf of the borrowers.

Note 3. Fund Balance with U.S. Treasury

FHA's fund balance with U.S. Treasury was comprised of the following as of September 30, 2018 and 2017:

(Dollars in millions)	FY 2018	Restated FY 2017
Fund Balances:		
Revolving Funds	$ 32,919	$ 28,000
Appropriated Funds	250	269
Other Funds	521	843
Total	**$ 33,690**	**$ 29,112**
Status of Fund Balance with U.S. Treasury:		
Unobligated Balance --		
Available	$ 9,851	$ 5,809
Unavailable	20,007	19,549
Obligated Balance Not Yet Disbursed	3,832	3,754
Non-Budgetary FBWT	-	-
Total	**$ 33,690**	**$ 29,112**

Revolving Funds

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

Appropriated Funds

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

Other Funds

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

Status of Fund Balance with U.S. Treasury

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

Note 4. Cash and Other Monetary Assets

(Dollars in millions)

	FY 2018	FY 2017
With the Public:		
Escrow Monies Deposited at Minority-Owned Banks	$ 22	$ 26
Deposits in Transit	12	14
Total	**$ 34**	**$ 40**

Escrow Monies Deposited at Minority-Owned Banks

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

Deposits in Transit

Deposits in Transit is cash that has not been confirmed as being received by the U.S. Treasury. Once the U.S. Treasury has confirmed that this cash has been received, the cash will be moved from Deposits in Transit to Fund Balance with U.S. Treasury.

Note 5. Investments

Investment in U.S. Treasury Securities

As discussed in Note 1, all FHA investments in Treasury securities are in non-marketable securities issued by the U.S. Treasury. These securities carry market-based interest rates. The market value of these securities is calculated using the bid amount of similar marketable U.S. Treasury securities as of September 30th. The cost, net amortized premium/discount, net investment, and market values of FHA's investments in U.S. Treasury securities as of September 30, 2018 were as follows:

(Dollars in millions)

FY 2018	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 26,461	$ 236	$ 26,697	$ 26,678
Total	**$ 26,461**	**$ 236**	**$ 26,697**	**$ 26,678**

The cost, net amortized premium/discount, net investment, and market values as of September 30, 2017 were as follows:

FY 2017 Restated	Cost	Amortized (Premium) / Discount, Net	Investments, Net	Market Value
MMI/CMHI Investments	$ 30,744	$ 51	$ 30,795	$ 30,747
MMI/CMHI Accrued Interest			46	-
Total	**$ 30,744**	**$ 51**	**$ 30,841**	**$ 30,747**

In fiscal year 2017, FHA overstated the MMI/CMHI Investment Market Value amount by incorporating accrued interest in the amount of $46 million to the presentation of the Market Value total. In fiscal year 2018, the presentation has been updated to exclude accrued interest from the Market Value total.

Investments in Private-Sector Entities

Investments in Private Sector Entities as of September 30, 2018 and 2017 were as follows:

(Dollars in millions)	Beginning Balance	New Acquisitions	Share of Earnings or Losses	Redeemed	Ending Balance
FY 2018					
Securities Held Outside of Treasury	$ 13	$ -	$ -	$ (13)	$ -
Risk Sharing Debentures	31	-	(17)	(6)	$ 8
Total	**$ 44**	**$ -**	**$ (17)**	**$ (19)**	**$ 8**
FY 2017					
Securities Held Outside of Treasury	$ -	$ 13	$ -	$ -	$ 13
Risk Sharing Debentures	31	-	-	-	31
Total	**$ 31**	**$ 13**	$ -	$ -	**$ 44**

Note 6. Accounts Receivable, Net

Accounts receivable, net, as of September 30, 2018 and 2017 are as follows:

	Gross		Allowance		Net	
(Dollars in millions)	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018	FY 2017
With the Public:						
Receivables Related to Credit Program Assets	$ 9	$ 12	$ -	$ (1)	$ 9	$ 11
Premiums Receivables	1	-	-	-	1	-
Partial Claims Receivables	10	18	(5)	(8)	5	10
Generic Debt Receivables	280	301	(201)	(300)	79	1
Settlements Receivables	26	109	-	-	26	109
Miscellaneous Receivables	17	89	-	-	17	89
Total	$ 343	$ 529	$ (206)	$ (309)	$ 137	$ 220

Receivables Related to Credit Program Assets

These receivables include asset sale proceeds receivables and rent receivables from FHA's foreclosed properties.

Premium Receivables

These amounts consist of the premiums due to FHA from the mortgagors at the end of the reporting period. The details of FHA premium structure are discussed in Note 14 – Earned Revenue/Premium Revenue.

Partial Claim Receivables

Partial Claim receivables represents partial claims paid by FHA to mortgagees as part of its loss mitigation efforts to bring delinquent loans current for which FHA does not yet have the promissory note recorded.

Generic Debt Receivables

These amounts are mainly comprised of receivables from various sources including Single Family Indemnifications and Single Family Restitutions.

Settlement Receivables

FHA receives signed consent judgments that are approved by the courts, but which funds have not been received.

Miscellaneous Receivables

Miscellaneous receivables include late charges and penalties receivables on delinquent premium receivables, refund receivables from overpayments of claims, distributive shares, and other immaterial receivables.

Allowance for Loss

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

Note 7. Direct Loans and Loan Guarantees, Non-Federal Borrowers

Direct Loan and Loan Guarantee Programs Administered by FHA include:
Single Family Forward Mortgages
Multifamily Mortgages
Healthcare Mortgages
Home Equity Conversion Mortgages (HECM)

FHA reports its insurance operations in four overall program areas: Single Family Forward mortgages, Multifamily mortgages, Healthcare mortgages, and Home Equity Conversion Mortgages (HECM). FHA operates these programs primarily through four insurance funds: Mutual Mortgage Insurance (MMI), General Insurance (GI), Special Risk Insurance (SRI), and Cooperative Management Housing Insurance (CMHI), with the MMI fund being the largest. There is a fifth fund, Hope for Homeowners (H4H), that became operational in fiscal year 2009 and only contains minimal activity.

FHA encourages homeownership through its Single Family Forward programs (Section 203(b), which is the largest program, and Section 234) with its mortgage insurance programs. These programs insure mortgage lenders against losses from default, enabling those lenders to provide mortgage financing on favorable terms to homebuyers. Multifamily Housing Programs (Section 213, Section 221(d)(4), Section 207/223(f), and Section 223(a)(7)) provide FHA insurance to approved lenders to facilitate the construction, rehabilitation, repair, refinancing, and purchase of multifamily housing projects such as apartment rentals, and cooperatives. Healthcare programs (Section 232 and Section 242) enable low cost financing of healthcare facility projects and improve access to quality healthcare by reducing the cost of capital. The HECM program provides eligible homeowners who are 62 years of age and older access to the equity in their property with flexible terms.

FHA Direct Loan and Loan Guarantee Programs and the related loan receivables, foreclosed property, and Loan Guarantee Liability as of September 30, 2018 and 2017 are as follows:

Direct Loan Programs:

Starting in FY 2015, FHA began a Federal Financing Bank (FFB) Risk Share program, an inter-agency partnership between HUD, FFB and various Housing Finance Authorities (HFAs). The FFB Risk Share program provides funding for multifamily mortgage loans insured by FHA. Under this program, FHA records a direct loan with the public as an asset on its balance sheet, and conversely, borrowing from FFB as a liability. The program does not change the basic structure of Risk Sharing; it only substitutes FFB as the funding source. The HFAs originate and service the loans and share in any losses.

The cash flow model for FFB direct loan program is developed by collecting and consolidating data from FHA's program and accounting systems. The model is based upon trends and assumptions of historical data and analysis but, where necessary, management's judgment. The model uses actual data through June of the current fiscal year and projections are used to estimate the direct loan cash flows for the 4th quarter. The model estimates total loan commitments and the percentage of commitments that will be disbursed prior to the end of the fiscal year.

Direct Loans Obligated (Pre-1992):
(Dollars in Millions)

September 30, 2018	GI/SRI - Multifamily	Total
Loan Receivables	$ 8	$ 8
Interest Receivables	14	14
Allowance	(4)	(4)
Total Value of Assets	$ 18	$ 18

September 30, 2017	GI/SRI - Multifamily	Total
Loan Receivables	$ 8	$ 8
Interest Receivables	13	13
Allowance	(4)	(4)
Total Value of Assets	$ 17	$ 17

Direct Loans Obligated (Post-1991):
(Dollars in Millions)

September 30, 2018	GI/SRI - Multifamily	Total
Loan Receivables	$ 1,666	$ 1,666
Interest Receivables	4	4
Allowance	203	203
Total Value of Assets	$ 1,873	$ 1,873

September 30, 2017	GI/SRI - Multifamily	Total
Loan Receivables	$ 1,193	$ 1,193
Interest Receivables	4	4
Allowance	37	37
Total Value of Assets	$ 1,234	$ 1,234

Total Amount of Direct Loans Disbursed (Post- 1991):
(Dollars in Millions)

Direct Loan Programs		FY 2018		FY 2017
Multifamily/Healthcare	$	473	$	639
GI/SRI Subtotal	$	473	$	639

Subsidy Expense for Direct Loans:

September 30, 2018

		GI/SRI		Total
Multifamily/Healthcare				
FFB				
Financing	$	(76)	$	(76)
Fees and Other Collections		17		17
Other		18		18
Subtotal	$	(41)	$	(41)

September 30, 2017

		GI/SRI		Total
Multifamily/Healthcare				
FFB				
Financing	$	(76)	$	(76)
Defaults		1		1
Fees and Other Collections		(18)		(18)
Other		21		21
Subtotal		(72)		(72)

Subsidy Expense for Re-estimates:

(Dollars in millions)

FY 2018		Technical Reestimate
GI/SRI	$	(103)
Total	$	(103)

FY 2017		Restated Technical Reestimate
MMI/CMHI	$	(6)
GI/SRI		70
Total	$	64

Total Direct Loan Subsidy Expense:

Direct Loan Programs		FY 2018		Restated FY 2017
MMI/CMHI	$	-		(6)
GI/SRI		(145)		(2)
Total	$	(145)	$	(8)

Subsidy Rates for Direct Loans by Program and Component

September 30, 2018

	Finance	Default	Fees and Other Collections	Other	Total
GI/SRI					
Multifamily					
FFB	-14%	0%	3%	3%	-8%

September 30, 2017

	Finance	Default	Fees and Other Collections	Other	Total
GI/SRI					
Multifamily					
FFB	-14%	0%	-1%	4%	-11%

Schedule for Reconciling Subsidy Cost Allowance Balances:

Beginning Balance, Changes, and Ending Balance	FY 2018	Restated FY 2017
Beginning balance of the subsidy cost allowance	$ (37)	$ (24)
Add: subsidy expense for direct loans disbursed during the reporting years by component		
-Financing	(76)	(76)
- Default costs (net recoveries)	-	1
- Fees and other collections	17	(18)
- Other subsidy costs	18	21
Total of the above subsidy expense components	$ (41)	$ (72)
Adjustments:		
- Fees received	1	3
- Subsidy allowance amortization	(3)	(4)
- Other	(19)	(4)
Ending balance of the subsidy cost allowance before reestimates	$ (99)	$ (101)
Add or subtract subsidy reestimates by component:		
- Technical/default reestimate	(100)	113
Adjustment of prior years' credit subsidy reestimates	(3)	(49)
Total Technical/Default Reestimate	$ (103)	$ 64
Ending balance of the subsidy cost allowance	**$ (202)**	**$ (37)**

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

(Dollars in Millions)

FY 2018	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	$ 17	$ -	$ 17
Foreclosed Property	4	9	13
Allowance for Loan Losses	(4)	(4)	(8)
Subtotal	**$ 17**	**$ 5**	**$ 22**
Multifamily/Healthcare			
Loan Receivables	$ -	$ 1,503	$ 1,503
Interest Receivables	-	234	234
Foreclosed Property	-	(5)	(5)
Allowance for Loan Losses	-	(616)	(616)
Subtotal	**$ -**	**$ 1,116**	**$ 1,116**
HECM			
Loan Receivables	$ -	$ 3	$ 3
Interest Receivables	-	1	1
Foreclosed Property	-	(2)	(2)
Allowance for Loan Losses	-	(3)	(3)
Subtotal	**$ -**	**$ (1)**	**$ (1)**
Total Guaranteed Loans	**$ 17**	**$ 1,120**	**$ 1,137**

(Dollars in Millions)

FY 2017	MMI/CMHI	GI/SRI	Total
Guaranteed Loans			
Single Family Forward			
Loan Receivables	$ 19	$ -	$ 19
Foreclosed Property	5	9	14
Allowance for Loan Losses	(4)	(4)	(8)
Subtotal	**$ 20**	**$ 5**	**$ 25**
Multifamily/Healthcare			
Loan Receivables	$ -	$ 1,614	$ 1,614
Interest Receivables	-	231	231
Allowance for Loan Losses	-	(682)	(682)
Subtotal	**$ -**	**$ 1,163**	**$ 1,163**
HECM			
Loan Receivables	$ -	$ 3	$ 3
Interest Receivables	-	1	1
Foreclosed Property	-	(2)	(2)
Allowance for Loan Losses	-	(1)	(1)
Subtotal	**$ -**	**$ 1**	**$ 1**
Total Guaranteed Loans	**$ 20**	**$ 1,169**	**$ 1,189**

*HECM loans, while not defaulted, have reached 98% of the maximum claim amount and have been assigned to FHA.

Defaulted Guaranteed Loans from Post-1991 Guarantees:

(Dollars in Millions)

FY 2018	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	$ 11,810	$ 416	$ 6	$ 12,232
Foreclosed Property	1,004	23	-	1,027
Allowance	(5,682)	(201)	(5)	(5,888)
Subtotal	**$ 7,132**	**$ 238**	**$ 1**	**$ 7,371**
Multifamily/Healthcare				
Loan Receivables	$ -	$ 693	$ -	$ 693
Foreclosed Property	-	27	-	27
Allowance	-	(315)	-	(315)
Subtotal	**$ -**	**$ 405**	**$ -**	**$ 405**
HECM				
Loan Receivables	$ 10,099	$ 3,983	$ -	$ 14,082
Interest Receivables	6,707	2,297	-	9,004
Foreclosed Property	82	108	-	190
Allowance	(5,208)	(2,812)	-	(8,020)
Subtotal	**$ 11,680**	**$ 3,576**	**$ -**	**$ 15,256**
Total Guaranteed Loans	**$ 18,812**	**$ 4,219**	**$ 1**	**$ 23,032**

(Dollars in Millions)

FY 2017 Restated	MMI/CMHI	GI/SRI	H4H	Total
Guaranteed Loans				
Single Family Forward				
Loan Receivables	$ 11,160	$ 416	$ 5	$ 11,581
Foreclosed Property	1,437	35	-	1,472
Allowance	(6,133)	(225)	(5)	(6,363)
Subtotal	**$ 6,464**	**$ 226**	**$ -**	**$ 6,690**
Multifamily/Healthcare				
Loan Receivables	$ -	$ 645	$ -	$ 645
Interest Receivables	-	(1)	-	(1)
Foreclosed Property	-	1	-	1
Allowance	-	(272)	-	(272)
Subtotal	**$ -**	**$ 373**	**$ -**	**$ 373**
HECM				
Loan Receivables	$ 6,992	$ 3,701	$ -	$ 10,693
Interest Receivables	4,176	1,981	-	6,157
Foreclosed Property	36	79	-	115
Allowance	(3,932)	(2,021)	-	(5,953)
Subtotal	**$ 7,272**	**$ 3,740**	**$ -**	**$ 11,012**
Total Guaranteed Loans	**$ 13,736**	**$ 4,339**	**$ -**	**$ 18,075**

*HECM loans, while not defaulted, have reached 98% of the maximum claim amount and have been assigned to FHA.

Guaranteed Loans Outstanding:

(Dollars in Millions)

Loan Guarantee Programs	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal Guaranteed
Guaranteed Loans Outstanding (FY 2018):		
MMI/CMHI		
Single Family Forward	$ 1,322,241	$ 1,192,283
Multifamily/Healthcare	763	718
MMI/CMHI Subtotal	**$ 1,323,004**	**$ 1,193,001**
GI/SRI		
Single Family Forward	$ 6,792	$ 4,427
Multifamily/Healthcare	140,955	129,317
GI/SRI Subtotal	**$ 147,747**	**$ 133,744**
H4H		
Single Family - 257	$ 75	$ 66
H4H Subtotal	**$ 75**	**$ 66**
Total	**$ 1,470,826**	**$ 1,326,811**
Guaranteed Loans Outstanding (FY 2017):		
MMI/CMHI		
Single Family Forward	$ 1,272,515	$ 1,153,875
Multifamily/Healthcare	640	605
MMI/CMHI Subtotal	**$ 1,273,155**	**$ 1,154,480**
GI/SRI		
Single Family Forward	$ 8,120	$ 5,414
Multifamily/Healthcare	128,163	117,604
GI/SRI Subtotal	**$ 136,283**	**$ 123,018**
H4H		
Single Family - 257	$ 81	$ 74
H4H Subtotal	**$ 81**	**$ 74**
Total	**$ 1,409,519**	**$ 1,277,572**

New Guaranteed Loans Disbursed (FY 2018):

(Dollars in Millions)

	Outstanding Principal of Guaranteed Loans, Face Value	Amount of Outstanding Principal
MMI/CMHI		
Single Family Forward	$ 208,985	$ 207,044
Multifamily/Healthcare	133	133
MMI/CMHI Subtotal	**$ 209,118**	**$ 207,177**
GI/SRI		
Single Family Forward	$ 80	$ 79
Multifamily/Healthcare	18,344	18,270
GI/SRI Subtotal	**$ 18,424**	**$ 18,349**
Total	**$ 227,542**	**$ 225,526**
New Guaranteed Loans Disbursed (FY 2017):		
MMI/CMHI		
Single Family Forward	$ 250,904	$ 248,286
Multifamily/Healthcare	22	22
MMI/CMHI Subtotal	**$ 250,926**	**$ 248,308**
GI/SRI		
Single Family Forward	$ 98	$ 97
Multifamily/Healthcare	16,786	16,710
GI/SRI Subtotal	**$ 16,884**	**$ 16,807**
Total	**$ 267,810**	**$ 265,115**

Home Equity Conversion Mortgage (HECM):

HECM (reverse mortgages) are not included in the previous tables due to the unique nature of the program. Since the inception of the program, FHA has insured 1,100,659 HECM loans with a maximum claim amount of $269 billion. Of these 1,100,659 HECM loans insured by FHA, 547,779 loans with a maximum claim amount of $144 billion are still active. As of September 30, 2018, the insurance-in-force (the outstanding balance of active loans) was $100 billion. The insurance in force includes balances drawn by the mortgagee; interest accrued on the balances drawn, service charges, and mortgage insurance premiums. The maximum claim amount is the dollar ceiling to which the outstanding loan balance can grow before being assigned to FHA.

Home Equity Conversion Mortgage Loans Outstanding (not included in the balances in the previous table)

(Dollars in Millions)

Loan Guarantee Programs		Current Year Endorsements	Cumulative Current Outstanding Balance	Cumulative Maximum Potential Liability
FY 2018	MMI/CMHI	$ 16,189	$ 72,389	$ 111,278
	GI/SRI	-	27,699	32,611
	Total	**$ 16,189**	**$ 100,088**	**$ 143,889**
FY 2017	MMI/CMHI	$ 17,691	$ 72,968	$ 110,252
	GI/SRI	-	30,629	37,330
	Total	**$ 17,691**	**$ 103,597**	**$ 147,582**

Loan Guarantee Liability, Net:

(Dollars in Millions)

FY 2018	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 2	$ -	$ -	$ 2
Multifamily/Healthcare	-	(1)	-	(1)
Subtotal	**$ 2**	**$ (1)**	**$ -**	**$ 1**
LLG				
Single Family Forward	$ (1,166)	$ 227	$ 18	$ (921)
Multifamily/Healthcare	(38)	(4,082)	-	(4,120)
HECM	14,899	9,248	-	24,147
Subtotal	**$ 13,695**	**$ 5,393**	**$ 18**	**$ 19,106**
Loan Guarantee Liability Total	**$ 13,697**	**$ 5,392**	**$ 18**	**$ 19,107**

FY 2017	MMI/CMHI	GI/SRI	H4H	Total
LLR				
Single Family Forward	$ 9	$ -	$ -	$ 9
Multifamily/Healthcare	-	(1)	-	(1)
Subtotal	**$ 9**	**$ (1)**	**$ -**	**$ 8**
LLG				
Single Family Forward	$ (2,143)	$ 339	$ 18	$ (1,786)
Multifamily/Healthcare	(17)	(4,108)	-	(4,125)
HECM	15,187	11,332	-	26,519
Subtotal	**$ 13,027**	**$ 7,563**	**$ 18**	**$ 20,608**
Loan Guarantee Liability Total	**$ 13,036**	**$ 7,562**	**$ 18**	**$ 20,616**

Subsidy Expense for Loan Guarantees by Program and Component:

(Dollars in millions)

FY 2018	MMI/CMHI	GI/SRI	Total
Single Family Forward			
Defaults	$ 5,058	$ 4	$ 5,062
Fees and Other Collections	(13,672)	(6)	(13,678)
Other	1,965	-	1,965
Subtotal	**$ (6,649)**	**$ (2)**	**$ (6,651)**
Multifamily/Healthcare			
Defaults	$ 3	$ 202	$ 205
Fees and Other Collections	(9)	(848)	(857)
Other	1	-	1
Subtotal	**$ (5)**	**$ (646)**	**$ (651)**
HECM			
Defaults	$ 635	$ -	$ 635
Fees and Other Collections	(714)	-	(714)
Subtotal	**$ (79)**	**$ -**	**$ (79)**
Total	**$ (6,733)**	**$ (648)**	**$ (7,381)**

FY 2017	MMI/CMHI	GI/SRI	Total
Single Family Forward			
Defaults	$ 6,073	$ 5	$ 6,078
Fees and Other Collections	(19,523)	(8)	(19,531)
Other	2,359	-	2,359
Subtotal	**$ (11,091)**	**$ (3)**	**$ (11,094)**
Multifamily/Healthcare			
Defaults	$ 1	$ 208	$ 209
Fees and Other Collections	(2)	(882)	(884)
Subtotal	**$ (1)**	**$ (674)**	**$ (675)**
HECM			
Defaults	$ 1,250	$ -	$ 1,250
Fees and Other Collections	(1,308)	-	(1,308)
Subtotal	**$ (58)**	**$ -**	**$ (58)**
Total	**$ (11,150)**	**$ (677)**	**$ (11,827)**

Subsidy Expense for Modification and Reestimates:

(Dollars in millions)

FY 2018		Technical Reestimate
MMI/CMHI	$	(506)
GI/SRI		(1,002)
Total	$	(1,508)

FY 2017		Restated Technical Reestimate
MMI/CMHI	$	23,182
GI/SRI		5,916
Total	$	29,098

Total Loan Guarantee Subsidy Expense:

(Dollars in millions)		FY 2018		Restated FY 2017
MMI/CMHI	$	(7,239)	$	12,032
GI/SRI		(1,650)		5,240
Total	$	(8,889)	$	17,272

Subsidy Rates for Loan Guarantee Endorsements by Program and Component:

(Percentage)	Defaults	Fees and Other	Total
Budget Subsidy Rates for Loans Guarantees for 2018 Cohort:			
MMI/CMHI			
Single Family			
SF - Forward	2.42	(5.60)	(3.18)
SF - HECM	3.92	(4.41)	(0.49)
Multifamily			
MF - CMHI- (Cooperatives)	2.42	(5.60)	(3.18)
GI/SRI			
Single Family			
Title I - Manufactured Housing	5.79	(10.15)	(4.36)
Title I - Property Improvements	4.35	(5.82)	(1.47)
Multifamily			
Apartments - NC/SC	2.20	(3.81)	(1.61)
Tax Credit Projects	0.89	(2.52)	(1.63)
Apartments- Refinance	0.28	(4.20)	(3.92)
HFA Risk Share	0.01	(0.28)	(0.27)
Other Rental	0.94	(4.62)	(3.68)
Healthcare			
FHA Full Insurance - Health Care	1.45	(8.49)	(7.04)
Health Care Refinance	0.67	(6.61)	(5.94)
Hospitals	1.52	(6.75)	(5.23)

(Percentage)	Defaults	Fees and Other	Total
Budget Subsidy Rates for Loans Guarantees for 2017 Cohort: Restated			
MMI/CMHI			
Single Family			
SF (Forward)	2.42	(6.84)	(4.42)
SF - HECM	7.06	(7.39)	(0.33)
Multifamily			
MF - CMHI- (Cooperatives)	2.42	(6.84)	(4.42)
GI/SRI			
Single Family			
Title I - Manufactured Housing	6.18	(9.96)	(3.78)
Title I - Property Improvements	4.66	(5.73)	(1.07)
Multifamily			
Apartments - NC/SC	1.49	(4.25)	(2.76)
Tax Credit Projects	0.95	(2.58)	(1.63)
Apartments- Refinance	0.28	(4.17)	(3.89)
HFA Risk Share	0.03	(1.08)	(1.05)
Other Rental	1.51	(4.96)	(3.45)
Healthcare			
FHA Full Insurance - Health Care	2.52	(8.37)	(5.85)
Health Care Refinance	1.54	(6.68)	(5.14)
Hospitals	1.14	(6.66)	(5.52)

Schedule for Reconciling Loan Guarantee Liability Balances:

(Dollars in Millions)	FY 2018 LLR	FY 2018 LLG	Restated FY 2017 LLR	Restated FY 2017 LLG
Beginning Balance of the Loan Guarantee Liability	$ 8	$ 20,608	$ -	$ (806)
Add: Subsidy Expense for guaranteed loans disbursed during the reporting fiscal years by component:				
Default Costs (Net of Recoveries)	-	5,902	-	7,537
Fees and Other Collections	-	(15,249)	-	(21,723)
Other Subsidy Costs	-	1,966	-	2,359
Total of the above subsidy expense components	**-**	**(7,381)**	**-**	**(11,827)**
Adjustments:				
Fees Received	$ -	$ 14,012	$ -	$ 14,567
Foreclosed Property and Loans Acquired	-	10,341	-	10,439
Claim Payments to Lenders	-	(17,692)	-	(21,185)
Interest Accumulation on the Liability Balance	-	434	-	274
Other	(7)	292	8	48
Ending Balance before Reestimates	**$ 1**	**$ 20,614**	**$ 8**	**$ (8,490)**
Add or Subtract Subsidy Reestimates by Component:				
Technical/Default Reestimate				
Subsidy Expense Component		$ (9,536)		$ 3,281
Adjustment of prior years' credit subsidy reestimates		8,028	-	25,817
Total Technical/Default Reestimate	-	(1,508)	-	29,098
Ending Balance of the Loan Guarantee Liability	**$ 1**	**$ 19,106**	**$ 8**	**$ 20,608**

Administrative Expense:

(Dollars in Millions)	FY 2018	Restated FY 2017
MMI/CMHI	$ 723	$ 708
Total	$ 723	$ 708

Other Information on Foreclosed Property:

Additional information on FHA foreclosed property as of September 30, 2018 and 2017 is as follows:

	FY 2018	FY 2017
Average number of days in inventory for Sold Cases	136	146
End of Fiscal Year active inventory	7,968	11,205

The above chart references the average holding period for FHA foreclosed property, and the total number of foreclosed properties on-hand as September 30, 2018. Foreclosed properties are primarily Single Family properties.

Defaulted Guaranteed Loans (Pre-92 and Post-91)

Restrictions on the use/disposal of foreclosed property:

The balance relating to foreclosures as of September 30, 2018 is comprised of only Single Family properties. There are no Multifamily properties currently in inventory.

The Secretary has the authority under the National Housing Act (12 U.S.C 1710 (g)) to manage or dispose of eligible HUD-owned property assets in a manner that will provide affordable, safe and sanitary housing to low-wealth families, preserve and revitalize residential neighborhoods, expand homeownership opportunities, minimize displacement of tenants residing in rental or cooperative housing, and protect the financial interest of the Federal government.

Single Family properties may be sold to eligible entities (24 CFR 291.303) through public asset sales. Eligibility of bidders will be determined by the Secretary and included in the bid package with a notice filed in the Federal Register. In addition, HUD must ensure that its policies and practices in conducting the single family property disposition program do not discriminate on the basis of disability (24 CFR 9.155(a)).

Several presentation updates were made this year. Refer to **Note 23. Financial Statement Presentation and Policy Disclosures** for details of changes to Note 7.

Credit Reform Valuation Methodology

FHA values its Credit Reform LLG and related receivables from notes and property inventories at the net present value of their estimated future cash flows.

To apply the present value computations, FHA divides loans into cohorts and "risk" categories. Multifamily and Healthcare cohorts are defined based on the year in which loan guarantee commitments are made. Single Family mortgages are grouped into cohorts based on loan endorsement dates for the GI/SRI and MMI fund. Within each cohort year, loans are subdivided into product groupings, which are referred to as risk categories in federal budget accounting. Each risk category has characteristics that distinguish it from others, including loan performance patterns, premium structure, and the type and quality of collateral underlying the loan. For activity related to fiscal years 1992-2008, the MMI Fund has one risk category, and for activity related to fiscal years 2009 and onward, the MMI Fund has two risk categories. The second category is for HECM loans, which joined the MMI Fund group of programs in 2009. The Single Family GI/SRI loans are grouped into four risk categories. Also in the GI/SRI Fund, there are nine multifamily risk categories and three health care categories.

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

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

- Conditional Termination Rates: The estimated probability of an insurance policy claim or non-claim termination in each year of the loan guarantee's term, given that a loan survives until the start of that year.
- Claim Amount: The estimated amount of the claim payment relative to the unpaid principal balance at the time the claim occurs.
- Recovery Rates: The estimated percentage of a claim payment or defaulted loan balance that is recovered through disposition of a mortgage note or underlying property.

In FY 2017, FHA used a middle of year (MOY) discount period methodology to calculate and record the year-end financial statement reestimate subsidy and interest expenses and a beginning of year (BOY) discount period methodology for the liquidation of the FY 2017 reestimate in FY 2018. During FY 2018, FHA discovered that OMB's Credit Subsidy Calculator uses a BOY discount period default, regardless of each agency's independent methodology. To be consistent with OMB, FHA management has made the decision to use BOY discount period methodology for the FY 2018 year-end financial statement reestimate and will continue to use this methodology going forward. This methodology change will also be consistent with the subsidy and interest expense allocation being published in the President's Budget and Federal Credit Supplement.

Had FHA used the BOY discount period methodology consistently throughout the year, its allocation between subsidy and interest components for the technical reestimate would have had the following impact on Note 7: Loan Guarantee technical reestimate GI/SRI subsidy expense component would have decreased by $12 million and the interest expense component would have increased by $12 million. Loan Guarantee MMI subsidy expense component would have decreased by $74 million and the interest expense component would have increased by $74 million. Direct Loan GI/SRI subsidy component would have decreased by $2 million and the interest expense component would have increased by $2 million.

The Note 13 impact would have been as follows: the Single Family Forward subsidy expense component would have decreased by $39 million, with a corresponding increase in the Single Family Forward interest expense

component. The HECM subsidy expense component would have decreased by $67 million, with a corresponding increase in the HECM interest expense component. The Multifamily subsidy expense component would have increased by $15 million, with a corresponding decrease in the Multifamily interest expense component. The Healthcare subsidy expense component would have increased by $3 million, with a corresponding decrease in the Healthcare interest expense component.

The total technical reestimate subsidy expense component would have decreased by $88 million and the interest expense component would have increased by $88 million for both Note 7 and Note 13. There was no net change to either Note 7 or Note 13 total technical reestimate expense as a result of this discount period methodology inconsistency.

Additional information about loan performance assumptions is provided below:

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

Economic assumptions: Independent forecasts of economic conditions are used in conjunction with loan-level data to generate Single Family, Multifamily, and Healthcare claim and prepayment rates. OMB provides the central economic assumptions used, such as interest rates, house price appreciation and the discount rates used against the cash flows. Other sources are used to distribute the central assumptions geographically.

Reliance on historical performance: FHA relies on the historical performance of its insured portfolio to generate behavioral response functions that are applied to economic forecasts to generate future performance patterns for the outstanding portfolio. Changes in legislation, program requirements, tax treatment, and economic factors all influence loan performance. FHA assumes that its portfolio will continue to perform consistently with its historical experience, respecting differences due to current loan characteristics and forecasted economic conditions.

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

Discount rates: The disbursement-timing-weighted interest rates on U.S. Treasury securities of maturities comparable to the terms of the guaranteed loans create the discount factors used in the present value calculations for cohorts 1992 to 2000. For the 2001 and future cohorts, the rates on U.S. Treasury securities of maturities comparable to the cash flow timing for the loan guarantees are used in the present value calculations. This latter methodology is referred to as the basket-of-zeros discounting methodology. OMB provides these rates to all Federal agencies for use in preparing credit subsidy estimates and requires their use under OMB Circular A-11, Part 4, and "Instructions on Budget Execution." The basket-of-zeros discount factors are also disbursement weighted.

Analysis of Change in the Liability for Loan Guarantees

FHA has estimated and reported on LLG calculations since fiscal year 1992. Over this time, FHA's reported LLG values have shown measurable year-to-year variance. That variance is caused by four factors: (1) adding a new year of insurance commitments each year; (2) an additional year of actual loan performance data used to calibrate forecasting models, (3) revisions to the methodologies employed to predict future loan performance, and (4) programmatic/policy changes that affect the characteristics of insured loans or potential credit losses.

Described below are the programs that comprise the majority of FHA's loan guarantee business. These descriptions highlight the factors that contributed to changing LLG estimates for FY 2018.

Mutual Mortgage Insurance (MMI) – On net, the MMI Fund LLG increased to $13,711 million at the end of fiscal year 2018. The increase in liability can be attributed to slight changes in economic forecasts and actual loan performance.

MMI Single Family Forward (SFF): The 2018 SFF LLG is very similar to the 2017 methodology. The models use historical data to generate claim and prepayment probabilities based on various borrower and loan-specific factors. These projections feed a Cash Flow Model (CFM) that discounts all cohort years using the latest Single Effective Rate (SER) specific to each cohort, in accordance with Federal Credit Reform Modeling guidelines. As with the 2017 LLG, the 2018 LLG estimate uses a single path (President's Economic Assumption released in June 2018) to compute the expected net present value of the future cash flows.

MMI Home Equity Conversion Mortgage (HECM): Like the SFF program, in 2018, the HECM LLG was modeled first by using actuarial models to estimate the "termination" probability for each loan. A HECM termination event was grouped into three (3) categories; borrower death, borrower move out of subject property or borrower refinance of subject property. These projections are used in calculating the LLG in the Cash Flow Model (CFM). The CFM discounts all cohort years using the latest Single Effective Rate (SER) specific to each cohort, in accordance with Federal Credit Reform Modeling guidelines. As with the 2017 LLG, the 2018 LLG estimate uses a single path (President's Economic Assumption released in June 2018) to compute the expected net present value of the future cash flows.

GI/SRI (HECM) - HECM endorsements from fiscal years 1990-2008 remain in the GI/SRI Fund. Estimation of the GI/SRI HECM LLG is consistent with that of the MMI HECM LLG estimation. The liability for these loans decreased to $9,248 million at the end of FY 2018 reflecting the winddown of the pre-2009 HECM cohorts. This liability is driven more by long term house price appreciation forecasts than short term forecasts. The majority of the remaining GI/SRI HECM loans have adjustable interest rates, which impacts the LLG through its influence on unpaid balances, claim and recovery rates.

GI/SRI Section 223(f) - Section 223(f) of the National Housing Act permits FHA mortgage insurance for the refinance or acquisition of existing multifamily rental properties consisting of five or more units. Under this program, FHA may insure up to 85 percent of the lesser of the project's appraised value or its replacement cost. Projects insured under the program must be at least three years old. The Section 223(f) program is the largest multifamily program in the GI/SRI fund with an insurance-in-force of $37.2 billion. The Section 223(f) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(f) liability increased this year by $2 million, from ($1,563) million to ($1,561) million, due to higher claim expectations.

GI/SRI Section 223(a)(7) - Section 223(a)(7) gives FHA authority to refinance FHA-insured loans. Under this program, the refinanced principal amount of the mortgage may be the lesser of the original amount of the existing mortgage or the remaining unpaid principal balance of the loan. Loans insured under any sections of the National Housing Act may be refinanced under 223(a)(7), including those already under 223(a)(7). The Section 223(a)(7) program has an insurance-in-force of $18.7 billion. The Section 223(a)(7) liability is negative, meaning that the present value of expected future premium revenues is greater than the present value of expected future (net) claim expenses. The 223(a)(7) liability increased this year by $52 million, from ($630) million to ($578) million due to higher claim expectations.

GI/SRI Section 221(d)(4) - Section 221(d)(4) of the National Housing Act authorizes FHA mortgage insurance for the construction or substantial rehabilitation of multifamily rental properties with five or more units. Under this program, FHA may insure up to 90 percent of the total project cost. This is the second largest multifamily program in the GI/SRI fund with an insurance-in-force of $19.8 billion. The Section 221(d)(4) liability increased by $130 million this year, from ($333) million to ($203) million, due to higher claim expectations.

GI/SRI Section 232 Healthcare New Construction (NC) - The Section 232 NC program provides mortgage insurance for construction or substantial rehabilitation of nursing homes and assisted-living facilities. FHA insures a maximum of 90 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 NC program has an insurance-in-force of $3.0 billion. The Section 232 NC liability increased by $1 million this year, from ($98) million to ($97) million due to a decrease in insurance-in-force.

GI/SRI Section 232 Healthcare Purchasing or Refinancing - The Section 232 Refinance program provides mortgage insurance for two purposes: purchasing or refinancing of projects that do not need substantial rehabilitation, and installation of fire safety equipment for either private, for-profit businesses or non-profit associations. For existing projects, FHA insures a maximum of 85 percent of the estimated value of the physical improvements and major movable equipment. The Section 232 Refinance program has an insurance-in-force of $26.4 billion. The Section 232 Refinance liability decreased by $125 million this year, from ($808) million to ($933) million due to an increase in insurance-in-force and a decrease in prepayment expectations.

GI/SRI Section 242 Hospitals - The Section 242 Hospitals program provides mortgage insurance for the construction, substantial rehabilitation, or refinance of hospitals and/or the purchase of major hospital equipment to either private, for-profit businesses or non-profit associations. FHA insures a maximum of 90 percent of the estimated replacement cost of the hospital, including the installed equipment. The Section 242 program has an insurance-in-force of $7.1 billion. The Section 242 liability decreased by $12 million this year from ($206) million to ($218) million due to higher premium revenue caused by decreased prepayment expectations as well as lower claims expected.

Risks to LLG Calculations

LLG calculations for some programs now use Monte Carlo simulations and stochastic economic forecasts. What is booked as an LLG value is the average or arithmetic "mean" value from a series of projections that view loan portfolio performance under a large variety of possible economic circumstances. The individual economic scenario forecasts are designed to mimic the types of movements in factors such as home prices, interest rates, and apartment vacancy rates that have actually occurred in the historical record. By creating a large number of these scenarios, each independent of the others, one creates a universe of potential outcomes that define the possible set of LLG values in an uncertain world. Using the mean value across all forecast scenarios is valuable for providing some consideration for "tail risk." Tail risk occurs in most loan guarantee portfolios because potential losses under the worst scenarios are multiples of potential gains under the best scenarios. The inclusion of tail events in the mean-value calculation creates an addition to LLG, which is the difference between the mean value from the simulations and the median value. The median is the point at which half of the outcomes are worse and half are better. By booking a mean value rather than a median, FHA is essentially providing some additional protection in its loss reserves against adverse outcomes. At the same time, booking an LLG based on a mean value results in a better than even chance future revisions will be in the downward direction.

The uncertainty built into Monte Carlo forecasts is only for economic risk, and not for model risk. All LLG values are fundamentally dependent upon forecasts of insured-loan performance. Those forecasts are developed through models that apply statistical, economic, financial, or mathematical theories, techniques, and assumptions to create behavioral-response functions from historical data. All such models involve risk that actual behavior of borrowers and lenders in the future will differ from the historical patterns embedded in the forecasting models. Model risk also

emanates from the possibility that the computer code used to create the forecasts has errors or omissions which compromise the integrity and reliability of projections.

Each year, HUD works with its contractors to evaluate the forecasting models for reasonableness of results on a number of dimensions. Model risk is also addressed through a continuous cycle of improvement, whereby lessons learned from the previous round of annual portfolio valuations—in the independent actuarial studies, LLG valuations, and President's Budget—are used as a basis for new research and model development in the current year.

For Multifamily programs, LLG risk comes from claims, recoveries and premiums. Claims and recoveries are dependent on continued rental-income trends and rental-price growth. Premiums are driven by FHA policy and industry demand for FHA products. Generally, risk comes from market, economic, and demographic influences such as changes in local employment conditions, the supply of rental housing in each market where FHA has a presence, population growth, and household formation. FHA's policy of insuring loans pre-construction in its 221(d)(4) program subject LLG calculations to risk from their capability to operate post-construction.

For Healthcare programs (Sections 232 and 242), LLG risk comes principally from healthcare reimbursement rates from Medicare and Medicaid. In addition, the financial health of State and Municipal government entities also is a source of LLG risk, as many of the FHA-insured projects benefit, in part, from periodic cash infusions from those entities. Risk also varies as does the quality of business management at each facility, and from the supply of medical care in each community relative to demand and the abilities of facility management to adapt to changing technologies and the competitive landscape. These are factors for which it is difficult to predict future trends.

For the SFF mortgage programs, LLG risk comes from claims, recoveries, and premiums. Claims and recoveries are largely dependent on house price appreciation and local market conditions such as demand to supply ratio and share of homes in foreclosure status. FHA recoveries are also dependent on the type of claim disposition. Various disposition types such as pre-foreclosure sale, CWCOT, and Note Sales typically recover more funds for FHA than REOs. Premiums are driven by FHA policy, industry demand for FHA products, and interest rate outlook, which determines the incentive of refinances. Generally, risk comes from portfolio characteristics, market and prevailing economic conditions.

For both HECM programs (GI/SRI and MMI cohorts), LLG risk comes from claims, recoveries and premiums. Claims and recoveries are largely dependent on house price appreciation and borrower behavior such as home maintenance and ability to meet property tax and insurance obligations. Premiums are driven by FHA policy and interest rates which determine the growth of HECM unpaid principal balances (UPB). Generally, risk comes from portfolio characteristics, market and prevailing economic conditions.

Pre-Credit Reform Valuation Methodology

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

MMI Single Family LLR - For the single-family portfolio, the aggregate liability for the remaining pre-credit reform loans in FY 2018 is $1.7 million.

GI/SRI Multifamily & Healthcare LLR - For the multifamily and healthcare portfolio, the remaining insurance-in-force for pre-credit reform loans is $173.8 million. The aggregate liability for the remaining pre-credit reform loans in FY2018 is ($916) thousand, which is a $30 thousand decrease from the ($886) thousand estimate in FY2017. The year-over-year decrease in aggregate liability is due to lower claim expectations.

Note 8. Accounts Payable

Accounts Payable as of September 30, 2018 and 2017 are as follows:

(Dollars in millions)

	FY 2018	FY 2017
Intragovernmental:		
Claims Payable to Ginnie Mae	$ 1	$ 1
Miscellaneous Payables to Other Federal Agencies	1	1
Total	**$ 2**	**$ 2**

	FY 2018	FY 2017
With the Public:		
Claims Payable	$ 285	$ 284
Premium Refunds Payable	142	124
Single Family Property Disposition Payable	43	28
Miscellaneous Payables	85	78
Total	**$ 555**	**$ 514**

Claims Payables

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

Premium Refunds Payables

Premium refund payables are refunds of previously collected Single Family premiums that will be returned to the borrowers resulting from prepayment of the insured mortgages.

Single Family Property Disposition Payables

Single family property disposition payables includes management and marketing contracts and other property disposition expenses related to foreclosed property.

Miscellaneous Payables

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

Note 9. Debt

The following tables describe the composition of Debt held by FHA as of September 30, 2017 and 2018:

(Dollars in millions)

	FY 2017			FY 2018		
	Beginning Balance	Net Borrowings	Ending Balance	Beginning Balance	Net Borrowings	Ending Balance
Other Debt:						
Borrowings from FFB	554	633	1,187	1,187	484	1,671
Borrowings from U.S. Treasury	30,319	(2,364)	27,954	27,954	(3,246)	24,708
Total	**$ 30,873**	**$ (1,731)**	**$ 29,141**	**$ 29,141**	**$ (2,762)**	**$ 26,379**

	FY 2017	FY 2018
Classification of Debt:		
Intragovernmental Debt	$ 29,141	$ 26,379
Total	**$ 29,141**	**$ 26,379**

Borrowings from U.S. Treasury

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

During fiscal year 2018, FHA's U.S. Treasury borrowings carried interest rates ranging from 1.02 percent to 7.59 percent. The maturity dates for these borrowings occur from September 2018 – September 2030. Loans may be repaid in whole or in part without penalty at any time prior to maturity.

Borrowings from Federal Financing Bank

Starting in FY 2015, FHA began a Federal Financing Bank (FFB) Risk Share program, an inter-agency partnership between HUD, FFB and the Housing Finance Authorities (HFAs). The FFB Risk Share program provides funding for multifamily mortgage loans insured by FHA. Under this program, FHA borrows from the FFB to disburse direct loans.

Note 10. Other Liabilities

The following table describes the composition of Other Liabilities as of September 30, 2018 and 2017:

(Dollars in millions)

FY 2018		Current
Intragovernmental:		
Receipt Account Liability	$	2,787
Total	**$**	**2,787**
With the Public:		
Trust and Deposit Liabilities	$	39
Multifamily Notes Unearned Revenue		252
Premiums collected on unendorsed cases		212
Miscellaneous Liabilities		79
Total	**$**	**582**

FY 2017		Restated Current
Intragovernmental:		
Receipt Account Liability	$	1,734
Total	**$**	**1,734**
With the Public:		
Trust and Deposit Liabilities	$	46
Multifamily Notes Unearned Revenue		250
Premiums collected on unendorsed cases		243
Miscellaneous Liabilities		97
Total	**$**	**636**

Receipt Account Payable Liability

The receipt account payable liability is created from downward credit subsidy reestimates in the GI/SRI receipt account.

Trust and Deposit Liabilities

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

Multifamily Notes Unearned Revenue

Multifamily Notes unearned revenue primarily includes the deferred interest revenue on Multifamily notes that are based on work out agreements with the owners. The workout agreements defer payments from the owners for a specified time but, the interest due on the notes is still accruing and will also be deferred until payments resume.

Premiums Collected on Unendorsed Cases

Premiums collected on unendorsed cases are mortgage insurance premium amounts collected by FHA for cases that have yet to be endorsed.

Miscellaneous Liabilities

Miscellaneous liabilities mainly include disbursements in transit (cash disbursements pending Treasury confirmation), unearned premium revenue, and any loss contingencies that are recognized by FHA for past events that warrant a probable, or likely, future outflow of measurable economic resources.

Note 11. Total Liabilities Not Requiring Budgetary Resources

	2018	2017
Total Liabilities Covered by Budgetary Resources	46,604	50,883
Total Liabilities Not Requiring Budgetary Resources	2,808	1,760
Total Liabilities	**$ 49,412**	**$ 52,643**

In fiscal year 2018, FHA presented Total Liabilities Not Requiring Budgetary Resources to align with OMB Circular A-136 guidance.

Total Liabilities Covered by Budgetary Resources – includes liabilities incurred that are covered by realized budgetary resources as of the Balance Sheet date.

Total Liabilities Not Requiring Budgetary Resources – includes liabilities that have not in the past required and will not in the future require the use of budgetary resources.

Note 12. Commitments and Contingencies

Litigation

FHA is party in various legal actions and claims brought by or against it. In the opinion of management and general counsel, the ultimate resolution of these legal actions will not have an effect on FHA's consolidated financial statements as of September 30, 2018. There are pending or threatened legal actions where judgment against FHA is reasonably possible with an estimated potential loss of $10.3 million or more.

Activity with Ginnie Mae

As of September 30, 2018, the Government National Mortgage Association ("Ginnie Mae") held defaulted FHA-insured mortgage loans. These loans, acquired from defaulted mortgage-backed securities issuers, had the following balances:

	FY 2018 (in Millions)	FY 2017 (in Millions)
Mortgages Held for Investment & Foreclosed Property (Pre-claim)	3,125	3,137
Short Sale Claims Receivable	22	47

"Ginnie Mae" may submit requests for claim payments to FHA for some or all of these loans. Subject to all existing claim verification controls, FHA would pay such claims to Ginnie Mae, another component of HUD, upon conveyance of the foreclosed property to FHA. Any liability for such claims, and offsetting recoveries, has been reflected in the Liability for Loan Guarantees on the accompanying financial statements based on the default status of the insured loans.

Note 13. Gross Costs

Gross costs incurred by FHA for the period ended September 30, 2018 and 2017 are as follows:

FY 2018	Single Family Forward	HECM	Multifamily	Healthcare	Administrative Expenses	Total
Intragovernmental:						
Interest Expense	$ 671	$ 264	$ 146	$ 43	$ -	1,124
Imputed Cost	-	-	-	-	17	17
Other Expenses	-	-	-	-	157	157
Total	**$ 671**	**$ 264**	**$ 146**	**$ 43**	**$ 174**	**$ 1,298**
With the Public:						
Salary and Administrative Expense	$ -	$ -	$ -	$ -	$ 566	$ 566
Subsidy Expense	(6,650)	(80)	(467)	(225)	-	(7,422)
Re-estimate Expense	(388)	(1,362)	(29)	166	-	(1,613)
Interest Accumulation Expense	76	453	(75)	(33)	-	421
Bad Debt Expense	2	3	17	-	-	22
Loan Loss Reserve	(7)	-	-	-	-	(7)
Other Expenses	9	-	18	1	-	28
Total	**$ (6,958)**	**$ (986)**	**$ (536)**	**$ (91)**	**$ 566**	**$ (8,005)**
Total Gross Costs	**$ (6,287)**	**$ (722)**	**$ (390)**	**$ (48)**	**$ 740**	**$ (6,707)**

FY 2017 Restated	Single Family Forward	HECM	Multifamily	Healthcare	Administrative Expenses	Total
Intragovernmental:						
Interest Expense	$ 765	$ 235	$ 114	$ 40	$ -	$ 1,154
Imputed Cost	-	-	-	-	13	13
Other Expenses	-	-	-	-	88	88
Total	**$ 765**	**$ 235**	**$ 114**	**$ 40**	**$ 101**	**$ 1,255**
With the Public:						
Salary and Administrative Expense	$ -	$ -	$ -	$ -	$ 620	$ 620
Subsidy Expense	(11,093)	(58)	(547)	(201)	-	(11,899)
Re-estimate Expense	10,355	19,702	(797)	(98)	-	29,162
Interest Expense	-	-	(6)	-	-	(6)
Interest Accumulation Expense	(213)	569	(62)	(23)	-	271
Bad Debt Expense	5	(3)	(136)	-	-	(134)
Loan Loss Reserve	8	-	-	-	-	8
Other Expenses	19	1	36	-	3	59
Total	**$ (919)**	**$ 20,211**	**$ (1,512)**	**$ (322)**	**$ 623**	**$ 18,081**
Total Gross Costs	**$ (154)**	**$ 20,446**	**$ (1,398)**	**$ (282)**	**$ 724**	**$ 19,336**

Interest Expense

Intragovernmental interest expense includes interest expense on borrowings from the U.S. Treasury and the Federal Financing Bank (FFB) in the financing account.

Imputed Costs/Imputed Financing

Imputed costs represent FHA's share of the departmental imputed cost calculated and allocated to FHA by the HUD CFO office. Federal agencies are required to report imputed costs under SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards,* and SFFAS No. 55, *Amending Inter-Entity Cost Provisions* to account for costs assumed by other Federal organizations on their behalf. The HUD CFO receives its imputed cost data from the Office of Personnel Management (OPM) for pension costs, federal employee health benefits (FEHB) and life insurance costs. It also receives Federal Employees' Compensation Act (FECA) costs from the Department of Labor (DOL). Subsequently, using its internally developed allocation basis, HUD CFO allocates the imputed cost data to each of its reporting offices. The imputed costs reported by FHA in its Statements of Net Cost are equal to the amounts of imputed financing in its Statements of Changes in Net Position.

Salary and Administrative Expenses

Salary and administrative expenses include FHA's reimbursement to HUD for FHA personnel costs and FHA's payments to third party contractors for administrative contract expenses. Beginning in fiscal year 2010 and going forward, FHA is only using the MMI program fund to record salaries and related expenses.

Subsidy Expense

Subsidy expense, positive and negative, consists of credit subsidy expense from new endorsements, and modifications. Credit subsidy expense is the estimated long-term cost to the U.S. Government of a direct loan or loan guarantee, calculated on a net present value basis of the estimated future cash flows associated with the direct loan or loan guarantee.

Reestimate Expense

Reestimate expense captures the cost associated with revisions to the liability for loan guarantee. A reestimate is calculated annually.

Interest Accumulation Expense

Interest accumulation expense is calculated as the difference between interest revenue and interest expense. For guaranteed loans, the liability for loan guarantees is adjusted with the offset to interest accumulation expense. In addition, for direct loans, the allowance for subsidy on credit program assets is adjusted with the offset to interest accumulation expense.

Bad Debt Expense

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

Loan Loss Reserve Expense

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

Other Expenses

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

Several presentation updates were made this year. Refer to **Note 23. Financial Statement Presentation and Policy Disclosures** for details of changes to Note 13.

Note 14. Earned Revenue

Earned revenues generated by FHA for the period ended September 30, 2018 and 2017 are as follows:

FY 2018	Single Family Forward	HECM	Multifamily	Healthcare	Total
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	$ 746	$ 718	$ 29	$ 10	$ 1,503
Interest Revenue from MMI/CMHI Investments	431	6	-	-	437
Total Intragovernmental	**$ 1,177**	**$ 724**	**$ 29**	**$ 10**	**$ 1,940**
With the Public:					
Insurance Premium Revenue	$ -	$ -	$ 1	$ -	$ 1
Income from Notes and Properties	5	-	90	-	95
Other Revenue	2	-	42	-	44
Total With the Public	**$ 7**	**$ -**	**$ 133**	**$ -**	**$ 140**
Total Earned Revenue	**$ 1,184**	**$ 724**	**$ 162**	**$ 10**	**$ 2,080**

FY 2017	Single Family Forward	HECM	Multifamily	Healthcare	Total
Intragovernmental:					
Interest Revenue from Deposits at U.S. Treasury	$ 552	$ 804	$ 23	$ 16	$ 1,395
Interest Revenue from MMI/CMHI Investments	253	26	-	-	279
Total Intragovernmental	**$ 805**	**$ 830**	**$ 23**	**$ 16**	**$ 1,674**
With the Public:					
Insurance Premium Revenue	$ -	$ -	$ 1	$ -	$ 1
Income from Notes and Properties	9	-	43	1	53
Other Revenue	1	-	23	-	24
Total With the Public	**$ 10**	**$ -**	**$ 67**	**$ 1**	**$ 78**
Total Earned Revenue	**$ 815**	**$ 830**	**$ 90**	**$ 17**	**$ 1,752**

Interest Revenue

Intragovernmental interest revenue includes interest revenue from deposits at the U.S. Treasury and investments in U.S. Treasury securities. FHA's U.S. Treasury deposits are generated from post-1991 loan guarantees and direct loans in the financing accounts. FHA's investments in U.S. Treasury securities consist of investments of surplus resources in the MMI/CMHI Capital Reserve account.

Premium Revenue

According to the FCRA accounting, FHA's premium revenue includes only premiums associated with the pre-1992 loan guarantee business. Premiums for post-1991 guarantee loans are included in the balance of the LLG. The FHA premium structure includes both up-front premiums and annual periodic premiums.

Up-front Premiums

The up-front premium rates vary according to the mortgage type and the year of origination. The FHA up-front premium rates for loans committed in fiscal year 2018 were:

Upfront Premium Rates	
10/01/2017 - 9/30/2018	
Single Family	1.75%
Multifamily	0.25%, 0.50%, 0.65%, 0.80% or 1.00%
HECM	2.00% (Based on Maximum Claim Amount)

Annual Periodic Premiums

The periodic premium rate is used to calculate monthly or annual premiums. These rates also vary by mortgage type and program. The FHA annual periodic premium rates for loans committed in fiscal year 2018 were:

Annual Periodic Premium Rates	
10/01/2017 - 9/30/2018	
Single Family - Term > 15 years	0.80%, 0.85%, 1.00% or 1.05%
Single Family - Term ≤ 15 years	0.45%, 0.70% or 0.95%
Multifamily	0.45%, 0.57%, 0.65% or 0.70%
HECM	0.50%

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

Income from Notes and Property

Income from Notes and Property includes revenue associated with FHA pre-1992 loan guarantees. This income includes revenue from Notes and Properties held and sold, and gains associated with the sale.

Other Revenue

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

Note 15. Gross Cost and Earned Revenue by Budget Functional Classification

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

Note 16. Transfers In and Other Financing Sources

Transfers In and Other Financing Sources incurred by FHA for the period ended September 30, 2018 and 2017 are as follows:

(Dollars in millions)

FY 2018	Cumulative Results of Operations	Unexpended Appropriations	Total
Transfers In:			
HUD	$ 611	$ -	$ 611
Other Financing Sources:			
Treasury	$ (2,373)	$ -	$ (2,373)

FY 2017 Restated	Cumulative Results of Operations	Unexpended Appropriations	Total
Transfers In:			
HUD	$ 600	$ -	$ 600
Non Exchange Revenue			
HUD	$ 2	$ -	$ 2
Other Financing Sources:			
Treasury	$ (473)	$ -	$ (473)

Transfers In from HUD

FHA does not receive an appropriation for salaries and expense; instead the FHA amounts are appropriated directly to HUD. To recognize these costs in FHA's Statement of Net Cost, a Transfer In from HUD is recorded based on amounts computed by HUD.

Non Exchange Revenue

Non exchange revenue consists of late fees incurred on Multi-Family and Single-Family premiums.

Other Financing Sources

Transfers out to U.S. Treasury consist of negative subsidy from new endorsements, modifications and downward credit subsidy reestimates in the GI/SRI general fund receipt account.

Note 17. Unexpended Appropriations

Unexpended appropriation balances at September 30, 2018 and 2017 are as follows:

(Dollars in millions)

FY 2018	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Ending Balance
Positive Subsidy	$ 2	$ -	$ -	$ -	$ 2
Authority for Contract Expenses	253	130	(39)	(112)	232
Reestimates	-	1,923	-	(1,923)	-
GI/SRI Liquidating	204	25	-	-	229
Total	**$ 459**	**$ 2,078**	**$ (39)**	**$ (2,035)**	**$ 463**

FY 2017	Beginning Balance	Appropriations Received	Other Adjustments	Appropriations Used	Ending Balance
Positive Subsidy	$ 2	$ -	$ -	$ -	$ 2
Authority for Contract Expenses	233	130	-	(108)	255
Reestimates	-	4,318	-	(4,318)	-
GI/SRI Liquidating	180	25	-	(3)	202
Total	**$ 415**	**$ 4,473**	**$ -**	**$ (4,429)**	**$ 459**

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

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

When appropriations are first received, they are reported as unexpended appropriations. As these appropriations are expended, appropriations used are increased and unexpended appropriations are decreased. Additionally, unexpended appropriations are decreased when: administrative expenses and working capital funds are transferred out to HUD; appropriations are rescinded; or other miscellaneous adjustments are required.

Note 18. Budgetary Resources

Obligated balances as of September 30, 2018 and 2017 are as follows:

Unpaid Obligations

(Dollars in Millions)				FY 2018
		Federal	**Non-Federal**	**Total**
MMI/CMHI	$	13	$ 1,819	$ 1,832
GI/SRI		18	993	1,012
H4H		-	2	2
Undelivered Orders Subtotal	**$**	**31**	**$ 2,814**	**$ 2,846**

				FY 2017
		Federal	**Non-Federal**	**Total**
MMI/CMHI	$	17	$ 1,877	$ 1,895
GI/SRI		-	912	912
H4H		-	1	1
Undelivered Orders Subtotal	**$**	**17**	**$ 2,790**	**$ 2,808**

The presentation of this note changed in FY2018 in accordance with OMB Circular A-136, Revised. Refer to **Note 23. Financial Statement Presentation and Policy Disclosures** for details of changes to Note 18.

Note 19. Budgetary Resources - Collections

The following table presents the composition of FHA's collections for the period ended September 30, 2018 and 2017:

(Dollars in Millions)

FY 2018	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 13,125	$ 872	$ 1	$ 13,998
Notes	1,149	659	-	1,808
Property	2,173	142	-	2,315
Interest Earned from U.S. Treasury	1,317	484	1	1,802
Subsidy	6,732	-	-	6,732
Reestimates	13,650	1,923	-	15,573
Collections from settlements	192	-	-	192
Other	142	135	-	277
Total	**$ 38,480**	**$ 4,215**	**$ 2**	**$ 42,697**

FY 2017	MMI/CMHI	GI/SRI	H4H	Total
Collections:				
Premiums	$ 13,431	$ 866	$ 1	$ 14,298
Notes	1,269	806	-	2,075
Property	3,385	196	-	3,581
Interest Earned from U.S. Treasury	1,193	471	-	1,664
Subsidy	11,151	-	-	11,151
Reestimates	20,369	4,720	-	25,089
Collections from settlements	150	-	-	150
Other	104	(368)	-	(264)
Total	**$ 51,052**	**$ 6,691**	**$ 1**	**$ 57,744**

Note 20. Budgetary Resources – Obligations

The following table presents the composition of FHA's obligations for the period ended September 30, 2018 and 2017:

(Dollars in Millions)

September 30, 2018	MMI/CMHI	GI/SRI	H4H	Total
Obligations				
Claims	$ 13,929	$ 2,107	$ 2	$ 16,038
Property Expenses	487	103	1	591
Interest on Borrowings	841	230	-	1,071
Subsidy	6,732	702	-	7,434
Downward Reestimates	1,012	433	-	1,445
Upward Reestimates	12,638	1,923	-	14,561
Administrative Contracts	131	-	-	131
FFB Direct Loans	-	636	-	636
Other	35	168	-	203
Total	**$ 35,805**	**$ 6,302**	**$ 3**	**$ 42,110**

September 30, 2017	MMI/CMHI	GI/SRI	H4H	Total
Obligations				
Claims	$ 15,694	$ 2,676	$ 1	$ 18,371
Property Expenses	613	49	-	662
Interest on Borrowings	904	230	-	1,134
Subsidy	11,152	800	-	11,952
Downward Reestimates	1,672	402	-	2,074
Upward Reestimates	18,691	4,318	-	23,009
Admin, Contract and Working Capital	133	-	-	133
FFB Direct Loans	-	951	-	951
Other	9	(103)	-	(94)
Total	**$ 48,868**	**$ 9,323**	**$ 1**	**$ 58,192**

Note 21. Budget and Accrual Reconciliation (BAR)

Federal Housing Administration
For the Period Ended September 30, 2018

	Intragovernmental	With the Public	Total
NET COST	$ (642)	$ (8,146)	$ (8,788)
Components of Net Cost That Are Not Part of Net Outlays:			
Increase/(decrease) in assets:			
Accounts receivable	-	(83)	(83)
Loans receivable	-	5,543	5,543
Investments	139	(36)	103
Other assets	-	(6)	(6)
(Increase)/decrease in liabilities:			
Accounts payable	(11)	(42)	(52)
Insurance and guarantee program liabilities	-	1,509	1,509
Other liabilities (Unfunded leave, Unfunded FECA, Actuarial FECA)	(1,052)	55	(998)
Other financing sources:			
Federal employee retirement benefit costs paid by OPM and imputed ot the agency	(18)	-	(18)
Transfers out (in) without reimbursement	(611)	-	(611)
Other imputed financing	-	-	-
Total Components of Net Cost That Are Not Part of Net Outlays	$ (1,553)	$ 6,940	$ 5,387
Components of Net Outlays That Are Not Part of Net Cost:			
Other	2,373	-	2,373
Total Components of Net Outlays That Are Not Part of Net Cost	$ 2,373	$ -	$ 2,373
Other Temporary Timing Differences	(1,321)	-	(1,321)
NET OUTLAYS	$ (1,143)	$ (1,206)	$ (2,349)
Net Outlays from SBR			$ (2,349)

The Budget and Accrual Reconciliation (BAR), requires a reconciliation of the entity's net outlays on a budgetary basis and the net cost of operations during the reporting period. The BAR replaces the current Statement of Finance (SOF) note disclosure, which reconciles the budgetary resources obligated (and some non-budgetary resources) and the net cost of operation.

Other Temporary Timing Differences

Captures the amount of FHA's General Fund Receipt Account cash transferred to Treasury at fiscal year-end.

Note 22. Restatement of FHA's Fiscal Year 2017 Financial Statements and Notes

In FY 2018, FHA corrected a material misstatement to recognize the effects of a discounting error in the HECM Return on Assets (ROA) cash flow model used to calculate the recovery rate applied to the annual financial statement reestimate. FHA discovered that it improperly discounted cash flows in the HECM ROA model back to the cohort year of endorsement, instead of discounting back to the year of forecast, September 30, 2017, which resulted in the rates for return on note assets to be lower, leading to less favorable estimates of FHA's financial performance. This correction impacted the Consolidated Balance Sheet (BS), the Statement of Net Cost (SNC) and the Statement of Changes in Net Position (SCNP) and related notes, and also resulted in a cohort in the GI fund to go from an upward reestimate to a downward reestimate, which created a payable to Treasury. On the BS, Net Loans Receivable and Related Foreclosed Property was understated by $1,696 million and Intragovernmental Other Liabilities were understated by $61 million. On the SNC, HECM Gross Costs with the Public were overstated by $1,696 million. On the SCNP, Net Cost of Operations was overstated by $1,696 million and Other Financing Sources were understated by $61 million, for a Net Cumulative Results of Operations increase of $1,636 million. The following FHA notes were impacted; Note 2 Non-Entity Assets, Note 7 Direct Loan and Loan Guarantees, Note 11 Other Liabilities, Note 13 Gross Costs, and Note 16 Transfers In and Other Financing Sources.

Although there was no budgetary impact as a result of the discounting error, if the allowance for subsidy calculation for the HECM program had used the correct discounting in FY2017, the liquidated upward re-estimate in FY2018 would have decreased leading to fewer obligations incurred in the Program accounts and fewer offsetting collections in the Financing accounts, by $1,632 million. Furthermore, the Program accounts would have seen a reduction in the permanent, indefinite appropriation received by $525 million. Alternatively, the liquidated downward re-estimate in FY2018 would have been larger, resulting in increased obligations in the Financing accounts and greater offsetting receipts/collections in the Downward Re-estimate Receipt and Capital Reserve accounts by $64 million.

HUD also corrected a cost allocation issue that underestimated allocated costs related to salaries and administrative expenses to FHA, resulting in an understatement of $174 million in expenses reported by FHA on the Statement of Net Costs. HUD allocated costs to the Office of Housing but did not further allocate costs directly attributed to FHA activities. As a result, the SNC's Salaries and Administrative Expenses, Intragovernmental Gross Costs, were understated by $74 million and Salaries and Administrative Expenses, Gross Costs with the Public, were understated by $100 million. In addition, the SCNP, Other Financing Sources (Nonexchange) Transfers In/Out Without Reimbursement were understated by $174 million. This restatement will also impact Note 13 Gross Costs and Note 16 Transfers In and Other Financing Sources.

Additionally, FHA incorrectly reported the following items in its FY 2017 financial statements notes: 1) Note 3 Fund Balance with U.S. Treasury; $233 million in Borrowing Authority Carried Forward, and $1.5 million Unfilled Customer Orders Without Advances, were reported as Unavailable Resources, instead of Available Resources. 2) Note 7 Direct Loans and Loan Guarantees, Non-Federal Borrowers; $8 million classified as LLR Technical/Default Re-estimate on the Schedule for Reconciling Loan Guarantee Liability Balances, should have been classified as LLR Adjustments Other. 3) Note 5 Investments; total Market Value of investments was overstated by $46 million, due to the erroneous inclusion of accrued interest.

FHA has restated its FY 2017 financial statements to correct for the impact of the restatements mentioned. Due to the imminent publishing of the FY 2018 audited financial statements, the FY2017 financial statement and notes restatement will be presented comparatively.

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
RESTATED BALANCE SHEET
As of September 30, 2017
(Dollars in Millions)

	FY 2017	Restated FY 2017	Difference
ASSETS			
Intragovernmental			
Fund Balance with U.S. Treasury (Note 3)	$ 29,112	$ 29,112	$ -
Investments (Note 5)	30,841	30,841	$ -
Total Intragovernmental	$ 59,953	$ 59,953	$ -
Cash and Other Monetary Assets (Note 4)	$ 40	40 *	$ -
Investments (Note 5)	$ 44	44	$ -
Accounts Receivable, Net (Note 6)	220	220	$ -
Loans Receivable and Related Foreclosed Property, Net (Note 7)	18,819	20,515	$ (1,696)
TOTAL ASSETS	**$ 79,076**	**$ 80,772**	$ (1,696)
LIABILITIES			
Intragovernmental			
Accounts Payable (Note 8)	$ 2	$ 2	$ -
Borrowings (Note 9)	29,141	29,141	$ -
Other Liabilities (Note 10)	1,673	1,734	$ (61)
Total Intragovernmental	$ 30,816	$ 30,877	$ (61)
Accounts Payable (Note 8)	$ 514	$ 514	$ -
Loan Guarantee Liability (Note 7)	20,616	20,616	$ -
Other Liabilities (Note 10)	636	636	$ -
TOTAL LIABILITIES	**$ 52,582**	**$ 52,643**	$ (61)
NET POSITION			
Unexpended Appropriations (Note 16)	$ 459	$ 459	$ -
Cumulative Results of Operations	26,035	27,670	$ (1,635)
TOTAL NET POSITION	**$ 26,494**	**$ 28,129**	$ (1,635)
TOTAL LIABILITIES AND NET POSITION	**$ 79,076**	**$ 80,772**	$ (1,696)

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
RESTATED STATEMENT OF NET COST
For the Periods Ended September 30, 2017
(Dollars in Millions)

	FY 2017	Restated FY 2017	Difference
Single Family Forward			
Intragovernmental Gross Costs	$ 765	$ 765	$ -
Less: Intragovernmental Earned Revenue	805	805	$ -
Intragovernmental Net Costs	$ (40)	$ (40)	$ -
Gross Costs With the Public	$ (919)	$ (919)	$ -
Less: Earned Revenues	10	10	$ -
Net Costs With the Public	$ (929)	$ (929)	$ -
Single Family Forward Net Cost (Surplus)	$ (969)	$ (969)	$ -
HECM			
Intragovernmental Gross Costs	$ 235	$ 235	$ -
Less: Intragovernmental Earned Revenue	830	830	$ -
Intragovernmental Net Costs	$ (595)	$ (595)	$ -
Gross Costs With the Public	$ 21,908	$ 20,211	$ 1,697
Less: Earned Revenues	-	-	$ -
Net Costs With the Public	$ 21,908	$ 20,211	$ 1,697
HECM Net Cost (Surplus)	$ 21,313	$ 19,616	$ 1,697
Multifamily			
Intragovernmental Gross Costs	$ 114	$ 114	$ -
Less: Intragovernmental Earned Revenue	23	23	$ -
Intragovernmental Net Costs	$ 91	$ 91	$ -
Gross Costs With the Public	$ (1,512)	$ (1,512)	$ -
Less: Earned Revenues	67	67	$ -
Net Costs With the Public	$ (1,579)	$ (1,579)	$ -
Multifamily Net Cost (Surplus)	$ (1,488)	$ (1,488)	$ -
Healthcare			
Intragovernmental Gross Costs	$ 40	$ 40	$ -
Less: Intragovernmental Earned Revenue	16	16	$ -
Intragovernmental Net Costs	$ 24	$ 24	$ -
Gross Costs With the Public	$ (322)	$ (322)	$ -
Less: Earned Revenues	$ 1	$ 1	$ -
Net Costs With the Public	$ (323)	$ (323)	$ -
Healthcare Net Cost (Surplus)	$ (299)	$ (299)	$ -
Salaries and Administrative Expenses			
Intragovernmental Gross Costs	$ 27	$ 101	$ (74)
Less: Intragovernmental Earned Revenue	-	-	$ -
Intragovernmental Net Costs	$ 27	$ 101	$ (74)
Gross Costs With the Public	$ 523	$ 623	$ (100)
Less: Earned Revenues	-	-	$ -
Net Costs With the Public	$ 523	$ 623	$ (100)
Adminstrative and Contracts Net Cost (Surplus)	$ 550	$ 724	$ (174)
			$ -
Net Cost of Operations	**$ 19,107**	**$ 17,584**	$ 1,523

FEDERAL HOUSING ADMINISTRATION
(AN AGENCY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT)
RESTATED STATEMENT OF NET POSITION
For the Periods Ended September 30, 2017
(Dollars in Millions)

	FY 2017	Restated FY 2017	Difference
Unexpended Appropriations (Note 17)			
Collections	415	415	-
Budgetary Financing Sources:			
Appropriations Received	4,473	4,473	-
Appropriations Used	(4,429)	(4,429)	-
Total Budgetary Financing Sources	44	44	-
Total Unexpended Appropriations	459	459	-
Cumulative Results of Operations (Note 17)			
Beginning Balance	**$ 40,682**	**$ 40,682**	**$ -**
Beginning Balance, As Adjusted	**$ 40,682**	**$ 40,682**	**$ -**
Budgetary Financing Sources:			
Appropriations Used	4,429	4,429	-
NonExchange Revenue	2	2	-
Other Financing Sources (Nonexchange):			
Donations and Forfeitures of Property	-	-	
Transfers In/Out Without Reimbursement	426	600	(174)
Imputed Financing From Costs	13	13	-
Other	(412)	(473)	61
Total Financing Sources	4,458	4,571	(113)
Net Cost of Operations	(19,107)	(17,584)	(1,523)
Net Change	(14,648)	(13,012)	(1,636)
Cummulative Results of Operation	26,034	27,670	(1,636)
Net Position	**$ 26,493**	**$ 28,129**	(1,636)

Note 23. Financial Statement Presentation and Policy Disclosures

During FY 2018, FHA management made several changes in accounting and reporting policy, some of which resulted from updated reporting requirements published in OMB Circular A-136 *Financial Reporting Requirements, Revised*, that affected balances of several lines of the FHA FY 2017 and 2018 financial statements and notes.

The FY 2018 Revised OMB Circular A-136 included changes to the presentation of the Statement of Changes in Net Position (SCNP) and the Statement of Budgetary Resources (SBR). The presentation of the SCNP was reformatted to show Unexpended Appropriations before Cumulative Results of Operations and the SBR presentation was changed to streamline requirements of the Federal Accounting Standards Board. In addition, the presentation of FHA Note 18, Budgetary Resources, was updated to disclose Federal and Non-Federal undelivered orders.

In prior years, FHA presented its technical reestimate subsidy reestimate expense and interest expense on the subsidy reestimate expense, as two separate components. In FY 2018, for consistency with OMB A-136 illustrative guidance, the subsidy reestimate expense and interest expense on the subsidy reestimate expense, were combined and reported as a single amount. This impacted Note 7 Direct Loan and Loan Guarantees and Note 13 Gross Costs. Because the interest expense on the subsidy reestimate expense component of the technical reestimate, was not previously reported as part of the Subsidy Expense in Note 7, Subsidy Expense for both Direct Loans and Loan Guarantees increased as follows: FHA's FY 2017 MMI/CMHI and GI/SRI Subsidy Expense for Modification and Reestimates increased by $3.2 and $2.8 billion, respectively, for a total increase of $6 billion. The Direct Loan GI/SRI Subsidy Expense for Reestimates increased by $2.6 million.

Since FHA's financial statements are audited and published comparatively, the presentation changes impacting FY 2017 were updated for comparative reporting.

Required Supplementary Information

Schedule A: Intragovernmental Assets

FHA's Intra-governmental assets, by Federal entity, are as follows on September 30, 2018 and 2017:

(Dollars in Millions)

FY 2018	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Total
U.S. Treasury	$ 33,690	$ 26,697	$ 60,387
Total	**$ 33,690**	**$ 26,697**	**$ 60,387**

FY 2017	Fund Balance with U.S. Treasury	Investments in U.S. Treasury Securities	Total
U.S. Treasury	$ 29,112	$ 30,841	$ 59,953
Total	**$ 29,112**	**$ 30,841**	**$ 59,953**

Schedule B: Intragovernmental Liabilities

FHA's Intra-governmental liabilities, by Federal entity, are as follows on September 30, 2018 and 2017:

(Dollars in Millions)

FY 2018	Accounts Payable	Borrowings	Other Liabilities	Total
Federal Financing Bank	$ -	$ 1,671	$ -	$ 1,671
U.S. Treasury	-	24,708	2,787	27,495
HUD	2	-	-	2
Total	**$ 2**	**$ 26,379**	**$ 2,787**	**$ 29,168**

FY 2017	Accounts Payable	Borrowings	Restated Other Liabilities	Total
Federal Financing Bank	$ -	$ 1,187	$ -	$ 1,187
U.S. Treasury	-	27,954	1,734	29,688
HUD	2	-	-	2
Total	**$ 2**	**$ 29,141**	**$ 1,734**	**$ 30,877**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2018:

Dollars in Millions	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance from prior year budget authority, net	$ 18,987	$ 80	$ 12,640	$ 43	$ 31,750
Appropriations (discretionary and mandatory)	-	130	1,923	25	2,078
Spending authority from offsetting collections (discretionary & mandatory)	7,995	-	-	162	8,157
Total budgetary resources	**$ 26,982**	**$ 210**	**$ 14,563**	**$ 230**	**$ 41,985**
Memorandum (non-add) entries:					
Net Adjustments to unobligated balance brought forward, Oct. 1	$ -	$ 5,161	$ 1	$ (5,025)	$ (137)
Status of Budgetary Resources:					
Obligations incurred	-	131	14,561	61	14,753
Unobligated balance, end of year:					
Apportioned	-	45	1	11	57
Unapportioned	26,982	-	1	157	27,140
Unexpired unobligated balance, end of year	26,982	45	2	169	27,198
Expired unobligated balance, end of year	-	34	-	-	34
Total unobligated balance, end of year	26,982	45	2	203	27,232
Total budgetary resources	**$ 26,982**	**$ 210**	**$ 14,563**	**$ 230**	**$ 41,985**
Budget Authority and Outlays, Net:					
Outlays, net (discretionary and mandatory)	$ (8,042)	$ 110	$ 14,561	$ (130)	$ 6,499
Distributed offsetting receipts (-)	-	-	-	(1,183)	(1,183)
Agency outlays, net (discretionary and mandatory)	**$ (8,042)**	**$ 110**	**$ 14,561**	**$ (1,313)**	**$ 5,316**

Required Supplementary Information

Schedule C: Comparative Combining Statement of Budgetary Resources by FHA Program for Budgetary September 30, 2017:

Dollars in Millions	MMI/CMHI Capital Reserve	MMI/CMHI Program	GI/SRI Program	Other	Budgetary Total
Budgetary Resources:					
Unobligated balance from prior year budget authority, net	$ 18,522	$ 18,779	$ 1	$ 41	$ 37,343
Appropriations (discretionary and mandatory)	-	130	4,318	25	4,473
Spending authority from offsetting collections (discretionary & mandatory)	13,112	-	-	177	13,289
Total budgetary resources	**$ 31,635**	**$ 18,909**	**$ 4,319**	**$ 242**	**$ 55,105**
Memorandum (non-add) entries:					
Net Adjustments to unobligated balance brought forward, Oct. 1	$ -	$ 8	$ -	$ (423)	$ (415)
Status of Budgetary Resources:					
Obligations incurred	-	18,824	4,318	75	23,217
Unobligated balance, end of year:					
Apportioned	-	46	1	22	69
Unapportioned	31,635	1	-	125	31,761
Unexpired unobligated balance, end of year	31,635	47	1	147	31,830
Expired unobligated balance, end of year	-	39	-	19	58
Total unobligated balance, end of year	31,635	47	1	205	31,888
Total budgetary resources	**$ 31,635**	**$ 18,909**	**$ 4,319**	**$ 242**	**$ 55,105**
Budget Authority and Outlays, Net:					
Outlays, net (discretionary and mandatory)	$ (13,099)	$ 18,797	$ 4,318	$ (131)	$ 9,885
Distributed offsetting receipts (-)	-	-	-	(1,070)	(1,070)
Agency outlays, net (discretionary and mandatory)	**$ (13,099)**	**$ 18,797**	**$ 4,318**	**$ (1,201)**	**$ 8,815**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2018:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total
Budgetary Resources:				
Unobligated balance from prior year budget authority, net	$ 16,517	$ 8,681	$ 57	$ 25,255
Borrowing authority (discretionary and mandatory)	6,450	1,051	703	8,204
Spending authority from offsetting collections (discretionary and mandatory)	20,772	2,861	44	23,677
Total budgetary resources	**$ 43,740**	**$ 12,592**	**$ 804**	**$ 57,136**
Memorandum (non-add) entries:				
Net Adjustments to unobligated balance brought forward, Oct. 1	$ 390	$ 72	$ 1	$ 463
Status of Budgetary Resources:				
Obligations incurred	23,011	3,650	696	27,357
Unobligated balance, end of year:				
Apportioned	7,597	2,873	16	10,486
Unapportioned	13,132	6,070	91	19,293
Unexpired unobligated balance, end of year	20,729	8,943	107	29,779
Total unobligated balance, end of year	20,729	8,943	107	29,779
Total budgetary resources	**$ 43,740**	**$ 12,592**	**$ 804**	**$ 57,136**
Budget Authority and Outlays, Net:				
Outlays, net (discretionary and mandatory)	$ (7,746)	$ (345)	$ 426	$ (7,665)
Agency outlays, net (discretionary and mandatory)	**$ (7,746)**	**$ (345)**	**$ 426**	**$ (7,665)**

Required Supplementary Information

Schedule D: Comparative Combining Budgetary Resources by FHA Program for Non-Budgetary September 30, 2017:

	MMI/CMHI Financing	GI/SRI Financing	Other	Non Budgetary Total
Budgetary Resources:				
Unobligated balance from prior year budget authority, net	$ 10,674	$ 6,027	$ 26	$ 16,727
Borrowing authority (discretionary and mandatory)	6,500	812	1,064	8,376
Spending authority from offsetting collections (discretionary and mandatory)	28,972	5,661	32	34,665
Total budgetary resources	**$ 46,146**	**$ 12,499**	**$ 1,123**	**$ 59,768**
Memorandum (non-add) entries:				
Net Adjustments to unobligated balance brought forward, Oct. 1	$ 65	$ 251	$ -	$ 316
Status of Budgetary Resources:				
Obligations incurred	30,019	3,887	1,069	34,975
Unobligated balance, end of year:				
Apportioned	3,568	2,664	40	6,272
Unapportioned	12,559	5,949	13	18,521
Unexpired unobligated balance, end of year	16,127	8,612	54	24,793
Total unobligated balance, end of year	16,127	8,612	54	24,793
Total budgetary resources	**$ 46,146**	**$ 12,499**	**$ 1,123**	**$ 59,768**
Budget Authority and Outlays, Net:				
Outlays, net (discretionary and mandatory)	$ (8,346)	$ (2,656)	$ 714	$ (10,288)
Agency outlays, net (discretionary and mandatory)	**$ (8,346)**	**$ (2,656)**	**$ 714**	**$ (10,288)**

Other Accompanying Information

For FY 2018, one material weakness was identified by the Office of the Inspector General in its audit of FHA's Principal Financial Statements and accompanying Notes. Table 1 provides a summary of financial audit findings with regard to the audit opinion. Table 2 is a summary of FHA's Federal Managers' Financial Integrity Act management assurances.

Table 1
Summary of Financial Statement Audit

Audit Opinion	Unmodified
Restatement	Yes

Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Controls Over Financial Reporting Had Weaknesses	1	0	1	0	0
Weaknesses in FHA's Modeling Processes	1	0	0	0	1
Total Material Weaknesses	2	0	1	0	1

Table 2
Summary of Management Assurances

Effectiveness of Internal Control over Financial Reporting (FMFIA section 2)	
Statement of Assurance	Qualified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Controls Over Financial Reporting Had Weaknesses	1	0	1	0	0
Weaknesses in FHA's Modeling Processes	1	0	0	0	1
Total Material Weaknesses	2	0	1	0	1