

V. AUDIT REPORT OF GINNIE MAE'S FY 2008
FINANCIAL STATEMENTS





Issue Date	November 7, 2008
Audit Case Number	2009-FO-0001

TO: Joseph J. Murin, 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 2008 and 2007

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 2008 and 2007 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 4, 2008 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 4, 2008 regarding other 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 with this report. Ginnie Mae plans to separately publish an annual report for fiscal year 2008 that conforms to FASAB standards.

The report contains one significant deficiency in Ginnie Mae's internal controls and one reportable instance of noncompliance with laws and regulations. The significant deficiency was carried over from previous year's audit. The report contains one new recommendation. Within 120 days of the report issue date, Ginnie Mae is required to provide its final management decision which included a corrective action plan for each recommendation. As part of the audit resolution process, we will record new recommendation(s) in the Department's Audit Resolution and Corrective Action Tracking System (ARCATS). We will also endeavor to work with Ginnie Mae to reach a mutually acceptable management decision prior to the mandated deadline. The proposed management decision and corrective action plan will be reviewed and evaluated by CBTC with concurrence from the OIG.

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 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 operation. 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, 2008 and 2007, 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, 2008 and 2007; 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 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 to be a significant deficiency in internal control.

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

- Continue to assure more effective follow up of the automated matching process with insurer loan data
- Eliminate independence issues within the MBS to ensure transparency within Ginnie Mae

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 at 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 we will be communicated in writing to management and those charged with governance.

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, noncompliance with 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 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.”

Our review of Ginnie Mae’s information system security controls over the Integrated Portfolio Management System (IPMS), which is managed and controlled by a Ginnie Mae contractor, disclosed that Ginnie Mae lacks assurance with IPMS that critical Information Technology general control elements are operating effectively to reduce agency information system risk .

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.

RESPONSIBILITIES

Management’s Responsibilities

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 2008 and 2007 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 4, 2008

APPENDIX A - SIGNIFICANT DEFICIENCY

Ginnie Mae should strengthen monitoring and management controls in regard to MBS program

Due to conditions in the current economic mortgage and credit environment, improvements and/or changes should be considered by Ginnie Mae's Senior Management to strengthen monitoring and management in regard to the Mortgage-Backed Securities (MBS) program.

- Assure more effective follow up of the automated matching process with insurer loan data (significant deficiency in prior year continuing during current year)
- Eliminate any independence issues whether real or perceived to ensure transparency (new)

MBS has improved its matching process during the current year and has begun a more effective follow up of issuers with unmatched loans within existing pools.

Ginnie Mae implemented a monthly match to terminated loan 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 are not predicted to be in place until fiscal year 2009. Furthermore, the HUD-OIG issued several findings during the current fiscal year that disclosed numerous control issues within Ginnie Mae's matching process.

In 2007, our audit identified a potential conflict of interest issue between issuer approval and issuer monitoring functions within Ginnie Mae's Office of MBS. This issue was reported as a significant deficiency in last year's Independent Auditors' report. 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 creation of the CRO during FY 2008 resolved the conflict of interest issue identified during FY 2007. However, in fiscal year 2008, the former SVP-MBS left the agency and the new CRO became the acting SVP-MBS which causes an appearance of conflict to re-occur.

- OMB Circular No. A-123 *Management's Responsibility for Internal Control*, (A-123) as revised December 21, 2004, "...specifically addresses internal control over financial reporting; operational program controls and financial reporting often overlap." Additionally, Section I states that "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner." Also, within the circular's attachment, Section IV, *Assessing Internal Control*, it states, "Agency managers should continuously monitor and improve the effectiveness of internal controls associated with their programs."
- Federal as well as private sector internal control guidance requires a separation of performance monitoring and revenue producing business duties. GAO's Standards for Internal Control in Federal Government published in November 1999, Subsection "Segregation of Duties," states: "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud."

Recommendations to Ginnie Mae's President that address the significant deficiency described above include:

1. Continue strengthening the completeness, timeliness, and controls of the automated pool collateral matching process as well as follow-up on unmatched loans with issuers data (repeat from prior year).
2. Eliminate any independence issues whether real or perceived to ensure management transparency (new).

APPENDIX B - MANAGEMENT'S RESPONSE TO RECOMMENDATIONS



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

PRESIDENT, GOVERNMENT
NATIONAL MORTGAGE ASSOCIATION

October 31, 2008

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

Re: Response to CBTC's Fiscal Year 2008 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 2008.

We are pleased that CBTC has acknowledged Ginnie Mae for its financial statement presentation on its FY 2008 financial audit. Ginnie Mae is also pleased to note that there were no material weaknesses.

In CBTC's Internal Control Report, one significant deficiency in the area of mortgage-backed securities ("MBS") was identified. CBTC recommended that Ginnie Mae improve its program compliance and controls regarding the monitoring of Ginnie Mae issuers. Ginnie Mae is committed to improving its MBS monitoring process that will better assure issuer program compliance. Ginnie Mae will be taking the following steps to address CBTC's concerns:

- Ginnie Mae will take quicker action regarding non-compliant issuers; and
- Ginnie Mae will strengthen controls related to appropriate separation of duties.

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

Sincerely,

A handwritten signature in black ink, appearing to read "J. Murin".

Joseph J. Murin

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

CBTC has reviewed Ginnie Mae management's response to the reported significant deficiency made in connection with our audit of Ginnie Mae's 2008 Financial Statements, which is included as Appendix B. Our assessment of management's response is discussed below.

We believe management's proposed actions are responsive to our recommendations. However, this significant deficiency will remain open until after CBTC has reviewed the effectiveness of Ginnie Mae's new monitoring matching process in regard to MBS programs, the timeliness of action taken by management in regard to noncompliant issuers and the elimination of independence issues within the MBS.

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 2007 Status
<p>1.a. Communication Ginnie Mae's Acting Vice-President should institute timely and regular communications among Senior Officials of an Issuer Risk Assessment Committee regarding issuer performance and issuer review to recognize the current risk and the possibility of a potential misstatement in Ginnie Mae's overall financial statements.</p>	Significant deficiency	Resolved. Ginnie Mae corrected by the implementation of a risk committee which includes senior management from differing Ginnie Mae departments.
<p>1.b. 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.</p>	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 are not predicted to be in place until fiscal year 2009. This deficiency continues to be reported as a significant deficiency during 2008.
<p>1.c. 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.</p>	Significant deficiency	Resolved. Ginnie Mae created a Risk Committee and a Chief Risk Officer (CRO) to enhance oversight and independent management control. The creation of the CRO during FY 2008 resolved the conflict of interest issue.

Ginnie Mae's FY 2008 Financial Statements

Balance Sheets		
September 30	2008	2007
<i>(Dollars in thousands)</i>		
Assets:		
Funds with U.S. Treasury	\$ 4,836,300	\$ 4,432,600
U.S. Government securities--Note B	9,254,000	8,735,900
Mortgages held for sale, net--Note C	21,400	19,000
Properties held for sale, net--Note D	4,700	3,200
Accrued interest on U.S. Government securities	36,400	53,200
Accrued fees and other receivables	25,900	23,300
Advances against defaulted Mortgage-Backed Security pools, net- Note E	2,700	1,000
Fixed assets--software, net of accumulated amortization--Note A	26,800	16,500
Other assets--Note A	680,200	426,000
Total Assets	\$ 14,888,400	\$ 13,710,700
Liabilities and Investment of U.S. Government:		
Liabilities:		
Reserve for loss on Mortgage-Backed Securities Program--Note F	\$ 550,000	\$ 535,800
Deferred revenue	90,000	75,600
Deferred liabilities and deposits	2,400	11,100
Accounts payable and accrued liabilities	39,100	41,700
Other liabilities--Note A	680,200	426,000
Total Liabilities	\$ 1,361,700	\$ 1,090,200
Commitments and Contingencies--Notes G, H, and I		
Investment of U.S. Government	13,526,700	12,620,500
Total Liabilities and Investment of U.S. Government	\$ 14,888,400	\$ 13,710,700

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	2008	2007
<i>(Dollars in thousands)</i>		
Revenues:		
Mortgage-Backed Securities Program income	\$ 373,100	\$ 308,500
Interest income	633,500	482,800
Other revenue source	8,800	-
Total Revenues	\$ 1,015,400	\$ 791,300
Expenses:		
Mortgage-Backed Securities Program expenses	\$ 49,000	\$ 41,900
Administrative expenses	8,800	10,600
Fixed asset amortization	1,200	500
Total Expenses	\$ 59,000	\$ 53,000
Provision for loss on Mortgage-Backed Securities Program--Note F	50,200	-
Excess of Revenues over Expenses	\$ 906,200	\$ 738,300
Investment of U.S. Government at Beginning of Year	12,620,500	11,882,200
Excess of revenues over expenses	906,200	738,300
Returned to U.S. Treasury	-	-
Investment of U.S. Government at End of Year	\$ 13,526,700	\$ 12,620,500

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

Statements of Cash Flows		
For the Years Ended September 30	2008	2007
<i>(Dollars in thousands)</i>		
Cash Flow from Operating Activities		
Net Excess of revenues over expenses	\$ 906,200	\$ 738,300
Adjustments to Reconcile Net Excess of Revenues Over Expenses to Net Cash from (used for) Operating Activities		
Depreciation & amortization	1,200	500
Decrease / increase in accrued interest Federal investments	16,800	3,000
Increase / decrease in advances against defaulted MBS pools	(1,700)	800
Decrease / increase in deferred liabilities and deposits	(8,700)	8,900
Decrease / increase in accounts payable and accrued liabilities	(2,600)	4,400
Increase / decrease in deferred revenue	14,400	2,800
Increase / decrease in MBS Reserve, net of other assets relating to operating activities	7,700	5,700
Total Adjustments	27,100	26,100
Net Cash from (used for) Operating Activities	\$ 933,300	\$ 764,400
Cash Flow from Investing Activities		
Purchase of U.S. Treasury Securities, net	(518,100)	(377,700)
Purchase of software	(11,500)	(10,600)
Net Cash from (used for) Investing Activities	\$ (529,600)	\$ (388,300)
Cash Flow from Financing Activities		
Financing activities	-	-
Net Cash from (used for) Financing Activities	-	-
Net increase in cash & cash equivalents	403,700	376,100
Cash & cash equivalents - beginning of period	4,432,600	4,056,500
Cash & cash equivalents - end of period	\$ 4,836,300	\$ 4,432,600

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

Notes to the Financial Statements

September 30, 2008 and 2007

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 \$4.8 billion in Funds with U.S. Treasury, \$3.5 billion is in the Reserve Receipt Account, which is a non-interest-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, 2008 and September 30, 2007, Ginnie Mae's Fixed Assets – Software balance was \$40.8 million, with accumulated amortization of \$14.0 million, and \$29.3 million, with accumulated amortization of \$12.8 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 guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guarantee. We have computed the fair value of our guarantee based on the life of the mortgage-backed securities and their underlying loans. Based on this evaluation we have disclosed an asset and liability of \$680.2 million as of September 30, 2008 and \$425.9 million as of September 30, 2007 categorized as other assets and other liabilities, see Note A. 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, 2008, range from 0.63 percent to 4.5 percent. As of September 30, 2007, they ranged from 0.88 percent to 4.625 percent.

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

<i>(Dollars in thousands)</i>	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 and fair values as of September 30, 2007, were as follows:

<i>(Dollars in thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	\$ 1,214,100	\$ -	\$ -	\$ 1,214,100
U.S. Treasury Notes	2,294,900	8,600	(2,900)	2,300,600
U.S. Treasury Inflation-Indexed Securities	5,226,900	-	(589,800)	4,637,100
Total	\$ 8,735,900	\$ 8,600	\$ (592,700)	\$ 8,151,800

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:

<i>(Dollars in thousands)</i>	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%

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2007, by contractual maturity date, were as follows:

<i>(Dollars in thousands)</i>	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	\$ 2,612,100	\$ 2,616,100	3.12%
Due after one year through five years	3,768,800	3,468,100	2.62%
Due after five years through ten years	2,355,000	2,067,600	2.20%
Total	\$ 8,735,900	\$ 8,151,800	2.98%

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:

<i>(Dollars in thousands)</i>	September 30	
	2008	2007
Unpaid principal balance	\$ 37,900	\$ 23,600
Allowance for losses	(16,500)	(4,600)
Mortgages held for sale, net	\$ 21,400	\$ 19,000

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:

<i>(Dollars in thousands)</i>	September 30	
	2008	2007
Cost of properties, beginning of year	\$ 13,900	\$ 11,300
Additions	8,200	7,200
Dispositions and Losses	(5,700)	(4,600)
Cost of properties, end of year	\$ 16,400	\$ 13,900
Allowance for losses and costs to sell	(11,700)	(10,700)
Properties held for sale, net	\$ 4,700	\$ 3,200

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

Under its MBS guaranty, Ginnie Mae advanced \$58.8 million in FY 2008, and \$30.4 million in FY 2007 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 \$37.8 million in FY 2008 and \$31.1 million in FY 2007. There were \$18.5 million advances written off in FY 2008 but no advances written off in FY 2007. There were no advances associated with USDA in FY 2008 or FY 2007.

<i>(Dollars in thousands)</i>	September 30	
	2008	2007
Advances against defaulted pools	\$ 18,400	\$ 15,900
Allowance for losses	(15,700)	(14,900)
Advances against defaulted pools	\$ 2,700	\$ 1,000

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 decreases, original estimates are compared with actual results over time, and the reserve's adequacy is assessed, and if necessary, the reserve is adjusted. In FY 2008, an adjustment of \$50.2 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, 2008, and 2007 were as follows:

<i>(Dollars in thousands)</i>	Single Family		Multifamily		Manufactured Housing		Total	
September 30, 2006								
Reserve for Loss	\$	237,900	\$	58,850	\$	237,700	\$	534,450
Reallocation between programs	\$	187,800	\$	(100)	\$	(187,700)		-
Recoveries		7,900		100		6,700		14,700
Realized Losses		(7,200)		(50)		(6,100)		(13,350)
Provision		-		-		-		-
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

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.

Three single family issuers defaulted during FY 2008. Ginnie Mae believes that the reserve for loss estimate is adequate to cover any noninsured loss 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, 2008, the amount of securities outstanding, which is guaranteed by Ginnie Mae, was \$576.8 billion, including \$38.7 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:

<i>(Dollars in billions)</i>	September 30	
	2008	2007
Outstanding MBS	\$ 576.8	\$ 427.6
Outstanding MBS Commitments	\$ 71.2	\$ 35.8

Note H: Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (e.g., 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, 2008:

<i>(Dollars in billions)</i>	Single Family		Multifamily		Manufactured Housing	
	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance
Largest performing issuers	20	\$ 513.0	10	\$ 27.9	1	\$ -
Other performing issuers	97	\$ 23.5	49	\$ 11.5	2	\$ 0.1
Defaulted issuers	14	\$ 0.4	3	\$ -	7	\$ -

As of September 30, 2008, Ginnie Mae's single family, multifamily, and manufactured housing defaulted portfolio had remaining principal balances of \$358.5 million, \$25.6 million, and \$9.6 million, respectively.

In FY 2008, Ginnie Mae issued a total of \$86.4 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, 2008, was \$253.1 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, 2008, 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 appropriated \$8.25 million in FY 2008 for payroll and payroll-related costs only. In FY 2007, Ginnie Mae reimbursed HUD \$10.6 million for Salaries and Expenses (travel, furniture, and supplies, etc.), including payroll and payroll-related costs. The FY 2008 appropriation 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 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, 2008, and 2007:

<i>(Dollars in thousands)</i>	September 30, 2008		September 30, 2007	
	Cost	Fair Value	Cost	Fair Value
Funds with U.S. Treasury	\$ 4,836,300	\$ 4,836,300	\$ 4,432,600	\$ 4,432,600
U.S. Government Securities	9,254,000	8,374,000	8,735,900	8,151,800
Advances against Defaulted MBS Pools	2,700	2,700	1,000	1,000
Other assets	\$ 88,400	\$ 88,400	98,700	98,700
Unrecognized financial instruments	-	2,412,000	-	1,643,000
Other liabilities	\$ 131,500	\$ 131,500	128,400	128,400

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 2007 to FY 2008, 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 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, 2008, Ginnie Mae had reserves of \$13.5 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.



GINNIE MAE EMPLOYEES IN FY 2008

Angela E. Aganad	Kirk D. Freeman	Michael J. Najjum Jr.
Pershing J. Anderson	Michael J. Frenz	Leonora D. Noel
Karen P. Beddoe	Kathleen M. Gibbons	Cheryl W. Owens
Damasque J. Blagburn	Cindy C. Gorman	Taryn S. Runion
Linda D. Blaylock	Merlene S. Hawkins	Gina B. Screen
Dawn A. Brown	Deborah V. Holmes	William L. Shen
Carlotta C. Bryant	Paul A. Imbraguglio	Tamara P. Smith
Philip H. Buckley	Eva E. Johnson	Paul R. St. Laurent III
Justin D. Burch	Daniel E. Kahn	Herbert L. Sterling
Jennifer S. Burke	Chitranjan Khandpur	Sharon C. Strange
Terry M. Carr	Carolyn L. Korn	Lindsay L. Sturdivant
Herbert G. Carroll	John Kozak	Sonya K. Suarez
Dan Cira	Stephen L. Ledbetter	James A. Thompson
Janie R. Cousin	Christine L. Martin	Sandra J. Usher
Ernest E. Cowan	Maria M. McQueen	Victoria Vargas
Nutan K. Deodhar	James D. Millhouse	Carol M. Vilsack
Patricia A. Dougherty	Sharolyn D. Moses	LaKevia S. Waller
Tisa I. Ebba	Joseph J. Murin	Richard J. Washington
David L. Ellis	Debra L. Murphy	Thomas R. Weakland
Helen E. Faunce	LaShonia M. Murphy	Karmen L. Young
Barbara A. Foreman		

As of September 30, 2008



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DECEMBER 2008
HUD-2008-02-GINNIEMAE

