Handbook 2000.04 REV-2 CHG-1

U.S. Department of Housing and Urban Development
Office of Inspector General

Independent Auditors

December 2001

Consolidated Audit Guide for Audits of HUD Programs

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U.S. Department of Housing and Urban Development
Office of the Inspector General

SPECIAL ATTENTION OF:
Title II and I Mortgagees, Lenders, Loan Correspondents, Loan Management Branch Chiefs, Ginnie Mae Issuers, Owners, Management Agents

TRANSMITTAL

Handbook No: 2000.04 REV-2 CHG-1
Issued: **December 31, 2001**

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1. This Transmits Handbook 2000.04 REV-2 CHG-1, Consolidated Audit Guide for Audits of HUD Programs.

2. Summary. This handbook is a change to Handbook IG 2000.04 REV-2 dated August 25, 1997. A change was necessary to reflect changes in financial reporting standards for HUD Housing programs. This Handbook serves as a reference to independent auditors of selected Housing and Ginnie Mae programs. The change affects chapters 1 through 4. The remaining chapters (5 through 8) are unaffected.

3. Significant Changes

   a. Incorporates revised reporting standards and program compliance for Multifamily Housing.

   b. Clarifies reporting requirements for Title II Nonsupervised Loan Correspondents.

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Forms Required by this Handbook

1. Statement of Profit and Loss, Form HUD-92410

2. Computation of Surplus Cash, Distributions and Residual Receipts, Form HUD-93486

Note: These forms may be reproduced as necessary.

CHAPTER 1. GENERAL AUDIT GUIDANCE

1-1 Purpose. This guide is to assist independent auditors (IAs) in performing program-specific audits of participants in selected Department of Housing and Urban Development (HUD) Housing and Ginnie Mae programs. These audits must be performed in accordance with the standards for financial audits of the U.S. General Accounting Office's (GAO) Government Auditing Standards, issued by the Comptroller General of the United States. The objectives of a HUD program-specific audit are to assist the program managers in HUD in determining whether the auditee has: (a) provided financial data and reports that can be relied upon; (b) internal control in place to provide reasonable assurance that it is managing HUD programs in compliance with applicable laws and regulations; and (c) complied with the terms and conditions of Federal awards and guarantees, and thus expended Federal funds properly and with supporting documentation. This guide is effective for audits of fiscal years ending March 31, 2002 and thereafter.

HUD program audit reports are a primary tool used by program managers to meet their stewardship responsibilities in overseeing these HUD programs and assuring the integrity of the funds. Program managers must act upon the areas of noncompliance and internal control weaknesses noted in these reports. To be of value, these reports must contain adequate information to give reported matters perspective and to allow the managers to take necessary corrective action.

Use of this guide is mandatory for audits by IAs of all for profit HUD program participants. Audits of non-profit participants are to be conducted in accordance with OMB Circular A-133 and related guidance.

This guide is divided into chapters. The first chapter discusses purpose, background, audit planning and other considerations and establishes certain requirements for the performance of the audit. The second chapter contains the reporting requirements. The remaining chapters of the guide contain a compliance supplement for a particular HUD program

(Chapter 3 has been reserved for future use). Each audit should be conducted in accordance with requirements of Chapters 1 and 2 and the applicable compliance supplement included in Chapters 4 through 8 of this guide.

Chapter 4 of this guide is reproduced in its entirety in the Real Estate Assessment Center's (REAC) *Summary of Financial Reporting and Audit Guidance for Multifamily Program Participants and Independent Auditors.* This summary is available on HUD's website at http://www.hud.gov/reac/products/prodmf.html. Auditors should refer to that document for a detailed discussion on HUD's electronic submission reporting requirements for multifamily program participants (refer to 24 CFR Par 5, Subpart H).

This guide is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgment of audit work required. Suggested audit procedures contained herein may not cover all circumstances or conditions encountered in a particular audit. The auditor should use professional judgment to tailor the procedures so that the audit objectives may be achieved. However, all applicable compliance requirements in this guide must be addressed by the auditor. If the auditor desires technical assistance pertaining to HUD programs, their regulations or operations, the auditor should contact the particular HUD Headquarters or Field program office listed in the applicable chapter. A list of local and state offices is available on the Internet at http://www.hud.gov.

1-2 Auditor Qualifications. An auditor must meet the auditor qualifications of Government Auditing Standards, including the qualifications relating to independence and continuing professional education. Additionally, the audit organization is to meet the quality control standards of Government Auditing Standards. While the Government Auditing Standards urge audit organizations to make their external quality control review reports available to appropriate oversight bodies, it is not necessary to submit the report to either the HUD Field Office or the HUD/OIG unless requested to do so.

The standards on auditor qualifications in the Government Auditing Standards require that accountants and accounting firms comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the audit is being conducted. If the auditee is located in a State outside the home State of the auditor, and the auditor performs substantial fieldwork in the auditee's State, the auditor should document his/her compliance with public accountancy laws of that State regarding licensing, in the audit working papers. This guide does not impose additional licensing requirements beyond those established by the individual state board of accountancies (some states allow temporary practice without a license).

Refer to HUD Handbooks 4370.2 and 4470.1 regarding additional requirements placed on the IA’s relationship with the mortgagor and/or general contractor.

1-3 Audit Scope and Approach. The audit should be sufficiently comprehensive in scope to permit an expression of an opinion on the financial statements and supplemental data of the HUD-assisted activity.

The opinion should state whether the basic financial statements present fairly, in all material respects, the financial position of the auditee as of the date of the financial statements and the results of its operations and its cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the audit of the basic financial statements and whether it is fairly stated in all material respects in relation to the financial statements taken as a whole.

The Government Auditing Standards require the IA to consider the auditee's internal control as part of planning and performing the audit and report on internal control. The auditor should report on internal control in accordance with Chapter 2 of the guide.

Also, the IA is required to test and report on the auditee's compliance with applicable HUD laws and regulations regardless of the amount of Federal financial assistance. The auditor's report on compliance should include an opinion on the auditee's compliance with specific requirements applicable to each of its major programs. Reporting requirements are discussed further in Chapter 2. Major program means an individual assistance program or a group of programs in a category of Federal financial assistance, which exceeds $300,000 during the applicable year. A project, which has an outstanding HUD-insured or guaranteed loan balance exceeding $300,000 as of the reporting date, shall be considered a major program. A mortgagee or loan correspondent, which originates and/or services an aggregate of FHA-insured loans exceeding $300,000 during the period under audit, is considered a major program. In addition, a Government National Mortgage Association (Ginnie Mae) Issuer with a remaining principal balance exceeding $300,000 as of the reporting date is considered a major program.

For Projects/Lenders/Issuers with HUD-assisted activity of $300,000 or less for the period under audit (a non-major program), the auditor must also test and report on the entity's compliance with specific requirements. The auditor's report on compliance is described in Chapter 2.

Government Auditing Standards require the reporting of all material instances of noncompliance and quantification in terms of dollar value, if appropriate.

1-4 Matters Requiring Immediate Action. The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors contained in AICPA SAS No. 82, Consideration of Fraud in a Financial Statement Audit.

Normally, an audit in accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention.

If the auditor becomes aware of illegal acts or fraud that have occurred or are likely to have occurred, the auditor should promptly prepare a separate written report and include all questioned costs. The auditor should submit this report to the HUD District Inspector General for Audit (DIGA), as the designated oversight official. A current list of DIGAs is available on the Internet at http://www.hud.gov/oig/oigindex.html and in the Appendix.

1-5 Planning the Audit. A letter of engagement between the auditee and the IA shall be prepared. The letter should state that the audit is to be performed in accordance with generally accepted auditing standards, the Government Auditing Standards, and this audit guide. It should specify that the scope of the audit and the contents of the financial report meet the requirements of this audit guide. It should also specify that the auditor is required to provide the Secretary of Housing and Urban Development, the HUD Inspector General and the GAO or their representatives access to working papers or other documents to review the audit. Access to working papers by HUD and GAO representatives includes making necessary photocopies.

Generally, the auditor should use professional judgment to determine the extent of testing necessary to support his/her opinion on the auditee's financial statements and to report on the auditee's compliance with applicable laws and regulations. Each of the applicable compliance requirements contained in this guide must be tested regardless of the amount of Federal financial assistance. Where the auditor decides not to perform detailed testing of a particular compliance requirement, the reasons therefore must be appropriately explained and documented in the working papers.

All material instances of noncompliance identified by the auditor must be reported as a finding, even in those cases where corrective action was taken by the auditee after the audit period. For guidance, consult the particular program chapter. The schedule of findings and questioned costs (Chapter 2, Example F) must include the following information for each finding, where applicable, as required by the Government Auditing Standards: (a) the number of

items and dollar value of the population; (b) the number of items and the dollar value of the selected sample; and (c) the number of items and the dollar value of the instances of noncompliance.

The auditor is required to obtain written representation from management that includes matters concerning compliance with program laws and regulations that have a material effect on the financial statements and each HUD-assisted program.

The auditor shall retain working papers and reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by a HUD office or the GAO to extend the retention period. When auditors are aware that HUD or the auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and report.

1-6 Consideration of Internal Control and Compliance. Overall guidance for the consideration of internal control, testing and reporting requirements for Federal financial assistance programs is provided in the Government Auditing Standards.

The Government Auditing Standards require that a sufficient understanding of internal control be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. In fulfilling the audit requirement relating to an understanding of internal control and assessing the level of control risk, the auditor should follow, at a minimum, the guidance contained in AICPA SAS No. 55, Consideration of the Internal Control Structure in a Financial Statement Audit and SAS No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55. In addition, when auditing HUD programs, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control in preventing or detecting material noncompliance with the requirements of the HUD-assisted programs. The auditor should perform these procedures regardless of whether the auditor assesses the internal control risk below the maximum. The steps performed and conclusions reached should be clearly evidenced in the

auditor's working papers. The working papers should clearly demonstrate the auditor's understanding and assessment of control risk related to internal control established for HUD-assisted activities. Tests may be omitted only in areas when internal control is likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or material weakness should be reported.

1-7 Quality Control Review for Audit Reports. The HUD Office of Inspector General (OIG) and the REAC have implemented procedures for evaluating audits performed by non-Federal auditors. As part of this evaluation of completed audits, the supporting audit working papers shall be made available upon request by the OIG or the REAC. To facilitate these requests, the transmittal letter should include the name, firm address, and telephone number of the audit partner on the engagement and the IA’s Federal employer ID number.

Whenever an evaluation of an audit report or working papers discloses inadequacies, the IA may be asked to take corrective action. If HUD determines that the audit report and working papers are substandard or contain major inadequacies, it will consider filing complaints with the cognizant State Board of Accountancy and initiating action to debar the practitioner from further participation in Federal programs.

1-8 Corrective Action Plan. To assist the Department in resolving instances of noncompliance and material weaknesses in internal control identified by the auditor, the auditee is required to submit a corrective action plan with the auditor's report on HUD-assisted programs. In the corrective action plan, the auditee must describe the corrective action taken or planned in response to findings identified by the auditor. In addition, the auditee must comment on the status of corrective action taken on prior findings. The corrective action plan is considered a necessary part of the Project/Lender/Issuer's audit requirement. Additional guidance concerning the corrective action plan is contained in Chapter 2 of this guide.

1-9 Fair Housing and Non-Discrimination. When performing compliance work in the fair housing and non-discrimination

area, the following references should be used: HUD Handbook 8004.1, Consolidated Civil Rights Monitoring Requirements for Section 8; 24 CFR Part 1 (Title VI of the Civil Rights Act, Americans with Disabilities Act, and others) and Part 8 (Section 504 of the Rehabilitation Act)(both of which are applicable to all HUD-assisted housing); and 24 CFR Part 100, The Fair Housing Act (applicable to all housing in the nation). The Fair Housing Act prohibits discrimination based on race, color, religion, national origin, sex, familial status or disability in all aspects of the sale or rental of a dwelling (familial status refers to family composition, such as number and ages of children). The prohibitions extend to actions, which have disparate impact because of any of the prohibited bases.

CHAPTER 2. REPORTING REQUIREMENTS AND SAMPLE REPORTS

2-1 Government Auditing Standards require that the auditor issue the following reports based on the audit of the financial statements: a report on the financial statements, a report on compliance with applicable laws and regulations, and a report on internal control. In addition, there are additional reports required to be issued in an audit conducted in accordance with this audit guide. The audit report should be issued to the auditee's governing body and/or top official, as appropriate. The report cover should clearly indicate the HUD-assisted activities and period(s) that were audited.

It is expected that the specific compliance requirements identified in this guide will cover those laws and regulations that, if not complied with, could have a direct and material effect on the financial statements. In such cases, the compliance reports (in Section C below) and illustrated in this guide are the only reports necessary for reporting on the auditee's compliance with laws and regulations. However, if the IA, as part of the audit of the financial statements, considered laws and regulations in addition to those noted in this guide, for which noncompliance could have a direct and material effect on the financial statements, the auditor should also issue the compliance report in accordance with Government Auditing Standards.

The following reports are required to be submitted by the auditee:

A. The auditor's report on the basic financial statements together with the auditor's report on accompanying supplemental information required by HUD, stating whether that supplemental information is fairly stated in all material respects in relation to the basic financial statements taken as a whole (Example A).

B. The auditor's combined report on internal control as it relates to both financial reporting and administering the HUD-assisted programs. It must identify any reportable conditions and material weaknesses noted (Example B).

C. A report on compliance with applicable laws and regulations that may have a direct and material effect on each HUD-assisted program including:

-- an opinion on compliance with specific requirements applicable to major HUD-assisted programs (Example C)

-- a report on compliance with specific requirements applicable to non-major HUD-assisted programs (Example D)

When performing tests of compliance requirements contained in Chapter 4, the IA should report on fair housing and non-discrimination. Where the HUD-assisted activity is non-major, fair housing reporting should be included in the auditor's report on non-major HUD-assisted programs. Where the HUD-assisted activity is major, the auditor's report on specific requirements applicable to fair housing should be separate (Example E) from the auditor's opinion on compliance with specific requirements applicable to major programs.

The report on compliance should also identify and include all material instances of noncompliance. The findings should include an identification of all material questioned costs, as a result of noncompliance. In addition, the findings should contain adequate information necessary to facilitate the audit resolution process, i.e. the number of items and dollar value of the population, the number of items and the dollar value of the selected sample, and the number of items and the dollar value of the instances of noncompliance (Example F). Nonmaterial instances of noncompliance should be communicated to the auditee in accordance with the Government Auditing Standards.

D. In the auditee’s comments on audit resolution matters, the auditee should determine if significant findings from previous HUD required annual audits, HUD-OIG audits, HUD management reviews, or REAC physical inspections have been corrected and disclose those which remain uncorrected at the time of the review (Example G). The auditor is required to follow up on prior audit findings, perform procedures to assess the reasonableness of the comments on audit resolution matters relating to HUD programs prepared by the auditee, and report, as a current-year audit finding,

when the auditor concludes that the comments materially misrepresent the status of any prior audit finding(s).

E. Any report from the auditors on illegal acts or fraud that have occurred or are likely to have occurred, including all questioned costs found as a result of these acts that the auditors become aware of, should be covered in a separate written report in accordance with the provisions of the Government Auditing Standards. This report should be sent to the cognizant District Inspector General for Audit(see Appendix for list of District Inspectors General for Audit). Illegal acts are to be reported on without regard to whether the condition giving rise to the questioned costs has been corrected or whether the auditee does or does not agree with the finding and questioned costs.

F. A corrective action plan developed by the auditee, wherein the auditee officials describe the corrective action taken or planned in response to the findings identified by the auditor. The plan should also include comments on the corrective action taken on prior findings resulting from IA or relevant HUD-OIG audits and HUD program reviews (Example H).

2-2 Auditor's Reports. The following are illustrations of reports on financial statements, on internal control, on compliance with specific requirements and the auditee's corrective action plan that may be issued in an audit in accordance with this guide. These reports are not meant to be all-inclusive; auditors should exercise professional judgment in tailoring their reports to the circumstances of individual audits.

Examples:

A. Report on Audited Financial Statements and Supplemental Information.

B. Report on Internal Control.

C. Opinion on Compliance with Specific Requirements Applicable to Major HUD Programs.

D. Report on Compliance with Specific Requirements Applicable to Non-major HUD Program Transactions.

E. Report on Compliance with Specific Requirements Applicable to Fair Housing and Non-Discrimination.

F. Schedule of Findings and Questioned Costs.

G. Auditee's Comments on Audit Resolution Matters Relating to HUD Programs.

H. Corrective Action Plan (An Auditee Responsibility).

EXAMPLE A

REPORT ON AUDITED FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

Independent Auditor's Report

To the Partners
[the Entity]
Anytown, U.S.A.:

We have audited the accompanying balance sheet of [the Entity] as of December 31, 20XX, and the related statements of income, changes in partners' capital and cash flows for the year then ended. These financial statements are the responsibility of the [the Entity's] management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [the Entity] as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report(s) dated [date of report] on our consideration of [the Entity's] internal control and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. Those reports are an integral part of the audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The accompanying supplemental information (shown on pages XX-XX) is presented for the purposes of additional analysis and is not a required part of the basic financial statements of [the Entity]. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE B

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL (COMBINED REPORT APPLICABLE TO INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS AND INTERNAL CONTROL OVER COMPLIANCE FOR HUD-ASSISTED PROGRAMS--REPORTABLE CONDITIONS WERE NOTED--NO MATERIAL WEAKNESSES)

To the Partners
[the Entity}
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended December 31, 20XX, and have issued our report thereon dated [Date]. We have also audited [the Entity's] compliance with requirements applicable to HUD-assisted programs and have issued our reports thereon dated [Date].

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide"), issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether [the Entity] complied with laws and regulations, noncompliance with which would be material to a HUD-assisted program.

The management of [the Entity] is responsible for establishing and maintaining effective internal control. In planning and performing our audit of the financial statements, we considered [the Entity’s] internal control over financial reporting and its internal control over compliance with requirements that would have a direct and material effect on a HUD-assisted program in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and on compliance and not to provide assurance on the internal control over financial reporting and the internal control over compliance.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect

[the Entity's] ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements or its ability to administer HUD-assisted programs in accordance with applicable laws and regulations.

[Include paragraphs to describe the reportable conditions noted.]

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements that would be material in relation to the financial statements being audited or that noncompliance with applicable requirements of laws and regulations that would be material in relation to a HUD-assisted program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE C

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO MAJOR HUD PROGRAMS

To the Partners
[the Entity]
Anytown, U.S.A.:

We have audited the compliance of [the Entity] with the specific program requirements governing [list those requirements tested] that are applicable to each of its major HUD-assisted programs, for the year ended December 31, 20XX. Compliance with those requirements is the responsibility of [the Entity’s] management. Our responsibility is to express an opinion on [the Entity’s] compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the requirements referred to above that could have a direct and material effect on a major HUD-assisted program occurred. An audit includes examining, on a test basis, evidence about [the Entity's] compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of [the Entity's] compliance with those requirements.

In our opinion, the [Entity] complied, in all material respects, with the requirements referred to above that are applicable to each of its major HUD-assisted programs for the year ended December 31, 20XX.

This report is intended solely for the information of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE D

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO NON-MAJOR HUD PROGRAM TRANSACTIONS

To the Partners
[the Entity]
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended December 31, 20XX, and have issued our report thereon dated [Date of report].

In connection with that audit and with our consideration of [the Entity's] internal control used to administer HUD programs, as required by the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General, we selected certain transactions applicable to certain non-major HUD-assisted programs for the year ended December 31, 20XX.

As required by the Guide, we performed auditing procedures to test compliance with the requirements governing [list those requirements tested] that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [the Entity's] compliance with these requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended solely for the information of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE E

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO FAIR HOUSING AND NON-DISCRIMINATION

To the Partners
[the Entity]
Anytown, USA

We have applied procedures to test [the Entity's] compliance with Fair Housing and Non-Discrimination requirements applicable to its HUD-assisted programs, for the year ended December 31, 20XX.

Our procedures were limited to the applicable compliance requirement described in the *Consolidated Audit Guide for Audits of HUD Programs* issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Our procedures were substantially less in scope than an audit, the objective of which would be the expression of an opinion on [the Entity's] compliance with the Fair Housing and Non-Discrimination requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended solely for the information and use of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE F

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
(Should be Attached to Auditor's Report on Compliance)

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable: (a) the size and corresponding dollar value of the population, (b) the size and dollar value of the sample tested, and (c) the size and dollar value of the instances of noncompliance.

The Government Auditing Standards state that well-developed findings generally consist of the following attributes:

-- **Statement of condition** - the nature of the deficiencies, e.g., a regulation not being followed, a control procedure not followed or one which is inadequate.

-- **Criteria** - what the auditee should be doing, e.g. the specific regulation, a prudent management practice, or an internal control procedure.

-- **Effect** - what happened as a result of the condition; this should be monetized in all possible instances and described as thoroughly as possible.

-- **Cause** - why the condition exists, e.g. the auditee was unaware of the regulation or internal control was not a high priority of the auditee.

-- **Recommendation** - what the auditee should do to correct the condition, normally addresses the cause e.g. develop procedures to implement regulation or follow established procedures.

The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to HUD officials to permit timely and proper corrective action. These findings may also serve as a basis for HUD to conduct additional work. In addition, as part of the finding, the auditor is required to make a recommendation for corrective action to the auditee. As part of this report, the auditor is required to include the auditee's summary comments on the findings and recommendations in the report. In addition, the auditee is responsible for developing a separate corrective action plan (see Example H) based on the auditor's findings and recommendations and including the plan when submitting the auditor's report. If

corrective action is not necessary, a statement by the auditor describing the reason it is not should accompany the audit report.

EXAMPLE G

AUDITEE'S COMMENTS ON AUDIT RESOLUTION MATTERS RELATING TO HUD PROGRAMS*

The Owner has not taken corrective action on findings from prior audit report, number and title:

Finding No. 1 - The required documentation with regard to eligibility was not obtained for tenants receiving rent supplements.

Status - The owner has not obtained the required documentation from third-party sources nor has the owner reimbursed the appropriate programs. The amount of the rent supplements received for these tenants for the prior audit period was $15,350.

Finding No. 2 -

Status -

* -- This includes all prior audits, program review reports and state agency reports.

* -- The auditor may rely on management's representation as to the completeness of reports submitted during the audit period. The auditor does not have to independently confirm the completeness of audit and other reports received by management.

EXAMPLE H

CORRECTIVE ACTION PLAN

Name and Number of Project _____
Auditor/Audit Firm _____
Audit Period _____

The following is a recommended format to be followed by auditees for submitting a corrective action plan:

Section I - Internal Control Review

A. Comments on Findings and Recommendations

The auditee should provide a statement of concurrence or nonconcurrence with the findings and recommendations. If the auditee does not agree with a finding, specific information should be provided by the auditee to support its position. If the information is voluminous, an appendix may be attached to the submission.

B. Actions Taken or Planned

The auditee should detail actions taken or planned to correct deficiencies identified in the report. Appropriate documentation should be submitted for actions taken. For planned actions, auditees should provide projected dates for completion of major tasks. Officials responsible for completing the proposed actions should also be identified. If the auditee believes a corrective action is not required, a statement describing the reasons should be included.

C. Status of Corrective Actions on Prior Findings

The auditee must comment on all prior findings whether or not corrective action has been completed. The auditee should provide a report on the status of corrective actions taken on prior findings that remain open. An update should be included on dates for completion of major tasks and responsible officials for any actions not completed. In addition, documentation should be submitted for any actions the auditee considers completed.

Section II - Compliance Review

A. Comments on Findings and Recommendations

(See Section I. A. above.)

B. Actions Taken or Planned

(See Section I. B.)

C. Status of Corrective Actions on Prior Findings

(See Section I. C.)

CHAPTER 3. [RESERVED]

CHAPTER 4. HUD Multifamily Housing Programs

4-1 Background. This chapter contains HUD's requirements for conducting annual financial audits of entities participating in profit motivated and limited distribution multifamily housing programs.

Separately, practitioners with non-profit clients who participate in FHA/HUD programs covered by the Single Audit Act should conduct financial audits in accordance with OMB Circular A-133 and the associated compliance supplement.

4-2 Reporting Requirements. The Regulatory Agreement incident to the insured mortgage requires the annual submission of audited financial statements prepared in accordance with the requirements of the Secretary, within 90 days after the end of the fiscal year. In addition to the basic financial statements of the housing project, the auditor is required to submit a report on the consideration of internal controls and a report on compliance with specific requirements as well as supplemental data reports. These statements must be certified to be accurate by the mortgagor, when the project is owned by an individual. It should be certified by two general partners, when the project is owned by a partnership or by two officers, when owned by a corporation. When circumstances prohibit the ideal number of partners' or officers' certifying signatures, explanatory information should be provided with the audit report. These statements must also be certified to by the CEO of the management agent, where applicable. The report shall include the Employer Identification Number assigned by the IRS. This number must be entered below the partner or corporate signatures. The report should include the following basic financial statements plus supplemental data prepared in accordance with REAC instructions.

The auditors' role is to conduct and report the results of their audit in accordance with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS). It is the owner's responsibility to file an accurate electronic submission with HUD's Real Estate Assessment Center. In that regard, the Independent Auditor shall:

A. Issue an *Independent Auditors' Report* (refer to Chapter 2, Example A) on the ownership entity's basic financial

statements. This report should cover the following items:

- Balance Sheet
- Statement of Income
- Statement of Changes in Partner's Capital[1]
- Statement of Cash Flows
- Footnotes to the basic financial statements, including descriptions of accounting policies.

B. Issue an *Independent Auditors' Report* (refer to Chapter 2, Example A) on the supplemental information. This report may be added to the auditors' report on the basic financial statements or may appear separately in the auditor-submitted document[2].

C. Issue the additional reports described in Chapter 2.

4-3 Compliance Requirements and Audit Areas

A. Federal Financial Reports

1. Compliance Requirement. Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

2. Suggested Audit Procedures

   a. Identify all required financial reports by inquiry of the owner/manager.

   b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

[1] Or similarly titled report based on the type of participating ownership entity. For example, if a Limited Liability Company owns the property, a *Statement of Changes in Members' Equity* should be opined upon.

[2] Refer to *AICPA Professional Standards, Volume 1, U.S. Auditing Standards*, AU §551.06 e.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

f. For a Section 236 Interest Reduction Payment Subsidy project, obtain a sample of the Monthly Reports of Excess Income for the period under audit and test the accuracy. Reconcile any differences. Report any delinquent unremitted excess income of the project as of the end of the period under audit as a finding. Determine if the owner has approval to retain excess income. If the owner is under a repayment plan for delinquent excess income, determine compliance with the plan.

B. Fair Housing and Non-Discrimination

1. Compliance Requirement. Management and owners are prohibited from discriminatory practices in accepting applications, renting units and designating units or sections of a project for renting to prohibited bases of the "Fair Housing Act" and according to the Regulatory Agreement.

2. Suggested Audit Procedures

a. Obtain a copy of the owner's approved Affirmative Fair Housing Marketing Plan, if applicable to the project.

b. Inquire of the owner/manager as to policies and procedures relating to: marketing of the units; processing, approving and rejecting applications, including determining that applicants are processed and selected in

appropriate order; and providing reasonable accommodation to applicants and tenants with disabilities in accordance with the requirements of applicable federal civil rights laws.

c. Test whether procedures were placed in operation as established by management through inquiry and examination of documentary evidence.

d. Review a sample of correspondence files for applications rejected, including documented reasons for valid rejections, or tenants evicted and legal invoices for any evidence of litigation or potential litigation related to discriminatory rental practices.

e. Determine that the HUD-approved Equal Housing Opportunity logo, slogan or statement is displayed in marketing materials.

C. Mortgage Status

1. Compliance Requirement. Owners shall promptly make all payments due under the note and mortgage (Regulatory Agreement).

2. Suggested Audit Procedures

a. Read the mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage

b. Obtain or prepare a schedule of the client’s mortgage and escrow payments and withdrawls for the reporting period. The schedule should include the amount, by escrow item, and date each item was paid or disbursed.

c. Verify that the monthly mortgage and escrow payments were made.

d. Confirm the outstanding loan balance and annual escrow account activity with the loan servicer as of the client’s fiscal year end. Determine

if payment on the notes are current at the reporting entity's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.)

e. If the project is operating under an agreement, (mortgage modification agreement, workout agreement, forbearance agreement, use agreement, etc.) test whether the owner is complying with the terms and conditions.

D. Replacement Reserve

1. Compliance Requirement. Owners of profit motivated and limited distribution properties shall establish a reserve for replacement account and make deposits in accordance with HUD requirements. Disbursements from such fund may be made only after receiving written consent from HUD. (Source – HUD Regulatory Agreeement)

2. Suggested Audit Procedures

a. Obtain an understanding of the project owner's procedures, including the Regulatory Agreement (and any amendments or other written agreements with HUD) for establishment and maintenance of the fund and for making approved disbursements from the reserve fund.

b. Determine that the reserve fund has been established in a federally insured depository approved by the mortgagee, interest was retained in the account and test whether the conditions were met for the funds not federally insured for the period.

c. Using the schedule prepared for the mortgage status compliance requirement, verify the reserve for replacement account activity for the reporting period for compliance with the client's Regulatory Agreement.

d. Verify that deposits were made into the replacement reserve.

e. Trace disbursements from the reserve for replacement to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statement(s) and the schedule prepared above. Determine if sampled disbursements were authorized by HUD and used for the purpose authorized by HUD.

f. Confirm the account balance and annual reserve for replacement account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.)

E. Residual Receipts

1. Compliance Requirement. Owners of limited distribution properties shall establish a residual receipts account and make deposits into the account in accordance with HUD requirements. Disbursements from such fund may be made only after receiving written consent from HUD (source – HUD Regulatory Agreement).

2. Suggested Audit Procedures

a. Read the client's Regulatory Agreement (and any amendments) to determine the client's requirements for making deposits into the residual receipts fund. Normally, program participants are required to deposit "surplus cash" into the account within 60 days after the end of each fiscal year.

b. Determine that the prior year's amount required to be deposited to the residual receipts fund was calculated correctly and deposited within 60 days of the close of the fiscal year.

c. Using the schedule prepared for the mortgage status compliance requirement, verify the

residual receipts account activity for the reporting period for compliance with the client's Regulatory Agreement.

d. Verify that deposits were made into the residual receipts account.

e. Trace disbursements from the residual receipts account to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statement(s) and the schedule prepared above. Determine if disbursements were authorized by HUD and used for the purpose intended.

f. Confirm the account balance and annual residual receipts account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.

g. Test whether established procedures for deposit of cash receipts into a federally insured bank are being followed through inquiry and examination of documentary evidence.

F. Distributions to Owners

1. Compliance Requirement. Owners of profit motivated and limited distribution properties are not allowed to make, or receive and retain any distribution of assets or any income of any kind of the project except surplus cash. Surplus cash distributions can only be made as of and after the end of a semiannual or annual fiscal period. Surplus cash distribution cannot be made when the owner is in default under any of the terms of the Regulatory Agreement or under the note or mortgage. The allowable distribution for limited distribution owners is further restricted to a percentage of the owner's initial equity investment as described in the Regulatory Agreement or subsequent HUD approved agreements.

2. Suggested Audit Procedures

a. Read the client's Regulatory Agreement (and any amendments or associated documents) to determine the client's requirements for receiving distributions.

b. Inquire of management about the existence of any notices of default under any of the terms of the Regulatory Agreement and read any notices.

c. Inquire of management about the payment of distributions during the reporting period. Conduct follow-up or corroboration of management's responses as considered necessary.

d. Read the minutes of Partner meetings held during the reporting period for evidence of any discussions about distributions.

e. Scan cash disbursements for evidence of payments made to the project owners. Trace payments and determine if they are allowable under the terms of the Regulatory Agreement.

f. If applicable, determine that surplus cash computations were prepared in accordance with HUD criteria.

G. Tenant Application, Eligibility, and Recertification

1. Compliance Requirement. Owners who participate in HUD's rent subsidy programs are responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy. They are also responsible for determining initial tenant eligibility, annual recertification of tenant eligibility, and rectifying improper or inaccurate tenant information.

2. Suggested Audit Procedures

a. Compare the client's procedures for accepting applications, determining initial eligibility,

total tenant payment, and reexamination of eligibility with the provisions in HUD Handbook 4350.3.

b. Review a sample of tenant files to determine that applications are complete, signed by the applicant, that tenants met the eligibility requirements pertaining to their subsidized unit for annual income, and family composition, that the tenant payment was calculated correctly and that the family income was reexamined on an annual basis. Include in the sample some of the oldest and some of the most recently admitted tenants.

c. Review a sample of tenant files for evidence of whether the owner noted any improper or inaccurate information while determining tenant eligibility or during tenant recertification. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow-up to suspected fraud.

d. Review a sample of tenant files to determine that the tenant file contains the following documents as follows:

(1) Application

(2) Required verifications of social security numbers, disability status, waiting list preferences, income and allowances for adjusted income

(3) Lease/Lease addenda in the form as required by HUD

(4) Certification and recertification forms (Form HUD-50059)

(5) Move-In and Move-Out inspections

(6) Computation of tenant’s contribution toward rent and utilities and the subsidized portion of the tenant’s monthly rent

e. Test Section 8 rents to ensure that those rents do not exceed the fair market rents.

f. Compare the amount claimed per the HAP billing to the supporting documentation in the tenant files.

g. Verify the mathematical accuracy of the billing, including the accuracy of the total number of units on the bill.

H. Management Functions

1. Compliance Requirement. The owner is responsible for performing management functions or contracting with a management agent to provide project management. The owner or the owner’s agent must be approved by HUD to manage a project and must certify that they will adhere to HUD’s project management regulations.

2. Suggested Audit Procedures

a. Determine that the owner's designated management agent has obtained a fidelity bond in an amount at least equal to two months potential collections. Where an agent has multiple projects, the coverage must be at least equal to two months of the highest potential collections. All principals of the management entity and all persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts and records must be covered.

b. Test workorders and complaints for timely followup and adherence to management’s procedures.

c. Test management’s procedures for ensuring that units meet applicable housing quality standards.

d. Inquire whether management has conducted routine unit and general property inspections, and if findings were identified, whether corrective action was taken (HUD Form 9834 Part A.4).

e. Inquire of management about any fees charged to the project for property management services. Also inquire about whether there has been a change in the project's property management agent. Conduct follow-up or corroboration of management's responses as considered necessary.

f. Read a copy of the owner's latest HUD approved management certification (form HUD-9839a, b, or c. as appropriate). Determine if HUD has approved the current management agent.

g. Review the management certification to determine if the owner has disclosed the existence of an identity of interest (item 12).

h. Review the Management Entity Profile for disclosure of identity of interest companies.

i. Review the maintenance contracts and vendor invoices for identity of interest relationships with the owner/agent and agent/service contractor.

j. Test a sample of payments, including those made to identity of interest relationship for services, supplies, etc., to determine that the amounts do not exceed the amounts ordinarily paid for such services and supplies.

k. Obtain from client or prepare a schedule analyzing the fees charged to the project for management services. Trace the amounts on the schedule to the client's general ledger.

l. Compare the schedule created above to form HUD-9839. Determine if the management fees charged exceeds the HUD approved amount.

m. Determine there is comprehensive general liability coverage on industry standard form, in an amount required by the project's mortgage and HUD is named as an additional payee in the event of loss.

I. Unauthorized Change of Ownership/Acquisition of Liabilities

1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer of encumbrance of such property (Source – HUD Regulatory Agreement).

2. Suggested Audit Procedures

a. Inquire of management about the existence of any agreements to sell or encumber any of the mortgaged property and read any agreements.

b. Confirm all material debt agreements listed on the client's balance sheet. Review confirmations to determine if a change of ownership has occurred, or if any of the mortgaged property was encumbered without HUD approval.

c. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.

d. Read the minutes of Partner meetings held during the reporting period for evidence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.

J. Unauthorized Loans of Project Funds

1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs (Source – HUD Regulatory Agreement.

2. Suggested Audit Procedures

a. Inquire of management about the existence of any agreements to assign, transfer, dispose of, or encumber any of the personal property of the project, including rents and read any agreements.

b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized transactions.

c. Read the minutes of Partner meetings held during the reporting period. Highlight discussions of any unauthorized agreements to assign, transfer, dispose of, or encumber any of the personal property of the project.

K. Unauthorized Transfer of Beneficial Interest

1. Compliance Requirements. Owners of profit motivatd and limited distribution properties shall not, without the prior written consent of HUD, convey, assign, or transfer any beneficial interest in any trust holding title to the property, or the interest of any general partner in a partnership owning the property, or any right to manage or receive the rents and profits from the mortgaged property (Source – HUD Regulatory Agreement).

2. Suggested Audit Procedures

a. Inquire of management about the existence of any agreements to convey, assign, or transfer any beneficial interest.[3]

b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, assignment, or transfer of any beneficial interest of any of the owners.

c. Read the minutes of Partner meetings held during the reporting period for evidence of discussions

[3] Beneficial interest is generally the right to profits from an estate or property, without owning the estate or property.

of any unauthorized conveyance, assignment or transfer of any beneficial interest of any of the owners.

L. Electronic Submission Verification

1. Compliance Requirements. Owners of profit motivated and limited distribution properties are required to submit electronically to HUD audited financial information in accordance with GAAP and HUD requirements (Source – HUD Regulatory Agreement and 24 CFR Part 5, Subpart H)

2. Suggested Audit Procedure

Compare the client's FASS submission from the last reporting period to the Annual Financial Report prepared for the same period. Identify any material misstatements or omission from the data electronically submitted to HUD's REAC.

M. Excess Income

1. Compliance Requirements. Owners of limited distribution properties with mortgages insured under Section 236 of the National Housing Act must obtain prior authorization from HUD before retaining Excess Income and use Excess Income only for HUD authorized purposes.

2. Suggested Audit Procedures

a. Inquire of management about the existence of a letter of permission or denial from HUD with respect to Excess Income. If the owner has received a letter from HUD permitting or denying the retention of Excess Income, obtain and read a copy of that correspondence from the property's management.

b. Select a sample of the HUD forms HUD-93104, *Monthly Report of Excess Income* filed by the client, covering the period under audit. Determine if the reports selected were prepared in accordance with HUD instructions.

c. For the sample, determine if the client retained Excess Income or remitted the amount collected to HUD in accordance with HUD instructions. Trace amounts retained back to the client's supporting records.

d. If Excess Income was retained by the client, determine if:

- HUD approved if the amount retained
- The amount retained was used for authorized purposes as enumerated in Housing Notices

CHAPTER 5. INSURED DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE

5-1 Program Objectives . Multifamily insured loans are an integral part of HUD's housing program which has the objectives of providing decent, safe, affordable and sanitary housing for low and moderate-income families. Through the insured multifamily project loan program, HUD insures mortgage repayments, thereby reducing investor risk and encouraging the availability of a money supply for the housing market. For the insured loan program, the project is ordinarily HUD's only source for loss recovery in the event of a foreclosure. Therefore, it is essential that collateral value is commensurate with the insurance risk.

5-2 Program Procedures . The cost certification is the basis for HUD's determination of the maximum insurable mortgage which is necessary before the project may proceed to final endorsement, a critical factor to multifamily projects. Effective dates for the determination of actual costs are usually the date of the final project inspection report showing final completion and the mortgagor's cost certification cut-off date. The HUD Field Office Manager has the option to set an earlier date to halt the unnecessary accumulation of certain costs. A reasonable time is set for submission of the cost certification which must be in the Field Office 30 days before final endorsement/closing.

HUD expects completed certifications, fully documented and in the prescribed format to be submitted by the mortgagor. If an identity of interest exists between the mortgagor and the contractor, or if a cost plus type construction contract was used, the contractor is also required to submit a cost certification. Similarly, if an identity of interest exists between a subcontractor, materials supplier, or an equipment lessor, then a cost certification must be submitted. Additional support for any cost items questioned by HUD is expected within 15 days of the request. Extended delays in the cost certification process which postpone final endorsement can cause substantial harm to the project's viability and eventual success.

5-3 Reference Material . The IA should obtain and become familiar with the following HUD Handbooks. If not available

from the owner, they may be obtained from the local HUD Field Office.

HUD Handbook No.	Title
4470.2	Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects
4571.1 REV-2	Section 202 Direct Loan Program for Housing for the Elderly and/or Handicapped
4571.5	Supportive Housing for Elderly - Conditional Commitment - Final Closing
4470.1 REV-2	Mortgage Credit Analysis For Project Mortgage Insurance (Section 207)
4450.1 REV-1	Cost Estimation For Project Mortgage Insurance

5-4 Reporting Requirements . The Mortgagor's Certificate of Actual Cost (Form HUD-92330) in a form prescribed by HUD shall be submitted after the cost certification cut-off date. Form HUD-92330 is submitted upon completion of the physical improvements to the satisfaction of HUD and before endorsement. The certificate shall show the actual cost to the mortgagor after deduction of any kickbacks, rebates, trade discounts or other similar payments to the mortgagor, or officers, stockholders, or partners.

24 CFR 207.27, 885.425 and 885.825 require mortgagors/ borrowers to submit Certificates of Actual Cost before final endorsement of the insured loans or disbursement of loan proceeds or capital advances for the project. Mortgagors and contractors are required to determine costs in accordance with HUD Handbook 4470.1 REV-2, Mortgage Credit Analysis for Project Mortgage Insurance, and with the Cost Certification Guide for Mortgagor and Contractors of HUD-Insured Multifamily Projects--HUD Handbook 4470.2. HUD Handbook 4470.2 contains the requirement for who among the mortgagor, general contractor, subcontractors, and suppliers must provide cost certifications and guidance on eligible costs, necessary financial statements which must accompany the Certificate of Actual Cost, and details concerning the

Form HUD-92330 (mortgagor) and Form HUD-92330-A (contractor).

Each Form HUD-92330 and Form HUD-92330-A must be accompanied by the auditor's report on the certification of actual cost. The IA is also required to report on the accompanying balance sheet and operating statement, the consideration of the mortgagor's internal control structure and the mortgagor's compliance with specific requirements. The period covered by the operating statement is from the beginning of marketing and rent-up activities to the cut-off date. The Form HUD-92330 should be supported by the information contained in the required financial statements. The Certificate of Actual Cost, auditor's reports and required financial statements should be submitted to the applicable HUD Field Office. An illustrative report on cost certification is provided in the final section of this Chapter.

For cost certifications due from contractors (HUD-92330-A), the auditor need only submit the Contractor's Certificate of Actual Cost and his/her report thereon. No other financial statements or reports are necessary, nor is this Certificate subject to an audit in accordance with the Government Auditing Standards.

5-5 Compliance Requirements and Audit Area

A. Federal Financial Reports .

1. Compliance Requirement . Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

2. Suggested Audit Procedures

a. Identify all required financial reports by inquiry of the owner/manager.

b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

B. Accounting System .

1. Compliance Requirement . Mortgagors and contractors involved in projects that are to receive HUD-insured loans have agreed to maintain adequate records for the purpose of determining the eligible costs associated with the projects (HUD Handbook 4470.2, Chapter 3).

2. Suggested Audit Procedures

a. Obtain an understanding of the mortgagor's and contractor's, accounting system for identifying actual costs associated with a given project. Test the system to determine that it identifies the costs to be reported on the Form HUD-92330 on an individual project basis.

b. Review Form HUD-92330 for completeness and support by the accounting records.

c. Trace significant data from Form HUD-92330 to supporting documentation, ie. worksheets, ledgers, etc. Report all material differences between the amounts reported on the Form HUD-92330 and the supporting documents.

C. Cut-Off Timing and Eligibility of Costs

1. Compliance Requirement . As a general rule, only the costs which have been or will be paid in cash within

45 days after the date of final endorsement or closing, or which are escrowed with the mortgagee are eligible for inclusion on the mortgagor's or contractor's Certificates of Actual Cost.

For projects with insured mortgages, the mortgagor determines the cost cut-off date for the actual cost of interest, taxes, and mortgage insurance premium. This date may, at the earliest, be the same date as the final completion date, and at the latest, be a date 60 days after the final completion date or at the mortgagor's option, any date in between. The date chosen as the cut-off date and the date to which the operating statement and balance sheet are computed must be the same.

The final completion date is the date on which the HUD representative signs the final HUD Representative's Trip Report, Form HUD-5379, showing substantial completion. This form must be properly endorsed by the Field Chief Architect.

HUD notifies the mortgagor/borrower, the general contractor and the mortgagee of the date of completion in writing. This date becomes the basis for establishing the cut-off date for insured projects, direct loan projects and capital advance projects (HUD Handbook 4470.2, Chapter 1).

Eligible costs are those costs of the project construction and certain fees actually paid in cash or such costs that will be paid in cash within 45 days of final endorsement. HUD Handbooks 4470.1 REV-2, 4450.1 REV and 4470.2, Chapter 2, contain information on allowable costs to be reported on Form HUD-92330 and the ways in which costs are to be adjusted for items considered to be a recovery of costs.

2. Suggested Audit Procedures

   a. Review the trip report Form HUD-5379 or similar notification to determine the final completion date.

   b. Based on the completion date, the mortgagor/borrower determines the project's

cut-off date for time sensitive expenses, such as interest, taxes and mortgage and property insurance premiums. Review these cost/charges to determine that none were incurred after the cut-off date.

c. Review the other amounts claimed on Form HUD-92330 to determine that the claims represent those expenses paid in cash or expected to be paid in cash within 45 days after final closing. All amounts claimed should be net of any adjustments or recoveries of costs.

D. Identity of Interest

1. Compliance Requirement . HUD Handbooks 4430.1 REV-1, 4470.1 REV-2 and 4470.2, Chapter 3, describe several situations which constitute an identity of interest involving a mortgagor, a contractor, a subcontractor, or a materials supplier. Where an identity of interest exists the contractor must also submit a Certificate of Actual Cost or the party involved in the identity of interest is required to submit additional documentation as required by 4470.2 Chapter 3. The contractor is also required to submit a Certificate of Actual Cost if a cost plus construction contract was used.

2. Suggested Audit Procedures

a. Review mortgagor and project records such as contracts and vendor invoices to determine if an identity of interest exists between any of the parties involved in the project, from mortgagors to contractors, suppliers and equipment lessors.

b. Where an identity of interest exists, determine that the additional reporting requirements of HUD Handbook 4470.2 have been met.

5-6 Illustrative Report

Report of Independent Certified Public Accountants

To the Partners
Sample Company

We have audited the Mortgagor's Certificate of Actual Costs (Form HUD-92330), through April 30, 1997, pertaining to the development of the Sample Company, Project No. xxx-xxxxx, the statement of assets, liabilities and project equity, as of April 30, 1997 and the results of project operations for the period from August 28, 1995 (date of commencement of marketing and rent-up activities, etc.) through April 30, 1997. These financial statements are the responsibility of the Partnership's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Certificate of Actual Cost and the Project's financial statements have been prepared on the basis of accounting and reporting practices prescribed by the Department of Housing and Urban Development (HUD). These prescribed practices are a comprehensive basis of accounting other than generally accepted accounting principles. Furthermore, the accompanying financial statements represent the financial statements of the project. This report is intended solely for filing with HUD and is not intended for any other purpose.

In our opinion, the Mortgagor's Certificate of Actual Cost and the financial statements referred to above, present fairly the actual costs of the Sample Company, through April 30, 1997, the assets, liabilities and project equity, as of April 30, 1997, and the results of project operations for the period from August 28, 1995 (date of commencement of marketing and rent-up activities, etc.) through April 30, 1997, on the basis of accounting described in Note 1.

In accordance with Government Auditing Standards, we have also issued a report dated [date of report] on our consideration of [the Entity's] internal controls and a report dated [date of report] on its compliance with laws and regulations.

Certified Public Accountant

[date of audit]

SAMPLE COMPANY
PROJECT NO. XXX-XXXXX

NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies

Basis of Presentation

The financial statements have been prepared in conformity with the accounting and reporting standards prescribed by the U.S. Department of Housing and Urban Development (HUD) in the Audit Guide for Auditing Development Costs of HUD-Insured Multifamily Projects. These standards differ in some respects from generally accepted accounting principles, and the financial statements reflect the following additional HUD accounting and reporting principles:

a. Costs are to be exclusive of kickbacks, rebates or trade discounts.

b. Financing charges are limited to the lesser of amounts actually paid, or amounts approved by HUD, on the Mortgagee's Certificate. For this project, the financing charges are the amounts actually paid.

c. The statement of rental operations reflects the rental activity and operating expenses of the Project from August 28, 1995. The statement does not include depreciation and amortization expenses and certain other expenses which are not incidental to the rental operation of the Project.

d. Project equity represents the difference between the funds received by the Project from Sample Company, and the costs incurred to develop the Project, and the income from the Project. Furthermore, Partnership (non-project) obligations are classified as project equity. Accordingly, Project equity is not intended to reflect the equity of the Partnership and the financial statements are not intended to represent those of the Partnership.

SAMPLE COMPANY
PROJECT NO. XXX-XXXXX

NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies

Organization

Sample Company is a limited partnership organized under the laws of the State of [State of Project], for the purpose of developing and operating the Sample Company, a 203-unit project located in [location of Project]. The Partnership will operate under the provisions of Section 221(d)(4) of the National Housing Act, with mortgage insurance provided by the Federal Housing Administration (FHA) of the Department of Housing and Urban Development.

The responsibility for management of the affairs of the Partnership, and the ongoing management of the Sample Company is vested with the general partners. Compensation for such services is as determined in the management agreement between the partners.

CHAPTER 6. GINNIE MAE ISSUERS OF MORTGAGE-BACKED SECURITIES AUDIT GUIDANCE

6-1 Program Objective . The Government National Mortgage Association, also known as Ginnie Mae, is a wholly-owned Government corporation. Created by Congress in 1968, Ginnie Mae's mission is to support expanded, affordable housing in America by providing an efficient government-guaranteed secondary market vehicle linking the global capital markets with the federal housing market. It does this by facilitating secondary market activities for packaged residential mortgages. Through its well known mortgage-backed securities (MBS) and multiclass programs, Ginnie Mae creates a vehicle for channeling funds from the securities markets into the mortgage market and helps to increase the supply of credit available for housing.

6-2 Program Procedures . The parties involved in the MBS program are Ginnie Mae, the securities issuer, the securities dealer, the investor, a custodian of mortgage documents, a mortgage servicer (often the issuer) and perhaps a transfer agent. Once approved by Ginnie Mae, the issuer of the mortgage-backed securities is responsible for acquiring eligible mortgages, creating a pool of mortgages to be held by a custodian, issuing the securities backed by a pool of mortgages, arranging for the marketing of the securities, servicing the mortgages in the pool, administering the securities outstanding and making the full and timely payment of all amounts due to the investors. The issuer is responsible for using its own resources to cover shortfalls in amounts due to investors that result from mortgage delinquencies or foreclosures.

For each pool or loan package of mortgages and accompanying issue of securities, there can be only one issuer. While the issuer is responsible for servicing the pool or loan package of mortgages, the servicing may be carried out on behalf of the issuer, by another servicer (referred to as a subcontract servicer), which must also be a Ginnie Mae-approved issuer. The issuer is responsible for and fully liable for the satisfactory performance of any work performed by a subcontract servicer. All activities of any subcontract servicer must be covered by a contractual

agreement between the issuer and the subcontract servicer, and approved by Ginnie Mae.

The issuer may not delegate or transfer to others its obligations to: (a) make monthly payments to investors; (b) submit required monthly reports to Ginnie Mae; © make the payment of the guarantee fee to Ginnie Mae; (d) withdraw mortgage documents from the document custodian; and (e) maintain the Register of Certificate Holders (HUD Handbooks 5500.1 and 5500.2).

6-3 Reference Material . Ginnie Mae program regulations are contained in 24 CFR Part 300 through 395. HUD Handbooks for Ginnie Mae are as follows:

HUD Handbook No.	Title
5500.1, Rev. 6	Government National Mortgage Association Mortgage-Backed Securities Guide for the Ginnie Mae I Program
5500.2	Government National Mortgage Association mortgage-Backed Securities Guide for the Ginnie Mae II Program

The issuer should have a copy of the appropriate guide(s). Information on the most recent issuances of the guides may be obtained from Ginnie Mae at (202) 401-8794. Current guides are also available on the Internet at www.ginniemae.gov.

6-4 Reporting Requirements . Ginnie Mae issuers of MBS, including those Ginnie Mae-approved issuers who are inactive, are required to submit the following financial statements, reports and supplemental information on an annual basis:

Type of Report	Reference in IG 2000.4 REV-1
Financial Statements and Opinion	Chapter 2, Section 2-1
Internal Controls	Chapter 2, Section 2-1
Compliance with Specific Requirements	Chapter 2, Section 2-1

Supplemental Information:

Issuer's Adjusted Net Worth	Chapter 6, Section 6-5
Parent's Adjusted Net Worth (if appropriate)	Chapter 6, Section 6-4
Insurance Requirement	Chapter 6, Section 6-5
Corrective Action Plan (if appropriate)	Chapter 1, Section 1-9

A. Audited Financial Statements . Issuers are required to submit audited annual financial statements which include a balance sheet, statement of operations, cash flow statement, notes to the financial statements, and supplemental schedules as stipulated in Chapter 2 of this guide. The financial documents are to be submitted to Ginnie Mae's Review Agent using the Transmittal/Checklist presented in Attachment F.

B. Other Reports . In addition to the financial statements, all issuers must submit a report on internal controls, and a report on compliance with specific requirements. A sample report on consideration of internal controls and report of compliance with specific requirements are included in Chapter 2.

The computation of the issuer's and issuer's parent adjusted net worth and computation of issuer's insurance requirements are to be reported on supplemental schedules to the basis financial statements. The computation of the issuer's and issuer's parent adjusted net worth is designed to eliminate those assets considered unacceptable by Ginnie Mae. Note that the adjusted net worth computation for the issuer's parent is only required when the issuer's parent presents a consolidated financial statement along with consolidating schedules that reflect the financial condition of the issuer and the issuer makes up less than 40 percent of the parent's equity. The required format for presenting this analysis is provided in Attachment B for the issuer and Attachment C for the issuer's parent. The required format for presenting the

analysis of the issuer's insurance is presented in Attachment D.

Ginnie Mae requires submission of audited financial statements exclusively of the issuer. However, Ginnie Mae will accept alternative financial statements (i.e., not exclusively of the issuer) if certain conditions are met as stated below:

1. For issuers that make up 40 percent or more of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided: the consolidating schedules, which distinguish the balance sheet and operating statement of the Ginnie Mae issuer are included with the parent's audit. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent.

2. For an issuer whose equity is less than 40 percent of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided the conditions in item (1) above are met and the issuer's parent enters into a Corporate Guarantee Agreement (Agreement) with Ginnie Mae to guarantee the performance of the issuer. The parent must meet the terms and conditions of the Agreement for the issuer to remain in good standing with Ginnie Mae.

   Furthermore, the issuer is required to submit with its parent's consolidated audited financial statements, an adjusted net worth calculation on the parent. The parent's net worth, after adjustments for unacceptable assets, is required to be at least 110 percent (120 percent for issuers approved to issue manufactured housing or multifamily pools) of the required net worth of the Issuer. The parent's audited financial statement and adjusted net worth calculations must be audited by the parent's auditor in accordance with this Audit Guide. The parent must also demonstrate in its adjusted net worth calculation that it meets the above 110 percent (120 percent for issuer approved to issue manufactured housing or multifamily pools) requirement.

The required format for presenting the "Presentation of Adjusted Net Worth Calculation for Issuer's Parent" is provided in Attachment C of this Chapter.

3. For issuers that are federally or state-regulated institutions, such as those under the supervision of Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, Ginnie Mae will accept audited financial statements on the issuer's parent, as long as the issuer makes up 90 percent or more of the parent's equity and there is no more than one bank holding company covered in the audit.

   In addition to the audited financial statement of the issuer's parent, the issuer must submit its unaudited regulatory report (Call report, OTS Report or 10K).

   Although Ginnie Mae may accept alternative audited financial statements, all other required reports (internal controls, compliance with specific requirements, adjusted net worth calculation, insurance requirement) must be prepared by the IA exclusively for the issuer.

   A sample auditor's report on the consolidating balance sheet and operating statement is included as Attachment E to this Chapter.

C. Submission of Reports . Two copies of the audited financial statements and auditor's reports should be submitted by the issuer, independent of whether the issuer had securities or commitment authority outstanding. Reports must be submitted within 90 days of the end of the issuer's fiscal year to Ginnie Mae's Review Agent. The Review Agent's address may be obtained from the address list "Addresses" found in HUD Handbooks 5500.1 and/or 5500.2.

D. Single Auditor Approach

In many instances it may be to the advantage of the custodian, the issuer, or both to engage an IA to conduct a review of the mortgage documents held by a particular custodian for several issuers rather than to have each issuer require that a different IA review that

part of the custodial documents pertaining to each issuer's pools. The single auditor approach also may solve practical problems associated with travel when the issuer, custodian, and IAs are not located near each other, thus reducing the cost of compliance while assuring necessary audit coverage.

To determine if the single auditor approach is practical in a given situation, the IA and issuer should contact the custodian(s) holding the issuer's pool loan documents to determine the extent of the custodian's activities with other issuers. Arrangements then may be reached as to the most effective approach to conducting the review of custodial documents. Under the single auditor approach, the custodian will arrange with an IA to review documents relating to each of the respective issuer's pools. Separate reports then will be prepared by the IA for each issuer's pools.

The single auditor approach or the review of custodial documents by the issuer's IA are both acceptable methods in completing the Custodial Review section of the audit guide.

6-5 Compliance Requirements and Suggested Audit Procedures

A. Federal Financial Reports .

1. Compliance Requirement . Issuers participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

2. Suggested Audit Procedures

   a. Identify all required financial reports by inquiry of the issuer.

   b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

   c. Select a sample of financial reports, other than those which are included in the audited

financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and issuer records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

B. Eligibility to Issue Mortgage-Backed Securities

1. Compliance Requirement . To be approved and maintain eligibility to issue Ginnie Mae-guaranteed mortgage backed securities and act as administrator of such securities, an applicant must meet and maintain the following requirements:

a. Be an FHA-approved mortgagee in good standing. A State or local government instrumentality that is an FHA-approved mortgagee is eligible. Mortgagees approved by FHA only as loan correspondents are not eligible to be Ginnie Mae issuers.

b. For issuers approved by Fannie Mae or Freddie Mac, a loss of either approval may cause the issuer to become ineligible to issue and service Ginnie Mae mortgage-backed securities.

c. Have as a principal element of its business operation the origination or servicing of mortgage loans.

d. Conduct its business operations in accordance with accepted sound mortgage lending and servicing practices, ethics, and standards, and have the experience, management capability, and access to adequate facilities necessary to assure Ginnie Mae of its ability to issue and service mortgage-backed securities. Except in instances where the issuer can demonstrate that an alternative arrangement constitutes a sound business practice, the issuer must have at least

three full-time officers and one additional employee, each with sufficient experience in the origination and/or servicing of mortgages of the type to be pooled to assure an ability to manage the pool on a long-term basis; the officer in charge of day-to-day operations must be a full-time employee solely of the issuer firm; and the issuer's offices must be self-contained and separate from those of any other entity.

e. Maintain policies that prohibit any discrimination of a borrower based on race, religion, color, sex, national origin, age, familial status or disability. The issuer shall comply with any applicable rules, regulations, and orders of general applicability issued under Title VI of the Civil Rights Act of 1964; Executive Order 11063, Equal Opportunity in Housing, issued November 20, 1962; Title VII of the Civil Rights Act of 1968, as amended; and with applicable rules and regulations of the Federal Housing Administration. Moreover, this section incorporates by reference section 202 of Executive Order 11246, Equal Employment Opportunity, issued on September 24, 1965, as amended. The issuer is required to comply with the implementing rules and regulations of the Department of Labor (41 CFR Part 60-1) and the Department of Housing and Urban Development (24 CFR Part 130).

f. Have and maintain fidelity bond coverage and a mortgage servicing errors and omissions policy based on the issuer's total servicing portfolio in accordance with HUD Handbooks 5500.1, Chapter 2 and 5500.2, Chapter 3, which names Ginnie Mae as loss payee.

g. Maintain a net worth based on an audited financial statement prepared in accordance with generally accepted accounting principles in assets acceptable to Ginnie Mae, as outlined in Section G. 2. of this Chapter.

2. Suggested Audit Procedures

a. Determine that the issuer meets requirements covered in Section 6-5, paragraph B. above.

b. Test whether the issuer has and follows an established policy which prohibits discrimination in housing and lending as provided by HUD Handbooks 5500.1, Chapter 2, 5500.2, Chapter 3 and Section 1-10 of this guide.

c. Recompute the issuer's required fidelity bond and mortgage servicing errors and omissions coverage policy at the end of the fiscal year in accordance with Handbooks 5500.1, Chapters 2 and 6, and 5500.2, Chapter 3. Verify that Ginnie Mae is named as the loss payee. Also inquire that the required levels of insurance were maintained throughout the year, with testing of the adequacy of insurance at least on a quarterly basis. Also verify that the fidelity bond and errors and omissions policies are written by an insurance carrier which has a Best's rating of B+ or better, and is specifically licensed or authorized by law to transact business with the state or territory where the name insured has its corporate headquarters. Lloyd's of London, although not rated, is an acceptable insurer.

An issuer's minimum insurance coverage must comply with the following, based on the issuer's total servicing portfolio irrespective of ownership:

(1) For issuers with a total mortgage servicing portfolio of $100 million or less: $300,000.

(2) For issuers with a total mortgage servicing portfolio of more than $100 million and up to $500 million: $300,000, plus 0.15 percent of the amount of total servicing in excess of $100 million.

(3) For issuers with a total mortgage servicing portfolio of more than $500 million and up to $1 billion: $900,000, plus 0.125 percent of the amount of total servicing in excess of $500 million.

(4) For issuers with a total mortgage servicing portfolio of more than $1 billion: $1,525,000, plus 0.1 percent of total servicing in excess of $1 billion.

The maximum mortgage servicing errors and omission insurance coverage requirement is $20,000,000. The maximum fidelity bond coverage is not limited.

The required format for presenting the "Presentation of Insurance Requirement" is provided in Attachment D of this Chapter.

d. Determine whether the issuer is an affiliate (parent, subsidiary, or related party) of any other Ginnie Mae issuer(s). All affiliated Ginnie Mae issuers should be identified in the auditor's verification of insurance. If an affiliate(s) is covered by the same insurance policy, then the servicing of each issuer must be added to calculate the combined total servicing portfolio. The amount of this combined servicing portfolio should be used to determine the minimum required insurance coverage.

e. Compare the issuer's adjusted net worth (net worth reported in the audited financial statements as adjusted for any Ginnie Mae unacceptable assets) to the minimum required net worth as discussed in Section 6-5, paragraph G.2 of this Chapter.

C. Review of Custodial Documents

1. Compliance Requirements . Documents relating to the pooled mortgages are required to be held on Ginnie Mae's behalf for the life of the pool by a custodial institution. It is the issuer's responsibility to arrange for such an institution to hold the

documents. The custodial relationship must be evidenced by the execution of a "Master Custodial Agreement" with the custodian certifying on the reverse side of the Schedule of Pooled Mortgages that it has examined and has in its possession the required documents.

A custodial institution is permitted to function as custodian to more than one issuer. An issuer may use more than one custodian. Pools issued on or after February 1, 1979 must have a single custodian, unless Ginnie Mae has given written permission for more than one custodian.

A custodial institution must meet the eligibility requirements as specified in Chapter 3 of the Ginnie Mae Guide, Standards for Documents Custodians, hereinafter referred to as Document Custodial Manual (HUD Handbook 5500.1, Appendix 77 and HUD Handbook 5500.2, Appendix 53).

The review of the document custodian must be performed at the document custodian facility. If the issuer's securities outstanding is less than $25 million and there has been no increase in the number of pools held by the document custodian within the last fiscal year, Ginnie Mae will permit an off-site review of the document custodian. The Auditor must follow the procedures in Section 6-5, paragraph C.2. below. All document custodians must have an on-site review every three years.

2. Suggested Audit Procedures

a. Determine if the issuer uses more than one custodial institution. If more than one custodian is used, at least one custodial institution must be reviewed each year and all custodial institutions must be reviewed within a three year cycle. Determine that the custodial institution meets the following eligibility requirements.

(1) Is a federally regulated financial institution in good standing with its primary regulator, and not in receivership, conservatorship, liquidation or any other

management oversight by its primary regulator, unless operating under an approved management plan.

(2) Maintains a secure, 1 and 1/2 hours fire resistant storage facility with adequate access controls.

(3) Utilizes knowledgeable employees in its custodial function to handle mortgage documents and perform custodial functions.

(4) Maintains for review annual financial statements audited by an independent auditor for itself or its parent.

(5) Maintains the minimum insurance requirements of its primary regulator and maintains coverage to indemnify against losses involving Ginnie Mae pools and loan documents custody.

(6) Maintains updated written procedures within its operation, in addition to the Document Custodian Manual.

(7) Satisfies eligibility requirements and other requirements as directed by Ginnie Mae.

(8) Self custodial issuers must maintain a separate trust department which is physically separate from the servicing area and operations. It must also have obtained prior approval to exercise fiduciary powers from its primary regulator. Such fiduciary powers must include ordinary trust services such as personal trust services, personal representative services (executor), guardianship, custodian services and/or investment advisory services offered to the public and not be limited to maintaining custody of valuable documents for Ginnie Mae issuers. The trust service function must be subject to periodic review or inspections by its primary regulator.

(9) If custody is by an affiliate, the custodial institutions must either meet all the requirements in paragraph C.2.a.(8) above, or if the custodial documents are not held in the trust department, the custodian must provide evidence that there is a vertical independence between the issuer and the custodial/warehouse institution.

b. Verify that the custodial institution maintains or performs the following inventory accounting requirements:

(1) Maintains an Issuer Master File which contains the Issuer Custodial Register, any blanket legal opinions, copy of the issuer's corporate resolution for a name change, and any other applicable issuer level documents.

(2) Maintains an Issuer Custodial Register which includes a list of pools currently in custody (must provide pool identification numbers), the actual and/or due dates for final certification and recertification, and a count of the total number of pools in custody.

(3) Maintains a Pool Master File for each pool in custody which contains a copy of the Master Custodial Agreement, Schedule of Pooled Mortgages, form HUD 11711B (Certification and Agreement), form HUD 11711A (Release of Security Interest) if applicable, original blanket interim assignment(s) (a copy of which is included in each individual loan file to which the blanket interim assignment applies), copies of opinion(s) from qualified outside legal counsel (originals maintained in the issuer master file), original pool level waiver letters from Ginnie Mae, and all forms HUD 11708 (Request for Release of Documents) for liquidated release codes.

(4) Has performed an Annual Physical Inventory of all pools held for the issuer, which will include at a minimum a reconciliation of the pool numbers on the issuer custodial register to a current issuer provided listing of pools, and the pool numbers on the issuer custodial register agree to the pool master files in custody.

(5) Maintains a Nonliquidation Release Inventory/File of all forms HUD 11708 submitted on or after July 1, 1992 on the basis of the nonliquidation reason code. If a file is maintained, copies of the forms HUD 11708 must be kept in chronological order by document release date. If an inventory is maintained it must contain the pool number, FHA/VA/Rural Housing Service of the Department of Agriculture (RHS) case number or loan number, and the document release date.

If any documents have been released for more than 180 days, the custodian is required to notify the issuer of the overdue documents every 90 days. The notification must be in writing and documented in the inventory or file.

c. If more than one custodial institution is used, it will be necessary for the issuer to identify which pools are at which custodial institution in order to select a sample of pooled mortgages for that institution. If the issuer uses only one custodial institution, obtain a list of the pools. Select a representative sample of Ginnie Mae pools for review. For pools selected determine if the pools include:

(1) An original form HUD 11711A (Release of Security Interest) executed by any and all secured institution(s) relating to any or all mortgages included in the mortgage pool that are being reviewed and that were closed after March 31, 1979. The form should state:

"The lending or other financing institution named herein agrees to relinquish any and all right, title or interest it may have in mortgages to be placed in this Ginnie Mae mortgage-backed securities pool no later than the date and time of delivery (release) of the securities by Ginnie Mae and/or its agent."

and/or

(2) An executed original form HUD 11711B (Certification) signed by an officer of the issuer covering the mortgages that are being reviewed and that were closed after March 31, 1979, stating that:

(a) Release(s) of security interest (form HUD 11711A) delivered by the issuer to the custodian comprise(s) all evidence of any security agreements affecting any and all mortgages in this pool; or

(b) Other than the unrecorded assignment to Ginnie Mae, there are and will be no other security agreements affecting any mortgages in this pool.

Note: If there has been a transfer of issuer responsibility and the pool was issued more than three years ago, the forms HUD 11711A and/or 11711B are not required to be in the custodial file.

d. Obtain a copy of the original Schedule of Pooled Mortgages (form HUD 11706) [1] from the document custodian for each of the pools selected. The purpose of the Schedule of Pooled Mortgages is

[1] For programs other than the Single Family Mortgage-Backed Securities Program, the form number, prior to January 1, 1996, was:

- Project loans: form HUD 11721.
- Manufactured home loans: form HUD 11725.

to provide a means of identifying and controlling mortgages placed in the pool which secure the obligations issued. Accordingly, select a sample of pooled mortgages from the Schedule of Pooled Mortgages.

e. For sampled mortgages, review the custodial files for the following documents and compare the information shown on these documents to the information on the Schedule of Pooled Mortgages. Procedures for the custodian document review are contained in Paragraph 8-4 and Appendix 77 of Ginnie Mae Handbook 5500.1 and Paragraph 7-5 and Appendix 53 of Ginnie Mae Handbook 5500.2. Reconcile and report on any differences.

(1) The original note or other evidence of indebtedness endorsed in blank and without recourse.

(2) An assignment to Ginnie Mae of the mortgage or other security instrument in recordable form but not recorded. The assignments to Ginnie Mae can be in blanket form. The blanket assignments must apply to mortgages in the same pool and same recording jurisdiction. If the pool was issued after March 31, 1979, and if the mortgage was originated by a mortgagee other than the issuer, there also must be a recorded assignment, if state law requires recordation in order to make the assignment valid against all lien holders from the originating mortgagee to any intervening interest holder and from such holder to any further holders of mortgage ownership. An assignment to the issuer must immediately precede the unrecorded assignment to Ginnie Mae. These interim assignments must be either originals or certified copies of the originals and, if required by state law to assure validity, be either recorded or certified by the issuer to have been transmitted for recordation.

f. Determine that within 12 months of the issuance of the securities, transfer of issuer and/or

custodial responsibility that the document files contain the following documents. Report any missing documentation as a finding.

Within 12 months of issuance of the securities the following documents must be in the custodial file.

(1) Original evidence of insurance or guaranty signed by FHA, VA or RHS. If the loan is a VA vendee loan or contract, there will not be evidence of guaranty. If evidence of insurance or guaranty is not on file, determine from the issuer why the required documents are missing. Loans that cannot be insured or guaranteed must be withdrawn from the pool but only after obtaining Ginnie Mae's approval.

(2) Original recorded mortgages (or other security instruments) signed by the mortgagor securing repayment of the indebtedness. (NOTE: Compare the mortgagor's name as it appears on the Schedule of Pooled Mortgages with that which appears on the recorded mortgage to assure identity). Copies of the recorded mortgage are acceptable if the copies clearly show the document recording information.

(3) Evidence that a mortgagee title insurance policy has been obtained or other evidence of the title's acceptability to FHA, VA or RHS (not required in cases involving conveyance of HUD Secretary-owned property, if an exception has been authorized by Ginnie Mae, or VA vendee loans or contracts). Copies of mortgagee title insurance policies are acceptable.

(4) A complete chain of original recorded interim assignments. These are not required if the mortgage is retained by the original lender. Copies of the recorded interim assignments are acceptable if the

copies clearly show the document recording information.

(5) Verify that the custodian has completed the final certification on the back of the Schedule of Pooled Mortgages.

Within 12 months of a transfer of issuer responsibility the following documents must be in the custodial file and the custodian is required to have completed recertification of the appropriate pools:

(6) An updated endorsement on the promissory notes;

(7) A recorded assignment of the mortgage to the issuer, and

(8) All documents required in paragraphs C.2.d and C.2.e above are in the custodial files.

Within 12 months of a transfer of custodial responsibility all documents required in C.2.d and C.2.e above must be in the custodial file. The custodian is required to have completed recertification of the appropriate pools within 12 months.

Report any pool(s) for which the final certification or recertification is past due and has not been completed.

g. Determine that documents and/or loan files released from custodial files are evidenced by a Request for Release of Documents (form HUD 11708). For the sampled mortgages:

(1) Ascertain whether the custodian is in possession of a form HUD 11708 for documents and/or files removed from the custodian's care.

(2) Prepare a list of missing documents and/or loan files not supported by a form HUD 11708. This listing should be reviewed with the custodian and subsequently with

the issuer. Any items not reconciled should be reported as a finding.

h. Select paid-in-full and/or foreclosed mortgages listed on form HUD 11708 on a test basis. Verify that these mortgage documents are no longer with the custodian. The custodian should note this removal on its inventory control record (The Schedule of Pooled Mortgages).

Any discrepancies should be noted on an exceptions listing noting the Pool Number, Mortgagor, and the defect, and reported as a finding. This listing should be reviewed with the custodian and errors corrected by the custodian. The custodian should furnish this listing to the appropriate issuers and the IA should subsequently review with the issuer the reasons for any missing or deficient documents. Missing documents for mortgages which are still current by the issuer's records could be an indication that the issuer has received mortgage pay-offs and not passed through payments to securities holders .

I. In lieu of an on site audit of the document custodian, the following procedures are acceptable, provided the conditions set forth in section C.1. above have been met.

(1) Confirm that the document custodian meets all the eligibility requirements as stated in Section 6-5, paragraph C.2.a. above. A written certification from the document custodian that it meets all eligibility requirements is acceptable.

(2) Confirm that the document custodian maintains or performs the required inventory accounting required in Section 6-5, paragraph C.2.b. above. A certification from the document custodian that it (I) maintains the Issuer Master File for the issuer, (ii) maintains a Pool Master File for each pool in custody for the issuer, (iii) has performed and provided the date of the Annual Physical Inventory for all

pools held for the issuer, (iv) maintains a Non-Liquidation Release Inventory/File of all forms HUD 11708 submitted on or after July 1, 1992 on the basis of the non-liquidation reason code, and (v) obtains from the document custodian a copy or list of any documents that have been released for more than 180 days and have not been returned to the document custodian. Item (v) above should be reviewed with the issuer and any items not reconciled should be reported as a finding.

(3) Select a representative sample of Ginnie Mae pools for review and request verification from the document custodian of the following:

(a) Using the issuer's trial balance, the custodian must certify that the loans on the trial balance agree to the loans in custody.

(b) Verify that all pools are properly certified and report any pool past due for certification in accordance with Section 6-5, paragraph C.2.f. above.

D. ISSUER'S ADMINISTRATION OF POOLED MORTGAGES

1. Compliance Requirement . Administration of the pool of mortgages and of payments to securities holders is the responsibility of the issuer. Servicing of pooled mortgages must be carried out in accordance with generally accepted practices in the mortgage lending industry. Contractual requirements with respect to pool administration are contained in the guaranty agreement executed by the issuer and Ginnie Mae for each pool. The servicing system must be capable of producing at any time for any mortgage, an accounting which identifies the Ginnie Mae pool number for each listed mortgage, and for each monthly due date, the amount of each collection, disbursement, advance, or adjustment and indicating the latest outstanding balances of principal, deposits, advance and unapplied payments. In no instance may the issuer or subservicer remove a loan

from a pool, reduce a loan balance or remove funds from a pool custodial account unless in compliance with the Ginnie Mae Guide and authorized by Ginnie Mae.

The issuer may incur losses for pooled loans that are not fully insured such as coinsured multifamily loans, manufactured housing loans and Department of Veterans Affairs (VA) guaranteed loans. For each of these loan types, should a foreclosure take place, the issuer may not be fully reimbursed through the claims process. Any shortfall in collections must be paid to the securities holder out of the issuer's own funds. These shortfalls have been particularly large in the VA program. Special attention should be given to issuers with a concentration of VA loans in declining market areas.

In the VA program, should a default occur, the VA will determine the cost effectiveness of bidding at the foreclosure sale. VA will not bid if its losses will exceed the guarantee amount. Consequently, this 'no-bid' will be costly to the issuer as it must pay off the security holder for the outstanding mortgage balance.

2. Suggested Audit Procedures

a. Test whether the issuer meets Ginnie Mae's requirement for separate custodial bank accounts for principal and interest collections (non-interest bearing) and tax and insurance escrow funds (option of interest bearing) applicable to pooled mortgages with the principal and interest accounts held in institutions meeting Ginnie Mae's rating requirements (All Participants Release, July 10, 1990). Test the custodial account titles for compliance with requirements established by Ginnie Mae Letter Agreements, Forms HUD-11709 and 11720. If a principal and interest disbursement clearing account is used, assure that it is used only for payments to Ginnie Mae securities holders. (NOTE: These accounts may contain funds for more than one pool provided that the issuer maintains separate accounting records for each pool).

b. Review monthly collections of mortgage principal and interest and collections of claims on defaulted and liquidated mortgages to ascertain that funds have been deposited in the proper custodial accounts on a daily basis.

c. Test whether the issuer is making payments of interest, principal, and unscheduled principal to securities holders by the 15th of the month. Test whether partial prepayments, prepayments in full, assignments, and foreclosures are passed through to the securities holders in the regular monthly payment following the month of receipt. Test that all such recoveries are recorded on Mortgage-Backed Securities report controls and the pool collateral is removed from the custodian's possession and the transaction is supported by documentation.

d. Test whether disbursements from principal and interest custodial bank accounts are authorized pursuant to the Guaranty Agreement.

e. Test whether the issuer is disbursing payments to Ginnie Mae I securities holders on a date that can be expected to result in receipt of the funds by the securities holders by the 15th of the month.

f. Review a representative sample of payments to securities holders to determine that such payments were made to those shown in the securities holders register for the pools being tested.

g. Compare mortgages listed in the issuer's Liquidation Schedule (Form HUD-11710E) to those identified on Form HUD-11708 held by the custodian as having been withdrawn from the pool to ensure proper pass-through of proceeds to securities holders.

h. Test whether the issuer is using its own resources to:

(1) Make advances to the pool accounts to cover shortfalls in collections from mortgagors.

(NOTE: Limited exceptions to this requirement are included in the Ginnie Mae Handbooks.) Special attention should be given to the issuer's calculation and use of excess funds, particularly for internal reserve pools.

(2) Cover principal amounts not recovered in claim settlements or which are due in connection with defective loans. (Issuers are required to "buy out" uninsured or otherwise defective loans from the pools in accordance with instruction in the Handbooks Ginnie Mae 5500.1 and 5500.2 using the issuer's own funds and only after receiving Ginnie Mae approval.)

I. Obtain an understanding of the issuer's controls to project the need for and availability of funds. These controls should allow the issuer to make required advances to securities holders, as required under Section 4.02 of the Guaranty Agreement.

j. Test whether the issuer incurred losses for pooled loans not fully insured such as coinsured multifamily loans, manufactured housing loans, and Department of Veterans Affairs guaranteed loans. Determine that the issuer has disclosed a contingent liability in the financial statements.

k. Test that the issuer has a system to follow up on and obtain the required documents to enable the custodian to make its final certification in a timely manner. Ginnie Mae must receive the final certification, covering documents listed on the reverse side of the Schedule of Pooled Mortgages, within the timeframes identified in Handbooks Ginnie Mae 5500.1 and 5500.2.

If the issuer has acquired pools from another issuer, or if the issuer has transferred pools from one document custodian to another, test whether these pools have received new final certifications (recertification) within the timeframes outlined in the Ginnie Mae Handbooks.

l. Test whether the issuer established a complete securities holders register in accordance with Ginnie Mae instructions and updated the register prior to paying holders each month. The register should include a record of all certificate transfers for the life of the pool.

m. Test whether the issuer is servicing delinquent mortgages and managing foreclosures and assignments in accordance with the applicable requirements of the VA, FHA, RHS and the Ginnie Mae Guide.

n. Test whether undelivered payments are deposited into the principal and interest custodial account and that checks which remain outstanding in excess of 6 months of the payment date are stopped and the funds are returned to the P&I custodial account. Undelivered payments should not be used as excess funds or used by the issuer to fund pool shortfalls.

o. Test whether any transfer of the P&I or T&I custodial accounts, change of document custodian, change of mortgage servicer or transfer of issuer responsibility was accomplished after written approval from Ginnie Mae.

E. Review of Monthly Accounting Reports and Quarterly Submissions

1. Compliance Requirement . Ginnie Mae issuers of MBS are required to submit the following reports periodically throughout the year:

a. Form HUD-11710A, Form HUD-11710D and Form HUD-11710E
Issuers reporting: All Ginnie Mae issuers of record
Frequency of reporting: Monthly
Deadline for submission: 10th day of following month

b. Trial Loan Balance Information
Issuers reporting: All Ginnie Mae issuers of record

Frequency of reporting: Quarterly
Deadline for submission: 45 days of end of calendar quarter

c. Mortgage Bankers Quarterly Financial Reporting, Form HUD-11750
Issuers reporting: Mortgage bankers not federally regulated
Frequency of reporting: Quarterly
Deadline for submission: 60 days after end of calendar quarters and 90 days after end of calendar year

d. Issuers must report to Ginnie Mae monthly on each pool. Such reports must be provided on Form HUD-11710A (Issuer's Monthly Accounting Report), Form HUD-11710E (Liquidation Schedule) and Form HUD-11710D (Issuer's Monthly Summary Report). Issuers with more than 100 pools (including Ginnie Mae I pools and Ginnie Mae II pools and loan packages) are required to report in electronic form using the procedures and format specified in Handbook 5500.1, Chapter 11.

Additional or alternative reports are required in connection with pools other than those for single family level payment loans, as explained in the chapters and appendices for the other programs.

The reports, along with supporting documents, must be sent to Ginnie Mae with sufficient lead time and via a method that ensures delivery no later than the tenth calendar day of each month. Instructions for the preparation and submission of the forms or magnetic tape are found in Appendices 11 through 14 of Handbook 5500.1.

e. Issuers must report to Ginnie Mae quarterly on all of the loans in their portfolio. Loan level detail must be reported by all issuers every 3 months. The loan level data should report trial balance information for all non-liquidated loans as of the cut-off date for the quarter (All Participants Release, September 24, 1990).

f. Issuers that are not federally regulated must report their financial condition quarterly to Ginnie Mae. Reports must be provided to Ginnie Mae on a pre-formatted disk, HUD-11750, which includes a Statement of Condition, Statement of Income and Additional Information. Federally regulated financial institutions (banks, savings and loans and credit unions) are not required to submit this report (All Participants Release, March 5, 1990).

2. Suggested Audit Procedures

a. Obtain an understanding of the issuer's procedures for collecting and entering all data relating to mortgage collections and securities payments on Form HUD-11710A. Test whether entries are made in accordance with instructions in the Ginnie Mae Handbooks.

b. Select a sample of Form HUD-11710A's and trace delinquency information to the issuer's internal mortgage servicing delinquency reports.

c. Compare the securities balance reported on the Form HUD-11710A to the Remaining Pool Balance (R.P.B.) reported to Ginnie Mae, or its agent, in accordance with Ginnie Mae MBS requirements.

d. Test whether a Liquidation Schedule (Form HUD-11710E) is submitted to Ginnie Mae for each loan removed from the pool. Also, test that the unpaid loan balances passed through to securities holders and reported in the Liquidation Schedule, agree to the issuer's records.

e. Compare the amount of checks sent to securities holders for the month to the amount reported to Ginnie Mae.

f. Compare the custodial account balances reported on Forms HUD-11710A and 11710D to the actual balances (after reconciliation) of the disbursement clearing and custodial bank accounts as shown by the bank statements.

g. On pools selected for review, reconcile the total unpaid principal balance of the pooled mortgages to the unpaid principal balance of the securities, as follows:

(1) Pool Principal Balance (Section 1, Line D, Form HUD-11710A)

(2) (plus) Prepaid Principal (Section 1, Line F)

(3) (minus) Delinquent Principal (Section 1, Line G)

(4) (minus) Concurrent Date (CD) Pools Only: Scheduled Principal (Section 1-A, Block C)

(5) (plus) CD Pools Only: Last Liquidation Principal Installment (Principal portion of last installment reported on Liquidation Schedule, Form HUD-11710E)

(6) (minus) CD Pools Only: Additional Principal Adjustment or FIC change for Graduated Payment Mortgage Pools (Section 2, Block D, Other)

(7) (equals) Security Principal Balance (Section 3, Line D)

Differences may arise in the reconciliation between the pooled loan balance and the outstanding securities balance due to additional principal payments or rounding. Such differences should not exceed $1.00 for each loan in the pool up to a maximum of $50.00 per pool. Any greater difference must be funded to the pool in the current report. At least once a year, adjustments to the securities holders payments must be made in Section 2, Block D, of Form HUD-11710A to fully correct for any difference. Reconcile and report on any difference.

h. For pools selected for review, test the expected Principal and Interest (P&I) Custodial Account balances at cut-off. This test (outlined below)

identifies a minimum dollar amount expected in the P&I account for any particular pool as of a given cut-off date. This test verifies the accuracy of the P&I balance reported in Section 5, Block B2 of the Form HUD-11710A report. The test formula will only yield accurate results when the mortgage and securities balances reconcile in Step 7 above.

The test assumes that all collections are paid out by the pass through of funds to securities holders or taken as issuer servicing fees. The test formula is different between Internal Reserve (IR) and Concurrent Date (CD) pools, but in either case indicates the amount of P&I funds which should be held in the account at the cut-off date, which include:

(1) (IR only) plus payment to securities holders, to be distributed on the 15th of the following month. (Form HUD-11710A, Section 2, Item G).

(2) (IR and CD) plus servicing fee, if taken after the cut-off date. If the issuer withdraws it servicing fee prior to the cutoff, this entry will be zero (Section 1, Item H).

(3) (IR and CD) plus prepaid P&I, funds which have been collected but are not required to be distributed to holders at the next payment date (Section 1, Item F, Total).

(4) (IR and CD) minus prepaid servicing fee, as calculated based on prepaid interest amounts (Section 1, Item F, Interest). Servicing fees collected on prepaid interest are already included in item (2) above.

(5) (IR and CD) minus delinquent P&I, funds not yet collected but which have already been distributed to holders through calculation of scheduled payment (Section 1, Item G, Total).

(6) (IR and CD) plus delinquent servicing fee as calculated based on total delinquent interest (Section 1, Item G, Interest). Servicing fees are not distributed to holders, so this amount is not a shortage in the account.

(7) (CD only) plus additional principal payments. These are funds collected but not due holders until the 15th of the following month (Section 1, Line B-2).

(8) (CD only) plus additional principal adjustment, the issuer-funded adjustment which has been deposited to the custodial account but is not distributed until the following month (Section 1, Line C, Pool Interest).

(9) (CD only) plus liquidation principal. Similarly, funds collected but not due to be distributed until the following month (Section 1, Item C).

(10) (CD only) plus fixed installment on liquidations, because it is necessary to amortize a liquidating loan through one payment beyond the month during which pay-off or foreclosure funds are received on CD pools. This "extra" month payment, normally not due until the following month, is included in the scheduled P&I amount.

(11) (CD only) minus servicing fee from liquidations, as calculated on the interest portion of the last payment installment (based on last interest installment on the Form HUD-11710E).

This calculated expected P&I balance should agree with the reported P&I balance (Form HUD-11710A, Section 5, B, 2). Differences should be reconciled and exceptions reported.

I. Obtain an understanding of the issuer's procedures and test whether the issuer meets the

delivery requirement by the tenth calendar day of each month.

j. Test that loan level information is being reported quarterly to Ginnie Mae.

k. For all issuers that are not federally regulated financial institutions, test that quarterly financial information is being submitted on the HUD-11750, a formatted disk.

F. Securities Marketing and Trading Practices

1. Compliance Requirement . Ginnie Mae has established securities marketing and trading requirements which are intended to assure that issuers carry out their securities marketing and trading activities in a manner consistent with prudent business practices and their own and others financial capacity. There are three components to these requirements: (a) a suitability rule, (b) prudent business practice rules, and © minimum forward delivery contract requirements relating to so-called mark to market deposit requirements. There also are recordkeeping and reporting requirements. These procedures must be implemented by all approved issuers, whether or not securities and/or commitments are outstanding. The applicable requirements are found in HUD Handbook 5500.1.

2. Suggested Audit Procedures

a. Obtain an understanding of the written procedures established by the issuer to determine the financial integrity of dealers, brokers, and investors, including an explanation of standards for, and steps taken in determining the financial capacity of dealers, brokers, or investors to complete transactions.

b. Test whether the issuer is following established procedures to determine the financial capacity of dealers, brokers, and investors to complete a transaction and to determine the business reputation of the dealers, brokers, and investors.

c. Obtain copies of the resolution executed by the issuer's Board of Directors designating key persons responsible for overall supervision of issuer activities relating to the marketing and trading of securities.

d. Obtain an understanding of the procedures established by the issuer to maintain a record of all commitments entered into to deliver or acquire securities.

e. Test whether the issuer's records of such commitments include the following:

   (1) Date of the transaction (trade date).

   (2) Type of securities.

   (3) Nature of the transaction: purchase, sale, optional or mandatory delivery, repurchase or other credit arrangement.

   (4) Settlement date.

   (5) Dollar amount of securities.

   (6) Interest rate on the securities.

   (7) "Price" of the securities.

   (8) Name of the firm and individual with whom the transaction was executed.

   (9) Current market price (value) of the contract.

f. For "regulated transactions" (see Note 1 at step h.) test whether the issuer's records include the following:

   (1) A copy of the delayed delivery contract required by the Ginnie Mae Handbook.

   (2) The name of the financial institution with which collateral is, or will be, deposited.

(3) Records of mark to market computations, including: market value, amounts of deposits by issuer and by contra-party, type of collateral deposited.

(4) If the collateral used is a letter of credit, a copy of the letter of credit.

g. Review the issuer's statement showing the computation of the issuer's "net position" and compare information to the issuer's accounting records. Prove the mathematical accuracy of the net position. The statement should identify amounts of loans and securities closed and held for sale, plus those expected to be acquired, less commitments the issuer has available for disposing of loans and securities. It also should include any positions involving repurchase, reverse-repurchase, or other credit transactions.

h. Determine the potential impact on an issuer's net worth of any identified forward or future commitment contract entered into by the issuer to purchase or sell securities, if there are material potential effects on the issuer's net worth, determine whether they are disclosed in the appropriate footnotes to the financial statements.

NOTE 1: "Regulated transaction" means the purchase or sale of securities by an issuer pursuant to a delay delivery contract except that the term does not include:

(1) A sale of securities where: (1) the issuer holds a valid, outstanding commitment to guaranty mortgage-backed securities (which is not applied in connection with another transaction) issued by Ginnie Mae in an amount at least equal to the face amount of the securities sold; and (2) the settlement date under the contract is no later than the last day of the calendar month in which the 150th day after the contract's trade date falls.

(2) A sale of securities guaranteed by Ginnie Mae and based on construction loans (construction loan securities) or project loans (project loan securities).

(3) A sale or purchase of securities pursuant to a contract which does not obligate the issuer to actually sell/purchase securities, that is, a put or call transaction in which the issuer has the option to perform.

(4) A purchase (or sale) of mortgage participation certificates directly from (or to) the Federal Home Loan Mortgage Corporation.

G. Adjusted Net Worth

1. Computation . A "Presentation of Adjusted Net Worth Calculation" is required for all issuers, even if there were no securities or commitments outstanding at fiscal year end. The required format for the "Presentation of Adjusted Net Worth Calculation" is provided on Attachment B of this Chapter.

Unacceptable assets are defined in Attachment A to this Chapter and should be itemized by asset classification. Do not aggregate the unacceptable assets into one line titled "Unacceptable Assets."

If evidence exists indicating the existence of related party receivables which have not been deducted by the IA, Ginnie Mae will deduct the amount from the issuer's adjusted net worth.

An issuer's adjusted net worth will be calculated by subtracting the total amount of unacceptable assets from the net worth as stated on the IA audited balance sheet. Excess/(deficit) net worth is computed as the difference between adjusted net worth and required net worth.

Failure of the issuer to respond timely and satisfactorily to requests made by Ginnie Mae, or its agent, for additional information could result

in disallowance of questionable assets and result in suspension or in termination of issuer status.

Where the Ginnie Mae issuer is a subsidiary, the adjusted net worth computation must focus exclusively on the assets and liabilities of the Ginnie Mae issuer.

2. Required Net Worth . Required Net Worth will be calculated as of the end of the issuer's fiscal year as follows:

   a. For issuers approved to securitize mortgage-backed securities pools backed by single family level payment, graduated payment, growing equity or adjustable rate mortgages, the net worth is: $250,000 base net worth plus one percent of the amount of securities outstanding in excess of $5 million, but less than $20 million; plus 0.2 percent of any additional securities, commitment authority and total pools funded [2] in excess of $20 million.

   b. For issuers approved to securitize mortgage-backed securities pools backed by manufactured home loans, the net worth is: $500,000 base net worth plus 0.2 percent of any additional securities, commitment authority and total pools funded in excess of $35 million.

   c. For issuers approved to securitize mortgage-backed securities pools backed by multifamily construction or permanent loans, the net worth is: $500,000 base net worth plus 0.2 percent of any additional securities, commitment authority, total pools funded and dollar amount of unexpended construction loan draws [3] in excess of $35 million.

[2]Pools that have been logged and are in the review process and the commitment line balance has been reduced.

[3]The net amount between Construction Loan commitment authority reserved and total Construction Loan draws made.

d. The base net worth requirement for all issuer types will be indexed to inflation and adjusted every five years with a one year advance notice to issuers. The change in price index will be measured by the Consumer Price Index (CPI). The base net worth requirement may float downward subject to a $250,000 or $500,000 minimum depending upon an issuer's pool type eligibility. The adjusted base net worth will be rounded to the nearest thousand. The reference period from which inflation will be calculated is December 1995. The first adjustment of the base net worth requirement will be on January 1, 2002 which will reflect the change in price level during 1996 through 2000. Future adjustments will follow in this manner. The Ginnie Mae President shall have discretion to waive or lessen any increase or decrease given by the indexing formula.

ATTACHMENT A

UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community. These pledged assets are acceptable for supervised institutions only.

2. An asset due from an officer or stockholder of the mortgagee or from a related entity, except for:

   - A construction loan receivable, secured by a first mortgage, from a related entity.

   - A mortgage loan receivable established in the normal course of business in an arm's length transaction and secured by a first mortgage on the related property.

   - A receivable from a related party where the affected parties have executed a cross-default agreement [4] or corporate guarantee agreement [5] with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest [6] unrelated to that person's position as an officer or stockholder of the mortgagee.

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[4]A cross default agreement is an agreement between related affiliated Ginnie Mae issuers which provides for the default of all affiliated issuers in the event of a default by any one of them.

[5]A corporate guarantee agreement is an agreement where the issuer's parent guarantees the performance of the issuer.

[6]"Personal interest" as used here indicated a relationship between the mortgagee and a person or entity in which that specified person (e.g. spouse, parent, grandparent, child, brother, sister, aunt, uncle, or in-law) has a financial interest in or is employed in a management position by the mortgagee.

4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity, as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.

5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.

6. The value of any servicing contract not determined in accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities and SFAS No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent revisions thereto.

7. Any asset not readily marketable and for which appraised values are very subjective. Examples include, but are not limited to, antiques, art work, and gemstones.

8. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.

9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.

10. Any asset which is principally used [7] for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes automobiles and personal residences.

11. "Other Assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or a schedule prepared by the issuer/mortgagee and signed by an officer of the issuer/mortgagee.

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[7] "Principally used" means that any other use of the property must be solely incidental.

12. That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution determined by an independent appraisal.

ATTACHMENT B

REQUIRED FORMAT FOR PRESENTATION OF ADJUSTED NET WORTH CALCULATION FOR ISSUER

A. Adjusted Net Worth Calculation :

Stockholders Equity per Statement of Financial Condition at end of reporting period		$ _____
Less:		
Itemized Unacceptable Assets [1/]		
1.	$ _____	
2.	$ _____	
3.	$ _____	
Total Unacceptable Assets		$ _____
Adjusted Net Worth		$ _____

B. Required Net Worth Calculation :

Unpaid Principal Balance of Securities Outstanding (Note: Number of Pools _____)	$ _____
Plus:	
Outstanding Balance of Commitments Authority Issued and Requested	$ _____
Total Outstanding Portfolio and Authority	$ _____
Required Net Worth	$ _____

C. Excess (Deficit) Net Worth $ _____ [2/]
(Adjusted Net Worth - Required Net Worth)

[1/] Unacceptable assets are defined in Attachment A.

[2/] In the event adjusted net worth does not meet the Ginnie Mae requirement, the IA may include any comments from representatives of the issuer of corrective measures contemplated.

ATTACHMENT C

REQUIRED FORMAT FOR PRESENTATION OF ADJUSTED NET WORTH CALCULATION FOR ISSUER'S PARENT

A. Adjusted Net Worth Calculation :

Stockholders Equity per Statement of Financial Condition at end of reporting period		$ _____
Less:		
Itemized Unacceptable Assets [1/]		
1.	$ _____	
2.	$ _____	
3.	$ _____	
Total Unacceptable Assets		$ _____
Adjusted Net Worth		$ _____

B. Comparison of Net Worth Calculations :

Issuer's Required Net Worth (taken from Issuer's Adjusted Net Worth Calculation)	$ _____
(Multiply issuer's required net worth by 110% for issuers with single family status only, otherwise multiply by 120%)	
Parent's Required Net Worth	$ _____

C. Excess/(Deficit) : $ _____

[1/] Unacceptable assets are defined in Attachment A.

ATTACHMENT D

REQUIRED FORMAT FOR PRESENTATION OF INSURANCE REQUIREMENT

A. Identification of Affiliated [1/] Ginnie Mae Issuers:

Affiliated Ginnie Mae Issuers:
(Issuer Name and Ginnie Mae Issuer Identification Number)

Affiliated Issuers on Same Insurance Policies:
(Issuer Name and Ginnie Mae Issuer Identification Number)

B. Required Insurance Calculation:

Servicing Portfolio:	
Ginnie Mae	$ _____
Fannie Mae	$ _____
Freddie Mac	$ _____
Conventional (Other)	$ _____
Total Servicing Portfolio	$ _____
Required Fidelity Bond Coverage	$ _____
Required Mortgage Servicing Errors and Omissions Coverage	$ _____

C. Verification of Insurance Coverage:

Fidelity Bond Coverage at End of Reporting Period	$ _____
Mortgage Servicing Errors and Omissions Coverage at End of Reporting Period	$ _____

D. Excess (Deficit) Insurance Coverage:

Fidelity Bond Coverage	$ _____
Required Mortgage Servicing Errors and Omissions Coverage	$ _____

E. Ginnie Mae Loss Payable Endorsement :

Fidelity Bond Coverage	$ Yes/No
Mortgage Servicing Errors and Omissions Coverage	$ Yes/No

[1/] Definition of an Affiliate : An affiliate is a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an issuer.

ATTACHMENT E

REPORT OF INDEPENDENT AUDITORS ON CONSOLIDATING
BALANCE SHEET AND STATEMENT OF INCOME

Board of Directors
ABC Financial Corporation

We have audited, in accordance with generally accepted auditing standards and Government Auditing Standards, the consolidated financial statements of ABC Financial Corporation and subsidiaries as of December 31, 1991 and have issued our unqualified opinion thereon dated January 24, 1992 included on page "XX" of [identify report]. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The following consolidating balance sheet and statement of income on pages "XX" and "XX," respectively, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements of ABC Financial Corporation and subsidiaries. Such information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

This report is intended for the information of the audit committee, management, and the Government National Mortgage Association (Ginnie Mae). However, this report is a matter of public record and its distribution is not limited.

[Firm Signature]

[Date]

REQUIRED TRANSMITTAL/CHECKLIST FOR ANNUAL SUBMISSION OF FINANCIAL DOCUMENTS

Address to: Ginnie Mae's Review Agent

To whom it may concern:

The following information is being sent to maintain eligibility in the Mortgage-Backed Securities Program. If you have any questions regarding the items being sent, you may contact Mr./Ms. _____ of the organization or me at telephone number _____. Our facsimile number is _____.

Complete Items 1 through 7

1. Issuer Name:_____
2. Issuer Address:_____
3. Issuer's Tax Identification No._____
4. Ginnie Mae I.D. No._____
5. FHA Mortgagee No._____
6. IA's Tax Identification No._____
7. IA's Contact Person_____
   and Telephone Number:_____

Place a Checkmark by Item(s) Submitted

1.___Annual Audited Financial Statement for period ended __/__/__
2.___IA's Report on Consolidating Balance Sheet and Statement of Income (if appropriate)
3.___IA's Report on Internal Controls
4.___IA's Report on Compliance with specific Requirements
5.___IA's Presentation of Insurance Requirement
6.___IA's Presentation of Adjusted Net Worth for Issuer
7.___IA's Presentation of Adjusted Net Worth for Parent, (if appropriate)
8.___Corrective Action Plan (if appropriate)
9.___Schedule of "Other Assets"
10.___Name, address and Ginnie Mae Issuer Number (if applicable) of all affiliates. An "affiliate" is defined for these purposes as an organization that is related to the issuer through some type of control or ownership (as defined by GAAP). Use additional page if necessary:

_____

_____

_____

Signature:_____Date:_____
Type of Print Signature Name:_____
Title:_____

CHAPTER 7. HUD-APPROVED TITLE II NONSUPERVISED MORTGAGEES AND LOAN CORRESPONDENTS AUDIT GUIDANCE

7-1 Program Objective . HUD insures mortgages made by private lending institutions to finance the purchase of single family and multifamily homes. HUD approves the mortgagees for participation in the mortgage insurance programs for single family and multifamily homes as evidenced by the mortgagee's receipt of the yearly verification report in the last month of its fiscal year. HUD approves lending institutions which belong to the Federal Reserve System or with Federal Deposit Insurance Corporation or National Credit Union Administration insurance on their accounts. These types of institutions are designated by HUD as supervised mortgagees. HUD also approves other financial institutions designated as nonsupervised mortgagees, loan correspondents, and investing mortgagees which have authority to originate, purchase, sell, or service HUD-insured mortgages depending on the type of institution. These institutions are approved on the basis of their financial capacity, experience, facilities, and other criteria as specified in HUD Handbook 4060.1.

7-2 Program Procedures . All mortgagees and loan correspondents, whether supervised or nonsupervised, must apply for initial or branch approval to participate in the HUD/FHA mortgage insurance programs through the Lender Approval and Recertification Division at HUD Headquarters, following the directions in HUD Handbook 4060.1, Mortgagee Approval and Recertification . After a review of the application and clearance through certain Headquarters systems, the applicant, if approved, will be assigned a unique HUD/FHA identification number and notified that it may now originate FHA insured mortgages.

7-3 Reference Material

Document	Title
24 CFR Part 202	Regulations Relating to the Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development

Mortgagees Letters	Various
HUD Handbook 4000.2 REV-1	Mortgagee's Handbook-Application Through Insurance (Single Family)
HUD Handbook 4000.4	Single Family Direct Endorsement Program
HUD Handbook 4060.1	Mortgagee Approval and Recertification
HUD Handbook 4060.3	Field Office Guide for Mortgagee Monitoring
HUD Handbook 4110.2	Mortgagee's Guide-Home Mortgage Insurance Fiscal Instructions
HUD Handbook 4155.1	Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties
HUD Handbook 4205.1	Single Family Coinsurance Program
HUD Handbook 4330.1	Administration of Insured Home Mortgages
HUD Handbook 4330.4	FHA Single Family Insurance Claims
HUD Handbook 4350.4	Multifamily Mortgagees

7-4 Reporting Requirements . A Title II, nonsupervised mortgagee or loan correspondent is required by 24 CFR Part 202 annually to submit an audit report to the Commissioner within 90 days of the close of its fiscal year. The audit shall be performed under Government Auditing Standards and shall include the auditor's report on the basic financial statements and a computation of the mortgagee's Adjusted Net Worth. These reports are required for every Title II nonsupervised mortgagee or loan correspondent regardless of the number of loans originated or serviced during the fiscal year. All instances of noncompliance identified by the auditor must be reported as findings, even in those cases where corrective action was taken by the auditee after the end of the fiscal year. A suggested format for the computation of Adjusted Net Worth and the list of unacceptable assets are shown in paragraph 7-6 of this chapter.

For nonsupervised mortgagees, other than nonsupervised loan correspondents, the audit report shall also cover internal controls, compliance with specific requirements that have a direct and material effect on HUD-assisted mortgages, including: an opinion on compliance with specific requirements applicable to major HUD-assisted programs (or a report on compliance with specific requirements applicable to nonmajor HUD-assisted program transactions).

For nonsupervised loan correspondents, although the audit is performed under Government Auditing Standards, the Office of Housing has changed the compliance and auditing requirements. The scope of the auditors' testing of compliance with internal controls and the presentation of the results of those tests may be included in the auditors' report on the basic financial statements. The audit is not subject to the requirements or procedures of paragraph 7-5 except where mandated by Government Auditing Standards.

Except for Ginnie Mae issuers, one copy of the report should be sent by the auditee to:

Mailing address:

U.S. Department of HUD
Lender Approval and Recertification Division
Room B-133 3214 Plaza
451 Seventh St. SW
Washington, DC 20410-8888

Delivery:

U.S. Department of HUD
Lender Approval and Recertification Division
Suite 3214
490 L'Enfant Plaza East
Washington, DC 20024

When a Title II mortgagee is also a Ginnie Mae issuer, the audited financial statements are now sent only to Ginnie Mae for review (See Chapter 6). Lenders/mortgagees that are approved under both Title I and Title II and also are Ginnie Mae issuers must submit one set of audited financial statements to Ginnie Mae and another, for Title I, to the Office of Lender Activities and Program Compliance.

All servicing/origination income must be accounted for in compliance with FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent amendments.

Where the mortgagee/loan correspondent is a subsidiary and information on its assets, liabilities and results of operation are included in the consolidated financial statements of its parent entity, HUD will accept the audited consolidated financial statements of the parent, if it includes consolidating schedules, audited by the IA, which distinguish the balance sheet and operating statement of the mortgagee/loan correspondent subject to the HUD audit requirement. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent and the auditor's opinion must cover the financial statement accounts of the subsidiary.

A sample auditor's report on the consolidating balance sheet and operating statement is included as Attachment A to this Chapter.

7-5 Compliance Requirements and Audit Areas

A. Quality Control Plan

1. Compliance Requirement

HUD-approved mortgagees are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and comply with all relevant Departmental rules and regulations. Each HUD-approved mortgagee is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4060.1 REV-2, Chapter 9 or the latest HUD guidance for loan origination and servicing. Each approved mortgagee must develop and implement a quality control plan consistent with its needs, and the above referenced guidance, to assist corporate management in determining whether HUD requirements and the mortgagee's policies and procedures are being followed by its personnel. The monthly quality control procedures may be conducted by the entity itself internally or an external review, which may

be performed by the independent auditor or other qualified organization.(24 CFR Subsection 202.5(h)).

2. Suggested Audit Procedures

a. Obtain a copy of the mortgagee's quality control plan and compare it to the general and specific requirements contained in Handbook 4060.1.

b. Determine whether the mortgagee has a procedure in place which assures that all employees involved in loan origination and servicing understand the mortgagee's quality control policies and procedures.

c. Inquire whether the mortgagee relies on an internal or external quality control review of its origination, underwriting, and servicing functions. If the mortgagee relies on the external review process and the IA's engagement includes the performance of the quality control review, the IA should report this as part of the additional information required under Chapter 2 of this guide. If the mortgagee relies on an internal review, determine that it was performed by knowledgeable personnel with no direct responsibilities in the areas they reviewed.

d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample in accordance with guidance in HUD Handbook 4060.1. It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review as required by HUD Handbook 4060.1 and that the plan includes coverage for any loan correspondents and authorized agents of the mortgagee.

e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4060.1 REV-2, Chapter 9 were included in the quality control review. The Quality Control Plan must provide for the written reverification of the mortgagor's

employment, deposits, gift letter or other sources of funds.

f. Obtain a written copy of the latest quality control report and determine that senior management officials also received a copy which included any deficiencies identified during the review. Determine that the mortgagee also notified the Office of Lender Activities and Program Compliance of any violations, false statements or program abuses in the report.

g. Determine that senior management officials promptly initiated corrective action for all deficiencies noted.

B. Branch Office Operations

1. Compliance Requirement . A mortgagee may maintain one or more branch offices for the submission of applications for mortgage insurance. A traditional branch office is a separately located unit of the mortgagee, in an office in which no business except that of the mortgagee is conducted. It may be located in the mortgagee's home office. In addition, a mortgagee may register a branch office that does not meet the requirements of a traditional branch office (non-traditional branch office). The mortgagee may determine the location and type of its branch office facilities. The non-traditional branch office facility may be located in either commercial or non-commercial space. Each branch office must be registered by HUD. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR Subsection 202.5(k) (HUD Handbook 4060.1 Chapter 5).

2. Suggested Audit Procedures

a. Determine that all branches are registered with HUD by review of the appropriate form or screen printout.

b. Through inquiry and/or physical observation, determine that the branch is a true branch and is not a subsidiary, net branch, independent contractor, agent of the auditee or separate

entity. A mortgagee with a separate tax ID number is required to have approval as a mortgagee in its own right. A branch must have at least one employee, including a branch manager, that serves only that branch. The branch office should have its own telephone and maintain its own accounting records.

c. Review auditee payroll records for indications of any branch office personnel, except the receptionist that are not employed exclusively for the auditee at any given time. Inquire of personnel to determine that branch employees conduct only the business affairs of that entity during normal business hours.

d. Determine that the branch office is located in space which is separated by a partition from any other entity and is clearly identified to the public and that the branch office's operating costs are paid by the approved mortgagee or loan correspondent.

e. Review company records for evidence that the present branch office manager is a corporate officer or an employee authorized to bind the corporation in matters involving loan origination and servicing and manages only one branch.

C. Loan Origination

1. Compliance Requirement . HUD requires the originators of insured mortgages to develop such loans in accordance with HUD requirements. They must obtain and verify information with at least the same care that would be exercised in originating a loan in which the mortgage would be entirely dependent on the property as security to protect its investment.

Information on the auditee's copy of Form HUD-92900, HUD/FHA Application for Commitment for Insurance Under the National Housing Act must be supported by documents in the auditee files (HUD Handbook 4000.2 REV-1).

Mortgagees may not require, as a condition of providing an insured loan, that the principal amount of the loan exceed a minimum amount established by the mortgagee (24 CFR 203.18d).

24 CFR 202.12 prohibits lenders from originating insured mortgages if it is the customary lending practice of the lender to engage in "tiered pricing" of its loans (for discount points, origination fee and other such fees) of more than two percent in an area (metropolitan statistical area or county, in rural areas). The regulation further requires HUD to ensure that any variations in mortgage charge rates be based only on the actual variations in costs to the lender to make the loan. The two percent limitation on variation in "mortgage charge rates" shall be applied to all Section 203 mortgages by loan type.

2. Suggested Audit Procedures

a. Obtain an understanding of the auditee's procedures for processing loan applications. Determine that the auditee's procedures provide that applicant's credit report, employment verification, and verification of deposits are sent directly to the auditee and do not pass through any third party.

b. Obtain a sample of files for loans originated during the audit period to test areas c-f, which follow. This should include loans originated at the auditee's branch offices and by their loan correspondents as well as the central office. Where an auditee uses an independent third party to perform quality control over loan origination, the IA may rely on the testing of loan files performed by the independent third party, provided the IA has reviewed the independent reviewer's procedures, retested some of the same files chosen for testing, and the independent written reports indicate no significant discrepancies were identified.

c. Review loan file documentation for evidence that a face-to-face interview with the loan applicant was conducted by a company employee and that the

completed loan application was reviewed with the loan applicant. A face-to-face interview is required only when the applicant puts down less than ten percent and does not have homeownership counseling.

d. Review all files in the sample for any forms that have been signed by the mortgagee but not completed by the applicant.

e. Determine that all employment and income data is supported by a verification of employment or other sources, especially for self-employed applicants and applicants with non-employment income. Review loan file documentation for evidence that the mortgagee reconciled any conflicting information prior to submitting the application package to the HUD Field Office for endorsement.

f. Test that the applicant's cash assets, source of funds, and liabilities are supported by documentation such as verifications of deposits, gift letters, etc., and credit reports.

g. Obtain a sample of files for rejected loans during the audit period. Review for the following:

(1) Determine that an individual review was provided for all applications denied due to a statistical category or score (e.g. credit score, debt/income ratio). Ensure that the score accurately reflected the financial status (e.g. loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.

(2) Determine that the rejection was made based on established criteria and the reason for the rejection was provided to the applicant. Ensure that all procedures for accepting and processing the loan were followed.

h. Test whether loan correspondents are selling mortgages to other than their sponsors without prior HUD approval. In connection with the Direct Endorsement Program, to determine that the loan correspondent does not underwrite loans, review selected loan documentation for indications of underwriting by the loan correspondent.

i. Review the agreements between the auditee and its staff appraisers and test for compliance with Handbook 4000.4 REV-1, Chapter 2.

D. Loan Settlement

1. Compliance Requirement . The mortgagee's responsibilities prior to and following loan settlement are minimal. The loan origination fee should normally compensate the mortgagee for the required services. However, HUD has specified the types and amount of additional charges and fees which the mortgagee may collect from the borrower. Additionally, the mortgagee is responsible for promptly submitting up-front mortgage insurance premiums to HUD following loan settlement and disbursing the funds and completing the transaction in accordance with the closing documents, without undue delay (HUD Handbook 4000.2 REV-1, and Chapter 7, 24 CFR 203.27).

2. Suggested Audit Procedures

a. Select a representative sample of loans for testing from those settled during the audit period.

b. Examine the signed settlement statement (Form HUD-1). Prove the mathematical accuracy of the Form. Compare amounts listed in the Form to other authentic loan documents.

c. Review the fees and charges collected from the mortgagors as shown on loan settlement statements to determine that they are equal to the mortgagee's actual out-of-pocket costs for the related service or the maximum charge allowed by HUD, whichever is lower. Determine

that the origination fee did not exceed one percent of the loan amount. Compare the fees and charges to the guidelines contained in HUD Handbook 4000.2 REV-1. Report any differences as findings.

d. Ensure points and closing costs are accurate. Determine whether the differences may be due to discriminatory practices.

e. Review computations and supporting data for amounts collected to establish escrow accounts for taxes and hazard insurance. Reconcile and report on any differences.

f. Review computations and supporting data for interest collected from the mortgagor at loan closing. Reconcile and report on any differences.

g. The Form HUD-92900 contains the acquisition cost of the property. The HUD-1 contains the amount of the insured mortgage. Compare the amount of the insured mortgage to the acquisition cost to determine that the mortgagor made the minimum investment.

h. Examine the canceled check or other supporting documentation for evidence that the mortgage insurance premium is submitted to HUD, in accordance with HUD policy at the time of closing, by the mortgagee. Test that payment reached HUD's depository within 15 days of closing.

i. Compare the purchase contract and the HUD-1 for agreement as to sales price, earnest money and any seller concessions.

E. Loan Servicing

1. Compliance Requirement . Mortgagees and loan correspondents which service HUD/FHA insured loans are permitted to collect certain fees from the borrowers in accordance with HUD regulations (HUD Handbook 4330.1, Chapter 4).

Mortgagees which service insured Home Equity Conversion Mortgages (HECM), with adjustable rate mortgages are responsible for adjusting those rates in accordance with the annual and lifetime caps as established by Handbook 4235.1.

Loan servicing procedures are to be followed consistently and should not vary based on any of the prohibited bases.

2. Suggested Audit Procedures

a. Select a sample of delinquent and defaulted loans including loans in foreclosure for testing the mortgagee's loan servicing procedures.

b. Review the loan file documentation for evidence that the auditee documents its records to reflect its servicing on delinquent and defaulted mortgages.

(1) Obtain an understanding of the auditee's servicing procedures.

(2) Ascertain whether the auditee maintains individual servicing records documenting collection (loan servicing) activities.

(3) Review the servicing records for recorded collection contacts attempted and completed.

c. Review selected loan file documents for evidence that the auditee communicates with the mortgagor or makes a reasonable effort to do so in order to determine the cause of default.

(1) Review the individual loan servicing records for recorded collection contacts of more than one type (i.e., telephone, letter, face-to-face interview, etc.) if one type of contact effort is unsuccessful.

(2) Review the individual loan servicing records for mortgagor explanations of defaults and documented attempts by loan

servicing personnel to contact the mortgagors.

(3) Based on the review of the individual loan servicing records, when the cause of delinquency appears to be temporary (i.e., illness, unemployment) test whether the auditee offers reasonable repayment plans.

d. Review selected receipts for evidence that the auditee accepts partial or late mortgage payments offered by mortgagors as provided for in HUD Handbook 4330.1.

(1) Review the servicing records for the recording of partial payments accepted, held in a pending file, or rejected. (Note: The decision to reject a late or partial payment must be a decision based on the individual circumstances.)

(2) Review the payment records of selected mortgagors to ascertain whether:

(a) The amount of the late charge, if any, was computed correctly.

(b) The late charge was assessed after 15 days of delinquency, or the 17th day of the month.

(3) Review the auditee's procedures for the handling of partial payments. Obtain a representation letter from the auditee concerning such procedures.

e. Inquire whether the auditee has implemented steps to comply with the provisions of HUD's Loss Mitigation procedures. Such steps would include informal forbearance, workout agreements, acceptance of partial payments and deeds in lieu of foreclosure. Review selected claims files for evidence that such relief measures were considered (refer to Mortgagee Letters 96-11, 96-25, 96-32 and 96-61).

f. Inquire whether the auditee sends notices to advise the mortgagor about HUD's foreclosure relief program once it has decided to foreclose. Review the loan files selected for evidence that such letters were sent prior to the initiation of foreclosure proceedings.

g. Compare charges assessed to borrowers for servicing activities to allowable amounts. For the loans selected:

   (1) Review charges to mortgagors for checks returned due to insufficient funds.

   (2) Review charges to the mortgagor for attorney's fees and test whether:

      (a) The charges were for services performed by someone other than salaried members of the auditee's staff.

      (b) The charges were made only in those cases where the auditee made a decision to foreclose and referred the loan to an attorney for initiation of foreclosure proceedings.

h. Obtain an understanding of the auditee's procedures for paying mortgage insurance premiums to HUD. Determine that the auditee follows one of the two acceptable methods of making mortgage insurance premium payments (electronic payment or bank check) and that its practices comply with HUD regulations.

i. Review a representative sample of insurance claims submitted to HUD following mortgage defaults. Recalculate the net claim amount on the Single Family Application for Insurance Benefits (Form HUD-27011) and compare the claim amount information to the accounting records. Test the amounts included in the claim for preservation and protection expenses to determine that they are supported by documentation.

j. Select a sample of adjustable rate HECMs and test that the limitations of the 2% annual and 5% lifetime caps are not being exceeded by the mortgagee.

k. Select a sample of HECMs and determine that the disbursements have been made in accordance with the mortgage note.

F. Escrow Accounts

1. Compliance Requirement . HUD requires that mortgagees establish escrow accounts and that mortgagors make monthly payments thereto, to insure that funds will be available to pay taxes and insurance premiums. Each month the mortgagee must collect from the mortgagor an amount which the mortgagee estimates will be sufficient to enable it to accumulate funds so as to pay all escrow obligations prior to delinquency, i.e., (a) mortgage insurance premiums, (b) taxes, special assessments, and ground rents, if any, (c) hazard insurance premiums, if any, and (d) flood insurance premiums where required. The mortgagee should analyze the escrow account, at least annually, to determine if projected escrow balances will be sufficient to fund escrow disbursements. Any projected escrow shortage should be collected by either (a) lump sum payment or (b) allocating the shortage over a 12-month period. The mortgage instrument provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills thirty days prior to the time the bills become delinquent (HUD Handbook 4330.1, Chapter 2).

2. Suggested Audit Procedures

a. Obtain an understanding of the policies and procedures for reconciling custodial trust accounts.

b. Obtain trial balances of individual escrow accounts and reconcile or review the reconciliation of the total with the auditee's control account and the related bank account. Test whether the auditee did not use escrow

funds for late charges, assumption fees or any purpose other than specified above.

c. For selected mortgages, obtain the most recent escrow analysis, note whether it was prepared not more than one year ago, and whether monthly deposits appear adequate to provide for payments of taxes, insurance, etc., by review of actual payments or other evidence of amounts due (e.g., tax assessment notice or prospective rate adjustment notices from insurance companies). Also, test whether the most recent real estate tax bills for each account were paid. If not paid within the discount period, inquire as to reasons for the delay and test whether the mortgagor retained the benefit of the discount, and any late charges assessed were borne by the auditee at its expense. Test whether the mortgagor was furnished a statement of interest paid during the preceding year within 60 days after the end of the calendar year.

d. On accounts selected for review, inspect supporting documents for escrow disbursements such as receipted invoices, tax bills, and canceled checks.

e. Test whether escrow funds are deposited in accounts fully insured by the Federal Deposit Insurance Corporation (FDIC), or National Credit Union Administration (NCUA) and whether the auditee covered any overdrafts on selected accounts by advancing its own funds to custodial accounts so that FDIC or NCUA insurance protection was not impaired. HUD regulations neither require or forbid that escrow accounts bear interest. However, in those cases where accounts are interest bearing, test whether interest earned, less expenses, is passed on to the mortgagor.

f. Test whether the auditee advises the mortgagor of the amount of any surplus escrow funds in accordance with HUD requirements.

g. Review the policies and procedures that the auditee has established to ensure that bills

payable from the escrow fund or the information needed to pay such bills is obtained in advance of the due date.

h. For any bills paid late by the auditee, determine that any late charges/penalties assessed are paid out of the auditee's funds and not the mortgagor's funds.

i. Inquire whether the auditee requires the mortgagor to purchase hazard insurance coverage from the auditee or from a specific company. This practice may fall within the purview of the Sherman Anti-Trust Act.

j. Review selected loan payoffs for evidence that the auditee returns to the mortgagor the amounts held in escrow for taxes and hazard insurance within 30 days of receipt by the mortgagee of payoff funds.

G. Section 235 Assistance Payments

1. Compliance Requirement . Under Section 235, HUD sends assistance payments to the mortgagee on behalf of the mortgagor as long as the mortgagor is eligible for the payments. HUD executes a contract with the mortgagee for each mortgage. Once a mortgage is insured, many of the initial eligibility criteria cease their applicability, however, the mortgagor must meet other continuing eligibility criteria. In addition, the mortgagee must secure recertifications of income, family composition, occupancy and employment at least annually and as otherwise required by HUD (HUD Handbook 4330.1 REV-3, Chapter 10).

2. Suggested Audit Procedures

a. Select a representative sample of mortgagors receiving Section 235 Assistance Payments from the records of the mortgagee.

b. Review the mathematical accuracy of Form HUD-93102, Mortgagee's Certification and Application for Assistance of Interest Reduction Payments, and Form HUD-300, Monthly Summary of

Assistance Payments Due Under Sections 235(b), 235(j), or 235(i) or of Interest Reduction Payments Due Under Section 236, or equivalent computer printout. Report on any discrepancies.

c. Compare a sample of HUD-93102s to copies paid by the U.S. Treasury to determine that the dollar amounts are identical. Also, compare the number of Section 235 loans shown on the billing to the Treasury to the records of the mortgagee's servicing portfolio. Report on any discrepancies. Copies of the paid HUD-93102s can be obtained from:

Director, General Accounting Operations Division
Office of Finance and Accounting - HUD
451 Seventh Street, SW, Room 3222
Washington, DC 20410-4500

d. Select a sample of individual loan files and:

(1) Examine documentary evidence that the mortgagee obtained and verified information concerning mortgagor income, family composition and occupancy of the property.

(2) Test the mathematical accuracy of assistance payments computed by the mortgagee and trace to the Form HUD-300 or computer printout. Tests should include both Formula I and Formula II computations and factors used in computations. Determine that the formula providing the greater/lesser amount of assistance was used.

(3) Ascertain that the recertification was completed in a timely manner by the mortgagor i.e., no sooner than 60 days before and no later than 30 days after the mortgage anniversary date. If the recertification was not completed timely, ascertain whether the auditee acted to suspend the assistance payments contract.

(4) Review the mortgagee's records of loans subject to recapture of assistance paid on behalf of mortgagors for documentation of the cumulative assistance paid so that it can be recaptured (Mortgagee Letter 81-38).

H. Federal Financial and Activity Reports .

1. Compliance Requirement . Mortgagees participating in HUD-assisted activities are required to ensure that financial status, Single Family Default Monitoring, and reports required under the Home Mortgage Disclosure Act contain reliable data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements, Handbooks and Mortgagee Letter contain the specific reporting requirements that the mortgagee is to follow (Handbooks 4330.1 REV-3, Chapter 7 and 4155.1 REV-4, Chapter 3; Mortgagee Letter 95-3).

2. Suggested Audit Procedures

a. Identify all HUD-required financial and activity reports by inquiry of the mortgagee.

b. Obtain an understanding of the auditee's procedures for preparing and reviewing the required reports.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. Select a sample of activity reports and determine that the reports selected are prepared in accordance with HUD requirements.

e. For the samples, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between selected reports and mortgagee records.

f. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

I. Kickbacks

1. Compliance Requirement . HUD regulations prohibit mortgagees from paying any fee, kickback, compensation or thing of value, including a fee representing all or part of the lender's origination fee to any person or entity other than for services actually performed or to any person or entity for referral of the loan or as a finder's fee (24 CFR 202.5(l).

2. Suggested Audit Procedures

a. Obtain the general ledger, cash journal, canceled checks and supporting invoices for at least two months of the audit period.

b. Test whether disbursements are supported by an invoice and were not for a unreasonable amount in return for goods or services actually performed. Reconcile and report on any differences.

c. During the review of loan origination and loan settlement documents, the auditor should be alert for any fees or other types of payments which may represent kickbacks. If the auditor notes any kickbacks or indications of it, these should be reported as a finding.

J. Mortgagee Approval Requirements

1. Compliance Requirement . A nonsupervised mortgagee or loan correspondent shall have and maintain a net worth, in assets acceptable to the Secretary, as follows:

Entity Type	Amount
Loan Correspondent	$50,000 plus $25,000 per branch, up to maximum of $250,000.
Direct Endorsement Nonsupervised Mortgagees	$250,000 plus 1% of mortgage volume in excess of $25 million, up to maximum net worth of $1 million
Multifamily only Nonsupervised Mortgagees	$250,000

For nonsupervised mortgagees and loan correspondents approved by HUD for program participation, at least 20 percent of the adjusted net worth must be in liquid assets (cash, cash equivalents or marketable securities) up to a maximum of $100,000 (24 CFR 202.7(b)(2) and 202.8(b)(4)).

All mortgagees, but not loan correspondents, shall maintain both fidelity bond and errors and omissions insurance of at least $300,000 each. (24 CFR 7(b)(5)).

2. Suggested Audit Procedure

Test whether the nonsupervised mortgagee or loan correspondent meets the required levels for adjusted net worth, liquid assets, fidelity bond coverage and errors and omissions bond, per Handbook 4060.1 REV-1.

7-6 ADJUSTED NET WORTH

A. REQUIREMENT . An FHA computation of Adjusted Net Worth is required for all nonsupervised mortgagees and loan correspondents even if there were no loans originated or serviced during the audit period. The required amount, which must be maintained throughout the year, varies by program participant type and approval date per the guidance in Section J, Mortgagee Approval Requirements. Where the mortgagee/loan correspondent

is a subsidiary, the adjusted net worth computation must focus on the assets and liabilities of the individual (non-consolidated) entity with the HUD audit requirement.

B. UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community. These pledged assets are acceptable for supervised institutions only.

2. An asset due from an officer or stockholder of the mortgagee or from a related entity, except for:

   - A construction loan receivable, secured by a first mortgage, from a related entity.

   - A mortgage loan receivable established in the normal course of business in an arm's length transaction and secured by a first mortgage on the related property.

   - A receivable from a related party where the affected parties have executed a cross-default agreement [1] or corporate guarantee agreement [2] with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest [3] unrelated to that person's position as an officer or stockholder of the mortgagee.

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[1]A cross default agreement is an agreement between related affiliated Ginnie Mae issuers which provides for the default of all affiliated issuers in the event of a default by any one of them.

[2]A corporate guarantee agreement is an agreement where the issuer's parent guarantees the performance of the issuer.

[3]"Personal interest" as used here indicated a relationship between the mortgagee and a person or entity in which that specified person (e.g. spouse, parent, grandparent, child, brother, sister, aunt, uncle, or in-law) has a financial interest in or is employed in a management position by the mortgagee.

4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity, as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.

5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.

6. The value of any servicing contract not determined in accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities and SFAS 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent revisions thereto.

7. Any asset not readily marketable and for which appraised values are very subjective. Examples include, but are not limited to, antiques, art work, and gemstones.

8. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.

9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.

10. Any asset which is principally used [4] for the personal enjoyment or benefit of an officer, director or stockholder and not for normal business purposes. This includes automobiles and personal residences.

11. "Other Assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or schedule prepared by the

[4] "Principally used" means that any other use of the property must be solely incidental.

issuer/mortgagee and signed by an officer of the issuer/mortgagee.

12. That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution determined by an independent appraisal.

ATTACHMENT A

REPORT OF INDEPENDENT AUDITORS ON CONSOLIDATING BALANCE SHEET AND STATEMENT OF INCOME

Board of Directors
ABC Financial Corporation

We have audited, in accordance with generally accepted auditing standards and Government Auditing Standards, the consolidated financial statements of ABC Financial Corporation and subsidiaries as of December 31, 1991 and have issued our unqualified opinion thereon dated January 24, 1992 included on page "XX" [identify report]. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The following consolidating balance sheet and statement of income on pages "XX" and "XX," respectively, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements of ABC Financial Corporation and subsidiaries. Such information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

This report is intended for the information of the audit committee, management, and HUD. However, this report is a matter of public record and its distribution is not limited.

[Firm Signature]

[Date]

Attachment B

COMPUTATION OF ADJUSTED NET WORTH
FOR APPROVAL OF NONSUPERVISED MORTGAGEES
OTHER THAN LOAN CORRESPONDENTS

Minimum Net Worth Required		$ 250,000
Stockholders Equity (Net Worth) per Balance Sheet	$ _____	
Less Unacceptable Assets	$ _____	
Adjusted Net Worth for HUD Requirement Purposes		$ _____
Adjusted Net Worth ABOVE Amount Required		$ _____
Adjusted Net Worth BELOW Amount Required		$ _____

Attachment C

COMPUTATION OF ADJUSTED NET WORTH FOR APPROVAL AND RECERTIFICATION OF NONSUPERVISED LOAN CORRESPONDENTS

1.	Home Office		$50,000
2.	Add:		
	Branch Office	$ 25,000	
	× Number of Branch Offices		
	Subtotal		$
3.	Total		$
4.	**Net Worth Required** (lesser of $250,000 or Line 3)		$
	Owners' Equity (Net Worth) per Balance Sheet	$	
	Less Unacceptable Assets	$	
	Adjusted Net Worth for HUD Requirement Purposes		$
	Adjusted Net Worth ABOVE Amount Required		$
	Adjusted Net Worth BELOW Amount Required		$

Attachment D

COMPUTATION OF ADJUSTED NET WORTH
FOR RECERTIFICATION OF NONSUPERVISED MORTGAGEES
OTHER THAN LOAN CORRESPONDENTS

1.	Servicing Portfolio* at: _____ (end of fiscal year under audit)		$ _____
2.	Add:		
	Originated* during fiscal year	$ _____	
	Purchased* from Loan Correspondent during fiscal year	$ _____	
	Subtotal		$ _____
3.	Less:		
	Amounts included in Line 2:		
	Servicing retained	$ _____	
	Loan Correspondent purchases retained	$ _____	
	Subtotal		$ _____
4.	**Total**		$ _____
5.	1% of Line 4		$ _____
6.	Minimum Net Worth required (Greater of $250,000 or Line 5)		$ _____
7.	**Net Worth Required** (Lesser of $1,000,000 or Line 6)		$ _____

Stockholders Equity (Net Worth) per Balance Sheet	$ _____	
Less Unacceptable Assets	$ _____	
Adjusted Net Worth		$ _____
Adjusted Net Worth ABOVE Amount Required		$ _____
Adjusted Net Worth BELOW Amount Required		$ _____

* HUD/FHA insured single family mortgages only. Include Home Equity Conversion Mortgages (HECMs) at maximum claim amount.

Attachment E

E X A M P L E

COMPUTATION OF ADJUSTED NET WORTH
FOR APPROVAL OF NONSUPERVISED MORTGAGEES
OTHER THAN LOAN CORRESPONDENTS

Minimum Net Worth Required		$250,000
Stockholders Equity (Net Worth) per Balance Sheet	$ *345,678*	
Less Unacceptable Assets	$ *54,321*	
Adjusted Net Worth for HUD Requirement Purposes		$ *291,357*
Adjusted Net Worth ABOVE Amount Required		$ *41,357*
Adjusted Net Worth BELOW Amount Required		$ _____

Attachment F

E X A M P L E

COMPUTATION OF ADJUSTED NET WORTH FOR APPROVAL AND RECERTIFICATION OF NONSUPERVISED LOAN CORRESPONDENTS

1.	Home Office		$50,000
2.	Add:		
	Branch Office	$ 25,000	
	× Number of Branch Offices	9	
	Subtotal		$ 225,000
3.	Total		$ 275,000
4.	**Net Worth Required** (lesser of $250,000 or Line 3)		$ 250,000
	Owners' Equity (Net Worth) per Balance Sheet	$ 321,098	
	Less Unacceptable Assets	$ 45,678	
	Adjusted Net Worth for HUD Requirement Purposes		$ 255,420
	Adjusted Net Worth ABOVE Amount Required		$ 5,420
	Adjusted Net Worth BELOW Amount Required		$ _____

Attachment G

E X A M P L E

COMPUTATION OF ADJUSTED NET WORTH
FOR RECERTIFICATION OF NONSUPERVISED MORTGAGEES
OTHER THAN LOAN CORRESPONDENTS

1.	Servicing Portfolio* at: 6/30/97 _____ (end of fiscal year under audit)		$ *87,654,321*
2.	Add:		
	Originated* during fiscal year	$ *23,900,000*	
	Purchased* from Loan Correspondent during fiscal year	$ *46,500,000*	
	Subtotal		$ *70,400,000*
3.	Less:		
	Amounts included in Line 2:		
	Servicing retained	$ *13,000,000*	
	Loan Correspondent purchases retained	$ *25,000,000*	
	Subtotal		$ *38,000,000*
4.	**Total**		$ *120,054,321*
5.	1% of Line 4		$ *1,200,543*
6.	Minimum Net Worth required (Greater of $250,000 or Line 5)		$ *1,200,543*
7.	**Net Worth Required** (Lesser of $1,000,000 or Line 6)	$ *1,000,000*	
	Stockholders Equity (Net Worth) per Balance Sheet	$ *3,456,789*	
	Less Unacceptable Assets	$ *345,678*	
	Adjusted Net Worth		$ *3,111,111*
	Adjusted Net Worth ABOVE Amount Required		$ *2,111,111*
	Adjusted Net Worth BELOW Amount Required		$ _____

* HUD/FHA insured single family mortgages only. Include Home Equity Conversion Mortgages (HECMs) at maximum claim amount.

U.S. Department of Housing and Urban Development
Office of the Inspector General

SPECIAL ATTENTION OF:
Title I Mortgagees, Lenders, and Loan Correspondents

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-2
Chapter Number: 8
Issued: September 1, 2006

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1. This transmits Handbook 2000.04, REV-2, CHG-2, Chapter 8, Consolidated Audit Guide for Audits of HUD Programs, HUD - Approved Title I Nonsupervised Lenders and Loan Correspondents Audit Guidance.

2. Summary: The Office of the Inspector General is in the process of updating the handbook and will release each chapter as it is completed. When all of the individual chapters of the Audit Guide are revised, they will be consolidated into a revised Audit Guide and issued as Handbook No. 2000.04, REV-3.

This handbook chapter is a change to Handbook IG 2000.04, REV-2, chapter 8, dated August 1997. A change was necessary to reflect changes in reporting, add suggested audit steps, and clarify existing information/guidance. This chapter serves as a reference for auditors who perform audits of approved Title I nonsupervised lenders and loan correspondents.

3. Significant Changes:

a. Electronic reporting requirements are added to this chapter in paragraphs 8-4B, Electronic Submission of Audited Financial Statements, and 8-4C, Auditor Involvement in the Electronic Submission Process.

b. Paragraph 8-3, Reference Material, contains the current reference documents at the time this Audit Guide chapter was issued and information on how to obtain the reference materials. Throughout this chapter, reference is made to handbooks, using the base handbook number without the revision number (i.e., REV-1, REV-6, etc.). This will enable periodic updates to paragraph 8-3 rather than to the entire handbook/chapter.

c. Included is a listing of unacceptable assets that are not to be used in the computation of adjusted net worth (paragraph 8-6C).

d. A section was added on reporting audit findings that are corrected or are being corrected before the completion of the audit (paragraph 8-7).

e. Auditors will be able to convey nonmaterial instances of noncompliance to management via management letter or other type of auditor communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements include that the existence of a management letter or other type of auditor communication must be mentioned in the independent auditor's report, the date of issuance is to be included, it must be provided to HUD with the audit report package, and it is not be used to report findings that were resolved before the audit report was issued.

f. Paragraph 8-8 was added to provide a contact point for questions that may arise during the course of the audit.

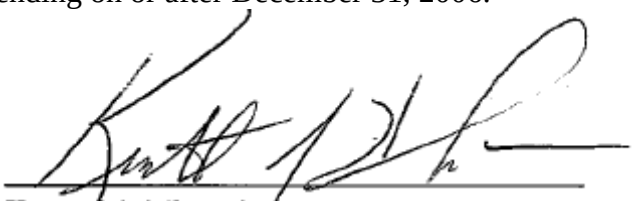
4. Filing Instructions:

The issuance of this chapter cancels chapter 8, dated August 1997.

Remove	Insert
Chapter 8, dated August 1997	Chapter 8, dated September 2006

5. Effective Date:

This chapter is effective and can be used upon issuance. The requirements in this chapter shall apply to audits of profit-motivated sponsors/entities with fiscal years ending on or after December 31, 2006.



Kenneth M. Donohue
Inspector General, G

CHAPTER 8. HUD-APPROVED TITLE I NONSUPERVISED LENDERS AND LOAN CORRESPONDENTS AUDIT GUIDANCE

8-1 **Program Objective.** The U.S. Department of Housing and Urban Development (HUD) insures private lending institutions against losses sustained as a result of borrower defaults on Title I property improvement and manufactured home loans. HUD approves four categories of private lending institutions for participation in the Title I program:

A. Supervised lenders are financial institutions that are members of the Federal Reserve System or the accounts of which are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.

B. Nonsupervised lenders are financial institutions, the principal activities of which are the lending or investment of funds in loans or mortgages and which are neither supervised lenders nor governmental institutions.

C. Loan correspondents are financial institutions approved by HUD for the purpose of originating Title I direct loans for sale or transfer to a sponsoring Title I lender. A loan correspondent may be either supervised or nonsupervised.

D. Investing lenders are financial institutions approved by HUD to purchase, hold, and sell Title I loans that have been originated by other lenders. An investing lender may not originate Title I loans in its own name, and it may not service such loans except with the prior approval of HUD.

Lending institutions are approved for participation in the Title I program on the basis of their financial capacity, experience, facilities, and other criteria as specified in HUD regulations at 24 CFR [*Code of Federal Regulations*] Part 202 and HUD Handbook 4700.2. (NOTE: Except in paragraph 8-5 D of this chapter, use of the term "lender" also includes the term "loan correspondent.")

8-2 **Program Procedures.** All mortgagees and loan correspondents, whether supervised or nonsupervised, must apply for initial or branch approval to participate in the HUD/Federal Housing Administration (FHA) mortgage insurance programs through the Lender Approval and Recertification Division at HUD Headquarters, following the directions in HUD *Handbook 4700.2, "Title I Lender Approval Handbook." After a review of the application and clearance through certain HUD Headquarters systems, the applicant, if approved, will be assigned a unique HUD/FHA identification number and notified that it may now originate FHA-insured mortgages.*

8-3 Reference Material.

*The following is the reference material that was in effect at the time this handbook chapter was issued. It is the auditor's responsibility to use the appropriate reference material that was in effect during the period covered by the audit.

Throughout this chapter, reference is made to handbooks using the base handbook number without the revision number (i.e., REV-1, REV-6, etc.) This will enable periodic updates to paragraph 8-3 rather than revising the references in the entire handbook/chapter. Also, the auditor should ensure that the updated reference is used for performing the audit. If reference to the handbook is needed in the audit report, the auditor should ensure that the entire updated reference, including the revision number, is used.

The information collection requirements contained in this handbook have been approved by the Office of Management and Budget (OMB) under the Paper Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned the following OMB approval numbers; 2502-0328, 2502-0551, and 2502-0005.

Document	Title
24 CFR Parts 5, 201, and 202	Regulations Relating to Title I Property Improvement and Manufactured Home Loans
HUD Handbook 1060.2 REV-6	Title I Property Improvement and Manufactured Home Loan Regulations
HUD Handbook 4700.2 REV-1	Title I Lender Approval Handbook
Title I letters	Various

If the program participant does not have this reference material, it may be obtained by accessing HUD's Client Information and Policy System (HUDCLIPS) at the following Web site:

http://www.hudclips.org/cgi/index.cgi

or may be ordered from HUD's Direct Distribution System by telephone at (800) 767-7468; in a letter addressed to HUD, Customer Service Center, Room B-100, 451 Seventh Street, SW, Washington, DC 20410; or by fax at (202) 708-2313.*

8-4 *Audit and Reporting Requirements.

A. Audit Requirements.

Every nonsupervised Title I lender or loan correspondent is required to have an annual audit and to submit it to HUD within 90 days of the close of its fiscal year, regardless of the number of loans originated or serviced.

The audit shall be performed in accordance with "generally accepted government auditing standards" ("GAGAS" also referred to as the "Yellow Book") and shall include the auditor's report on the basic financial statements, a computation of the lender's adjusted net worth,[3] and a hard copy of the completed Lender Assessment Subsystem (LASS) Financial Data Templates (FDT). The auditor's report must include an opinion on the lender's adjusted net worth and on the fair presentation of the hard copy of the LASS FDT in relation to the audited basic financial statements in accordance with Statement on Auditing Standards (SAS) 29, "Reporting on Information Accompanying the Basic Financial Statements in Auditor Submitted Documents." These reports are required for every Title I lender regardless of the number of loans originated or serviced during the fiscal year.

All instances of noncompliance with any HUD requirements identified by the auditor (including adjusted net worth or liquidity deficiencies) must be reported as findings in the report on compliance, even in those cases in which corrective action was taken by the auditee after the end of the fiscal year. Refer to paragraph 8-7 for information on reporting findings in the audit report. A suggested format for the computation of the adjusted net worth and the list of unacceptable assets are shown in paragraph 8-6 of this chapter.

In accordance with GAGAS, the audit report is to include reports on internal control structure and compliance with specific requirements that have a direct and material effect on HUD-insured loans made by nonsupervised Title I lenders and loan correspondents, including an opinion on compliance with specific requirements applicable to major HUD-assisted programs, or a report on compliance with specific requirements applicable to nonmajor HUD-assisted program transactions. These reports are required for every Title I lender, regardless of the number of loans originated or serviced during the fiscal year

B. Electronic Submission of Audited Financial and Compliance Data.

Every nonsupervised Title I lender is required by 24 CFR 5.801, 202.7, and 202.8 to electronically submit its financial and compliance data to the Office of Lender Approval and Recertification Division through LASS within 90 days of the close of*

[3] Adjusted net worth must reflect only those assets acceptable to the Secretary.

*its fiscal year, regardless of the number of loans originated or serviced. This electronic submission must be completed based on the paper copy of the audit of the lender's financial statements.

Lenders/mortgagees that are approved under both Title I and Ginnie Mae must complete an electronic submission of their financial and compliance data through LASS. Also, these lenders/mortgagees must submit a paper copy of their audited financial statements to Ginnie Mae. Ginnie Mae issuers must send the paper copy of the audit report to

Ginnie Mae Special Project Group
1915 B Chain Bridge Road, PMB 701
McLean, VA 22102-4401

When the mortgagee/loan correspondent is a subsidiary of a parent company and the information on its assets, liabilities, and results of operation are included in the consolidated financial statements of the parent entity, HUD will accept the LASS electronic submission based on the audited consolidated financial statements of the parent if it includes consolidating schedules, audited by the independent auditor, which distinguish the balance sheet, operating statement, and computation of adjusted net worth of the mortgagee/loan correspondent subject to the HUD audit requirement. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent, and the auditor's opinion must cover the financial statement accounts of the subsidiary.

C. Auditor Involvement in the Electronic Submission Process.

Regulations in 24 CFR 5.801, 202.7, and 202.8 established the requirement for Title I and Title II nonsupervised mortgagees, nonsupervised lenders, and loan correspondents to submit annual financial information based on audited financial statements electronically to HUD. To facilitate this online data collection, HUD developed LASS. LASS collects the following information:

1. FDT – Collection of financial data via a financial data template from the balance sheet, operations and equity statement, cash flow statement, net worth statement, and liquidity statement.

2. Data Collection Form (DCF) – Collection of certain basic information regarding the lender's recertification submission, such as fiscal year-end data, audit period covered, lender and auditor information, and the type and details of the audit opinions and findings. Also, the signed audit opinion report, internal control report, and compliance reports must be attached as portable document format, pdf, .gif, or .jpeg files.*

3. *Notes and Finding – Collection of the lender's footnotes accompanying the financial statements and if applicable the schedule of findings and questioned costs and lender's corrective action plan. These documents must be attached in a .pdf, .gif, or .jpeg file format.

The responsibility for the electronic submission of the lender's financial and compliance data through LASS rests with the lender. To ensure the accuracy and completeness of the data within LASS, auditors are required to perform a separate "agreed-upon procedures" engagement. In general, the auditor must compare the electronic data in LASS to the hard copy of the basic financial statements, audit reports, and FDT. This procedure should be performed under the Statement of Standards for Attestation Engagements (SSAE) No. 10, "Agreed-Upon Procedures Engagements," of the American Institute of Certified Public Accountants (AICPA). Although the procedure is simple, it is over and above the issuance of the SAS 29 reporting discussed earlier, and it will require some additional time. Consequently, the audit engagement letter should be expanded to include this separate attestation engagement, which may involve additional costs.

To perform these procedures, auditors must register with HUD's Secure Connection system for a user ID and password, as well as obtain a unique independent public account (IPA) identifier (UII). For further information about obtaining a user ID, passwords, and UII, refer to the LASS User Manual at the LASS Web site:

http://www.hud.gov/offices/hsg/sfh/lass/prodlass.cfm

As stated above, the auditors will compare the "submitted" information within all LASS templates (FDT, DCF, notes and findings) and all attachments (footnotes, findings, corrective action plans, and signed copy of the audit reports) with the hard copy information prepared by the lender and reported by the auditor. If the information agrees "exactly," the auditor will complete the attestation report on the "LASS Auditor Reporting" screen by clicking on the "Agrees" option button. This will return the data to the lender for final submission to HUD for its review and evaluation. The lender can only submit final data that "agrees" with hard copy documents. The secure features of LASS will not permit the lender or HUD to alter data after the auditor's reporting process. The term "exactly" refers to substantive matters and does not include nonsubstantive typographical, spelling, font, and formatting difference or differences in amounts that are clearly inconsequential (e.g., rounding differences).

By clicking the "Agrees" option button, the auditor will be attesting to the statements listed in the second paragraph of the independent auditor's report. These exhibits address situations in which (a) a lender has a stand-alone audit performed of its financial statements, and (b) a lender is a subsidiary of a parent or is a parent and a stand-alone audit of the lender's financial statements has not been performed. It*

*should be noted that the "agreed-upon procedures" attestation report could be submitted by the auditor who audited the financial statement or by another independent auditor who did not perform the financial statement audit.

When the "Agrees" option buttons in the independent accountant's report are checked and the report is ready for submission, a hard copy of the report should be printed for the auditor's records. After submission, the system will not permit this report to be printed.

If the information does not agree exactly, the auditor will complete the attestations report on the "LASS Auditor Reporting" screen by clicking on the "Does Not Agree" option button. This will return the data to the lender and allow the lender to correct the data. Once the lender resubmits the corrected data, the auditor must repeat the above process. While the LASS report screens identify those elements that do not agree, most auditors will find it beneficial to discuss any areas of disagreement with the lender and come to a resolution before the lender's submission of the financial and compliance data to HUD.

If the user experiences technical problems using the LASS system, the LASS technical assistance center should be contacted at (202) 755-7400, extension 163, or by e-mail at lass@hud.gov.*

8-5 Compliance Requirements and Suggested Audit Procedures.

A. Branch Office Operations.

1. **Compliance Requirement.** A lender may maintain one or more branch offices for the origination of Title I loans. Each branch office that is originating Title I loans must be approved by HUD following submission of the form for branch office notification. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR Part 202 and HUD Handbook 4700.2.

2. **Suggested Audit Procedures.**

   a. Determine whether HUD accepted the branch office as evidenced by a copy of Form HUD-92001-B, Branch Office Notification.

   b. Test whether the branch is a true branch and is not a subsidiary, an agent of the lender, or a separate entity and that it has at least one employee, including a branch manager, that serves only that branch. The branch office must have its own telephone and maintain its own accounting records.

c. Review lender payroll records to determine that all branch office personnel, except the receptionist, are employed exclusively for one HUD-approved lender at any given time and conduct only the business affairs of that entity during normal business hours.

d. Determine whether the branch office (1) is located in a space which is separated by a partition from any other entity, (2) is clearly identified to the public, and (3) had its operating costs paid by the approved lender.

e. Determine whether the present branch office manager is a corporate officer or an employee authorized to bind the corporation in matters involving loan origination and servicing.

B. Loan Origination.

1. Compliance Requirement. HUD expects that the lender will exercise prudence and diligence in determining whether the borrower is solvent and an acceptable credit risk with a reasonable ability to make payments on the loan obligation. All documentation supporting this determination of credit worthiness shall be retained in the loan file (24 CFR 201.22).

2. Suggested Audit Procedure.

a. Compare the lender's procedures for processing Title I loan applications and making a decision on the borrower's credit worthiness with the requirements in 24 CFR 201.22.

b. Obtain a sample of files for loans originated during the audit period to be examined for the documentation required by the regulations. The sample should include loans originated at the lender's branch offices as well as the home office.

(1) Determine whether the lender obtained a separate dated credit application on the HUD-approved form from the borrower, any comaker, and/or cosigner and verified the validity of the borrower's Social Security number in accordance with Title I Letter TI-414.

(2) Determine whether all income and employment data are supported by written verification or other documentation, especially for self-employed applicants and those with nonemployment income.

(3) Determine whether the lender obtained a complete and current consumer credit report on the borrower, any comaker, and/or cosigner and checked on any credit inquiries reported within the previous 90 days.

(4) Determine whether the lender obtained written verification of the borrower's payment status on any senior mortgages or deeds of trust on the property to be improved.

(5) For each person on the credit application, determine whether the lender checked HUD's Credit Alert System to verify whether the borrower is in default or a claim has been paid on behalf of the borrower on any federally insured or guaranteed loan and whether the lender recorded the borrower's "credit alert response code" on the application for each person listed.

(6) When the principal balance of the loan exceeds $5,000 and the initial payment exceeds 5 percent of the loan amount, determine whether the lender obtained written verification of the source of these funds through verifications of deposit, bank statements, gift letters, or other methods/evidence.

(7) Review the loan file documentation for evidence that the lender conducted a face-to-face or telephone interview with the borrower before making a final determination on the borrower's credit worthiness.

(8) *For dealer loans with a credit application date of December 12, 2001, or later, lenders are required to conduct a telephone interview before disbursing the loan, which is in addition to the credit underwriting telephone interview. Review the file documentation to determine whether the telephone interview before loan disbursement was made.*

c. Obtain a sample of files for rejected loans during the audit period and perform the following review:

(1) Determine whether an individual review was provided for all rejected applications that were denied due to a statistical category or score (e.g., credit score, debt/income ratio). Determine whether the score accurately reflected the financial status (e.g., loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.

(2) Determine whether the rejection was made based on established criteria and the reason for the rejection was provided to the applicant. Determine whether procedures for accepting and processing the loan were followed.

C. Loan Disbursement.

1. Compliance Requirement. The lender has certain responsibilities to be carried out in connection with the disbursement of loan proceeds (24 CFR 201.26 and 201.40). These responsibilities vary widely, depending upon whether the loan is a property improvement or manufactured home loan and whether the disbursement is made directly to the borrower or to a dealer. The disbursement of loan proceeds must be adequately documented in the lender's file. When dealer loans are involved, the lender must also maintain separate dealer files, which reflect compliance with HUD's requirements concerning the dealer's approval and supervision (24 CFR 201.27).

2. Suggested Audit Procedures.

a. Review the lender's procedures for determining borrower eligibility and evaluating whether the loan proceeds are being used for eligible purposes (24 CFR 201.20 or 201.21 as appropriate). Also, review the lender's procedures for documenting that the property improvements have been completed or the manufactured home has been satisfactorily delivered and installed (24 CFR 201.26(a) or (b) as appropriate).

b. Select a representative sample of property improvement loan files and determine whether each file contains the following:

(1) *The note, security instrument, if any, credit application, completion certificate, and notice of HUD's role in the loan transaction required by 24 CFR 201.26(b)(7) for manufactured home loans and 24 CFR 201.26(a)(8) for property improvement loans.*

(2) A contract or contract proposal between the borrower and a dealer/contractor or a detailed written description of the work with *a materials list and estimated costs if the borrower is carrying out the work without a dealer/contractor.*

(3) Evidence of an on-site inspection to determine that the improvements were completed if the loan is for $7,500 or more.

c. Select a representative sample of manufactured home loan files. Review the files to determine whether each file contains the following documents:

(1) The note, security instrument, credit application, purchase contract, manufacturer's invoice, itemized statements of other costs, and fees or charges.

(2) Evidence of the borrower's initial payment, a placement certificate signed by the borrower and dealer, and the notice of HUD's role in the loan transaction required by 24 CFR 201.26(b)(7).

(3) Copies of all other documents relating to the loan transaction.

d. For each file reviewed under C.2.c above, determine whether the lender has documented a site-of-placement inspection within 60 days after disbursement of the loan proceeds.

e. When the lender approves dealer loans, determine whether

(1) The lender supervised and monitored each dealer and visited the dealer periodically.

(2) Each dealer's approval is documented on a HUD-approved form, signed and dated by both parties.

(3) Each dealer's file contained the dealer's current financial statement, including a determination that the dealer met the minimum adjusted net worth requirements of 24 CFR 201.27(a)(1) and credit reports on the dealership and its owners, principals, and officers.

(4) The file contained documentation of the lender's experience with the dealer's Title I loans, including information on borrower defaults and borrowers' complaints and evidence of the resolution of those complaints.

D. <u>Loan Servicing</u>.

1. <u>Compliance Requirement</u>. The lender shall service loans in accordance with accepted practices of prudent lending institutions. It shall have adequate facilities for contacting the borrower in the event of default and shall otherwise exercise diligence in collecting the amount due. The lender shall remain responsible to the Secretary for proper collection efforts, even though

actual loan servicing and collection may be performed by an agent of the lender. The lender shall have an organized means of periodically identifying the payment status of delinquent loans to enable personnel to initiate and follow up on collection activities and shall document its records to reflect its collection activities on delinquent loans. The lender shall accept partial payments under an executed modification agreement or an acceptable repayment plan (refer to 24 CFR 201.41 for more details). A modification agreement may be used to increase or reduce monthly payments but not to increase the term or the interest rate to assure that the delinquent or defaulted loan is brought current before or by the end of the loan term. A modification agreement may also be used to effect a reduction in the interest rate and in the monthly payment for current loans, 24 CFR 201.18.

2. <u>Suggested Audit Procedures</u>.

a. *The auditor is to obtain an understanding of the lender's servicing procedures.

b. The auditor is to select a sample of delinquent and defaulted loans and determine whether

(1) The lender documented its records to reflect its servicing on delinquent and defaulted loans.

(2) The lender maintained individual servicing records documenting collection (loan servicing) activities.

(3) The servicing records contained information on collection contacts attempted and completed.

(4) The lender communicated with the borrower or made a reasonable effort to do so to determine the cause of default and seek its cure before accelerating the maturity of the loan. Review the individual loan servicing records to determine whether more than one type of contact was made (i.e., telephone, letter, face-to-face interview, etc.) when one type of contact effort was unsuccessful.

(5) The lender offers special relief measures such as modification agreements or informal repayment plans when such measures are appropriate and the selected loan files evidence that such relief measures were considered.*

(6) *The notice of default and acceleration used by the lender is in compliance with the regulations (24 CFR 201.50(b)) and Title I Letter TI-408.

c. The auditor is to obtain an understanding of the lender's procedures for paying loan insurance premiums to HUD. On the sample selected, determine whether the lender follows an acceptable method of making annual payments and that its practices comply with HUD regulations.*

E. Eligible Fees and Charges.

1. Compliance Requirement. Title I Letter TI-440, dated May 2, 1996, lists all fees and charges allowed in the program.

2. Suggested Audit Procedures.

*Obtain the lender's general ledger, cash journal, canceled checks, and supporting invoices for at least two months of the audit period and determine whether

a. The fees and charges were within the allowable amounts contained in Title I Letter TI-440 and report amounts paid in excess of the allowable amounts.

b. Disbursements are supported by invoices and were not for unreasonable amounts in return for goods or services actually performed in connection with a Title I loan. Review and report on any differences.

c. Referral fees are being paid. During the review of loan origination and loan settlement documents (paragraphs 8-5B and C), the auditor should be alert for any fees or other types of payments, which may represent referral fees. If the auditor notes any such referral fees, they must be reported as a finding.

d. Points and closing costs are accurate. Determine whether any differences may be due to discriminatory practices and report any problems noted.*

F. Federal Financial Reports.

1. Compliance Requirement. Lenders participating in HUD-assisted activities are required to submit various reports in accordance with the terms of

applicable agreements between the entity and HUD. The following specific reports are required:

a. ***Originating Lenders:** Submission of annual Home Mortgage Disclosure Act reports by March 1 of each year pursuant to Title I Letter TI-479.

b. **All Lenders:** Reporting of any noncompliance by borrowers, contractors, or other parties related to a Title I-insured loan pursuant to Title I Letter TI-447.*

2. Suggested Audit Procedures.

a. Identify all HUD-required activity reports by inquiry of the lender.

b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine whether the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation; i.e., worksheets, ledgers, etc. Report all material differences between financial reports and lender records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate the propriety of those adjustments.

G. Financial Approval Requirements.

1. Compliance Requirements. A nonsupervised lender shall have and maintain an adjusted net worth of not less then $250,000 in assets acceptable to the Secretary. It shall also have a reliable warehouse line of credit or other funding program acceptable to the Secretary of not less than $500,000 for uses in originating or purchasing Title I loans.

A loan correspondent shall have and maintain an adjusted net worth of not less than *$63,000* in assets acceptable to the Secretary, plus an additional $25,000 for each branch office authorized by the Secretary, up to a maximum requirement of $250,000.

2. **Suggested Audit Procedures.**

   a. Test whether the nonsupervised lender or loan correspondent maintained the required levels for adjusted net worth.

   b. Test whether the nonsupervised lender maintained the required level for its warehouse line of credit.

H. Quality Control Plan.

1. **Compliance Requirement.** HUD-approved lenders are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and comply with all relevant departmental rules and regulations. Each HUD-approved lender is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4700.2 or the latest HUD guidance. Each approved lender must develop and implement a quality control plan, consistent with its needs and the above referenced guidance, to assist corporate management in determining whether HUD requirements and the lender's policies and procedures are being followed by its personnel. The monthly quality control procedures may be conducted by the entity itself internally or by an external review, which may be performed by the independent auditor or other qualified organization (24 CFR 202.5(h)). The following suggested audit procedures are to be followed whether the quality control review was performed by the entity or by an external source.

2. **Suggested Audit Procedures.**

   a. Obtain a copy of the lender's quality control plan and compare it to the general and specific requirements contained in Handbook 4700.2.

   b. Determine whether the lender has a procedure in place, which ensures that all employees involved in loan origination and servicing understand the lender's quality control policies and procedures.

   c. Inquire whether the lender relies on an internal or external quality control review of its origination, underwriting, and servicing functions. If the lender relies on the external review process and the independent auditor's engagement includes the performance of the quality control review, the independent auditor should report this as part of the additional information required under chapter 2 of this guide. If the lender relies on an internal review, determine that it was performed by knowledgeable personnel with no direct responsibilities in the areas they reviewed.

d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample of at least 10 percent of the number of insured mortgages originated or a statistically derived sample. It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review at least once during the year and that the plan includes coverage for any loan correspondents and authorized agents of the lender.

e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4700.2 were included in the quality control review. The quality control plan must provide for the written reverification of the lender's employment, deposits, gift letter, or other sources of funds.

f. Obtain a written copy of the latest quality control report and determine that senior management officials also received a copy, which included any deficiencies identified during the review. Determine that the lender also notified the Quality Assurance Division of any violations, false statements, or program abuses in the report.

g. *Determine whether the files evidenced the actions taken by senior management to correct all deficiencies noted and that the corrective action was promptly initiated.

h. Determine whether the files evidence that the employees were notified of the deficiencies and provided instructions to correct the deficiencies and prevent a recurrence. *

8-6 Adjusted Net Worth.

A. Audit Requirement.

*An FHA computation of adjusted net worth is required for all nonsupervised Title I lenders and loan correspondents, even if there were no loans originated during the period.

B. Computation.

The required amount that must be maintained throughout the year varies by program participant type and approval data according to the guidance in this chapter, paragraph 8-5 G, Financial Approval Requirements. If an entity is both a Title I and Title II lender, the adjusted net worth under Title II is the only statement necessary. When the lender is a

parent or a subsidiary to a parent, the adjusted net worth computation must focus on the * *assets and liabilities of the individual (nonconsolidated) entity with the HUD audit requirement.*

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XYZ Lender Corporation
Computation of Adjusted Net Worth
to Determine Compliance with
HUD Net Worth Requirements
March 31, XXXX

Stockholders equity (net worth) per balance sheet		$17,500,000
Less unacceptable assets: construction loans to related company – not secured by first mortgage	$12,000,000	
Other – goodwill	300,000	$12,300,000
Adjusted net worth for HUD requirement purposes		$ 5,200,000 [1]

[1] In the event adjusted net worth does not meet or exceed the minimum HUD requirement, an explanation of the steps taken to correct the adjusted net worth deficiency, along with any relevant documentation, must be submitted as part of the corrective action plan.

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C. Unacceptable Assets for Computation of Adjusted Net Worth.

*The following are unacceptable assets and are not to be used in the computation of adjusted net worth.

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community. These pledge assets are acceptable for supervised institutions only.

2. An asset due from an officer or stockholder of the mortgagee or from a related entity, except for*

a. *A construction loan receivable, secured by a first mortgage, from a related entity.

b. A mortgage loan receivable established in the normal course of business in an arm's length transaction and secured by a first mortgage on the related property.

c. A receivable from a related party when the affected parties have executed a cross-default agreement[2] or corporate guarantee agreement[3] with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagee has a personal interest[4] unrelated to that person's position as an officer or stockholder of the mortgagee.

4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.

5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.

6. The value of any servicing contract not determined in accordance with Statement of Financial Accounting Standards (SFAS) No. 65, Accounting for Certain Mortgage Banking Activities, and SFAS 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or revisions thereto.

7. Any asset not readily marketable and for which appraised values are subjective. Examples include but are not limited to antiques, artwork, and gemstones.*

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[2]Cross-default agreement is an agreement between related affiliated Ginnie Mae issuers which provides for the default of all affiliated issuers in the event of a default by any one of them.

[3]A corporate guarantee agreement is an agreement in which the issuer's parent guarantees the performance of the issuer.

[4] "Personal interest" as used here indicates a relationship between the mortgagee and a person or entity in which that specified person (e.g., spouse, parent, grandparent, child, brother, sister, aunt, uncle, or in-law) has a financial interest in or is employed in a management position by the mortgagee.

8. *That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market value, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.

9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.

10. Any asset, which is principally used[5] for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes automobiles and personal residences.

11. "Other assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or schedule prepared by the issuer/mortgagee and signed by an officer of the issuer/mortgagee.

12. That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution determined by an independent appraisal.

8-7 Audit Finding Reporting.

All material instances of noncompliance with any HUD requirement, regulation, including adjusted net worth and/or liquidity deficiencies, deficiencies in internal control, instances of fraud or illegal acts, or contract violations that were disclosed during the audit process must be reported as findings in the audit report. All nonmaterial instances of noncompliance, deficiencies in internal control, instances of fraud or illegal acts, or contract violations disclosed during the audit process may be reported separately to management. Such reporting must be in writing in a Management Letter or other type of written auditor communication and must be mentioned in the Independent Auditor's Report including the date of the Management Letter or other written communication. Non compliances, deficiencies, instances or violations that were corrected during the audit process, after the fiscal year under audit, or if they were disclosed as a part of the audit process before the end of the fiscal year under audit, and/or prior to the issuance of the audit report, must be included in the report as resolved findings or in a management letter depending on their materiality.

A. Content of Finding.

Findings are to be presented in accordance with the standards and requirements of the "Yellow Book." A finding should be supported by sufficient, competent, and relevant

[5] "Principally used" means that any other use of the property must be solely incidental.

evidence; be presented in a manner to promote adequate understanding of the matters reported; and provide convincing but fair presentations in proper perspective.

Please refer to chapter 2 for the information that is to be included in a finding.*

B. *Corrective Action in Process.

Many times when auditees are presented with draft findings, they will start to take action to correct the deficient condition. When this action is underway and the auditor has completed his/her fieldwork, the auditee can include the action completed and the action remaining to be taken in the auditee's comments and in the corrective action plan. Regardless of whether the auditee is in the process of correcting the finding, the auditor is to include the finding in the report with all required elements.

C. **Corrective Action Completed.**

Many times when auditees are presented with draft findings, they will start to take action and complete that action, correcting the deficient condition, prior to the completion of the fieldwork. When this occurs, the finding is still to be included in the audit report with all required elements. The action taken/completed should be included in the auditee's comment section and should be validated by the auditor. The recommendation section should follow the auditee's comment section, and the auditor should state whether he/she tested the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on the testing of that action.

8-8 **Technical Assistance Needed.** The Office of Lender Approval and Recertification Division receives, reviews, and acts on audit reports conducted using this chapter. It is important that the report meet its requirements and expectations. For this reason, questions on audits performed using this chapter should be referred to that office's help desk at (202) 755-7400, extension 163; or by sending an e-mail to lass@hud.gov.*

Appendix

HUD District Inspectors General for Audit

New England District Inspector General for Audit
Department of Housing and Urban Development
Thomas P. O'Neill, Jr. Federal Building
10 Causeway Street, Room 370
Boston, MA 02222-1092
Telephone number: (617)565-5259
FAX number: (617)565-6878

CT, ME, MA, NH, RI, VT

New York/New Jersey District Inspector General for Audit
Department of HUD
26 Federal Plaza
New York, NY 10278-0068
Telephone number: (212)264-4174
FAX number: (212)264-1400

NY, NJ

Mid-Atlantic District Inspector General for Audit
Department of HUD
The Wannamaker Building
Philadelphia, PA 19107-3390
Telephone number: (215)656-3401
FAX number: (215)656-3409

DE, DC, MD, PA, VA, WV

Southeast/Caribbean District Inspector General for Audit
Department of HUD
Richard B. Russell Federal Building
75 Spring Street, SW, Room 700
Atlanta, GA 30303-3388
Telephone number: (404)331-3369
FAX number: (404)730-2382

AL, FL, GA, KY, MS, NC, SC, TN

Midwest District Inspector General for Audit
Department of HUD
77 West Jackson Boulevard - 26th Floor
Chicago, IL 60604-3507
Telephone number: (312)353-7832
FAX number: (312)353-8866

IL, IN, MI, MN, OH, WI

Southwest District Inspector General for Audit
Department of HUD
1600 Throckmorton
P.O. Box 2905
Fort Worth, TX 76113-2905
Telephone number: (817)885-5551
FAX number: (817)885-2725

AR, LA, NM, OK, TX

Great Plains District Inspector General for Audit
Department of HUD
Gateway Tower II, 5th floor
Kansas City, KS 66101-2406
Telephone number: (913)551-5870
FAX number: (913)551-5877

IA, KS, MO, NE

Rocky Mountains District Inspector General for Audit
Department of HUD
First Interstate Tower
Denver, CO 80202-2349
Telephone number: (303)672-5452
FAX number: (303)672-5006

CO, MT, ND, SD, UT, WY

Pacific/Hawaii District Inspector General for Audit
Department of HUD
450 Golden Gate Avenue, Room 8-5139
San Francisco, CA 94102-3448
Telephone number: (415)436-8101
FAX number: (415)436-8107

AZ, CA, HI, NV

Northwest/Alaska District Inspector General for Audit
Department of HUD
909 First Avenue
Seattle, WA 98104-1000
Telephone number: (206)220-5360
FAX number: (206)220-5162

AK, WA, ID, OR