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.

Paragraph Page

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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 <u>Planning the Audit</u>. 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]

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.)

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

SPECIAL ATTENTION OF:
HUD Multifamily Housing Program Owners & Management Agents

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-7
Chapter Number: 3
Issued: July 2008

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1. This transmits Handbook 2000.04 REV-2 CHG-7, Chapter 3, Consolidated Audit Guide for Audits of HUD Programs, HUD Multifamily Housing Programs.

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 so it will be available for use. When all of the chapters providing audit guidance are revised, the entire handbook will be repackaged and released as REV-3.

   This handbook chapter is a change to Handbook IG 2000.04 REV-2, chapter 4, dated December 2001. A change was necessary to reflect changes in reporting, add suggested audit steps for areas not covered in the previous audit guide, and clarify existing information/guidance. This chapter serves as a reference for auditors who perform audits of profit-motivated and limited-distribution entities participating in Federal Housing Administration (FHA) and other U.S. Department of Housing and Urban Development (HUD) multifamily housing programs.

3. **Significant Changes:**

   a. This revision of Handbook IG 2000.04 REV-2, chapter 4 is re-designated as Chapter 3. We plan to create a separate chapter covering audits of the HUD multifamily hospital program and will designate that chapter as chapter 4. Until the new chapter 4 is written, Handbook IG 2000.04 REV-2, chapter 4, is reissued and is to be used for guidance for auditing the HUD multifamily hospital program, and its title is changed to HUD multifamily hospital program.

   b. Paragraph 3-1, Background, was modified to permit "group project-based sampling" of certain areas of compliance when audits are performed for projects that are owned/managed by the same owner and/or management agent if certain conditions exist as described in that paragraph.

   c. Paragraph 3-2, Reference Material, contains the reference documents current 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 3-2 rather than to the entire handbook/chapter.

d. Paragraph 3-3, Reporting Requirements, was updated to include current requirements as stated in existing HUD policies/procedures.

e. Paragraph 3-4, Sample Selection and appendix A, requiring attribute sampling and/or minimum sample sizes should another sampling system be used, were added to provide sufficient evidential matter to support the audit opinion.

f. Paragraph 3-5G and appendix B were added to establish a uniform understanding of equity skimming conditions to facilitate identification and reporting should the auditor find such conditions as a result of the audit.

g. The following compliance areas were added to the guide with appropriate audit steps since those areas were not in the prior guide and many auditors did not cover those areas in their audit or the audit coverage was not sufficient.

- Paragraph 3-5 H. Cash Receipts
- Paragraph 3-5 I. Cash Disbursements
- Paragraph 3-5 K Tenant Security Deposits
- Paragraph 3-6 Mark to Market Program (M2M Program)

h. Paragraph 3-7, Audit Finding Reporting, was added to provide guidance on reporting audit findings that have been corrected or were being corrected before the completion of the audit.

Also, auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor-written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide 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, and those letters/communications must be provided to HUD with the audit report package.

i. Paragraph 3-8, Technical Assistance Needed, was added to provide a point of contact for programmatic questions or questions regarding the Financial Assessment Subsystem.

j. Various audit steps were added to the compliance areas. Those changes and other changes made in this chapter are denoted between asterisks (for example, *All material instances of noncompliance....... *).

4. **Filing Instructions:** The issuance of this chapter cancels chapter 4 dated December 2001, for all programs except for the HUD multifamily hospital program.

Remove	**Insert**
None	Chapter 3, dated July 2008

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, 2008.

Kenneth M. Donohue
Inspector General

CHAPTER *3.* HUD Multifamily Housing Programs

3-1. **Background.** This chapter contains the U.S. Department of Housing and Urban Development's (HUD) requirements for conducting the compliance portion of the annual financial audits of profit-motivated and limited-distribution entities participating in HUD's Federal Housing Administration (FHA) multifamily housing programs *except for hospitals, which are covered by chapter 4 of this guide.*

*For audits performed under this chapter, which include many different types of projects, the required compliance testing must be done for each project on an individual basis except when the project is owned and/or managed by an entity that owns and/or manages multiple HUD/FHA-assisted projects. When this condition exists, audit guide compliance sections, paragraph 3-5.J, Tenant Application, Eligibility, and Recertification; paragraph 3-5.L, Tenant Security Deposits; and paragraph 3-5.M, Management Functions, can be audited on an individual project basis or can be sampled using a group project-basis sample (defined later in this section) if

A. The same system is used by management for the compliance section for all projects selected for inclusion in this group project-based sample.

B. For the projects that are to be included in the population and sample, the compliance section has the same supervisor for all projects, the procedures followed are identical, and the test of internal controls did not disclose any weaknesses.

C. The owner(s) agrees to the project-based sample method.

D. The auditor fully documents in the work papers the above information upon which the determination was made, including the owner's signed agreement.

All other compliance sections except for the three cited above must be performed on each project.

When a condition or weakness is found during the testing that is required to be reported, it must be reported in the audit report for each project in the population. Reference should be made to each report that contains that type finding. If dollars are involved, only the dollars belonging to that specific project should be included in that project's audit finding. For example, significant deficiencies found or findings developed must be included in the audit report for all projects that were grouped for the group project-based population. The* *following illustrates wording that can be used. "This internal control problem applies to and is reported in 15 audit reports, 5 for projects owned by companies related to the X Housing Cooperation and 10 projects owned by two unrelated owners. The total disallowed cost is $450,000, of which $100,000 applies to this project, and $200,000 applies to the other 4 projects owned by companies related to the X Housing Cooperation and $150,000 applies to the 10 projects owned by the two unrelated owners." Additionally, nonmaterial instances of noncompliance must be reported in a management letter or other written correspondence for each project in the population (reporting requirements are included in paragraph 3-8 of this chapter).

A group project-based sample must include at least 20 percent of the projects with no less than a minimum of four projects to be reviewed each year for compliance with audit steps contained in sections 3-5J, 3-5L, and 3-5M. This will result in each project in the population being reviewed at least every five years or less for those compliance sections. The following examples illustrate this point:

> Example 1. An auditor has 50 projects in the population that are to be audited, and the conditions permit the auditor to use group project-based sampling. The auditor would test 20 percent or 10 projects since this amount is greater than four.
>
> Example 2. An auditor has 10 projects in the population that are to be audited, and the conditions permit the auditor to use group project-based sampling. The auditor would test the minimum of four projects since 20 percent would only be two projects.

Specific projects from the population may be added to the sample based on a risk analysis or for any other reason. However, any specific project shall not be counted as a part of the 20 percent or minimum sample of four for that year.

If the auditor elects to use the project-based sampling method, the sampling schedule and system for selecting must be included in the work papers so auditors can later ensure that all projects in the population will continue to be audited systematically.

The auditor's opinion on compliance is to be provided for each individual project, and the compliance testing must support the opinion for each individual project and not the group as a whole.

Practitioners with nonprofit projects as clients, who participate in HUD/FHA multifamily housing programs covered by the Single Audit Act, are to conduct audits in accordance with Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local**

**Governments and Non-Profit Organizations*, and with the requirements contained in OMB Circular A-133's, *Compliance Supplement*, which can be found on the OMB Web site

http://www.whitehouse.gov/omb/grants/grants_circulars.html.

This chapter is not intended to be a program-specific audit guide for compliance with the A-133 requirements. If the *Compliance Supplement* includes the program that is being audited, the guidance in the supplement is to be used. If the *Compliance Supplement* does not include the program that is being audited, part 7 of the supplement provides guidance on how to identify the applicable compliance requirements to test. Paragraph 1d of part 7 states "If there is an audit guidance issued by the Federal agency's Office of Inspector General (OIG), the auditor may wish to consider this guidance in identifying the program objectives, program procedures, and compliance requirements." This guide should be used only for that purpose.

3-2. **Reference Material.** The following is the reference material that was in effect at the time this audit guide was issued. It is the auditor's responsibility to use the procedures that were in effect during the period covered by the audit.

The audit procedures that are established in this guide are based on the procedures that were in effect when the guide was written. The auditor must determine the procedures that were in effect during the audit period which their client was to follow. The auditor must conform those procedures to the audit steps in this guide. Changes, as found necessary, must be made to the audit steps.

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 3-2 should any of the material referenced below be revised, causing a change to documents' revision number, rather than revising the entire handbook/chapter, since the base handbook number would not change. Also, the auditor should ensure that the updated reference, listed in this paragraph, is used for performing the audit. The versions listed below were those in effect at the time this audit guide was issued. If reference to a handbook is needed in the audit report, the auditor should ensure that the entire updated reference, including the current revision number, is used.

Document	**Title**
HUD Handbook 4370.2, REV-1	Financial Operations and Accounting Procedures for Insured Multifamily Projects*

*HUD Handbook 4350.3, REV-1	Occupancy Requirements of Subsidized Multifamily Housing Programs
HUD Handbook 4370.1, REV-2	Reviewing Annual and Monthly Financial Statements
HUD Handbook 4381.5, REV-2, CHG-2	The Management Agent Handbook
HUD Handbook 4350.1	Multifamily Asset Management and Project Servicing
Not numbered	M2M Program Operating Procedures Guide Located at Web site: http://www.hud.gov/offices/hsg/omhar/readingrm/opglinks.cfm

Reference material may be obtained by accessing HUD's Client Information and Policy System (HUDCLIPS) at the following Web site:

http://www.hudclips.org/

Reference material may also be ordered from HUD's direct distribution system by telephone, (800) 767-7468; in a letter addressed to HUD, Customer Service Center, Room B-100, 451 Seventh St., SW, Washington, DC 20410; or by fax, (202) 708-2313.*

3-3. **Reporting Requirements.** The regulatory agreement for the project requires the owner to submit audited financial statements, prepared in accordance with the requirements of the Secretary, within 90 days after the end of the fiscal year. *Although most regulatory agreements may indicate a required submission date of 60 days after the end of the fiscal year, 24 CFR [*Code of Federal Regulations*] 5.801, Uniform Financial Reporting Standards (UFRS), supersedes this requirement by giving projects 90 days to submit their financial statements*. In addition to issuing an opinion, the basic financial statements, and supplemental (supporting) data, the auditor is required to issue, at a minimum, a report on the internal control structure and a report on compliance. The owner must certify to the completeness and accuracy of the financial statements. The management agent, if applicable, must certify to the management of the project. *The owner and management agent certifications are to be made in accordance with the requirements of HUD Handbook 4370.2, paragraphs 3-7 and 3-8. When circumstances prohibit the specified number of partners' or officers' certifying signatures, explanatory information should be provided with the audit report.

The auditor's role is to conduct and report the results of the audit in accordance with auditing standards generally accepted in the United States of America (GAAS) as issued by the American Institute of Certified Public Accountants (AICPA) and the standards* *applicable to financial audits contained in the generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. It is the owner's responsibility to file an accurate electronic submission with the Real Estate Assessment Center (REAC). In that regard, the independent auditor shall*

A. Issue an independent auditor's 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 profit and loss.*
- 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 auditor's report (refer to chapter 2, example A) on the supplemental information. A paragraph may be added to the auditor's report on the basic financial statements, or a full report may be issued separately.[2] *Supplemental information includes the REAC financial data templates, which essentially include support and detail for specific accounts included in the basic financial statement data and certain other information as required by HUD Handbook 4370.2, chapter 3, and as further described in REAC's *Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards* (UFRS) located on REAC's Web site. The Web address is

http://www.hud.gov/offices/reac/products/fass/mf_doc.cfm.

Use of the guidelines is mandatory for all engagements covered under UFRS.

The financial data templates are further defined in the appendixes of the *Industry User Guide for Financial Assessment Subsystem – Multifamily Housing* (FASSUB). The Industry User Guide is available at the following Web address:

http://www.hud.gov/offices/reac/products/fass/fassmf_guide.cfm.

*

[1] Or similarly titled report based on the type of participating ownership entity. For example, if a limited liability company owns the property, "statement of changes in members' equity" should be discussed.

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

C. Issue any additional reports described in chapter 2.

3-4. **<u>*Sample Selection.</u>** According to the Government Auditing Standards, published by the Government Accountability Office (GAO), the third fieldwork standard for financial audits states:

> The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

Audit sampling, when properly applied, can provide sufficient appropriate evidence to support the audit opinion.

Audit sampling is defined as the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. There are two general approaches to audit sampling: nonstatistical and statistical. Both approaches require the auditor to use professional judgment in planning, performing, and evaluating a sample and in relating the audit evidence produced by the sample to other audit evidence when forming a conclusion about the related account balance or class of transactions.

It is important that the sample selected be representative of the population. The size of a sample necessary to provide sufficient audit evidence depends on both the objectives and the efficiency of the sample. Because of the previous inconsistency in the application of the sampling process in auditing HUD programs, OIG convened a panel consisting of representatives from OIG, HUD REAC, AICPA, and several auditing firms with significant HUD experience to discuss the issue and potential solutions. Based on the feedback from that panel, OIG decided and all participants agreed that attribute sampling[3] is the appropriate sampling methodology for use in auditing programs using this chapter to provide consistency and to assure adequate coverage to support the audit opinions rendered.

The attribute sampling method of selecting a sample is to be used anytime in this chapter a statement is made that a sample is to be selected. If the auditor is of the opinion that another sampling method should be used for a particular audit; for example, when the objective is to sample transaction dollar values for purposes of statistically estimating over/understatements (variable sampling methodology), the working papers must contain justification for the methodology used. Appendix A to this chapter provides additional*

[3] Until such time as OIG decides to extend this approach to other chapters, attribute sampling will only apply to audits performed using chapter 3.

*information on attribute sampling. The sample sizes stated in appendix A are to be the minimum sample sizes to be used regardless of the methodology the auditor uses in lieu of attribute sampling.

3-5. Compliance Requirements and Audit Areas. The following sections contain suggested audit procedures that HUD believes should be performed. If an auditor determines that the stated procedures to be inappropriate and/or other audit procedures should be performed, the deviation from the stated procedures must be justified and documented in the auditor's working papers.*

A. Federal Financial Reports.

1. **Compliance Requirement.** Projects 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 project and HUD. The individual agreements contain the specific reporting requirements that the project must follow. *HUD will usually require monthly reports whenever annual financial reviews, on-site reviews, or other information indicates that the project is experiencing financial or management difficulties or the owner/agent is suspected of noncompliance (HUD Handbook 4370.1, chapter 3). The type of annual statements can vary by program. HUD Handbooks 4370.2 and 4350.1 provide detailed guidance as to which owners must submit financial statements and the types of statements that are required.*

2. **Suggested Audit Procedures.**

   a. Identify all required financial reports by inquiry of the owner/management agent and review of agreements and correspondence with HUD. Request a copy of auditee submissions to HUD during the period under audit.

   b. Obtain an understanding of the owner/management agent's procedures for preparing and reviewing the financial reports.

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

d. For the sample selected, determine whether significant data reported are accurate. Report all material differences between financial reports and project records.

e. *Determine whether the project complied with HUD's reporting requirements.*

B. Fair Housing and Nondiscrimination.

1. Compliance Requirement. Owners and management agents are prohibited from discriminatory practices in accepting applications, renting units, and designating units or sections of a project for renting to prohibited bases in accordance with the Fair Housing Act and the provisions of the regulatory agreement.

2. Suggested Audit Procedures.

a. Obtain a copy of the project's approved affirmative fair housing marketing plan, if applicable. Review the marketing plan for compliance with appropriate statutes and the regulatory agreement. Section 232 projects will not have an affirmative fair housing marketing plan but have a regulatory obligation not to discriminate.

b. Obtain an understanding of the owner/management agent's policies and procedures relating to marketing of the units; processing, approving, and rejecting applications; and providing reasonable accommodation to applicants and tenants with disabilities in accordance with the requirements of applicable federal civil rights laws *and the Americans with Disabilities Act.*

c. *Obtain a copy of the project's tenant selection plan as required by HUD Handbook 4350.3. Review the plan for compliance with the handbook and perform the following steps:

(1) Determine whether there are indications of any discriminatory practices such as prohibited screening practices based on

i. Race, color, religion, sex, national origin, age, family status, or disability;*

ii. *Segments of population, e.g., welfare recipients, single-parent household;

iii. Income;

iv. Lack of rental history; or

v. Other civil rights and nondiscrimination requirements listed in Handbook 4350.3.

(2) Determine whether the plan is updated every five years.*

d. Determine whether procedures were placed in operation as established by the owner/management agent through inquiry and physical examination of documentary evidence. Documentation can vary based on the procedures established.

e. Review a sample of the correspondence chronology files for the period under audit for correspondence evidencing litigation or potential litigation related to discriminatory rental practices.

f. *During the review of cash disbursements under audit step 3-5.I.1.2.c, look for payments that would evidence actual or potential litigation for any discriminatory rental practices.

g. During the review of tenant files under audit step 3-5.J.1.2.e(16), look for evidence of discriminatory practices.*

h. Determine that the HUD-approved equal housing opportunity logo, slogan, or statement is displayed in marketing materials.

C. <u>Mortgage Status.</u>

1. <u>Compliance Requirement</u>. Owners shall promptly make all payments due under the note and mortgage.

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

a. Obtain a copy of the mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements.

b. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage.

c. *Determine whether all related mortgage and escrow payments were made by either*

(1) Obtaining or preparing a schedule of the client's mortgage and escrow payments and withdrawals for the period under audit (the schedule should include the amount, including escrow items, and date each item was paid or disbursed. Determine whether monthly payments were made on time and the loan was current at the end of the fiscal year) or

(2) Confirming the outstanding loan balance and annual escrow account activity with the lender as of the project's fiscal year end (determine whether monthly payments were made on time and the loan was current at the end of the fiscal year).

d. If the project is operating under a mortgage modification agreement, workout agreement, forbearance agreement, use agreement, or other agreement, determine whether the owner is complying with the terms and conditions of the agreement.

D. <u>Replacement Reserve.</u>

1. <u>Compliance Requirement</u>. Owners, if required, shall establish a reserve for replacement account and make deposits in accordance with HUD requirements, usually the regulatory agreement *or business agreement*. The reserve for replacement account is usually required to be under the control of the lender. Disbursements from the reserve for replacement fund may be made only after written consent is received from HUD.

Reserve for replacement funds are to be invested in interest-bearing accounts for certain projects. Interest earned on these projects is required to be maintained in the reserve for replacement account. For other projects, HUD strongly encourages owners to invest the reserve for replacement funds. The mortgagee is authorized to invest funds in excess of $100,000 (the Federal Deposit Insurance Corporation (FDIC) federally insured limit) in approved securities and/or financial institutions as long as it follows the requirements in HUD Handbook 4350.1, paragraph 4-22. Interest on those investments is *considered project funds and may not be disbursed directly to owners or directly to any individual associated with the project. All interest must flow through the project accounts and be disclosed in the accounting records.*

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

a. Obtain an understanding of the project owner's deposit and maintenance requirements included in the regulatory agreement,*business agreement* and any amendments or other written agreements with HUD and determine whether there were any changes to the funding requirement by

(1) *Reviewing Form HUD-9250, Reserve Funds for Replacement Authorization, or

(2) Questioning the owner/management agent if any changes were made when rents were increased. Increases will be documented on Form HUD-92458, Rent Schedule Low Rent Housing.*

b. Obtain an understanding of the project owner's procedures for depositing, maintaining, requesting, and disbursing reserve for replacement funds.

c. Determine whether the reserve fund has been established in a federally insured depository under the control of the mortgagee, if required. *For funds in excess of federally insured limits, determine whether the owner/management agent reviewed the depository quarterly to verify that it met HUD requirements as described in HUD Handbook 4350.1.

d. Using confirmation or the schedule prepared for the mortgage status compliance requirement in 3-5.C.2.c, determine whether all required deposits to the reserve for replacement were made in compliance with HUD requirements and agreements.*

e. Determine whether all disbursements from the reserve for replacement account, identified in the mortgage confirmation or the schedule prepared in 3-5.C.2.c, were properly authorized by HUD.

f. *Select a sample of repairs covered by funds from the reserve for replacement account. Trace the reimbursed amount to cancelled* *invoices and determine whether funds were used for the purpose authorized by HUD.

g. For projects for which HUD requires funds to be invested, determine whether funds were invested and interest was only withdrawn with HUD approval.

h. For projects for which HUD does not require funds to be invested, determine whether funds were invested. Perform the following steps:

(1). If funds were not invested, determine why and consider including a comment in the management letter or other auditor communication.

(2). If funds were invested, determine whether interest was disbursed to the project by the lender and if so, whether the interest was deposited into project accounts and recorded in the project's accounting records.

(3). If funds were invested, determine whether interest was disbursed directly to owners or any individual associated with the project in violation of HUD requirements.*

E. Residual Receipts.

1. Compliance Requirement. *Non-profit owners and owners of limited distribution projects, Section 202 projects, and Section 811 projects* shall establish a residual receipts account and make deposits into the account in accordance with HUD requirements *within 90 days after the close of the fiscal year.* Disbursements from such fund may be made only after written consent is received from HUD.

2. Suggested Audit Procedures.

a. Obtain a copy of the project's regulatory agreement and any amendments or other HUD business agreements, to identify the project owner's requirements for making deposits into the residual receipts fund and copies of the surplus cash calculations from the end of the prior audit period and semiannual period, as applicable.

b. Obtain an understanding of the owner/management agent's procedures for determining and depositing residual receipts.

c. *Determine whether the surplus cash calculations were prepared in accordance with the regulatory agreement and other HUD guidance.

d. Determine whether the project deposited all required amounts into the residual receipts account for the period under audit according to the surplus cash calculation(s)*.

e. Using the confirmation or the alternative schedule prepared for the mortgage status compliance requirement in 3-5C2c, determine whether residual receipts were deposited in the residual receipts account within *90* days after the end of the fiscal year or semiannual period, if applicable.

f. *Determine whether disbursements from the residual receipts account, identified on the confirmation or alternative schedule prepared in 3-5.C.2.c, were properly authorized by HUD and used for the purpose intended*.

F. Distributions to Owners.

1. Compliance Requirement. Owners may not make, receive, and/or retain any distribution of assets or any income of any kind of the project except surplus cash and then only under certain conditions. Surplus cash distributions can only be made as of and after the end of a semiannual or annual fiscal period. Surplus cash distributions cannot be made when the owner is in default under any of the terms of the regulatory agreement, the note, or mortgage. *Surplus cash distributions cannot be made out of borrowed funds or if the owner has not complied with all outstanding notices, from HUD or from the mortgagee, for proper maintenance of the project.* 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, business agreement or subsequent HUD-approved agreements *with the balance of surplus cash required to be deposited in a residual receipts account (see steps 3-5.E).*

2. Suggested Audit Procedures.

a. Obtain a copy of the project's regulatory agreement, business agreement and any amendments or associated documents to determine the owner's rights for receiving distributions and surplus cash calculations for the prior fiscal period and semiannual period, if applicable.

b. *Obtain an understanding of the owner/management agent's procedures for determining surplus cash and making distributions.*

c. Scan minutes of board or partnership meetings for discussions authorizing distributions.

d. Question the owner or management agent about the existence of any notices of default or other items of noncompliance under any of the terms of the regulatory or business agreement.

e. *Determine whether the surplus cash calculations were prepared in accordance with the regulatory or business agreement and other HUD guidance.

f. Determine whether distributions taken during the audit period exceeded the amounts calculated and/or authorized for that period.*

g. Scan cash disbursements for evidence of any payments made to the project owners *or related parties. Scan journal entries for unexplained decreases in accounts payable, notes payable, and related interest to project owners or related parties. Determine whether the owner/management agent paid partnership management fees, asset management fees, incentive management fees, and write-offs of related party receivables from funds other than surplus cash or distributions.

h. Scan the bank statements for any deposit, from the project owners and/or related parties, which would evidence that incorrect distributions or payments were made and that those funds were redeposited into the project's accounts before the audit.

i. Review inspection reports and owner responses to verify compliance with all outstanding notices for proper maintenance of the project. Delays in making repairs could erroneously result in surplus cash being reported to be on hand at the end of the reporting period, making funds available for distribution to the owners.*

G. *Equity Skimming.

1. **Compliance Requirement.** Equity skimming is the willful misuse of any part of the rent, assets, proceeds, income, or other funds derived from the project covered by the mortgage for any purpose other than to meet actual or necessary expenses of the project. Equity skimming deprives the project of needed funds for repairs, maintenance, and improvements, which contributes to the financial and physical deterioration of the project and the standard of living conditions for the families who depend on the federal government to provide housing. Also, a community where the project is located suffers since the project may become the breeding ground for crime, violence, and drugs. Appendix B includes areas disclosed in audit reports in which equity skimming was found in the operations of multifamily projects.

2. **Suggested Audit Procedures.** In the various compliance areas in this chapter, we have included audit steps that are designed to disclose equity skimming. The auditor should be aware of the conditions noted in appendix B and modify any of the audit steps based on the policies/procedures of the auditee.

H. Cash Receipts.

1. **Compliance Requirement.** All cash receipts, including those collected by a management agent, must be deposited into an account in the name of the project at an institution in which deposits are federally insured. The project's owner must verify that depositories where it maintains funds in excess of $100,000 meet certain conditions as outlined in chapter 2 of HUD Handbook 4370.2.

   Most projects will have at least three bank accounts including a regular operating account, a reserve for replacement account (held by the mortgagee, see paragraph 3-5.D for audit steps), and a tenant security deposit account (see paragraph 3-5.L for audit steps). Non-profits and limited distribution projects will also have a residual receipts account (see paragraph 3-5.E for audit steps).

   The regular operating account is a general operating account in the name of the project, which is used for depositing receipts of the project other than those specifically designated for the security deposits account. A centralized account can only be used as provided for in chapter 2 of HUD Handbook 4270.2.*

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

a. Obtain an understanding of the owner/management agent's procedures for handing cash receipts.

b. Determine whether the project owner's written and actual procedures for receiving and depositing funds in the regular operating account/centralized account are in compliance with the regulatory agreement and chapter 2 of HUD Handbook 4370.2.

c. Determine whether the account is exclusively in the name of the project except as allowed by HUD Handbook 4370.2 for centralized accounts.

d. Select a sample of deposits from the cash receipts ledger and perform the following steps:

(1) Determine whether the deposits were made in a timely manner after receipt of funds and are in the name of the project. Usually tenant cash receipts are deposited daily during the heavy rent collection days during the first part of the month and when certain amounts of funds are accumulated during the rest of the month.

(2) Test the supporting documentation for each deposit in the sample and determine whether all funds that were received were properly accounted for and included in the deposit.

(3) Determine that all deposits in the books of account are in agreement with the related bank statements as to amounts and dates.

(4) Determine whether the deposits were posted to the appropriate general ledger accounts.

(5) Trace all amounts other than tenant/member rental receipts to any contracts, agreements, or other documentation and determine whether the amount that was received was properly deposited and posted to the appropriate account.

(6) Select a sample of tenant/member rental receipts and trace the amount from the source documents to the individual* *tenant/member accounts receivable record and their executed leases.

(7) If any amounts are added to the account by way of an institution's memorandum or other type of document, determine the reason for that transaction and whether it was proper.

e. Owners may be motivated to both understate and overstate revenue. The following audit steps are designed to disclose such occurrences:

(1) Consider the fraud risk factors and the potential for material misstatement of the financial statements related to revenue recognition including vacancy loss and bad debt expense. Perform testing to address any material fraud risk factors identified. The auditor should tailor audit steps/procedures based on the individual risk factors identified and the results of other audit evidence gathered.

(2) Determine whether vacancy loss is greater than 15 percent of total rental revenue or if the change in vacancy loss between the current year and prior year is greater than 5 percent. If so, the following steps should be performed:

i. Determine whether rent potential and vacancy loss were properly calculated.

ii. For all revenue accounts, scan the detailed general ledger. Review the supporting documentation for all material manual entries and unusual entries.

iii. Determine the reason for the increase or cause of the high vacancy rate via discussion with management. The auditor may also want to select a sample of vacant units and perform tests to substantiate the high vacancy rate. Possible tests on the sample include but are not limited to the following:

(i). Reviewing the move-out notice from the tenant.

(ii). Reviewing the documentation from the move-out inspection.*

(iii). *Determining whether the security deposit was refunded to the tenant.

(iv). Reviewing the itemized list of damages and charges provided to the tenant, which was used to reduce the amount of security deposit due back to the tenant.

(v). Inspecting the vacant unit if the unit is still unoccupied.

(vi). Questioning site personal, including the resident manager and the building manager, to determine the period when the unit was vacant.

(vii). Reviewing work orders to determine the period when the unit was vacant.

(3) Determine whether bad debt expense is greater than 10 percent of total rental revenue or whether the change in bad debt expense is greater than 5 percent between the current year and the prior year. If so, the following steps should be performed:

i. Obtain an understanding of the owner/management agent's procedures for collecting delinquent debt and policy for writing off debt.

ii. Determine whether delinquent accounts are sufficiently pursued according to procedures.

iii. Select a sample of accounts written off to bad debts expense and review supporting documentation to determine whether debt was written off in accordance with policy and generally accepted accounting principles.

f. Determine the reason for any activity on the tenant record after the debt was written off. *

I. *Cash Disbursements.

1. **Compliance Requirement.** All disbursements from the regular operating account must be supported by approved invoices, bills, or other supporting documentation. Project funds should only be used to pay for mortgage payments, required deposits to the reserve for replacement fund, reasonable expenses necessary for the operation and maintenance of the project, distributions of surplus cash as permitted, and repayment of owner advances from surplus cash or as authorized by HUD. Disbursements from a centralized account must clearly be traceable to each project. The actual cash position of each project in this account must be easily identifiable at all times without exception.

2. **Suggested Audit Procedures.**

   a. Obtain an understanding of the project owner/management agent's procedures for withdrawing funds from the regular operating account or centralized account and determine whether they are properly supported and used in accordance with the regulatory agreement.

   b. Select a sample of disbursements from the cash disbursement ledger or similar record and perform the following steps:

   (1) For centralized accounts, determine whether the disbursements were recorded in the books of the appropriate project in accordance with HUD Handbook 4370.2. Review cash account balances of each project to ensure that balances are easily identifiable to each project. Also, determine whether any projects have a negative or zero balance, which could indicate an improper loan between projects.

   (2) Determine whether the disbursements are supported by approved invoices, bills, or other supporting documentation; the supporting documents are in the name of the project; and the costs are reasonable and necessary for the operation of the project. If the supporting documentation is not in the name of the project, determine whether only the portion applicable to the project was paid from project funds.*

(3) *Determine whether the disbursements were made on behalf of other projects or entities since project funds cannot be loaned or used for nonproject purposes. Report instances even if amounts have been repaid.

(4) Determine whether the disbursements were properly charged to the correct account.

c. Scan the cash disbursements journal for payments that would evidence actual or potential litigation for any discriminatory rental practices.

d. If any amounts are withdrawn from the project account by way of an institution's memorandum or other type of document, determine the reason for that transaction and that it is proper.

e. For accounts with balances in excess of FDIC-insured limits, determine whether the owner or management agent followed the steps outlined in chapter 2 of HUD Handbook 4370.2 to determine the eligibility of the financial institution.

J. Tenant Application, Eligibility, and Recertification.

1. Compliance Requirement. Owners who participate in HUD's rent subsidy programs are responsible for accepting applications, maintaining a waiting list, determining eligibility, calculating the tenant's contribution toward rent and utilities, calculating subsidy, and recertifying the tenant annually in accordance with HUD requirements.

2. Suggested Audit Procedures.

a. Obtain a copy of the housing assistance payments contracts or equivalent subsidy contracts with any amendments to determine the owner's responsibilities in this compliance area.

b. Obtain an understanding of the owner/management agent's procedures for accepting applications, managing the waiting list, determining initial eligibility, determining a tenant's rent and subsidy, and recertifying annually and determine whether they are in compliance with the provisions in HUD Handbook 4350.3.*

c. *Review the results of any field reviews performed covering tenant application, eligibility, and recertification activity. Consider the impact on the audit steps to be preformed. If deficiencies were disclosed, additional testing should be performed on current activity to determine whether the problem has been corrected or corrective action was put in place.

d. Select a sample of applicants that were selected from the waiting list during the fiscal year. The sample should include some tenants that were denied admission. Perform the following steps at a minimum:

(1). Determine whether applicants were selected in the correct order.

(2). Determine whether preferences granted were verified before admitting the applicant as a tenant, if applicable.

(3). Determine whether the waiting list was purged. If so, determine whether it was done in accordance with written procedures.

(4). For denied applicants, determine whether the following documentation was maintained:

i. The reason the applicant was denied admittance in accordance with the tenant selection plan and that the reason was properly supported.

ii. Any indication of discriminatory rental practices or if the applicant threatened or entered litigation because of discriminatory practices.

iii. The rejection letter provided to the applicant advising the applicant of his/her right to appeal.

e. Select a sample of tenant files. The sample should include some recently admitted tenants as well as some tenants who no longer reside at the project. The requirements below are covered in HUD Handbook 4350.3. The auditor should review the Handbook to determine whether requirements have been added or removed to ensure completeness of* *review in this area. Perform a minimum of the following steps, as applicable:

(1) Determine whether all appropriate parties signed the application.

(2) Determine whether household members were correctly identified and the head, cohead, and all tenants age 18 and older signed the applicant's/tenant's consent to the release of information, Form HUD 9887-A.

(3) Determine whether the owner/management agent verified Social Security numbers of all occupants six years of age and older, disability status, waiting list preferences, and income and allowances for adjusted income (refer to Handbook 4350.3, appendix 3, for additional information on acceptable form of verification).

(4) Determine whether the resident rights and responsibilities were acknowledged.

(5) Determine whether citizenship declaration or eligible immigrant status was obtained.

(6) Determine whether all adult tenants were screened for criminal and drug background checks as well as sex offender registration.

(7) Determine whether the correct HUD model lease and addendums were used and correctly signed/executed.

(8) Determine whether the appropriate security deposit and prorated rent were correctly calculated and collected.

(9) Determine whether the appropriate security deposit and prepaid rent were returned within 30 days after move-out.

(10) Determine whether the owner's certification of compliance with HUD's tenant eligibility and rent procedures, Form HUD-50059, was completed correctly.*

(11) *Determine whether move-in and move-out inspection forms were completed.

(12) Determine whether the computation of the tenant's contribution toward rent and utilities and the subsidized portion of the tenant's monthly rent were properly calculated.

(13) Determine whether the initial certification and the last recertification forms were completed correctly and were accurate (Form HUD-50059).

(14) Verify that the Section 8 rents charged and paid did not exceed the contract rents approved by HUD.

(15) Trace the housing assistance payment calculated in the tenant file to the amount charged to HUD in the monthly voucher request.

(16) For those tenants who were evicted, determine whether

i. The basis for the eviction was in accordance with the established rental policy, or

ii. The tenant was evicted for any discriminatory reasons.

(17) Determine whether any evidence is contained in the file indicating that any improper or inaccurate information was discovered while determining tenant eligibility or rent calculation. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow up on suspected fraud.

K. Units Leased to Extremely Low-Income Families.

1. **Compliance Requirement.** For each project assisted under a contract for project-based Section 8 assistance, the owner must lease not fewer than 40 percent of the dwelling units to extremely low-income families (HUD Handbook 4350.3, chapter 3, and chapter 4, paragraph 4-5).

2. **Suggested Audit Procedures.***

a. *Select a sample of Section 8 tenants or use the sample selected in step 3-5.J above if all tenants in that sample receive subsidy. For the sample items selected,

(1) Obtain a copy of the tenant selection plan for a description of the methodology the owner uses in income targeting.

(2) Obtain an understanding of the owner/management agent's procedures for implementing that plan and determine whether the procedures properly implement the tenant selection plan.

b. Determine whether at least 40 percent of the units that became available during the period under review served extremely low-income families.

(1) If the tenant files that were stated in the owner's income target determination were in the sample selected, determine that extremely low-income families occupied those units.

(2) If none of the extremely low-income families were in the sample selected, select a separate sample from the owner's determination documentation and determine whether the units were rented to extremely low-income families.

c. If the 40 percent has not been reached and the owner is renting units to other eligible families, determine whether the owner has documented its marketing efforts to target extremely low-income families.

L. <u>Tenant Security Deposits.</u>

1. <u>Compliance Requirement.</u> Funds collected as a security deposit shall be kept in the name of the project, separate and apart from all other funds of the project in a trust account. The amount of this account shall at all times equal or exceed the aggregate of all outstanding obligations under that account. Funds must not be commingled with funds from any other projects. All disbursements from the security deposit account must be only for refunds to tenants and for payment of expenses incurred by or on behalf of the tenant, not to exceed the amount to which the tenant is entitled. All disbursements must have supporting documentation. In addition, state and local governments may have specific regulations governing the handling of tenant security deposits.*

2. *Suggested Audit Procedures.

a. Obtain an understanding of the project owner's procedures, including state and local laws, and regulatory agreement and HUD requirements (HUD Handbook 4370.2, chapter 2) for establishment and maintenance of the security deposit account and making approved disbursements from that account.

b. Determine whether the account has been established in a federally insured depository in the name of the project, which is segregated from project operating funds, and the owner's records support the amount on deposit.

c. Determine whether, at the end of the reporting period and throughout the period under review, the amount on deposit is at least equal to the outstanding obligations under the security deposit account.

d. Determine whether interest is earned on the security deposit account and the disposition of that interest. If state and local law requires the owner to pay the tenant for interest earned, determine that the tenant interest is credited to tenants and paid upon termination of tenancy.

e. Select a sample of tenants that moved in and tenants that moved out during the period under review and perform the following steps:

(1) Determine whether security deposits were collected at the time of the initial lease and agree with the amount required in the lease agreement and regulations.

(2) Determine whether security deposits collected were deposited promptly in the security deposit account.

(3) Trace tenant balances reported on the balance sheet at the end of the fiscal year as the outstanding obligation to the tenant list of security deposits for the same period and determine if it agrees.

(4) Determine whether refunds and/or an itemized list of claims were provided to tenants within 30 days after move-out or as required by state or local law. *

(5) *Determine whether refunds were disbursed to the former tenant and in the appropriate amount. Determine the disposition of or proposed disposition of the amounts for checks outstanding for more than 60 days.

(6) Identify disbursements from the security deposit bank account statement that do not appear to be tenant refunds to ensure that those disbursements were only made for payment of appropriate expenses incurred by the tenant or on behalf of the tenant.

(7) Determine whether forfeited security deposits applied to rents and damages were appropriately recorded as rental income.*

M. Management Functions.

1. **Compliance Requirement.** The owner is responsible for complying with all requirements of the regulatory agreement. *The owner may perform all management functions or contract with a management agent to provide project management, but the responsibility cannot be delegated to the management agent. The owner or management agent must be approved by HUD and must certify that it will follow HUD's rules and regulations. *

2. **Suggested Audit Procedures.**

   a. Obtain a copy of the most recent HUD-approved management agent's certification (Form HUD-9839-A, B, or C, as appropriate). Perform the following steps:

   (1). Determine whether HUD has approved the owner or current management agent.

   (2). If the project owner's/management agent's certification, Form HUD-9839-B, was used, determine whether companies that have an identity-of-interest relationship with the owner (item 12) have been reported in the notes to the financial statements.

   (3). Obtain a copy of the management entity profile, Form HUD-9832, to identify additional identity-of-interest companies *(items 11a and b) that were not included in the management* *agent certification for inclusion in the notes to the financial statements.*

(4). Review maintenance contracts and major contracts and vendor invoices to determine whether there are additional identity-of-interest relationships with the owner/agent that need to be reported to HUD and in the notes to the financial statements.

(5). Determine whether the management agent fees paid exceeded the amount listed on the management agent certification. This amount should also agree with the amount in the management agreement.

(6). *For payments made to identity-of-interest companies, determine whether the amounts paid exceed the amounts ordinarily paid for such services and supplies. The amounts ordinarily paid can be determined by comparing costs to similar disbursements noted during the cash disbursement analysis or from the auditors' knowledge of amounts generally paid for services and supplies in the same geographic area, gained through their audits of other area clients.*

b. Determine whether the owner or the management agent has obtained a fidelity bond in accordance with chapter 2.14 of HUD Handbook 4381.5.

c. *Determine whether hazard insurance has been obtained in the amount required by the project's mortgage.*

d. Determine whether liability coverage is sufficient as determined by chapter 21 of HUD Handbook 4350.1.

e. Determine whether the owner or management agent has responded to all HUD management review reports, physical inspection reports, and inquiries regarding annual financial statements or monthly accounting reports within 30 days.

f. *On a sample basis, test work orders and tenant complaints for timely follow up and compliance with management's procedures. Handbook 4381.5 states that whenever possible, owners/agents should take* *immediate action to address problems or concerns registered by the resident.

g. Determine whether the project is maintained in good repair and condition. If the units are subsidized, determine whether management's procedures ensure that units meet applicable housing quality standards.

h. Inquire whether HUD, a contract administrator, or the lender has conducted routine unit and general property inspections. If findings were identified, determine whether corrective action was taken.

i. Question management and scan revenue accounts for any fees charged to the project or residents for additional services. Conduct followup or corroboration of management's responses as considered necessary to ensure that fees charged agree with the management agent certification or have been approved by HUD.*

N. <u>Unauthorized Change of Ownership/Acquisition of Liabilities.</u>

1. <u>Compliance Requirements.</u> Owners shall not, without the prior written consent of HUD, convey, assign, transfer, dispose of, or encumber any of the mortgaged property or permit the conveyance, transfer, or encumbrance of such property.

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

a. Question management about the existence of any agreements to sell, assign, dispose of, or encumber any of the mortgaged property or assets of or beneficial interest[4] in the property. Review any agreements. Determine whether HUD has approved transactions or is in the process of approving transactions and report any instances of noncompliance.

b. Confirm all material liabilities listed on the client's balance sheet. Review for indications of change of ownership or additional encumbrances that may have been made without HUD approval.

c. *Report any other instances of unauthorized conveyance, assignment, transfer, disposal, or encumbrance of any of the mortgaged property or*

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

assets of or beneficial interest in the property identified during the course of the audit.

O. Unauthorized Loans of Project Funds.

1. **Compliance Requirements.** Owners 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 for reasonable operating expenses and necessary repairs.

2. **Suggested Audit Procedures.**

   a. Question 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. *Test accounts receivable to determine whether receivables are the result of routine operations and whether project funds have been loaned to the management agent, other projects, employees, or the owner.*

P. *Excess Income.

1. **Compliance Requirements.** Owners of properties with mortgages insured under Section 236 of the National Housing Act must submit excess income within 10 days of the end of the month in which it was collected.

2. **Suggested Audit Procedures.**

   a. Obtain copies of the monthly report of excess income, Form HUD-93094, for the period under review and any approval letters from HUD regarding retention of excess income.

   b. *Select a sample of the reports and determine whether the reports were prepared in accordance with HUD instructions.*

c. *For the sample items selected, determine whether the client remitted the full amount collected to HUD in accordance with HUD instructions and in a timely manner.

d. If excess income was not remitted to HUD, determine whether funds were retained in accordance with HUD approval and funds were used for the intended purpose.

Q. Leased Nursing Homes.

1. Compliance Requirements. Owners may enter into lease agreements to operate the facility, in which case the operator will be required to execute a regulatory agreement (HUD 92466-NHL) with HUD before the note is endorsed for insurance. The regulatory agreement requires lease payments to be sufficient to pay all mortgage payments including payments to reserves for taxes, insurance, etc., and payments to the reserve for replacements. If at the end of any fiscal year, payments under the lease have not been sufficient to pay for the above items, the owner and operator/lessee, upon request in writing from HUD, shall renegotiate the amounts due under the lease so that the lease payments shall be sufficient to pay for such items. In addition, the operator/lessee shall provide HUD, within 30 days of request, a financial report, in a form satisfactory to HUD, covering the operations of the mortgaged property and of the project.

The regulatory agreement also requires the operator/lessee to not sublease the project and maintain it in good repair. The owner's regulatory agreement requires the owner to make mortgage payments and reserve deposits. These responsibilities cannot be assigned.

2. Suggested Audit Procedures.

a. Obtain a copy of the lease agreement, as may be amended, to operate the facility, if applicable, and the executed regulatory agreements (there will be one for the owner and one for the operator/lessee).

b. Determine whether the owner received lease payments in a timely manner.

c. Determine whether the total lease payments were adequate to cover the debt service (including tax and insurance escrows) and reserve for replacement deposits.*

d. *Obtain maintenance logs, inspection reports, and other data to determine that the lessee has properly maintained the project. On a sample basis, review that documentation to determine whether the lessee made repairs to the project to properly maintain the property in accordance with housing quality standards. Visual inspection of the common areas and grounds should be made.

e. Determine whether major changes have been made to the project without HUD approval.

f. Determine whether the owner or operator/lessee complied with nondiscrimination, equal opportunity, or other requirements of state or local law or of HUD/FHA.

g. Examine the terms of the lease to determine whether responsibility for making mortgage payments and reserve deposits has been assigned/delegated to the lessee. Verify that payments were made by the owner.

3-6. Mark-to-Market Program (M2M).

In 1997, Congress established the Mark-to-Market Program (M2M) to help preserve the availability and affordability of low-income rental housing while reducing the cost to the federal government of rental assistance provided to low-income households using project-based Section 8 funds. Under this program, HUD resets the rents to the prevailing market level and restructures the property's mortgage debt, if needed, to permit a positive cash flow. The operations of M2M projects are to be audited using the steps in section 3-5 in addition to the following audit procedures. The auditor must obtain the business agreement and conform the requirements in that agreement to the audit steps in this section. Changes, as found necessary, should be made to the audit steps since these steps were established based on the M2M procedures stated in the M2M Program Operating Procedure Guide which may be different from those set forth in the Business Agreement.

A. Capital Recovery Payments for M2M Projects.

1. Compliance Requirements. In most M2M transactions, owners are required to invest new money either out-of-pocket or through borrowing. These funds cannot be provided through a loan secured by the project assets. In return, the owner receives capital recovery payments. These payments provide a market* *rate of return to owners on the new money invested and may only be collected when certain conditions are met. This requirement is not applicable to cooperatives.

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

a. Obtain a copy of the restructuring commitment and other restructuring documents to determine whether the owner invested new funds as required, including any new funds for reserves, repairs, transaction costs, or similar property costs.

b. Obtain a copy of the source documents identifying the interest rate and payments period for the capital recovery payments. Obtain or prepare an amortization schedule of the payments showing the amount advanced for the restructuring, interest rate, and payment period. Determine whether the capital recovery payment is being paid as authorized over the applicable period of 7-10 years.

c. Determine whether the terms and conditions of the capital recovery payments listed below were met on a monthly basis.

(1). All expenses are paid, and there are no material accrued payables.

(2). The first mortgage is current.

(3). The property is in acceptable physical condition (the most recent REAC score is at least 60 or the multifamily HUB or program center has accepted the owner's proposal for curing a less favorable score).

(4). There are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with the rehabilitation escrow deposit agreement.

(5). The project's most recently issued audited financial statements reflected positive surplus cash, and any payables shown as due on the surplus cash schedule have been paid.*

(6). *If funds are not available, payment will accrue until surplus cash becomes available. Interest is paid on the accrued amount.*

B. *Incentive Performance Fee for M2M Projects.

1. **Compliance Requirements.** The incentive performance fee is provided to recognize owner equity and as an incentive for demonstrating operating efficiencies. This fee is a percentage, generally 3 percent, of annual effective gross income with a floor of $100 and a ceiling of $200 per unit per year. The owner can collect this payment annually if certain conditions are met. The percentage can be increased or decreased by the participating administrative entity to establish a fee within the maximum and minimum limitations.

2. **Suggested Audit Procedures.**

   a. Obtain a copy of the restructuring commitment and other restructuring documents and determine the incentive performance fee percentage.

   b. Determine whether the terms and conditions of payment listed below were met for the annual period during which the owner collected the incentive performance fee.

   (1). All expenses are paid, and there are no material accrued payables.

   (2). The first mortgage is current.

   (3). The property is in acceptable physical condition (the most recent REAC score is at least 60 or the multifamily HUB or program center has accepted the owner's proposal for curing a less favorable score).

   (4). There are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with the rehabilitation escrow deposit agreement.

   (5). Only funds available after payment of the expenses, debt service on any first mortgage, and any capital recovery* *payment were used. If funds are not available, payment cannot accrue.

C. Distribution of Surplus Cash for M2M Projects.

1. **Compliance Requirements.** After payment of all operating expenses, debt service on any first mortgage, any capital recovery payment, and the incentive performance fee, the owner will receive up to 25 percent of the remaining surplus cash annually. The remainder of surplus cash will be paid toward the M2M second (or third) mortgage. Since requirements in the Business Agreements my vary from the procedures contained in the M2M Program Operating Procedure Guide which were used to establish the audit steps listed below, the auditor must obtain a copy of the Business Agreement and compare it to the audit guide steps and make the changes deemed appropriate,

2. **Suggested Audit Procedures.**

   a. Obtain a copy of the restructuring commitment and other restructuring documents and determine the requirements and/or restrictions that exist for the capital recovery payment, the incentive performance fee, and the M2M (surplus cash) note payment and distributions

   b. Review the prior-year surplus cash computation and note that the owner distribution does not exceed 25 percent of the surplus cash available for distribution or the percentage determined by Office of Affordable Housing Preservation.

   c. Determine that the M2M (surplus cash) note payment and distributions were paid after all required payments were made and that the capital recovery payment and incentive performance fee were properly made as determined in audit steps 3-6.A and 3-6.B.

D. Special Rules for Cooperatives.

1. **Compliance Requirements.** For cooperatives, additional requirements are included in the audit procedures listed below. The compliance requirements in 3-6.B and 3-6.C also apply to cooperatives. Capital recovery payments listed in 3-6.A do not apply.

2. **Suggested Audit Procedures. ***

a. *Obtain a copy of the restructuring commitment and other restructuring documents and note the additional operating reserve requirement.

b. Determine whether the cooperative is in compliance with the annual escrow deposit of 3 percent of annual operating expenses plus principal and interest and mortgage insurance premium.

c. Determine whether the surplus cash and the incentive performance fee of the cooperative were deposited in a separate residual receipts account.

d. Determine whether withdrawals from the residual receipts account for the period under audit were approved by the multifamily HUB or program center director and were used for the purpose requested.

3-7. Section 236 Decoupling Projects.

1. **Compliance Requirements.** As a condition for receiving continued interest reduction payments (IRP) under section 236(e)(2) and section 236(b), the owner agrees to operate the project in accordance with all low-income affordability restrictions for the period identified by the use agreement.

2. **Suggested Audit Procedures.**

a. Obtain a copy of the applicable IRP agreement, any use agreements, and Housing Notice 00-8, *Guidelines for Continuation of Interest Reduction Payments after Refinancing*, and related notices for reinstatement and extension.

b. On a sample basis, review tenant files and ensure that the owner is in compliance with the low-income affordability restrictions for the period covered by the IRP and use agreements.

3-8. Audit Finding Reporting.

All instances of conditions contained in Appendix B, material noncompliance with any HUD requirement or regulations which result in material questioned or disallowed cost and/or, 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 disclosed during the audit process must be reported separately to management. Such reporting must be in writing in a management letter or other type of written communication, and form and date of written communication must be mentioned in the independent auditor's report. Noncompliance, deficiencies, or violations that were corrected before the issuance of the audit report must be included in the report as resolved findings or in a management letter or other written communication depending on their materiality.

A. <u>Content of Finding.</u>

Findings are to be presented in accordance with the standards and requirements of GAGAS. Refer to chapter 2 for further information on the information that is to be included in a finding.

B. <u>Corrective Action Not Started or in Process.</u>

When the project's management has not started to correct the findings or is in the process of correcting a finding at the time of report issuance, the auditee can include a description of the action completed and the action remaining to be taken in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action plan.

C. <u>Corrective Action Completed.</u>

When the project's management has corrected a finding, the action taken should be included in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action plan, and should be validated by the auditor. The auditor's recommendation in the finding should state the results of the auditor's validation testing. In addition, the auditor could include any additional recommendations that he/she believes are necessary based on the auditor's validation of that action.

D. <u>Reporting When Using the Group Project-Based Sample Method</u>.

When a condition or weakness is found in one of the projects in the sample, during the audit testing, that is required to be reported in a finding, it must be reported in the audit report for each project in the population from which the sample was drawn. Reference should be made to each report that contains that type finding. If dollars are involved, only the dollars belonging to that specific project should be included in that project's audit finding. For example, the following illustrates wording that can be used: "This internal control problem applies to and is reported in 15 audit reports, 5 for projects* *owned by companies related to the X Housing Cooperation and 10 projects owned by two unrelated owners. The total disallowed cost is $450,000, of which $100,000 applies to this project, and $200,000 applies to the other 4 projects owned by companies related to the X Housing Cooperation and $150,000 applies to the 10 projects owned by the two unrelated owners."

If the condition is only to be reported in the management letter or other written communication, it must be communicated similarly in all projects of the population from which the sample was drawn.

3-9. <u>Technical Assistance Needed.</u>

The Office of Asset Management is responsible for answering programmatic questions for the programs being audited using the procedures outlined in this chapter. Programmatic questions on audits performed using this chapter should be referred to that office, (202) 402-3730.

REAC is responsible for the Financial Assessment Subsystem (FASS). Questions regarding that system are to be referred to REAC's technical assistance center, (888) 245-4860.*

*Appendix A

Attribute Sampling

When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and should determine whether the audit procedure, or combination of procedures, to be applied will achieve that objective. The size of a sample necessary to provide sufficient evidential matter depends on both the objectives and the efficiency of the sample. As noted in section 3-8 of this chapter, all material instances of noncompliance, including those identified through sampling, must be reported as findings in the audit report.

Determining Test Objective, Defining the Population, and Defining an Exception.

Before beginning testing, the auditor must understand and document what attribute and/or assertions are being tested. The auditor needs to identify and document the appropriate population and should also perform procedures (e.g., reconciliations, inquiry) to ensure that the population from which the samples are selected is complete.

Each compliance requirement selected for testing should be considered a separate population, and samples should be selected accordingly. The sample selected could possibly be used to test multiple attributes within each compliance requirement. Additionally, auditors must assess the control environment at entities with multiple locations. If controls at the different locations are significantly different, each location must be considered a separate population.

The auditor must document the "sampling unit," which is the individual item subject to sampling in the population (i.e., reconciliations, loan files, cash disbursements, cash receipts, etc.).

When selecting the sample of individual items, auditors must ensure that the sample is representative of the universe for the compliance requirement being tested.

The auditor should also clearly define what would be considered an exception. A single exception would indicate noncompliance, subject to further determination of materiality necessary to determine the required method of reporting.

Determining the Sample Size.*

*To determine attribute testing sample sizes, the auditor needs to determine the value for three inputs: desired confidence level, tolerable exception rate, and expected exception rate.

Desired Confidence. Auditors should obtain a high degree of assurance by using a confidence level of 90, 95, or 99 percent.

Tolerable Exception Rate. A 5-10 percent exception rate is acceptable.

Expected Exception Rate. No exceptions should be accepted.

Materiality. Using attribute testing, monetary materiality or tolerable misstatement is not a necessary input for determining sample size.

Sample Size Table. Using the preferences above and an attribute sampling software program, if a high level of assurance is defined as 90 percent confidence and tolerable exception rate is 5 or 10 percent with an expectation of zero exceptions, the sample size is 48 or 23 (respectively for 5 and 10 percent exception rates), which is rounded to 50 and 25 below. Similarly, using 95 percent confidence, zero exceptions, and a 5 or 10 percent tolerable exception rate, the sample size is 64 or 32, which is rounded to 65 and 35 below.

Compliance sample size table

Importance/significance of the attribute being tested	Confidence level	Tolerable rate	Minimum sample size for populations over 200
Low	90%	5%	50
Low	90%	10%	25
High	95%	5%	65
High	95%	10%	35

This table is illustrative but does not replace professional judgment. As noted in the table, these are minimum sample sizes, and there may be many situations in which the auditor should also consider qualitative factors when determining sample size. Such qualitative factors may include but are not limited to

(1). First year the auditor audited an entity.
(2). Larger, decentralized entities.
(3). High number of findings in the past.
(4). Significant deficiencies or material weaknesses in the past.*

(5). *Poor internal controls.
(6). Extremely high volume of activity in a particular compliance requirement.
(7). High project employee turnover in a particular area or department.

If the initial sample does not include a particular attribute being tested, then typically there would be a need to have additional items included in the sample to address just that specific attribute.

Each compliance test performed should be evaluated separately for purposes of determining sample size. Judgment should be used to determine what tests are considered low risk and which are considered high risk. When making the determination of high or low risk, it will be important to understand the population.

Populations of 200 or Fewer Items.

When performing compliance testing of populations of fewer than 200 items, the following guidance is provided. Generally examine at least

(1). 20 items when the population being tested contains between 100 and 199 items,
(2). 10 items when the population being tested contains between 50 and 99 items,
(3). Five items when the population being tested contains between 20 and 49 items, and
(4). Fewer than five items for smaller populations

As noted above, these are suggested minimum sample sizes, and there may be quantitative factors used to determine the sample size to be used.

Testing and Evaluating Results.

The sample sizes in the table above are based on an expectation of no exceptions. If the testing performed discovers no exceptions, then the auditor has achieved a high degree of confidence that the attribute/assertion is performed at an acceptable level.

If there are observed exceptions, the auditor should investigate the nature and cause of the exceptions to determine whether the exceptions are immaterial or material compliance findings, significant deficiencies, or material weaknesses in internal control. It is not necessary to expand testing when exceptions are found. All exceptions must be reported. Refer to paragraph 3-8 for reporting requirements using this audit guide.

In cases in which an exception is found, the auditor must determine whether the individual exception is material enough to be included in the report. If it is determined that an exception* *is not material enough to be reported as a finding, the auditor may want to apply additional procedures to evaluate the magnitude of the exception.

The auditor should consider whether the lack of an effective internal control constitutes a significant deficiency or a material weakness and document the basis for an unqualified opinion if a finding is determined to be a significant deficiency or material weakness.

Work Paper Documentation Needed.

Documentation of sampling procedures must include the test objective, definition of an exception, description of the population tested and the sampling unit, confidence level, significance of the attribute, sample size, and the results of testing.

Technical Assistance Available.

Technical guidance on audit sampling is available in the following documents:

SAS No. 39. *Audit Sampling* (AICPA)
SAS No 111. Amendment to **SAS No. 39**, Audit Sampling (AICPA, *Professional Standards,* vol. 1, AU sec. 350), as amended
AICPA Audit Guide. *Audit Sampling,* New Edition as of April 1, 2001
AICPA Audit Guide. *Government Auditing Standards*
SAS No. 74. *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards, vol. 1, AU sec. 801)**

*Appendix B**

Information on Equity Skimming

This appendix discusses conditions that were found in audits of multifamily programs that are categorized as equity skimming. This information is included to help establish an understanding of equity skimming conditions.

Equity skimming is considered to be a fraud, which can be prosecuted through either criminal or civil statutes. When the auditor suspects equity skimming exists, the auditor must contact OIG's National Single Audit Coordinator, at 215-430-6733, to discuss the auditor's findings and the method used to report them.

Review of Cash Disbursements and Expense Accounts. A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for

(a). Maintenance, administrative, or other expenses of the owner, other programs, or other projects.

(b). Debts of the owners or management agent.

(c). Loans to owners, principals, or affiliate companies.

(d). Mortgages and related expenses not related to the project.

(e). Personal expenses, such as food, clothing, entertainment of wife and friends, private car expenses, etc., on a project credit card.

(f). Individual partner tax preparation or counseling fees (the preparation of the project tax return may be paid from operations).

(g). Legal fees for handling disputes among partners.

(h). Expenses related to arranging the sale of the project or part of the project.

(i). Splitting of fees with the management agent or others who provide services to the project. This can be an illegal kickback whereby a company agrees to refund a portion of its fees to an owner in return for awarding the management or services contract to the company.*

(j). *Theft of funds in which owners or management agents may write checks to themselves or relatives and not try to hide the fact that they have taken the funds.

(k). Expenses to identity-of-interest companies when

(1). The identity-of-interest company is a conduit for the purchase of materials and supplies and adds on an excessive percentage markup beyond what it needs to cover its own costs.

(2). The identity-of-interest company is paid for labor and materials to repair the project but is using on-site maintenance staff and/or materials to do the work.

(3). The identity-of-interest company is leasing equipment to the project at rates significantly in excess of those charged on the open market.

(4). No work was ever done. The identity-of-interest company may not actually exist, and the bank account may be used to launder funds.

(5). The cost for property and liability insurance for the project is in excess of prices charged on the open market or for coverage that is inadequate to protect HUD's interests.

(6). The identity-of-interest company provides insurance for the property under a blanket policy covering several HUD and non-HUD properties. The owner or management agent may be prorating an excessive amount to the HUD properties and using the excess reimbursement to offset insurance costs for its non-HUD projects or as a means to divert project funds.

<u>Review of Project Income.</u>

A review of cash receipts and/or revenue accounts of projects revealed that

(a). Rental units were used for owner activities without HUD approval and no rent was collected for the unit.

(b). Income from contracted services such as laundry services, cell tower leases, and cable fees to tenants was retained by the owner.

(c). Units were recorded as vacant but were actually rented. The rent received was split between the owner and the management agent.*

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

SPECIAL ATTENTION OF:
HUD Multifamily Hospital Program Owners & Management Agents

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-8
Chapter Number: 4
Issued: July 2008

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1. This transmits Handbook 2000.04, REV-2, CHG-8, Chapter 4, Consolidated Audit Guide for Audits of the HUD Multifamily Hospital Program.

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 so it will be available for use. When all of the chapters providing audit guidance are revised, the entire handbook will be repackaged and released as REV-3.

   This handbook chapter is essentially the same chapter that was in Handbook IG 2000.04, REV-2, as chapter 4, dated December 2001. Because Chapter 4 previously applied to more than just the hospital program, portions will no longer be applicable. Auditors are expected to use professional judgment in applying this guide to audits of the HUD multifamily hospital program.

3. **Significant Changes:**

   a. This revision of Handbook IG 2000.04, REV-2, chapter 4, changed the title of the chapter so it applies only to the HUD multifamily hospital program. We plan to create a new chapter and will replace this chapter when it is completed. Until the new chapter 4 is issued, Handbook IG 2000.04, REV-2, chapter 4, is to be used for guidance in auditing the HUD multifamily hospital program.

   b. Paragraph 4-7, Audit Finding Reporting, was added, since it is in the other revised chapters, was agreed upon by all program offices, and went through the departmental clearance process. This paragraph will provide guidance on uniform reporting of audit findings.

   Also, auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor-written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide 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, and those letters/communications must be provided to HUD with the audit report package.

c. Paragraph 4-8, Technical Assistance Needed, was added to provide a point of contact for programmatic questions. This paragraph also is included in all other chapters and went through the departmental clearance process.

4. **Filing Instructions:** The issuance of this chapter cancels chapter 4 dated December 2001.

Remove	Insert
Chapter 4, dated 2001	Chapter 4, dated July 2008

5. **Effective Date:**

This chapter is effective upon issuance.

Kenneth M. Donohue
Inspector General

CHAPTER 4. HUD Multifamily Hospital Program

4-1. **Background.** This chapter contains the U.S. Department of Housing and Urban Development's (HUD) requirements for conducting annual financial audits of entities participating in the profit-motivated and limited-distribution HUD multifamily hospital program.

Separately, practitioners with nonprofit clients who participate in Federal Housing Administration (FHA)/HUD programs covered by the Single Audit Act should conduct financial audits in accordance with Office of Management and Budget (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. They 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 chief executive officer of the management agent when applicable. The report shall include the employer identification number assigned by the Internal Revenue Service. 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 Real Estate Assessment Center (REAC) instructions.

The auditors' role is to conduct and report the results of their audits 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 REAC. In that regard, the independent auditor shall

A. Issue an independent auditor's 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, and
- 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 auditor's 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.

   c. Select a sample of financial reports, other than those that 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.

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[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.

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 whether 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 Nondiscrimination.**

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 withdrawals 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 whether payments 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 agreement).

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 and that 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 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 whether 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 whether 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 whether 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 and 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 on suspected fraud.

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

(1) Application;

(2) Required verifications of Social Security numbers, disability status, waiting list preferences, income, and allowances for adjusted income;

(3) Lease/lease addendums in the form as required by HUD;

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

(5) Move-in and move-out inspections; and

(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 according to the housing assistance payment 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 it will follow 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. When 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 work orders and complaints for timely follow-up and compliance with 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 whether HUD has approved the current management agent.

g. Review the management certification to determine whether 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 whether the management fees charged exceed the HUD-approved amount.

m. Determine that there is comprehensive general liability coverage on an industry standard form, in an amount required by the project's mortgage, and that 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, or 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 whether a change of ownership has occurred or whether 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-motivated 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 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 [Code of Federal Regulations] Part 5, Subpart H).

2. Suggested Audit Procedure. Compare the client's Financial Assessment Subsystem submission from the last reporting period to the annual financial

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

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 whether the reports selected were prepared in accordance with HUD instructions.

   c. For the sample, determine whether 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 whether

   (1) HUD approved if the amount was retained.

   (2) The amount retained was used for authorized purposes as enumerated in housing notices.

4-4. *Audit Finding Reporting.

All instances of noncompliance with any HUD requirement or regulation, 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 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 communication, and form and date of written communication must be mentioned in the independent auditor's report. Noncompliance, deficiencies, or violations that were* *corrected before the issuance of the audit report must be included in the report as resolved findings or in a management letter or other written communication depending on their materiality.

A. **<u>Content of Finding</u>.** Findings are to be presented in accordance with the standards and requirements of GAGAS. Refer to chapter 2 for further information on the information that is to be included in a finding.

B. **<u>Corrective Action Not Started or in Process.</u>** When the project's management is in the process of correcting a finding at the time of report issuance, the auditee can include a description of the action completed and the action remaining to be taken in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action plan.

C. **<u>Corrective Action Completed</u>.** When the project's management has corrected a finding, the action taken should be included in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action* *plan, and should be validated by the auditor. The auditor's recommendation in the finding should state the results of the auditor's validation testing. In addition, the auditor could include any additional recommendations that he/she believes are necessary based on the auditor's testing of that action.

4-5. **<u>Technical Assistance Needed.</u>** The Office of Insured Health Care Facilities is responsible for answering programmatic questions for the programs being audited using the procedures outlined in this chapter. Programmatic questions on audits performed using this chapter should be referred to that office, 202-708-0599 or 877-458-4342.*

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

SPECIAL ATTENTION OF:
Office of Multifamily Development and
Real Estate Assessment Center

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-5
Chapter Number: 5
Issued: March 23, 2007

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1. This transmits Handbook 2000.04, REV-2, CHG-5, Chapter 5, Consolidated Audit Guide for Audits of HUD Programs, HUD - Development Cost Certification 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 5, dated August 1997. A change was necessary to clarify reporting requirements, suggested audit steps, and existing information/guidance. This chapter serves as a reference for auditors who perform cost certification audits of HUD multifamily-insured projects.

3. **Significant Changes:**

   a. Paragraph 5-1 added a provision that this chapter can be used to provide audit guidance to not-for-profit mortgagors for their audits of development cost certifications as provided for under OMB Circular A-133, paragraph 235(a), program-specific audit guide available.

   b. Paragraph 5-2 clarified the method of submitting these audits to the Department. Cost certification audits are not to be submitted electronically to REAC. But, the first operational audit and subsequent audits prepared in accordance with chapter 3 of this handbook must be submitted electronically to REAC.

   c. In paragraph 5-3, reference material was updated with the current material needed to understand the process and perform a cost certification audit. Also, references are added to documents not in the HUD unified issuance system along with a description of the auditors' responsibility with regard to the reference material.

   d. Paragraph 5-4 clarified the reporting requirements of the mortgagors, contractors, subcontractors, and others. The information in this paragraph was expanded to help auditors under the certification, reporting, and submission process.

   e. Auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide 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 to be used to report findings that were resolved before the audit report was issued. (paragraph 5-6).

f. Auditors will be able to convey nonmaterial instances of noncompliance to management in a written management letter or other type of written auditor communication, and the auditor must mention the noncompliance in the independent auditor's report, including the date of the issuance of the management letter or other written correspondence. This information must also be provided to HUD with the audit report package.

g. Suggested audit steps are established for areas in which HUD procedures were changed. Those changes and other changes made in this chapter are denoted between asterisks. For example, the statement that follows starting with regulation and ending with violation, was added to an existing paragraph

> 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* must be reported as findings in the audit report.

h. Paragraph 5-8 was added to provide a contact point for program type questions that may arise during the course of the audit.

4. Filing Instructions:

The issuance of this chapter cancels chapter 5 dated, August 1997.

Remove	Insert
Chapter 5, dated August 1997	Chapter 5, dated March 2007

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 June 30, 2007.

Kenneth M. Donohue
Inspector General, G

CHAPTER 5. DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE

5-1 **Program Objective.** Multifamily projects are an integral part of the U.S. Department of Housing and Urban Development's (HUD) housing programs, which have the objectives of providing decent, safe, affordable, and sanitary housing for low- and moderate-income families. *The loans for the multifamily projects are insured through the multifamily project loan program. *HUD- Federal Housing Administration (FHA) insures lenders against losses on mortgages providing the financing for the construction or rehabilitation of multifamily rental projects. 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 be commensurate with the insurance risk.

This handbook chapter is intended for use by for-profit mortgagors to provide audit guidance for the audit of development cost certifications. However, this chapter can also be used to provide audit guidance to not-for-profit mortgagors for their audits of development cost certifications as provided for under OMB Circular A-133, paragraph 235(a), program-specific audit guide available.

5-2 **Program Procedures.** *The cost certification is the basis for HUD's determination of the project's actual development cost and/or the maximum insurable mortgage, which is necessary before the project may proceed to final formal endorsement, a critical factor to multifamily projects. The effective date for the determination of actual costs is usually the date the HUD inspector signs the final HUD representative's trip report (Form HUD-95379), provided that the trip report is subsequently endorsed by the construction manager. Construction must be completed, except for acceptable items of delayed completion (Multifamily Accelerated Processing Guide (MAP Guide), chapter 14, section 14.7). 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 HUD field office 30 days before final endorsement/closing. Typically, the cost certification is prepared and submitted within 60 to 90 days after the cost cutoff date. The cost certification is submitted in hard-copy format to the HUD field office. The cost certification **is not submitted electronically** to HUD's Real Estate Assessment Center (REAC).

The owner's first operating audit will cover the period beginning on the day after the cost certification cutoff through the owner's fiscal year end. All operating audits must be prepared in accordance with chapter 3, HUD Multifamily Housing Programs, of this guide and must be submitted to REAC electronically via the Financial Assessment Subsystem (FASS) within 90 days of the owner's fiscal year end.*

On occasion, the owner may be responsible for submitting financial statements with reporting periods of less than 12 months (referred to as a stub period). If that reporting period is less than 90 days, upon request, HUD may approve the deferment of the owner's reporting of the stub period and add that period to the next full year financial statements (Submission and Review Requirements & REMS Critical Data Fields for Annual Financial Statements, attachment 2, paragraph C).

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 equipment lessor, 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.** *One of the primary sources of guidance for cost certifications is the MAP Guide. In particular, chapter 14 contains the most current guidance issued by HUD regarding the cost certification process. 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 5-3 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.*

Document	Title
HUD Handbook 4571.5	Supportive Housing for Elderly, Conditional Commitment - Final Closing
*HUD Handbook 4571.4	Supportive Housing for Persons with Disabilities, Conditional Commitment - Final Closing*
HUD Handbook 4571.1, REV-2	Section 202 Direct Loan Program for Housing for the Elderly and/or Handicapped

Document	Title
HUD Handbook 4470.2, REV-1	Cost Certification Guide for Mortgagors and Contractors of HUD-Insured and Section 202/811 Multifamily Projects
HUD Handbook 4470.1, REV-2	Mortgage Credit Analysis for Project Mortgage Insurance, Section 207
HUD Handbook 4450.1, REV-1	Cost Estimation for Project Mortgage Insurance
*HUD Handbook 4435.1, REV-1	Project Construction and Servicing Before Final Closing*
*Notice H 96-102	Redesigned Section 202 Supportive Housing for the Elderly and Section 811 Supportive Housing for Persons with Disabilities Programs - Firm Commitment*
*Mortgagee Letter 04-41	Multifamily Accelerated Processing Guide Revised March 15, 2002 (1)*
*Document does not have a HUD number or transmittal reference	Submission and Review Requirements & REMS Critical Data Fields for Annual Financial Statements (2)*

*

(1) = This document is not a numbered document under the HUD unified issuance system and can be obtained by using the following link:

http://www.hud.gov/offices/hsg/mfh/map/mapguide/mapguide.cfm

(2) = This document is not a numbered document under the HUD unified issuance system and can be obtained by using the following link:

http://www.hud.gov/offices/reac/products/PDFs/finl_memo_2004_1a.pdf

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.

5-4 Reporting Requirements.

Regulations at 24 CFR [*Code of Federal Regulations*] 200.95, 200.96, 200.97, and 891.545 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 Mortgage Credit Analysis for Project Mortgage Insurance, HUD Handbook 4470.1; Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects, HUD Handbook 4470.2; Chapter 5, Supportive Housing for Persons with Disabilities, Conditional Commitment - Final Closing, HUD Handbook 4571.4; Chapter 5, Supportive Housing for Elderly – Conditional Commitment Final Closing, HUD Handbook 4571.5; Section VI of HUD Notice H 96-102; and chapter 14 of the MAP Guide. The MAP Guide, as well as HUD Handbook 4470.2, contains the requirement for who among the mortgagor, general contractor, subcontractors, and suppliers must provide cost certifications, guidance on eligible costs, necessary financial statements which must accompany the certificate of actual cost, and details concerning the mortgagor's Form HUD-92330 and contractor's Form HUD-92330-A.

Mortgagors and contractors must prepare certification of actual cost and submit the required financial statements. The mortgagor's certificate of actual cost (Form HUD-92330) shall be submitted after the cost certification cutoff date. It 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. Those documents must be prepared in conformity with the basis of accounting and reporting procedures prescribed by HUD, which is a comprehensive basis of accounting other than generally accepted accounting principles. The owner must sign and date Form HUD-92330, and the contractor must sign and date Form HUD-92330-A, in the areas provided on the forms, by no later than the date of the audit opinion.

A. **Mortgagor Submission Requirements.** Mortgagors must certify for all projects except 207/223(f) refinances in which the insured value is 80 percent or less of value. They are to submit the mortgagor's cost certification (Form HUD-92330) supported by an accountant's opinion, an audited balance sheet of the mortgage entity as of the cutoff date, and an audited operating statement if occupancy* *occurred before the cost certification cutoff date. An audit report with the certification by an independent certified public accountant or an independent public accountant must accompany the mortgagor's certification of actual cost, the audited balance sheet and operating statement of the mortgagor, and the contractor's certificate of actual cost (Form HUD-92330A). The period covered by the operating statement is from the beginning of marketing and rent-up activities to the cutoff date. Costs reported on Form HUD-92330 support certain entries on the required financial statements. If there were more than three months between the cost cutoff date and the start of amortization, the mortgagor must submit a supplemental operating statement.

The certificate of actual cost, auditor's reports, and required financial statements are to be submitted to the applicable HUD field office.

The auditor must conduct the audit under both the auditing standards generally accepted in the United States of America and the generally accepted government auditing standards (GAGAS) issued by the comptroller general of the United States (MAP Guide chapter 14, section 14.11, paragraph 6 and chapter 2 of this guide). Illustrative reporting information on the cost certification is provided in paragraph 5-7 of this chapter.

B. Contractor Submission Requirements: Contractors must certify when

(1) The contractor has an identity of interest with the mortgagor and/or

(2) The contractor used the Construction Contract Cost Plus, Form HUD-92442-A.

A subcontractor at any tier, equipment lessor, material supplier, and manufacturer of industrialized housing must certify when

(3) The total of all subcontracts, purchases, and leases is more than .5 percent of the mortgage and

(4) An identity of interest exists or comes into being between such subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing and either the mortgagor or the contractor if the contractor must certify.

The contractor is to submit a certificate of actual cost (Form HUD-92330A), supported by an accountant's opinion, to the mortgagor. A certification by an independent certified public accountant or an independent public accountant must* *accompany the contractor's certification of actual cost. The auditor must use GAGAS in auditing the cost certification. No other financial statements or reports of the contractor are required to be submitted. The contractor should submit the reporting package to the mortgagor for inclusion in the mortgagor's submission to the appropriate HUD field office.*

5-5 Compliance Requirements and Audit Area.

A. Federal Financial Reports.

1. **Compliance Requirement.** Projects with a HUD - insured mortgage or receiving HUD direct loans or capital advances 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 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 and capital advances 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 whether 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; i.e., worksheets, ledgers, etc. Report all material differences between the amounts reported on the Form HUD-92330 and the supporting documents.

C. Cutoff 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 cutoff date for the actual cost of the interest, taxes, insurance, and mortgage insurance premium as well as soft costs and special escrow items. 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 cutoff date and the date to which the operating statement and balance sheet are computed must be the same. *The mortgagor, general contractor, and mortgagee will be notified in writing of the final completion date (MAP Guide chapter 14, section 14.7).*

The final completion date is the date on which the HUD inspector signs the final HUD Representative's Trip Report, Form HUD-95379, showing substantial completion. The field construction manager must properly endorse this form.

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 cutoff date for insured projects, direct loan projects, and capital advance projects (HUD Handbook 4470.2, chapter 1, *and MAP Guide, chapter 14)*.

Eligible costs are those costs of the project construction and certain fees paid in cash or such costs that will be paid in cash within 45 days of final endorsement. HUD Handbooks 4470.1; 4450.1; 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-95379, or similar notification to determine the final completion date.

b. Based on the completion date, the mortgagor/borrower determines the project's cutoff date for time-sensitive expenses, such as interest, taxes, insurance, mortgage, and property insurance premiums, as well as soft costs and special escrow items. Review these costs/charges to determine that none were incurred after the cutoff date *and that the costs are proper charges to the project.*

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 on behalf of the project. All amounts claimed should be net of any adjustments or recoveries of costs.

D. Identity of Interest.

1. Compliance Requirement. HUD Handbooks 4430.1; 4470.1; 4470.2, chapter 3; and MAP Guide, chapter 14, Section 14.15, describe several situations, which constitute an identity of interest involving a mortgagor, a contractor, a subcontractor, or a materials supplier. When 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 HUD Handbook 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 whether an identity of interest exists among any of the parties involved in the project, from mortgagors to contractors, suppliers, and equipment lessors. *Inquire to determine whether an identity-of-interest relationship exists.*

b. When an identity of interest exists, determine that the additional reporting requirements of HUD Handbook 4470.2 and MAP Guide, chapter 14, have been met.

*

5-6 Audit Finding Reporting.

All material instances of noncompliance with any HUD requirement or regulation, deficiencies in internal control, 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, 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. Noncompliance's, deficiencies, or instances of violations that were corrected during the audit process, after the fiscal year under audit, or disclosed as a part of the audit process before the end of the fiscal year under audit and/or before the issuance of the audit report must be included in the report as resolved findings or in a management letter or other types of written auditor communication, 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 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 before 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 validated the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on their validation of that action.

If costs are involved and if those costs have been repaid, the auditor should validate that the auditee made the necessary adjustments to its books-of-account. The auditor's certified statements should contain all necessary adjustments to the reported amounts, with appropriate notes, so that the certified costs of the project are accurately stated. Comments should also be included in the report in the "action taken" section of the finding. *

5-7 **Illustrative Reporting.** *These samples are for the ***Sample Company,*** which is a partnership. The wording is to be changed based on the type of ownership of the property.*

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 [insert cutoff date, for example, April 30, 2010]; pertaining to the development of the ***Sample Company***, Project No. [Insert project number]. We have also audited the [insert names of statements included in the report (financial statement)] as of [insert the cutoff date, for example, April 30, 2010], and the results of project operations for the period from [insert date, for example, August 28, 2008, which is the date of commencement of marketing and rent-up activities, etc.] through [insert the cutoff date, for example, April 30, 2010]. The Form HUD-92330 and the financial statements are the responsibility of the ***Sample Company's*** management. Our responsibility is to express an opinion on the Form HUD-92330 and on the 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 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 Form HUD-92330 and the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Form HUD-92330 and 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 [insert the note number], the certificate of actual cost (Form HUD-92330) and the project's financial statements were prepared in conformity with the basis of accounting and reporting practices prescribed by the U.S. Department of Housing and Urban Development (HUD), which is a comprehensive basis of accounting other than generally accepted accounting principles. Further, the accompanying financial statements represent the financial statements of the project.

In our opinion, the mortgagor's certificate of actual costs (Form HUD-92330) and the financial statements referred to above present fairly, in all material respects, the actual costs of the ***Sample Company***, through [insert cutoff date, for example, April 30, 2010]; the assets, liabilities, and project equity as of [insert cutoff date, for example, April 30, 2010]; and the results of project operations for the period from [insert date, for example August 28, 2008, which is the date of commencement of marketing and rent-up activities, etc.] through [insert cutoff date, for example, April 30, 2010], on the basis of accounting described in note [insert the note number].

In accordance with government auditing standards,, we have also issued our report dated [*date of report*] on our consideration of the ***Sample Company's*** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with government auditing standards and should be considered in assessing the results of our audit.

This report is intended solely for the information and use of the board of directors and management of the ***Sample Company*** and HUD and is not intended to be and should not be used by anyone else other than these specified parties.

Certified Public Accountant Signature

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Date

Sample Company
Project No. XXX-XXXXX

Notes to Financial Statements

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 [insert comment that applies - actually paid or approved by HUD].

c. The (insert actual name of statement; i.e., statement of rental operations) reflects the rental activity and operating expenses of the project beginning [insert date of commencement of marketing and rent-up activities, etc., for example, August 28, 2008]. 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, plus the income from the project. More detailed information on the determination of equity is contained in the MAP Guide, chapters 7, 12, and 14. Further, partners' (members') (nonproject) obligations are classified as project equity. Partners' (members') equity is not intended to reflect the actual equity of the partnership because it may include partnership obligations and adjustments for the as-is value of land. The financial statements are not intended to represent those of the partnership.

Sample Company
Project No. XXX-XXXXX

Notes to Financial Statements

Summary of Significant Accounting Policies

Organization

Sample Company is a limited partnership organized under the laws of the state of [Insert name of State], for the purpose of developing and operating 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 U.S. 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.

*

5-8 Technical Assistance Needed.

The chief, Technical Support Division, Office of Multifamily Housing Development, is responsible for answering programmatic questions for the programs being audited using the procedures outlined in this chapter. Programmatic questions on audits performed using this chapter should be referred to that office, 202-708-0614, extension 2559.*

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

SPECIAL ATTENTION OF:
HUD-Ginnie Mae Issuers of Mortgage Backed Securities

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-4
Chapter Number: 6
Issued: April 3, 2007

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1. This transmits Handbook 2000.04 REV-2 CHG-4, Chapter 6, Consolidated Audit Guide for Audits of HUD Programs, HUD - Ginnie Mae Issuers of Mortgage-Backed Securities 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 chapters providing audit guidance are released, the remaining chapters will be revised and the entire handbook will be repackaged and released as REV-3.

   This handbook chapter is a change to Handbook IG 2000.04 REV-2, chapter 6, 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 Ginnie Mae issuers of mortgage-backed securities. This handbook serves as a reference to independent auditors of selected HUD and Ginnie Mae programs.

3. **Significant Changes:**

   a. Paragraph 6-3, Reference Material, contains the reference documents current 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 6-3 rather than to the entire handbook/chapter.

   b. Paragraph 6-4, Reporting Requirements, was updated to include current requirements and up dated illustrations in the attachments to this chapter.

   c. Paragraph 6-5C was modified to include information on government sponsored enterprises.

   d. Paragraph 6-6, Audit Finding Reporting, was added to provide guidance on reporting audit findings that are corrected or are being corrected before the completion of the audit.

Also, auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide 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 to be used to report findings that were resolved before the audit report was issued.

e. Paragraph 6-7, Technical Assistance Needed, was added to provide a contact point for questions that may arise during the course of the audit.

f. Added various audit steps to the compliance areas. Those changes and other changes made in this chapter are denoted between asterisks (for example, *All material instances of noncompliance....... *).

4. **Filing Instructions:** The issuance of this chapter cancels chapter 6 dated August 1997.

Remove	**Insert**
Chapter 6, dated August 1997	Chapter 6, dated April 2007

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 June 30, 2007.

Kenneth M. Donohue

Kenneth M. Donohue
Inspector General

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 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 only be 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 (hereafter referred to as a subcontract servicer), which must also be a Ginnie Mae-approved issuer. The issuer is responsible 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) withdraw funds from a Principal and Interest (P&I) custodial account for any purpose, (b) sign any accounting reports and certifications to Ginnie Mae, and (c) withdraw mortgage documents from the document custodian. In addition to obligations described above, Ginnie Mae I MBS program issuers may not delegate or transfer the following obligations to others: (a) sign checks to Ginnie Mae, (b) sign remittance advice to security holders, (c) fund guaranty fees due Ginnie Mae, and (d) maintain the register for security holders.*

6-3 **Reference Material.** *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 6-3 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.

Ginnie Mae program regulations are contained in 24 CFR [*Code of Federal Regulations*] Parts 300 through 395. The HUD Handbook for Ginnie Mae is 5500.3, REV-1, Government National Mortgage Association Mortgage-Backed Securities Guide (MBS Guide). The issuer should have a copy of or access to the guide. The MBS Guide is 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, attachment B
Parent’s adjusted net worth (if appropriate)	Chapter 6, attachment C
Insurance requirement	Chapter 6, attachment D
Corrective action plan (if appropriate)	Chapter 1, section 1-9

Nonprofit organizations that elect to submit audited financial statements in accordance with OMB Circular A-133 must also independently submit evidence of meeting Ginnie Mae’s fidelity bond and errors and omissions insurance requirements and adjusted net *worth requirements. The issuer's chief financial officer or executive officer must certify to the accuracy of the unaudited insurance and net worth schedules.

Issuers that did not have outstanding Ginnie Mae securities or commitment authority to issue new securities at any time during the fiscal year under audit do not have to submit an internal controls report, a report on compliance with specific requirements, and supplemental information. However, they must still submit evidence of meeting Ginnie Mae's fidelity bond and errors and omissions insurance requirements and adjusted net worth requirements. The issuer's chief financial officer, president, or chief executive officer must certify to the accuracy of the unaudited insurance and net worth schedules.*

A. **Audited Financial Statements.** Issuers are required to submit audited annual financial statements, which include a balance sheet, statement of operations, cash flow statements, notes to 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 to this chapter.

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 parent's adjusted net worth and computation of issuer's insurance requirements are to be reported on supplemental schedules to the basic financial statements. The computation of the issuer's and issuer parent's 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.** Similarly, the required reporting format for presenting this analysis is provided in attachment B for the issuer and attachment C for the issuer's parent. The required reporting 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 their parent (the 40 percent threshold may be collectively met by related party issuers that have entered into a cross-default agreement with Ginnie Mae), Ginnie Mae will accept consolidated financial statements of the issuer's parent provided that 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.

Further, 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. That organization's auditor, in accordance with this audit guide, must audit the parent's audited financial statement and adjusted net worth calculations. The parent must also demonstrate in its adjusted net worth calculation that it meets the 110 percent (120 percent for issuers approved to issue manufactured housing or multifamily pools) requirement noted above.

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 federal- or state-regulated institutions, such as those under the supervision of the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, Ginnie Mae will accept audited financial statements of the issuer's parent, so long as the issuer makes up *40* percent or more of the parent's equity and there is no more than one bank holding company covered in the audit. *In such instances and 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 *a certified public accounting firm that is an independent auditor (auditor) 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. <u>Submission of Reports.</u> The issuer must submit two copies of the audited financial statements and auditor's reports, 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 found in the *MBS Guide.*

D. <u>Single Auditor Approach.</u> In many instances, it may be to the advantage of the custodian, the issuer, or both to hire a *certified public accounting firm (auditor)* to conduct a review of the mortgage documents that are held by a particular custodian who has responsibility for several issuers' documents, rather than having each issuer require that a different auditor review that part of the custodial documents pertaining to each issuer's pools. The single auditor approach may also resolve practical problems associated with travel when the issuer, custodian, and auditor are not located near each other, thus reducing the cost of compliance while assuring necessary audit coverage.

To determine whether the single auditor approach is practical in a given situation, the auditor and the issuer should contact the custodian(s) holding the issuer's pool and loan documents to determine the extent of the custodian's activities with other issuers. Arrangements may then 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 auditor to review documents relating to each of the respective issuer's pools. The auditor for each issuer's pools will then prepare separate reports.

The single auditor approach and the reviews of custodial documents by the issuer's auditor are both acceptable methods under the Custodial Review section of the audit guide.

6-5 <u>Compliance Requirements and Suggested Audit Procedures.</u>

A. <u>Federal Financial Reports.</u>

1. **<u>Compliance Requirement.</u>** 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. **<u>Suggested Audit Procedures.</u>**

   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 a Federal Housing Administration (FHA)-approved mortgagee in good standing. A state or local government instrumentality that is an FHA-approved mortgagee is eligible. Mortgagees approved by FHA solely as loan correspondents are not eligible to be Ginnie Mae issuers.

b. *Maintain its Fannie Mae and/or Freddie Mac approval, which ever they have or both if they have both.* Loss of either approval may cause the issuer to become ineligible to issue and service Ginnie Mae mortgage-backed securities.

c. Conduct, 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 in which 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 ensure effective pool management 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 U.S. Department of Labor (41 CFR Part 60-1) and the U.S. 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 *the MBS Guide, chapters 2 and 3, both of which* name 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 paragraph 6-5, section G.2 of this chapter.

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

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

b. Test whether the issuer has in place and follows an established policy that prohibits discrimination in housing and lending as communicated in chapters 2 and 3 of the MBS Guide, as well as 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 *chapters 2 and 6 of the MBS Guide.* Verify that: (1) Ginnie Mae is named as the loss payee, (2) the required levels of insurance were maintained throughout the year, with testing of the adequacy of insurance at least *once per quarter* and,(3) verify that the fidelity bond and errors and omissions policies are written by an insurance carrier *who maintains an A.M. Best rating of B+ or better in the Best Insurance Reports and* is specifically licensed or authorized by law to transact business within the state or territory where the named insured has its corporate headquarters. Lloyd's of London, although not rated, is an accepted 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 million. The maximum fidelity bond coverage is not limited.

The required reporting format for 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 together 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 unacceptable Ginnie Mae 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 all required documents.

A custodial institution is permitted to function as a 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 13 of the Ginnie Mae MBS Guide. The eligibility requirements for custodians are also depicted in chapter 2 of the Document Custody Manual, hereinafter referred to as Document Custody Manual MBS Guide, appendix V-1.*

If an (i) onsite review of the document custodian was performed within one of the previous two fiscal years, (ii) the issuer's securities balance outstanding amounts to less than $50 million, and (iii) the document custodian has not received any pools within the past 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 with Ginnie Mae portfolios must have an on-site review at least once every three years.

2. Suggested Audit Procedures.

a. Determine whether an 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. If *the document custodian is a Government Sponsored Enterprise (GSE)-approved document custodian, it must be in good standing* *with the GSE(s). The auditor shall determine whether the issuer has ever been the subject of any adverse action by a GSE.*

(2) If recognized by Ginnie Mae before September 1, 2004, maintains a secure, one and one-half hour fire-resistant storage facility standard with adequate access controls *Document custodians recognized by Ginnie Mae after August 31, 2004, are required to maintain a secure, two hour fire resistant storage facility standard with adequate access controls.*

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

(4) Maintains for review annual financial statements audited by an 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) *A custodian that maintains issuer records on its own behalf, its parent or affiliated entity (self-custodian) must be part of a trust department that is physically separate from the service area and operations of the issuer.* The self-custodian 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 inspection by its primary regulator.

(9) *If a non self-custodian does not* meet all of 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.

(10) *Maintains a written disaster recovery plan that covers restoration of the facilities, physical recovery of the files, and backup and recovery of information from electronic tracking systems.

(11) Tests whether the document custodian has in place a quality control plan for document review standards.*

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, a 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 pool listing and verification that the pool numbers on the issuer custodial register agree with 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 release code 6. 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/U.S. Department of Veterans Affairs (VA)/U.S. Department of Agriculture *Rural Development (RD)*/Office of Public and Indian Housing (PIH) case number or loan number, and the document release date.

If any documents have been released for more than* 90 days (non-liquation reason code 6)*, the custodian is required to notify the issuer of the overdue documents every 90 days. *It the document is outstanding after 180 days, Ginnie Mae must be notified*. The notification must be in writing and documented in the inventory or file.

c. If more than one custodial institution is used, identify which pools are at which custodial institution 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 whether the pools include

(1) 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. Upon the delivery of securities, only Ginnie Mae will have any ownership interest in and to the pooled mortgages, or

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

(2) If noted on the form HUD 11711B that a form HUD 11711A is required, 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 below 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 or loan package no later than the date and time of delivery of the securities by Ginnie Mae or its agent."*

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 to provide a means to identify and control mortgages placed in the pool, which secures the obligations issued. Accordingly, select a sample of pooled mortgages from the schedule of pooled mortgages.

e. *Procedures for the custodian document review are contained in paragraph 13-4 and appendix V1 of Ginnie Mae's MBS Guide. 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. Reconcile and report on any differences.*

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

(2) For multifamily and manufactured housing pools only, 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 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. Within 12 months of the issuance of the securities,* transfer of issuer, and/or change of custodial responsibility, the files at the custodian must

[1] For programs other than the Single Family Mortgage-Backed Securities Program, the form number, before January 1, 1996, was
- Project loans: form HUD 11721.
- Manufactured home loans: form HUD 11725.

contain the following documents. *Report any missing documentation as a finding.*

(1) Original evidence of guaranty for PIH loans or evidence of the custodian's verification of insurance or guaranty for the FHA, VA, and RD loans if the loans were originated before January 1, 2003, or

If the loan is a VA vendee loan or contract, there will be a portfolio loan statement of settlement form from VA, rather than a loan guarantee certificate (LGC).

(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 mortgage title insurance policy has been obtained or other evidence of title acceptability to FHA, VA, RD, or PIH (not required in cases involving the conveyance of HUD secretary-owned property, if an exception has been authorized by Ginnie Mae, or on 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) Verification 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.

(8) All documents required in paragraphs C.2.d and C.2.e above.

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 a 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.

If an issuer has entered into a representations and warranties (R&W) agreement with Ginnie Mae, the documents referenced above that must be in the custodian file are subject to chapter 13 and appendix V-1 of the Ginnie Mae MBS Guide 5500.3, REV-1.

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) Determine 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 also 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, the mortgagor, and the defect, and reported as a finding. This listing should be reviewed with the custodian, and errors should be corrected by the custodian. The custodian should furnish this listing to the appropriate issuers, and the auditor should then review with the issuer the reasons for any missing or deficient documents.

Missing documents for mortgages that are still current by the issuer's records could be an indication that the issuer has received mortgage payoffs and not passed through payments to securities holders.

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

(1) Confirm that the document custodian meets all 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 nonliquidation release inventory/file for all forms HUD 11708 submitted on or after July 1, 1992, on the basis of the nonliquidation 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, certify that the loans on the trial balance agree with 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 Mortgage.

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. It should also indicate the latest outstanding balances of principal, deposits, advances, 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 any pool custodial account without prior written approval 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 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, VA will determine the cost effectiveness of bidding at the foreclosure sale. VA will not bid if it believes its losses will exceed the guarantee amount. Consequently, this "no bid" scenario may 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 Memorandum, dated 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, verify that it is only used 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, as well as collections of claims on defaulted and liquidated mortgages, to determine that funds have been deposited into the appropriate custodial account(s) on a daily basis.

c. Test whether the issuer is making proper payments of interest, principal, and unscheduled principal to certificated securities holders so that those payments are received no later than 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, 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. 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.

f. 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.

g. 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 communicated in the *MBS Guide*, using the issuer's own funds. *Such buyouts may only occur once the issuer has received prior approval by Ginnie Mae).*

h. 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.

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

j. 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 the *MBS Guide.*

k. 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 has established a complete securities holders' register in accordance with Ginnie Mae instructions and has updated the register before 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 VA, FHA, RD, PIH, 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 six months of the payment date are made payable to Ginnie Mae and sent to the pool processing agent pending a claim from the security owner. 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 were accomplished after written approval from Ginnie Mae was obtained

E. <u>Review of Monthly Accounting Reports and Quarterly Submissions.</u>

1. <u>Compliance Requirement.</u> Ginnie Mae issuers of mortgage-backed securities are required to submit the following reports periodically throughout the year:

a. Forms: HUD-11710A, HUD-11710D, and HUD 11710E.
Issuers reporting: all Ginnie Mae issuers of record.
Frequency of reporting: monthly.
Deadline for submission: *on or before the 10th calendar day of the month following the month covered in the report.*

b. Trial balance *(loan level)* information.
Issuers reporting: all Ginnie Mae issuers of record.
Frequency of reporting: *monthly.*
Deadline for submission: *on or before the 15th calendar day of month.*

c. Mortgage Bankers Quarterly Financial Reporting, Form HUD-11750.
Issuers reporting: mortgage bankers not federally regulated.
Frequency of reporting: quarterly.
Deadline for submission: *30 days after end of calendar quarters and 60 days after end of calendar year.*

d. *Monthly reports must be submitted to Ginnie Mae 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 the *MBS Guide.*

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 appendixes 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 10th calendar day of each month. Instructions for the preparation and submission of the forms or *compact disc* are found in *appendix VI of the MBS Guide*.

e. *Monthly reports must be submitted to Ginnie Mae on all of the loans in their portfolio. All issuers must report loan level detail every month. The loan level data should report trial balance information for all nonliquidated loans as part of the cutoff date for the month.

f. Quarterly reports on their financial condition must be submitted to Ginnie Mae by issuers that are not federally regulated. Reports must be submitted electronically, using form HUD 11750, Mortgage Bankers' Financial Reporting Form. Issuers may access this shared form at www.mbfrf.org. Federally regulated financial institutions (banks, savings and loans, and credit unions) are not required to submit this report. *

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 *MBS Guide*.

b. Select a sample of form HUD-11710As 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 (RPB) 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 with 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 fixed installment control (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 for each loan in the pool up to a maximum of $50 per pool. Any greater difference must be funded to the pool in the current report. At least once a year, adjustments to the securities holder 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 randomly selected for review, test the expected P&I custodial account balances at cutoff. This test (outlined below) identifies a minimum dollar amount expected in the P&I account for any particular pool as of a given cutoff 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 CD pools but in either case indicates the amount of P&I funds which should be held in the account at the cutoff 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 cutoff date. If the issuer withdraws its servicing fee before 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 15^{th} of the following month (section 1, line B-2).

(8) (CD only) plus additional principal adjustment, the issuer-funded adjustment that 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 payoff 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 5B2). 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 10th calendar day of each month.

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

k. For all issuers that are not federally regulated financial institutions, test that quarterly financial information (HUD-11750) is being submitted *electronically through the Mortgage Bankers' Financial Reporting Form (MBFRF) Web-based system.*

F. Securities Marketing and Trading Practices.

1. Compliance Requirement. Ginnie Mae has established securities marketing and trading requirements, which are intended to ensure that issuers fulfill their securities marketing and trade 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 (c) minimum forward delivery contract requirements related to so-called mark-to-market deposit requirements. There are also record-keeping and reporting requirements. All approved issuers must implement these procedures, whether or not securities and/or commitments are outstanding. The applicable requirements are found in the *MBS Guide.*

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 counterparty, and the 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 delayed delivery contract, except that the term does not include

(1) A sale of securities when (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 standby commitment on 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. <u>Adjusted Net Worth.</u>

1. **<u>Computation.</u>** 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 in attachments B and C of this chapter.

   Unacceptable assets are defined in attachment A of this chapter and should be itemized by asset classification. <u>Do not</u> aggregate the unacceptable assets into one line entitled "Unacceptable Assets." *In certain circumstances, and at its sole discretion, Ginnie Mae may accept a corporate guaranty as consideration for reclassifying certain assets that are treated as unacceptable under the HUD Consolidated Audit Guide (e.g., for purposes of computing adjusted net worth, Ginnie may elect to accept a corporate guaranty as consideration for accepting pledged assets).*

   If evidence exists indicating the existence of related party receivables, which have not been deducted by the auditor, 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 auditor's 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 satisfactorily and in a timely manner to requests made by Ginnie Mae or its agent for additional information could result in disallowance of questionable assets and suspension or termination of issuer status.

   When 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. **<u>Required Net Worth.</u>** 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 1 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.

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 Consumer Price Index (CPI) will measure the change in price index. 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.

*

6-6 **<u>Audit Finding Reporting.</u>** All material instances of noncompliance with any HUD requirement or regulation, deficiencies in internal control, 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, 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. Noncompliances, deficiencies, or instances of violations that were corrected during the audit process, after the fiscal year under audit, or disclosed as a part of the audit process before the end of the fiscal year under audit and/or before the issuance of*

[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.

*the audit report must be included in the report as resolved findings or in a management letter, depending on their materiality.

A. **<u>Content of Finding</u>**. 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 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. **<u>Corrective Action in Process.</u>** 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. **<u>Corrective Action Completed.</u>** Many times when auditees are presented with draft findings, they will start to take action and complete that action, correcting the deficient condition before 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 validated the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on the validation of that action.

6-7 **<u>Technical Assistance Needed.</u>** Ginnie Mae contractors will receive, review, and act on audit reports conducted using this chapter. It is important that the report meet Ginnie Mae's requirements and expectations. For this reason, questions on audits performed using this chapter should be referred to Ginnie Mae's Office of Mortgage-Backed Securities at (202) 708-1535.*

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. 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[4] or corporate guarantee agreement[5] with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagee has a personal interest[6] 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.

[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 in which the issuer's parent guarantees the performance of the issuer.

[6] "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.

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 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, artwork, 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 cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.

10. Any asset that 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 auditor or a 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.

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

Attachment B

Required Format for Presentation of Adjusted Net Worth Calculation for Issuer

A. Adjusted net worth calculation:

Stockholder's 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 commitment authority issued and requested	$ __________
Total outstanding portfolio and authority	$ __________
Required net worth	$ __________

C. Excess (deficit) net worth

(Adjusted net worth – required net worth) $ __________[2/]

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

[2/] In the event that adjusted net worth does not meet the Ginnie Mae requirement, the auditor 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:

Stockholder's 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 calculation:

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 [insert ending date, for example December 31, 1991] and have issued our unqualified opinion thereon, dated [insert date, for example January 24, 1992] included on page [insert page number] 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 [insert page numbers], 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]

Attachment F

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./Mrs. ___________________________ 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.S. no.: ____
5. FHA mortgagee no.: ____
6. Auditor's tax identification no.: ____
7. Auditor's contact person ____
   and telephone number: ____

Place a checkmark by item(s) submitted

1. ___Annual audited financial statement for period ended __/__/__
2. ___Auditor's report on consolidating balance sheet and statement of income (if appropriate)
3. ___Auditor's report on internal controls
4. ___Auditor's report on compliance with specific requirements
5. ___Auditor's presentation of insurance requirement
6. ___Auditor's presentation of adjusted net worth for issuer
7. ___Auditor'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 generally accepted accounting principles (GAAP). Use additional page if necessary:
    ____
    ____
    ____

Signature: ____ Date: _________________
Type or print signature name: ____
Title: ____

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

SPECIAL ATTENTION OF:
HUD-Approved Title II Nonsupervised Mortgagees and Loan Correspondents

TRANSMITTAL

Handbook No: 2000.04, REV-2, CHG-6
Chapter Number: 7
Issued: April 27, 2007

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1. This transmits Handbook 2000.04 REV-2 CHG-6, Chapter 7, Consolidated Audit Guide for Audits of HUD Programs, HUD-Approved Title II Nonsupervised Mortgagees 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.

3. This handbook chapter is a change to Handbook IG 2000.04 REV-2, chapter 7, dated August 25, 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 II nonsupervised mortgagees and loan correspondents. This handbook serves as a reference to independent auditors of selected HUD and Ginnie Mae programs.

4. **Significant Changes:**

   a. Electronic reporting requirements are added to this chapter in paragraphs 7-4B, Electronic Submission of Audited Financial Statements and Compliance Data, and 7-4C, Auditor Involvement in the Electronic Submission Process.

   b. Paragraph 7-3, Reference Material, contains the reference documents current 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 7-3 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 7-6B).

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

e. Auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide 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 to be used to report findings that were resolved before the audit report was issued.

f. Paragraph 7-8 was added to provide a contact point for questions that may arise during the course of the audit.

g. Suggested audit steps are established for areas in which HUD procedures were changed. Those changes and other changes made in this chapter are denoted between asterisks. For example, the statement that follows starting with regulation and ending with violation, was added to an existing paragraph

> 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* must be reported as findings in the audit report.

h. Reporting requirements are clarified for Title II nonsupervised mortgagees and loan correspondents.

5. **Filing Instructions:** The issuance of this chapter cancels chapter 7 dated August 1997.

Remove	**Insert**
Chapter 7, dated August 1997	Chapter 7, dated March 2007

6. **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 June 30, 2007.

Kenneth M. Donohue
Inspector General

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

7-1 **Program Objective.** The U.S. Department of Housing and Urban Development (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 mortgagees' receipt of the yearly verification report in the last month of its fiscal year. HUD can approve the following institutions for participation in the program.

*

A. **Supervised mortgagees** are financial institutions that are members of the Federal Reserve System and financial institutions whose accounts are insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA). Examples of supervised mortgagees are banks, savings associations, and credit unions. Supervised institutions may choose instead to apply as supervised loan correspondents or investing mortgagees.

A subsidiary or an affiliate of a supervised mortgagee must apply separately for HUD/Federal Housing Administration (FHA) approval as either a nonsupervised Mortgagee or nonsupervised loan correspondent. FHA approval only applies to the legal entity that is the actual applicant and does not cover any of its subsidiaries or affiliates.

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

C. **Supervised loan correspondents** are mortgagees that qualify for approval as supervised mortgagees and can also be approved as supervised loan correspondents but must have one or more sponsors who underwrite mortgages. Those sponsors must be "DE mortgagees."[1]

D. **Nonsupervised loan correspondents** (i.e., mortgage brokers) are nondepository financial entities that have as their principal activity the origination of FHA-insured mortgages for sale or transfer to one or more sponsors who underwrite the mortgages. Sponsors must be "DE mortgagees." *

[1] The term "DE mortgagee" means a mortgagee who has received unconditional direct endorsement approval, DE approval, from one of the Homeownership Centers (HOC's) and is also commonly known as an underwriting mortgagee.

E. ***Investing mortgagees** are organizations, including charitable or not-for-profit institutions or pension funds, which are not approved as another type of institutions and that invests funds under their own control. They may purchase, hold, and sell FHA-insured mortgages but may not originate them. Investing mortgagees may only service FHA-insured mortgages with the prior permission of FHA.

F. **Governmental institutions** may be approved as mortgagees. Governmental institutions are federal government agencies, government-sponsored enterprises, state government agencies, state housing agencies, municipal government agencies, public housing agencies, federal reserve banks, federal home loan banks, the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal National Mortgage Association (Fannie Mae).

These institutions are approved on the basis of their financial capacity, experience, facilities, and other criteria as specified in HUD Handbook 4060.1**,** Mortgagee Approval Handbook. *

7-2 **Program Procedures.** All mortgagees, loan correspondents, and governmental institutions, 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. 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. Each FHA-approved mortgagee must renew its approval annually.

*

7-3 **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.

Through out 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 7-3 rather than revising the references in the entire handbook/chapter. Also, the auditor should assure that the updated reference is used for performing the audit. If reference to the handbook is needed in the audit report, the auditor should assure that the entire updated reference, including the revision number is used.*

Document	Title
* 24 CFR Part 5	General HUD Program Requirements: Waivers *

Document	Title
24 CFR Part 202	Approval of Lending Institutions and Mortgagees
* Mortgagee Letters	Various
Forms	Various
HUD Handbook 4000.2, REV-3	Mortgagees' Handbook-Application Through Insurance
HUD Handbook 4000.4, REV-1	Single Family Direct Endorsement Program
HUD Handbook 4060.1, REV-2	Mortgagee Approval Handbook
HUD Handbook 4060.3, REV-2	Field Office Guide for Mortgagee Monitoring *
HUD Handbook 4110.2	The Mortgagee Guide-Home Mortgage Insurance Fiscal Instructions
* HUD Handbook 4145.1, REV-2	Architectural Processing and Inspections for Home Mortgage Insurance
HUD Handbook 4150.1, REV-1	Valuation Analysis for Home Mortgage Insurance
HUD Handbook 4150.2	Valuation Analysis for Single Family One-to-Four-Unit Dwellings
HUD Handbook 4155.1, REV-5	Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties
HUD Handbook 4165.1, REV-1	Endorsement for Insurance for Home Mortgage Programs (Single Family) *
HUD Handbook 4205.1	Single Family Coinsurance Program
*HUD Handbook 4235.1, REV-1	Home Equity Conversion Mortgages
HUD Handbook 4240.2, REV	The Graduated Payment Mortgage Program*
*HUD Handbook 4240.4, REV-2	203K Handbook Rehabilitation Home Mortgage Insurance

Document	Title
HUD Handbook 4330.1, REV-5	Administration of Insured Home Mortgages
HUD Handbook 4330.4, REV-1	FHA Single Family Insurance Claims *
HUD Handbook 4350.4	Insured Multifamily Mortgagee Servicing and Field Office

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

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

or it 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 St, SW, Washington, DC 20410; or by fax at (202) 708-2313. *

7-4 Audit and Reporting Requirements.

A. Audit Requirements.

*

Title II nonsupervised mortgagees and/or loan correspondent are required to have an annual audit and to submit their reported audited financial statements and compliance data electronically through the Lender Assessment Subsystem (LASS) within 90 days of the close of its fiscal year, regardless of the number of loans originated or serviced. The hard copy of the basic financial statements and the audit report must be issued before the mortgagee initiates its electronic submission.

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**,** an auditor’s computation of the mortgagee’s adjusted net worth**,** and a hard copy of the completed LASS Financial Data Templates (FDT). The auditor’s report must include an opinion on the an auditor’s computation of mortgagee’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 The 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 II*** *nonsupervised mortgagee or loan correspondent, regardless of the number of loans originated or serviced during the fiscal year.

For all lenders the audit report shall also cover internal controls and 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 or nonmajor HUD-assisted programs.

An independent auditor's report on compliance with specific requirements applicable to major/nonmajor HUD programs is required. Major program mortgagees are subject to an audit of their compliance with HUD major programs. Nonmajor program mortgagees are subject to a review of their compliance with HUD nonmajor 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 (HUD Handbook 4060.1, paragraph 4-4A1e). Guidelines for determining major and nonmajor programs are also contained in chapter 1 of this guide.

For Title II loan correspondents, the requirement for the auditor to review and report on the mortgagee’s compliance has been modified under the condition that the sponsor agrees to assume the responsibility of assuring compliance for each loan correspondent under its sponsorship. In those instances in which the sponsor agrees to assume the responsibility of assuring compliance of loan correspondents under its sponsorship, the sponsor must communicate annually in writing to the individual loan correspondents its intent to assume responsibility for their compliance, indicate the areas of compliance that it will be assuming, issue annually a written report summarizing the results of its compliance testing, and accumulate and retain the supporting information that served as the basis for the written annual compliance report issued to the loan correspondent. In accordance with 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 Yellow Book, 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 nonsupervised loan correspondent is also approved under the Title I program, separate reports on * *internal control and compliance will have to be issued for that program (Handbook 4060.1, Paragraph 4-4A2e).

All servicing/origination income must be accounted for in compliance with the Federal Accounting Standards Board (FASB) Statements No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases", and No.125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", or subsequent amendments.

All material instances of noncompliance with any HUD requirements identified by the auditor (including net worth or liquidity deficiencies) must be reported as findings in the report on compliance and immaterial instances of noncompliance must be reported in a management letter, even in those cases in which corrective action was taken by the auditee after the end of the fiscal year. Refer to paragraph 7-7 for information on reporting findings in the audit report or management letter.

Paragraph 7-6 of this chapter set forth the requirements for the computation of net worth and contains the listing of unacceptable assets. Also included are Attachments A, B, and C that should be used to compute the net worth. Attachments D, E, and F illustrates the use of the Attachments.

B. <u>Electronic Submission of Audited Financial Statements and Compliance Data.</u>

Title II, nonsupervised mortgagee and/or loan correspondent are required by 24 CFR [*Code of Federal Regulations*] 5.801, 202.7, and 202.8 to electronically submit their financial and compliance data to the Lender Approval and Recertification Division through the LASS system within 90 days of the close of their fiscal year. The LASS system specifies the materials that must be submitted and those materials are not specified in this guide. This electronic submission must be completed based on the paper copy of audit(s) of the lenders' financial statements.

Lenders/mortgagees that are approved under both Title II and Ginnie Mae must complete the electronic submission of their financial and compliance data through LASS. Also, these lenders/mortgagees must submit paper copies 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 Rd. PMB 701
McLean, VA 22102-4401

Many mortgagees/loan correspondents are subsidiaries to 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. The LASS templates only* *require the financial information of the approved mortgagee and not the consolidated entity. However, HUD will accept the audits of the consolidated financial statements of the parent if it includes consolidating schedules, audited by the 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. These amounts are the amounts entered into LASS. 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 at 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 lenders 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 in a PDF file format.

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 as portable document in a PDF file format.

The responsibility for the electronic submission of the lender's financial and compliance data through LASS rests with the lender. To assure 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, footnotes, 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 reports discussed earlier, and it will require additional time. Consequently, a separate engagement letter should be obtained for this engagement. Alternatively, the audit

engagement letter may 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 Accountant (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" to 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 it's 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.

It is recommended that when all 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 it 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 resolve differences before the submission of the financial and compliance data to HUD.

Additional information is contained in HUD Handbook 4060.1, paragraphs 4-4 through 4-9. If the user experiences technical problems in using the LASS system, the LASS technical assistance center should be contacted by calling 202-755-7400, extension 163, or by sending an e-mail to lass@hud.gov.

D. <u>Extension Requests.</u>

Extensions for submission of the audit report 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 before the submission due date and no later than 15 days before the submission due date (HUD Handbook 4060.1, paragraph 4-4C). *

7-5 Compliance Requirements and Suggested Audit Procedures.

A. <u>Quality Control Plan.</u>

1. **<u>Compliance Requirement.</u>** HUD-approved mortgagees are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and to comply with all relevant HUD 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, chapter 7, 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 its personnel are following HUD requirements and the mortgagee's policies and procedures. The monthly quality control procedures may be conducted by the entity itself internally, by personnel not involved in any aspect of mortgage origination or servicing, or by an external reviewer, such as the independent auditor or another qualified organization (24 CFR 202.5(h)).

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

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

*

(1) If the mortgagee relies on an internal review,

(a) Determine whether knowledgeable personnel performed the review and that they have no involvement in the day-to-day process that they reviewed.

(b) Determine whether the mortgagee provided the staff access to current guidelines relating to the operations they are responsible to review, either in hard copy format or electronic format.

(2) If the mortgagee relies on the external review process,

(a) Determine whether the mortgagee ensured that the outside firm met HUD's requirements.

(b) Determine that the agreement with the outside firm is in writing, states the roles and responsibilities of each party, and is available for review by HUD staff.

d. Determine whether the sample sizes of HUD loans used throughout the year were determined in accordance with HUD Handbook 4060.1. This includes a random sample of insured loans being serviced by the mortgagee or its agent.

e. Determine whether any branch offices received an on-site review as required by HUD Handbook 4060.1.

f. Determine whether the quality control plan includes coverage for any loan correspondents and authorized agents of the mortgagee.

(1) Determine whether the sponsor Quality Control Program provides for the sponsor to review the loans originated and sold by each of its loan correspondents. If it does,

(a) Determine whether the sponsor determined an appropriate percentage of loans to be reviewed.*

(b) *Determine whether the sponsor retained the documents and methodologies used in making that determination and the results of the review.

(c) Review the documentation for compliance with HUD requirements and determine whether the findings were reported and followed up in accordance with the mortgagee policies/procedures.

(2) If the sponsor allowed the loan correspondents to conduct their own quality control review, determine

(a) Whether the arrangement with the sponsor(s) is detailed in writing.

(b) That the aggregate number and scope of reviews meet FHA requirements.

(c) That loans are reviewed within 90 days of closing.

(d) That findings are clear as to source and cause.

(e) That the results are available in a timely manner to both mortgagees and HUD.

g. Review the supporting documentation of the most recent review to determine whether all the required general and specific elements included in HUD Handbook 4060.1, chapter 7 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.

h. Obtain a written copy of the latest quality control report and determine whether senior management officials also received a copy, which included any deficiencies identified during the review.

i. Determine whether the mortgagee notified the Office of Lender Activities and Program Compliance of any violations, false statements, or program abuses that were in the quality control report.

j. Determine whether senior management officials promptly initiated corrective action for all deficiencies noted. *

k. Determine whether the files evidenced the actions taken by senior management to correct the deficiencies.

l. *Determine whether the files evidence that the employees were notified of the deficiencies and provided instructions to correct the deficiencies and prevent recurrence.

B. Sponsor Responsibility over Title II Loan Correspondents.

1. Compliance Requirement. The sponsor can agree to assume the responsibility of assuring that the loan correspondent under its sponsorship is in compliance with HUD requirements. The sponsor can assume the responsibility for any number or for all of its Title II loan correspondents. The sponsor's acceptance of responsibility is provided for in HUD Handbook 4060.1 paragraph 4-4.

2. Suggested Audit Procedures.

a. Determine whether the sponsor

(1) Annually communicate in writing, to the individual loan correspondent its intent to assume responsibility for the loan correspondent's compliance.

(2) Indicate in the correspondence the areas of compliance over which the sponsor would assume responsibility.

(3) Issue a written report annually, summarizing the results of its compliance testing.

(4) Accumulate and retain the supporting information that serves as the basis for each written annual compliance report issued to the loan correspondent.

b. Test the documentation supporting the reviews and the reports to assure its accuracy and reliability.

c. Assure that the areas not included in the sponsor's assumption of responsibility are included in the auditor's testing and reporting for the period under audit. *

C. 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 (nontraditional branch office). The mortgagee may determine the location and type of its branch office facilities. The nontraditional branch office facility may be located in either commercial or noncommercial space. Each branch office must be registered by HUD. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR 202.5(k) (HUD Handbook 4060.1, paragraph 2-11 B and C).

*An approved mortgagee is prohibited from engaging an existing, separate mortgage company or broker to function as a branch of the approved mortgagee and allowing that separate entity to originate insured mortgages under the approved mortgagee's FHA mortgagee number. This constitutes a prohibited branch arrangement[2]. Separate entities may not operate as "branches" or "DBAs" of a FHA approved mortgagee (HUD Handbook 4060.1, paragraph 2-14 A).

The direct lending branch office must meet the office facilities and staff requirements of a traditional branch office except that it must have a separate manager and can be collocated with a lender's home office or one of its traditional branches (HUD Handbook 4060.1, paragraph 2-11 D). *

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

a. Determine whether all branches are registered with HUD by reviewing the appropriate form or screen printout.

b. Through inquiry and/or physical observation, determine whether the branch is a true branch and is not a subsidiary, 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 *(a W-2 employee)* including, a branch manager. The branch manager can manage more than one branch except if the branch is a direct lending branch, which must have a separate manager. The branch office must have its own telephone and maintain its own accounting records.

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

d. Determine whether the branch office (1) is located in space which is separated by a partition from any other entity, (2) is clearly identified to the public, (3) operating costs are paid by the approved mortgagee or loan correspondent, (4)

[2] Mortgagee letter 00-15 dated May 1, 2000, referred to this practice as "net branches". That letter was cancelled with the issuance of the revised handbook. The term "net branches" is not used in the revised handbook.

display the "fair housing poster", (5) provides privacy for conducting interviews and (6) has adequate space and equipment.

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 whether the branch office manager of a direct lending branch office only manages that branch.

f. *During the period under audit, if a separate entity was purchased and legally merged into the approved mortgagee, determine if a copy of the merger documents and state license (s) were provided to FHA's Lender Approval and Recertification Division.*

D. 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).

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

Regulations at 24 CFR 202.12 prohibit 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 2 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 2 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 whether the auditee's procedures provide for applicant's credit report, employment verification, and verification of deposits to be sent directly to the auditee and not pass through any interested third party (e.g., realtor).

b. Obtain a sample of files for loans originated during the audit period to perform the following tests. This should include loans originated at the auditee's branch offices and by its loan correspondents as well as its central office. When an auditee uses an independent third party to perform quality control over loan origination, the auditor may rely on the testing of loan files performed by the independent third party, provided the auditor has reviewed the independent reviewer's procedures and retested some of the same files chosen for testing and the quality control written reports indicated no significant discrepancies were identified.

(1) Review loan file documentation for evidence that the loan applicant had an opportunity for a face-to-face interview. If the loan applicant opted not to have a face-to-face interview, *determine whether the mortgagee asked sufficient questions to elicit a complete picture of the borrower's (i) financial situation, (ii) source of funds for the transaction, and (iii) intended use of the property. Verification of all this information, as well as the identity of the loan applicant, must be documented in the loan file. *

(2) Review all files in the sample to determine whether any forms have been signed by the mortgagee but not completed by the applicant.

(3) Determine whether all employment and income data are supported by a verification of employment or other sources, especially for self-employed applicants and applicants with nonemployment income. Review loan file documentation for evidence that the mortgagee reconciled any conflicting information before submitting the application package to the appropriate HUD Homeownership Center for endorsement.

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

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). 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 whether 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.

d. Test whether loan correspondents are selling mortgages to entities other than their sponsors without prior HUD approval. In connection with the direct endorsement program, to confirm that the loan correspondent does not underwrite loans, review selected loan documentation for indications of underwriting by the loan correspondent.

e. Review the agreements between the auditee and its staff appraisers and test for compliance with HUD Handbook 4000.4, chapter 2.

E. Loan Settlement.

1. Compliance Requirement. The mortgagee's responsibilities before 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, disbursing the funds, and completing the transaction in accordance with the closing documents without undue delay (24 CFR 203.284).

2. Suggested Audit Procedures.

a. *Obtain an understanding of the auditee's procedures for settling and completing loan transactions. *

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

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

(2) Review the fees and charges collected from the mortgagors as shown on loan settlement statements to determine whether 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 whether the origination fee did not exceed 1 percent of the loan amount. Compare the fees and charges to the guidelines contained in HUD Handbook 4000.2. Report any differences as findings.

(3) *Review the accuracy of points and closing costs. Determine whether the differences may be due to discriminatory practices. *

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

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

(6) 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 costs to determine whether the mortgagor made the minimum investment.

(7) Examine the canceled check or other supporting documentation for evidence that the mortgagee submitted the mortgage insurance premium to HUD, in accordance with HUD policy at the time of closing. *Determine whether payment reached HUD's depository within 10 calendar days of closing (Mortgagee Letter 2005-28 dated June 20, 2005). *

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

F. <u>Loan Servicing.</u>

1. <u>Compliance Requirement.</u> Mortgagees that 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). * Loan correspondents are not allowed to service loans. *

Mortgagees that 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 HUD Handbook 4235.1.

Loan servicing procedures are to be followed consistently and should not vary. *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 203.500.*

2. Suggested Audit Procedures.

a. *Obtain an understanding of the auditee's procedures for servicing loans. *

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

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

(1) *Determine* whether the auditee maintains individual servicing records documenting collection (loan servicing) activities.

(2) Review the servicing records to determine whether they contain information on collection contacts, attempted and completed.

d. Review selected loan file documents for evidence that the auditee communicates with the mortgagor or makes a reasonable effort to do so 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.

e. 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 auditee's procedures for the handling of partial payments. Obtain a representation letter from the auditee concerning such procedures. *

(2) 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.)

(3) Review the payment records of selected mortgagors to determine 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.

f. Inquire whether the auditee has implemented steps to comply with the provisions of HUD's Loss Mitigation program. *Servicing mortgagees can use the following five tools to mitigate losses to the insurance fund: special forbearance, mortgage modification, partial claim, pre foreclosure sale, and deed in lieu of foreclosure. HUD requires that all loss mitigation tools are considered, and the servicing mortgagee is required to document its loss mitigation efforts. Review selected claims files for evidence that such relief measures were considered (refer to Mortgagee Letter 00-05). *

g. 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 before the initiation of foreclosure proceedings.

h. 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 in which the auditee made a decision to foreclose and referred the loan to an attorney for initiation of foreclosure proceedings.

i. 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.

j. 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 whether they are supported by documentation.

k. Select a sample of adjustable rate HECMs and test whether the mortgagee is not exceeding the limitations of the 2 percent annual and 5 percent lifetime caps.

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

G. Escrow Accounts.

1. Compliance Requirement. HUD requires that mortgage**e**s establish escrow accounts and that mortgagors make monthly payments thereto, to ensure 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 to pay all escrow obligations before 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 whether 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 30 days before the time the bills become delinquent (HUD Handbook 4330.1, chapter 2).

*Mortgagees may not use mortgagor escrow funds for any purpose other than for which they were received and the mortgagee cannot report escrows as its own assets. If escrow funds are reported on the balance sheet, they must be fully offset by a corresponding liability and must be segregated on the balance sheet. *

2. Suggested Audit Procedures.

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

b. *Determine whether escrows are reported on the balance sheet. If so, assure that the proper liability account is established and reported, and the accounts are segregated as required. *

c. 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.

d. For selected mortgages, obtain the most recent escrow analysis and 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 notices 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.

e. On accounts selected for review, inspect supporting documents for escrow disbursements such as receipts, invoices, tax bills, and canceled checks. *Determine that the funds were only used for the intended purpose and the proper amount was disbursed. *

f. Test whether escrow funds are deposited in accounts fully insured by the FDIC or 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 nor forbid that escrow accounts bear interest. However, in those cases in which accounts are interest bearing, test whether interest earned, less expense, is passed on to the mortgagor.

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

h. 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.

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

j. Inquire whether the auditee requires the mortgagor to purchase hazard insurance coverage from the auditee or from a specific company.

k. 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.

H. 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, 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 whether the dollar amounts are identical. Also, compare the number of Section 235 loans shown on the billing to the U.S. Treasury to the records of the mortgagee's servicing portfolio. Report on any discrepancies. Copies of the paid HUD-93102s can be obtained from

*Office of the CFO - HUD
Assistant CFO for Accounting
Division of Accounting, Monitoring and Analysis*
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 whether the formula providing the greater/lesser amount of assistance was used.

(3) *Determine* whether 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 in a timely manner, determine 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).

I. 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 letters contain the specific reporting requirements that the mortgagee is to follow (HUD Handbooks 4330.1, chapter 7 and 4155.1, 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 that are included in the audited financial statements, and determine whether the reports selected are prepared in accordance with HUD instructions.

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

   e. For the sample, 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 the propriety of those adjustments.

J. 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(1).

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 an unreasonable amount in return for goods or services actually performed. Reconcile and report on any differences.

c. *Determine whether any funds were advanced to real estate agents, real estate brokers, mortgage brokers, or packagers as an advance of anticipated commissions on sales to be financed with a FHA-insured mortgage. *

d. *Determine whether any low-interest or no-interest loans were made to a real estate broker, real estate agent, mortgage broker, packager, builder, or any other party from whom the mortgagee accepts proposals involving FHA-insured mortgages.

e. Determine whether any payment was made for a gratuity or for a gift valued above items that are customarily distributed in the normal course of advertising, public relations, or as a general promotion device to any person or entity involved in FHA-insured mortgage transactions of the mortgagee.

f. Determine whether any fees or compensation was paid that is prohibited by the *Real Estate Settlement Procedures Act* (RESPA). *

g. 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 kickbacks, these should be reported as a finding.

K. Mortgagee Approval Requirements.

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

Entity type	Amount
*Loan Correspondent, lenders and mortgagees, except multifamily mortgagees *	*Minimum of $63,000 plus $25,000 per branch, up to maximum of $250,000*

Entity type	Amount
*Title II supervised or nonsupervised lenders and mortgagees, except multifamily mortgagees *	Minimum of $250,000 plus 1% of the mortgages volume in excess of $25 million, up to maximum net worth of $1 million
Multifamily only - nonsupervised *lenders and* mortgagees	$250,000

Supervised or nonsupervised mortgagees or loan correspondents, approved by HUD for program participation, must maintain liquid assets of 20 percent of the adjusted net worth. The adjusted net worth must be in liquid assets (cash, cash equivalents or marketable securities)[3] 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)).

*Mortgagees must also file a verification report with HUD each year. This report should be printed from FHA Connection, signed and mailed to HUD (24 CFR 202.5(m)).

Mortgagees must also submit to HUD either an audited or unaudited financial statement, within 30 days of the end of each fiscal quarter in which the mortgagee experiences an operating loss of 20 percent of its net worth and until the mortgagee demonstrates an operating profit for two consecutive quarters or until the next recertification, whichever is the longer period (24 CFR 202.5(m)(1)).

Mortgagees must also pay the annual renewal fee online through the FHA Connection by accessing Pay.gov. and using the “pay now” button (HUD Handbook 4060.1 paragraph 4-3 B.) (24 CFR 202.5(i)). *

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

a. Test whether the nonsupervised mortgagee or loan correspondent meets the required levels for adjusted net worth, liquid assets, fidelity bond coverage

[3] According to HUD Handbook 4060.1, chapter 2, paragraphs 2-6 B and C, lines of credit and loans held for sale are not considered liquid assets. Cash includes cash on hand, checking accounts, savings accounts, and certificates of deposit. Cash equivalents are readily marketable investments; e.g., securities readily convertible into cash. To be considered a liquid asset, the cash or cash equivalent must not be restricted or otherwise reserved for any purpose other than the payment of a current liability.

and errors and omissions bond, according to HUD Handbook 4060.1. *If the mortgagee or loan correspondent does not meet the requirement, report the deficiency in the report on compliance. Determine whether there are internal control deficiencies related to the noncompliance that should be reported in the report on internal controls.*

b. *Ensure that the mortgagee has filed the annual verification report and paid the annual renewal fee.

c. Determine the client's compliance in reporting any quarterly loss in excess of 20 percent. *

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 according to the guidance in HUD Handbook 4060.1 paragraph 2-5. When the mortgagee/loan correspondent is a parent or a subsidiary to a parent, 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.

*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 related party when 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.

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 revisions thereto.

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

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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 in which the issuer's parent guarantees the performance of the issuer.

[6] "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.

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 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.

7-7 *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 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.

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

B. Corrective Action in Process.

Many times when auditee's 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 the auditee is presented with draft findings, it will start to take action and complete that action, correcting the deficient condition before 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 validated the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on the testing of that action.

7-8 Technical Assistance Needed.

The Lender Approval and Recertification Division receives, reviews and acts on audit reports prepared using this chapter. It is important that the report meets its requirements and expectations. For this reason, questions on audits performed using this chapter should be referred to that office using its help line telephone number, 202-755-7400, extension 163 or send an email to lass@hud.gov. *

Attachment A

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 B

Computation of Adjusted Net Worth for Approval and Recertification of Nonsupervised Loan Correspondents

1. Home office		$ 63,000
2. Add:		
Branch office	$ 25,000	
x Number of branch offices	________	
Subtotal		$ ________
3. Total		$ ________
4. Net worth required (Lesser of $250,000 or Line 3)		$ ________
Owner's 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 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 HECMs at maximum claim amount.

Attachment D

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 E

Computation of Adjusted Net Worth for Approval and Recertification of Nonsupervised Loan Correspondents

1. Home office		$ 63,000
2. Add:		
Branch office	$ 25,000	
x Number of branch offices	9	
Subtotal		$ 225,000
3. Total		$ 288,000
4. Net worth required (Lesser of $250,000 or Line 3)		$ 250,000
Owner's equity (net worth) per Balance sheet	$ 321,098	
Less unacceptable assets	$ 45,678	
Adjusted net worth for HUD Requirement purposes		$ 275,420
Adjusted net worth above amount Required		$ 25,420
Adjusted net worth below amount Required		$ ___________

Attachment F

Computation of Adjusted Net Worth for Recertification of Nonsupervised Mortgagees Other Than Loan Correspondents

1.	Servicing portfolio* at: June 30. 1997 (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	$ 32,400,000
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 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. Loan Servicing.

1. **Compliance Requirement.** 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. <u>Unacceptable Assets for Computation of Adjusted Net Worth</u>.

*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, <u>Accounting for Certain Mortgage Banking Activities</u>, and SFAS 125, <u>Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities</u>, 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-OIG Regional Inspectors General for Audit

Region - 1 Boston, MA
Regional 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) 994-8380
Facsimile number: (617) 565-6878
States Covered: CT, ME, MA, NH, RI, VT

Region - 2 New York, NY
Regional Inspector General for Audit
Department of Housing and Urban Development
26 Federal Plaza, Room 3430
New York, NY 10278-0068
Telephone number: (212) 264-4174
Facsimile number: (212) 264-1400
States Covered: NY, NJ

Region - 3 Philadelphia, PA
Regional Inspector General for Audit
Department of Housing and Urban Development
The Wannamaker Building
100 Penn Square East, 10th Floor
Philadelphia, PA 19107-3380
Telephone number: (215) 656-3401
Facsimile number: (215) 656-3409
States Covered: DE, DC, MD, PA, VA, WV

Region - 4 Atlanta, GA
Regional Inspector General for Audit
Department of Housing and Urban Development
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388
Telephone number: (404) 331-5001
Facsimile number: (404) 730-2382
States Covered: AL, FL, GA, KY, MS, NC, PR, SC, TN

Region - 5 Chicago, IL
Inspector General for Audit
Department of Housing and Urban Development
Metcalfe Federal Building - Room 2646
77 West Jackson Boulevard
Chicago, IL 60604-3507
Telephone number: (312) 353-6236
Facsimile number: (312) 353-8866
States Covered: IL, IN, MI, MN, OH, WI

Region - 6 Ft. Worth, TX
Regional Inspector General for Audit
Department of Housing and Urban Development
Fritz G. Lanham Federal Building
819 Taylor Street, Suite 13A09
Fort Worth, Texas 76102-6195
Telephone number: (817) 978-9309
Facsimile number: (817) 978-9316
States Covered: AR, LA, NM, OH, WI

Region – 7 & 8 Kansas City, KS
Regional Inspector General for Audit
Department of Housing and Urban Development
Gateway Tower II, 5th Floor
400 State Avenue
Kansas City, KS 66101-2406
Telephone number: (913) 551-5870
Facsimile number: (913) 551-5877
States Covered: CO, IA, KS, MO, MT, ND, NE, SD, UT, WY

Region – 9 & 10 Los Angeles, CA
Regional Inspector General for Audit
Department of Housing and Urban Development
611 West 6th Street, Suite 1160
Los Angeles, CA 90017
Telephone number: (213) 894-8016
Facsimile number: (213) 894-8115
States Covered: AK, AZ, CA, HI, ID, NV, OR, WA

Region – 11 Gulf States

Regional Inspector General for Audit
Department of Housing and Urban Development
Hale Boggs Federal Building, 9th Floor
500 Poydras St.
New Orleans, LA 70130
Telephone number: (504) 589-7267
Facsimile number: (504) 589-7277