# V. Ginnie Mae's FY 2006 Financial Statements

## Balance Sheets

| September 30 | 2006 | 2005 |
|---|---|---|
| *(Dollars in thousands)* | | |
| **Assets:** | | |
| Funds with U.S. Treasury | $ 4,056,500 | $ 3,711,400 |
| U.S. Government securities—Note B | 8,358,100 | 7,921,000 |
| Mortgages held for sale, net—Note C | 23,000 | 30,400 |
| Properties held for sale, net—Note D | 2,600 | 7,300 |
| Accrued interest on U.S. Government securities | 56,200 | 49,800 |
| Accrued fees and other receivables | 24,300 | 27,800 |
| Advances against defaulted Mortgage-Backed Security pools, net—Note E | 1,800 | 2,400 |
| Fixed assets—software, net of accumulated amortization | 6,500 | 2,200 |
| Other assets—Note A | 363,700 | 382,300 |
| **Total Assets** | $ 12,892,700 | $ 12,134,600 |
| **Liabilities and Investment of U.S. Government** | | |
| **Liabilities:** | | |
| Reserve for loss on Mortgage-Backed Securities Program—Note F | $ 534,500 | $ 538,500 |
| Deferred revenue | 72,800 | 76,700 |
| Deferred liabilities and deposits | 2,200 | 1,800 |
| Accounts payable and accrued liabilities | 37,300 | 42,400 |
| Other liabilities—Note A | 363,700 | 382,300 |
| **Total Liabilities** | $ 1,010,500 | $ 1,041,700 |
| **Commitments and Contingencies—Notes G, H, and I** | | |
| Investment of U.S. Government | 11,882,200 | 11,092,900 |
| **Total Liabilities and Investment of U.S. Government** | $ 12,892,700 | $ 12,134,600 |

See accompanying notes to financial statements.

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

| For the Years Ended September 30 | 2006 | 2005 |
|---|---|---|
| *(Dollars in thousands)* | | |
| **Revenues:** | | |
| Mortgage-Backed Securities Program income | $ 300,300 | $ 327,500 |
| Interest income | 549,000 | 458,800 |
| Other income, net | – | 200 |
| **Total Revenues** | $ 849,300 | $ 786,500 |
| **Expenses:** | | |
| Mortgage-Backed Securities Program expenses | $ 47,700 | $ 58,300 |
| Administrative expenses | 10,600 | 10,600 |
| Fixed asset amortization | 1,700 | 2,400 |
| **Total Expenses** | $ 60,000 | $ 71,300 |
| Provision for loss on Mortgage-Backed Securities Program - Note F | – | 10,000 |
| **Excess of Revenues over Expenses** | 789,300 | 705,200 |
| **Investment of U.S. Government at Beginning of Year** | 11,092,900 | 10,387,700 |
| Excess of revenues over expenses | 789,300 | 705,200 |
| Returned to U.S. Treasury | – | – |
| **Investment of U.S. Government at End of Year** | $ 11,882,200 | $ 11,092,900 |

See accompanying notes to financial statements.

## Statements of Cash Flows

| For the Years Ended September 30 | 2006 | 2005 |
|---|---|---|
| *(Dollars in thousands)* | | |
| **Cash Flows From Operating Activities:** | | |
| Interest received | $ 542,500 | $ 468,300 |
| Mortgage-Backed Securities Program fees | 303,800 | 324,300 |
| Advances against defaulted Mortgage-Backed Security pools | 500 | (1,200) |
| Mortgage-Backed Securities losses and expenses | (50,100) | (50,600) |
| Other income received | (3,900) | 1,800 |
| Administrative expenses | (10,600) | (10,600) |
| Purchases of mortgages/properties, net of disposal | 6,000 | 6,000 |
| **Net Cash Provided by Operating Activities** | $ 788,200 | $ 738,000 |
| **Cash Flows from Investing Activities:** | | |
| Purchase of U.S. Treasury Securities, net | (437,100) | (381,200) |
| Purchase of software | (6,000) | (500) |
| **Net Cash Used by Investing Activities** | (443,100) | (381,700) |
| **Cash Flows from Financing Activities:** | | |
| Cash returned to U.S. Treasury | – | – |
| **Net Cash Used by Financing Activities** | – | – |
| **Net Increase in Cash** | 345,100 | 356,300 |
| **Funds with U.S. Treasury at Beginning of Year** | 3,711,400 | 3,355,100 |
| **Funds with U.S. Treasury at End of Year** | $ 4,056,500 | $ 3,711,400 |
| **Net excess of revenues over expenses** | $ 789,300 | $ 705,200 |
| **Adjustments to Reconcile Net Excess of Revenues Over Expenses to Net Cash Provided by Operating Activities:** | | |
| Provision for loss on Mortgage-Backed Securities Program | – | 10,000 |
| (Increase) decrease in accrued interest Federal Investments | (6,500) | 9,400 |
| Decrease (increase) in advances against defaulted Mortgage-Backed Security pools | 600 | (800) |
| Increase (decrease) in deferred liabilities and deposits | 500 | (3,100) |
| (Decrease) increase in accounts payable and accrued liabilities | (5,100) | 2,700 |
| (Decrease) increase in deferred revenue | (3,900) | 1,600 |
| Increase in Mortgage-Backed Securities Reserve, net of other assets, relating to operating activities | 11,600 | 10,600 |
| Fixed asset amortization | 1,700 | 2,400 |
| **Total Adjustments** | (1,100) | 32,800 |
| **Net Cash Provided by Operating Activities** | $ 788,200 | $ 738,000 |

See accompanying notes to financial statements.

# Notes to the Financial Statements

*September 30, 2006 and 2005*

## 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 Rural Housing Service (RHS) (formerly Farmer's Home Administration), 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 $4.1 billion in Funds with U.S. Treasury, $2.9 billion is in the Reserve Receipt Account, which is a non-interest-bearing account at the U.S. Treasury. For purposes of the Statements of Cash Flows, 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, 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 RHS 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.

**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 RHS insurance or guaranty are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenue 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 HUD/FHA, VA, and RHS are recognized when they occur.

**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, a n interpretation of FASB Statements No. 5, 57, and 107, and Rescission of FASB Interpretation No. 34, in November 2002. During FY 2006, Ginnie Mae changed its methodology for applying FIN 45. This methodology was adopted because management believes it will result in a more systematic approach to the calculation resulting in a more relevant financial presentation. No current period or prior period adjustments were required but future calculations are expected to vary as a result of this adoption. We have completed an evaluation of our guarantees for disclosures required by FIN 45, and have disclosed an asset and liability of $363.7 million as of September 30, 2006 and $382.3 million as of September 30, 2005 (i.e., Other Assets and Other Liabilities).

**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, 2006, range from 0.88 percent to 6.50 percent. As of September 30, 2005, they ranged from .88 percent to 7.00 percent.

The amortized cost and fair values as of September 30, 2006, were as follows:

| *Dollars in Thousands* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury Overnight Certificates | $ 1,262,400 | $ – | $ – | $ 1,262,400 |
| U.S. Treasury Notes | 1,994,100 | 2,900 | (14,000) | 1,983,000 |
| U.S. Treasury Inflation-Indexed Securities | 5,101,600 | 108,800 | (67,800) | 5,142,600 |
| | **$ 8,358,100** | **$ 111,700** | **$ (81,800)** | **$ 8,388,000** |

The amortized cost and fair values as of September 30, 2005, were as follows:

| *Dollars in Thousands* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury Overnight Certificates | $ 1,340,000 | $ – | $ – | $ 1,340,000 |
| U.S. Treasury Notes | 1,687,400 | 23,600 | (9,200) | 1,701,800 |
| U.S. Treasury Inflation-Indexed Securities | 4,893,600 | 271,000 | (6,000) | 5,158,600 |
| | **$ 7,921,000** | **$ 294,600** | **$ (15,200)** | **$ 8,200,400** |

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government Securities at September 30, 2006, by contractual maturity date, were as follows:

| *Dollars in Thousands* | Amortized Cost | Fair Value | Weighted Average Interest Ratio |
|---|---|---|---|
| Due within one year | $ 1,762,300 | $ 1,763,500 | 5.11% |
| Due after one year through five years | 2,026,000 | 1,990,500 | 4.13% |
| Due after five years through ten years | 4,569,800 | 4,634,000 | 2.33% |
| | **$ 8,358,100** | **$ 8,388,000** | **3.34%** |

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2005, by contractual maturity date, were as follows:

| *Dollars in Thousands* | Amortized Cost | Fair Value | Weighted Average Interest Ratio |
|---|---|---|---|
| Due within one year | $ 2,029,900 | $ 2,040,200 | 3.70% |
| Due after one year through five years | 1,506,400 | 1,504,500 | 3.26% |
| Due after five years through ten years | 4,384,700 | 4,655,700 | 1.65% |
| | **$ 7,921,000** | **$ 8,200,400** | **2.46%** |

## 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:

| | September 30, | |
|---|---|---|
| *Dollars in Thousands* | 2006 | 2005 |
| Unpaid principal balance | $ 29,100 | $ 36,000 |
| Allowance for losses | (6,100) | (5,600) |
| **Mortgages held for sale, net** | **$ 23,000** | **$ 30,400** |

## 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:

| | September 30, | |
|---|---|---|
| *Dollars in Thousands* | 2006 | 2005 |
| Cost of properties, beginning of year | $ 10,400 | $ 7,700 |
| Additions | 6,000 | 7,000 |
| Dispositions and Losses | (5,100) | (4,300) |
| Cost of properties, end of year | 11,300 | 10,400 |
| Allowances for losses and costs to sell | (8,700) | (3,100) |
| **Properties held for sale, net** | **$ 2,600** | **$ 7,300** |

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

Under its MBS guaranty, Ginnie Mae advanced $30 million in FY 2006, and $40.9 million in FY 2005 against defaulted MBS pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guaranty proceeds, were $30.4 million in FY 2006 and $39.9 million in FY 2005. There were no advances written off in FY 2006 and FY 2005. There were no advances associated with RHS in FY 2006.

| | September 30, | |
|---|---|---|
| *Dollars in Thousands* | 2006 | 2005 |
| Advances against defaulted pools | $ 13,100 | $ 10,900 |
| Allowance for losses | (11,300) | (8,500) |
| **Advances against defaulted pools** | **$ 1,800** | **$ 2,400** |

## 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. This model, Policy and Financial Analysis Model (PFAM), has not been updated with current third party data since 2002. The ultimate outcome of not using current economic data cannot be presently determined. Ginnie Mae did not record any adjustment to the financial statements due to this uncertainty; however, in the opinion of management, Ginnie Mae's reserve is more than adequate.

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. 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, 2006, and 2005 were as follows:

| *Dollars in Thousands* | Single Family | Multifamily | Manufactured Housing | Total |
|---|---|---|---|---|
| *September 30, 2004 Reserve for Loss* | $ 221,100 | $ 58,100 | $ 239,500 | $ 518,700 |
| Recoveries | 15,800 | 600 | 5,700 | 22,100 |
| Realized Losses | (8,600) | (100) | (3,600) | (12,300) |
| Provision | 10,000 | – | – | 10,000 |
| *September 30, 2005 Reserve for Loss* | $ 238,300 | $ 58,600 | $ 241,600 | $ 538,500 |
| Recoveries | 4,800 | 250 | 7,100 | 12,150 |
| Realized Losses | (5,200) | – | (11,000) | (16,200) |
| Provision | – | – | – | – |
| **September 30, 2006** *Reserve for Loss* | **$ 237,900** | **$ 58,850** | **$ 237,700** | **534,450** |

Ginnie Mae incurs losses when FHA, VA, and RHS 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 guaranties; (2) ineligible mortgages included in defaulted Ginnie Mae pools; (3) improper use of proceeds by an issuer; and (4) nonreimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

Two of Ginnie Mae's single-family issuers defaulted during FY 2006. Ginnie Mae believes that the estimated reserve for loss is more than adequate to cover any noninsured loss sustained for these issuers and from unknown future losses from the occurrence of any normal 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 counter parties.

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, RHS, or VA mortgage loans. On September 30, 2006, the amount of securities outstanding, which are guaranteed by Ginnie Mae, was $410 billion, in addition $66.9 million of Ginnie Mae guaranteed bonds. However, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral, and the FHA, RHS, and VA insurance or guaranty indemnifies Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guaranty, 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 securities and commitments were as follows:

| | September 30, | |
|---|---|---|
| *Dollars in Billions* | 2006 | 2005 |
| Outstanding MBS Securities | $ 410.0 | $ 412.3 |
| Outstanding MBS Commitments | $ 22.8 | $ 55.2 |

## Note H: Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counter parties (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, 2006:

| Dollars in Billions | Single Family Number of Issuers | Single Family Remaining Principal Balance | Multifamily Number of Issuers | Multifamily Remaining Principal Balance | Manufactured Housing Number of Issuers | Manufactured Housing Remaining Principal Balance |
|---|---|---|---|---|---|---|
| Largest performing issuers | 20 | $ 346.8 | 9 | $ 24.8 | 1 | $ 0.1 |
| Other performing issuers | 116 | 25.5 | 62 | 13.1 | 3 | 0.1 |
| Defaulted issuers | 10 | 0.2 | 2 | – | 8 | – |

As of September 30, 2006, Ginnie Mae's single-family, multifamily, and manufactured housing defaulted portfolio had remaining principal balances of $188.6 million, $35 million, and $19.5 million, respectively.

In FY 2006, Ginnie Mae issued a total of $23.8 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, 2006, was $198.7 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, 2006, Ginnie Mae was named in several legal actions, virtually all of which involved claims under the guaranty program. It is not possible to predict the eventual outcome of the various actions; however, in the opinion of management and counsel, the resolution of these claims will not result in adverse judgments to the extent that they would materially affect Ginnie Mae's financial position or operating results.

## 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 reimbursed HUD $10.6 million in FY 2006, and $10.6 million in FY 2005, for administrative expenses (office space, etc.), including payroll and payroll-related costs. Payroll-related costs reimbursed to HUD included matching contributions to the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). Although Ginnie Mae funds a portion of pension benefits under these programs, it has no liability for future payments to employees under them. 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 nonemployee 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, 2006, and 2005:

| | September 30, 2006 | | September 30, 2005 | |
|---|---|---|---|---|
| *Dollars in Thousands* | Cost | Fair Value | Cost | Fair Value |
| Funds with U.S. Treasury | $ 4,056,500 | $ 4,056,500 | $ 3,711,400 | $ 3,711,400 |
| U.S. Government Securities | 8,358,100 | 8,388,000 | 7,921,000 | 8,200,400 |
| Advance against MBS pools | 1,800 | 1,800 | 2,400 | 2,400 |
| Other assets | 106,100 | 106,100 | 115,300 | 115,300 |
| Unrecognized financial instruments | – | 1,306,000 | – | 1,056,000 |
| Other liabilities | 112,300 | 112,300 | 120,900 | 120,900 |

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 2005 to FY 2006, 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, 2006, Ginnie Mae had reserves of $11.9 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.

# VI. Audit Report of Ginnie Mae's FY 2006 Financial Statements

**Issue Date:** November 7, 2006
**Number:** 2007-FO-0001

TO: Robert M. Couch, President, Government National Mortgage Association, T

Randy W. McGinnis

FROM: Randy W. McGinnis, Director, Financial Audits Division, GAF

SUBJECT: **Audit of the Government National Mortgage Association's (Ginnie Mae) Financial Statements for Fiscal Years 2006 and 2005**

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 & Company, P.C. to audit the fiscal year 2006 financial statements of the Government National Mortgage Association (Ginnie Mae). The contract required that the audit be performed according to Generally Accepted Government Auditing Standards (GAGAS). The Office of Inspector General audited the fiscal year 2005 financial statements and expressed an unqualified opinion on those statements as indicated in our report dated November 7, 2005.

Carmichael, Brasher, Tuvell & Company, P.C. is responsible for the attached auditors' report dated November 6, 2006 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 and regulations. Carmichael, Brasher, Tuvell & Company, P.C. expects to issue a separate letter dated today to management within the next 60 days regarding other matters that came to their 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 a section devoted to Management's Discussion and Analysis (MD&A) of the financial statements and related information. The MD&A is not included with this report. Ginnie Mae plans to separately publish an annual report for fiscal year 2006 that conforms to FASAB standards.

We appreciate the courtesies and cooperation extended to the Carmichael, Brasher, Tuvell & Company, P.C. and OIG audit staffs during the conduct of the audit.

## INDEPENDENT AUDITOR'S REPORT

**To the President,**
**Government National Mortgage Association**

We have audited the accompanying balance sheets of Ginnie Mae as of September 30, 2005 and 2004 and the related statements of revenues and expenses and changes in investments of U.S. governments and of cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae management. The objective of our audit was to express an opinion on the fair presentation of the financial statements.

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 principal 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, 2006 and 2005, and the related statements of revenues and expenses, investments of the U. S. Government and statement 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. The financial statements of Ginnie Mae as of September 30, 2005 were audited by other auditors whose report dated November 7, 2005 expressed an unqualified opinion on those statements. Our opinion expressed herein, as it relates to amounts included for Ginnie Mae as of September 30, 2005, is based solely on the report of other auditors.

### *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, 2006 and 2005; 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 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 its internal controls, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine 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. 06-03, *Audit Requirements for Federal Financial Statements*. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that material misstatements in relation to the audited financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted no matters involving the internal control and its operation that we consider to be a material weakness as defined above.

A separate letter will be provided to management regarding other matters that came to our attention as a result of our audit.

### *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 and regulations specified in OMB Bulletin No. 06-03, 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.

The results of our tests of compliance with the laws and regulations discussed in the preceding paragraph disclosed no instances of noncompliance with laws and regulations that are required to be reported under Government Auditing Standards or OMB Bulletin No. 06-03, 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.

### *Auditor's Responsibilities*

Our responsibility is to express an opinion on the fiscal year 2006 and 2005 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. 06-03, as applicable to government corporations. Those standards and OMB Bulletin No. 06-03 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. 06-03 relating to the Federal Financial Management Improvement Act of 1996 (FFMIA); they are not considered applicable at the Ginnie Mae level. 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 report is intended solely for the information and use of the management of U. S. Department of Housing and Urban Development and Ginnie Mae, the OMB 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, PC

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

Atlanta, Georgia
November 6, 2006

# Ginnie Mae Employees in FY 2006

Aganad, Angela E.
Anderson, Pershing J.
Beddoe, Karen P.
Blagburn, Damasque J.
Blaylock, Linda D.
Bryant, Carlotta C.
Buckley, Philip H.
Burch, Justin D.
Burke, Jennifer S.
Carr, Terry M.
Carroll, Herbert G.
Cira, Dan
Couch, Robert M.
Cousin, Janie R.
Cowan, Ernest E.
Coward, Corey C.
Dougherty, Patricia A.
Ebba, Tisa I.
Ellis, David L.
Etheridge, Linda F.
Faunce, Helen E.
Foreman, Barbara A.
Foster, Theodore B.
Freeman, Kirk D.
Frenz, Michael J.
Garcia, Michael C.
Godoy, Guillermo J.
Gorman, Cindy C.
Griffin, Paulette M.
Hackett, Jeannette
Hawkins, Merlene S.
Holmes, Deborah V.
Imbraguglio, Paul A.
Johnson, Eva E.
Jones, Wesley E.
Kahn, Daniel E.
Khandpur, Chitranjan
Korn, Carolyn L.
Kozak, John
Kumi, Thomas
Ledbetter, Stephen L.
McMaster, Sean K.
McQueen, Maria M.
Milhouse, J. Dion
Moses, Sharolyn D.
Murphy, Debra L.
Murphy, LaShonia M.
Najjum, Michael J.
Noel, Leonora D.
Owens, Cheryl W.
Pessagno, Keri L.
St. Laurent, Paul R. III
Screen, Gina B.
Smith, Tamara P.
Sterling, Herbert L.
Stewart, Marcus L.
Sturdivant, Lindsay L.
Suarez, Sonya K.
Thompson, James A.
Usher, Sandra J.
Vargas, Victoria
Vilsack, Carol M.
Waller, LaKevia S.
Washington, Richard J.
Weakland, Thomas R.
Young, Karmen L.

**Staff as of September 30, 2006**

Ginnie Mae®
U.S. Department of Housing and Urban Development
Washington, DC 20410-9000

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