Government National Mortgage Association,Washington, DC

Fiscal Years 2014 and 2013 Financial Statements Audit

Office of Audit, Financial Audits Division
Washington, DC

Audit Report Number: 2015-FO-0003
February 27, 2015

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To: Theodore Tozer, President Government National Mortgage Association, T

//**signed**//

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

Subject: Audit of the Government National Mortgage Association's Financial Statements for Fiscal Years 2014 and 2013

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of the Government National Mortgage Association's fiscal year 2014 financial statements.

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

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

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

Audit Report Number: 2015-FO-0003
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Audit of the Government National Mortgage Association's Financial Statements for Fiscal Years 2014 and 2013

Highlights

What We Audited and Why

The Chief Financial Officers Act of 1990, as amended, requires the Office of Inspector General (OIG) or an independent auditor, as determined by OIG, to audit annually the financial statements of the Government National Mortgage Association (Ginnie Mae). We were engaged to audit the accompanying financial statements and notes of Ginnie Mae as of September 30, 2014. This report presents the results of our fiscal year 2014 audit of Ginnie Mae's financial statements, including our report on Ginnie Mae's internal control and test of compliance with selected provisions of laws and regulations applicable to Ginnie Mae. We contracted with the independent certified public accounting firm of CliftonLarsonAllen LLP to audit Ginnie Mae's fiscal year 2013 financial statements. CliftonLarsonAllen was responsible for its audit reports and the conclusions expressed on those reports.

What We Found

We were unable to obtain sufficient appropriate evidence to express an opinion on the fairness of the $6.6 billion in nonpooled loan assets from Ginnie Mae's defaulted issuers' portfolio and $735 million in liability for loss on the mortgage-backed securities program guaranty. In addition, Ginnie Mae improperly accounted for Federal Housing Administration reimbursable costs as an expense instead of capitalizing the costs as an asset. This error resulted in the misstatement of the asset and net income. Overall, the issues cited in this report were tied to the problems associated with the acquisition and management of a multi-billion dollar defaulted issuers' portfolio, which is a non-core segment of Ginnie Mae's business. Due to the scope limitation in our audit work and the effects of material weaknesses in internal control, we have not been able to obtain sufficient appropriate evidence to provide a basis for an audit opinion on Ginnie Mae's fiscal year 2014 financial statements. Accordingly, we do not express an opinion on the fiscal year 2014 financial statements. We identified four material weaknesses and one significant deficiency. Ginnie Mae's inadequate monitoring, oversight and governance of its accounting and reporting functions by the executive management team, loss of several key Office of Chief Financial Officer personnel, and the inability to track accounting transactions and events at a loan level due to system limitations were all contributing factors to these issues.

What We Recommend

Our audit recommendations are directed toward strengthening Ginnie Mae's governance of its financial operations. Our audit recommendations for this year are presented after each finding, and the status of open recommendations from a prior year audit is in the Followup on Prior Audits section of this report.

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Independent Auditor's Report

President
Government National Mortgage Association

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Government National Mortgage Association (Ginnie Mae), which comprise the balance sheets as of September 30, 2014, and the related statements of revenues and expenses and changes in investment of the U.S. Government, the cash flows for the year then ended, and the related notes to the financial statements. The independent certified public accounting firm of CliftonLarsonAllen LLP, under contract with the Office of Inspector General (OIG), audited Ginnie Mae's fiscal year 2013 principal financial statements. CliftonLarsonAllen LLP was responsible for its audit report and the conclusions expressed on that report.

Management's Responsibility for the Financial Statements

Ginnie Mae's management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles. This responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Management is also responsible for (1) evaluating the effectiveness of internal control over financial reporting; (2) providing a statement of assurance on the overall effectiveness of internal control over financial reporting, including providing reasonable assurance that the broad objectives of the Federal Managers Financial Integrity Act are met; and (3) ensuring compliance with other applicable laws and regulations.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with U.S. generally accepted government auditing standards. However, we were not able to obtain sufficient appropriate evidence to provide a basis for an audit opinion because of the unresolved matters described in the Basis for Disclaimer of Opinion paragraph below.

Basis for Disclaimer of Opinion

The following unresolved matters are a scope limitation in our audit work that contributed to our disclaimer of opinion on the fiscal year 2014 financial statements. There were no other satisfactory alternative audit procedures that we could adopt to obtain sufficient appropriate evidence with respect to these unresolved matters. Readers are cautioned that amounts reported in the financial statements and related notes may not be reliable because of these unresolved matters.

- Nonpooled loan assets. Despite multiple attempts, we were unable to obtain sufficient appropriate evidence to express an opinion on the fairness of the $6.6 billion in nonpooled loan assets from Ginnie Mae's defaulted issuers' portfolio. The nonpooled loan assets arose from the acquisition of nonperforming loans (typically over 120 days old delinquent) from Ginnie Mae's defaulted issuers' portfolio. The $6.6 billion in nonpooled loan assets, which represents 26 percent of the total assets, was made up of a number of asset line items in the balance sheet. These are (1) mortgage loans held for investment ($5.3 billion), (2)advances against defaulted mortgage-backed security pools ($193 million), (3) short sale claims receivable ($50 million), (4) foreclosed property ($616 million), (5) accrued interest on mortgage loans held for investment ($414 million), and (6) properties held for sale ($17 million). Ginnie Mae was unable to provide relevant documents and data that we needed to complete our audit testing on these asset balances because of functional limitations of financial management systems to perform loan level accounting as well as poor accounting and record keeping practices.

- Receivable for reimbursable expenses from FHA and liability for loss on mortgage-backed securities program guaranty. Ginnie Mae improperly accounted for Federal Housing Administration (FHA) reimbursable costs as an expense. These costs were charged to the mortgage-backed security loss liability account instead of being capitalized as an asset. This error resulted in the misstatement of the asset and net income and may require restatement of previous years' financial statements resulting from multiple years of incorrect accounting. We were not able to determine with sufficient accuracy a proposed adjustment to correct the error due to insufficient available data. Using Ginnie Mae's limited data, our estimate of the error is between $144 million and $248 million. Ginnie Mae also had an insufficient basis for supporting the fairness of the $735 million in the mortgage-backed security loss liability account. The loss liability represents Ginnie Mae's estimated non-recoverable servicing and foreclosure costs to be incurred from its defaulted issuers' portfolio of nonpooled loans. This loss liability account was based on estimates and consisted of multiple assumptions. The foreclosure cost and loan redefault rate assumptions were two areas of audit concern.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matters

Prior Period Financial Statements Audited by a Predecessor Auditor

Ginnie Mae's financial statements as of September 30, 2013, were audited by CliftonLarsonAllen LLP (CLA), which expressed in a report on November 25, 2013, an unqualified opinion on those statements. In fiscal year 2014, we communicated to CLA material misstatements in the financial statements that we identified during our audit that affected previously issued financial statements. CLA reviewed the issues raised and concurred with our conclusion. Accordingly, CLA notified OIG that CLA is withdrawing the opinion rendered in connection with its audit of Ginnie Mae's 2013 financial statements because the opinion can no longer be relied upon.

Other Information

Ginnie Mae's Annual Report to Congress contains a wide range of information that is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements. Therefore, it has not been subjected to the auditing procedures applied in the audit of the financial statements. As a result, we do not express an opinion on the information or provide assurance on it.

Report on Internal Control Over Financial Reporting and on Compliance Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Ginnie Mae's internal control over financial reporting to determine the appropriate audit procedures for expressing our opinion on the financial statements. However, we did not plan our audit for the purpose of expressing an opinion on the effectiveness of Ginnie Mae's internal control. As a result, we do not express an opinion on the effectiveness of Ginnie Mae's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of Ginnie Mae's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified five deficiencies in internal control that are described below. We consider the first four issues to be material weaknesses and the remaining issue to be a significant deficiency.

Material Weaknesses in Financial Reporting

Material Asset Balances Related to Nonpooled Loans Were Not Auditable
Due to deficiencies in Ginnie Mae's control environment, accounting practices used, and financial systems deployed, we encountered problems related to the auditability of the accounting data and records used to support the completeness, accuracy, and reliability of the $6.6 billion in nonpooled loan assets reported in Ginnie Mae's financial statements as of September 30, 2014. These assets include (1) mortgage loans held for investment ($5.3 billion), (2) advances against defaulted mortgage-backed security pools ($193 million), (3) short sale claims receivable ($50 million), (4) foreclosed property ($616 million), (5) accrued interest on mortgage loans held for investment ($414 million), and (6) properties held for sale ($17 million).

Factors contributing to these issues include (1) the inability of the master-subservicers' servicing systems to handle loan level transaction accounting at a granular level, and (2) poor servicing performance of its previous master-subservicers. As a result of these issues, we were unable to perform all of the audit procedures necessary to obtain sufficient appropriate evidence to express an opinion on the fairness of Ginnie Mae's $6.6 billion in assets as of September 30, 2014.

Ginnie Mae's Internal Control Over Financial Reporting Had Weaknesses
Ginnie Mae had ineffective internal control over its financial reporting processes. Specifically, these material weaknesses in internal controls were issues related to the (1) improper accounting for FHA reimbursable costs incurred and accrued interests earned on Ginnie Mae's $6.6 billion portfolio of nonpooled loans, (2) errors in the preparation of financial reports, (3) nonreporting of escrow deposits held in trust by Ginnie Mae for the borrowers in its financial statements, and (4) improper classification and presentation of financial information in Ginnie Mae's balance sheet and statement of cash flows. Ginnie Mae's inadequate monitoring, governance and oversight of its accounting and reporting functions by executive management staff, loss of several key Office of Chief Financial Officer personnel (OCFO) and the inability to track accounting transactions and events at a loan level because of system limitations contributed to these issues. These deficiencies resulted in material misstatements in Ginnie Mae's financial statements.

The Mortgage-Backed Securities Loss Liability Account in Ginnie Mae's Balance Sheet Was Unreliable
We questioned the reliability of the $735 million in liability for loss on the mortgage-backed securities (MBS) program guaranty account reported in Ginnie Mae's balance sheet as of September 30, 2014. Specifically, our reliability concerns were related to the (1) improper accounting treatment of selected accounting transactions related to nonpooled loans in the MBS loss liability account and (2) insufficient evidence to support the reasonableness of key management assumptions used in the model. Factors that contributed to the issue included adoption of an inappropriate loan accounting policy and a lack of in-depth analysis to validate the reasonableness of the management assumptions. As a result, we believe the loss liability account is unreliable.

Financial Management Governance Issues Contributed to Ginnie Mae's Inability to Produce Auditable Financial Statements

Ginnie Mae failed to establish an appropriate financial management governance structure to ensure that Ginnie Mae is capable of producing accurate, timely information, and accounting records to plan, monitor and report its business operations. This failure in the governance was the underlying cause of the problems cited in this report. We noted a number of problems in the oversight, management and operations of Ginnie Mae's OCFO. Specifically, Ginnie Mae (1) left a number of critical financial management positions unfilled which weakened its organizational structure and created a gap in Ginnie Mae's internal control system for monitoring over a $6 billion portfolio of nonperforming loans, (2) failed to adequately identify, analyze and respond to changes in the control environment and risks associated with the acquisition of a multi-billion servicing portfolio from one of Ginnie Mae's largest defaulted issuers, and (3) failed to adequately establish accounting policies, procedures, and accounting systems to manage and control the loan accounting and processing of the activities related to its defaulted issuers' portfolio. This occurred because of Ginnie Mae executive management's failure to respond appropriately to changes in its business environment and risks and the void in HUD's senior leadership created by an extended absence of a permanent HUD Chief Financial Officer. The combination of these failures in the governance resulted in material misstatements and contributed to Ginnie Mae's inability to produce auditable financial statements for use by its external and internal users.

Significant Deficiency in Financial Reporting

Ginnie Mae's Financial Management System Information Security Controls Did Not Fully Comply With Federal Requirements and Its Own Security Policies

Ginnie Mae did not ensure that information security controls over the Ginnie Mae Financial Accounting System fully complied with Federal requirements and its own security policies in its financial management system. The Ginnie Mae Financial Accounting System is a financial management system that tracks, records, and reports on the agency's accounting information. This process involves information used in the aggregate set of accounting practices and procedures to allow for accurate and effective handling of government revenues, funding, and expenditures. The Ginnie Mae Financial Accounting System supports the financial functions required to track financial events and provides information significant to the financial management of the agency. It also maintains financial information that is used for meeting Office of Management and Budget and U.S. Government Accountability Office reporting requirements.

Report on Compliance

We performed tests of Ginnie Mae's compliance with certain applicable provisions of laws and regulations that could have a direct and material effect on the determination of financial statement amounts except for the Federal Financial Management Improvement Act of 1996, which was tested agencywide at the HUD consolidated audit level. However, providing an opinion on compliance with those provisions was not an objective of our audit. Therefore, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported in accordance with government auditing standards, issued by the U.S. Comptroller General.

Additional information about the material weaknesses and significant deficiency are presented in more detail in the body of this report.

Management's Response to Findings and Our Evaluation

Management's response to the findings identified in our report and the evaluation of management's comments are presented in appendix A. We did not audit management's response, and, accordingly, we express no opinion on it.

This report is intended for the information and use of the management of Ginnie Mae, the U.S. Department of Housing and Urban Development (HUD), the Office of Management and Budget, the U.S. Government Accountability Office, and the United States Congress and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited. In addition to the internal control and compliance issues included in this report, other matters involving internal control over financial reporting and Ginnie Mae's operation that are not included in this report will be reported to Ginnie Mae management in a separate management letter.

Randy W. McGinnis

Randy W. McGinnis
Assistant Inspector General for Audit
February 24, 2015

Material Weaknesses

Finding 1: Material Asset Balances Related to Nonpooled Loans Were Not Auditable

We encountered problems related to the auditability of the accounting data and records used to support the completeness, accuracy, and reliability of the $6.6 billion in nonpooled loan assets reported in Ginnie Mae's financial statements as of September 30, 2014. These assets include (1) mortgage loans held for investment ($5.3 billion), (2) advances against defaulted mortgage-backed security pools ($193 million), (3) short sale claims receivable ($50 million), (4) foreclosed property ($616 million), (5) accrued interest on mortgage loans held for investment ($414 million), and (6) properties held for sale ($17 million). Contributing to these issues were (1) the inability of the master-subservicers' servicing systems to handle loan level transaction accounting at a granular level, and (2) the poor servicing performance of Ginnie Mae's previous master-subservicers. In light of these issues, we were unable to perform all of the audit procedures that we determined necessary for obtaining sufficient appropriate evidence. As a result, our audit scope was insufficient to express an opinion on Ginnie Mae's $6.6 billion in assets as of September 30, 2014.

Issues Related to the Auditability of Ginnie Mae's and Previous Master-Subservicers' Accounting Data and Records to Adequately Support Multiple Significant Financial Statement Line Items

We were unable to obtain sufficient appropriate evidence to express an opinion on the fairness of $6.6 billion in balance sheet asset amounts reported in Ginnie Mae's financial statements as of September 30, 2014. This condition was due to a lack of accounting data and accounting records at a loan level to validate the amounts reported for existence, completeness, accuracy, and reliability. The $6.6 billion represents 26 percent of Ginnie Mae's total assets as of September 30, 2014, and was over our materiality thresholds.

> *Nonpooled loan asset balances were assessed as high risk during our fiscal year 2014 audit*. Historically, Ginnie Mae relied on the accounting reports supplied by the master-subservicers for reporting the balances in the financial statements. However, in fiscal year 2014, we could not rely on the accuracy and reliability of the accounting reports for auditing purposes without performing additional detailed loan level analysis due to ineffective controls over financial reporting.
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> In fiscal year 2013, there was a significant deficiency reported by the previous auditor, CliftonLarsonAllen LLP, concerning the unreliability of monthly accounting reports supplied by the master-subservicers to Ginnie Mae.[1] Additionally, our preliminary risk assessment identified Ginnie Mae's ineffective controls and oversight over master-

[1] Government National Mortgage Association Fiscal Years 2013 and 2012 Financial Statements Audit, 2014-FO-0001, dated December 6, 2013

subservicers' financial reporting functions. These weaknesses included (1) inadequate financial monitoring and oversight of the contractors' work due to the loss of several key Office of Chief Financial Officer personnel since the beginning of fiscal year 2014, (2) serious concerns expressed by Ginnie Mae's senior management about the ability of previous master-subservicers to perform under their contract with Ginnie Mae, and (3) the absence of other controls, noted during our preliminary risk assessment that were in place and relied upon in prior years, such as the contract assessment reviews and special master-subservicer reviews.

Multiple attempts to audit the $6.6 billion in nonpooled loan asset balances failed. Of the $6.6 billion, $607 million (9 percent) was related to advances against defaulted mortgage-backed security pools and accrued interest on mortgage loans held for investment accounts. Ginnie Mae could not provide the requested loan level details and other supporting documents to support the $607 million asset balance for these two accounts. Our attempts to audit the remaining four accounts totaling $6 billion are provided in detail below.

- *Interim testing*. In response to a high risk assessment for these accounts, we expanded our audit procedures with additional loan level detail testing to reduce our overall audit risks to a low level. In July 2014, we selected 197 loan samples (28 initial loan samples and 169 remaining loan samples) of 40,518 loans in the population as of March 31, 2014. These loans totaled $5.4 billion. To test the 197 loan samples, we requested pertinent documents supporting selected loan level transactions that make up the mortgage held for investments, foreclosed-upon properties, and short sale claims receivable accounts as part of our planned interim testing. By late September 2014, we continued to be unable to perform our interim testing because Ginnie Mae or its previous master-subservicers could not provide all of the documentation to substantiate the accounting transactions recorded and processed in their accounting systems, including the 28 initial loan samples. Ginnie Mae attributed its inability to produce the requested documents to its master-subservicers' protracted and disconnected accounting systems and processes. Ginnie Mae also stated that the procurement delay in replacing the previous master-subservicer was a contributing factor.

- *Yearend testing*. Since we were unable to accomplish our interim testing, in October 2014, we also attempted to test a full year's worth of transactions as part of the yearend audit testing. Similar to the audit process that we used during interim testing, we requested loan level transaction datasets from Ginnie Mae. Since our yearend testing occurred after the master-subservicer transition, the datasets we received were supplied by the new two master-subservicers. However, we could not select audit samples using the data from the new master-subservicers because we had several data integrity and reliability concerns. For example, the loan level data provided to us did not account for 100 percent of the loans that were within the scope of our audit. This condition was partly because an undetermined amount of loan level data from two previous master-subservicers did not move over to the new master-subservicers. Additionally, using the new master-subservicer data, the control totals for each of the assets could not be reconciled when compared to the third quarter financial statement balances. Further, there were several other data integrity issues, such as potential duplicate entries and the sum of the beginning balance and detailed entries not agreeing with the ending balances. As a result, our second attempt to audit the nonpooled loan asset balances failed.

- *Postyearend testing*. In light of the audit challenges encountered during the year, as noted above, in mid-November 2014, the Office of Management and Budget granted Ginnie Mae an extension through March 1, 2015, to resolve the audit matters with OIG. We worked with Ginnie Mae to obtain an acceptable amount of detailed loan level data needed for our substantative testing of the asset balances related to nonpooled loans. In late December 2014, we received the datasets from Ginnie Mae. In mid-January 2015, we completed our data analysis and data integrity checks and advised Ginnie Mae of the results. However, there continued to be deficiencies in the completeness and accuracy of the data provided. For example, we could not tie the quarterly asset balances according to Ginnie Mae data to the quarterly asset balances in Ginnie Mae's financial statements. Therefore, for the third time, we were unable to make sample selection and move forward with the audit testing. On February 5, 2015, Ginnie Mae completed a second reconciliation of its third nonpooled loan portfolio submission. We determined that there was not enough time remaining to complete the necessary audit work in this area because of the March 1st extension deadline. Efforts to determine the fairness of the nonpooled loan portfolio valuation are planned for the fiscal year 2015 audit.

Conclusion

Ginnie Mae and its master-subservicers failed to adequately maintain sufficient records and data at a loan level to support the nonpooled loan asset balances reported in Ginnie Mae's financial statements. This condition adversely impacted our ability to complete our audit work in fiscal year 2014 and resulted in a disclaimer of opinion, which is expressed in this year's audit report. We will continue to work with Ginnie Mae to resolve these matters during our fiscal year 2015 audit.

Recommendations

We recommend that Ginnie Mae's Chief Financial Officer

1A. Establish and implement policies and procedures to demonstrate how Ginnie Mae provides appropriate accounting and financial reporting oversight of the master-subservicers to ensure that the master-subservicers are capable of producing accurate and reliable accounting records and reports.

1B. Establish and implement policies and procedures to properly account for and track at a loan level all of the accounting transactions and events in the life cycle of the loans. This measure is intended to compensate for the servicing system's inability to perform loan level transaction accounting.

Material Weakness

Finding 2: Ginnie Mae's Internal Control Over Financial Reporting Had Weaknesses

Ginnie Mae had ineffective internal control over its financial reporting processes. These material weaknesses in internal controls were issues related to the (1) improper accounting for FHA reimbursable costs incurred and accrued interests earned on Ginnie Mae's $6.6 billion portfolio of nonpooled loans, (2) errors in the preparation of financial reports, (3) nonreporting of escrow deposits held in trust by Ginnie Mae for the borrowers in its financial statements, and (4) improper classification and presentation of financial information in Ginnie Mae's balance sheet and statement of cash flows. Factors contributing to these issues were Ginnie Mae's inadequate monitoring and oversight of its accounting and reporting functions by the executive management team, loss of several key Office of Chief Financial Officer personnel, and the inability to track accounting transactions and events at a loan level. These deficiencies resulted in material misstatements in Ginnie Mae's financial statements.

Ginnie Mae Took on the Role and Responsibilities of a Servicer in Fiscal Year 2009

Ginnie Mae did not appropriately respond to business changes by analyzing the changes and how they could impact its internal control system. Given the size of Ginnie Mae's workforce, it relied heavily on contractors to perform the day-to-day processing and accounting of activities related to its defaulted issuers' portfolio. Before fiscal year 2009, Ginnie Mae did not have a loan level accounting system and relied on the contractors' servicing system to track and account for all of the loan transactions in its portfolio. Ginnie Mae's internal processes may have been appropriate at that time, given that the volume in Ginnie Mae's defaulted issuers' portfolio was low and fairly manageable. In fiscal year 2009, however, Ginnie Mae defaulted one of its largest issuers and acquired 178,000 loans worth more than $25 billion in servicing portfolio. The surge in the volume of loans that Ginnie Mae was obligated to service, including Ginnie Mae's acquisition of more than 40,000 defaulted mortgages, created significant stress in its servicing operations as well as complexity in accounting for these loans. As Ginnie Mae intended to keep the servicing of these loans only on a short-term basis, it decided not to make the appropriate changes in its internal processes and information systems to accommodate the significant changes. This was not a prudent decision as Ginnie Mae's inappropriate response to the changes contributed to the financial reporting problems facing Ginnie Mae in fiscal year 2014.

FHA's Reimbursable Costs Incurred and Accrued Interest Earned on Nonpooled Loans Were Not Properly Accounted for in Ginnie Mae's Books in Accordance With Generally Accepted Accounting Principles

Ginnie Mae failed to properly capitalize FHA's reimbursable costs[2] incurred on nonpooled loans as receivables. Instead, it used a cash basis of accounting and accounted for these FHA reimbursable costs as expenses, and posted these expenses as chargeoffs to the mortgage-backed securities loss liability account, which was a departure from generally accepted accounting principles. Additionally for short sale loans, we noted that accrued interest earned was accounted for only through the date of purchase from the mortgage-backed securities pools rather than accruing interest for all of the periods allowed by the insuring agency, which is from the date of default to the date of filing.

Ginnie Mae steps into the role of a servicer when an issuer defaults. As a servicer, Ginnie Mae is required to purchase deliquent loans over 120 days old from the mortgage-backed securities pools. Ginnie Mae began purchasing significant numbers of seriously delinquent loans from mortgage-backed securities pools when one of its largest issuers defaulted in August 2009 and had continued to purchase loans. Ginnie Mae accounted for these delinquent loans in its balance sheet as nonpooled loan assets. As of September 30, 2014, Ginnie Mae had more than 43,000 nonpooled loan assets with an unpaid principal balance totaling $5.9 billion. Ginnie Mae's nonpooled loans consisted of loans insured by FHA, the U.S. Department of Veterans Affairs, and the U.S. Department of Agriculture – Rural Development, which carry a 100 percent guarantee on FHA and a partial guarantee on Veterans Affairs and Rural Development loans. A majority of these loans were insured by FHA.

Since the FHA loans carry a 100 percent guarantee, Ginnie Mae can expect full recovery from FHA of the unpaid principal balance, accrued interest covering the months allowed by the insuring agency's timeline from the date of default through the date of filing, and other reimbursable costs. Accordingly, Ginnie Mae should capitalize the reimbursable costs and accrue the allowable interest as receivables in its books because these amounts represent future claims for cash. However, as noted above, Ginnie Mae accounted for reimbursable costs as chargeoffs to the mortgage-backed securities loss liability account and the accrued interest was only partially accounted for by the servicers in its accounting records.

According to Ginnie Mae, its annual FHA reimbursable costs ranged from $144 million to $248 million. OIG believes that these numbers could be in the low- to mid-range of the spectrum since some of the nonpooled loans were a year or more old and there were prior years' reimbursable costs that should have been capitalized but were not. Given the significance of these errors, we concluded that the balances reported by Ginnie Mae as nonpooled loan assets and mortgage-backed securities loss liability were materially misstated. Additionally, Ginnie

[2] A majority of the Ginnie Mae's nonpooled loans are insured by FHA. FHA insurance allows Ginnie Mae to receive reimbursement for certain costs it incurs, such as taxes and insurance, property preservation, foreclosure, and other allowable costs. Because these costs are recovered by Ginnie Mae upon receipt of the FHA insurance claims proceeds, they should be capitalized and recorded as receivables in Ginnie Mae's books.

Mae's inability to track reimbursable costs and other accounting activities at a loan level caused Ginnie Mae to not effectively monitor its portfolio and accurately determine the amount of gain or loss incurred on nonpooled loans.

Financial Reporting Errors Were Identified Related to Mortgage-Backed Securities Loss Liability and Probable Legal Claims Liability Accounts

During our review of Ginnie Mae's financial statements for the quarter ending September 30, 2014, the following errors were identified:

- The amounts reported by Ginnie Mae for the mortgage-backed securities loss liability line item in the balance sheet and the supporting documents did not agree. The mortgage-backed securities loss liability reported in the balance sheet was $411 million, while the supporting documents showed $735 million, a net understatement of $324 million. We brought this matter to Ginnie Mae's attention during the audit. It was determined that the error occurred because of an oversight in Ginnie Mae's review and consolidation of the estimated loss amounts from several reports.

- Ginnie Mae did not properly evaluate the legal cases presented to Ginnie Mae in the legal representation letter. Our review of the letter identified one case in which Ginnie Mae's legal counsel determined that an unfavorable legal claim amounting to $14.9 million was likely to occur. This determination met the definition of ***probable*** for legal contingencies under Accounting Standards Codification number 450. As a result, Ginnie Mae should accrue it as a liability in its financial statements. However, it failed to properly accrue the $14.9 million in probable legal claims as required.

The errors in financial reporting resulted in a misstatement of Ginnie Mae's liability balances by $339 million. Ginnie Mae agreed to correct these errors.

Escrow Deposits Held in Trust by Ginnie Mae for the Borrowers of the Loans in Its Defaulted Issuers' Portfolio Were Not Reported in the Financial Statements as Required by Generally Accepted Accounting Principles

Ginnie Mae failed to report on its financial statements and notes the mortgage escrow funds held in trust by its master-subservicers that were designated to pay taxes and insurance for its defaulted issuers. As a servicer,[3] part of Ginnie Mae's responsibility is to ensure proper administration and management of the escrow accounts. Although maintaining an escrow account was not a requirement for obtaining a loan under the Real Estate Settlements Procedures Act,[4] FHA requires lenders to establish escrow accounts and requires that all FHA borrowers make monthly payments to ensure that funds will be available to pay taxes and insurance premiums when they come due. Therefore, it is imperative for Ginnie Mae, as FHA's

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[3] Although Ginnie Mae uses contractors to subservice the loans, the responsibility for servicing the loans remains with Ginnie Mae.

[4] The Real Estate Settlement Procedures Act (12 U.S.C. (United States Code) chapter 27, section 2605) is the statute that regulates the administration of an escrow account when an escrow account is established by a lender in connection with a federally related mortgage loan.

counterparty, to comply with FHA's accounting, reporting, and other compliance requirements.[5] Additionally, reporting escrow deposits in the entity's financial statements is an acceptable practice under generally accepted accounting principles. However, Ginnie Mae had not reported the escrow balances in its financial statements in previous years. The balance of the escrow funds held by Ginnie Mae through its master-subservicers for the pooled loans in its defaulted issuer's portfolio was $115 million and $83 million as of September 30, 2013, and September 30, 2014, respectively.[6]

In accordance with generally accepted accounting principles,[7] the balance of the escrow funds should be reported as an asset and a liability in the balance sheet and statement of cash flows. According to section 6.20 of the American Institute of Certified Public Accountants' Audit and Accounting Guide, Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies, the net increase and net decrease in mortgage escrow deposits are reported as financing activities in the entity's statement of cash flows. Using this guide, the mortgage escrow deposits are accounted for in the cash account[8] of the entity's balance sheet since the statement of cash flows provides information regarding how the entity obtains and spends cash.

Ginnie Mae acknowledged that the escrow funds were not reported in its financial statements in previous years. Additionally, although disclosing the escrow information as a note disclosure was acceptable to Ginnie Mae, it is also Ginnie Mae management's view that the escrow deposits should not be reported on the face of the financial statements. Ginnie Mae and OIG disagree on this matter.

Given the materiality of the escrow fund balances and how they impacted the reliability of previously issued financial statements, Ginnie Mae should notify users to not rely on the financial information until it has been restated. Ginnie Mae should comply with the restatement procedures as called for in Office of Management and Budget Circular A-136, Financial Reporting Requirements, section II.4.5.4.

Classification and Presentation of Financial Information Were Not Properly Presented in Ginnie Mae's Balance Sheet and Cash Flows Statement in Accordance With Generally Accepted Accounting Principles

The asset and liability accounts were not properly classified and presented in Ginnie Mae's balance sheet as of June 30, 2014. In accordance with generally accepted accounting principles, the assets and liabilities should be classified as current or noncurrent. Additionally, assets should

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[5] Chapter 2 of HUD Handbook 4330.1, REV 5, Administration of Insured Home Mortgage, and section 2-21(B) of HUD Handbook 4060.1, Mortgagee Approval Handbook, govern the administration and management of escrow accounts on FHA-insured loans.

[6] Ginnie Mae provided the escrow balances reported here. Nothing has come to our attention to question the escrow balances that Ginnie Mae reported to OIG based on our limited review.

[7] Financial Accounting Standards Board Accounting Standards Codification, section 105-10-05, and sections 6.18 and 6.20 of the American Institute of Certified Public Accountants Audit and Accounting Guide, Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies.

[8] Since the mortgage escrow funds are not Ginnie Mae assets, they should be segregated from the entity's cash account, but the activities for these fiduciary accounts need to be tracked and accounted for just like other cash accounts.

be presented in the order of liquidity, while liabilities should be presented in the order of maturity. Further, during the review of Ginnie Mae's fiscal year 2013 financial statements, we noted that the accounts were not presented and classified consistent with generally accepted accounting principles. Ginnie Mae had no explanation for why the assets and liabilities were not classified and presented in accordance with generally accepted accounting principles.

Ginnie Mae's statement of cash flows was not presented in accordance with generally accepted accounting principles. Specifically, Ginnie Mae did not present the investing cash inflows separately from investing cash outflows. Additionally, there was a number of investing activity cash flows related to nonpooled loan assets that were presented incorrectly in the operating activity cash flows section of the statement. In accordance with Accounting Standards Codification 230-10-45-26, investing cash inflows must be reported separately from investing cash outflows. Ginnie Mae's practice of reporting the "net" cash flows from its investing activities was a departure from generally accepted accounting principles.

Conclusion

Overall, Ginnie Mae's system of internal control over its financial reporting processes was ineffective. Ginnie Mae's inadequate monitoring and oversight of master-subservicers' financial reporting operations and the need for additional appropriately skilled and experienced personnel who could perform the required financial management responsibilities contributed to Ginnie Mae's inability to produce reliable financial information.

Recommendations

We recommend that Ginnie Mae's Chief Financial Officer

2A. Establish and implement policies and procedures to ensure that reimbursable costs are tracked and accounted for at the loan level.

2B. Determine the amount of reimbursable costs incurred by Ginnie Mae per loan, report the reimbursable costs incurred as receivables rather than expensing them, and adjust them out of the mortgage-backed securities loss liability account as appropriate.

2C. Restate fiscal year 2013 financial statements to correct the impact of the accounting errors determined in recommendation 2B.

2D. Review and recalculate the appropriate amount of interest accrued on the loans and adjust the accrued interest receivable balances reported as appropriate.

2E. Report the escrow fund balances on the face of the financial statements, including additional disclosure information in the notes, in accordance with generally accepted accounting principles.

2F. Restate fiscal year 2013 financial statements to show escrow fund balances omitted on the face of the financial statements.

2G. Properly present and classify the financial information in the balance sheet in accordance with generally accepted accounting principles.

2H. Comply with generally accepted accounting principles by (1) presenting investing cash inflows separately from investing cash outflows and (2) reclassifying the presentation of the nonpooled loan assets from cash flow from operating activity section to the cash flow from investing activity section.

Material Weakness

Finding 3: The Mortgage-Backed Security Loss Liability Account Balance Was Unreliable

Based on the results of our audit work, we had concerns regarding the reliability of the $735 million in liability for losses on the mortgage-backed securities program guaranty (loss liability)[9] account reported in Ginnie Mae's balance sheet as of September 30, 2014. Our reliability concerns were related to the (1) improper accounting treatment of selected accounting transactions related to nonpooled loans in the mortgage-backed securities loss liability account, and (2) insufficiency of evidence to support the reasonableness of key management assumptions used in the loss reserve model. Factors that contributed to the issue included the adoption of an inappropriate loan accounting policy and a lack of in-depth analysis to validate the reasonableness of the management assumptions. Considering the impact of these issues and their significance, we deemed the mortgage-backed securities loss liability account to be unreliable.

Selected Accounting Transactions Related to Nonpooled Loans Were Improperly Accounted for in the Mortgage-Backed Securities Loss Liability Account

Ginnie Mae's accounting for certain FHA reimbursable costs[10] incurred related to nonpooled loans, including the accounting for the repayment of these costs from the insuring agency, was not in accordance with generally accepted accounting principles and raised concerns regarding the accuracy of the amounts shown on the financial statements.

- Ginnie Mae had improperly accounted for the foreclosure costs and advances on taxes and insurance as chargeoffs[11] against the mortgage-backed securities loss liability account rather than capitalizing them as assets (see finding 2). Since FHA's loan guarantee provides reimbursement of these costs, in accordance with generally accepted accounting principles, the amount paid by Ginnie Mae for these costs should be accounted for as assets rather than expenses because it represents future claims for cash from FHA.[12]

- The repayment of the costs was also improperly accounted for as a credit to the mortgage-backed securities loss liability account. As noted above, the FHA reimbursable costs should have been accounted for as assets. Accordingly, the collection of insurance

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[9] The loss liability represents Ginnie Mae's estimated non-recoverable servicing and foreclosure costs to be incurred from its defaulted issuers' portfolio of nonpooled loans.
[10] Examples of FHA reimbursable costs incurred by Ginnie Mae related to nonpooled loans are foreclosure costs and taxes and insurance advances.
[11] According to Ginnie Mae, charge offs represent a reduction to the mortgage-backed securities loss liability account when losses are confirmed. Therefore, to account for these costs as charge offs before losses are realized would not be appropriate. Losses are realized when insurance proceeds are not sufficient to fully cover the foreclosure costs and servicing advances.
[12] Accounting Standards Codification 105-10-05 and Office of the Comptroller of the Currency Bank Accounting Series, dated September 2013, page 55.

proceeds to reimburse these costs should have been recorded as a credit to the asset account and not to the mortgage-backed securities loss liability account.

According to Ginnie Mae's accounting record, $239 million in reimbursable costs was incurred and $194 million in insurance claims reimbursements was received in fiscal year 2014. This improper accounting treatment resulted in the understatement of Ginnie Mae's asset and mortgage-backed securities loss liability accounts. Therefore, the mortgage-backed securities loss liability account was unreliable because of the impact of these errors.

The condition described above occurred because Ginnie Mae adopted an accounting policy for loans that was not in accordance with generally accepted accounting principles. Ginnie Mae had adopted the accounting policy of recording the FHA reimbursable costs as chargeoffs to the liability account instead of capitalizing them as assets since at least fiscal year 2011.

Ginnie Mae Had an Inadequate Basis for Supporting the Reasonableness of Certain Management Assumptions in the Loss Reserve Model

We also had concerns regarding the lack of evidence to adequately support the reasonableness of certain management assumptions used in the loss reserve model; specifically, the foreclosure cost and loan redefault rate assumptions. The issuance of a guarantee under the mortgage-backed securities program obligates Ginnie Mae to make future payments if certain triggering events or conditions occur.[13] Ginnie Mae accounts for this obligation in the same way loss contingencies are measured under Accounting Standard Codification, Subtopic 450-20, Loss Contingencies, which is to accrue a loss when the loss is probable and estimable. The future loss estimates[14] are reported as mortgage-backed securities loss liability in Ginnie Mae's balance sheet. In estimating the loss, Ginnie Mae develops management assumptions, which feed into the model. The loan redefault rate and foreclosure cost assumptions are two areas of audit concern.

The mortgage-backed securities loss liability amount was $700 million and $735 million in fiscal years 2013 and 2014, respectively. In fiscal year 2013, the mortgage-backed securities loss liability had two components:[15] liability for currently defaulted issuers' pooled loans ($319 million)[16] and liability for currently defaulted issuers' nonpooled loans ($374 million). In fiscal year 2014, only nonpooled components made up the mortgage-backed securities loss liability amount. The pooled loan component was excluded in fiscal year 2014 because Ginnie Mae estimated that this loss component would be brought down to zero primarily because of much lower servicing costs expected as a result of switching to better master-subservicers.

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[13] Under Ginnie Mae's mortgage-backed securities program, the triggering condition or event occurs when the borrower stops making the mortgage payment.

[14] Ginnie Mae's future loss estimates occur when its projection of cash outflows (costs incurred from issuer defaults) exceed cash inflows (insurance proceeds).

[15] See financial statement note 1 for the definition of the three loss components.

[16] This amount includes liability for probable issuer defaults and other adjustments.

- FHA foreclosure cost assumption. Ginnie Mae did not have sufficient appropriate evidence to support the reasonableness of the management assumption used in the model related to FHA foreclosure costs.[17] The foreclosure cost assumption was a data entry to the pooled and nonpooled loan loss components of the model. For pooled loans, Ginnie Mae used an annual foreclosure cost of $5,768 and $3,000 in fiscal years 2013 and 2014, respectively. For nonpooled loans, Ginnie Mae used an annual foreclosure cost of $5,768 and $8,600 in fiscal years 2013 and 2014, respectively. We believe that the foreclosure cost amounts used in the model were not reasonable and appropriate for the following reasons:

    - Based on our analysis, the foreclosure cost assumption used on nonpooled loans was not realistic and may have been overly conservative if we take into account Ginnie Mae's actual foreclosure cost experience. For example, Ginnie Mae's foreclosure cost assumption in fiscal year 2014 was $8,600. This was 60 percent ($5,600) higher than the $3,400 average foreclosure cost experience based on our estimate.[18] To produce a reliable estimate of anticipated loss, Ginnie Mae needs to develop a methodology to validate the accuracy and reasonableness of this foreclosure cost assumption.

    - Ginnie Mae did not take into account FHA's reimbursement of the foreclosure costs.[19] Since part of FHA's loan guarantee is to make lenders whole for any customary and reasonable foreclosure costs incurred by the lenders, we believe that the cash flows from FHA's insurance proceeds would have significant impact on the foreclosure cost assumption. Ginnie Mae needs to determine its FHA foreclosure cost reimbursement rate experience to reasonably estimate its expected loss.

    - We did not find sufficient appropriate evidence to support that the foreclosure cost assumption used in the model was an accurate reflection of the master-subservicers' foreclosure cost performance. For example, on pooled loans, in fiscal year 2013, Ginnie Mae used the maximum foreclosure cost of $5,768 based on an industry survey. According to Ginnie Mae, this was due to the poor quality of loan servicing from the previous master-subservicers. In fiscal year 2014, Ginnie Mae used the minimum $3,000 annual foreclosure cost because it projected lower cost as a result of much better servicing expected from the new master-subservicers, which is yet to be proven. We did not find sufficient appropriate evidence to support management's foreclosure cost expectation based on its perceived quality of loan servicing from the master-subservicers. The lack of well-documented analysis to support management's foreclosure cost expectation based on its perceived quality of loan servicing was a concern.

[17] Ginnie Mae's foreclosure costs management assumption was based on the industry participant survey.
[18] Based on Ginnie Mae's accounting record, actual foreclosure costs incurred in fiscal year 2014 were $137 million, and the total number of loans was more than 40,000.
[19] Ginnie Mae used foreclosure cost data in the industry survey. Ginnie Mae made the assumption that the FHA reimbursements were considered in the survey data even though there was no information in the survey that indicates so.

- We found inconsistency in the foreclosure cost assumptions between pooled and nonpooled loans. As noted above, Ginnie Mae switched to new master-subservicers in fiscal year 2014. For pooled loans, Ginnie Mae changed the foreclosure cost assumption from maximum to minimum based on the expectation of much better servicing from the new master-subservicers. For nonpooled loans, Ginnie Mae kept the maximum foreclosure cost assumption. If there was an expectation of much better loan servicing from the new master-servicers, we would expect that much improved servicing would trickle down to the nonpooled loans as well.

- Loan redefault rate[20] assumption. Ginnie Mae did not have sufficient evidence to support its loan redefault rate management assumption. Specifically, on nonpooled loans, Ginnie Mae assumed that 100 percent of the defaulted issuers' portfolio of nonperforming loans,[21] which were previously modified, would eventually redefault. We took exception to the 100 percent redefault rate assumption because we did not find sufficient appropriate evidence to support the reasonableness of this assumption. Our conclusion was based on the analysis of Ginnie Mae data and redefault rate experience according to the Office of the Comptroller of the Currency Mortgage Metrics Report, dated December 2014.[22]

  In fiscal year 2014, of $735 million (43,150 loans) in the nonpooled loans loss component, our analysis indicated that $348 million was the reserve for loss set aside for the 16,324 loans for which borrowers had resumed paying the full amount of the restructured principal and interest payments after a loan modification. Of 16,324 loans, 5,755 (35 percent) had demonstrated at least 6 months of sustained contractual performance. The amount of reserve for loss for the 5,755 reperforming loans was $130 million. When a loan has demonstrated a sustained performance in accordance with the modified contractual terms for a reasonable period, the borrower's loan has returned to a performing loan status. Therefore, the probability of 100 percent of the reperforming loans redefaulting would be highly unlikely.

[20] Redefault rate means the percentage of modified loans that later become delinquent or enter the foreclosure process.
[21] Ginnie Mae's Chief Risk Officer has represented to OIG that there may be some loans in this group that were not previously modified.
[22] The Office of the Comptroller of the Currency Mortgage Metrics Report presents data on first-lien residential mortgages serviced by seven national banks (Bank of America, JP Morgan Chase, Citibank, Hong Kong and Shanghai Banking Corporation, PNC, U.S. Bank, and Wells Fargo) and one Federal savings association (One West Bank) with large mortgage-servicing portfolios. The data in this report represent 46 percent of all first-lien residential mortgages outstanding in the country.

According to the Office of the Comptroller of the Currency's study of the mortgage performance of the eight largest financial institutions, their redefault rate experience was 42 percent as of September 30, 2014.[23] Ginnie Mae asserted that the redefault rate experience of its portfolio was worse than the redefault rate experience of non-government insured loans. For this reason, the overall performance for all modified loans delivered into a Ginnie Mae security was more than 65 percent.[24]

Taking all of these points together, we believe that Ginnie Mae's 100 redefault assumption was unsupported and may be unrealistic and overly conservative. Ginnie Mae should perform further analysis of its data to adequately determine its historical redefault rate experience. While it would not be possible for us to estimate the redefault rate, taking into account Ginnie Mae's suggested redefault experience of 65 percent, we estimated that the mortgage-backed securities loss liability provision may have been overstated by at least $122 million.

The condition described above occurred because Ginnie Mae failed to perform proper validation of the management assumptions used in the loss reserve model. According to Ginnie Mae, it leveraged third-party sources because of limitations in the data. Additionally, management made conservative assumptions to account for other factors such as the poor quality of Ginnie Mae's defaulted portfolios and the quality of the loan servicing delivered by Ginnie Mae's master-subservicers. While applying conservative assumptions may be acceptable, it needs to be within a reasonable range to ensure that it could produce a reliable estimate of anticipated loss.

According to section II(A) of Office of Management and Budget Circular A-123, Appendix A, Management's Responsibility for Internal Control, Ginnie Mae management is responsible for establishing internal control over financial reporting. Reliability of financial reporting means that management can reasonably make assertions that all assets and liabilities in the financial statements have been properly valued. Ginnie Mae uses accounting estimates to accrue a liability related to the contingent portion of its mortgage-backed securities activities. It is Ginnie Mae management's responsibility to establish a process for basing its estimates, including the development of assumptions that best represent management's judgment of the most likely circumstances and events with respect to the relevant factors that may affect the accounting estimates.

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[23] The study analyzed redefault experience on 3.6 million loan modifications completed from 2008 through September 2014.

[24] The 65 percent redefault rate was the cumulative loan performance of those loans that have been modified in the last 6 months of 2010 and was based on the data analysis performed by Ginnie Mae from its active (i.e. non-defaulted) issuers' portfolio. However, OIG has not audited this analysis. Cumulative redefault rate loan performance of other loans was 55 percent, 42 percent, and 17 percent at the end of 2011, 2012 and 2013 respectively.

Conclusion

Ginnie Mae estimates the amount of accrual for loss contingency on defaulted issuer portfolios in connection with its mortgage-backed securities program. Accounting estimates generally involve the development of assumptions by management based on judgments about the outcome of future conditions, transactions, or events. Because management assumptions cited in this report are critical to the development of the accounting estimate, it is imperative that the management assumptions be based on a careful, well-documented, and consistently applied analysis of the loans. In developing the assumptions, Ginnie Mae relied on the information supplied by the third party without performing proper validations. While sourcing the data from a third party could provide a reasonable starting point, this alone would not be sufficient, without further analysis, to ensure that the data are sufficiently reliable to produce a reasonable estimate.

Taking into consideration the impact of the accounting errors related to nonpooled loan transactions and the issues related to the reasonableness of the management assumptions, we determined that the mortgage-backed securities liability account balance was materially unreliable.

Recommendations

We recommend that Ginnie Mae's Chief Financial Officer coordinate with the Chief Risk Officer to

3A. Establish and implement policies and procedures for the documentation and validation of Ginnie Mae management assumptions, including foreclosure costs and redefault rates, used in the loss reserve model going forward.

3B. Reevaluate the reasonableness of foreclosure cost and redefault rate management assumptions used in fiscal year 2014, considering the audit points cited in this report; document the results of the reevaluation for OIG's review; and determine the accounting adjustments needed, if any, to the fiscal year 2014 mortgage-backed securities loss liability account as a result of the changes in the management assumptions.

3C. Determine Ginnie Mae's foreclosure cost reimbursement rate and take this information into account when developing its foreclosure cost management assumption.

3D. Perform a validation of the FHA foreclosure cost assumption amount used in fiscal year 2014, document the results of the validation, and determine whether an adjustment to the fiscal year 2014 financial statements is warranted based on the updated foreclosure cost management assumption.

3E. Perform a separate reserve for loss estimate analysis on reperforming nonpooled loans and, based on the results of this analysis, establish separate loss reserve estimates on reperforming nonpooled loans.

Material Weakness

Finding 4: Financial Management Governance Issues Contributed to Ginnie Mae's Inability to Produce Auditable Financial Statements

In fiscal year 2014 Ginnie Mae failed to establish an appropriate financial management governance structure[25] to ensure that Ginnie Mae is capable of producing accurate, timely information, and accounting records to plan, monitor and report its business operations. This failure in the governance was the underlying cause of the problems cited in this report. We noted a number of problems in the oversight, management and operations of Ginnie Mae's Office of the Chief Financial Officer (OCFO). Specifically, Ginnie Mae (1) left a number of critical financial management positions unfilled which weakened its organizational structure and created a gap in its internal control system for monitoring a more than $6 billion portfolio of nonperforming loans, (2) failed to adequately identify, analyze and respond to changes in the control environment and risks associated with the acquisition of a multi-billion servicing portfolio from one of its largest defaulted issuers, and (3) failed to adequately establish and maintain accounting policies, procedures, and accounting systems to manage and control the loan accounting and processing of the activities related to its defaulted issuers' portfolios. This condition occurred because of Ginnie Mae executive management failed to respond appropriately to changes in its business environment and additional risks and the void in HUD's senior leadership created by the extended absence of a permanent HUD Chief Financial Officer was a contributing factor. The combination of these failures in governance resulted in material misstatements and contributed to Ginnie Mae's inability to produce auditable financial statements for use by its external and internal users. Overall, the issues cited in this report were tied to the problems associated with the acquisition and management of a multi-billion dollar defaulter issuers' portfolio, which is a non-core segment of Ginnie Mae's business.

Ginnie Mae Organizational Structure Within the Office of the Financial Officer Was Insufficient to Handle the Demands and Complexity of its Financial Management Operations

Ginnie Mae's executive management did not ensure that key positions within the OCFO were properly staffed by experienced personnel with the appropriate skills despite significant changes in its operating environment. Ginnie Mae's main mission is to provide a guarantee on the timely payment of principal and interest to investors on securities backed by government-insured

[25] Financial management governance, in this context, is the exercise of putting together a framework that requires appropriate policies, procedures, people, systems and control in place to ensure the reliability and integrity of Ginnie Mae's financial and accounting information. This framework is driven by financial management statutes such as Federal Financial Management Improvement Act, Federal Managers Financial Integrity Act of 1982, and the Chief Financial Officers Act of 1990, generally accepted accounting principles, Office of Management and Budget guidance such as A-123 appendixes C and D, as well as Government Accountability Office's Standards for Internal Control for the Federal Government in addition to Ginnie Mae's operating environment.

mortgages. Ginnie Mae's role and business model significantly changed when it defaulted one of its largest issuers beginning in August 2009 and became the servicer of a multi-billion dollar servicing portfolio. In addition, Ginnie Mae's decision to buy over $6 billion in non-performing loans out of mortgage-backed securities pools to save money by minimizing on the cost of capital, rather than continue principal and interest payments to investors changed Ginnie Mae's accounting and reporting requirements in that Ginnie Mae is now required to perform loan level accounting on these loans. The additional level of detailed information, which was not collected, also became a problem because this information was necessary to prepare accurate reports for non-pooled loans receivable accounts and for more precise assumptions used in the reserve for loss calculation.

As far back as 2011[26], Ginnie Mae executive management was aware of the need for loan level information. Attempts were made to collect additional information, but as noted in the fiscal year 2013 financial statement audit report,[27] the accounting reports were inaccurate and incomplete. Ginnie Mae staff has stated that intense efforts at monthly reconciliation were required to prepare monthly financial reports.

Before fiscal year 2014, there were already signs of a weakening organizational OCFO structure due to the stresses created by an increase in financial management, reporting and operational accounting responsibilities resulting from Ginnie Mae's assumption of a multi-billion dollar defaulted issuer portfolio. Ginnie Mae's organizational structure within the OCFO was further weakened at the beginning of fiscal year 2014 by the departure of 4 key staff within the OCFO. The Deputy Chief Financial Officer left in November 2013, the Chief Financial Officer left in December 2013, and the Controller left in April 2014. In addition, the Internal Controls Manager transferred to a different office within Ginnie Mae in June 2013.

Based on our review, we determined that executive management made little effort to retain key staff, with the exception of a cash award paid to the former Ginnie Mae Controller. Ginnie Mae filled the Chief Financial Officer position within 4 months; however the selected individual's resume indicated no Federal financial management experience. The Deputy Chief Financial Officer position has remained vacant as of January 2015, more than a year after the former Deputy Chief Financial Officer left; and the announcement for the Controller position was not posted until January 2015, 9 months after the former Controller left; and the announcement for Internal Controls Director (Governance and Compliance Office) was not posted until November 2014, more than a year after the former Internal Controls Director left. We also noted other key staff with financial reporting responsibilities that vacated their positions because they either left Ginnie Mae or transferred to other offices. As of April 18, 2014, 7 positions were vacant out of 20 total positions in the OCFO; the number of vacancies in the OCFO was unchanged as of January 23, 2015. The largest number of vacancies within OCFO was in the Controller's division. Ginnie Mae indicated that backfilling the vacancies was deferred temporarily to allow the new Chief Financial Officer an opportunity to assess the organization and overall staffing

[26] Enhancing Ginnie Mae's Risk Management Capabilities, dated June 24, 2011. This was a study performed by a consulting firm to provide an independent enterprise wide risk assessment of Ginnie Mae.
[27] Audit Report of the Government National Mortgage Association Financial Statements, 2014-FO-0001, issued December 6, 2013.

needs. We question how this could be that executive management would not have already known its staffing skills and needs in such an important office. The loss of institutional knowledge and experienced staff is impossible to replace, and without timely replacements, create difficulties in an organization's ability to produce accurate, timely financial statements.

Due to the additional financial management and accounting responsibilities taken on by Ginnie Mae when it assumed a large defaulted portfolio, Ginnie Mae's executive management should have ensured that key staff positions within OCFO were filled in a timely manner and that experienced staff was hired to fill those key staff positions. Ginnie Mae's management should also have been focused on filling other vacancies within OCFO, especially in the Controller's division.

Ginnie Mae Did Not Appropriately Respond to the Changes in its Business Environment and Risks to Maintain an Effective Internal Control System

Ginnie Mae did not analyze and respond appropriately to the significant changes in its business environment and risks related to financial management goverance and operations. The change in conditions and risks was triggered by the acquisition of a large defaulted issuer portfolio. In accordance with internal control standards for the Federal government and HUD Handbook 1840.1, Departmental Management Control Program, Ginnie Mae is responsible for identifying risks throughout the entity, as part of its risk assessment, to form a basis for designing appropriate risk responses. As noted earlier, Ginnie Mae failed to implement an appropriate organizational structure that could withstand the rigors and complexities of the changed conditions resulting from the acquisition of a large defaulted issuer portfolio.

Additionally, there were inherent operational and financial reporting risks associated with the acquisition of a large defaulted issuer portfolio in fiscal year 2009 and Ginnie Mae did not evaluate the significance of the risks and how the risks would impact the achievement of its financial reporting responsibilities. For example, the accounting for Ginnie Mae's business activities was simple and less complex before the acquisition. The acquisition of Taylor, Bean and Whitaker'sservicing portfolio and purchase of delinquent loans out of mortgage-backed securities pools changed the dynamics of Ginnie Mae's role from being a guarantor to a multi-billion dollar servicer and investor of whole loans. Ginnie Mae executive management's failure to properly respond to changes did not allow for an adjustment in its processes to ensure that an effective internal control system would be maintained.

Ginnie Mae Did Not Establish Appropriate Accounting Policies, Procedures and Accounting Systems To Effectively Manage and Control the Loan Accounting and Processing of the Activities Related to its Defaulted Issuers' Portfolio

Ginnie Mae failed to establish appropriate accounting policies, procedures and accounting systems to ensure that management had accurate, timely and complete information, including accounting records, to plan, monitor and report business operations. As noted earlier, when Ginnie Mae was presented with the financial reporting and operational challenges related to the acquisition of a large defaulted issuer portfolio, it did not appropriately respond to the changes and risks in its business. Ginnie Mae may have underestimated the impact or significance of the change in conditions and did not adequately prepare to respond to these risks. As in previous years, Ginnie Mae's initial plan was to hold these loans on a short-term basis only. However, its initial plan did not materialize. As a result, Ginnie Mae was left with the responsibility of accounting for these loans at a loan level without the appropriate policies, procedures and accounting systems in place. For example, Ginnie Mae did not have an accounting system in place to account for and track the reimbursable costs at a loan level. Additionally, it adopted a policy of expensing reimbursable costs, instead of capitalizing them, which was a departure from generally accepted accounting principles.

Due to staffing and accounting system limitations, Ginnie Mae historically relied on contractors and their information systems to perform most of the work needed to accomplish its mission and manage its day-to-day activities. Ginnie Mae's contractors used a servicing system that was not designed to function as an accounting system. Therefore, the system was not adequate to perform loan level accounting, which is needed to comply with generally accepted accounting principles. With more than 40,000 loans in its nonpooled loan assets, the effort to produce auditable accounting and financial information was nearly impossible to achieve without adequate accounting systems. Another problem created as a result of an inadequate accounting system was the inability to produce accounting and financial information to estimate Ginnie Mae's guaranty loss reserves. Specifically, financial information needed to develop the foreclosure costs and redefault rate management assumptions. This is more fully described in Finding 3. These problems would have been prevented or mitigated with the appropriate accounting policies and procedures and accounting systems in place to effectively manage and control risks related to defaulted issuers' portfolio.

Ginnie Mae Did Not Effectively Monitor the Service Organization Engaged To Perform Operational Processes and Accounting for Ginnie Mae

Ginnie Mae did not effectively monitor the accounting and reporting activities of the master-subservicers as service organization because the division of operational servicing and financial reporting oversight responsibilities had not been appropriately assigned and clearly defined.

The master-subservicers are responsible for nearly 95,000 loans worth more than $11 billion in servicing portfolio. Although Ginnie Mae assigns the operational servicing and accounting responsibility to the master-subservicers with regard to its defaulted issuers' portfolio, Ginnie Mae retains the responsibility for the performance of processes assigned to the master-subservicers. As the nature of the services provided by the master-subservicers is significant to Ginnie Mae, it is critical to Ginnie Mae's financial reporting responsibility to ensure that the controls over the outsourced functions are in place and working effectively. Ginnie Mae did not require the master-subservicers to provide it with the appropriate Statements on Standards for Attestation Engagements No. 16 (SSAE16)[28] report, from both the report type and audit scope perspectives. Other examples and the outcome of Ginnie Mae's ineffective monitoring of the mastersubservicers are discussed in more detail in findings 1 and 2.

[28] Statements on Standards for Attestation Engagement No. 16 is an attestation standard that addresses engagements undertaken by a service auditor for reporting on controls at organizations that provide services to user entities, for which a service organization's controls are likely to be relevant to user entities' internal control over financial reporting.

A contributing factor to the inadequate monitoring of the master-subservicers' accounting and reporting activities was that Ginnie Mae executive management placed more emphasis on operational servicing and less on its financial management and reporting responsibilities. The office responsible for the monitoring of the master-subservicers is the Monitoring and Asset Management Division, which is part of the Office of Issuer and Portfolio Management. To adequately monitor the activities of the master-subservicers from the operational servicing and accounting perspectives, Ginnie Mae needs to balance the monitoring oversight responsibilities between the OCFO and the Office of Issuer and Portfolio Management. Additionally, Ginnie Mae's bylaws have not been updated to appropriately define the division of responsibilities.

Overall, the financial management governance problems described in this report stemmed from Ginnie Mae executives' failure to respond appropriately to the risks and changes in its business. The absence of a permanent HUD Chief Financial Officer for 3 years was another contributing factor. The new HUD Chief Financial Officer, who was confirmed in September 2014, had made efforts consistent with the Chief Financial Officers Act requirements, to address some of the financial management governance issues facing Ginnie Mae.

Conclusion

Ginnie Mae is responsible for designing, implementing, and operating an effective internal control system to ensure the reliability and integrity of its financial and accounting information. Although Ginnie Mae had expanded its role to include being a servicer and investor in addition to being a guarantor, Ginnie Mae executives did not appropriately respond to the changes in its business environment and risks by appropriately adjusting the organizational structure, policies, procedures and systems to adequately respond to the risks. In fiscal year 2015, Ginnie Mae needs to address its financial management governance deficiencies by filling the gaps in its financial management staff, reviewing its control environment to identify and analyze its risks, and developing the appropriate accounting policies and procedures.

Recommendations

We recommend that Ginnie Mae's President

4A. Work with HUD's Chief Financial Officer to ensure that Ginnie Mae has a sufficient number of appropriately skilled and experienced staff in place to perform the required financial management duties by filling the vacancies of key personnel that oversee or work in OCFO.

4B. Work with HUD's Chief Financial Officer to design and implement a compliant financial management governance structure.

4C. Review and update Ginnie Mae's bylaws and delegations of authority to correspond to the current organizational structure and agency mission requirements.

We recommend that the HUD Chief Financial Officer, in accordance with provisions of the Chief Financial Officers Act of 1990, assist Ginnie Mae to implement a compliant financial management governance structure by

4D. Overseeing a comprehensive risk assessment of Ginnie Mae's financial management governance.

4E. Preparing and implementing a plan, based on the results of the risk assessment in recommendation 4D, that

i) Demonstrates HUD OCFO oversight of Ginnie Mae's, as a HUD component, financial management activities;
ii) Ensures that Ginnie Mae updates its financial management policies to reflect conclusions reached in the financial management risk assessment;
iii) Provides complete, reliable, consistent and timely information for defaulted issuers' pooled and non-pooled loans, prepared on a uniform basis for preparation of Ginnie Mae financial statements, management reporting, and cost reporting; and
iv) Ensures all of Ginnie Mae's financial management systems, both owned and outsourced, provide the financial information necessary to prepare and support financial statements that comply with generally accepted accounting principles.

Significant Deficiency

Finding 5: Ginnie Mae's Financial Management Information System Security Controls Did Not Fully Comply With Federal Requirements and its Own Security Policies

Ginnie Mae did not ensure that information security controls over the Ginnie Mae Financial Accounting System (GFAS)[29] fully complied with Federal requirements and its own security policies. This process involves information used in the aggregate set of accounting practices and procedures to allow for the accurate and effective handling of government revenues, funding, and expenditures. GFAS supports the financial functions required to track financial events and provides financial information significant to the financial management of the agency. It also maintains financial information that is used for meeting the Office of Management and Budget and U.S. Government Accountability Office reporting requirements. Based on our review of general and application controls over GFAS, the following deficiencies were identified.

Router and Firewall Access Paths Were Not Adequately Protected

GFAS information flow protections were not enforced to the extent possible. GFAS networks were not appropriately configured to enforce the flow of information to adequately protect access paths in the system. As a result, the network access paths for processing and recording financial events within the GFAS network were vulnerable to several different types of network attacks.

Remote Access Sessions Were Not Completely Protected With Encryption

GFAS remote access sessions were not completely protected with encryption. Ginnie Mae did not ensure that its contractors identified access paths outside the virtual private network[30] and validated those paths for encryption. If the weaknesses in these access paths were exploited, there could be unauthorized disclosure and modification of GFAS data while in transit. This information includes sensitive data, programs, or password files, which are used to process, record, and track financial events that support reporting on the financial management of the agency.

Authentication Management Needs Improvement

The GFAS network administrator did not consistently implement locally configured passwords on all firewalls, routers, and switches. This condition occurred because the GFAS system owner did not focus on all aspects of password security. Not sufficiently protecting passwords on network devices increased risk of unauthorized disclosure or modification of GFAS data.

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[29] Ginnie Mae Financial Accounting System is a financial management system that tracks, records, and reports on the agency's accounting information.

[30] A virtual private network is a protected information system link, using tunneling, security controls, and endpoint address translation, giving the impression of a dedicated line

Conclusion

Ginnie Mae must improve its information security controls over GFAS to fully comply with Federal requirements and its own security policies to prevent an increased risk of unauthorized disclosure or modification of GFAS data.

Recommendations

Recommendations were included in a separate OIG audit report.[31] Therefore, no recommendations are reported here.

[31] Audit report 2015-DP-0002, Ginnie Mae Financial Accounting System, issued October 29, 2014.

Scope and Methodology

In accordance with the Chief Financial Officers Act of 1990, as amended, OIG is responsible for the conduct of the annual financial statement audit of Ginnie Mae. The scope of this work includes the audit of Ginnie Mae's balance sheet as of September 30, 2014 and 2013, and the related statements of revenues and expenses and changes in investment of the U.S. Government and cash flows for the years then ended and the related notes to the financial statements. We conducted the audit in accordance U.S. generally accepted government auditing standards and Office of Management and Budget Bulletin 14-02, as amended, Audit Requirements for Federal Financial Statements.

In fiscal year 2014, we were unable to express an opinion on the accompanying financial statements because of the limitation in the scope of our audit work. The limitation in our audit scope was due to a number of unresolved audit matters, which are described in detail in the body of this report. These unresolved matters restricted our ability to obtain sufficient appropriate audit evidence to form an audit opinion. Accordingly, we do not express an opinion on the financial statements and notes.

Followup on Prior Audits

Government National Mortgage Association Fiscal Years 2013 and 2012 Financial Statements Audit, 2014-FO-0001

The underlying issue relative to the inaccuracy of the accounting reports has not been fully resolved. In fiscal year 2014, Ginnie Mae transferred the servicing of its defaulted issuer to two new master-subservicers. As this issue continues to evolve, we will continue to monitor Ginnie Mae's efforts to reconcile accounting reports and the loan level detail support.

We reviewed the recommendations for audit report 2014-FO-0001 covering Ginnie Mae's financial statement audit for fiscal years 2013 and 2012. The report had three recommendations for improving Ginnie Mae's internal controls over financial reporting process. Our assessment of the current status of the recommendations is presented below:

Fiscal year 2013 recommendations	Type	Fiscal year 2014 status
1A: Obtain a corrective action plan from the master-subservicing contractor with critical milestones to document how all information is to be provided, supported, and reconciled to the appropriate underlying information system.	Significant deficiency 2013	Closed/Merged to Finding 1 – the fiscal year 2013 audit recommendation could not be implemented in its present form because of the master-subservicers' transition that occurred on July 31, 2014. In fiscal year 2014, in response to the audit recommendation Ginnie Mae's switched the servicing of its defaulted issuers' portfolio to two master-subservicers. However, since there was insufficient time left in fiscal year 2014 for the new process to run to determine if the new process is working effectively, we do not consider this issue resolved and we plan to test it during fiscal year 2015 audit.
1B: Review the projected workload requirements with the master-subservicing contractor, evaluate the remaining impact of ongoing delays in recording servicing activity, and document the anticipated effort on future financial reporting.	Significant deficiency 2013	Closed/Merged to Finding 1 – the fiscal year 2013 audit recommendation could not be implemented in its present form because of the master-subservicers' transition that

		occurred on July 31, 2014. In fiscal year 2014, in response to the audit recommendation Ginnie Mae's switched the servicing of its defaulted issuers' portfolio to two master-subservicers. However, since there was insufficient time left in fiscal year 2014 for the new process to run to determine if the new process is working effectively, we do not consider this issue resolved and we plan to test it during fiscal year 2015 audit.
1C: Continue efforts to confirm the insured status of loans not yet matched with data from the insuring agencies.	Significant deficiency 2013	Not implemented – Although Ginnie Mae agreed in May 2014 to perform an analysis between the master-subservicer and insuring agency data to identify and resolve differences in the insured status of loans, as of the report date, Ginnie Mae had not implemented this recommendation.

Appendixes

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

Ginnie Mae

Our Guaranty Matters

OFFICE OF THE CHIEF FINANCIAL OFFICER
Washington, DC 20410-3000

February 24, 2015

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

FROM: David Fender
Chief Financial Officer, TF

SUBJECT: Management Response to FY 2014 Audit Report

Comment 1

Ginnie Mae appreciates the opportunity to comment on the Inspector General's audit of our financial statements for Fiscal Year 2014. As recommended, we will continue to take corrective action to strengthen our governance of financial operations. In particular, we will address shortcomings related to the accounting for mortgages held for investment.

Comment 2

While your findings present serious and specific accounting challenges, they do not relate to Ginnie Mae's execution and reporting of its core activity of managing the U.S. Government's explicit guarantee on $1.5 trillion of mortgage-backed securities.

Comment 3

The inability to complete the FY 2014 audit within the statutory deadline is due primarily to unprecedented circumstances related to the precise valuation of $6.6 billion in mortgages held for investment resulting from the largest seizure of assets in Ginnie Mae's history. The seizure occurred against the backdrop of the financial crisis that affected every player in the mortgage market, including the master subservicer of the defaulted portfolio.

Comment 4

The master subservicer's decision to halt all foreclosures for an extended period due to real or perceived risks that it would face severe fines from the Federal Housing Administration, complicated matters both operationally, and potentially financially. It exposed Ginnie Mae to outsized foreclosure and claims timelines and increased the risk that the FHA would substantially reduce loss-reimbursement rates compared to historical rates. With no precedent or commensurate data we made conservative financial assumptions that focused on protecting the interests of U.S. taxpayers.

Ginnie Mae's financial position is safe and sound. In FY 2014, Ginnie Mae generated core revenues[1] of $1.03 billion with operating expenses of only $143.6 million (just 13.9 percent of revenues). Since 2010, Ginnie Mae has contributed an average of $772 million in core profits to the federal government annually. This past fiscal year, we guaranteed $302.1 billion in mortgage-backed securities (MBS) issuance, ensuring that millions of Americans can either own their home or live in clean, safe rental homes.

Comment 1

From an operations standpoint, our staffing levels and infrastructure were challenged by the unprecedented asset seizure and subservicer performance. We are confident we can address these shortcomings:

Ref to OIG Evaluation	Auditee Comments

Comment 1

- We have transitioned pooled and non-pooled portfolios to industry-leading servicers and we are focusing on the queue of mortgages held for investment to attempt to accelerate, where possible, the receipt of claims proceeds and other techniques to liquidate the portfolio.
- We will seek strategies to exit our non-core businesses as soon as prudent.
- We continue to work diligently to strengthen operations of the Office of the Chief Financial Officer to ensure rigorous accounting compliance, enhanced controls and automation of highly manual processes.

We appreciate the IG's willingness to revisit the audit work for FY 2014 in connection with the FY 2015 audit. We are confident that the steps we are taking will facilitate the FY15 audit, and will be helpful as you revisit the fair presentation of our FY14 statements.

[1] Ginnie Mae's core revenues are comprised of guaranty fees, commitment fees, multiclass fees and other miscellaneous fees.

OIG Evaluation of Auditee Comments

On February 19, 2015, OIG provided a draft of this report to Ginnie Mae for review and comment. OIG received a written response dated, February 24, 2015, which is presented in appendix A of this report. We also received technical comments from Ginnie Mae, which we considered and incorporated in the final audit report as appropriate. We did not audit management's response, and, accordingly, we express no opinion on it.

Comment 1 In its written comments, Ginnie Mae acknowledged the serious and specific accounting and financial reporting challenges that affected Ginnie Mae in fiscal year 2014. Additionally, it recognized the need to strengthen the governance of its financial operations to overcome these challenges. The Ginnie Mae executive management team's recognition of the financial accounting and reporting problems related to its defaulted issuers' portfolio is a step in the right direction. Ginnie Mae needs to continue taking positive steps toward improving its accountability by pledging its commitment to address material weaknesses in its internal control system cited in this report. We will work with Ginnie Mae during the fiscal year 2015 financial statement audit in resolving the accounting, financial reporting, financial management governance and other issues affecting its ability to produce reliable financial information for use by its internal and external users.

Comment 2 Since this is a financial statement audit, our audit was specifically designed to obtain sufficient appropriate evidence to express an opinion on the fairness of the financial statements. Because of this limited purpose, our audit was not designed to assess the efficiency and effectiveness of its operations nor did we intend to provide any assurance about the effectiveness of Ginnie Mae's execution and reporting of its core activity related to the $1.5 trillion guarantee business portfolio. Accordingly, we do not express such an opinion. According to the U.S. Government Accountability Office's Standards for Internal Control in the Federal Government, ensuring that Ginnie Mae runs its operations efficiently and effectively is equally important as ensuring that Ginnie Mae is also capable of producing accurate, timely information and accounting records to plan, monitor and report on its business operations. Therefore, maintaining the right balance in meeting these two objectives is the key to achieving Ginnie Mae's mission.

Comment 3 As discussed in the audit report, the $6.6 billion in total assets that we were unable to audit was not strictly confined to mortgage held for investments. The $6.6 billion in nonpooled loan assets was made up of six financial statement line items. These assets included (1) mortgage held for investment ($5.3 billion), (2) advances against defaulted mortgage-backed security pools ($193 million), (3) short sale claims receivable ($50 million), (4) foreclosed property ($616 million), (5) accrued interest on mortgage loans held for investment ($414 million), and (6) properties held for sale ($17 million). Collectively we called these assets, nonpooled loan assets, because Ginnie Mae became the owner/investor of these assets as a result of purchasing delinquent mortgages that did not meet program requirements out of its defaulted issuers' portfolio of mortgage-backed security pools.

Comment 4 While we recognize that the financial crisis may be a contributing factor to some of the accounting and operational problems experienced by Ginnie Mae in fiscal year 2014 related to its defaulted issuers' portfolio, OIG believes that Ginnie Mae executive management team's failure to (1) appropriately respond to changes in its business environment and risks, (2) establish appropriate accounting policies and procedures, and accounting systems in place to effectively manage and control the loan accounting and processing of activities related to its defaulted issuers' portfolio, and (3) ensure that the organizational structure within the Office of the Chief Financial Officer was sufficient to handle the demands and complexity of its financial management operations, should also be recognized as the underlying causes of problems facing Ginnie Mae. Since Ginnie Mae acquired its large defaulted portfolio in 2009, it had ample time to make changes/adjustments to its operations, systems and processes. However, since Ginnie Mae failed to respond appropriately to the changes, it lost the opportunity to mitigate the risks. We also note Ginnie Mae executive management's failure to appropriately act on the recommendation by a consulting firm to obtain a loan level data to enhance its master-subservicer monitoring based on an independent study of enterprise wide risk assessment of Ginnie Mae.

Appendix B

Ginnie Mae Fiscal Years 2014 and 2013 Financial Statements and Notes

Government National Mortgage Association
Financial Statements

Balance Sheets				
As of September 30		**2014**		**2013**
(Dollars in thousands)				
Assets:				
Funds with U.S. Treasury	$	13,470,000	$	9,622,400
U.S. Government securities		150,500		1,810,200
Accrued interest on U.S. Government securities		-		10,400
Insurance claims receivable		1,800		8,400
Accrued fees and other receivables		78,100		76,100
Bank of America settlement receivable		200,000		-
Short sale claims receivables		50,100		81,600
Less: Allowance for uncollectible short sale claims receivables		(27,700)		(19,900)
Short sale claims receivables, net		22,400		61,700
Foreclosed property		615,800		494,600
Less: Allowance for foreclosed property		(38,600)		(13,500)
Foreclosed property, net		577,200		481,100
Properties held for sale		17,400		29,600
Less: Allowance for losses on properties held for sale		(3,200)		(6,200)
Properties held for sale, net		14,200		23,400
Advances against defaulted mortgage-backed security pools		192,500		261,600
Less: Allowance for uncollectible advances		(110,700)		(162,500)
Advances against defaulted mortgage-backed security pools, net		81,800		99,100
Mortgage loans held for investment		5,309,000		6,169,600
Less: Allowance for mortgage loans held for investment		(465,400)		(502,200)
Mortgage loans held for investment, net		4,843,600		5,667,400
Accrued interest on mortgage loans held for investment		413,600		504,900
Less: Allowance for losses on accrued mortgage interest		(360,200)		(460,000)
Accrued interest on mortgage loans held for investment, net		53,400		44,900
Fixed assets--software		102,100		94,600
Less: Accumulated amortization		(69,800)		(58,100)
Fixed assets--software, net		32,300		36,500
Mortgage servicing rights		44,600		65,100
Guaranty asset		5,963,100		7,012,900
Total Assets	$	25,533,000	$	25,019,600
Liabilities and Investment of U.S. Government:				
Liabilities:				
Liability for loss on mortgage-backed securities program guaranty		735,400		700,300
Ocala Funding settlement liability		14,900		-
Deferred revenue		128,900		139,200
Deferred liabilities and deposits		300		300
Accounts payable and accrued liabilities		109,000		167,200
Guaranty liability		5,963,100		7,012,900
Total Liabilities	$	6,951,600	$	8,019,900
Commitments and Contingencies				
Investment of U.S. Government		18,581,400		16,999,700
Total Liabilities and Investment of U.S. Government	$	25,533,000	$	25,019,600

See the accompanying notes to the financial statements.

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

For the Years Ended September 30	2014	2013
(Dollars in thousands)		
Revenues:		
Mortgage-backed securities guaranty fees	$ 928,300	$ 870,900
Interest income - mortgage loans held for investment	346,800	116,400
Interest income - US Government securities	136,000	98,700
Commitment fees	60,700	92,200
Multiclass fees	48,200	39,900
Other mortgage-backed securities program income	5,600	7,000
Total Revenues	1,525,600	$ 1,225,100
Expenses:		
Mortgage-backed securities program expenses	(111,600)	(100,200)
Administrative expenses	(20,300)	(17,500)
Fixed asset amortization	(11,700)	(10,700)
Total Expenses	(143,600)	$ (128,400)
Recapture (Provision) for loss on properties held for sale	(10,400)	(17,200)
Recapture (Provision) for loss mortgage loans held for investment	88,200	(16,100)
Recapture (Provision) for loss on mortgage-backed securities liability	115,000	(402,100)
Recapture (Provision) for loss on short sale claims and other receivables	10,200	(9,700)
Recapture (Provision) for loss on foreclosed property	(25,000)	(13,500)
Recapture (Provision) for loss on uncollectible advances	50,800	35,900
Total Recapture (Provision)	228,800	$ (422,700)
Gain (Loss) on disposition of investment	17,100	-
Gain (Loss) on credit impairment of mortgage loans HFI, net	(25,700)	(50,000)
Gain (Loss) on mortgage servicing rights	(20,500)	4,400
Total Other Gains / (Losses)	(29,100)	$ (45,600)
Excess of Revenues over Expenses	1,581,700	628,400
Investment of U.S. Government at Beginning of Year	16,999,700	16,371,300
Investment of U.S. Government at End of Year	$ 18,581,400	$ 16,999,700

See the accompanying notes to the financial statements.

Statements of Cash Flows

For the Years Ended September 30	2014	2013
(Dollars in thousands)		
Cash Flow from Operating Activities		
Net Excess of Revenues over Expenses	$ 1,581,700	$ 628,400
Adjustments to reconcile Net Excess of Revenues Over Expenses to Net Cash from Operating Activities:		
Amortization	11,700	10,700
Decrease / (increase) in accrued interest on U.S. Government securities	10,400	(100)
Decrease / (increase) in insurance claims receivables	6,600	(1,900)
Decrease / (increase) in advances against defaulted mortgage-backed securities pools, net	17,300	(39,400)
(Increase) / decrease in accrued interest on mortgage loans held for investment, net	(8,500)	43,700
Decrease / (increase) in mortgage servicing rights	20,500	(4,400)
(Decrease) / increase in deferred revenue	(10,300)	4,800
Decrease in deferred liabilities and deposits	-	3,000
(Decrease) in accounts payable and accrued liabilities	(43,300)	(68,000)
(Increase) in accrued fees and other receivables	(2,000)	(9,800)
(Increase) in Bank of America settlement receivable	(200,000)	-
Decrease / (increase) in short sale claims receivables, net	39,300	(40,600)
(Increase) / decrease in foreclosed property, net	(96,100)	371,500
Decrease / (increase) in properties held for sale, net	9,200	(11,800)
Increase in liability for loss on mortgage-backed securities program guaranty	20,200	342,900
Increase in Ocala Funding settlement liability	14,900	-
Net Cash from Operating Activities	$ 1,371,600	$ 1,229,000
Cash Flow from Investing Activities		
Change in mortgage loans held for investment, net	823,800	1,021,700
Sale of U.S. Government securities, net	1,659,700	303,400
Purchase of software	(7,500)	(7,200)
Net Cash from Investing Activities	$ 2,476,000	$ 1,317,900
Cash Flow from Financing Activities		
Financing activities	-	-
Net Cash from Financing Activities	$ -	$ -
Net increase (decrease) in cash & cash equivalents	3,847,600	2,546,900
Cash & cash equivalents - beginning of period	9,622,400	7,075,500
Cash & cash equivalents - end of period	$ 13,470,000	$ 9,622,400

Supplemental Schedule of Non-Cash Activities

For the Years Ended September 30	2014	2013
(Dollars in thousands)		
Transfer of Advances against Defaulted MBS pools to Mortgage Loans Held for Investment	$ 488,900	$ 1,055,400
Transfer from Mortgage Loans Held for Investment to Properties Held for Sale	$ 20,200	$ 42,600

See the accompanying notes to the financial statements.

Notes to the Financial Statements

September 30, 2014 and 2013

Note 1: Entity and Mission

The Government National Mortgage Association (Ginnie Mae) was created in 1968, through an amendment of Title III of the National Housing Act as a government corporation within the United States (U.S.) 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 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 U.S. Federal Housing Administration (FHA), another government Corporation within HUD, 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.

To ensure that adequate capital continues to flow to the mortgage markets, Ginnie Mae offers reliable solutions that meet the needs of a broad constituent base and provide sufficient flexibility to respond to market changes. At the core of its business model and its product offering menu is the simple pass-through security, which comes in the form of two product structures—Ginnie Mae I MBS and Ginnie Mae II MBS. Each Ginnie Mae product structure has specific characteristics regarding pool types, note rates, collateral, payment dates, and geographical locations.

The underlying source of loans for the Ginnie Mae I MBS and Ginnie Mae II MBS comes from Ginnie Mae's following four main programs, which serve a variety of loan financing needs and different issuer origination capabilities:

- ***Single Family Program*** – The majority of Ginnie Mae securities are backed by single family mortgages predominantly originated through FHA and VA loan insurance programs.
- ***Multifamily Program*** **–** Ginnie Mae insures securities backed by FHA and USDA purchase and refinance loans for the purchase, construction, and renovation of apartment buildings, hospitals, nursing homes, and assisted living facilities.
- ***HMBS Program*** **–** Ginnie Mae's Home Equity Conversion Mortgage (HECM) securities program provides capital and liquidity for FHA-insured reverse mortgages. HECM loans are insured separately from regular single family mortgages due to their unique cash flow and fee

structure. HECM loans can be pooled into HECM Mortgage Backed Securities (HMBS) within the Ginnie Mae II MBS program.

- ***Manufactured Housing Program*** – Ginnie Mae's Manufactured Housing program allows the issuance of pools of loans insured by FHA's Title I Manufactured Home Loan Program.

Note 2: Summary of Significant Accounting Policies

Basis of Presentation: The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) established by the Financial Accounting Standards Board (FASB).

Use of Estimates: The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues and expenses during the reporting period, and related disclosures in the accompanying notes. Ginnie Mae has made significant estimates in a variety of areas including, but not limited to, valuation of certain financial instruments and assets (such as MSRs, properties held for sale, and fixed assets - software), and liabilities (such as accruals for payments of contracts and miscellaneous expenses related to maintaining mortgage assets, and litigation-related obligations), including establishing the MBS loss liability. While Ginnie Mae believes its estimates and assumptions are reasonable based on historical experience and other factors, actual results could differ from those estimates.

Fair Value: Ginnie Mae measures the fair value of its financial instruments in accordance with ASC Topic 820, *Fair Value Measurement* (ASC 820) that requires an entity to base fair value on exit price and maximize the use of observable inputs and minimize the use of unobservable inputs to determine the exit price. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date.

Ginnie Mae categorizes its financial instruments, based on the priority of inputs to the valuation technique, into a three-level hierarchy, as described below.

Level 1 Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury and other U.S. Government securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include securities with quoted prices that are traded less frequently than exchange-traded instruments that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Funds with U.S. Treasury: All Ginnie Mae receipts and disbursements are processed by the U.S. Treasury Department, which in effect maintains Ginnie Mae's bank accounts. All funds are accessible in the event of a default. For purposes of the Statements of Cash Flows, Funds with U.S. Treasury are considered cash.

U.S. Government Securities: U.S. Government Securities are classified as held for investment as Ginnie Mae has both the ability and the intent to hold them until their maturity, and accordingly, they are carried at amortized cost. U.S. Treasury short-term securities are one-day overnight certificates that are issued with a stated rate of interest to be applied to their par amount with a maturity date on the next business day. These overnight certificates are measured at fair value. Interest income on such securities is presented on the Statements of Revenues and Expenses and Changes in Investment of U.S. Government. Discounts and premiums are amortized, on a level yield basis, over the life of the related security.

Insurance Claims Receivable: Ginnie Mae records a receivable for insurance claims which have been submitted to an insuring agency for claim, but have not been paid as of the end of the reporting period. Because it is a Federal Receivable, Ginnie Mae expects full reimbursement. As a result, no allowance is calculated on this receivable.

Accrued Fees and Other Receivables: Ginnie Mae's Accrued Fees and Other Receivables line item includes accrued guarantee fees and miscellaneous program receivables. The accrued guarantee fees are discussed in the Financial Guarantees section above. There is no allowance related to the miscellaneous program receivables because they are receivables with the U.S. Government.

Fixed Assets: Ginnie Mae's fixed assets consist solely of computer systems (software) that are used to accomplish its mission. Ginnie Mae capitalizes software development project costs based on guidance in the ASC Subtopic 350-40 *Intangibles—Goodwill and Other – Internal-Use Software* (ASC 350-40). Ginnie Mae amortizes costs over a three- to five-year period beginning with the project's completion on a straight-line basis.

Mortgage Loans Held for Investment (HFI): When a Ginnie Mae issuer defaults, Ginnie Mae is required to step into the role of the issuer and make the timely pass-through payments to investors, and subsequently, assumes the servicing rights and obligations of the issuer's entire Ginnie Mae guaranteed, pooled loan portfolio of the defaulted issuer. Ginnie Mae utilizes the Master Subservicers (MSSs) to service these portfolios. There are currently two MSSs for Single Family and one MSS for Manufactured Housing defaulted issuers. These MSSs currently service 100% of all non-pooled loans. As of August 1, 2014, Ginnie Mae changed the two servicers for the Single Family portfolios.

In its role as servicer, Ginnie Mae assesses individual loans within its pooled portfolio to determine whether the loan must be purchased out of the pool as required by the Ginnie Mae MBS Guide. Ginnie Mae purchases mortgage loans out of the MBS pool when:

a. Mortgage loans are uninsured by the FHA, USDA, VA or PIH

b. Mortgage loans were previously insured but insurance is currently denied (collectively with (a.), referred to as uninsured mortgage loans)

c. Mortgage loans are insured but are delinquent for more than 90 and 120 days based on management discretion for manufactured housing and single family loans, respectively.

During the year ended September 30, 2014, the majority of purchased mortgage loans were bought out due to borrower delinquency of more than 90 or 120 days depending on loan type (i.e., Single Family or Manufactured Housing).

Ginnie Mae has the ability and the intent to hold these acquired loans for the foreseeable future or until maturity. Therefore, Ginnie Mae classifies the mortgage loans as held for investment (HFI). The mortgage loans HFI are reported net of allowance for loan losses. Mortgage loans HFI also includes mortgage loans that are undergoing a foreclosure process.

Ginnie Mae evaluates the collectability of all purchased loans and assesses whether there is evidence of credit deterioration subsequent to the loan's origination and if it is probable, at acquisition, that Ginnie Mae will be unable to collect all contractually required payments receivable. Ginnie Mae considers guarantees and insurance from FHA, USDA, VA and PIH in determining whether it is probable that Ginnie Mae will collect all amounts due according to the contractual terms.

For FHA insured loans, Ginnie Mae expects to collect the full amount of the unpaid principal balance and debenture rate interest (only for months allowed in the insuring agency's timeline), when the insurer reimburses Ginnie Mae subsequent to filing a claim. As a result, these loans are accounted for under ASC Subtopic 310-20, *Receivables – Nonrefundable Fees and Other Costs*. In accordance with ASC 310-20-30-5, these loans are recorded at the unpaid principal balance which is the amount Ginnie Mae pays to repurchase these loans. Accordingly, Ginnie

Mae recognizes interest income on these loans on an accrual basis at the debenture rate for the number of months allowed under the insuring agency's timeline. After the allowed timeline, Ginnie Mae considers these loans to be non-performing as the collection of interest is no longer reasonably assured, and places these loans on nonaccrual status. Ginnie Mae recognizes interest income for loans on nonaccrual status when cash is received.

Ginnie Mae separately assesses the collectability of mortgage loans bought out of the defaulted portfolios that are uninsured and loans that are non-FHA insured for which Ginnie Mae only receives a portion of the outstanding principal balance. If the principal and interest payments are not fully guaranteed from the insurer (i.e., there is a lack of insurance), or loans are delinquent at acquisition, it is probable that Ginnie Mae will be unable to collect all contractually required payments receivable. Accordingly, these loans are considered to be credit impaired and are accounted for under ASC Subtopic 310-30, *Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality*. At the time of acquisition, these loans are recorded at the lower of their acquisition cost or present value of expected amounts to be received. As non-performing loans, these loans are placed on nonaccrual status.

Ginnie Mae performs periodic and systematic reviews of its loan portfolios to identify credit risks and assess the overall collectability of the portfolios for the estimated uncollectible portion of the principal balance of the loan. As a part of this assessment, Ginnie Mae incorporates the probable recovery amount from mortgage insurance (e.g., FHA, USDA, VA, or PIH) based on established insurance rates. Additionally, Ginnie Mae reviews the delinquency of mortgage loans, industry benchmarks, as well as the established rates of insurance recoveries from insurers. Ginnie Mae records an allowance for the estimated uncollectible amount. The allowance for loss on mortgage loans HFI represents management's estimate of probable credit losses inherent in Ginnie Mae's mortgage loan portfolio. The allowance for loss on mortgage loans HFI is netted against the balance of mortgage loans HFI.

Ginnie Mae records a charge-off as a reduction to the allowance for loan losses when losses are confirmed through the receipt of assets in full satisfaction of a loan, such as the receipt of claims proceeds from an insuring agency or underlying collateral upon foreclosure.

Advances Against Defaulted MBS Pools: Advances against defaulted MBS pools represent pass-through payments made to fulfill Ginnie Mae's guaranty of timely principal and interest payments to MBS security holders. The advances are reported net of an allowance to the extent that management believes that they will not be recovered. The allowance for uncollectible advances is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA and PIH. Other factors considered in the estimate include market analysis and appraised value of the loans. These loans are still accruing interest because they have not reached the required delinquency thresholds to be purchased from the defaulted issuer pools.

Once Ginnie Mae purchases the loans from the pools after the 90 and 120 day delinquency thresholds for Manufactured Housing and Single Family loans, respectively, the loans are reclassified as Mortgage Loans Held for Investment (HFI) below. The cost basis for the purchased loans includes any unrecovered advances. Any advances that are not ultimately recovered through sales of the loan or the related insurance proceeds are recorded as a charge-off as a reduction to the related allowance for loan losses when losses are confirmed through the receipt of assets in full satisfaction of a loan, such as the receipt of claims proceeds from an insuring agency or underlying collateral upon foreclosure.

Short Sales Claims Receivable: As an alternative to foreclosure, a property may be sold for its appraised value even if the sale results in what is referred to as a short sale where the proceeds are not sufficient to pay off the mortgage. Ginnie Mae's MSSs analyze mortgage loans HFI for factors such as delinquency, appraised value of the loan, and market in locale of the loan to identify loans that may be short sale eligible. These transactions are analyzed and approved by Ginnie Mae's MBS program office.

For FHA insured loans, for which the underlying property was sold in a short sale, the FHA typically pays Ginnie Mae the difference between the proceeds received from the sale and the total contractual amount of the mortgage loan and interest at the debenture rate. Ginnie Mae records a short sale claims receivable while it awaits repayment of this amount from the insurer. For short sales claims receivable for which Ginnie Mae believes that collection is not probable, Ginnie Mae records an allowance for short sales claims receivable. The allowance for short sales claims receivable is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. The aggregate of the short sales receivable and the allowance for short sales receivable is the amount that Ginnie Mae determines to be collectible. Ginnie Mae records a charge-off as a reduction to the allowance for loan losses when losses are confirmed through the receipt of claims in full satisfaction of a loan from an insuring agency.

Foreclosed Property: Ginnie Mae records foreclosed property when a MSS receives title to a property which has completed the foreclosure process in the respective state. These properties differ from properties held for sale because they will be conveyed to an insuring agency, and not sold by the MSS. The asset is measured as the principal and interest of a loan which is in the process of being conveyed to an insuring agency, net of an allowance. These assets are conveyed to the appropriate insuring agency within six months. Foreclosed property has previously been placed on nonaccrual status after the loan was repurchased from a pool.

The allowance for foreclosed property is estimated based on actual and expected recovery experience including expected recoveries from FHA, USDA, VA, and PIH. The aggregate of the foreclosed property and the allowance for foreclosed property is the amount that Ginnie Mae determines to be collectible. Ginnie Mae records a charge-off as a reduction to the allowance for loan losses when losses are confirmed through the receipt of assets in full satisfaction of a loan, such as the receipt of claims proceeds from an insuring agency.

Properties Held for Sale: Properties held for sale represent assets that Ginnie Mae has received the title of the underlying collateral (e.g. completely foreclosed upon and repossessed) and intends to sell the collateral. For instances in which Ginnie Mae does not convey the property to the insuring agency, Ginnie Mae holds the title until the property is sold. As the properties are available for immediate sale in their current condition and are actively marketed for sale, they are reported as Properties Held for Sale on the Balance Sheets in accordance with ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*. The Properties held for sale are reported at the lower of the carrying amount or fair value less estimated cost to sell. The properties are appraised by independent entities on a regular basis throughout the year. Ginnie Mae expects sale of the property to occur prior to one year from the date of the foreclosure. As a result, Ginnie Mae does not depreciate these assets. Ginnie Mae records an allowance to account for potential sale costs including maintenance and miscellaneous expenses, along with a loss percentage based on historical data, which includes declines in the fair value of foreclosed properties.

Mortgage Servicing Rights: Mortgage Servicing Rights (MSR) represent Ginnie Mae's right and obligation to service mortgage loans in mortgage backed securities obtained from defaulted issuers. Ginnie Mae contracts with multiple MSSs to provide the servicing of its mortgage loans. The servicing functions typically performed by Ginnie Mae's MSSs include: collecting and remitting loan payments, responding to borrower inquiries, accounting for principal and interest, holding custodial funds for payment of property taxes and insurance premiums counseling delinquent mortgagors, supervising foreclosures and property dispositions, and generally administering the loans. Ginnie Mae receives a weighted average servicing fee annually on the remaining outstanding principal balances of the loans. These servicing fees are included in and collected from the monthly payments made by the borrowers. Ginnie Mae pays a servicing expense to the MSSs in consideration for servicing the loans.

Ginnie Mae records a servicing asset or liability each time it takes over a defaulted issuer's Ginnie Mae-guaranteed portfolio. The balance of the MSR represents the present value of the estimated compensation for mortgage servicing activities that exceeds the fair market cost for such servicing activities. Ginnie Mae considers its fair market cost to be the amount of compensation that would be required by a substitute MSS should one be required. Typically, the benefits of servicing are expected to be more than adequate compensation to a substitute MSS for performing the servicing, and the contract results in a servicing asset. However, if the benefits of servicing are not expected to adequately compensate a substitute MSS for performing the servicing, the contract results in a servicing liability.

Ginnie Mae has irrevocably elected to us the fair value method or the MSRs to better reflect the potential net realizable or market value that could be ultimately realized from the disposition of the MSR asset or the settlement of a future MSR liability. To determine the fair value of the MSRs Ginnie Mae uses a valuation model that calculates the present value of estimated future net servicing income. The model factors in key economic assumptions and inputs including prepayment rates, cost to service a loan, contractual servicing fee income, ancillary income, escrow account earnings, and the discount rate. The discount rate is used to estimate the present value of the projected cash flows in order to estimate the fair value of the MSRs. The discount rate assumptions reflect the market's required rate of return adjusted for the relative risk of the asset type. This approach consists of projecting servicing cash flows and estimating the present value of these cash flows using discount rates. Upon acquisition, Ginnie Mae measures its MSRs at fair value and subsequently re-measures the assets or liabilities with changes in the fair value recorded in the Statements of Revenues and Expenses.

Financial Guarantees: Ginnie Mae, as guarantor, follows the guidance in FASB Accounting Standards Codification (ASC) Topic 460, *Guarantees* (ASC 460), for its accounting, and disclosure, relating to the issuance of certain types of guarantees. ASC 460 requires that upon issuance of a guaranty, the guarantor must recognize a liability for the fair value of the obligation it assumes under the guaranty. The issuance of a guaranty under the MBS program obligates Ginnie Mae to stand ready to perform over the term of the guaranty in the event that the specified triggering events or conditions occur. Ginnie Mae will advance funds to investors and will service an issuer's portfolio in the event of their default.

At inception of the guaranty, Ginnie Mae recognizes a liability for the guaranty it provides on MBS issued by third-party issuers. Ginnie Mae applies the practical expedient in ASC 460, which allows the guaranty liability to be recognized at inception based on the premium received or receivable by the guarantor, provided the guaranty is issued in a standalone arm's length transaction with an unrelated party.

Ginnie Mae provides the guaranty of principal and interest payments to MBS holders in the event of issuer default and, in exchange, receives monthly guaranty fees from the issuers on the unpaid principal balance of the outstanding MBS in the non-defaulted issuer portfolio. Accordingly, the guaranty asset is based on the expected present value of these fees, taking into account anticipated amortization of defaults and prepayments.

Additionally, as the guaranty is issued in a standalone transaction for a premium, Ginnie Mae records a guaranty liability to recognize the future expense for its guaranty as the offsetting entry for the guaranty asset. Thus, there is no net impact from the initial recording of the guaranty liability and asset on the net financial position of Ginnie Mae.

Liability for Loss on MBS Program Guaranty: Liability for loss on MBS program guaranty (MBS loss liability) represents management's estimate of future losses to be incurred as a result of the guaranty provided on MBS portfolios when information indicates a loss is probable and the amount of loss can be reasonably estimated.

The MBS loss liability is established to the extent management believes losses due to issuer defaults are probable and estimable and servicing income and FHA, USDA, VA, and PIH insurance proceeds do not fully cover Ginnie Mae servicing and loan acquisition related costs.

Ginnie Mae establishes a MBS loss liability through a provision charged to operations when, in management's judgment, losses associated with existing defaulted issuers or performing issuer defaults are probable and estimable. 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. Ginnie Mae also analyzes the ability of the borrowers to pay as well as the recovery amount from mortgage insurance when estimating valuations of the mortgage-related assets and liabilities.

Additionally, Ginnie Mae's Office of Enterprise Risk (ERO) utilizes CorporateWatch to assist in the analysis of potential defaults. CorporateWatch assigns each issuer an internal risk grade using an internally developed proprietary risk-rating methodology. The objective of the methodology is to identify those Ginnie Mae issuers that display an elevated likelihood of default relative to their peers. To this end, the methodology assigns each active Issuer a risk grade ranging from 1-8, with 1 representing a low probability of default and 8 representing an elevated probability of default. A higher probability of default would arise from an observed weakness in an entity's financial health. Those Issuers with an elevated probability of default are assigned an internal risk grade of 7 or 8 and are automatically included in Risk Category I of the Watch List. ERO prepares written financial reviews on all Issuers appearing in Risk Category I of Watch List to assess the level of on-going monitoring needed to ensure that these Issuers remain viable Ginnie Mae counterparties or to take other mitigation actions.

Ginnie Mae's MBS loss liability is made up of two components:

A. Liability for currently defaulted issuers' non-pooled loans – Separate from the unpaid principal and interest of MHI, Ginnie Mae records a liability for estimated non-recoverable foreclosure costs that arise from the servicing and managing of mortgage loans HFI and properties held for sale.
B. Liability for probable issuer defaults – loss contingency that arises from the guaranty obligation that Ginnie Mae has to the MBS holders as a result of a probable issuer default. The issuers have the obligation to make timely principal and interest payments to investors. However, in the event that the issuer defaults Ginnie Mae will advance funds to investors in the Ginnie Mae MBS and will service the issuer's portfolio. The liability is valued as the net present value of future advances and servicing costs, net of insurance proceeds and recoveries. For the issuers who are identified as probable defaults, Ginnie Mae records a contingent liability for the estimated amount of the cash flows in the loss liability.

The MBS loss liability is a liability account on the Balance Sheet. Ginnie Mae recognizes the loss by recording a charge to the provision for loss on MBS program guaranty on the Statements of Revenue and Expenses. Ginnie Mae records charge-offs as a reduction to the MBS loss liability account when losses are confirmed and records recoveries as a credit to the MBS loss liability account. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios. Accordingly, the MBS loss liability is increased by provisions recorded as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries. Among other losses and recoveries, miscellaneous expenses related to foreclosure are not capitalized on the Balance Sheet and are charged off against the MBS loss liability and recoveries of these expenses through the claims process are shown as recoveries against the MBS loss liability.

On an annual basis, Ginnie Mae assesses the loss liability model for reasonableness and predictive capabilities. As Ginnie Mae's defaulted issuer portfolio changes, the Budget and Economic Modeling Division reviews the original estimates by comparing them with actual results and historical data. This includes reviewing market inputs such as interest rates and volatility. If changes are necessary, the model is changed appropriately and reevaluated to verify that the changes were implemented properly.

Recognition of Revenues and Expenses: Ginnie Mae recognizes revenue from the following sources:

- Guaranty Fees – Ginnie 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 guaranty of MBS are recognized as earned.
- Interest Income – Mortgage Loans HFI – Ginnie Mae earns interest income on an accrual basis at the debenture rate for the number of months allowed under the insuring agency's timeline.
- Interest Income – U.S. Government Securities – Ginnie Mae earns interest income on U.S. Government Securities related to U.S. Treasury Overnight Certificates, Treasury Notes, and Treasury Inflation-Index Securities.
- Commitment Fees – 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.
- Multiclass Fees – Ginnie Mae receives one-time upfront fees related to the issuance of multiclass products. These multiclass fees are recognized as revenue over the service period in proportion to the costs expected to be incurred.
- Other MBS Program Income – Ginnie Mae also recognizes income through fees related to New Issuer Applications and Transfers of Servicing.

Ginnie Mae's expenses are classified into three groups: MBS program expenses, administrative expenses, and fixed asset amortization. The main components of the MBS program expense line item are multiclass expenses, MBS information systems and compliance expenses, and transfer agent expenses.

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. Ginnie Mae classifies cash flows from operations related to its programs and overall business operations (i.e., accrued interest, deferred revenue and liabilities, accounts payable, and MBS loss liability) as operating activities. Ginnie Mae classifies cash flows from securities that Ginnie Mae intends to hold for investment (i.e., U.S. Government securities and mortgage loans HFI) and capital expenditures and proceeds from sale of software as investing activities. Ginnie Mae classifies cash flows from any non-federal transactions necessary to finance or fund the operations of the agency, of which there were none in 2014 and 2013, as financing activities. Management determines the cash flow classification at the date of purchase of a loan, whether it intends to sell (operating activity) or hold the loan for the foreseeable future (investing activity).

Note 3: 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 include U.S. Treasury overnight certificates, U.S. Treasury notes, and U.S. Treasury inflation-indexed securities (reflecting inflation compensation). Ginnie Mae's long-term securities matured during the year ended September 30, 2014 , with a realized gain of $17.1 million. The coupon rates in overnight certificates as of September 30, 2014 were 0.01 percent. As of September 30, 2013, they ranged from 1.88 percent to 2.00 percent.

The amortized cost and fair values as of September 30, 2014 were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 150,540	$ -	$ -	$ 150,540
U.S. Treasury Notes	-	-	-	-
U.S. Treasury Inflation-Indexed Securities	-	-	-	-
Total	**$ 150,540**	**$ -**	**$ -**	**$ 150,540**

The amortized cost and fair values as of September 30, 2013 were as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	$ 192,100	$ -	$ -	$ 192,100
U.S. Treasury Notes	998,600	24,500	-	1,023,100
U.S. Treasury Inflation-Indexed Securities	619,500	33,800	-	653,300
Total	**$ 1,810,200**	**$ 58,300**	**$ -**	**$ 1,868,500**

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2014, by contractual maturity date, were as follows:

(Dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 150,540	$ 150,540	0.01%
Due after one year through five years	-	-	
Due after five years through ten years	-	-	
Total	**$ 150,540**	**$ 150,540**	**0.01%**

The amortized cost, fair value, and annual weighted average interest rates of U.S. Government securities at September 30, 2013, by contractual maturity date, were as follows:

(Dollars in thousands)	Amortized Cost	Fair Value	Weighted Average Interest Rate
Due within one year	$ 1,810,200	$ 1,868,500	-3.03%
Due after one year through five years	-	-	
Due after five years through ten years	-	-	
Total	**$ 1,810,200**	**$ 1,868,500**	**-3.03%**

Note 4: Financial Guarantees and Financial Instruments with Off-Balance Sheet Risk

Ginnie Mae receives a guaranty fee from issuers which is calculated based on the unpaid principal balance of outstanding MBS in the non-defaulted issuer portfolio. It is Ginnie Mae's compensation for taking on the risk of providing the guaranty to MBS investors for the timely payment of principal and interest in the event of issuer default.

Ginnie Mae recognizes a guaranty asset upon issuance of a guaranty for the expected present value of these guaranty fees. The guaranty liability is a non-contingent guaranty liability for Ginnie Mae's obligation to stand ready to perform on the guaranty. The guaranty liability recognized on the Balance Sheets is $5,963.1 million and $7,012.9 million as of September 30, 2014 and 2013, respectively.

In addition to the guaranty liability, Ginnie Mae recognizes a MBS loss liability, which is contingent liability for estimable and probable losses in relation to these guarantees (i.e., MBS Loss Liability). The MBS loss liability recognized on the Balance Sheets is $735.4 million and $700.3 million as of September 30, 2014 and 2013, respectively.

For the guarantee asset and liability recognized on the Balance Sheets, Ginnie Mae's maximum potential exposure under these guarantees is primarily comprised of the amount of MBS securities outstanding. On September 30, 2014, the amount of securities outstanding, which is guaranteed by Ginnie Mae, was $1.5 trillion, including $0.4 million of Ginnie Mae-guaranteed MBS. However, Ginnie Mae's potential loss is considerably less because of the financial strength of its issuers. Additionally, in the event of default of an issuer, the underlying mortgages serve as primary collateral, and FHA, USDA, VA, and PIH insurance or guaranty indemnifies Ginnie Mae for most losses. 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 of Ginnie Mae issuers. Other than those issuers considered in the MBS loss liability, Ginnie Mae does not anticipate nonperformance by its other counterparties. The approximate term of the guarantee is 15-30 years. The maximum term is capped at 40 years.

Ginnie Mae is also subject to credit risk for its outstanding commitments to guarantee MBS which are not reflected in its Balance Sheets. The fair values of these commitments are an unrecognized MBS commitment for financial statement purposes. During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty 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 the outstanding balance of MBS commitments due in part to Ginnie Mae's ability to limit commitment authority granted to individual MBS issuers. Outstanding MBS and commitments were as follows:

	September 30	
(Dollars in billions)	2014	2013
Outstanding MBS	$ 1,526.5	$ 1,457.1
Outstanding MBS Commitments	$ 97.8	$ 118.1

If all outstanding MBS commitments were utilized as of September 30, 2014, Ginnie Mae's corresponding guaranty liability, its obligation to stand ready to perform on these securities, would be approximately $401.0 million as of September 30, 2014 and $602.4 million as of September 30, 2013.

The Ginnie Mae MBS serves as the underlying collateral for multiclass products, such as Real Estate Mortgage Investment Conduits (REMIC), Callable Trusts, Platinum, and Stripped Mortgage-Backed Securities (SMBS), for which Ginnie Mae also guarantees the timely payment of principal and interest. These structured transactions allow the private sector to combine and restructure cash flows from Ginnie Mae MBS into securities that meet unique investor requirements for yield, maturity, and call-option features.

In its multiclass securities program, Ginnie Mae issued a total of $113.7 billion as of September 30, 2014 and $99.1 billion as of September 30, 2013. . The estimated outstanding balance of multiclass securities included in the outstanding MBS balance was $487.1 billion and $468.5 billion as of September 30, 2014 and September 30, 2013, respectively. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

Note 5: Mortgage Servicing Rights

The following table presents activity for residential first mortgage MSRs:

	September 30	
(Dollars in thousands)	2014	
Balance, October 1, 2013	$	65,100
Additions		-
Changes in Fair Value		(20,500)
Balance, September 30, 2014	**$**	**44,600**

	September 30	
(Dollars in thousands)	2013	
Balance, October 1, 2012	$	60,700
Additions		-
Changes in Fair Value		4,400
Balance, September 30, 2013	**$**	**65,100**

The Unpaid Principal Balance (UPB) of the MSRs for the total portfolio was $5.6 billion and 7.8 billion as of September 30, 2014 and September 30, 2013, respectively.

The amounts reflected in the table above can, and generally do, change from period to period as market conditions and projected interest rates change, and could have an adverse impact on the value of the MSRs and could result in a corresponding reduction in servicing income. The decrease in MSR value is attributable to sale of pooled loans, increase in prepayments, higher cost of servicing, and higher delinquency and foreclosure rates, amongst other fair value drivers.

The impact of key economic assumptions used in determining the fair value of the Ginnie Mae's MSRs are as follows:

	September 30	
(Dollars in thousands)	2014	2013
Valuation at period end:		
Fair value (thousands)	$ 44,600	$ 65,100
Weighted- average life (years)	4.14	5.38
Prepayment rates assumptions:		
Rate assumption	19.91%	17.69%
Impact on fair value of a 10% adverse change	(2,600)	(4,000)
Impact on fair value of a 20% adverse change	(5,000)	(7,700)
Discount rate assumptions:		
Rate assumption	12.58%	12.57%
Impact on fair value of a 10% adverse change	(1,700)	(2,700)
Impact on fair value of a 20% adverse change	(3,200)	(5,200)

These sensitivities are hypothetical and should be considered with caution. Changes in fair value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumptions to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another (e.g., increased market interest rates may result in lower prepayments and increased credit losses) that could magnify or counteract the sensitivities.

One of the primary risks associated with Ginnie Mae's MSRs is interest rate risk and the resulting impact on prepayments. A significant decline in interest rates could lead to higher−than−expected prepayments that could reduce the value of the MSRs.

Ginnie Mae collected $27.1 million and $41.1 million in mortgage servicing fees for the years ended September 30, 2014 and 2013, respectively. This amount is recorded as a recovery in the MBS loss liability.

Note 6: Advances Against Defaulted MBS Pools

The advances against defaulted MBS pools balance are $81.8 million as of September 30, 2014 and $99.1 million as of September 30, 2013, as follows:

(Dollars in thousands)	September 30 2014	2013
Advances against defaulted MBS pools	$ 192,500	$ 261,600
Allowance for Uncollectible Advances	(110,700)	(162,500)
Advances against defaulted MBS pools, net	**$ 81,800**	**$ 99,100**

Note 7: Ginnie Mae Defaulted Issuer Loan Portfolio Profile

Ginnie Mae's defaulted issuer loan portfolio profile consists of primarily single family loans. As of September 30, 2014, there are no multifamily mortgage loans within the Ginnie Mae defaulted issuer portfolio. The table below describes the aging of the single family defaulted issuer loan profile (i.e., mortgage loans HFI, foreclosed property, properties held for sale, short sale claims receivable, etc.) and UPB in thousands:

30 - 59 Days Delinquent	60 - 89 Days Delinquent	90-119 Days Delinquent	120+ Days Delinquent	Total Delinquent	Current	Total	Loans Over 120 Days Delinquent and Accruing Interest	Recorded Investment in Nonaccrual Loans
As of September 30, 2014								
$ 1,553,400	$ 618,700	$ 276,400	$ 3,232,100	$ 5,680,500	$ 195,400	$ 5,876,000	$ 380,600	$ 512,300
As of September 30, 2013								
$ 63,900	$ 340,800	$ 126,700	$ 3,907,300	$ 4,438,700	$ 2,320,700	$ 6,759,500	$ 1,739,300	$ 2,572,800

Ginnie Mae analyzes its risk structure based on a loan's insurance coverage. Loans, which are insured by the FHA, have the least credit risk and are classified as Credit Risk Level 1 because Ginnie Mae expects to receive full recovery of principal in the event of a loan default. Loans, which are classified as a Credit Risk Level 2, are insured by other agencies (i.e., VA, USDA, etc.). These loans are more risky than Credit Level 1 loans because Ginnie Mae expects to receive partial recovery of principal. All loans without insurance coverage are classified as a Credit Risk Level 3. These loans are high risk because they have a lower probability for recovery than insured loans. The breakdown of loans by credit risk level and UPB in thousands is below:

	September 30 2014	2013
Credit Risk Level 1 - FHA Loans	$ 5,009,300	$ 5,836,700
Credit Risk Level 2 - Non-FHA Loans	331,600	396,700
Credit Risk Level 3 - Uninsured Loans	535,100	526,100
Total	**$ 5,876,000**	**$ 6,759,500**

Note 8: Mortgage Loans Held for Investment, Net

Mortgage loans HFI, net as of September 30, 2014 and 2013 were as follows:

	September 30			
(Dollars in thousands)	2014		2013	
Total Mortgage Loans HFI	$	5,309,000	$	6,169,600
Total Mortgage Loans HFI Allowance for Loss		(465,400)		(502,200)
Total Mortgage Loans HFI, net	**$**	**4,843,600**	**$**	**5,667,400**

Ginnie Mae purchased $488.9 million and $1.1 billion of loans from defaulted issuer pools as of September 30, 2014 and 2013, respectively. As of September 30, 2014 and September 30, 2013 there were no multifamily mortgage loans within the Ginnie Mae defaulted issuer portfolio.

Ginnie Mae's credit risk on the MHI loans is limited by the underlying insurance on the loans provided by FHA, USDA, VA, and PIH. The table below presents the UPB of MHI loans by the underlying insurer.

In the years ended September 30, 2014 and 2013, Ginnie Mae recorded $346.8 million and $116.4 million, respectively, in interest income on mortgage loans HFI.

Note 9: Foreclosed Property, Net

The Foreclosed property balance is $577.2 million as of September 30, 2014 and $481.1 million as of September 30, 2013, net of the allowance for foreclosed property, as follows:

	September 30			
(Dollars in thousands)	2014		2013	
Foreclosed property	$	615,800	$	494,600
Allowance for foreclosed property		(38,600)		(13,500)
Foreclosed property, net	**$**	**577,200**	**$**	**481,100**

Ginnie Mae utilizes the non-pooled valuation and allowance methodology to evaluate Foreclosed Property on an individual basis. Items are evaluated to determine impairment include insurance status and probable recovery amount based on experience and industry studies. As of September 30, 2014 and September 30, 2013 there was no multifamily foreclosed property.

Note 10: Short Sale Claims Receivable, Net

The Short Sale Claims Receivable balance is $22.4 million as of September 30, 2014 and $61.7 million as of September 30, 2013, as follows:

	September 30	
(Dollars in thousands)	**2014**	**2013**
Short Sale Claims Receivable	$ 50,100	$ 81,600
Allowance for Short Sale Claims Receivable	(27,700)	(19,900)
Short Sale Claims Receivable, net	**$ 22,400**	**$ 61,700**

Ginnie Mae utilizes the non-pooled valuation and allowance methodology to evaluate Short Sale Claims Receivable on an individual basis. Items are evaluated to determine impairment including insurance status and probable recovery amount based on experience and industry studies. As of September 30, 2014, there are no multifamily mortgage loans within the Ginnie Mae defaulted issuer portfolio.

Note 11: Insurance Claims Receivable

The Claims Receivable balance is $1.8 million as of September 30, 2014 and $8.4 million as of September 30, 2013. There is no allowance on Insurance Claims Receivable because it is a Federal receivable.

Note 12: Properties Held for Sale, Net

Balances and activity for these acquired properties were as follows:

	September 30	
(Dollars in thousands)	2014	2013
Balance of properties, beginning of year	$ 29,600	$ 15,500
Additions	20,200	42,600
Dispositions and Losses	(32,400)	(28,500)
Balance of properties, end of year	$ 17,400	$ 29,600
Valuation Allowance	(3,200)	(6,200)
Properties held for sale, net	**$ 14,200**	**$ 23,400**

During the year ended September 30, 2014, $20.2 million of loans were repurchased out of pools and categorized as properties held for sale. The properties held for sale balance is composed primarily of single family collateral.

Note 13: Fair Value Measurements

This note discusses the recurring and non-recurring changes in fair value measurement as well as the fair value of financial instruments.

Recurring Changes in Fair Value

The following table presents the fair value measurement hierarchy level for Ginnie Mae's assets that are measured at fair value on a recurring basis subsequent to initial recognition, including financial instruments for which Ginnie Mae has elected the fair value option. Mortgage Servicing Rights is the only Ginnie Mae asset which is measured on a recurring basis subsequent to initial recognition. The fair value of the Mortgage Servicing Rights and its measurement basis is shown below.

	September 30, 2014			
(Dollars in thousands)	Level 1	Level 2	Level 3	Total
Mortgage Servicing Rights	$ -	$ -	$ 44,600	$ 44,600
Total Assets at Fair Value	$ -	$ -	$ 44,600	$ 44,600

	September 30, 2013			
(Dollars in thousands)	Level 1	Level 2	Level 3	Total
Mortgage Servicing Rights	$ -	$ -	$ 65,100	$ 65,100
Total Assets at Fair Value	$ -	$ -	$ 65,100	$ 65,100

Ginnie Mae measures the fair value of MSRs based on the present value of expected cash flows of the underlying mortgage assets using management's best estimates of certain key assumptions, which include prepayment speeds, forward yield curves, adequate compensation, and discount rates commensurate with the risks involved. Changes in anticipated prepayment speeds, in particular, result in fluctuations in the estimated fair values of the servicing rights. If actual prepayment experience differs from the anticipated rates used in the model, this may result in a material change in the fair value. Note 5 contains additional detail in regards to specific fair value assumptions.

The following table presents a reconciliation for the MSRs measured at fair value on a recurring basis using significant unobservable inputs for the years ended September 30, 2014 and 2013:

(Dollars in thousands)	Mortgage Servicing Rights
October 1, 2013	$ 65,100
Net realized/unrealized gains (losses) included in Excess of Revenue over Expenses	(20,500)
September 30, 2014	**$ 44,600**
Assets:	
October 1, 2012	$ 60,700
Net realized/unrealized gains (losses) included in Excess of Revenue over Expenses	4,400
September 30, 2013	**$ 65,100**

The table below summarizes gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in excess of revenue over expenses for the fiscal year ended 2014 and 2013 for the MSRs:

	Total Gains and Losses on Mortgage Service Rights	
(Dollars in thousands)	2014	2013
Classification of gains and losses (realized/unrealized) included in Excess of Revenue over Expenses for the period:		
Gain (Loss) on MSR	(20,500)	4,400
Total	**$ (20,500)**	**$ 4,400**

Nonrecurring Changes in Fair Value

The following table displays the asset measured on the Balance Sheets at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (e.g., when Ginnie Mae evaluates for impairment), and the gains or losses recognized for these assets and liabilities for the years ended September 30, 2014 and 2013, as a result of fair value measurements:

September 30, 2014					
(Dollars in thousands)	Level 1	Level 2	Level 3		Total Losses
Properties held for sale, net			$	14,200	-

September 30, 2013					
(Dollars in thousands)	Level 1	Level 2	Level 3		Total Losses
Properties held for sale, net			$	23,400	-

Properties held for sale, net represents foreclosed property received in full satisfaction of a loan, which Ginnie Mae intends to sell, net of a valuation allowance. The properties held for sale are reported at the lower of the carrying amount or fair value less estimated cost to sell. The fair value estimate is based on relevant current and historical factors available at the time of valuation. The properties are appraised by independent entities on a regular basis throughout the year. The appraisals include viewing the condition of properties and analyzing market conditions (e.g. comparing similar properties, recent sales, etc.). Acquired property is classified within Level 3 of the valuation hierarchy because significant inputs are unobservable.

Fair Value of Financial Instruments

The following table displays the carrying value and estimated fair value of Ginnie Mae's financial instruments as of September 30, 2014 and 2013.

	September 30, 2014				September 30, 2013	
(Dollars in thousands)	Carrying Value	Level 1	Level 2	Level 3	Carrying Value	Fair Value
Financial Assets:						
Funds with U.S. Treasury	$ 13,470,000	$ 13,470,000	$ -	$ -	$ 9,622,400	$ 9,622,400
U.S. Government securities	$ 150,500	$ 150,500	$ -	$ -	$ 1,810,200	$ 1,868,500
Mortgages held for investment, net	$ 4,843,600	$ -	$ -	$ 4,843,600	$ 5,667,400	$ 5,667,400
Foreclosed property, net	$ 577,200	$ -	$ -	$ 577,200	$ 481,100	$ 481,100
Advances against defaulted MBS Pools, net	$ 81,800	$ -	$ -	$ 81,800	$ 99,100	$ 99,100
Short sale claims receivable, net	$ 22,400	$ -	$ -	$ 22,400	$ 65,100	$ 65,100
Mortgage servicing rights	$ 44,600	$ -	$ -	$ 44,600	$ 65,100	$ 65,100
Guaranty asset	$ 5,963,100	$ -	$ -	$ 5,963,100	$ 7,012,900	$ 7,012,900
Financial Liabilities:						
Guaranty liability	$ 5,963,100	$ -	$ -	$ 5,963,100	$ 7,012,900	$ 7,012,900

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. Therefore, the fair values presented in the table above do not purport to present the net realizable, liquidation, or market value as a whole. Amounts which Ginnie Mae ultimately realizes from the disposition of assets or settlement of liabilities may vary significantly from the fair values presented.

U.S. Government Securities – Ginnie Mae records the fair value of this asset based on quoted data from the U.S. Bureau of Public Debt.

Mortgage loans held for investment, net – Mortgage loans held for investment, net is impaired when purchased and is measured as the unpaid principal balance which Ginnie Mae pays to purchase the loans from a defaulted issuer pool. These loans are reported net of an allowance for loan losses. Ginnie Mae expects to receive the entire principal and interest balances through the insurers or borrowers in most instances, except for VA-insured loans.

Guaranty asset and liability – Ginnie Mae uses the practical expedient to determine the guaranty asset and liability based on the present value of the expected future cash flows from the guaranty fees based on the unpaid principal balance of the outstanding MBS in the non-defaulted issuer portfolio which results from new issuances of MBS, scheduled run-offs of MBS, prepayments and defaults. Subsequently, the guaranty asset and liability is measured by a systematic and rational amortization method. It is not practicable to calculate a fair value on the guaranty asset and liability because there is no market to compare the estimates. Note 4 provides additional information in regards to the guaranty asset and liability.

Note 14: MBS Loss Liability

Ginnie Mae establishes a MBS loss liability on an annual basis. The changes in the MBS loss liability for the years ended September 30, 2014, and 2013 were as follows:

(Dollars in thousands)	Single Family	Multifamily	Manufactured Housing	Total
MBS Loss Liability September 30, 2012	**$ 356,500**	**$ 100**	**$ 800**	**$ 357,400**
Provision for losses	403,300	(100)	(1,100)	402,100
Charge-offs	(203,200)	-	(800)	(204,000)
Recoveries	143,100	-	1,700	144,800
MBS Loss Liability September 30, 2013	**$ 699,700**	**$ -**	**$ 600**	**$ 700,300**
Provision for losses	(114,595)	5	(410)	(115,000)
Charge-offs	(280,205)	(9)	(400)	(280,614)
Recoveries	430,500	4	210	430,714
MBS Loss Liability September 30, 2014	**$ 735,400**	**$ -**	**$ -**	**$ 735,400**

Management believes that its MBS loss liability is adequate to cover probable and estimable losses on the MBS program guaranty. Ginnie Mae incurs losses when FHA, USDA, VA, and PIH insurance and guaranty proceeds do not cover losses that result from issuer defaults or in the event loans are uninsured and proceeds do not cover losses from default. As of September 30, 2014, Ginnie Mae's single family and pooled defaulted portfolio had remaining principal balances of $5.6 billion.

Note 15: Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (for example, issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers. Concentrations of credit risk are as noted below, as of September 30, 2014:

	Single Family			Multifamily			Manufactured Housing			Home Equity Conversion (HECM/HMBS)		
(Dollars in billions)	Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance	
Largest performing issuers	25	$	1,163.5	20	$	75.9	1	$	0.3	14	$	48.9
Other performing issuers	237	$	222.3	33	$	12.1	2	$	-	0	$	-
Defaulted issuers	18	$	5.6	0	$	-	0	$	-	0	$	-

Concentrations of credit risk are as noted below, as of September 30, 2013

	Single Family			Multifamily			Manufactured Housing			Home Equity Conversion (HECM/HMBS)		
(Dollars in billions)	Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance		Number of Issuers	Remaining Principal Balance	
Largest performing issuers	25	$	1,169.6	21	$	70.7	1	$	0.3	12	$	44.6
Other performing issuers	210	$	157.1	36	$	9.2	2	$	-	0	$	-
Defaulted issuers	23	$	7.8	0	$	-	1	$	-	0	$	-

Issuers are permitted only to pool insured or guaranteed loans (from FHA, USDA, VA or PIH). The insuring and guarantying entities have strict underwriting standards and criteria for quality of collateral. In the event of issuer default, Ginnie Mae assumes the rights and obligations of the issuer and becomes the owner of the MSR asset, which typically is a saleable asset. In addition, in the event of borrower delinquency in excess of 90 or 120 days for Single Family or Manufactured Housing respectively, Ginnie Mae has the right to repurchase the loan out of the pool and can obtain access to the underlying collateral or insurance claim by pursuing foreclosure.

Note 16: Contingencies

As of September 30, 2014, and as of this report, Ginnie Mae's Office of General Counsel has not identified one pending or threatened action or unasserted claim or assessment in which Ginnie Mae's exposure is $1.0 million, individually, or in the aggregate for similar matters. Additionally, Ginnie Mae's Office of General Counsel has determined that there are no pending or threatened actions or unasserted claims or assessments in which Ginnie Mae's potential loss exceeds $3.0 million in the aggregate for cases not listed individually or as part of similar cases that could be material to the financial statements. In the opinion of Ginnie Mae's management and Office of General Counsel the likelihood of an unfavorable outcome is remote in each case. It is the opinion of Ginnie Mae's management that the disposition or ultimate resolution of the case will not have a material adverse effect on the financial position of Ginnie Mae.

On or about August 20, 2014, the Department of Justice, on behalf of Ginnie Mae, among others, entered into a settlement agreement with Bank of America. The settlement agreement addressed the contractual legal claims of Ginnie Mae against Bank of America and Countrywide relating to the performance of Bank of America and Countrywide under the Master Subservicer contract with Ginnie Mae. Pursuant to the settlement agreement, Ginnie Mae will receive $200 million. This settlement amount represents that mutual agreement of Ginnie Mae and Bank of America to resolve the contractual claims of Ginnie Mae.

Taylor, Bean & Whitaker, a defaulted Ginnie Mae issuer, made three corporate advances totaling roughly $78 million on its Ginnie Mae portfolio using money from Ocala Funding (Ocala), its financing affiliate. On July 8, 2014, Ocala filed a lawsuit under the Bankruptcy Code 11 U.S.C. § § 105,541,544, 550 and 551 which permits Ocala, the debtor, to raise claims under state law. The claims that Ocala asserts arise under Florida Uniform Fraudulent Transfers Act. Ocala claims that Ginnie Mae was a direct transferee of the fraudulent transfers and therefore is liable to return the funds. Parties engaged in settlement negotiations and the agreement was reached in principle to settle the lawsuit. Ginnie Mae agreed to pay Ocala $14.9 million in exchange for Ocala releasing its claims against Ginnie Mae in a subsequent period.

Ginnie Mae has commitments to guaranty MBS, which are off-balance sheet financial instruments. Additional information is provided in Note 4: Financial Guarantees and Financial Instruments with Off-Balance Sheet Risk.

Ginnie Mae's management recognizes the uncertainties that could occur in regard to potential defaulted issuers and other indirect guarantees, such as large issuer portfolio default, lack of proper insurance coverage of defaulted loans, etc. Additional information is discussed in Note 14: MBS Loss Liability.

Note 17: Related Parties

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

Ginnie Mae was authorized to use $21.4 million during the year ended September 30, 2014 for personnel (payroll) and non-personnel (travel, training) costs only. During the year ended September 30, 2014, Ginnie Mae incurred $20.3 million, net, for Salaries and Expenses. Ginnie Mae has no liability for future payments to employees under the CSRS or FERS 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 and are treated as such for the Statements of Cash Flow. Ginnie Mae has authority to borrow from the U.S. Treasury to finance operations in lieu of appropriations, if necessary.

Additionally, Ginnie Mae has an intra-entity relationship with the FHA, which is part of HUD. Of the total mortgage loans HFI, net, approximately $5.4 billion and $5.3 billion of loans were insured by FHA as of September 30, 2014 and 2013, respectively. In addition, Ginnie Mae submits and receives claim proceeds for FHA-insured loans that have been through the foreclosure and short sale process. The breakdown of FHA claims pending payment or pre-submission to FHA is below:

	September 30	
(Dollars in thousands)	2014	2013
Foreclosed Property	$ 493,600	$ 479,500
Short Sales Claims Receivable	6,500	44,100
Insurance Claims Receivable	1,800	8,400
Total FHA Claims, net	**$ 501,900**	**$ 532,000**

Note 18: 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, 2014, the U.S. Government has an investment of $19.0 billion in Ginnie Mae. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management and HUD's general counsel, Ginnie Mae is not subject to the Federal Credit Reform Act.

Note 19: Subsequent Events

Ginnie Mae management has evaluated potential subsequent events through November 27, 2014, the date through which the financial statements were made available to be issued. Based on the evaluation, Ginnie Mae management identified no subsequent events.