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BlackRock Enhanced Government Fund, Inc.  
Form N-CSR  
February 27, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT  
COMPANIES**

Investment Company Act file number: 811-21793

Name of Fund: BlackRock Enhanced Government Fund, Inc. (EGF)

Fund Address: 100 Bellevue Parkway, Wilmington, DE 19809

Name and address of agent for service: John M. Perlowski, Chief Executive Officer, BlackRock Enhanced Government Fund, Inc., 55 East 52<sup>nd</sup> Street, New York, NY 10055

Registrant's telephone number, including area code: (800) 882-0052, Option 4

Date of fiscal year end: 12/31/2014

Date of reporting period: 12/31/2014

Item 1 – Report to Stockholders

DECEMBER 31, 2014

ANNUAL REPORT

**BlackRock Enhanced Government Fund, Inc. (EGF)**

**Not FDIC Insured   May Lose Value   No Bank Guarantee**

**Section 19(a) Notice**

BlackRock Enhanced Government Fund, Inc.'s (EGF) (the Fund) reported amounts and sources of distributions are estimates and are provided to you pursuant to regulatory requirements and are not being provided for tax reporting purposes. The actual amounts and sources for tax reporting purposes will depend upon the Fund's investment experience during the year and may be subject to changes based on the tax regulations. The Fund will provide a Form 1099-DIV each calendar year that will tell you how to report these distributions for federal income tax purposes.

**December 31, 2014**

	Total Cumulative Distributions for the Fiscal Year-to-Date			% Breakdown of the Total Cumulative Distributions for the Fiscal Year-to-Date				
	Net Investment Income	Net Realized Capital Gains	Return of Capital	Total Per Common Share	Net Investment Income	Net Realized Capital Gains	Return of Capital	Total Per Common Share
EGF	\$0.532926		\$0.127074	\$0.660000	81%	0%	19%	100%

The Fund estimates that it has distributed more than the amount of earned income and net realized gains; therefore, a portion of the distribution may be a return of capital. A return of capital may occur, for example, when some or all of the shareholder's investment in the Fund is returned to the shareholder. A return of capital does not necessarily reflect the Fund's investment performance and should not be confused with 'yield' or 'income'. When distributions exceed total return performance, the difference will incrementally reduce the Fund's net asset value per share.

Section 19(a) notices for the Fund, as applicable, are available on the BlackRock website at <http://www.blackrock.com>.

**Section 19(b) Disclosure**

The Fund, acting pursuant to a U.S. Securities and Exchange Commission (SEC) exemptive order and with the approval of the Fund's Board of Directors (the Board), has adopted a plan, consistent with its investment objectives and policies to support a level distribution of income, capital gains and/or return of capital (the Plan). In accordance with the Plan, the Fund currently distributes \$0.055 per share on a monthly basis.

The fixed amount distributed per share is subject to change at the discretion of the Fund's Board. Under its Plan, the Fund will distribute all available investment income to its shareholders, consistent with its primary investment objectives and as required by the Internal Revenue Code of 1986, as amended (the Code). If sufficient investment income is not available on a monthly basis, the Fund will distribute long-term capital gains and/or return of capital to shareholders in order to maintain a level distribution. Each monthly distribution to shareholders is expected to be at the fixed amount established by the Board, except for extraordinary distributions and potential distribution rate increases or decreases to enable the Fund to comply with the distribution requirements imposed by the Code.

Shareholders should not draw any conclusions about the Fund's investment performance from the amount of these distributions or from the terms of the Plan. The Fund's total return performance on net asset value is presented in its financial highlights table.

The Board may amend, suspend or terminate the Fund's Plan without prior notice if it deems such actions to be in the best interests of the Fund or its shareholders. The suspension or termination of the Plan could have the effect of creating a trading discount (if the Fund's stock is trading at or above net asset value) or widening an existing trading discount. The Fund is subject to risks that could have an adverse impact on its ability to maintain a level distribution. Examples of potential risks include, but are not limited to, economic downturns impacting the markets, decreased market volatility, companies suspending or decreasing corporate dividend distributions and changes in the Code. Please refer to the Fund's prospectus for a more complete description of its risks.



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## The Markets in Review

Dear Shareholder.

After an extended period of calm, market volatility increased over the course of 2014, driven largely by higher valuations in risk assets (such as equities and high yield bonds), rising geopolitical risks and expectations around global central bank policies. Several key trends drove strong performance in U.S. markets, particularly large-cap stocks, Treasuries and municipal bonds, while markets outside the U.S. were more challenged.

Investors began the year in search of relatively safer assets due to heightened risks in emerging markets, slowing growth in China and weakening U.S. economic data. As a result, equities globally declined in January while bond markets strengthened despite the expectation that interest rates would rise as the U.S. Federal Reserve had begun reducing its asset purchase programs. Strong demand for relatively safer assets pushed U.S. Treasury bond prices higher and thus kept rates low in the United States. This surprising development, as well as increasing evidence that the soft patch in U.S. economic data had been temporary and weather-related, brought equity investors racing back to the market in February.

In the months that followed, interest rates trended lower in a modest growth environment and more investors turned to equities in search of yield. Markets remained relatively calm despite rising tensions in Russia and Ukraine and further signs of decelerating growth in China. Strong corporate earnings, increased merger and acquisition activity and signs of a strengthening recovery in the U.S. and other developed economies kept equity prices moving higher. Not all segments benefited from these trends, however, as investors ultimately became wary of high valuations, resulting in a broad rotation into cheaper assets.

Volatility ticked up in the summer as geopolitical tensions escalated and investors feared that better U.S. economic indicators may compel the Fed to increase short-term interest rates sooner than previously anticipated. Global credit markets tightened as the U.S. dollar strengthened, ultimately putting a strain on investor flows, and financial markets broadly weakened in the third quarter.

Several themes dominated the markets in the fourth quarter, resulting in higher levels of volatility and the outperformance of U.S. markets versus other areas of the world. Economic growth strengthened considerably in the United States while the broader global economy showed signs of slowing. The European Central Bank and the Bank of Japan took aggressive measures to stimulate growth while the Fed moved toward tighter policy. This divergence in central bank policy caused further strengthening in the U.S. dollar versus other currencies. Oil prices, which had been falling gradually since the summer, plummeted in the fourth quarter due to a global supply-and-demand imbalance. Energy stocks sold off sharply and oil-exporting economies suffered, resulting in the poor performance of emerging market stocks.

At BlackRock, we believe investors need to think globally, extend their scope across a broad array of asset classes and be prepared to move freely as market conditions change over time. We encourage you to talk with your financial advisor and visit [blackrock.com](http://blackrock.com) for further insight about investing in today's markets.

Sincerely,

**Rob Kapito**

President, BlackRock Advisors, LLC

**Rob Kapito**

President, BlackRock Advisors, LLC

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### Total Returns as of December 31, 2014

	6-month		12-month	
U.S. large cap equities (S&P 500 <sup>®</sup> Index)	6.12	%	13.69	%
U.S. small cap equities (Russell 2000 <sup>®</sup> Index)	1.65		4.89	

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International equities (MSCI Europe, Australasia, Far East Index)	(9.24 )	(4.90 )
Emerging market equities (MSCI Emerging Markets Index)	(7.84 )	(2.19 )
3-month Treasury bill (BofA Merrill Lynch 3-Month U.S. Treasury Bill Index)	0.01	0.03
U.S. Treasury securities (BofA Merrill Lynch 10-Year U.S. Treasury Index)	4.33	10.72
U.S. investment grade bonds (Barclays U.S. Aggregate Bond Index)	1.96	5.97
Tax-exempt municipal bonds (S&P Municipal Bond Index)	3.00	9.25
U.S. high yield bonds (Barclays U.S. Corporate High Yield 2% Issuer Capped Index)	(2.84 )	2.46

Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

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4 THIS PAGE NOT PART OF YOUR FUND REPORT



## Option Over-Writing

In general, the goal of the Fund is to provide shareholders with current income and gains. The Fund seeks to pursue this goal primarily by investing in a portfolio of U.S. Government and U.S. Agency securities and utilizing an option over-writing strategy in an effort to enhance distribution yield and total return performance. However, these objectives cannot be achieved in all market conditions.

The Fund writes call options on individual U.S. Government and U.S. Agency securities or on baskets of such securities or on interest rate swaps (swaptions), and may write call options on other debt securities. When writing (selling) a call option, the Fund grants the counterparty the right to buy an underlying reference security or enter into a defined transaction (e.g., a swap contract, in the case of the swaption) at an agreed-upon price (strike price) within an agreed upon time period. The Fund receives cash premiums from the counterparties upon writing (selling) the option or swaption, which along with net investment income and net realized gains, if any, are generally available to support current or future distributions paid by the Fund. During the option term, the counterparty may elect to exercise the option if the market value of the underlying reference security or underlying contract rises above the strike price, and the Fund is obligated to sell the security or contract to the counterparty at the strike price, realizing a gain or loss. If the option remains unexercised upon its expiration, the Fund realizes gains equal to the premiums received.

Writing call options and swaptions entails certain risks, which include but are not limited to, the following: an increase in the value of the underlying security above the strike price can result in the exercise of a written option (sale by the Fund to the counterparty) when the Fund might not otherwise have sold the security; exercise of the option by the counterparty may result in a sale below the current market value and in a gain or loss realized by the Fund; writing call options and swaptions limits the potential appreciation on the underlying interest rate swap or security and the yield on the Fund could decline; if current market interest rates fall below the strike price, the counterparty could exercise a written swaption when the Fund might not otherwise have entered into an interest rate swap; the Fund is bound by the terms of the underlying interest rate swap agreement upon exercise of the option by the counterparty which can result in a loss to the Fund in excess of the premium received. As such, an option over-writing strategy may outperform the general fixed income market in rising or flat interest rate environments (when bond prices are steady or falling) but underperform in a falling interest rate environment (when bond prices are rising).

The Fund employs a plan to support a level distribution of income, capital gains and/or return of capital. The goal of the plan is to provide shareholders with consistent and predictable cash flows by setting distribution rates based on expected long-term returns of the Fund. Such distributions, under certain circumstances, may exceed the Fund's total return performance. When total distributions exceed total return performance for the period, the difference reduces the Fund's total assets and net asset value per share (NAV) and, therefore, could have the effect of increasing the Fund's expense ratio and/or reducing the amount of assets the Fund has available for long-term investment. In order to make these distributions, the Fund may have to sell portfolio securities at less than opportune times.

The final tax characterization of distributions is determined after the fiscal year and is reported in the Fund's annual report to shareholders. Distributions can be characterized as ordinary income, capital gains and/or return of capital. The Fund's taxable net investment income or net realized capital gains (taxable income) may not be sufficient to support the level of distributions paid. To the extent that distributions exceed the Fund's current and accumulated earnings and profits, the excess may be treated as a non-taxable return of capital. Distributions that exceed the Fund's taxable income but do not exceed the Fund's current and accumulated earnings and profits may be classified as ordinary income, which is taxable to shareholders.

A return of capital distribution does not necessarily reflect the Fund's investment performance and should not be confused with 'yield or 'income. A return of capital is a return of a portion of an investor's original investment. A return of capital is not taxable, but it reduces a shareholder's tax basis in his or her shares, thus reducing any loss or increasing any gain on a subsequent disposition by the shareholder of his or her shares. It is possible that a substantial portion of the distributions paid during a calendar year may ultimately be classified as return of capital for income tax purposes when the final determination of the source and character of the distributions is made.

The Fund intends to write call options to varying degrees depending upon market conditions. Please refer to the Schedule of Investments and the Notes to Financial Statements for details of written swaptions.

### The Benefits and Risks of Leveraging

The Fund may utilize leverage to seek to enhance the yield and NAV of its common shares ( Common Shares ). However, these objectives cannot be achieved in all interest rate environments.

In general, the concept of leveraging is based on the premise that the financing cost of leverage, which is based on short-term interest rates, is normally lower than the income earned by the Fund on its longer-term portfolio investments purchased with the proceeds from leverage. To the extent that the total assets of the Fund (including the assets obtained from leverage) are invested in higher-yielding portfolio investments, the Fund's shareholders benefit from the incremental net income. The interest earned on securities purchased with the proceeds from leverage is paid to shareholders in the form of dividends, and the value of these portfolio holdings is reflected in the per share NAV.

To illustrate these concepts, assume the Fund's capitalization is \$100 million and it utilizes leverage for an additional \$30 million, creating a total value of \$130 million available for investment in longer-term income securities. If prevailing short-term interest rates are 3% and longer-term interest rates are 6%, the yield curve has a strongly positive slope. In this case, the Fund's financing costs on the \$30 million of proceeds obtained from leverage are based on the lower short-term interest rates. At the same time, the securities purchased by the Fund with the proceeds from leverage earn income based on longer-term interest rates. In this case, the Fund's financing cost of leverage is significantly lower than the income earned on the Fund's longer-term investments acquired from such leverage proceeds, and therefore the holders of Common Shares ( Common Shareholders ) are the beneficiaries of the incremental net income.

However, in order to benefit shareholders, the return on assets purchased with leverage proceeds must exceed the ongoing costs associated with the leverage. If interest and other costs of leverage exceed the Fund's return on assets purchased with leverage proceeds, income to shareholders is lower than if the Fund had not used leverage. Furthermore, the value of the Fund's portfolio investments generally varies inversely with the direction of long-term interest rates, although

other factors can influence the value of portfolio investments. In contrast, the value of the Fund's obligations under its leverage arrangement generally does not fluctuate in relation to interest rates. As a result, changes in interest rates can influence the Fund's NAV positively or negatively. Changes in the future direction of interest rates are very difficult to predict accurately, and there is no assurance that the Fund's intended leveraging strategy will be successful.

Leverage also generally causes greater changes in the Fund's NAV, market price and dividend rate than comparable portfolios without leverage. In a declining market, leverage is likely to cause a greater decline in the net asset value and market price of a Fund's shares than if the Fund were not leveraged. In addition, the Fund may be required to sell portfolio securities at inopportune times or at distressed values in order to comply with regulatory requirements applicable to the use of leverage or as required by the terms of leverage instruments, which may cause the Fund to incur losses. The use of leverage may limit the Fund's ability to invest in certain types of securities or use certain types of hedging strategies. The Fund incurs expenses in connection with the use of leverage, all of which are borne by shareholders and may reduce income to the shares.

The Fund may utilize leverage through reverse repurchase agreements as described in the Notes to Financial Statements.

Under the Investment Company Act of 1940, as amended (the 1940 Act ), the Fund is permitted to issue debt up to ~~33~~39% of its total managed assets. The Fund may voluntarily elect to limit its leverage to less than the maximum amount permitted under the 1940 Act.

If the Fund segregates or designates on its books and records cash or liquid assets having values not less than the value of the Fund's obligations under the reverse repurchase agreement (including accrued interest), then such transaction is not considered a senior security and is not subject to the foregoing limitations and requirements under the 1940 Act.

### Derivative Financial Instruments

The Fund may invest in various derivative financial instruments. Derivative financial instruments are used to obtain exposure to a security, index and/or market without owning or taking physical custody of securities or to manage market, equity, credit, interest

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rate, foreign currency exchange rate, commodity and/or other risks. Derivative financial instruments may give rise to a form of economic leverage. Derivative financial instruments also involve risks, including the imperfect correlation between the value of a derivative financial instrument and the underlying asset, possible default of the counterparty to the transaction or illiquidity of the derivative financial

instrument. The Fund's ability to use a derivative financial instrument successfully depends on the investment advisor's ability to predict pertinent market movements accurately, which cannot be assured. The use of derivative financial instruments may result in losses greater than if they had not been used, may limit the amount of appreciation the Fund can realize on an investment and/or may result in lower distributions paid to shareholders. The Fund's investments in these instruments are discussed in detail in the Notes to Financial Statements.

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Fund Summary as of December 31, 2014

## Fund Overview

**BlackRock Enhanced Government Fund, Inc. s (EGF) (the Fund )** investment objective is to provide shareholders with current income and gains. The Fund seeks to achieve its investment objective by investing primarily in a portfolio of U.S. Government securities and U.S. Government Agency securities, including U.S. Government mortgage-backed securities that pay interest in an attempt to generate current income, and by employing a strategy of writing (selling) call options on individual or baskets of U.S. Government securities, U.S. Government Agency securities or other debt securities held by the Fund in an attempt to generate gains from option premiums.

No assurance can be given that the Fund s investment objective will be achieved.

## Portfolio Management Commentary

### How did the Fund perform?

For the 12-month period ended December 31, 2014, the Fund returned 7.08% based on market price and 3.65% based on NAV. For the same period, the BofA Merrill Lynch 1-3 Year U.S. Treasury Index returned 0.62% and the Citigroup Government/Mortgage Index posted a return of 5.32%. All returns reflect reinvestment of dividends. The Fund s discount to NAV, which narrowed during the period, accounts for the difference between performance based on price and performance based on NAV. The following discussion pertains to performance based on NAV.

### What factors influenced performance?

The Fund s performance is reviewed on an absolute basis due to the unique strategy of the Fund, which entails writing call options on individual or baskets of U.S. government securities or interest rates. The index returns listed above are for reference purposes only as these indices do not reflect an option over-writing strategy.

The Fund held an allocation to securitized assets, specifically agency mortgage-backed securities ( MBS ), which consisted of 15-year and 30-year pass-throughs as well as adjustable-rate mortgages ( ARMs ) and collateralized mortgage obligations ( CMOs ). This allocation had a positive impact on Fund performance during 2014, a time that was characterized by benign volatility in U.S. interest rates and low prepayments. The Fund s positions in longer-duration capital securities also added to performance. (Duration is a measure of interest-rate sensitivity). In addition, the Fund s performance was helped by its yield curve positioning.

Conversely, the Fund s duration exposure and allocation to U.S. Treasuries had a negative impact on performance.

The Fund utilized interest rate swaps as a means to manage interest rate risk, duration, spread exposure and yield curve positioning. During the period, the use of swaps was a small contributor to performance. The use of swaps continues to be an efficient interest rate management tool and should be viewed in the context of its overall contribution to risk reduction as well as performance.

As part of its principal investment strategy, the Fund writes covered calls on interest rates to generate income while dampening the level of portfolio volatility. The Fund took advantage of the continued environment of relatively low interest rates by purchasing U.S. Treasury securities and writing call options to generate incremental yield.

### Describe recent portfolio activity.

The Fund tactically adjusted its yield curve positioning throughout the period, while maintaining a flattening bias in

the short end of the yield curve. (A flattening yield curve indicates a falling gap between the yields on short- and long-term bonds). The Fund increased leverage by purchasing Treasuries and writing call options to generate incremental yield.

**Describe portfolio positioning at period end.**

The Fund's option over-writing strategy had the effect of reducing overall portfolio duration. The Fund maintained a high degree of liquidity through a core exposure to government-owned and government-related debt securities, with U.S. Treasuries and agency MBS being the two largest sector allocations. The Fund also maintained limited exposure to a diversified basket of non-government spread sectors, including commercial mortgage-backed securities, asset-backed securities, corporate credit and non-agency residential MBS.

The views expressed reflect the opinions of BlackRock as of the date of this report and are subject to change based on changes in market, economic or other conditions. These views are not intended to be a forecast of future events and are no guarantee of future results.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 7

**Fund Information**

Symbol on New York Stock Exchange ( NYSE )	EGF
Initial Offering Date	October 31, 2005
Current Distribution Rate on Closing Market Price as of December 31, 2014 (\$14.26) <sup>1</sup>	4.63%
Current Monthly Distribution per Common Share <sup>2</sup>	\$0.055
Current Annualized Distribution per Common Share <sup>2</sup>	\$0.660
Economic Leverage as of December 31, 2014 <sup>3</sup>	32%

<sup>1</sup> Current Distribution Rate on closing market price is calculated by dividing the current annualized distribution per share by the closing market price. The current distribution rate consists of income, net realized gains and/or a return of capital. See the Section 19(a) Notice on page 2 for the estimated actual sources and character of distributions. Past performance does not guarantee future results.

<sup>2</sup> The distribution rate is not constant and is subject to change. A portion of the distribution may be deemed a return of capital or net realized gain.

<sup>3</sup> Represents reverse repurchase agreements as a percentage of total managed assets, which is the total assets of the Fund, including any assets attributable to reverse repurchase agreements, minus the sum of liabilities (other than borrowings representing financial leverage). For a discussion of leveraging techniques utilized by the Fund, please see The Benefits and Risks of Leveraging on page 6.

**Market Price and Net Asset Value Per Share Summary**

	12/31/14	12/31/13	Change	High	Low
Market Price	\$14.26	\$13.95	2.22%	\$14.50	\$13.75
Net Asset Value	\$14.97	\$15.13	(1.06)%	\$15.27	\$14.95

**Market Price and Net Asset Value History For the Past Five Years****Overview of the Fund's Long-Term Investments**

Portfolio Composition	12/31/14	12/31/13
U.S. Government Sponsored Agency Securities	53%	58%
U.S. Treasury Obligations	41	35
Preferred Securities	2	2
Asset-Backed Securities	2	2
Corporate Bonds	1	2
Non-Agency Mortgage-Backed Securities	1	1

Credit Quality Allocation <sup>4</sup>	12/31/14	12/31/13
AAA/Aaa <sup>5</sup>	94%	95%
AA/Aa		1
BBB/Baa	2	3
BB/Ba	4	1

<sup>4</sup> For financial reporting purposes, credit quality ratings shown above reflect the highest rating assigned by either Standard & Poor's ( S&P ) or Moody's Investors Service ( Moody's ) if ratings differ. These rating agencies are independent, nationally recognized statistical rating organizations and are widely used.

Investment grade ratings are credit ratings of BBB/Baa or higher. Below investment grade ratings are credit ratings of BB/Ba or lower. Investments designated N/R are not rated by either rating agency. Unrated investments do not necessarily indicate low credit quality. Credit quality ratings are subject to change.

- <sup>5</sup> The investment advisor evaluates the credit quality of not-rated investments based upon certain factors including, but not limited to, credit ratings for similar investments and financial analysis of sectors, individual investments and/or issuer. Using this approach, the investment advisor has deemed U.S. Government Sponsored Agency Securities and U.S. Treasury Obligations as AAA/Aaa.

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Schedule of Investments December 31, 2014

(Percentages shown are based on Net Assets)

	Par (000)	Value
<b>Asset-Backed Securities</b>		
First Franklin Mortgage Loan Trust, Series 2005-FF2, Class M2, 0.83%, 3/25/35 (a)	\$ 642	\$ 641,799
Securitized Asset Backed Receivables LLC Trust (a):		
Series 2005-OP1, Class M2, 0.84%, 1/25/35	1,417	1,333,444
Series 2005-OP2, Class M1, 0.60%, 10/25/35	1,025	895,650
<b>Total Asset-Backed Securities 2.4%</b>		2,870,893
<b>Corporate Bonds</b>		
<b>Diversified Telecommunication Services 1.8%</b>		
Verizon Communications, Inc., 2.50%, 9/15/16	2,057	2,102,614
<b>Non-Agency Mortgage-Backed Securities</b>		
<b>Collateralized Mortgage Obligations 1.1%</b>		
Bank of America Mortgage Securities, Inc., Series 2003-J, Class 2A1, 2.78%, 11/25/33 (a)	155	154,802
Bear Stearns Alt-A Trust, Series 2004-13, Class A1, 0.91%, 11/25/34 (a)	217	215,428
Homebanc Mortgage Trust, Series 2005-4, Class A1, 0.44%, 10/25/35 (a)	1,158	1,027,292 1,397,522
<b>Interest Only Collateralized Mortgage Obligations 0.1%</b>		
CitiMortgage Alternative Loan Trust, Series 2007-A5, Class 1A7, 6.00%, 5/25/37	303	80,518
<b>Total Non-Agency Mortgage-Backed Securities 1.2%</b>		1,478,040
<b>U.S. Government Sponsored Agency Securities</b>		
<b>Agency Obligations 3.3%</b>		
Federal Farm Credit Bank, 4.55%, 6/08/20	3,500	3,943,859
<b>Collateralized Mortgage Obligations 7.9%</b>		
Fannie Mae Mortgage-Backed Securities, Series 2014-28, Class BD, 3.50%, 8/25/43	1,866	1,962,168
Ginnie Mae Mortgage-Backed Securities, Series 2006-3, Class C, 5.24%, 4/16/39 (a)	7,390	7,550,405 9,512,573
<b>Interest Only Collateralized Mortgage Obligations 2.2%</b>		
Fannie Mae Mortgage-Backed Securities:		
Series 2012-96, Class DI, 4.00%, 2/25/27	2,472	247,725
Series 2012-M9, Class X1, 4.04%, 12/25/17 (a)	5,285	497,933
Series 2012-47, Class NI, 4.50%, 4/25/42	2,043	294,458
Ginnie Mae Mortgage-Backed Securities (a):		
Series 2006-30, Class IO, 1.03%, 5/16/46	1,003	65,942
Series 2009-78, Class SD, 6.03%, 9/20/32	2,117	377,859
<b>U.S. Government Sponsored Agency Securities</b>	<b>Par (000)</b>	<b>Value</b>



**Interest Only Collateralized Mortgage Obligations (concluded)**

## Ginnie Mae Mortgage-Backed Securities (a) (concluded):

Series 2009-116, Class KS, 6.31%, 12/16/39	\$ 795	\$ 107,063
Series 2011-52, Class NS, 6.51%, 4/16/41	5,621	1,000,075
		2,591,055

**Mortgage-Backed Securities 64.7%**

## Fannie Mae Mortgage-Backed Securities:

2.50%, 4/01/28	7,656	7,811,024
3.00%, 6/01/42 4/01/43	8,188	8,297,314
3.50%, 8/01/26 8/01/44	16,847	17,716,505
4.00%, 4/01/24 2/01/41	16,152	17,270,096
4.50%, 4/01/39 8/01/40	10,778	11,795,668
5.00%, 11/01/33 2/01/40	6,231	6,925,224
5.50%, 10/01/23 1/01/45 (b)	5,626	6,316,802
6.00%, 2/01/36 3/01/38	1,113	1,264,951
Freddie Mac Mortgage-Backed Securities, 4.50%, 5/01/34	271	293,996
Ginnie Mae Mortgage-Backed Securities, 5.00%, 11/15/35	10	11,026
		77,702,606
<b>Total U.S. Government Sponsored Agency Securities 78.1%</b>		<b>93,750,093</b>

**U.S. Treasury Obligations**

## U.S. Treasury Bonds:

6.63%, 2/15/27	2,000	2,916,876
5.38%, 2/15/31	2,000	2,787,656
3.88%, 8/15/40 (c)	12,000	14,649,372
4.38%, 5/15/41 (c)	10,000	13,264,060
3.75%, 8/15/41 (c)	10,000	12,052,340
3.38%, 5/15/44 (c)	3,000	3,377,343

## U.S. Treasury Notes:

0.50%, 7/31/17	1,600	1,581,875
1.38%, 6/30/18	3,000	3,005,859
1.63%, 4/30/19 (c)	5,000	5,017,190
3.13%, 5/15/21 (c)	10,000	10,731,250
1.75%, 5/15/22 (c)	2,000	1,966,094

**Total U.S. Treasury Obligations 59.4%**

71,349,915

**Preferred Securities****Capital Trusts****Diversified Financial Services 0.4%**

ZFS Finance (USA) Trust V, 6.50%, 5/09/67 (a)(d)	504	536,760
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**Electric Utilities 1.7%**

PPL Capital Funding, Inc., 6.70%, 3/30/67 (a)	2,000	1,995,000
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**Total Capital Trusts 2.1%**

2,531,760

**Portfolio Abbreviations**

**LIBOR** London Interbank Offered Rate

**OTC** Over-the-Counter

**TBA** To Be Announced

See Notes to Financial Statements.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014

Schedule of Investments (continued)

(Percentages shown are based on Net Assets)

	Shares	Value
<b>Trust Preferred 1.7%</b>		
<b>Capital Markets 1.7%</b>		
Morgan Stanley Capital Trust VIII, 6.45%, 4/15/67	80,000	\$ 1,988,587
<b>Total Preferred Securities 3.8%</b>		4,520,347
<b>Total Long-Term Investments</b>		
<b>(Cost \$166,653,538) 146.7%</b>		176,071,902
<hr/>		
<b>Short-Term Securities</b>		
BlackRock Liquidity Funds, TempFund, Institutional Class, 0.04% (e)(f)	1,848,337	1,848,337
<b>Total Short-Term Securities</b>		
<b>(Cost \$1,848,337) 1.5%</b>		1,848,337
<b>Total Investments Before TBA Sale</b>		
<b>Commitments and Options Written</b>		
<b>(Cost \$168,501,875) 148.2%</b>		177,920,239
<b>TBA Sale Commitments</b>	<b>Par (000)</b>	<b>Value</b>
Fannie Mae Mortgage-Backed Securities, 5.50%, 1/01/45 (b)	\$5,300	\$ (5,928,547)
<b>Total TBA Sale Commitments</b>		
<b>(Proceeds \$5,925,719) (4.9)%</b>		(5,928,547)
<b>Options Written</b>		
<b>(Premiums Received \$400,000) (0.4)%</b>		(422,617)
<b>Total Investments, Net of TBA Sale Commitments and Options</b>		
<b>Written</b>		
<b>(Cost \$162,176,156) 142.9%</b>		171,569,075
<b>Liabilities in Excess of Other Assets (42.9)%</b>		(51,522,931)
<b>Net Assets 100.0%</b>		\$120,046,144

## Notes to Schedule of Investments

- (a) Variable rate security. Rate shown is as of report date.  
(b) Represents or includes a TBA transaction. As of December 31, 2014, unsettled TBA transactions were as follows:

Counterparty	Value	Unrealized Depreciation
Credit Suisse Securities (USA) LLC	\$(2,349,047)	\$(1,313)
Goldman Sachs & Co.	\$(3,467,641)	\$(1,500)

- (c) All or a portion of security has been pledged as collateral in connection with outstanding reverse

repurchase agreements.

- (d) Security exempt from registration pursuant to Rule 144A under the Securities Act of 1933, as amended. These securities may be resold in transactions exempt from registration to qualified institutional investors.
- (e) As of December 31, 2014, investments in issuers considered to be an affiliate of the Fund for purposes of Section 2(a)(3) of the 1940 Act, as amended, were as follows:

<b>Affiliate</b>	<b>Shares Held at December 31, 2013</b>	<b>Net Activity</b>	<b>Shares Held at December 31, 2014</b>	<b>Income</b>
BlackRock Liquidity Funds, TempFund, Institutional Class	3,984,792	(2,136,455)	1,848,337	\$ 1,891
(f)	Represents the current yield as of report date.			
	As of December 31, 2014, reverse repurchase agreements outstanding were as follows:			

<b>Counterparty</b>	<b>Interest Rate</b>	<b>Trade Date</b>	<b>Maturity Date<sup>1</sup></b>	<b>Face Value</b>	<b>Face Value Including Accrued Interest</b>
Merrill Lynch, Pierce, Fenner & Smith, Inc.	0.11%	10/28/14	Open	\$10,895,000	\$10,897,131
Merrill Lynch, Pierce, Fenner & Smith, Inc.	0.11%	10/28/14	Open	1,975,000	1,975,386
Credit Suisse Securities (USA) LLC	0.16%	12/10/14	Open	9,143,750	9,144,700
Credit Suisse Securities (USA) LLC	0.16%	12/10/14	Open	5,037,500	5,038,023
Credit Suisse Securities (USA) LLC	0.09%	12/18/14	Open	12,166,000	12,166,703
Credit Suisse Securities (USA) LLC	0.16%	12/18/14	Open	13,804,000	13,804,947
BNP Paribas Securities Corp.	0.14%	12/19/14	Open	3,371,250	3,371,493
Credit Suisse Securities (USA) LLC	0.16%	12/22/14	Open	1,060,000	1,060,053
<b>Total</b>				<b>\$57,452,500</b>	<b>\$57,458,436</b>

<sup>1</sup>Certain agreements have no stated maturity and can be terminated by either party at any time.

See Notes to Financial Statements.

10BLACKROCK ENHANCED GOVERNMENT FUND, INC.DECEMBER 31, 2014

## Schedule of Investments (continued)

As of December 31, 2014, OTC interest rate swaptions written were as follows:

Description	Counterparty	Put/Call	Exercise Rate	Pay/Receive	Floating Index	Expiration Date	Notional Amount (000)	Market Value
2-Year Interest Rate Swap	Barclays Bank PLC	Call	0.89%	Pay	3-Month Libor	1/28/15	\$37,500	\$(29,817)
5-Year Interest Rate Swap	Barclays Bank PLC	Call	1.77%	Pay	3-Month Libor	1/28/15	\$37,500	\$(111,505)
10-Year Interest Rate Swap	Barclays Bank PLC	Call	2.27%	Pay	3-Month Libor	1/28/15	\$22,500	\$(127,324)
30-Year Interest Rate Swap	Barclays Bank PLC	Call	2.69%	Pay	3-Month Libor	1/28/15	\$1,300	\$(153,971)
<b>Total</b>								<b>\$(422,617)</b>

As of December 31, 2014, centrally cleared interest rate swaps outstanding were as follows:

Fixed Rate	Floating Rate	Clearinghouse	Expiration Date	Notional Amount (000)	Unrealized Depreciation
2.29% <sup>1</sup>	3-Month LIBOR	Chicago Mercantile	5/30/23	\$880	\$(8,102)

As of December 31, 2014, OTC interest rate swaps outstanding were as follows:

Fixed Rate	Floating Rate	Counterparty	Expiration Date	Notional Amount (000)	Market Value	Premiums Paid/Received	Unrealized Depreciation
5.96% <sup>1</sup>	3-Month LIBOR	Deutsche Bank AG	12/27/37	\$23,900	\$(14,172,809)		\$(14,172,809)

<sup>1</sup> Fund pays a fixed rate and receives floating rate.

**Fair Value Measurements** Various inputs are used in determining the fair value of investments and derivative financial instruments. These inputs to valuation techniques are categorized into a disclosure hierarchy consisting of three broad levels for financial statement purposes. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3. The inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the fair value hierarchy classification is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The categorization of a value determined for investments and derivative financial instruments is based on the pricing transparency of the investment and derivative financial instrument and is not necessarily an indication of the risks associated with investing in those securities. The three levels of the fair value hierarchy are as follows:

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Level 1 unadjusted quoted prices in active markets/exchanges for identical assets or liabilities that the Fund has the ability to access

Level 2 other observable inputs (including, but not limited to, quoted prices for similar assets or liabilities in markets that are active, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the assets or liabilities (such as interest rates, yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates) or other market-corroborated inputs)

Level 3 unobservable inputs based on the best information available in the circumstances, to the extent observable inputs are not available (including the Fund's own assumptions used in determining the fair value of investments and derivative financial instruments)

Changes in valuation techniques may result in transfers into or out of an assigned level within the disclosure hierarchy. In accordance with the Fund's policy, transfers between different levels of the fair value disclosure hierarchy are deemed to have occurred as of the beginning of the reporting period. For information about the Fund's policy regarding valuation of investments and derivative financial instruments, refer to Note 2 of the Notes to Financial Statements.

As of December 31, 2014, the following tables summarize the Fund's investments and derivative financial instruments categorized in the disclosure hierarchy:

	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investments:				
Long-Term Investments:				
Asset-Backed Securities		\$ 2,870,893		\$ 2,870,893
Corporate Bonds		2,102,614		2,102,614
Non-Agency Mortgage-Backed Securities		1,478,040		1,478,040
U.S. Government Sponsored Agency Securities		93,750,093		93,750,093
U.S. Treasury Obligations		71,349,915		71,349,915
Preferred Securities	\$ 1,988,587	2,531,760		4,520,347
Short-Term Securities	1,848,337			1,848,337
<b>Liabilities:</b>				
Investments:				
TBA Sale Commitments		(5,928,547)		(5,928,547)
<b>Total</b>	<b>\$ 3,836,924</b>	<b>\$ 168,154,768</b>		<b>\$ 171,991,692</b>

See Notes to Financial Statements.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 11

## Schedule of Investments (concluded)

	Level 1	Level 2	Level 3	Total
Derivative Financial Instruments <sup>1</sup>				
<b>Liabilities:</b>				
Interest rate contracts		\$(14,603,528)		\$(14,603,528)

<sup>1</sup> Derivative financial instruments are swaps and options written. Swaps are valued at the unrealized appreciation/depreciation on the instrument and options written are shown at value.

The Fund may hold assets and/or liabilities in which the fair value approximates the carrying amount for financial statement purposes. As of December 31, 2014, such assets and/or liabilities are categorized within the disclosure hierarchy as follows:

	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Cash pledged for centrally cleared swaps	\$ 35,000			\$ 35,000
Cash pledged as collateral for OTC derivatives	15,040,000			15,040,000
Foreign currency at value	316			316
<b>Liabilities:</b>				
Cash received as collateral for reverse repurchase agreements		\$ (1,047,000)		(1,047,000)
Reverse repurchase agreements		(57,458,436)		(57,458,436)
<b>Total</b>	<b>\$ 15,075,316</b>	<b>\$(58,505,436)</b>		<b>\$(43,430,120)</b>

During the year ended December 31, 2014, there were no transfers between levels.

See Notes to Financial Statements.

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## Statement of Assets and Liabilities

**December 31, 2014****Assets**

Investments at value unaffiliated (cost \$166,653,538)	\$176,071,902
Investments at value affiliated (cost \$1,848,337)	1,848,337
Cash pledged as collateral for OTC derivatives	15,040,000
Cash pledged for centrally cleared swaps	35,000
TBA sale commitments receivable	5,925,719
Interest receivable	1,184,080
Options written receivable	400,000
Swaps receivable	4,522
Foreign currency at value (cost \$345)	316
Prepaid expenses	4,507
<b>Total assets</b>	<b>200,514,383</b>

**Liabilities**

Reverse repurchase agreements	57,458,436
Unrealized depreciation on OTC swaps	14,172,809
TBA sale commitments at value (proceeds \$5,925,719)	5,928,547
Cash received as collateral for reverse repurchase agreements	1,047,000
Options written payable	646,000
Options written at value (premiums received \$400,000)	422,617
Income dividends payable	441,031
Investments purchased payable	112,042
Investment advisory fees payable	98,480
Variation margin payable for centrally cleared swaps	20,034
Swaps payable	15,876
Officers and Directors fees payable	3,789
Other accrued expenses payable	101,578
<b>Total liabilities</b>	<b>80,468,239</b>
<b>Net Assets</b>	<b>\$120,046,144</b>

**Net Assets Consist of**

Paid-in capital	\$135,883,196
Distributions in excess of net investment income	(441,031)
Accumulated net realized loss	(10,608,000)
Net unrealized appreciation/depreciation	(4,788,021)
<b>Net Assets</b>	<b>\$120,046,144</b>

**Net Asset Value**

Based on net assets of \$120,046,144 and 8,018,739, shares outstanding, 200 million shares authorized, \$0.10 par value	\$ 14.97
See Notes to Financial Statements.	

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 13



## Statement of Operations

**Year Ended December 31, 2014****Investment Income**

Interest	\$ 5,905,153
Income affiliated	1,891
Total income	5,907,044

**Expenses**

Investment advisory	1,619,689
Transfer agent	53,625
Professional	53,577
Accounting services	25,778
Repurchase offer	20,453
Custodian	17,949
Officer and Directors	11,820
Printing	10,275
Registration	9,329
Miscellaneous	31,738
Total expenses excluding interest expense	1,854,233
Interest expense	55,593
Total expenses	1,909,826
Less fees waived by Manager	(302,345)
Less fees paid indirectly	(127)
Total expenses after fees waived and paid indirectly	1,607,354
Net investment income	4,299,690

**Realized and Unrealized Gain (Loss)**

Net realized gain (loss) from:	
Investments	(82,303)
Financial futures contracts	(245,499)
Foreign currency transactions	(711)
Options written	(2,605,984)
Swaps	(1,419,351)
	(4,353,848)
Net change in unrealized appreciation/depreciation on:	
Investments	10,418,715
Financial futures contracts	4,534
Foreign currency translations	361
Options written	(149,495)
Swaps	(6,112,415)
	4,161,700
Net realized and unrealized loss	(192,148)
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$ 4,107,542</b>

See Notes to Financial Statements.



## Statements of Changes in Net Assets

	<b>Year Ended December 31,</b>	
<b>Increase (Decrease) in Net Assets:</b>	<b>2014</b>	<b>2013</b>
<b>Operations</b>		
Net investment income	\$ 4,299,690	\$ 4,571,883
Net realized loss	(4,353,848)	(408,613)
Net change in unrealized appreciation/depreciation	4,161,700	(6,610,592)
Net increase (decrease) in net assets resulting from operations	4,107,542	(2,447,322)
<b>Distributions to Shareholders From<sup>1</sup></b>		
Net investment income	(3,160,205)	(3,578,331)
Return of capital	(2,622,197)	(3,836,527)
Decrease in net assets resulting from distributions to shareholders	(5,782,402)	(7,414,858)
<b>Capital Share Transactions</b>		
Redemption of shares resulting from a repurchase offer <sup>2</sup>	(13,106,004)	(14,775,653)
<b>Net Assets</b>		
Total decrease in net assets	(14,780,864)	(24,637,833)
Beginning of year	134,827,008	159,464,841
End of year	\$ 120,046,144	\$ 134,827,008
Distributions in excess of net investment income, end of year	\$ (441,031)	\$ (490,034)

<sup>1</sup>Distributions for annual periods determined in accordance with federal income tax regulations.

<sup>2</sup>Net of repurchase fees of \$267,469 and \$301,544, respectively.

See Notes to Financial Statements.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 15

## Statement of Cash Flows

**Year Ended December 31, 2014****Cash Provided by Operating Activities**

Net increase in net assets resulting from operations	\$ 4,107,542
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities:	
Increase in interest receivable	(160,063)
Increase in swaps receivable	(3,543)
Decrease in prepaid expenses	1,125
Decrease in variation margin receivable on centrally cleared swaps	2,897
Decrease in cash pledged for financial futures contracts	4,000
Increase in cash pledged as collateral for OTC derivatives	(7,050,000)
Decrease in cash pledged as collateral for reverse repurchase agreements	1,075,000
Decrease in investment advisory fees payable	(20,413)
Decrease in interest expense payable	(10,902)
Increase in other accrued expenses payable	2,546
Decrease in swaps payable	(7,855)
Decrease in variation margin payable on financial futures contracts	(344)
Increase in variation margin payable on centrally cleared swaps	20,034
Increase in cash received as collateral for reverse repurchase agreements	1,047,000
Decrease in Officers and Directors fees payable	(774)
Net realized loss on investments and options written	2,813,704
Net unrealized gain on investments, options written and swaps	(4,217,415)
Amortization of premium and accretion of discount on investments	1,410,498
Premiums received from options written	5,408,916
Proceeds from sales and principal paydowns of long-term investments	166,700,382
Purchases of long-term investments	(152,280,659)
Net proceeds from sales of short-term securities	2,136,455
Premiums paid on closing options written	(7,368,900)
Cash provided by operating activities	13,609,231

**Cash Used for Financing Activities**

Cash dividends paid to Common Shareholders	(5,831,405)
Net borrowing of reverse repurchase agreements	5,327,375
Payment on redemption of capital shares	(13,106,004)
Cash used for financing activities	(13,610,034)

**Cash Impact from Foreign Exchange Fluctuations**

Cash impact from foreign exchange fluctuations	(52)
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**Cash and Foreign Currency**

Net decrease in cash and foreign currency	(855)
Cash and foreign currency at beginning of period	1,171
Cash and foreign currency at end of period	\$ 316

**Supplemental Disclosure of Cash Flow Information**

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Cash paid during the period for interest	\$	66,495
See Notes to Financial Statements.		

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## Financial Highlights

## Year Ended December 31,

	2014	2013	2012	2011	2010
<b>Per Share Operating Performance</b>					
Net asset value, beginning of year	\$ 15.13	\$ 16.11	\$ 16.25	\$ 16.40	\$ 16.59
Net investment income <sup>1</sup>	0.49	0.47	0.67	0.70	0.64
Net realized and unrealized gain (loss) <sup>2</sup>	0.01	(0.69)	0.02	0.07	0.16
Net increase (decrease) from investment operations	0.50	(0.22)	0.69	0.77	0.80
Distributions from: <sup>3</sup>					
Net investment income	(0.36)	(0.37)	(0.55)	(0.39)	(0.80)
Net realized gain	(0.30)	(0.39)	(0.28)	(0.53)	(0.19)
Total distributions	(0.66)	(0.76)	(0.83)	(0.92)	(0.99)
Net asset value, end of year	\$ 14.97	\$ 15.13	\$ 16.11	\$ 16.25	\$ 16.40
Market price, end of year	\$ 14.26	\$ 13.95	\$ 15.63	\$ 15.25	\$ 15.51
<b>Total Return<sup>4</sup></b>					
Based on net asset value	3.65%	(1.06)%	4.59%	5.15%	4.95%
Based on market price	7.08%	(5.98)%	8.13%	4.34%	(3.54)%
<b>Ratio to Average Net Assets</b>					
Total expenses	1.43%	1.32%	1.43%	1.39%	1.22%
Total expenses after fees waived and paid indirectly	1.20%	1.25%	1.42%	1.39%	1.22%
Total expenses after fees waived and paid indirectly and excluding interest expense	1.16%	1.20%	1.35%	1.35%	1.18%
Net investment income	3.22%	2.98%	4.15%	4.32%	3.87%
<b>Supplemental Data</b>					
	\$ 120,046	\$ 134,827	\$ 159,465	\$ 178,765	\$ 189,918

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Net assets, end of year (000)					
Borrowings outstanding, end of year (000)	\$ 57,458	\$ 52,142	\$ 66,410	\$ 90,460	\$ 75,230
Asset coverage, end of year \$1,000	\$ 3,089	\$ 3,586	\$ 3,401	\$ 2,976	\$ 3,525
Portfolio turnover rate <sup>5</sup>	86%	111%	142%	115%	163%

<sup>1</sup>Based on average shares outstanding.

<sup>2</sup>Net realized and unrealized gain (loss) per share amounts include repurchase fees of \$0.03, \$0.03, \$0.03, \$0.02, and \$0.00 for the years ended December 31, 2014 through December 31, 2010, respectively.

<sup>3</sup>Distributions for annual periods determined in accordance with federal income tax regulations.

Total returns based on market price, which can be significantly greater or less than the net asset value, may result in substantially different returns. Where applicable, excludes the effects of any sales charges and assumes the reinvestment of distributions.

<sup>5</sup>Includes mortgage dollar roll transactions. Additional information regarding portfolio turnover is as follows:

Portfolio turnover (excluding mortgage dollar roll transactions)	42%	57%	83%	98%	137%
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See Notes to Financial Statements.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 17

## Notes to Financial Statements

### 1. Organization:

BlackRock Enhanced Government Fund, Inc. (the Fund) is registered under the 1940 Act, as a diversified, closed-end management investment company. The Fund is organized as a Maryland corporation. The Fund determines and makes available for publication its NAV on a daily basis.

### 2. Significant Accounting Policies:

The Fund's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America ( U.S. GAAP ), which may require management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates. The Fund is considered an investment company under U.S. GAAP and follows the accounting and reporting guidance applicable to investment companies. The following is a summary of significant accounting policies followed by the Fund:

**Valuation:** The Fund's investments are valued at fair value as of the close of trading on the New York Stock Exchange ( NYSE ) (generally 4:00 p.m., Eastern time). U.S. GAAP defines fair value as the price the Fund would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. The Fund determines the fair values of its financial instruments at market value using independent dealers or pricing services under policies approved by the Board of Directors of the Fund (the Board ). The BlackRock Global Valuation Methodologies Committee (the Global Valuation Committee ) is the committee formed by management to develop global pricing policies and procedures and to provide oversight of the pricing function for the Fund for all financial instruments.

Bond investments are valued on the basis of last available bid prices or current market quotations provided by dealers or pricing services. In determining the value of a particular investment, pricing services may use certain information with respect to transactions in such investments, quotations from dealers, pricing matrixes, market transactions in comparable investments, various relationships observed in the market between investments and calculated yield measures. Asset-backed and mortgage-backed securities are valued by independent pricing services using models that consider estimated cash flows of each tranche of the security, establish a benchmark yield and develop an estimated tranche-specific spread to the benchmark yield based on the unique attributes of the tranche. Financial futures contracts traded on exchanges are valued at their last sale price. To-be-announced ( TBA ) commitments are valued on the basis of last available bid prices or current market quotations provided by pricing services. Swap agreements are valued utilizing quotes received daily by the Fund's pricing service or through brokers, which are derived using daily swap curves and models that incorporate a number of market data factors, such as discounted cash flows, trades and values of the underlying reference instruments. Certain centrally cleared swaps are valued at the price determined by the relevant exchange or clearinghouse. Investments in open-end registered investment companies are valued at NAV each business day.

Securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollars using exchange rates determined as of the close of business on the NYSE. Forward foreign currency exchange contracts are valued at the mean between the bid and ask prices and are determined as of the close of business on the NYSE. Interpolated values are derived when the settlement date of the contract is an interim date for which quotations are not available.

Exchange-traded options are valued at the mean between the last bid and ask prices at the close of the options market in which the options trade. An exchange-traded option for which there is no mean price is valued at the last bid (long positions) or ask (short positions) price. If no bid or ask price is available, the prior day's price will be used, unless it is determined that the prior day's price no longer reflects the fair value of the option. Over-the-counter ( OTC ) options and options on swaps ( swaptions ) are valued by an independent pricing service using a mathematical model, which incorporates a number of market data factors, such as the trades and prices of the underlying instruments.

In the event that the application of these methods of valuation results in a price for an investment that is deemed not to be representative of the market value of such investment, or if a price is not available, the investment will be valued by the Global Valuation Committee, or its delegate, in accordance with a policy approved by the Board as reflecting fair value ( Fair Value Investments ). When determining the price for Fair Value Investments, the Global Valuation Committee, or its delegate, seeks to determine the price that the Fund might reasonably expect to receive or pay from the current sale or purchase of that asset or liability in an arm's-length transaction. Fair value determinations shall be based upon all available factors that the Global Valuation Committee, or its delegate, deems relevant consistent with the principles of fair value measurement. The pricing of all Fair Value Investments is subsequently reported to the Board or a committee thereof on a quarterly basis.





Notes to Financial Statements (continued)

Generally, trading in foreign instruments is substantially completed each day at various times prior to the close of business on the NYSE. Occasionally, events affecting the values of such instruments may occur between the foreign market close and the close of business on the NYSE that may not be reflected in the computation of the Fund's net assets. If events (e.g., a company announcement, market volatility or a natural disaster) occur during such periods that are expected to materially affect the value of such instruments, those instruments may be Fair Value Investments and be valued at their fair value, as determined in good faith by the Global Valuation Committee, or its delegate, using a pricing service and/or policies approved by the Board.

**Foreign Currency:** The Fund's books and records are maintained in U.S. dollars. Purchases and sales of investment securities are recorded at the rates of exchange prevailing on the respective date of such transactions. Generally, when the U.S. dollar rises in value against a foreign currency, the Fund's investments denominated in that currency will lose value because that currency is worth fewer U.S. dollars; the opposite effect occurs if the U.S. dollar falls in relative value.

The Fund does not isolate the portion of the results of operations arising as a result of changes in the foreign exchange rates from the changes in the market prices of investments held or sold for financial reporting purposes. Accordingly, the effects of changes in foreign currency exchange rates on investments are not segregated in the Statement of Operations from the effects of changes in market prices of those investments but are included as a component of net realized and unrealized gain (loss) from investments. The Fund reports realized currency gains (losses) on foreign currency related transactions as components of net realized gain (loss) for financial reporting purposes, whereas such components may be treated as ordinary income for federal income tax purposes.

**Segregation and Collateralization:** In cases where the Fund enters into certain investments (e.g., dollar rolls, TBA sale commitments, financial futures contracts, options written and swaps) or certain borrowings (e.g., reverse repurchase transactions) that would be senior securities for 1940 Act purposes, the Fund may segregate or designate on its books and records cash or liquid securities having a market value at least equal to the amount of the Fund's future obligations under such investments or borrowings. Doing so allows the investment or borrowing to be excluded from treatment as a senior security. Furthermore, if required by an exchange or counterparty agreement, the Fund may be required to deliver/deposit cash and/or securities to/with an exchange, or broker-dealer or custodian as collateral for certain investments or obligations.

**Investment Transactions and Investment Income:** For financial reporting purposes, investment transactions are recorded on the dates the transactions are entered into (the trade dates). Realized gains and losses on investment transactions are determined on the identified cost basis. Interest income, including amortization and accretion of premiums and discounts on debt securities, is recognized on the accrual basis.

**Distributions:** Distributions paid by the Fund are recorded on the ex-dividend date. Subject to the Fund's level distribution plan, the Fund intends to make monthly cash distributions to shareholders, which may consist of net investment income, net options premium and net realized and unrealized gains on investments and/or return of capital.

Portions of return of capital distributions under U.S. GAAP may be taxed at ordinary income rates.

The character of distributions is determined in accordance with federal income tax regulations, which may differ from U.S. GAAP. The portion of distributions that exceeds the Fund's current and accumulated earnings and profits, which are measured on a tax basis, will constitute a non-taxable return of capital. Realized net capital gains can be offset by capital losses carried forward from prior years. However, the Fund has capital loss carryforwards from pre-2011 tax years that offset realized net capital gains but do not offset current and accumulated earnings and profits. Consequently, if distributions in any tax year are less than the Fund's current earnings and profits but greater than net investment income and net realized capital gains (taxable income), distributions in excess of taxable income are not treated as non-taxable return of capital, but rather may be taxable to shareholders at ordinary income rates. Under certain circumstances, taxable excess distributions could be significant. See Note 7, Income Tax Information, for the tax character of the Fund's distributions paid during the year.

**Deferred Compensation Plan:** Under the Deferred Compensation Plan (the Plan) approved by the Fund's Board, the independent Directors (Independent Directors) may defer a portion of their annual complex-wide compensation. Deferred amounts earn an approximate return as though equivalent dollar amounts had been invested in common shares of certain other BlackRock Closed-End Funds selected by the Independent Directors. This has the same economic effect for the Independent Directors as if the Independent Directors had invested the deferred amounts directly in certain other BlackRock Closed-End Funds.



Notes to Financial Statements (continued)

The Plan is not funded and obligations thereunder represent general unsecured claims against the general assets of the Fund. Deferred compensation liabilities are included in officer's and directors' fees payable in the Statement of Assets and Liabilities and will remain as a liability of the Fund until such amounts are distributed in accordance with the Plan.

**Recent Accounting Standard:** In June 2014, the Financial Accounting Standards Board issued guidance to improve the financial reporting of reverse repurchase agreements and other similar transactions. The guidance will require expanded disclosure for entities that enter into reverse repurchase agreements and similar transactions accounted for as secured borrowings. It is effective for financial statements with fiscal years beginning on or after December 15, 2014 and interim periods within those fiscal years. Management is evaluating the impact, if any, of this guidance on the Fund's financial statement disclosures.

**Other:** Expenses directly related to the Fund are charged to the Fund. Other operating expenses shared by several funds are prorated among those funds on the basis of relative net assets or other appropriate methods.

The Fund has an arrangement with the custodian whereby fees may be reduced by credits earned on uninvested cash balances, which, if applicable, are shown as fees paid indirectly in the Statement of Operations. The custodian imposes fees on overdrawn cash balances, which can be offset by accumulated credits earned or may result in additional custody charges.

### 3. Securities and Other Investments:

**Asset-Backed and Mortgage-Backed Securities:** The Fund may invest in asset-backed securities. Asset-backed securities are generally issued as pass-through certificates, which represent undivided fractional ownership interests in an underlying pool of assets, or as debt instruments, which are also known as collateralized obligations, and are generally issued as the debt of a special purpose entity organized solely for the purpose of owning such assets and issuing such debt. Asset-backed securities are often backed by a pool of assets representing the obligations of a number of different parties. The yield characteristics of certain asset-backed securities may differ from traditional debt securities. One such major difference is that all or a principal part of the obligations may be prepaid at any time because the underlying assets (i.e., loans) may be prepaid at any time. As a result, a decrease in interest rates in the market may result in increases in the level of prepayments as borrowers, particularly mortgagors, refinance and repay their loans. An increased prepayment rate with respect to an asset-backed security subject to such a prepayment feature will have the effect of shortening the maturity of the security. In addition, the Fund may subsequently have to reinvest the proceeds at lower interest rates. If the Fund has purchased such an asset-backed security at a premium, a faster than anticipated prepayment rate could result in a loss of principal to the extent of the premium paid.

The Fund may purchase certain mortgage pass-through securities. There are a number of important differences among the agencies and instrumentalities of the U.S. government that issue mortgage-related securities and among the securities that they issue. For example, mortgage-related securities guaranteed by Ginnie Mae are guaranteed as to the timely payment of principal and interest by Ginnie Mae and such guarantee is backed by the full faith and credit of the United States. However, mortgage-related securities issued by Freddie Mac and Fannie Mae, including Freddie Mac and Fannie Mae guaranteed mortgage pass-through certificates, which are solely the obligations of Freddie Mac and Fannie Mae, are not backed by or entitled to the full faith and credit of the United States but are supported by the right of the issuer to borrow from the U.S. Treasury.

**Multiple Class Pass-Through Securities:** The Fund may invest in multiple class pass-through securities, including collateralized mortgage obligations (CMOs) and commercial mortgage-backed securities. These multiple class securities may be issued by Ginnie Mae, U.S. government agencies or instrumentalities or by trusts formed by private originators of, or investors in, mortgage loans. In general, CMOs are debt obligations of a legal entity that are collateralized by, and multiple class pass-through securities represent direct ownership interests in, a pool of residential or commercial mortgage loans or mortgage pass-through securities (the Mortgage Assets), the payments on which are used to make payments on the CMOs or multiple pass-through securities. Classes of CMOs include interest only (IOs), principal only (POs), planned amortization classes and targeted amortization classes. IOs and POs are stripped mortgage-backed securities representing interests in a pool of mortgages, the cash flow from which has been separated into interest and principal components. IOs receive the interest portion of the cash flow while POs receive the principal portion. IOs and POs can be extremely volatile in response to changes in interest rates. As interest rates rise and fall, the value of IOs tends to move in the same direction as interest rates. POs perform best when prepayments on the underlying mortgages rise since this increases the rate at which the principal is returned and the yield to maturity on the PO. When payments on mortgages underlying a PO are slower than anticipated, the life of the PO is lengthened and the yield to maturity is reduced. If the underlying Mortgage Assets experience greater than anticipated pre-payments of principal, the Fund may not fully recoup its initial investment in IOs.



Notes to Financial Statements (continued)

**Stripped Mortgage-Backed Securities:** The Fund may invest in stripped mortgage-backed securities issued by the U.S. government, its agencies and instrumentalities. Stripped mortgage-backed securities are usually structured with two classes that receive different proportions of the interest (IOs) and principal (POs) distributions on a pool of Mortgage Assets. The Fund also may invest in stripped mortgage-backed securities that are privately issued.

**Capital Trusts and Trust Preferred Securities:** The Fund may invest in capital trusts and/or trust preferred securities. These securities are typically issued by corporations, generally in the form of interest-bearing notes with preferred securities characteristics, or by an affiliated business trust of a corporation, generally in the form of beneficial interests in subordinated debentures or similarly structured securities. The securities can be structured as either fixed or adjustable coupon securities that can have either a perpetual or stated maturity date. For trust preferred securities, the issuing bank or corporation will pay interest to the trust, which will then be distributed to holders of the trust preferred securities as a dividend. Dividends can be deferred without creating an event of default or acceleration, although maturity cannot take place unless all cumulative payment obligations have been met. The deferral of payments does not affect the purchase or sale of these securities in the open market. Payments on these securities are treated as interest rather than dividends for federal income tax purposes. These securities generally are rated below that of the issuing company's senior debt securities and are freely callable at the issuer's option.

**TBA Commitments:** The Fund may enter into TBA commitments. TBA commitments are forward agreements for the purchase or sale of mortgage-backed securities for a fixed price, with payment and delivery on an agreed upon future settlement date. The specific securities to be delivered are not identified at the trade date. However, delivered securities must meet specified terms, including issuer, rate and mortgage terms. When entering into TBA commitments, the Fund may take possession of or deliver the underlying mortgage-backed securities but can extend the settlement or roll the transaction. TBA commitments involve a risk of loss if the value of the security to be purchased or sold declines or increases, respectively, prior to settlement date.

In order to better define contractual rights and to secure rights that will help the Fund mitigate its counterparty risk, TBA commitments may be entered into by the Fund under Master Securities Forward Transaction Agreements (each, an MSFTA). An MSFTA typically contains, among other things, collateral posting terms and netting provisions in the event of default and/or termination event. The collateral requirements are typically calculated by netting the mark to market amount for each transaction under such agreement and comparing that amount to the value of the collateral currently pledged by the Fund and the counterparty. Cash collateral that has been pledged to cover the obligations of the Fund and cash collateral received from the counterparty, if any, is reported separately on the Statement of Assets and Liabilities as cash pledged as collateral for TBA commitments or cash received as collateral for TBA commitments, respectively. Non-cash collateral pledged by the Fund, if any, is noted in the Schedule of Investments. Typically, the Fund is permitted to sell, repledge or use the collateral it receives; however, the counterparty is not permitted to do so. To the extent amounts due to the Fund are not fully collateralized, contractually or otherwise, the Fund bears the risk of loss from counterparty non-performance.

**Mortgage Dollar Roll Transactions:** The Fund may sell TBA mortgage-backed securities and simultaneously contract to repurchase substantially similar (i.e., same type, coupon and maturity) securities on a specific future date at an agreed upon price. During the period between the sale and repurchase, the Fund will not be entitled to receive interest and principal payments on the securities sold. The Fund accounts for mortgage dollar roll transactions as purchases and sales and realizes gains and losses on these transactions. These transactions may increase the Fund's portfolio turnover rate. Mortgage dollar rolls involve the risk that the market value of the securities that the Fund is required to purchase may decline below the agreed upon repurchase price of those securities.

**Reverse Repurchase Agreements:** The Fund may enter into reverse repurchase agreements with qualified third party broker-dealers. In a reverse repurchase agreement, the Fund sells securities to a bank or broker-dealer and agrees to repurchase the same securities at a mutually agreed upon date and price. During the term of the reverse repurchase agreement, the Fund continues to receive the principal and interest payments on the securities sold. Certain agreements have no stated maturity and can be terminated by either party at any time. Interest on the value of the reverse repurchase agreements issued and outstanding is based upon competitive market rates determined at the time of issuance. The Fund may utilize reverse repurchase agreements when it is anticipated that the interest income to be earned from the investment of the proceeds of the transaction is greater than the interest expense of the transaction. Reverse repurchase agreements involve leverage risk and also the risk that the market value of the securities to be repurchased may decline below the repurchase price.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 21

## Notes to Financial Statements (continued)

For financial reporting purposes, cash received in exchange for securities delivered plus accrued interest due to the counterparty is recorded as a liability in the Statement of Assets and Liabilities at face value including accrued interest. Due to the short term nature of the reverse repurchase agreements, face value approximates fair value. Interest payments made by the Fund to the counterparties are recorded as a component of interest expense in the Statement of Operations. In periods of increased demand for the security, the Fund may receive a fee for use of the security by the counterparty, which may result in interest income to the Fund.

For the year ended December 31, 2014, the average amount of reverse repurchase agreements outstanding and the daily weighted average interest rate for the Fund was \$56,753,027 and 0.10%, respectively.

Reverse repurchase transactions are entered into by the Fund under Master Repurchase Agreements (each, an MRA), which permit the Fund, under certain circumstances, including an event of default (such as bankruptcy or insolvency), to offset payables and/or receivables under the MRA with collateral held and/or posted to the counterparty and create one single net payment due to or from the Fund. With reverse repurchase transactions, typically the Fund and the counterparties are permitted to sell, re-pledge, or use the collateral associated with the transaction. Bankruptcy or insolvency laws of a particular jurisdiction may impose restrictions on or prohibitions against such a right of offset in the event of the MRA counterparty's bankruptcy or insolvency. Pursuant to the terms of the MRA, the Fund receives or posts securities as collateral with a market value in excess of the repurchase price to be paid or received by the Fund upon the maturity of the transaction. Upon a bankruptcy or insolvency of the MRA counterparty, the Fund is considered an unsecured creditor with respect to excess collateral and, as such, the return of excess collateral may be delayed.

As of December 31, 2014 the following table is a summary of the Fund's open reverse repurchase agreements by counterparty which are subject to offset under an MRA on a net basis:

Counterparty	Reverse Repurchase Agreements	Fair Value of Non-cash Collateral Pledged Including Accrued Interest <sup>1</sup>	Cash Collateral Pledged <sup>1</sup>	Net Amount <sup>2</sup>
BNP Paribas Securities Corp.	\$ 3,371,493	\$ (3,371,493)		
Credit Suisse Securities (USA) LLC	41,214,426	(41,214,426)		
Merrill Lynch, Pierce Fenner & Smith, Inc.	12,872,517	(12,742,461)		\$ 130,056
<b>Total</b>	<b>\$57,458,436</b>	<b>\$(57,328,380)</b>		<b>\$ 130,056</b>

<sup>1</sup> Net collateral with a value of \$57,526,322 has been pledged in connection with open reverse repurchase agreements.

<sup>1</sup> Excess of collateral pledged to the individual counterparty is not shown for financial reporting purposes.

<sup>2</sup> Net amount represents the net amount payable due to the counterparty in the event of default.

In the event the counterparty of securities under an MRA files for bankruptcy or becomes insolvent, the Fund's use of the proceeds from the agreement may be restricted while the counterparty, or its trustee or receiver, determines whether or not to enforce the Fund's obligation to repurchase the securities.

#### 4. Derivative Financial Instruments:

The Fund engages in various portfolio investment strategies using derivative contracts both to increase the returns of the Fund and/or to economically hedge its exposure to certain risks such as interest rate risk. These contracts may be transacted on an exchange or OTC.

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**Financial Futures Contracts:** The Fund purchases and/or sells financial futures contracts and options on financial futures contracts to gain exposure to, or economically hedge against, changes in interest rates (interest rate risk), or foreign currencies (foreign currency exchange rate risk). Financial futures contracts are agreements between the Fund and a counterparty to buy or sell a specific quantity of an underlying instrument at a specified price and at a specified date. Depending on the terms of the particular contract, financial futures contracts are settled either through physical delivery of the underlying instrument on the settlement date or by payment of a cash settlement amount on the settlement date.

Upon entering into a financial futures contract, the Fund is required to deposit initial margin with the broker in the form of cash or securities in an amount that varies depending on a contract's size and risk profile. The initial margin deposit must then be maintained at an established level over the life of the contract. Securities deposited as initial margin are designated on the Schedule of Investments and cash deposited, if any, is recorded on the Statement of Assets and Liabilities as cash pledged for financial futures contracts. Pursuant to the contract, the Fund agrees to receive from or

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## Notes to Financial Statements (continued)

pay to the broker an amount of cash equal to the daily fluctuation in value of the contract. Such receipts or payments are known as variation margin. Variation margin is recorded by the Fund as unrealized appreciation or depreciation and, if applicable, as a receivable or payable for variation margin in the Statement of Assets and Liabilities.

When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. The use of financial futures contracts involves the risk of an imperfect correlation in the movements in the price of financial futures contracts, interest rates and the underlying assets.

**Options:** The Fund purchases and writes call and put options to increase or decrease its exposure to underlying instruments (including interest rate risk) and/or, in the case of options written, to generate gains from options premiums. A call option gives the purchaser (holder) of the option the right (but not the obligation) to buy, and obligates the seller (writer) to sell (when the option is exercised), the underlying instrument at the exercise or strike price at any time or at a specified time during the option period. A put option gives the holder the right to sell and obligates the writer to buy the underlying instrument at the exercise or strike price at any time or at a specified time during the option period. When the Fund purchases (writes) an option, an amount equal to the premium paid (received) by the Fund is reflected as an asset (liability). The amount of the asset (liability) is subsequently marked-to-market to reflect the current market value of the option purchased (written). When an instrument is purchased or sold through an exercise of an option, the related premium paid (or received) is added to (or deducted from) the basis of the instrument acquired or deducted from (or added to) the proceeds of the instrument sold. When an option expires (or the Fund enters into a closing transaction), the Fund realizes a gain or loss on the option to the extent of the premiums received or paid (or gain or loss to the extent the cost of the closing transaction exceeds the premiums received or paid). When the Fund writes a call option, such option is covered, meaning that the Fund holds the underlying instrument subject to being called by the option counterparty. When the Fund writes a put option, such option is covered by cash in an amount sufficient to cover the obligation.

Swaptions are similar to options on securities except that instead of selling or purchasing the right to buy or sell a security, the writer or purchaser of the swaptions is granting or buying the right to enter into a previously agreed upon interest rate swap agreement (interest rate risk and/or credit risk) at any time before the expiration of the option.

In purchasing and writing options, the Fund bears the risk of an unfavorable change in the value of the underlying instrument or the risk that the Fund may not be able to enter into a closing transaction due to an illiquid market. Exercise of written option could result in the Fund purchasing or selling a security when it otherwise would not, or at a price different from the current market value.

For the year ended December 31, 2014, transactions in options written including swaptions were as follows:

	<b>Calls</b>	
	<b>Notional (000)</b>	<b>Premiums Received</b>
Outstanding options, beginning of year	\$ 145,000	\$ 499,916
Options written	1,305,600	5,309,000
Options expired	(455,100)	(1,316,644)
Options exercised	(33,800)	(285,800)
Options closed	(852,900)	(3,806,472)
Outstanding options, end of year	\$ 108,800	\$ 400,000

**Swaps:** The Fund enters into swap agreements in which the Fund and a counterparty agree either to make periodic net payments on a specified notional amount or a net payment upon termination. Swap agreements are privately negotiated in the OTC market and may be entered into as a bilateral contract ( OTC swaps ) or centrally cleared ( centrally cleared swaps ). Swaps are marked-to-market daily and changes in value are recorded as unrealized appreciation (depreciation).

For OTC swaps, any upfront premiums paid are recorded as assets and any upfront fees received are recorded as liabilities and are shown as swap premiums paid and swap premiums received, respectively, in the Statement of Assets and Liabilities and amortized over the term of the OTC swap. Payments received or made by the Fund for OTC swaps are recorded in the Statement of Operations as realized gains or losses, respectively. When an OTC swap is terminated, the Fund will record a realized gain or

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loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Fund's basis in the contract, if any. Generally, the basis of the contract is the premium received or paid.

BLACKROCK ENHANCED GOVERNMENT FUND, INC. DECEMBER 31, 2014 23

Notes to Financial Statements (continued)

In a centrally cleared swap, immediately following execution of the swap agreement, the swap agreement is novated to a central counterparty (the CCP) and the Fund's counterparty on the swap agreement becomes the CCP. The Fund is required to interface with the CCP through a broker. Upon entering into a centrally cleared swap, the Fund is required to deposit initial margin with the broker in the form of cash or securities in an amount that varies depending on the size and risk profile of the particular swap. Securities deposited as initial margin are designated on the Schedule of Investments and cash deposited is recorded on the Statement of Assets and Liabilities as cash pledged for centrally cleared swaps. The daily change in valuation of centrally cleared swaps is recorded as a receivable or payable for variation margin in the Statement of Assets and Liabilities. Payments received from (paid to) the counterparty, including at termination, are recorded as realized gain (loss) in the Statement of Operations.

Swap transactions involve, to varying degrees, elements of interest rate, credit and market risk in excess of the amounts recognized in the Statement of Assets and Liabilities. Such risks involve the possibility that there will be no liquid market for these agreements, that the counterparty to the agreements may default on its obligation to perform or disagree as to the meaning of the contractual terms in the agreements, and that there may be unfavorable changes in interest rates and/or market values associated with these transactions.

**Interest rate swaps** The Fund enters into interest rate swaps to gain or reduce exposure to interest rates or to manage duration, the yield curve or interest rate risk by economically hedging the value of the fixed rate bonds, which may decrease when interest rates rise (interest rate risk). Interest rate swaps are agreements in which one party pays a stream of interest payments, either fixed or floating, for another party's stream of interest payments, either fixed or floating, on the same notional amount for a specified period of time.

The following is a summary of the Fund's derivative financial instruments categorized by risk exposure:

**Fair Values of Derivative Financial Instruments as of December 31, 2014**

		Value	
Statement of Assets and Liabilities Location	Derivative Assets	Derivative Liabilities	
Interest rate contracts	Net unrealized appreciation/depreciation <sup>1</sup> ; Unrealized appreciation/depreciation on OTC swaps; Options written at value		\$14,603,528

<sup>1</sup> Includes cumulative appreciation/depreciation on centrally cleared swaps, if any, as reported in the Schedule of Investments. Only current day's variation margin is reported within the Statement of Assets and Liabilities.

**The Effect of Derivative Financial Instruments in the Statement of Operations  
Year Ended December 31, 2014**

	Net Realized Gain (Loss) From	Net Change in Unrealized Appreciation/Depreciation on
<b>Interest rate contracts:</b>		
Financial futures contracts	\$ (245,499)	\$ 4,534
Swaps	(1,419,351)	(6,112,415)
Options	(2,605,984)	(149,495)
Foreign currency exchange contracts:		

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Foreign currency transactions/translations	(444)	413
<b>Total</b>	\$ (4,271,278)	\$ (6,256,963)

For the year ended December 31, 2014, the average quarterly balances of outstanding derivative financial instruments were as follows:

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Financial futures contracts:		
Average notional value of contracts purchased		\$ 8,645,106
Average notional value of contracts sold		\$ 1,512,188
Forward foreign currency exchange contracts:		
Average U.S. dollar amount purchased		\$ 13,596
Options:		
Average notional amount of swaption contracts written		\$108,800,000
Interest rate swaps:		
Average notional amount pays fixed rate		\$ 24,779,600

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Notes to Financial Statements (continued)

**Counterparty Credit Risk:** A derivative contract may suffer a mark-to-market loss if the value of the contract decreases due to an unfavorable change in the market rates or values of the underlying instrument. Losses can also occur if the counterparty does not perform under the contract.

The Fund's risk of loss from counterparty credit risk on OTC derivatives is generally limited to the aggregate unrealized gain netted against any collateral held by the Fund. For OTC options purchased, the Fund bears the risk of loss of the amount of the premiums paid plus the positive change in market values net of any collateral held by the Fund should the counterparty fail to perform under the contracts. Options written by the Fund do not typically give rise to counterparty credit risk, as options written generally obligate the Fund, and not the counterparty, to perform.

With exchange-traded futures and centrally cleared swaps, there is less counterparty credit risk to the Fund since the exchange or clearinghouse, as counterparty to such instruments, guarantees against a possible default. The clearinghouse stands between the buyer and the seller of the contract; therefore, credit risk is limited to failure of the clearinghouse. While offset rights may exist under applicable law, the Fund does not have a contractual right of offset against a clearing broker or clearinghouse in the event of a default (including the bankruptcy or insolvency) of the clearing broker or clearinghouse. Additionally, credit risk exists in exchange traded futures and centrally cleared swaps with respect to initial and variation margin that is held in a clearing broker's customer accounts. While clearing brokers are required to segregate customer margin from their own assets, in the event that a clearing broker becomes insolvent or goes into bankruptcy and at that time there is a shortfall in the aggregate amount of margin held by the clearing broker for all its clients, typically the shortfall would be allocated on a pro rata basis across all the clearing broker's customers, potentially resulting in losses to the Fund.

In order to better define its contractual rights and to secure rights that will help the Fund mitigate its counterparty risk, the Fund may enter into an International Swaps and Derivatives Association, Inc. Master Agreement ( ISDA Master Agreement ) or similar agreement with its counterparties. An ISDA Master Agreement is a bilateral agreement between the Fund and a counterparty that governs certain OTC derivatives and typically contains, among other things, collateral posting terms and netting provisions in the event of a default and/or termination event. Under an ISDA Master Agreement, the Fund may, under certain circumstances, offset with the counterparty certain derivative financial instruments' payables and/or receivables with collateral held and/or posted and create one single net payment. The provisions of the ISDA Master Agreement typically permit a single net payment in the event of default including the bankruptcy or insolvency of the counterparty. Bankruptcy or insolvency laws of a particular jurisdiction may restrict or prohibit the right of offset in bankruptcy, insolvency or other events. In addition, certain ISDA Master Agreements allow counterparties to OTC derivatives to terminate derivative contracts prior to maturity in the event the Fund's net assets decline by a stated percentage or the Fund fails to meet the terms of its ISDA Master Agreements. The result would cause the Fund to accelerate payment of any net liability owed to the counterparty.

**Collateral Requirements:** For derivatives traded under an ISDA Master Agreement, the collateral requirements are typically calculated by netting the mark-to-market amount for each transaction under such agreement and comparing that amount to the value of any collateral currently pledged by the Fund and the counterparty.

Cash collateral that has been pledged to cover obligations of the Fund and cash collateral received from the counterparty, if any, is reported separately on the Statement of Assets and Liabilities as cash pledged as collateral and cash received as collateral, respectively. Non-cash collateral pledged by the Fund, if any, is noted in the Schedule of Investments. Generally, the amount of collateral due from or to a party has to exceed a minimum transfer amount threshold (typically either \$250,000 or \$500,000) before a transfer is required, which is determined at the close of business of the Fund. Any additional required collateral is delivered to/pledged by the Fund on the next business day. Typically, the Fund and counterparties are not permitted to sell, re-pledge or use the collateral they receive. To the extent amounts due to the Fund from its counterparties are not fully collateralized, the Fund bears the risk of loss from counterparty non-performance. Likewise, to the extent the Fund has delivered collateral to a counterparty and stands ready to perform under the terms of its agreement with such counterparty, the Fund bears the risk of loss from a counterparty in the amount of the value of the collateral in the event the counterparty fails to return such collateral.

For financial reporting purposes, the Fund does not offset derivative assets and derivative liabilities that are subject to netting arrangements, if any, in the Statement of Assets and Liabilities.

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Notes to Financial Statements (continued)

At December 31, 2014, the Fund's derivative assets and liabilities (by type) are as follows:

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	<b>Assets</b>	<b>Liabilities</b>
<b>Derivative Financial Instruments:</b>		
Options written		

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