

CHAPTER 4

ANNUAL RENEWAL OF FHA APPROVAL

4-1 Requirement for Annual Renewal. A mortgagee must renew its approval each year. In addition to continuing to meet all the requirements it met for initial approval, it must also execute the Title II Yearly Verification Report. A mortgagee, except a governmental entity, must pay an annual recertification fee. A non-supervised mortgagee or non-supervised loan correspondent must submit an acceptable audited financial statements and supplementary reports.

4-2 Yearly Verification Report. Annually, each mortgagee must complete and return to the Department a Title II Yearly Verification Report (V-Form) which can be downloaded from their Institution Profile page in the Lender Approval part of the FHA Connection. See instructions at: https://entp.hud.gov/pdf/mp_lndapp.pdf. The report must be completed by the mortgagee, signed by a senior officer (vice president or above) and returned to FHA within 30 days after the close of the mortgagees fiscal year. A copy should be given to a non-supervised mortgagees auditor for review and as proof of FHA approval.

A. Update By Mortgagee. The mortgagee must make the necessary changes to its institution profile in the FHA Connection to ensure the V-Form information is correct before downloading, signing and submitting the form.

B. Branch Office Information. The report displays the total number of registered branch offices of the mortgagee. If the number is incorrect or, within the past year, branches have moved, changed or added a dba or changed managers, the mortgagee should record the corrections through the Lender Approval functions on FHA Connection before downloading, signing and submitting the form.

4-3 Annual Renewal Fees. All mortgagees except governmental institutions must pay an annual renewal fee within 30 days after the close of the mortgagees fiscal year.

A. Amount. A mortgagee must remit a \$500 annual renewal fee for its approved main office and \$200 for any registered branch office that was registered at least six months prior to the end of the mortgagees fiscal year. No renewal fee is due for branches registered in the last six months of a mortgagees fiscal year. In addition, no fee is required for a non-registered office or any office that the mortgagee deletes through the Lender Approval functions on FHA Connection before they pay their renewal fee.

B. Payment. This payment must be made by accessing pay.gov via the FHA Connection by using the Pay Now button that has been added to the Institution Profile page of each mortgagee. Delete any branches that are not being renewed before clicking on the Pay Now button, in order to be charged the correct amount. See instructions at: https://entp.hud.gov/pdf/mp_lndapp.pdf.

4-4 LASS Submission of Annual Audited Financial Statements. Within 90 days after the close of its fiscal year, non-supervised mortgagees and non-supervised loan correspondents must submit their audited financial and compliance data electronically through LASS. The LASS homepage at

<http://www.hud.gov/offices/hsg/sfh/llass/prodlass.cfm> contains links on how to register to use LASS, FAQs, latest updates and additional links to many items including the LASS User Manual. LASS consists of: (1) specifically designed financial data templates (FDT) which collect financial data; (2) a data collection form (DCF) which will collect information about the mortgagee and the auditor reporting on the financial statements, internal controls, compliance data, and the attachment of the mortgagees signed audit reports, including the compliance and internal control reports to their financial statements and (3) a Note and Finding template which allows for the attachment of the mortgagees audited footnotes, auditors finding, and mortgagees corrective action plans.

The hard copy basic financial statements and auditor reports must be issued prior to the mortgagee initiating their electronic submission of their financial and compliance data and are the basis for the mortgagees electronic submission. The basic financial statements must be prepared and audited in accordance with HUD IG most recent Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs; and GAOs most recent Government Auditing Standards (the Yellow Book). The audit must be done by a Certified Public Accountant (or a Public Accountant licensed on or before Dec. 31, 1970) qualified to perform the audit and licensed to practice in the State in which the mortgagee has its home office, and who has not been suspended, debarred, or otherwise excluded from performing audits of mortgagees. When requested by the Department, a mortgagee must submit any other materials that may be needed to make a determination regarding continuation of approval.

If the auditor becomes aware of illegal acts or fraud that have occurred or are likely to have occurred, the auditor must report instances of fraud and illegal acts. The auditor must report directly to the HUD District Inspector General for Audit. For details, see Chapter 1 of the most recent version of HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs. The Office of the Inspector will notify the appropriate offices within the Department, including the Office of Lender Activities and Program Compliance.

A. Required Reports by Type of Mortgagee For LASS Submission.

1. Non-supervised Mortgagee. A non-supervised mortgagee, unless exempt per paragraph 4-4(B)(5), must maintain the following documents to support their electronic submission:

a. Audited financial statements

- * Balance sheet;
- * Income statement;
- * Cash flow statement;
- * Statement of Equity; and
- * Footnotes.

b. Computation of adjusted net worth including a Statement of Auditing Standards (SAS) 29 opinion. The SAS 29 opinion can be issued in a separate report or included within the Independent Auditors Report on the Financial Statements.

c. Independent Auditors Report on the Financial Statements.

d. Independent Auditors Report on Internal Control.

e. Independent Auditors Report on Compliance with Specific Requirements Applicable to Major/Non-Major HUD Programs. Major program mortgagees are subject to an audit of their compliance with HUD major programs. Non-major program mortgagees are subject to a review of their compliance with HUD non-major programs. 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.

f. Schedule of Audit Finding. When reporting deficiencies in internal control or instances noncompliance the auditor should generate a schedule of finding. The auditor should place their findings in proper perspective by providing a description of the work performed that resulted in the finding. To the extent possible the auditor should develop the elements of criteria, condition, cause, effect, and recommendations to assist management in understanding the need for taking corrective action.

g. Corrective Action Plan. If the auditor has noted any findings then the mortgagee must submit a corrective action plan, which addresses each finding.

2. Non-supervised Loan Correspondent. A non-supervised loan correspondent, unless exempt per paragraph 4-4(B)(5), must maintain the following documents to support their electronic submission:

a. Audited financial statements.

- * Balance sheet;
- * Income statement;
- * Cash flow statement;
- * Statement of Equity; and
- * Footnotes.

b. Computation of adjusted net worth including a Statement of Auditing Standards (SAS) 29 opinion. The SAS 29 opinion can be issued in a separate report or included within the Independent Auditors Report on the Financial Statements.

c. Independent Auditors Report on the Financial Statements.

d. Independent Auditors Report on Internal Control.

e. Independent Auditors Report on Compliance with Specific Requirements Applicable to Major/Non-major HUD Programs. Major program mortgagees are subject to an audit of their compliance with HUD major programs. Non-major program mortgagees are subject to a review of their compliance with HUD non-major programs. 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.

For Title II loan correspondents, the requirement for the auditor to review and report on the mortgagees compliance has been modified under the condition that the Sponsor agrees to assume the responsibility of assuring compliance for each loan correspondent under their sponsorship. In those instances where the Sponsor agrees to assume the responsibility of assuring compliance of loan correspondents under their sponsorship the Sponsor must communicate annually in writing to the individual loan correspondents their intent to assume responsibility for their compliance. The Sponsor must indicate the areas of compliance that they will be assuming. The Sponsor must issue annually a written report summarizing the results of their compliance testing. In addition, the Sponsor must accumulate and retain the supporting information that served as the basis for the written annual compliance report issued to the loan correspondent. Nevertheless, in accordance with Government Auditing Standards (the Yellow Book) it is incumbent upon the auditor to test and report on those areas of compliance not assumed by the Sponsor. In addition, the auditor must determine where applicable that the Sponsors are testing and reporting the results of their compliance reviews. Accordingly, when meeting the requirements of Government Auditing Standards, the auditor should issue a Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with GOVERNMENT AUDITING STANDARDS. The report may vary depending on whether there are reportable instances of noncompliance or material weaknesses. However, if the non-supervised loan correspondent is also approved under the Title I program, then separate reports on internal control and compliance will have to be issued for that program.

f. Schedule of Audit Finding. When reporting deficiencies in internal control or instances noncompliance the auditor should generate a schedule of finding. The auditor should place their findings in proper perspective by providing a description of the work performed that resulted in the finding. To the extent possible the auditor should develop the elements of criteria, condition, cause, effect, and recommendations to assist management in understanding the need for taking corrective action.

g. Corrective Action Plan. If the auditor has noted any findings then the mortgagee must submit a corrective action plan, which addresses each finding.

B. Types of Mortgagee for Which LASS Submission are Not Required.

1. Supervised Mortgagee.

2. Supervised Loan Correspondent.

3. Investing Mortgagee.

4. Governmental Institution.

5. Newly Approved Mortgagee. If the mortgagees initial approval date is less than six months prior to the end of its fiscal year and the audited financial statements submitted for approval are for the period ended not more than six months prior to the end of its fiscal year, then the mortgagee

is not required to submit new audited financial statements for recertification, nor is an annual recertification fee due. However, the audited financial statements submitted with its next renewal must cover the period from the date of its initial audited financial statements to the end of its fiscal year. The period covered by the renewal audit cannot exceed 18 months.

C. Extensions. Extensions are granted only in cases of catastrophic events beyond the control of lender or auditor. Extension requests must be submitted through LASS. The request must be received no earlier than 45 days prior to the submission due date and no later than 15 days prior to the submission due date.

4-5 LASS Review Procedures. Each annual LASS submission by a non-supervised mortgagee or non-supervised loan correspondent is reviewed to determine compliance with the Departments net worth, liquidity, audit reporting and other financial requirements for continued approval. The review consists of, but is not limited to, the following procedures.

A. Auditors Report. HUD reviews the information provided in the LASS submission to verify:

1. The audit was done by a qualified auditor, the audit firm contact is identified, and contact information and identifying information on the audit firm is provided.

2. The attestation was done by a qualified auditor, the attester is identified, and contact information and identifying information on the audit firm is provided.

3. The period covered by the financial statements corresponds to the date recorded in FHA records as stated in the mortgagee history profile screen.

4. The audit was done in accordance with:

* Generally Accepted Auditing Standards (GAAS);
* Generally Accepted Government Auditing Standards (GAGAS) as contained in the most recent General Accountability Office (GAO) Audit Guide -- Government Auditing Standards (commonly known as the Yellow Book); and

* The most recent version of HUD IG Handbook 2000.04
Consolidated Audit Guide for Audits of HUD Programs

5. The financial statements comply with Generally Accepted Accounting Principles (GAAP).

6. The auditors opinion on the financial statements, including all notes. In addition, the auditor must express a SAS 29 opinion on the mortgagees computation of its adjusted net worth.

B. Annual Submission. HUD reviews the mortgagees LASS submission for completeness and consistency and to verify that it includes:

1. Audited Financial Statements.

- * Balance Sheet. All accounts are properly classified and reported within the FDT. All unacceptable assets must be clearly identifiable. Escrows must be excluded from assets of the mortgagee;
- * Income Statement. Revenues from mortgage and non-mortgage related activities must be clearly identifiable and properly classified;
- * Statement of Equity;
- * Statement of Cash Flows;
- * Notes to the financial statements. Footnotes must be attached and must comply with GAAP;
- * Computation of Adjusted Net Worth for FHA Requirements. Mortgagee has maintained their Net Worth required for their program type; and
- * Liquidity. Mortgagee has maintained their required Liquidity for their program type.

2. Independent Auditors Report on Internal Control. Through review of the LASS submission, HUD verifies that the audit contains the required and properly prepared report on internal control structure.

3. Independent Auditors Report on Compliance with Specific Requirements Applicable to Major/Non-major HUD Programs. Through review of the LASS submission, HUD verifies that the audit contains required and properly prepared compliance report: the CPAs Report on the Internal Control Structure and Report on Compliance with Specific Requirements Applicable to Major HUD Programs (if aggregate balances originated or serviced were \$300,000 or more) or Report on Compliance with Specific Requirements Applicable to Non-major HUD Program Transactions. HUD checks that the reports are in accordance with:

- * HUD IG most recent Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs;
- * GAOs most recent Government Auditing Standards (the Yellow Book), and
- * Statement of Auditing Standards (SAS) Number 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance, Feb. 1995.

If a loan correspondent submits the alternative Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards, the report must adhere to Government Auditing Standards reporting requirements.

4. Audit Findings & Corrective Action Plans. HUD verifies that there is an acceptable audit finding and corrective action plan for every reportable condition and/or material weakness and material noncompliance indicator.

5. Adjusted Net Worth. HUD reviews the mortgagees financial statements and notes to the LASS submission to determine if there are unacceptable assets. Unacceptable assets are listed in chapter 7 of the most recent version of HUD IG Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs. Unacceptable assets must be deducted from owners equity as shown in the Balance Sheet. The computation must be shown in the Computation of Adjusted Net Worth.

a. Correction of Deficiency Before Audit Report is Issued. If the mortgagees adjusted net worth falls below FHA requirements, HUD

reviews the notes to the financial statements to determine if there has been a subsequent event that brings the mortgagees net worth to FHA requirements.

b. Correction of Deficiency After Audit Report is Issued. When the mortgagee has corrected a deficiency in its Adjusted Net Worth after the date of the auditors report, then the mortgagee must submit documentation to support that sufficient amount of capital has been contributed to the company to correct the deficiency. This documentation must include the audit finding, written by the financial statement auditor, on the lack of compliance with the net worth requirement and the corrective action plan, written by the mortgagee, detailing how the deficiency was corrected and how the compliance will be monitored. The mortgagees corrective action plan must describe the form of the capital contribution, the exact date of the contribution, and the amount or value of the contribution. Also, the auditor must provide a signed statement that they verified the subsequent capital contribution to the mortgagees books and records.

c. Failure to Meet Net Worth Requirement. Analysis of the LASS submission and notes that reveals that the mortgagees adjusted net worth does not meet FHA requirements is grounds for administrative action by HUDs Mortgage Review Board.

d. Failure to Maintain Required Net Worth. If the review of a LASS submission discloses that the mortgagee does not consistently maintain the required net worth throughout the year, the Department may request that the mortgagee submit interim audited or compiled financial statements and consider further actions. The failure to consistently maintain the required net worth is grounds for an administrative action by the Mortgage Review Board.

6. Liquid Assets. HUD reviews the Balance Sheet, Statement of Cash Flows, and notes to the mortgagees LASS submission to verify that the mortgagee has, and has consistently maintained, adequate liquid assets.

a. Correction of Deficiency Before Audit Report is Issued. If the mortgagees total liquid assets fall below FHA requirements, HUD reviews the notes to the financial statements to determine if there has been a subsequent event that brings the mortgagees liquid assets to FHA requirements.

b. Correction of Deficiency After Audit Report is Issued. When the mortgagee has corrected a deficiency in its liquid assets after the date of the auditors report, then the mortgagee must submit documentation to support that sufficient amount of cash and/or acceptable cash equivalents has been infused into the company to correct the deficiency. This documentation must include the audit finding, written by the financial statement auditor, on the lack of compliance with the requirement and the corrective action plan, written by the mortgagee, detailing how the deficiency was corrected and how the compliance will be monitored. Also, the auditor must provide a signed statement that they verified the subsequent liquid asset infusion to the mortgagees books and records. Depending on the situation, HUD may require a higher level of assurance or additional documentation.

c. Failure to Meet Liquid Assets Requirement. Analysis of the LASS submission and notes that reveals that the mortgagees total liquid assets do not meet FHA requirements is grounds for administrative action by the

Mortgagee Review Board.

d. Failure to Maintain Required Liquid Assets. If HUDs review of LASS submission discloses that the mortgagee does not consistently maintain the required liquid assets throughout the year, the Department may request that the mortgagee submit interim audited or compiled financial statements and consider further actions. The failure to consistently maintain the minimum liquid assets is grounds for an administrative action by the Mortgagee Review Board.

7. Revenues. The principal source of revenues of a non-supervised mortgagee or non-supervised loan correspondent must be from its mortgage lending operations, property improvement or manufactured home lending activities. The mortgagee may include in its revenues activity from loans secured by real property or unsecured Title I insured loans.

8. Indications of Noncompliance. HUD reviews the financial statement submission, including the notes to the financial statements and the other documentation, for any indication of fraud, illegality, or practices not in compliance with FHA requirements. The review also provides a means to determine whether the mortgagee meets the FHA principal activity requirement.

If violations of FHA requirements, fraud, or illegality are identified, the mortgagee is referred to the Quality Assurance Division, the Office of Inspector General, and/or the Mortgagee Review Board for further action or, where appropriate, a letter is sent to the mortgagee requesting an explanation.

9. Reports on Compliance and Internal Control. Where the auditor has reported noncompliance or material weaknesses in the compliance report or internal control report, the mortgagees management must provide a Corrective Action Plan, which details the actions to be taken to correct the noncompliance or weaknesses. Depending on the nature of the findings, the mortgagee may be referred to the Quality Assurance Division, the Office of Inspector General, or the Mortgagee Review Board for further appropriate action.

4-6 Acceptance of LASS Submission. After HUD has reviewed all the information contained in the LASS submission and has determined it is acceptable, the mortgagee is recertified from a financial standpoint. Mortgagees can check the status of their LASS submission within the LASS system, which will show its status as Audit Accepted.

4-7 Deficient LASS Submission. In some instances, FHA will determine the submission is deficient. When this occurs, the mortgagee must adhere to the review comments attached to the submission and follow the instructions in the LASS user manual on how to cure a deficient submission. Failure to submit an acceptable cure within the prescribed timelines outlined in the LASS user manual may result in the loss of a mortgagees FHA approval.

4-8 Rejected LASS Submission. In some instances HUD will reject a submission. A rejected submission allows the mortgagee to modify the submission to correct a deficiency that in HUDs opinion may have been attributed to an oversight by the mortgagee and the auditor. Once the submission has been changed the mortgagee must transmit the submission

to the auditor for review. If the auditor agrees with the content of the template then they will transmit the submission back to the mortgagee for submission to HUD. If the auditor disagrees with the content of the template then they indicate their disagreement and the submission is returned to the mortgagee for modification. The process continues until the auditor has deemed the submission acceptable. The mortgagee transmits the revised submission to HUD through the LASS system. Failure to submit an acceptable submission within the prescribed timelines outlined in the LASS user manual may result in the loss of a mortgagee's FHA approval.

4-9 Termination of FHA Mortgagee Approval.

A. Notice of Violation. If a mortgagee, when required, fails to pay its annual renewal fee, return its annual verification report, or in the case of non-supervised mortgagees and non-supervised loan correspondents, submit an acceptable LASS submission, the Mortgagee Review Board may send the mortgagee a Notice of Violation that gives the mortgagee 30 days from receipt of the notice to comply.

B. Notice of Withdrawal û Termination of Approval. If the mortgagee fails to comply with the Notice of Violation, the Mortgagee Review Board may send the mortgagee a Notice of Withdrawal terminating its approval upon receipt of the notice.

C. Appeal of Notice of Withdrawal. All mortgagees have a 30-day period to appeal their termination and request reinstatement.

1. Annual Fee. Reinstatement requests due to nonpayment of the annual fee must be sent directly to the Lender Approval and Recertification Division. The terminated mortgagee will be sent a Settlement Agreement, which must be executed and returned with payment of the required annual fee and a \$1,000 reinstatement fee. Once the settlement agreement and required monies are received and reviewed, the mortgagee will be reinstated.

2. LASS Submission of Audited Financial Statements. Reinstatement requests due to either an unacceptable or no LASS submission must be made through the LASS system. The terminated mortgagee must submit an audit submission that meets all of our reporting and threshold requirements. In addition, where applicable the mortgagee must submit a corrective action plan that adequately resolves all reported internal control weaknesses and noncompliance. Once the submission has been accepted the mortgagee must execute a Settlement Agreement online in LASS and then submit a \$1,000 reinstatement fee directly to the Lender Approval and Recertification Division. Once the reinstatement fee is received the mortgagee will be reinstated and then must complete the LASS submission of their annual audit.

If the termination was based on both nonpayment of the annual fee and no acceptable LASS submission, two settlement agreements will be required, but only one reinstatement fee must be paid.

Terminated mortgagees who don't appeal or seek reinstatement within the 30 day period may not reapply for FHA approval until 12 months after the effective date of their termination.

4-10 Requests for Information. Under the Departments regulations at 24 CFR 202.5(g), mortgagees must provide, upon request, not only a copy of their latest financial statements, but any additional information that the Department requests to be submitted to an examination of that portion of the mortgagees records that relates to its FHA insured mortgage activities.