audit report

Issue Date
November 6, 2009
Audit Case Number
2010-FO-0001

TO: Thomas R. Weakland, Acting Executive Vice President, Government National Mortgage Association, T

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

SUBJECT: Audit of Government National Mortgage Association's (Ginnie Mae) Financial Statements for Fiscal Years 2009 and 2008

In accordance with the Government Corporation Control Act as amended (31 U.S.C. 9105), the Office of Inspector General engaged the independent certified public accounting firm of Carmichael, Brasher, Tuvell and Company, P. C. (CBTC) to audit the fiscal year 2009 and 2008 financial statements of Ginnie Mae. The contract required that the audit be performed according to generally accepted government auditing standards (GAGAS).

CBTC is responsible for the attached auditors' report dated November 3, 2009 and the conclusions expressed in the report. Accordingly, we do not express an opinion on Ginnie Mae's financial statements or conclusions on Ginnie Mae's internal controls or compliance with laws, regulations and government-wide policies. Within 60 days of this report, CBTC expects to issue a separate letter to management dated November 3, 2009 regarding other less significant matters that came to its attention during the audit.

This report includes both the Independent Auditors' Report and Ginnie Mae's principal financial statements. Under Federal Accounting Standards Advisory Board (FASAB) standards, a general-purpose federal financial report should include as required supplementary information (RSI) a section devoted to Management's Discussion and Analysis (MD&A). The MD&A is not included in this report. Ginnie Mae plans to separately publish an annual report for fiscal year 2009 that conforms to FASAB standards.

The report contains one significant deficiency in Ginnie Mae's internal controls which was a repeat finding from last year and one reportable instance of noncompliance with laws and regulations and government-wide policies. The report contains one recommendation which was carried over from the previous year's audit report. As part of the audit resolution process, corrective action verification will be performed in fiscal year 2010 to verify implementation of Ginnie Mae's action plan which was approved in fiscal year 2009.

We appreciate the courtesies and cooperation extended to the CBTC and OIG audit staffs during the conduct of the audit.

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INDEPENDENT AUDITORS' REPORT

To the Acting Executive Vice President
Government National Mortgage Association

The Government National Mortgage Association (Ginnie Mae's) financial statements are subject to the annual reporting requirements of the Chief Financial Officers Act of 1990 which requires an annual report to Congress on their financial status and any other information needed to fairly present the financial position and results of operations. Ginnie Mae is a wholly owned government corporation within the U.S. Department of Housing and Urban Development (HUD). In accordance with the Government Corporations Control Act, as amended (31 U.S.C. 9105), we audited Ginnie Mae's financial statements.

The objectives of the audit are to express an opinion on the fair presentation of Ginnie Mae's financial statements, obtain an understanding of Ginnie Mae's internal control, and test compliance with laws and regulations that could have a direct and material effect on the financial statements.

We have audited the accompanying balance sheets of Ginnie Mae as of September 30, 2009 and 2008, and the related statements of revenues and expenses, investments of the U. S. Government and statements of cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audit.

OPINION ON FINANCIAL STATEMENTS

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ginnie Mae as of September 30, 2009 and 2008; and the results of its operations and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in the Management's Discussion and Analysis of Results of Operations and Financial Position is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or, as applicable, Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

REPORT ON INTERNAL CONTROL

In planning and performing our audit, we considered Ginnie Mae's internal control over financial reporting by obtaining an understanding of the design effectiveness of its internal controls, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, but not for the purpose of expressing an opinion on the effectiveness of Ginnie Mae's internal control. Accordingly, we do not express an opinion on the effectiveness of Ginnie Mae's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of Ginnie Mae's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiency reported in the previous fiscal year to continue to be a significant deficiency in internal control.

Ginnie Mae should strengthen monitoring and management controls in regard to the Mortgage-backed Securities (MBS) program

- Continue to assure more effective follow up of the automated matching process with insurer loan data

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

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Ginnie Mae's internal control.

Our consideration of internal control was for the limited purpose described above and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we did identify other matters in internal control that came to our attention during our audit which will be communicated to the management of Ginnie Mae and those charged with governance in a separate letter, dated November 3, 2009.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The management of Ginnie Mae is responsible for complying with laws and regulations applicable to government corporations. As part of obtaining reasonable assurance about whether Ginnie Mae's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, which could have a direct and material effect on the determination of financial statement amounts, and certain other laws, regulations and government-wide policies specified in OMB Bulletin No. 07-04, as applicable to government corporations. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to Ginnie Mae. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

Our tests of compliance with certain provisions of laws, regulations and government-wide policies discussed in the preceding paragraph disclosed the following instance of noncompliance required to be reported under U.S. generally accepted government auditing standards and OMB audit guidance.

> **The Federal Information Security Management Act (FISMA**),
> Subchapter III, Paragraph 3544(b), states "Each agency shall develop, document, and implement an agency-wide information security program…to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source, that includes-
>
> (6) establishing a process for planning, implementing, evaluating, and documenting remedial action to address any deficiencies in the information security policies, procedures, and practices of the agency.
>
> (8) plans and procedures to ensure continuity of operations for information systems that support the operations and assets of the agency."
>
> Ginnie Mae did not perform systems reaccreditation on the Integrated Portfolio Management System (IPMS) and initial certification and accreditation on Single Family Mastersubservicer Servicing System (SFMSS) as required by FISMA before these systems were allowed to operate.

Except as noted above, our tests of compliance with the laws and regulations discussed in the preceding paragraph disclosed no other instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards or OMB Bulletin No. 07-04, as applicable to government corporations.

Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

MANAGEMENTS' RESPONSIBLITIES

The Government Management Reform Act of 1994 (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, Ginnie Mae prepares annual financial statements. Ginnie Mae is a wholly owned government corporation within the U. S. Department of Housing and Urban Development (HUD).

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis; and
- Complying with laws and regulations.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

AUDITORS' RESPONSIBILITIES

Our responsibility is to express an opinion on the fiscal year 2009 and 2008 financial statements of Ginnie Mae based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to audits contained in Government Auditing Standards and OMB Bulletin No. 07-04, as applicable to government corporations. Those standards and OMB Bulletin No. 07-04 require that we plan and perform audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Our audit was not designed to test the requirements of OMB Bulletin No. 07-04 relating to the Federal Financial Management Improvement Act of 1996 (FFMIA). Compliance with FFMIA will be evaluated and reported on by the HUD Office of Inspector General (OIG) in connection with their audit of the consolidated financial statements of HUD. Our audit was also not designed to test the requirements of the Federal Credit Reform Act of 1990, because Statement of Federal Financial Accounting Standards No. 2, Accounting for Direct Loans and Loan Guarantees, has not been considered in preparing these financial statements.

An audit includes:

- Examining on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion.

DISTRIBUTION

This communication is intended solely for the information and use of HUD-OIG, the management of U. S. Department of Housing and Urban Development, Ginnie Mae, and others within the organization, the OMB, the Government Accountability Office and the U. S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

CARMICHAEL, BRASHER, TUVELL & COMPANY, P.C.

Carmichael, Brasher, Tuvell + Co., P.C.

Atlanta, Georgia
November 3, 2009

APPENDIX A - SIGNIFICANT DEFICIENCY

Ginnie Mae Should Strengthen Monitoring and Management Controls in Regard to MBS Program

In fiscal year 2008, we reported control deficiencies in Ginnie Mae's Mortgage-Backed Securities (MBS) Program for not adequately monitoring unmatched loans. Additionally, we reported segregation of duty issue because at that time one senior Ginnie Mae management official was charged with a role of a Chief Risk Officer as well as MBS Division Director which created potential conflict of interest. In fiscal year 2009, we performed audit follow-up and reviewed documentation related to the implementation of the corrective action plan. We found that while Ginnie Mae made significant improvements in their operating procedures in 2009, we believe the issues had not been fully remediated as of September 30, 2009. The evidence necessary to verify the operating effectiveness of the new procedures will have to be tested in fiscal year 2010. Accordingly, we report repeat audit findings from prior year as required by the AICPA and GAO audit standards. Below is our understanding of the current status of this issue as of the end of our fieldwork.

- Loan Matching Process – In 2007, we noted that the MBS Division was not following up the mortgage insurance status of unmatched loans completely and in a timely manner. In 2008, several new loan matching procedures were proposed but were not approved by the Ginnie Mae Risk Committee until October 2008. Additionally, the new "Insurance Matching Procedures" was not finalized until March 2009. Consequently, a number of other important improvements for identifying high risk, including timely and complete follow-up of unmatched exception loans did not take effect until the middle of fiscal year 2009 thereby leaving insufficient time to verify effective implementation of the new procedures. Furthermore, Ginnie Mae agreed to modify the protocol on the loan matching procedures again in October 2009 as a result of 2009 HUD-OIG audit follow-up related to unmatched loan issue.

- Segregation of Duty - During 2007, our audit identified a potential conflict of interest issue between issuer approval and issuer monitoring functions within Ginnie Mae's Office of MBS. In fiscal year 2008, Ginnie Mae created a Risk Committee and a Chief Risk Officer (CRO) to enhance oversight and to provide independent management control of the MBS program. The establishment of a CRO in 2009 should resolve the conflict of interest issue but the same issue reoccurred when the CRO became the MBS Division Director for the majority of fiscal year 2009. Ginnie Mae hired the new CRO in October 2009.

Recommendation to Ginnie Mae that address the significant deficiency described above includes:

> Continue improving monitoring controls over Ginnie Mae's automated pool collateral loan matching process to ensure issues regarding unmatched loans are followed-up completely and resolved timely (repeat from previous two years).

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APPENDIX B – MANAGEMENT'S RESPONSE TO RECOMMENDATION

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-9000

GOVERNMENT NATIONAL
MORTGAGE ASSOCIATION

October 30, 2009

Mr. Ben W. Carmichael, Jr., CPA
Carmichael, Brasher, Tuvell & Company
1647 Mount Vernon Road
Atlanta, GA 30338

Re: Response to CBTC's Fiscal Year 2009 Ginnie Mae Audit Report

Dear Mr. Carmichael:

It is my pleasure to present to you Ginnie Mae's management response to Carmichael, Brasher, Tuvell & Company's ("CBTC") audit report on Ginnie Mae's financial statements for Fiscal Year 2009.

We are pleased that CBTC has acknowledged Ginnie Mae for its financial statement presentation on its FY 2009 financial audit. Ginnie Mae is also pleased to note that there were no material weaknesses.

In CBTC's Internal Control Report, one significant deficiency was identified in the area of mortgage-backed securities ("MBS"). CBTC recommended that Ginnie Mae continue to assure more effective follow up of the automated matching process with insurer loan data. Ginnie Mae improved its loan matching process during FY 2009, and will continue to utilize these new processes. In addition, we will continue to analyze and evaluate the matching process on an ongoing basis.

If you have any questions regarding Ginnie Mae's response, you may contact me at 202-708-0926.

Sincerely,

Thomas R. Weakland

Thomas R. Weakland
Acting Executive Vice President

www.hud.gov espanol.hud.gov

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APPENDIX C - CBTC'S ASSESSMENT OF MANAGEMENT'S RESPONSE TO RECOMMENDATION

CBTC has reviewed Ginnie Mae management's response to the reported significant deficiency made in connection with our audit of Ginnie Mae's 2009 Financial Statements, which is included in Appendix B. Our assessment of management's response is discussed below.

> We believe management's proposed actions are responsive to our recommendations. However, the matching process significant deficiency will remain open until after CBTC has reviewed the continued effectiveness of Ginnie Mae's new monitoring matching process in regard to MBS programs. The Significant deficiency for segregation of duties has been resolved assuming the continued elimination of independence issues within the MBS division.

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APPENDIX D – STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS

Our assessment of the current status of significant deficiency identified in prior year audit is presented below.

Prior Year Finding/Recommendation	Type	Fiscal Year 2009 Status
Matching Process Ginnie Mae's Acting Vice-President should review and strengthen the completeness and timeliness of the automated pool collateral matching process as well as follow-up on unmatched loans with issuers.	Significant deficiency	Partially resolved. Ginnie Mae has implemented a monthly match to terminated process to improve and put into production what had previously been a yearly, ad hoc process. However, a number of other important improvements for identifying high risk, including timely and complete follow-up of unmatched exception loans has continued during fiscal year 2009. This deficiency continues to be reported as a significant deficiency during 2009.
Segregation of Duties Ginnie Mae's Acting Vice-President should segregate issuer monitoring duties from MBS program functions to enhance independent management control over issuers.	Significant deficiency	Resolved. Ginnie Mae created a Risk Committee and a Chief Risk Officer (CRO) to enhance oversight and independent management control. The hiring of the CRO during late FY 2008 resolved the conflict of interest issue.

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Ginnie Mae's FY 2009 Financial Statements

Balance Sheets				
September 30		**2009**		**2008**
(Dollars in thousands)				
Assets:				
Funds with U.S. Treasury	$	5,253,800	$	4,836,300
U.S. Government securities--Note B		9,235,800		9,254,000
Mortgages held for sale, net--Note C		32,000		21,400
Properties held for sale, net--Note D		4,500		4,700
Accrued interest on U.S. Government securities		41,300		36,400
Accrued fees and other receivables		44,600		25,900
Advances against defaulted Mortgage-Backed Security pools, net-Note E		120,100		2,700
Fixed assets--software, net of accumulated amortization--Note A		39,800		26,800
Other assets--Note A		902,500		680,200
Total Assets	$	15,674,400	$	14,888,400
Liabilities and Investment of U.S. Government:				
Liabilities:				
Reserve for loss on Mortgage-Backed Securities Program--Note F	$	559,900	$	550,000
Deferred revenue		114,400		90,000
Deferred liabilities and deposits		2,600		2,400
Accounts payable and accrued liabilities		58,700		39,100
Other liabilities--Note A		902,500		680,200
Total Liabilities	$	1,638,100	$	1,361,700
Commitments and Contingencies--Notes G, H, and I				
Investment of U.S. Government		14,036,300		13,526,700
Total Liabilities and Investment of U.S. Government	$	15,674,400	$	14,888,400

The accompanying notes are an integral part of these financial statements.

Statements of Revenues and Expenses and Changes in Investment of U.S. Government

For the Years Ended September 30	2009		2008	
(Dollars in thousands)				
Revenues:				
Mortgage-Backed Securities Program income	$	547,800	$	373,100
Interest income		109,500		633,500
Other revenue source		-		8,800
Total Revenues	$	657,300	$	1,015,400
Expenses:				
Mortgage-Backed Securities Program expenses	$	55,400	$	49,000
Administrative expenses		8,600		8,800
Fixed asset amortization		5,100		1,200
Total Expenses	$	69,100	$	59,000
Provision for loss on Mortgage-Backed Securities Program--Note F		78,600		50,200
Excess of Revenues over Expenses	$	509,600	$	906,200
Investment of U.S. Government at Beginning of Year		13,526,700		12,620,500
Excess of revenues over expenses		509,600		906,200
Returned to U.S. Treasury				
Investment of U.S. Government at End of Year	$	14,036,300	$	13,526,700

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows				
For the Years Ended September 30		**2009**		**2008**
(Dollars in thousands)				
Cash Flow from Operating Activities				
Net Excess of revenues over expenses	$	509,600	$	906,200
Adjustments to Reconcile Net Excess of Revenues Over Expenses to Net Cash from (used for) Operating Activities				
Depreciation & amortization		5,100		1,200
Increase / decrease in accrued interest Federal investments		(4,900)		16,800
Increase / decrease in advances against defaulted MBS pools		(117,400)		(1,700)
Increase / decrease in deferred liabilities and deposits		200		(8,700)
Increase / decrease in accounts payable and accrued liabilities		19,600		(2,600)
Increase / decrease in deferred revenue		24,400		14,400
Decrease / increase in MBS Reserve, net of other assets relating to operating activities		(19,200)		7,700
Total Adjustments		(92,200)		27,100
Net Cash from (used for) Operating Activities	$	417,400	$	933,300
Cash Flow from Investing Activities				
Purchase of U.S. Treasury Securities, net		18,200		(518,100)
Purchase of software		(18,100)		(11,500)
Net Cash from (used for) Investing Activities	$	100	$	(529,600)
Cash Flow from Financing Activities				
Financing activities		-		-
Net Cash from (used for) Financing Activities		-		-
Net increase in cash & cash equivalents		417,500		403,700
Cash & cash equivalents - beginning of period		4,836,300		4,432,600
Cash & cash equivalents - end of period	$	5,253,800	$	4,836,300

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

September 30, 2009 and 2008

Note A: Organization and Summary of Significant Accounting Policies

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act as a government corporation within the Department of Housing and Urban Development (HUD). The Mortgage-Backed Securities (MBS) program is Ginnie Mae's primary ongoing activity. Its purpose is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential mortgage loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private mortgage institutions. This guaranty is backed by the *full faith and credit of the U.S. Government*. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the U.S. Department of Agriculture (USDA), the Department of Veterans Affairs (VA), or the HUD Office of Public and Indian Housing (PIH). These MBS are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets.

Funds with U.S. Treasury: All of Ginnie Mae's receipts and disbursements are processed by the U.S. Treasury, which in effect maintains Ginnie Mae's bank accounts. Of the $5.3 billion in Funds with U.S. Treasury, $4.4 billion is in the Reserve Receipt Account, which is a noninterest-bearing account at the U.S. Treasury. For purposes of the Statement of Cash Flow, Funds with U.S. Treasury are considered cash.

U.S. Government Securities: Ginnie Mae classifies its investments in U.S. Government securities based on its ability and intent to hold them to maturity. Therefore, Ginnie Mae's investment in U.S. Government securities is recorded at amortized cost. Discounts and premiums are amortized, on a level yield basis, over the life of the related security.

Mortgages Held for Sale: Mortgages held for sale, which are purchased out of MBS pools, are carried at the lower of cost or fair value and with any unrealized losses included in current period earnings. The related allowance for loss is established to reduce the carrying value of mortgages held for sale to their estimated fair value, which is based on the amount Ginnie Mae expects to realize in cash upon sale of the mortgages.

Properties Held for Sale: Foreclosed assets are recorded at the lower of cost or fair value, less estimated costs to sell. The related allowance for loss is established to reduce the property carrying value to fair value, less cost to sell. Property related expenses incurred during the holding period are included in MBS program expenses.

Advances against Defaulted MBS Pools: Advances against defaulted MBS pools represent payments made to fulfill Ginnie Mae's guarantee of timely principal and interest payments to MBS security holders. Such advances are reported net of an allowance for doubtful recoveries to the extent management believes they will not be recovered. The allowance for doubtful recoveries is estimated based on actual and expected recovery experience and is adjusted for FHA, VA, and USDA claims that have been filed.

Fixed Assets: Ginnie Mae's fixed assets represent systems (software) that are used to accomplish its mission. Ginnie Mae defers significant software development project costs and amortizes them over a three- to five-year period beginning with the project's completion. As of September 30, 2009, and September 30, 2008, Ginnie Mae's Fixed Assets – Software balance was $58.8 million, with accumulated amortization of $19.0 million, and $40.8 million, with accumulated amortization of $14.0 million, respectively.

Reserve for Loss on MBS Program: In the operation of its MBS programs, Ginnie Mae estimates the cost of liquidating its existing portfolio of mortgage servicing rights acquired from defaulted issuers and expected issuer defaults. Reserves are established to the extent management believes issuer defaults are probable and FHA, VA, and USDA insurance or guarantee are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries.

Recognition of Revenues and Expenses: Ginnie Mae receives monthly guaranty fees for each MBS mortgage pool, based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guarantee of MBS are recognized as earned. Ginnie Mae receives commitment fees as issuers request commitment authority, and recognizes the commitment fees as income as issuers use their commitment authority, with the balance deferred until earned or expired, whichever occurs first. Fees from expired commitment authority are not returned to issuers. Ginnie Mae recognizes as income the major portion of fees related to the issuance of multiclass securities in the period the fees are received, with the balance deferred and amortized over the weighted average life of the underlying mortgages to match the recognition of related administrative expenses. Losses on assets acquired through liquidation and claims against FHA, VA, and USDA are recognized when they occur.

Statements of Cash Flows: Ginnie Mae prepares the Statements of Cash Flows on an indirect basis. For purposes of the Statements of Cash Flows, Funds with U.S. Treasury are considered cash.

FIN 45: The Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statements No. 5, 57, and 107, and Rescission of FASB Interpretation No. 34*, in November 2002. FIN 45 clarifies the requirements of FASB Statement No. 5, *Accounting for Contingencies*, relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. FIN 45 requires that upon issuance of a guaranty, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guaranty. Ginnie Mae has computed the fair value of its guaranty based on the life of the mortgage-backed securities and their underlying loans. Based on this evaluation, Ginnie Mae has disclosed an asset and liability of $902.5 million as of September 30, 2009, and $680.2 million as of September 30, 2008, categorized as other assets and other liabilities. There is no impact on the net financial position of Ginnie Mae due to FIN 45.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets, 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 those estimates.

Note B: U.S. Government Securities

The U.S. Government securities portfolio is held in special market-based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book-entry form at the Bureau of Public Debt and are made up of overnight certificates, U.S. Treasury notes, and U.S. Treasury inflation-indexed securities (reflecting inflation compensation). The coupon rates of Ginnie Mae's holdings as of September 30, 2009, range from 0.63 percent to 3.63 percent. As of September 30, 2008, they ranged from 0.63 percent to 4.5 percent.

The amortized cost and fair values as of September 30, 2009, were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 1,825,700	$ -	$ -	$ 1,825,700
U.S. Treasury Notes	1,489,600	5,200	(1,300)	1,493,500
U.S. Treasury Inflation-Indexed Securities	5,920,500	248,900		6,169,400
Total	**$ 9,235,800**	**$ 254,100**	**$ (1,300)**	**$ 9,488,600**

The amortized cost and fair values as of September 30, 2008, were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 2,313,500	$ -	$ -	$ 2,313,500
U.S. Treasury Notes	898,800	17,400	-	916,200
U.S. Treasury Inflation-Indexed Securities	6,041,700	-	(897,400)	5,144,300
Total	**$ 9,254,000**	**$ 17,400**	**$ (897,400)**	**$ 8,374,000**

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2009, by contractual maturity date, were as follows:

(Dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 2,893,200	$ 2,899,700	0.21%
Due after one year through five years	5,771,800	5,995,100	1.03%
Due after five years through ten years	570,800	593,800	1.15%
Total	**$ 9,235,800**	**$ 9,488,600**	**0.79%**

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2008, by contractual maturity date, were as follows:

(Dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 2,713,000	$ 2,718,200	0.48%
Due after one year through five years	5,244,600	4,559,100	1.91%
Due after five years through ten years	1,296,400	1,096,700	2.05%
Total	**$ 9,254,000**	**$ 8,374,000**	**1.47%**

Note C: Mortgages Held for Sale, Net

Ginnie Mae acquires certain mortgages from defaulted issuers' portfolios to bring the pools into conformity with MBS program requirements. Ginnie Mae acquires mortgages ineligible to remain in pools when servicing rights are sold. Mortgages held for sale were as follows:

(Dollars in thousands)	September 30	
	2009	2008
Unpaid principal balance	$ 48,600	$ 37,900
Allowance for losses	(16,600)	(16,500)
Mortgages held for sale, net	**$ 32,000**	**$ 21,400**

Note D: Properties Held for Sale, Net

Ginnie Mae acquires residential properties by foreclosure out of the defaulted issuer portfolios to comply with MBS program requirements. Balances and activity in properties held for sale were as follows:

(Dollars in thousands)	September 30	
	2009	2008
Cost of properties, beginning of year	$ 16,400	$ 13,900
Additions	9,300	8,200
Dispositions and Losses	(9,100)	(5,700)
Cost of properties, end of year	$ 16,600	$ 16,400
Allowance for losses and costs to sell	(12,100)	(11,700)
Properties held for sale, net	**$ 4,500**	**$ 4,700**

Note E: Advances against Defaulted Mortgage-Backed Security Pools, Net

Under its MBS guaranty, Ginnie Mae advanced $305.4 million in FY 2009 and $58.8 million in FY 2008 against defaulted MBS pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guarantee proceeds, were $115.3 million in FY 2009 and $37.8 million in FY 2008. There were $1.6 million advances written off in FY 2009 and $18.5 million FY 2008.

(Dollars in thousands)	**September 30**	
	2009	2008
Advances against defaulted pools	$ 210,100	$ 18,400
Allowance for losses	(90,000)	(15,700)
Advances against defaulted pools	**$ 120,100**	**$ 2,700**

During FY 2009, Ginnie Mae defaulted two single family issuers with portfolios of $26.3 billion and $18.8 million, respectively. The increase in advances is directly related to the larger defaulted portfolio. Ginnie Mae believes the allowance for losses for advances is adequate to cover any potential losses related to advances against defaulted pools.

Note F: Reserve for Losses on MBS Program

Ginnie Mae establishes a reserve for losses through a provision charged to operations when, in management's judgment, defaults of MBS issuers become probable. The reserve for losses is based on an analysis of the MBS portfolio outstanding. In estimating losses, management utilizes a statistically-based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience. Management also considers uncertainties related to estimates in the reserve setting process. The reserve is relieved as losses are realized from the disposal of the defaulted issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights. As Ginnie Mae's defaulted issuer portfolio changes, original estimates are compared with actual results over time and the reserve's adequacy is assessed. If necessary, the reserve is adjusted. In FY 2009, an adjustment of $78.6 million was made to the reserve. Management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed MBS. Changes in the reserve for the years ended September 30, 2009, and 2008 were as follows:

(Dollars in thousands)	Single Family	Multifamily	Manufactured Housing	Total
September 30, 2007 Reserve for Loss	**$ 426,400**	**$ 58,800**	**$ 50,600**	**$ 535,800**
Recoveries	4,100	-	7,800	11,900
Realized Losses	(43,500)	-	(4,400)	(47,900)
Provision	50,200	-	-	50,200
September 30, 2008 Reserve for Loss	**$ 437,200**	**$ 58,800**	**$ 54,000**	**$ 550,000**
Recoveries	20,000	50	8,200	28,250
Realized Losses	(90,500)	(150)	(6,300)	(96,950)
Provision	78,600	-		78,600
September 30, 2009 Reserve for Loss	**$ 445,300**	**$ 58,700**	**$ 55,900**	**$ 559,900**

Ginnie Mae incurs losses when principal FHA, VA, and USDA insurance and guaranty do not cover expenses that result from issuer defaults. Such expenses include: (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees; (2) ineligible mortgages included in defaulted Ginnie Mae pools; (3) improper use of proceeds by an issuer; and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

During FY 2009, Ginnie Mae defaulted two single family issuers with portfolios of $26.3 billion and $18.8 million, respectively. Ginnie Mae believes that the reserve for loss estimate is adequate to cover any noninsured losses sustained for these issuers and from unknown future losses from the occurrence of periodic defaults.

Note G: Financial Instruments with Off-Balance Sheet Risk

Ginnie Mae is subject to credit risk for financial instruments not reflected in its balance sheet in the normal course of operations. These financial instruments include guarantees of MBS and commitments to guarantee MBS. The Ginnie Mae guaranteed security is a pass-through security whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the security's structure, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's exposure to credit loss is contingent on the nonperformance by other parties to the financial instruments. Other than those issuers considered in the reserve for loss on the MBS program (see Note F), Ginnie Mae does not anticipate nonperformance by the counterparties.

Ginnie Mae guarantees the timely payment of principal and interest to MBS holders should the issuers fail to do so. The securities are backed by pools of insured or guaranteed FHA, USDA, or VA mortgage loans. On September 30, 2009, the amount of securities outstanding, which is guaranteed by Ginnie Mae, was $826.0 billion, including $26.8 million of Ginnie Mae-guaranteed bonds. However, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral, and FHA, VA, and USDA insurance or guarantee indemnifies Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guarantee, Ginnie Mae enters into commitments to guarantee MBS. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities, due in part to Ginnie Mae's ability to limit commitment authority granted to individual MBS issuers.

Outstanding MBS and commitments were as follows:

	September 30	
(Dollars in billions)	2009	2008
Outstanding MBS	$ 826.0	$ 576.8
Outstanding MBS Commitments	$ 98.5	$ 71.2

Note H: Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (for example, issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers as noted below, as of September 30, 2009:

	Single Family		Multifamily		Manufactured Housing		Home Equity Conversion (HECM/HMBS)	
(Dollars in billions)	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance
Largest performing issuers	20	$ 717.5	10	$ 32.7	1	$ 0.2	9	$ 6.1
Other performing issuers	112	$ 35.4	45	$ 9.0	2	$ -	0	$ -
Defaulted issuers	16	$ 26.2	3	$ -	7	$ -	0	$ -

As of September 30, 2009, Ginnie Mae's single family, multifamily, and manufactured housing defaulted portfolio had remaining principal balances of $26.2 billion, $19.0 million, and $6.7 million, respectively.

In FY 2009, Ginnie Mae issued a total of $168.6 billion in its multiclass securities program. The estimated outstanding balance of multiclass securities included in the total MBS securities balance in Note G as of September 30, 2009, was $350.4 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

Note I: Commitments and Contingencies

As of September 30, 2009, Ginnie Mae has no legal actions pending. However, Ginnie Mae's management recognizes the uncertainties that could occur in regard to potential default issuers and other indirect guarantees. (See Note A, Note F, and Note M.)

Note J: Related Parties

Ginnie Mae is subject to controls established by government corporation control laws (31 U.S.C. Chapter 91) and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). These controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

Ginnie Mae was authorized by Congress to use $10.0 million in FY 2009 for payroll and payroll-related costs only. In FY 2009, Ginnie Mae incurred $8.6 million for Salaries and Expenses (travel, furniture, and supplies, and so forth.), including payroll and payroll-related costs. This covered the payroll-related costs to HUD including the contributions to the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). Ginnie Mae has no liability for future payments to employees under the retirement systems. Ginnie Mae does not account for the assets of CSRS or FERS nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are allocated to HUD. OPM also accounts for the health and life insurance programs for federal employees and retirees and funds the non-employee portion of these programs' costs.

Cash receipts, disbursements, and investment activities are processed by the U.S. Treasury. Funds with U.S. Treasury represent cash currently available to finance purchase commitments and pay current liabilities. Ginnie Mae has authority to borrow from the U.S. Treasury to finance operations in lieu of appropriations, if necessary.

Note K: Fair Value of Financial Instruments

The following table shows the fair value of the financial instruments to which Ginnie Mae has a contractual obligation to deliver cash to, or a contractual right to receive cash from, another entity as of September 30, 2009, and 2008:

	September 30, 2009			September 30, 2008	
(Dollars in thousands)	Cost	Fair Value		Cost	Fair Value
Funds with U.S. Treasury	$ 5,253,800	$ 5,253,800		$ 4,836,300	$ 4,836,300
U.S. Government Securities	9,235,800	9,488,600		9,254,000	8,374,000
Advances against Defaulted MBS Pools	120,100	120,100		2,700	2,700
Other assets	$ 122,400	$ 122,400		$ 88,400	$ 88,400
Unrecognized financial instruments	-	4,139,000		-	2,412,000
Other liabilities	$ 175,700	$ 175,700		$ 131,500	$ 131,500

The fair value of Ginnie Mae's largest asset, U.S. Government securities, is estimated based on quoted market prices for securities of similar maturity. The fair values of Funds with U.S. Treasury, advances against MBS pools, other assets, and other liabilities are not materially different from their carrying values.

Unrecognized financial instruments comprise the net fair value of the fee Ginnie Mae receives for the guarantee of timely payment of principal and interest. The value was derived by discounting the estimated future net cash flows relating to Ginnie Mae guaranteed MBS outstanding. The assumptions and estimates used in calculating the fair values of unrecognized financial instruments are based on management's evaluation of economic conditions and, therefore, are not subject to precise quantification.

These discounted cash flows consist of estimated future guaranty fees, taking into account estimated prepayments, in excess of: (1) projected losses relating to the MBS program, including projected losses on defaulted pools of MBS; and (2) projected administrative expenses. The discount rate approximates an interest rate for risk-free instruments of a type and duration similar to the Ginnie Mae guaranty. The fair value of Ginnie Mae's guaranty recognizes the present value of future fees, which are not recognized under accounting principles generally accepted in the U.S., since to do so would record revenue prior to realization. The fair value of unrecognized financial instruments increased from FY 2008 to FY 2009 and is primarily attributable to the impact of interest rate volatility.

Ginnie Mae's standing as a federal government corporation whose guaranty carries the full faith and credit of the U.S. Government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Accordingly, the amount Ginnie Mae would realize upon the sale of its financial instruments could differ, perhaps materially, from the amounts shown above.

Note L: Credit Reform

The Federal Credit Reform Act of 1990, which became effective on October 1, 1991, was enacted to more accurately measure the cost of federal credit programs and to place the cost of these credit programs on a basis equivalent with other federal spending. Credit reform focuses on credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to the U.S. Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations. As of September 30, 2009, Ginnie Mae had reserves of $14.0 billion held in the U.S. Treasury. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management and HUD's general counsel, Ginnie Mae is not subject to the Federal Credit Reform Act.

Note M: Subsequent Events

On October 29, 2009, Ginnie Mae defaulted a multifamily issuer with a portfolio of $7.2 billion. Estimated losses on this default are not readily determinable and management believes that the reserve for loss estimate of $559.9 million (Note F) is adequate to cover any losses incurred by Ginnie Mae due to this default.