

**NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL**

**NCUA FINANCIAL STATEMENT AUDITS
FOR
OPERATING FUND
SHARE INSURANCE FUND
CENTRAL LIQUIDITY FACILITY
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND**



For the year ended December 31, 2003

Audited Financial Statements	Audit Report Number
NCUA Operating Fund	OIG-04-01
National Credit Union Share Insurance Fund	OIG-04-02
Central Liquidity Facility	OIG-04-03
Community Development Revolving Loan Fund	OIG-04-04

March 31, 2004

Herb Yolles
Inspector General

EXECUTIVE SUMMARY

PURPOSE AND SCOPE

The National Credit Union Administration (NCUA) Office of Inspector General contracted with the independent public accounting firm of Deloitte & Touche to perform the financial statement audits of the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund, for the year ended December 31, 2003.

The purpose of the audits is to express an opinion on whether the financial statements are fairly presented. The independent firm also reviewed the internal control structure and evaluated compliance with laws and regulations, as part of their audit.

The audits were performed in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. These standards require the reporting of any personal impairment to independence that could affect the auditor's impartiality or the appearance of impartiality. Prior to his appointment as Inspector General, the Inspector General served as NCUA's Deputy Director of the Office of Examination and Insurance; and as the President of the Central Liquidity Facility. In order to avoid the appearance of an independence impairment, the day to day and overall responsibility for oversight of the financial statement audit was delegated to the Deputy Inspector General for Audits.

FINANCIAL STATEMENT CONTRACT

The Inspector General contracted with Deloitte & Touche in August 2003 to perform the financial statement audits mentioned above. The contract was for 2003, with options for 2004 and 2005. The Deputy Inspector General for Audits is the contracting officer's technical representative for this contract.

AUDIT RESULTS

Deloitte & Touche expressed unqualified opinions, stating that the financial statements present fairly, in all material respects, the financial position of the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund, at December 31, 2003, and the results of operations for the year then ended.

Although Deloitte & Touche does not express an overall opinion of the Funds' compliance with laws and regulations, their testing of compliance did not disclose any significant deviations.

Deloitte & Touche did not find any matters considered to be *material* weaknesses in their review of the Funds' internal control structures pertinent to financial reporting. However, during the performance of the audit, we developed recommendations related to internal control over financial reporting and certain observations and recommendations on other accounting, administrative, and operating matters. The observations and recommendations section of this report is restricted to official use only.

***National Credit Union
Administration
Operating Fund***

*Financial Statements for the Years Ended
December 31, 2003 and 2002, and
Independent Auditors' Reports*

NATIONAL CREDIT UNION ADMINISTRATION OPERATING FUND

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	3
FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002:	
Balance Sheets	4
Statements of Revenues, Expenses, and Changes in Fund Balance	5
Statements of Cash Flows	6
Notes to Financial Statements	7-11
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	12

INDEPENDENT AUDITORS' REPORT

Inspector General
National Credit Union Administration

We have audited the accompanying balance sheets of the National Credit Union Administration Operating Fund as of December 31, 2003 and 2002, and the related statements of revenues, expenses, and changes in fund balance, and of cash flows for the years then ended. These financial statements are the responsibility of the National Credit Union Administration Operating Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Operating Fund as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2004, on our tests of the National Credit Union Administration Operating Fund's compliance with certain provisions of laws, regulations, contracts, and grants, and our consideration of its internal control over financial reporting. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

February 24, 2004

NATIONAL CREDIT UNION ADMINISTRATION OPERATING FUND

BALANCE SHEETS DECEMBER 31, 2003 AND 2002 (Dollars in thousands)

ASSETS	2003	2002
ASSETS:		
Cash and cash equivalents	\$ 24,450	\$ 18,582
Due from National Credit Union Share Insurance Fund (Note 4)	1,914	670
Employee advances	339	254
Other accounts receivable	189	96
Prepaid expenses	267	97
Fixed assets—net of accumulated depreciation and amortization (Note 3)	<u>37,208</u>	<u>36,197</u>
TOTAL ASSETS	<u>\$ 64,367</u>	<u>\$ 55,896</u>
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Accounts payable	\$ 4,505	\$ 3,311
Obligations under capital leases (Note 5)	2,367	548
Accrued wages and benefits	5,455	4,987
Accrued annual leave	8,232	7,669
Accrued employee travel	77	776
Notes payable to National Credit Union Share Insurance Fund (Note 4)	<u>26,484</u>	<u>28,922</u>
Total liabilities	47,120	46,213
FUND BALANCE	<u>17,247</u>	<u>9,683</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 64,367</u>	<u>\$ 55,896</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
OPERATING FUND**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCE
YEARS ENDED DECEMBER 31, 2003 AND 2002
(Dollars in thousands)**

	2003	2002
REVENUES:		
Operating fees	\$ 57,984	\$ 53,820
Interest	427	565
Other	<u>121</u>	<u>188</u>
Total revenues	<u>58,532</u>	<u>54,573</u>
EXPENSES (Note 4):		
Employee wages and benefits	39,625	39,842
Travel	3,806	4,146
Rent, communications, and utilities	1,498	1,553
Contracted services	2,224	1,987
Other	<u>3,815</u>	<u>3,456</u>
Total expenses	<u>50,968</u>	<u>50,984</u>
EXCESS OF REVENUES OVER EXPENSES	7,564	3,589
FUND BALANCE—Beginning of year	<u>9,683</u>	<u>6,094</u>
FUND BALANCE—End of year	<u>\$ 17,247</u>	<u>\$ 9,683</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
OPERATING FUND**

**STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002**

(Dollars in thousands)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenues over expenses	\$ 7,564	\$ 3,589
Adjustments to reconcile excess of revenues over expenses to cash provided by operating activities:		
Depreciation and amortization	2,967	3,406
Loss on disposal of employee residences held for resale	21	54
Loss on disposal of fixed assets	15	16
Miscellaneous allowances		(4)
(Increase) decrease in assets:		
Due from National Credit Union Share Insurance Fund	(1,244)	1,053
Employee advances	(85)	275
Other accounts receivable	(93)	(3)
Prepaid expenses	(170)	168
(Decrease) increase in liabilities:		
Accounts payable	1,194	(2,084)
Accrued wages and benefits	468	189
Accrued annual leave	563	138
Accrued employee travel	(699)	
	<u>10,501</u>	<u>6,797</u>
Net cash provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of fixed assets and employee residences held for resale	(1,086)	(1,517)
Proceeds from sale of employee residences held for resale	<u>162</u>	<u>595</u>
	<u>(924)</u>	<u>(922)</u>
Net cash used in investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of notes payable	(2,438)	(1,413)
Principal payments under capital lease obligations	<u>(1,271)</u>	<u>(1,760)</u>
	<u>(3,709)</u>	<u>(3,173)</u>
Net cash used in financing activities		
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,868	2,702
CASH AND CASH EQUIVALENTS—Beginning of year	<u>18,582</u>	<u>15,880</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 24,450</u>	<u>\$ 18,582</u>

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Interest paid during the years ended December 31, 2003 and 2002, was \$743 and \$1,210, respectively.

SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES:

Capital lease obligations of \$3,119 and \$23 were incurred when the Fund entered into leases for new equipment during the years ended December 31, 2003 and 2002, respectively.

See notes to financial statements.

NATIONAL CREDIT UNION ADMINISTRATION OPERATING FUND

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003 AND 2002

1. ORGANIZATION AND PURPOSE

The National Credit Union Administration Operating Fund (the “Fund”) was created by the Federal Credit Union Act of 1934. The Fund was established as a revolving fund in the United States Treasury under the management of the National Credit Union Administration (“NCUA”) Board for the purpose of providing administration and service to the Federal Credit Union System.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash Equivalents—The Federal Credit Union Act permits the Fund to make investments in United States Government securities or securities guaranteed as to both principal and interest by the United States Government. Cash equivalents are highly liquid investments with original maturities of three months or less. All investments in 2003 and 2002 were cash equivalents and are stated at cost, which approximates fair value.

Depreciation and Amortization—Building, furniture and equipment, equipment under capital leases, and leasehold improvements are recorded at cost. Depreciation and amortization are computed by the straight-line method over the estimated useful lives of the building, furniture and equipment, and the shorter of the estimated useful life or lease term for leasehold improvements. Estimated useful lives are forty years for the building and three to ten years for the furniture, equipment, and leasehold improvements.

Operating Fees—The Fund assesses each federally chartered credit union an annual fee based on the credit union’s asset base as of the preceding December 31. The fee is designed to cover the costs of providing administration and service to the Federal Credit Union System. The Fund recognizes this operating fee revenue ratably over the year.

Income Taxes—The Fund is exempt from Federal income taxes under Section 501(c) (1) of the Internal Revenue Code.

Fair Value of Financial Instruments—The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

Cash and cash equivalents, receivable from National Credit Union Share Insurance Fund (“NCUSIF”), employee advances, other accounts receivable, accounts and notes payable to NCUSIF, and other accounts payable are recorded at book values, which approximate the respective fair values.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management’s estimates.

Accounting for Exit and Disposal Activities- The Fund accounts for exit and disposal activities in accordance with Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit and Disposal Activities*. This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than the date of an entity's commitment to an exit plan. The Fund's conformance with this standard affects the timing of the recognition of costs of its regional restructuring plan described in Note 9.

3. FIXED ASSETS

Fixed assets are comprised of the following (in thousands):

	2003	2002
Office building and land	\$ 42,453	\$ 42,453
Furniture and equipment	11,509	10,607
Equipment under capital leases	<u>3,237</u>	<u>4,918</u>
Total	57,199	57,978
Less: Accumulated depreciation and amortization	<u>(19,991)</u>	<u>(21,781)</u>
Fixed assets—net	<u>\$ 37,208</u>	<u>\$ 36,197</u>

Accumulated amortization balances for equipment under capital leases as of December 31, 2003 and 2002, were \$860,000 and \$4,432,000, respectively.

4. TRANSACTIONS WITH NCUSIF

Certain administrative services are provided by the Fund to NCUSIF. The Fund charges NCUSIF for these services based upon an annual allocation factor approved by the NCUA Board and derived from a study of actual usage. The allocation factor was 62.00% to NCUSIF for both 2003 and 2002, respectively. The cost of the services allocated to NCUSIF, which totaled approximately \$83,158,000 and \$83,182,000 for 2003 and 2002, is reflected as a reduction of the corresponding expenses in the accompanying financial statements.

In 1988, the Fund entered into a \$2,161,000 thirty-year unsecured term note with NCUSIF for the purchase of a building. Interest costs incurred were approximately \$11,000 and \$46,000 for 2003 and 2002, respectively. The outstanding principal balances at December 31, 2003 and 2002, were \$0 and \$1,098,000, respectively. The balance of \$0 reflects the payoff of the note.

In 1992, the Fund entered into a commitment to borrow up to \$41,975,000 in a thirty-year secured term note with NCUSIF. The monies were drawn as needed to fund the costs of constructing a building in 1993. Interest costs incurred were approximately \$732,000 and \$1,164,000 for 2003 and 2002, respectively. The note payable balances at December 31, 2003 and 2002, were approximately \$26,484,000 and \$27,824,000, respectively.

The above notes require principal repayments as follows (in thousands):

	Secured Term Note
2004	\$ 1,341
2005	1,341
2006	1,341
2007	1,341
2008	1,341
Thereafter	<u>19,779</u>
	<u>\$ 26,484</u>

The variable rate on both notes is equal to NCUSIF's prior-month yield on investments. The average interest rates during 2003 and 2002 were 2.70% and 4.09%, respectively. The interest rates at December 31, 2003 and 2002, were 2.08% and 3.51%, respectively.

5. LEASE COMMITMENTS

Description of Leasing Agreements—The Fund has entered into a number of lease agreements with vendors for the rental of office space as well as the lease of office equipment that includes laptops, printers, monitors, and copiers.

Operating Leases—The Fund leases office space under lease agreements that expire through 2008. Office rental charges amounted to approximately \$1,133,000 and \$1,009,000 of which approximately \$702,460 and \$625,500 was reimbursed by NCUSIF for 2003 and 2002, respectively. In addition, the Fund leases office equipment under operating leases with lease terms of less than one year.

Capital Leases—The Fund leases computer equipment under lease agreements that expire through 2008.

The future minimum lease payments as of December 31, 2003, are as follows (in thousands):

	Operating Leases	Capital Leases
2004	\$ 1,069	\$ 1,089
2005	823	1,059
2006	470	279
2007	461	14
2008	<u>284</u>	<u>8</u>
Total	<u>\$ 3,107</u>	<u>2,449</u>
Less: Imputed interest		<u>82</u>
Present value of minimum lease payments		<u>\$ 2,367</u>

Based on the allocation factor approved by the NCUA Board for 2003, NCUSIF will reimburse the Fund for approximately 62% of the future operating lease payments.

6. RETIREMENT PLAN

The employees of the Fund are participants in the Civil Service Retirement and Disability Fund, which includes the Federal Employees' Retirement System ("FERS"). Both plans are defined benefit

retirement plans covering all of the employees of the Fund. FERS is comprised of a Social Security Benefits Plan, a Basic Benefits Plan, and a Savings Plan. Contributions to the plans are based on a percentage of employees' gross pay. Under the Savings Plan, employees can also elect additional contributions between 1% and 14% of their gross pay, and the Fund will match up to 5% of the employees' gross pay. In 2003 and 2002, the Fund's contributions to the plans were approximately \$10,422,000 and \$10,783,000, respectively, of which approximately \$6,462,000 and \$6,685,000 were reimbursed by NCUSIF, respectively.

The Fund does not account for the assets of the above plans and does not have actuarial data with respect to accumulated plan benefits or the unfunded liability relative to eligible employees. These amounts are reported by the U.S. Office of Personnel Management for the Civil Service Retirement and Disability Fund and are not allocated to individual employers.

7. DISCLOSURES OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the Fund's financial instruments are as follows (in thousands):

	December 31, 2003		December 31, 2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 24,450	\$ 24,450	\$ 18,582	\$ 18,582
Due from NCUSIF	1,914	1,914	670	670
Employee advances	339	339	254	254
Other accounts receivable	189	189	96	96
Accounts payable	4,505	4,505	3,311	3,311
Obligation under capital lease	2,367	2,367	548	548
Notes payable to NCUSIF	26,484	26,484	28,922	28,922

8. CONTINGENCIES

NCUA is currently a party to a number of disputes that involve or may involve litigation. In the opinion of management, the ultimate liability with respect to these disputes, if any, will not be material to NCUA's financial position.

9. RESTRUCTURING

NCUA announced on January 29, 2003, a regional restructuring plan, previously approved by the Board on November 21, 2002. The restructuring plan relocated the Region VI office in Concord, California, to Tempe, Arizona, and renumbered it to Region V. The plan also closed the Region IV regional office in Chicago, Illinois. The process of relocating Region VI began early in 2003 and will be completed no later than December 2004. Region V, located in Austin, Texas, was renumbered to Region IV. Credit union supervision was aligned with the five regions and became effective as of January 1, 2004.

NCUA estimates that the costs to be incurred for the regional restructuring plan are \$3,636,000, which includes relocation costs of \$3,000,000, and miscellaneous administrative and other costs of approximately \$636,000. Approximately \$2,185,000 of these costs was incurred during 2003. Based on the allocation factors approved by the NCUA Board, the Operating Fund is responsible for 38.00% for 2003. The Fund's estimated cost for the regional restructuring plan will be approximately \$1,382,000. The SIF's estimated cost for the regional restructuring plan will be approximately \$2,254,000. In accordance with SFAS Statement No. 146, *Accounting for Costs Associated with Exit and Disposal Activities*, an accrual of approximately \$1.4 million has been made in the Fund as of December 31, 2003.

* * * * *

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Inspector General
National Credit Union Administration

We have audited the financial statements of the National Credit Union Administration Operating Fund (the "Fund") as of and for the year ended December 31, 2003, and have issued our report thereon dated February 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of the Fund in a separate letter dated February 24, 2004.

This report is intended solely for the information and use of the Inspector General, and the Board of the National Credit Union Administration, and the management of the National Credit Union Administration Operating Fund and is not intended to be and should not be used by anyone other than these specified parties.

February 24, 2004

National Credit Union Share Insurance Fund

*Financial Statements for the Years Ended
December 31, 2003 and 2002, and
Independent Auditors' Reports*

NATIONAL CREDIT UNION SHARE INSURANCE FUND

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	3
FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002:	
Balance Sheets	4
Statements of Operations	5
Statements of Fund Balance	6
Statements of Cash Flows	7
Notes to Financial Statements	8-16
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	17

INDEPENDENT AUDITORS' REPORT

Inspector General
National Credit Union Administration

We have audited the accompanying balance sheets of the National Credit Union Share Insurance Fund as of December 31, 2003 and 2002, and the related statements of operations, fund balance and cash flows for the years then ended. These financial statements are the responsibility of the National Credit Union Share Insurance Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Share Insurance Fund as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2004, on our tests of the National Credit Union Share Insurance Fund's compliance with certain provisions of laws, regulations, contracts, and grants, and our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

February 24, 2004

NATIONAL CREDIT UNION SHARE INSURANCE FUND

BALANCE SHEETS

DECEMBER 31, 2003 AND 2002

(Dollars in thousands)

ASSETS	2003	2002
ASSETS:		
Investments (Note 6)	\$4,709,610	\$4,535,537
Cash and cash equivalents	1,364,954	1,008,693
Accrued interest receivable	45,761	69,174
Capital assessment receivable		3,697
Assets acquired in assistance to insured credit unions	12,217	15,417
NCUSIF subordinated note	1,711	
Notes receivable—National Credit Union Administration Operating Fund (Note 8)	26,484	28,922
Other notes receivable and advances	880	
Fixed assets—net of accumulated depreciation and amortization (Note 3)	<u>934</u>	<u>265</u>
TOTAL ASSETS	<u>\$6,162,551</u>	<u>\$5,661,705</u>
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Estimated losses from supervised credit unions (Note 4)	\$ 76,667	\$ 47,543
Amounts due to insured shareholders of liquidated credit unions	9,541	6,228
Due to National Credit Union Administration Operating Fund (Note 8)	1,914	670
Cash assistance liability	100	
Accounts payable	3	3
Obligations under capital leases (Note 9)	<u>936</u>	<u>165</u>
Total liabilities	<u>89,161</u>	<u>54,609</u>
FUND BALANCE:		
Insured credit unions' accumulated contributions	4,704,596	4,267,169
Insurance fund balance	<u>1,368,794</u>	<u>1,339,927</u>
Total fund balance	<u>6,073,390</u>	<u>5,607,096</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$6,162,551</u>	<u>\$5,661,705</u>

See notes to financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2003 AND 2002 (Dollars in thousands)

	2003	2002
REVENUES:		
Interest	\$ 151,174	\$ 213,252
Other	<u>761</u>	<u>1,226</u>
Total revenues	<u>151,935</u>	<u>214,478</u>
EXPENSES (Note 8):		
Administrative expenses:		
Employee wages and benefits	64,652	65,005
Travel	6,210	6,764
Rent, communications, and utilities	2,443	2,533
Contracted services	3,629	3,241
Provision for insurance losses (Note 4)	38,043	12,513
Other	<u>8,091</u>	<u>7,824</u>
Total expenses	<u>123,068</u>	<u>97,880</u>
EXCESS OF REVENUES OVER EXPENSES	<u>\$ 28,867</u>	<u>\$ 116,598</u>

See notes to financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF FUND BALANCE YEARS ENDED DECEMBER 31, 2003 AND 2002 (Dollars in thousands)

	Insured Credit Unions' Accumulated Contributions	Insurance Fund Balance
BALANCE AT JANUARY 1, 2002	\$3,812,459	\$1,223,329
Contributions from insured credit unions	454,710	
Excess of revenues over expenses	<u> </u>	<u>116,598</u>
BALANCE AT DECEMBER 31, 2002	4,267,169	1,339,927
Contributions from insured credit unions	437,427	
Excess of revenues over expenses	<u> </u>	<u>28,867</u>
BALANCE AT DECEMBER 31, 2003	<u>\$4,704,596</u>	<u>\$1,368,794</u>

See notes to financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2003 AND 2002 (Dollars in thousands)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenues over expenses	\$ 28,867	\$ 116,598
Adjustments to reconcile excess of revenues over expenses to cash provided by operating activities:		
Depreciation and amortization	575	764
Reserves (recoveries) relating to losses from supervised credit unions—net	29,124	(3,480)
Decrease (increase) in assets:		
Accrued interest receivable	23,413	(1,996)
Capital assessment receivable	3,697	(3,697)
Assets acquired in assistance to insured credit unions, net	3,200	(4,980)
NCUSIF subordinated notes	(1,711)	2,000
Other notes receivable and advances	(880)	173
Increase (decrease) in liabilities:		
Amounts due to National Credit Union Administration Operating Fund	1,244	(1,053)
Amounts due to insured shareholders of liquidated credit unions	3,313	136
Accounts payable		(61)
Cash assistance liability	100	
Net cash provided by operating activities	<u>90,942</u>	<u>104,404</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(2,473,375)	(2,493,156)
Proceeds from maturities of investments	2,299,302	1,606,197
Purchase of fixed assets	(4)	
Collections on note receivable—National Credit Union Administration Operating Fund	2,438	1,413
Net cash used in investing activities	<u>(171,639)</u>	<u>(885,546)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Contributions from insured credit unions	437,427	454,710
Principal payments under capital lease obligation	(469)	(628)
Net cash provided by financing activities	<u>436,958</u>	<u>454,082</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	356,261	(327,060)
CASH AND CASH EQUIVALENTS—Beginning of year	<u>1,008,693</u>	<u>1,335,753</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$1,364,954</u>	<u>\$1,008,693</u>

See notes to financial statements.

NATIONAL CREDIT UNION SHARE INSURANCE FUND

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003 AND 2002

1. ORGANIZATION AND PURPOSE

The National Credit Union Share Insurance Fund (NCUSIF, the "Fund") was created by the Public Law 91-468 (Title II of the Federal Credit Union Act), which was amended in 1984 by Public Law 98-369. The Fund was established as a revolving fund in the United States Treasury under the management of the National Credit Union Administration ("NCUA") Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state credit unions that request insurance. The maximum amount of insurance is \$100,000 per shareholder account.

NCUA exercises direct supervisory authority over federal credit unions and coordinates required supervisory involvement with the state chartering authority for state-chartered credit unions insured by the Fund. Insured credit unions are required to report certain financial and statistical information to NCUA on a semiannual or quarterly basis depending on the size of the credit union and are subject to periodic examination by NCUA. Information derived through the supervisory and examination process provides the Fund with the ability to identify credit unions experiencing financial difficulties that may require assistance from the Fund.

Credit unions experiencing financial difficulties may be assisted by the Fund in continuing their operations if these difficulties are considered by the Fund to be temporary or correctable. This special assistance may be in the form of a waiver of statutory reserve requirements, a guarantee account, and/or cash assistance. If continuation of the credit union's operations with Fund assistance is not feasible, a merger partner may be sought. If the assistance or merger alternatives are not practical, the credit union is liquidated.

The first form of special assistance is waivers of statutory reserve requirements, whereby the credit union is permitted to cease making additions to its regular reserve and, in more severe cases, to commence charging operating losses against its regular reserve. When all reserves have been depleted by the credit union, the Fund may provide a reserve guarantee account in the amount of the reserve deficit. In addition, the Fund may provide cash assistance in the form of share deposits and NCUSIF subordinated notes, or may purchase assets from the credit union.

Mergers of financially troubled credit unions with stronger credit unions may also require Fund assistance. Merger assistance may be in the form of cash assistance, purchase of certain assets by the Fund, and/or guarantees of the values of certain assets (primarily loans).

When a credit union is no longer able to continue operating and the merger and assistance alternatives are not practical, the Fund will liquidate the credit union, dispose of its assets, and pay members' shares up to the maximum insured amount. The values of certain assets sold (primarily loans) are sometimes guaranteed to third-party purchasers by the Fund.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash Equivalents and Investments—Title II of the Federal Credit Union Act limits the Fund’s investments to United States Government securities or securities guaranteed as to both principal and interest by the United States Government. Cash equivalents are highly liquid investments with original maturities of three months or less. All investments are classified as held-to-maturity under Statement of Financial Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, the Fund records investments at amortized cost. Amortized cost is the face value of the securities plus the unamortized premium or less the unamortized discount.

Depreciation and Amortization—Furniture, equipment and capital leases are recorded at cost. Depreciation and amortization are computed by the straight-line method over the estimated useful lives of the furniture and equipment and the shorter of the estimated useful life or lease term for capital leases. Estimated useful lives are three years for the furniture, equipment and capital leases.

Advances to Insured Credit Unions—The Fund provides cash assistance in the form of interest and noninterest-bearing NCUSIF (“National Credit Union Share Insurance Fund”) Subordinated notes (carried at face value), share deposits, and loans to certain credit unions to assist them in continuing their operations.

Assets Acquired from Credit Unions—The Fund acquires the assets of liquidating credit unions pending their ultimate disposition. To assist in the merger of credit unions, the Fund may purchase certain credit union assets. In addition, the Fund may provide cash assistance by acquiring non-performing assets of a credit union experiencing financial difficulty. These acquired assets are maintained by the Asset Management and Assistance Center in Austin, Texas, and are recorded by the Fund at their estimated net realizable value.

Premium Revenue—The Fund may assess each insured credit union a premium charge for insurance in an amount stated as a percentage of insured shares outstanding as of December 31 of the preceding insurance year if the Fund’s equity ratio is less than 1.3%. The NCUA Board waived the 2003 and 2002 share insurance premiums (see Note 5).

Income Taxes—The Fund is exempt from Federal income taxes under Section 501(c)(1) of the Internal Revenue Code.

Fair Value of Financial Instruments—The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

- a. *Cash and Cash Equivalents*—The carrying amounts for cash and cash equivalents approximate fair values.
- b. *Investments*—The fair value for investments is the quoted market value.
- c. *NCUSIF Subordinated Notes and Other Notes Receivable*—It is not practicable to estimate the fair value of these assets as there is no secondary market. The Fund has the ability and the intention to hold these notes to maturity.
- d. *Other*—Accrued interest receivable, capital assessment receivable, notes receivable from NCUA Operating Fund, payable to NCUA Operating Fund, lease obligations, due to insured shareholders of liquidated credit unions and other accounts payable are recorded at book values, which approximate the respective fair values.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions, particularly the estimated losses from supervised credit unions, that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management’s estimates.

Accounting for Exit and Disposal Activities—The Fund accounts for Exit and Disposal activities in accordance with Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit and Disposal Activities*. This statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than the date of an entity’s commitment to an exit plan. The Fund’s conformance with this standard affects the timing of the recognition of costs of its regional restructuring plan described in Note 13, Restructuring.

Recent Accounting Pronouncements—In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (“FIN 45”). This interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees. It also clarifies that at the time an entity issues a guarantee, the entity must recognize an initial liability for the fair value of the obligations it assumes under that guarantee and must disclose that information in its financial statements. This guidance does not apply to certain guarantee contracts, such as those issued by insurance companies or for a lessee’s residual value guarantee embedded in a capital lease. The initial recognition and measurement provisions of FIN 45 apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor’s fiscal year-end. The disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on its financial position or results of operations of the Fund in 2003.

3. FIXED ASSETS

Fixed assets are comprised of the following (in thousands):

	December 31,	
	2003	2002
Furniture and equipment	\$ 526	\$ 522
Equipment under capital leases	<u>1,240</u>	<u>1,781</u>
Total	1,766	2,303
Less: Accumulated depreciation and amortization	<u>(832)</u>	<u>(2,038)</u>
Total fixed assets—net	<u>\$ 934</u>	<u>\$ 265</u>

Accumulated amortization balances for equipment under capital leases as of December 31, 2003 and 2002, totaled \$310,000 and \$1,628,000, respectively.

4. PROVISION FOR INSURANCE LOSSES

Management identifies credit unions experiencing financial difficulty through the Fund's supervisory and examination process. The estimated losses from these supervised credit unions are determined by management on a specified case basis. Management also evaluates overall economic trends and monitors potential system-wide risk factors such as increasing levels of consumer debt, bankruptcies, and delinquencies. Nonspecified case reserve requirements are determined based upon an assessment of insured risk and historic loss experience. The anticipated losses are net of estimated recoveries from the disposition of the assets of failed credit unions.

Total insurance in force as of December 31, 2003 and 2002, is \$479 billion and \$443 billion, respectively, which includes natural person and corporate credit unions. The total net reserves for identified and anticipated losses from supervised credit unions' failures is \$77 million and \$48 million at December 31, 2003 and 2002, respectively. Should there be no recoveries provided during the resolution process, possible additional reserves for \$18 million and \$23 million would be required as of December 31, 2003 and 2002, respectively.

In exercising its supervisory function, the Fund will, at times, extend guarantees of assets (primarily loans) to third-party purchasers or to credit unions to facilitate mergers. The Fund would be obligated upon non-performance. Such guarantees totaled approximately \$0 at both December 31, 2003 and 2002. The estimated losses from asset and merger guarantees are determined by management on a case-by-case evaluation.

In addition, the Fund may grant a guaranteed line-of-credit to a third party credit provider, such as a corporate credit union or bank, if a credit union has a current or immediate liquidity concern and the credit provider has refused to extend credit without a guarantee. The Fund would be obligated if the credit union failed to perform. Total line-of-credit guarantees of credit unions at December 31, 2003 and 2002, are approximately \$800,000 and \$1,800,000, respectively. The total balances outstanding under these line-of-credit guarantees at December 31, 2003 and 2002, are approximately \$126,000 and \$80,000, respectively.

The activity in the reserves for estimated losses from supervised credit unions was as follows (in thousands):

	Year Ended December 31,	
	2003	2002
BEGINNING BALANCE	\$ 47,543	\$ 51,023
Insurance losses	(15,006)	(21,625)
Recoveries	6,087	5,632
Provision for insurance losses	<u>38,043</u>	<u>12,513</u>
ENDING BALANCE	<u>\$ 76,667</u>	<u>\$ 47,543</u>

5. FUND CAPITALIZATION

The Credit Union Membership Access Act of 1998 (“CUMAA”) mandated changes to the Fund’s capitalization provisions effective January 1, 2000. Each insured credit union shall pay to and maintain with the Fund a deposit in an amount equaling 1% of the credit union’s insured shares. The amount of each insured credit union’s deposit shall be adjusted as follows, in accordance with procedures determined by the NCUA Board, to reflect changes in the credit union’s insured shares: (i) annually, in the case of an insured credit union with total assets of not more than \$50,000,000; and (ii) semiannually, in the case of an insured credit union with total assets of \$50,000,000 or more. The annual and semiannual adjustments are based on member share deposits outstanding as of December 31 of the preceding year and June 30 of the current year, respectively. The 1% contribution will be returned to the insured credit union in the event that its insurance coverage is terminated, or is obtained from another source, or the operations of the Fund are transferred from the NCUA Board.

The CUMAA mandates certain premium charges from insured credit unions and distributions from the Fund under certain circumstances. A premium charge to insured credit unions is required if the Fund’s equity ratio (as defined in the CUMAA) falls below 1.2% of insured shares. Also, pro rata distributions to insured credit unions after each calendar year are required if, as of year-end:

- (i) Any loans to the Fund from the Federal Government, and any interest on those loans, have been repaid;
- (ii) The Fund’s equity ratio exceeds the normal operating level (as defined in the CUMAA, an equity ratio specified by the NCUA Board, which shall be not less than 1.2% and not more than 1.5%); and
- (iii) The Fund’s available assets ratio, as defined in the CUMAA, exceeds 1.0%.

The NCUA Board has determined that the normal operating level is 1.30% at December 31, 2003 and 2002. The calculated equity ratios at both December 31, 2003 and 2002 were 1.27%.

Beginning in 2000, the CUMAA mandates that dividends are determined from specific ratios, which are based upon year-end reports of insured shares. Accordingly, dividends associated with insured shares at year-end are declared and paid in the subsequent year.

The NCUA Board has declared that no dividends were payable on insured shares as of December 31, 2003 and 2002, because the equity ratios of 1.27% were below the normal operating level of 1.30%. Total insured shares as of December 31, 2003 and 2002, were \$479 billion and \$443 billion, respectively.

6. INVESTMENTS

All cash received by the Fund that is not used for outlays related to assistance to insured credit unions and liquidation activities is invested in U.S. Treasury securities.

Investments consist of the following (in thousands):

	December 31, 2003				
	Yield to Maturity at Market	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. TREASURY SECURITIES:					
Maturities up to one year	2.87 %	\$2,536,670	\$ 19,986	\$ -	\$2,556,656
Maturities after one year through five years	1.74 %	<u>2,172,940</u>	<u>5,530</u>	<u> </u>	<u>2,178,469</u>
Total		<u>\$4,709,610</u>	<u>\$25,516</u>	<u>\$ -</u>	<u>\$4,735,125</u>
December 31, 2002					
	Yield to Maturity at Market	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. TREASURY SECURITIES:					
Maturities up to one year	4.59 %	\$2,224,524	\$ 36,008	\$ -	\$2,260,532
Maturities after one year through five years	3.18 %	<u>2,311,013</u>	<u>56,394</u>	<u> </u>	<u>2,367,407</u>
Total		<u>\$4,535,537</u>	<u>\$92,402</u>	<u>\$ -</u>	<u>\$4,627,939</u>

Total investment purchases during 2003 and 2002 were approximately \$2.4 billion and \$2.5 billion, respectively. Investment maturities during 2003 and 2002 were approximately \$2.2 billion and \$1.6 billion, respectively. The Fund has the capability and management has the intention to hold all investments held at December 31, 2003 and 2002, to maturity. There were no investment sales during 2003 and 2002.

7. AVAILABLE BORROWINGS

The Fund is authorized by the Federal Credit Union Act to borrow from the Treasury of the United States, upon authorization by the NCUA Board, up to a maximum of \$100,000,000. The NCUA Central Liquidity Facility ("CLF") is authorized to make advances to the Fund under terms and conditions established by the NCUA Board. No borrowings were obtained from these sources during 2003 and 2002.

8. TRANSACTIONS WITH NCUA OPERATING FUND

Substantial administrative services are provided to the Fund by the NCUA Operating Fund. The NCUA Operating Fund charges the Fund for these services based on an annual allocation factor approved by the NCUA Board and derived from a study of actual usage conducted by the management of these Funds. The allocation factor was 62.00% to the Fund for each in 2003 and 2002. The cost of services provided by the NCUA Operating Fund was approximately \$83,158,000 and \$83,182,000 for 2003 and 2002, respectively, and includes pension contributions of approximately \$6,462,000 and \$6,685,000 to the Civil Service Retirement System and Federal Employees Retirement System defined benefit retirement plans for 2003 and 2002, respectively.

In 1988, the Fund entered into a \$2,161,000 thirty-year unsecured term note with the NCUA Operating Fund. Interest received was approximately \$11,000 and \$46,000 for 2003 and 2002, respectively. The note receivable balances at December 31, 2003 and 2002, were approximately \$0 and \$1,098,000, respectively. The balance of \$0 reflects the payoff of the note.

In 1992, the Fund entered into a commitment to fund up to \$41,975,000 through a thirty-year secured term note with the NCUA Operating Fund. The monies were advanced to the NCUA Operating Fund as needed to fund the costs of constructing a building. Interest income was approximately \$732,000 and \$1,164,000 for 2003 and 2002, respectively. The note receivable balances at December 31, 2003 and 2002, were approximately \$26,484,000 and \$27,824,000, respectively.

The above note matures as follows (in thousands):

	Secured Term Note
2004	\$ 1,341
2005	1,341
2006	1,341
2007	1,341
2008	1,341
Thereafter	<u>19,779</u>
Total	<u>\$ 26,484</u>

The variable rate on both term notes is equal to the Fund's prior-month yield on investments. The average interest rates during 2003 and 2002 were approximately 2.70% and 4.09%, respectively. At December 31, 2003 and 2002, the rates were 2.08% and 3.51%, respectively.

The NCUA Operating Fund leases certain office space and equipment under operating lease agreements that expire through 2008. Based on the allocation factor determined by the NCUA's Board, the Fund reimburses the NCUA Operating Fund approximately 62.00% of the total lease payments. The cost of services provided by the NCUA Operating Fund includes rental charges of approximately \$702,460 and \$625,500 for 2003 and 2002, respectively.

The NCUA Operating Fund's total future minimum lease payments on operating leases as of December 31, 2003, are as follows (in thousands):

2004	\$ 1,069
2005	823
2006	470
2007	461
2008	<u>284</u>
Total	<u>\$ 3,107</u>

9. LEASE COMMITMENTS

Description of Leasing Agreements—The Fund has entered into lease agreements with vendors for the lease of equipment that includes computers, laptops, and printers. The Fund leases computer equipment under capital lease agreements that expire through 2006.

A schedule of future minimum lease payments as of December 31, 2003, is as follows (in thousands):

2004	\$ 423
2005	423
2006	<u>106</u>
Total	<u>952</u>
Less: Imputed interest	<u>(16)</u>
Present value of net minimum lease payments	<u>\$ 936</u>

10. DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the Fund's financial instruments are as follows:

	<u>December 31, 2003</u>		<u>December 31, 2002</u>	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments	\$4,709,610	\$4,735,125	\$4,535,537	\$4,627,939
Cash and cash equivalents	1,364,954	1,364,954	1,008,693	1,008,693
Accrued interest receivable	45,761	45,761	69,174	69,174
Capital assessment receivable			3,697	3,697
Notes receivable—NCUA				
Operating Fund	26,484	26,484	28,922	28,922
Amounts due to insured shareholders of liquidated credit unions	9,541	9,541	6,228	6,228
Due to NCUA Operating Fund	1,914	1,914	670	670
Accounts payable	3	3	3	3
Lease obligation	936	936	165	165

11. CONCENTRATIONS

There are no significant concentrations of member share deposits within any region of the United States. Concentrations of member shares do exist within the manufacturing, governmental, and educational industries.

12. CONTINGENCIES

NCUA is currently a party to a number of disputes that involve or may involve litigation. In the opinion of management, the ultimate liability with respect to these disputes, if any, will not be material to NCUA's financial position.

13. RESTRUCTURING

NCUA announced on January 29, 2003, a regional restructuring plan, previously approved by the Board on November 21, 2002. The restructuring plan relocated the Region VI office in Concord, California, to Tempe, Arizona, and renumbered it to Region V. The plan also closed the Region IV regional office in Chicago, Illinois. The process of relocating Region VI began early in 2003 and will be completed no later than December 2004. Region V, located in Austin, Texas, was renumbered to Region IV. Credit union supervision was aligned with the five regions and became effective as of January 1, 2004.

NCUA estimates that the costs to be incurred for the regional restructuring plan are \$3,636,000, which includes relocation costs of \$3,000,000, and miscellaneous administrative and other costs of approximately \$636,000. Approximately \$2,185,000 of these costs was incurred during 2003. Based on the allocation factors approved by the NCUA Board, the NCUSIF is responsible for 62.00% for 2003. . The Fund's estimated cost for the regional restructuring plan will be approximately \$2,254,000. The Operating Fund's estimated cost for the regional restructuring plan will be approximately \$1,382,000. In accordance with SFAS Statement No. 146, *Accounting for Costs Associated with Exit and Disposal Activities*, an accrual of approximately \$1.4 million has been made in the NCUA Operating Fund as of December 31, 2003, of which \$.9 million was allocated to the NCUSIF through the overhead transfer.

* * * * *

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Inspector General
National Credit Union Administration

We have audited the financial statements of the National Credit Union Share Insurance Fund (the "Fund") as of and for the year ended December 31, 2003, and have issued our report thereon dated February 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of the Fund in a separate letter dated February 24, 2004.

This report is intended solely for the information and use of the Inspector General, and the Board of the National Credit Union Administration, and the management of the National Credit Union Share Insurance Fund and is not intended to be and should not be used by anyone other than these specified parties.

February 24, 2004

***National Credit Union
Administration
Central Liquidity Facility***

*Financial Statements for the Years Ended
December 31, 2003 and 2002, and
Independent Auditors' Reports*

NATIONAL CREDIT UNION ADMINISTRATION CENTRAL LIQUIDITY FACILITY

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002	3
FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002:	
Balance Sheets	4
Statements of Operations	5
Statements of Members' Equity	6
Statements of Cash Flows	7
Notes to Financial Statements	8-11
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	12

INDEPENDENT AUDITORS' REPORT

Inspector General
National Credit Union Administration

We have audited the accompanying balance sheets of the National Credit Union Administration Central Liquidity Facility ("CLF") as of December 31, 2003 and 2002, and the related statements of operations, members' equity, and cash flows for the years then ended. These financial statements are the responsibility of CLF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Central Liquidity Facility as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2004, on our tests of the National Credit Union Administration Central Liquidity Facility's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

February 24, 2004

**NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY**

**BALANCE SHEETS
DECEMBER 31, 2003 AND 2002
(In thousands)**

ASSETS	2003	2002
ASSETS:		
Cash	\$ 10	\$ 11
Investments with U.S. Central Credit Union (Notes 5, 8, and 9)	1,238,056	1,081,362
Accrued interest receivable	<u>3,653</u>	<u>5,042</u>
TOTAL ASSETS	<u>\$1,241,719</u>	<u>\$1,086,415</u>
 LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES:		
Member deposits (Note 7)	\$ 11,522	\$ 13,905
Accounts payable and other liabilities	<u>136</u>	<u>108</u>
Total liabilities	<u>11,658</u>	<u>14,013</u>
MEMBERS' EQUITY:		
Capital stock—required (Note 7)	1,218,654	1,060,995
Retained earnings	<u>11,407</u>	<u>11,407</u>
Total members' equity	<u>1,230,061</u>	<u>1,072,402</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$1,241,719</u>	<u>\$1,086,415</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY**

**STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2003 AND 2002
(In thousands)**

	2003	2002
REVENUE—Investment income	<u>\$ 14,991</u>	<u>\$ 21,965</u>
EXPENSES (Note 10):		
Operating expenses:		
Group agent service fee	1	2
Personnel services	126	124
Other services	42	40
Rent, communications, and utilities	7	10
Personnel benefits	26	25
Supplies and materials	2	2
Printing and reproduction	<u>5</u>	<u>4</u>
Total operating expenses	209	207
Interest—member deposits		169
Interest-liquidity reserve	<u>105</u>	<u> </u>
Total expenses	<u>314</u>	<u>376</u>
EXCESS OF REVENUE OVER EXPENSES	<u>\$ 14,677</u>	<u>\$ 21,589</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY**

**STATEMENTS OF MEMBERS' EQUITY
YEARS ENDED DECEMBER 31, 2003 AND 2002
(In thousands)**

	Capital Stock	Retained Earnings
BALANCE—January 1, 2002	\$ 956,709	\$ 11,402
Issuance of required capital stock	105,519	
Redemption of required capital stock	(1,233)	
Dividends		(21,584)
Excess of revenue over expenses	<u> </u>	<u>21,589</u>
BALANCE—December 31, 2002	1,060,995	11,407
Issuance of required capital stock	158,987	
Redemption of required capital stock	(1,328)	
Dividends		(14,677)
Excess of revenue over expenses	<u> </u>	<u>14,677</u>
BALANCE—December 31, 2003	<u>\$ 1,218,654</u>	<u>\$ 11,407</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY**

**STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002
(In thousands)**

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of revenue over expenses	\$ 14,677	\$ 21,589
Adjustments to reconcile excess of revenue over expenses to net cash provided by operating activities:		
Decrease in accrued interest receivable	1,389	53
Increase (decrease) in accounts payable and other liabilities	<u>28</u>	<u>6</u>
Net cash provided by operating activities	<u>16,094</u>	<u>21,648</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments—net	<u>(156,694)</u>	<u>(101,440)</u>
Net cash used in investing activities	<u>(156,694)</u>	<u>(101,440)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Additions to member deposits	959	2,226
Issuance of required capital stock	158,987	105,519
Dividends	(14,677)	(21,584)
Withdrawal of member deposits	(3,342)	(5,138)
Redemption of required capital stock	<u>(1,328)</u>	<u>(1,233)</u>
Net cash provided by financing activities	<u>140,599</u>	<u>79,790</u>
NET DECREASE IN CASH	(1)	(2)
CASH, BEGINNING OF YEAR	<u>11</u>	<u>13</u>
CASH, END OF YEAR	<u><u>\$ 10</u></u>	<u><u>\$ 11</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION—Cash paid during the year for:		
Interest	<u>\$ 105</u>	<u>\$ -</u>

See notes to financial statements.

NATIONAL CREDIT UNION ADMINISTRATION CENTRAL LIQUIDITY FACILITY

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003 AND 2002

1. ORGANIZATION AND PURPOSE

The National Credit Union Administration Central Liquidity Facility (“CLF”) was created by the National Credit Union Central Liquidity Facility Act (the “Act”). The CLF is designated as a mixed-ownership government corporation under the Government Corporation Control Act. The CLF exists within the National Credit Union Administration (“NCUA”) and is managed by the National Credit Union Administration Board. The CLF became operational on October 1, 1979.

The purpose of the CLF is to improve general financial stability by meeting the liquidity needs of credit unions. The CLF is a tax-exempt organization under Section 501(c)(1) of the Internal Revenue Code.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The CLF maintains its accounting records on the accrual basis of accounting.

Loans and Allowance for Loan Losses—Loans, when made to members, are on a short-term or long-term basis. For all loans, the CLF may obtain a security interest in the assets of the borrower. In determining the allowance for loan losses, when applicable, the CLF evaluates the collectibility of its loans to members through examination of the financial condition of the individual borrowing credit unions and the credit union industry in general.

Investments—The CLF invests in redeposits and share accounts at U.S. Central Credit Union (see Notes 5 and 8). All other investments are short-term with no maturities in excess of one year. All investments are classified as held-to-maturity. Accordingly, the CLF records investments at amortized cost. Amortized cost is the face value of the securities plus the unamortized premium or less the unamortized discount.

Fair Value of Financial Instruments—The following methods and assumptions were used in estimating the fair value disclosures for financial instruments:

- a. *Cash*—The carrying amounts for cash approximate fair value.
- b. *Investments*—Securities held have maturities of one year or less and, as such, the carrying amounts approximate fair value.
- c. *Loans*—For loans advanced to member credit unions, the carrying amounts approximate fair value.
- d. *Member Deposits*—Funds maintained with the CLF in excess of required capital amounts are recorded as member deposits. These deposits are due upon demand and the carrying amounts approximate the fair value.

- e. *FFB Notes Payable*—For notes issued to the Federal Financing Bank, when applicable, the carrying amounts approximate fair value.
- f. *Other*—Accrued interest receivable, accounts payable and other liabilities are recorded at book values, which approximate the respective fair values.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management’s estimates. Certain amounts have been reclassified in the current year.

3. GOVERNMENT REGULATIONS

The CLF is subject to various Federal laws and regulations. The CLF’s operating budget requires Congressional approval, and the CLF may not make loans to members for the purpose of expanding credit union loan portfolios. The CLF’s investments are restricted to obligations of the United States Government and its agencies, deposits in Federally insured financial institutions, and shares and deposits in credit unions. Borrowing is limited by statute to twelve times the subscribed capital stock and surplus. However, there is a Congressional limitation of \$1.5 billion on funds that are borrowed and then loaned out at any one point in time.

At December 31, 2003 and 2002, the CLF was in compliance with its borrowing authority. Borrowings would be from the Federal Financing Bank with interest generally payable upon maturity (see Note 12).

4. LOANS TO MEMBERS

There were no loans or loan commitments outstanding at December 31, 2003 and 2002. The CLF can provide members with extended loan commitments.

5. FUNDS ON DEPOSIT WITH U.S. CENTRAL CREDIT UNION

Funds not currently required for operations are invested as follows (in thousands):

	December 31,	
	2003	2002
U.S. Central Credit Union Redeposit account (see Note 8)	<u>\$1,238,056</u>	<u>\$1,081,362</u>

6. BORROWING AUTHORITY

The Secretary of the Treasury is authorized by the Act to lend up to \$500 million to the CLF in the event that the Board certifies to the Secretary that the CLF does not have sufficient funds to meet the liquidity needs of credit unions. This authority to lend is limited to such extent and in such amounts as are provided in advance by Congressional Appropriation Acts. On December 23, 1981, the President signed PL 97-101, which provided \$100 million of permanent indefinite borrowing authority that may be provided by the Secretary of the Treasury to the CLF to meet emergency liquidity needs of credit unions. Borrowings would be from the Federal Financing Bank with interest generally payable upon maturity (see Note 12).

7. CAPITAL STOCK AND MEMBER DEPOSITS

The required capital stock account represents subscriptions remitted to the CLF by member credit unions. Regular members' required subscription amounts equal one-half of one percent of their paid-in and unimpaired capital and surplus, one-half of which is required to be remitted to the CLF. Agent members' required subscription amounts equal one-half of one percent of the paid-in and unimpaired capital and surplus of all of the credit unions served by the agent member, one-half of which is required to be remitted to the CLF. In both cases, the remaining one-half of the subscription is required to be held in liquid assets by the member credit unions subject to call by the National Credit Union Administration Board. These unremitted subscriptions are not reflected in the CLF's financial statements. Subscriptions are adjusted annually to reflect changes in the member credit unions' paid-in and unimpaired capital and surplus. Dividends are declared and paid on required capital stock.

Member deposits represent amounts remitted by members over and above the amount required for membership. Interest is paid on member deposits at a rate equivalent to the dividend rate paid on required capital stock.

8. U.S. CENTRAL CREDIT UNION MEMBERSHIP

During fiscal year 1984, the CLF accepted a membership request from U.S. Central Credit Union ("USC") on behalf of its corporate credit union members. At December 31, 2003 and 2002, \$1,168,602,000 and \$1,015,902,000, respectively, of the required portion of subscribed capital stock were purchased from the CLF by USC on behalf of its member credit unions. The CLF has 31 and 32 corporate credit union members as of December 31, 2003 and 2002, respectively.

In addition, by accepting the USC membership request, the CLF was initially committed to reinvest all but \$50,000,000 of its total share capital in USC at market rates of interest. Beginning April 1, 1996, the CLF reinvests all of its agent member share capital in USC at market rates of interest. At December 31, 2003 and 2002, approximately \$1,238,056,000 and \$1,081,362,000, respectively, were invested in USC accounts at 1.17% and 1.85%, respective yields.

9. CONCENTRATION OF CREDIT RISK

At December 31, 2003 and 2002, the CLF has a concentration of credit risk for its investments on deposit with USC of approximately \$1,238,056,000 and \$1,081,362,000, respectively (see Notes 5 and 8).

10. SERVICES PROVIDED BY THE NATIONAL CREDIT UNION ADMINISTRATION

The National Credit Union Administration provides the CLF with data processing and other miscellaneous services and supplies. In addition, the National Credit Union Administration pays CLF's employees' salaries and benefits as well as the CLF's portion of monthly building operating costs. The CLF reimburses the National Credit Union Administration on a monthly basis for these items. Total reimbursements were approximately \$205,000 for each of the years ended December 31, 2003 and 2002.

11. DISCLOSURE OF FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount and the estimated fair value of the CLF's financial instruments are as follows (in thousands):

	December 31, 2003		December 31, 2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash	\$ 10	\$ 10	\$ 11	\$ 11
Investments	1,238,056	1,238,056	1,081,362	1,081,362
Accrued interest receivable	3,653	3,653	5,042	5,042
Member deposits	11,522	11,522	13,905	13,905
Accounts payable and other liabilities	136	136	108	108

12. SHORT-TERM REVOLVING CREDIT FACILITY

On July 15, 1999, the National Credit Union Administration signed a note purchase agreement with the Federal Financing Bank on behalf of CLF. The agreement originally provided for a commitment amount of \$20.7 billion. Subsequently, the agreement expired on September 30, 2002, and was extended through consecutive short-term revolving credit facility promissory notes. These promissory notes reduced the credit facility to \$5 billion and expire yearly on the 31st of March. The current promissory note expires March 31, 2004.

* * * * *

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Inspector General
National Credit Union Administration

We have audited the financial statements of the National Credit Union Administration Central Liquidity Facility ("CLF") as of and for the year ended December 31, 2003, and have issued our report thereon dated February 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the CLF financial statements are free of material misstatement, we perform tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the CLF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of the CLF in a separate letter dated February 24, 2004.

This report is intended solely for the information and use of the Inspector General, the Board of the National Credit Union Administration, and the management of the National Credit Union Administration Central Liquidity Facility and is not intended to be and should not be used by anyone other than these specified parties.

February 24, 2004

***National Credit Union
Administration
Community Development
Revolving Loan Fund***

*Financial Statements for the Years Ended
December 31, 2003 and 2002, and
Independent Auditors' Reports*

NATIONAL CREDIT UNION ADMINISTRATION COMMUNITY DEVELOPMENT REVOLVING LOAN FUND

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS	3
FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002:	
Balance Sheets	4
Statements of Operations	5
Statements of Changes in Fund Balance	6
Statements of Cash Flows	7
Notes to Financial Statements	8-11
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	12

INDEPENDENT AUDITORS' REPORT

Inspector General
National Credit Union Administration

We have audited the accompanying balance sheets of the National Credit Union Administration Community Development Revolving Loan Fund ("CDRLF") as of December 31, 2003 and 2002, and the related statements of operations, changes in fund balance, and cash flows for the years then ended. These financial statements are the responsibility of the CDRLF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the National Credit Union Administration Community Development Revolving Loan Fund as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2004, on our tests of the National Credit Union Administration Community Development Revolving Loan Fund's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

February 24, 2004

**NATIONAL CREDIT UNION ADMINISTRATION
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND**

**BALANCE SHEETS
DECEMBER 31, 2003 AND 2002**

ASSETS	2003	2002
Cash and cash equivalents (Note 2)	\$ 8,962,039	\$ 5,496,705
Loans—net of allowance (Note 4)	5,298,019	7,754,404
Interest receivable	<u>20,004</u>	<u>40,087</u>
TOTAL ASSETS	<u>\$14,280,062</u>	<u>\$13,291,196</u>
 LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Accrued technical assistance	<u>\$ 142,692</u>	<u>\$ 106,978</u>
Total liabilities	<u>142,692</u>	<u>106,978</u>
 FUND BALANCE:		
Revolving fund capital (Note 3)	13,031,596	12,303,548
Accumulated earnings	<u>1,105,774</u>	<u>880,670</u>
Total fund balance	<u>14,137,370</u>	<u>13,184,218</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$14,280,062</u>	<u>\$13,291,196</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND**

**STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2003 AND 2002**

	2003	2002
SUPPORT AND REVENUES:		
Interest on cash equivalents	\$ 84,369	\$ 97,588
Interest on loans	98,901	158,188
Appropriation revenue	<u>266,359</u>	<u>442,121</u>
Total	<u>449,629</u>	<u>697,897</u>
EXPENSES:		
Technical assistance	(400,486)	(542,067)
Reduction of (provision for) allowance for loan losses	<u>175,961</u>	<u>(86,827)</u>
Total	<u>(224,525)</u>	<u>(628,894)</u>
EXCESS OF SUPPORT AND REVENUES OVER EXPENSES	<u>\$ 225,104</u>	<u>\$ 69,003</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND**

**STATEMENTS OF CHANGES IN FUND BALANCE
YEARS ENDED DECEMBER 31, 2003 AND 2002**

	2003	2002
FUND BALANCE, BEGINNING OF YEAR	\$13,184,218	\$13,557,336
Change in unexpended appropriations:		
Operating appropriations received (Note 3)	994,407	
Appropriation revenue recognized (Note 3)	(266,359)	(442,121)
Excess of support and revenues over expenses	<u>225,104</u>	<u>69,003</u>
FUND BALANCE, END OF YEAR	<u>\$ 14,137,370</u>	<u>\$ 13,184,218</u>

See notes to financial statements.

**NATIONAL CREDIT UNION ADMINISTRATION
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND**

**STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002**

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of support and revenues over expenses	\$ 225,104	\$ 69,003
Adjustments to reconcile the excess of support and revenues over expenses to net cash (used in) provided by operating activities:		
Change in unexpended appropriations	(266,359)	(442,121)
Provision for(reduction of) allowance for loan losses, net of recoveries	(159,851)	86,827
Changes in assets and liabilities:		
Decrease in interest receivable	20,083	16,266
(Decrease) increase in accrued technical assistance	<u>35,714</u>	<u>(89,422)</u>
Net cash used in operating activities	<u>(145,309)</u>	<u>(359,447)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loan principal repayments	3,496,233	3,717,342
Loan disbursements	<u>(879,997)</u>	<u>(2,719,000)</u>
Net cash provided by investing activities	<u>2,616,236</u>	<u>998,342</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Appropriations received—revolving fund capital	<u>994,407</u>	<u> </u>
Net cash provided by financing activities	<u>994,407</u>	<u>-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,465,334	638,895
CASH AND CASH EQUIVALENTS—Beginning of year	<u>5,496,705</u>	<u>4,857,810</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 8,962,039</u>	<u>\$ 5,496,705</u>

See notes to financial statements.

NATIONAL CREDIT UNION ADMINISTRATION COMMUNITY DEVELOPMENT REVOLVING LOAN FUND

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2003 AND 2002

1. NATURE OF ORGANIZATION

The Community Development Revolving Loan Fund for Credit Unions (“CDRLF”) was established by an act of Congress (Public Law 96-123, November 20, 1979) to stimulate economic development in low-income communities. The National Credit Union Administration (“NCUA”) and the Community Services Association (“CSA”) jointly adopted Part 705 of NCUA Rules and Regulations, governing administration of the Fund, on February 28, 1980.

Upon the dissolution of CSA in 1983, administration of the CDRLF was transferred to the Department of Health and Human Services (“HHS”). Because HHS never promulgated final regulations governing the administration of the CDRLF, the Fund was dormant.

The Community Development Credit Union Transfer Act (Public Law 99-604, November 6, 1986) transferred CDRLF administration back to NCUA. The NCUA Board adopted amendments to Part 705 of NCUA Rules and Regulations on September 16, 1987, and began making loans/deposits to participating credit unions in 1990.

The purpose of the CDRLF is to stimulate economic activities in the communities served by low-income credit unions which will result in increased income, ownership and employment opportunities for low-wealth residents and other economic growth. The policy of NCUA is to revolve the loans to qualifying credit unions as often as practical in order to gain maximum impact on as many participating credit unions as possible.

2. SIGNIFICANT ACCOUNTING AND OPERATIONAL POLICIES

Basis of Accounting—The CDRLF reports its financial statements on the accrual basis of accounting.

Cash Equivalents—The Federal Credit Union Act permits the CDRLF to make investments in United States Government Treasury securities. All investments in 2003 and 2002 were cash equivalents and are stated at cost which approximates fair value. Cash equivalents are highly liquid investments with original maturities of three months or less.

Allowance for Loan Losses—The CDRLF records a provision for estimated loan losses. Loans considered to be uncollectible are charged to the allowance for loan losses. Management continually evaluates the adequacy of the allowance for loan losses based upon prevailing circumstances and an assessment of collectibility risk of the total loan portfolio. Accrual of interest is discontinued on non-performing loans when management believes collectibility is doubtful. At December 31, 2003 and 2002, there were no nonaccrual loans.

Salary and Operating Expenses—NCUA provides certain general and administrative support to the CDRLF, including office space, salaries, and certain supplies. The value of these contributed services is not charged to the CDRLF.

Revenue Recognition—Appropriation revenue is recognized as the related technical assistance expense is recognized. Total appropriation revenues will differ from total technical assistance expenses because not all technical assistance is funded by appropriations.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management’s estimates.

3. GOVERNMENT REGULATIONS

The CDRLF is subject to various Federal laws and regulations. Assistance, which includes lending and technical assistance, is limited by Congress to a total of the \$12,303,548 appropriated for the CDRLF plus accumulated earnings. Federally chartered and state-chartered credit unions may participate in the CDRLF’s Community Loan Fund. Loans may only be made to low-income credit unions as defined by the NCUA.

NCUA Rules and Regulations section 705.7 permit the classification of the loan in the participating credit union’s accounting records as either a note payable or a nonmember deposit. As a nonmember deposit, an amount not to exceed \$100,000 per credit union is insured by the National Credit Union Share Insurance Fund (“NCUSIF”). The covered amount of loans recorded as nonmember deposits by participating credit unions insured by the NCUSIF totaled approximately \$3,730,636 and \$6,188,000 at December 31, 2003 and 2002, respectively. Under the CDRLF Loan Program, loans recorded in the credit union’s accounting records as notes payable may be collateralized.

Loans are limited to a maximum amount of \$300,000 per credit union. Loans issued between January 1, 1995, and December 31, 1998, carry a fixed interest rate of 3%; loans issued between January 1, 1999, and December 31, 2001, carry a fixed rate of 2%; and loans issued after January 1, 2002, carry a fixed rate of 1%. Interest and principal are repaid on a semiannual basis beginning six months and one year, respectively, after the initial distribution of the loan. The maximum term of each loan is five years. Participating credit unions are required to match the value of the loan within one year of the date of approval of the loan.

During the year ended December 31, 2003, appropriations for loans and technical assistance in the amount of \$994,407 were received. Of this amount, \$298,050 was designated to be used as operating appropriations for technical assistance and \$696,357 was designated to be used as revolving fund capital. For the appropriations received, monies expire on September 30, 2004.

Activities by each appropriation, from inception	Public Law No. 107-73	Public Law No. 106-377	Total
Operating appropriation received	\$ 696,357	\$ 298,050	\$ 994,407
Appropriation revenue recognized	<u>(696,357)</u>	<u>(298,050)</u>	<u>(994,407)</u>
Balance, December 31, 2003	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

	2003	2002
Unexpended appropriations:		
Balance, beginning of the year	\$ 9,348	\$ 451,469
Operational appropriations received	994,407	
Appropriation revenue recognized	<u>(266,359)</u>	<u>(442,121)</u>
Balance, end of year	<u>\$ 737,396</u>	<u>\$ 9,348</u>
Revolving fund capital:		
Balance, beginning of the year	\$ 12,303,548	\$ 12,745,669
Appropriations—revolving fund capital		
Change in unexpended appropriations	<u>728,048</u>	<u>(442,121)</u>
Balance, end of year	<u>\$ 13,031,596</u>	<u>\$ 12,303,548</u>

4. LOANS

Loans outstanding at December 31, 2003 and 2002, are scheduled to be repaid during the following subsequent years:

	2003	2002
Year 1	\$ 1,676,793	\$ 2,213,135
Year 2	1,713,228	2,067,690
Year 3	849,821	2,008,000
Year 4	788,718	951,400
Year 5	<u>409,459</u>	<u>814,030</u>
	5,438,019	8,054,255
Less allowance for loan losses	<u>(140,000)</u>	<u>(299,851)</u>
Net loans outstanding	<u>\$ 5,298,019</u>	<u>\$ 7,754,404</u>

Changes in the allowance for loan losses are summarized below:

	2003	2002
Balance, beginning of year	\$ 299,851	\$ 213,024
Loans recovered	16,109	
Provision for (reduction of) allowance for loan losses	<u>(175,960)</u>	<u>86,827</u>
Balance, end of year	<u>\$ 140,000</u>	<u>\$ 299,851</u>

5. CONCENTRATION OF CREDIT RISK

At December 31, 2003 and 2002, there are no significant concentrations of credit risk in the loan portfolio. As discussed in Note 1, the CDRLF provides loans to credit unions that serve predominantly low-income communities.

6. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosures of the estimated fair value of financial instruments are made in accordance with the requirements of Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments*. The methods and assumptions used in estimating the fair value disclosures for financial instruments are as follows:

Cash and Cash Equivalents—The carrying amounts for cash and cash equivalents approximate fair values.

Interest Receivable and Accrued Technical Assistance—Such items are recorded at book values, which approximate the respective fair values.

Loans—The fair value is estimated by discounting projected future cash flows using current market interest rates. For purposes of this calculation, the discount rate used was the prime interest rate plus two percent (6.00% at December 31, 2003 and 6.25% at December 31, 2002).

The carrying amount and the estimated fair value of the CDRLF's financial instruments are as follows:

	December 31, 2003		December 31, 2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	<u>\$ 8,962,039</u>	<u>\$ 8,962,039</u>	<u>\$ 5,496,705</u>	<u>\$ 5,496,705</u>
Interest receivable	<u>\$ 20,004</u>	<u>\$ 20,004</u>	<u>\$ 40,087</u>	<u>\$ 40,087</u>
Loans	\$ 5,438,019	\$ 5,070,631	\$ 8,054,225	\$ 7,681,555
Allowance for loan losses	<u>(140,000)</u>	<u>(140,000)</u>	<u>(299,851)</u>	<u>(299,851)</u>
Loans, net of allowance	<u>\$ 5,298,019</u>	<u>\$ 4,930,631</u>	<u>\$ 7,754,404</u>	<u>\$ 7,381,704</u>
Liabilities:				
Accrued technical assistance	<u>\$ 142,692</u>	<u>\$ 142,692</u>	<u>\$ 106,978</u>	<u>\$ 106,978</u>

It is the intent of the CDRLF to hold its loans to maturity. The CDRLF anticipates realizing the carrying amount in full. Fair value is less than the carrying amount because loans are made at less than market interest rates.

* * * * *

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Inspector General
National Credit Union Administration

We have audited the financial statements of the National Credit Union Administration Community Development Revolving Loan Fund ("CDRLF") as of and for the year ended December 31, 2003, and have issued our report thereon dated February 24, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the CDRLF's financial statements are free of material misstatement, we perform tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the CDRLF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the management of the CDRLF in a separate letter dated February 24, 2004.

This report is intended solely for the information and use of the Inspector General, the Board of the National Credit Union Administration, and the management of the National Credit Union Administration Community Development Revolving Loan Fund and is not intended to be and should not be used by anyone other than these specified parties.

February 24, 2004