



Handbook

2000.04 REV-2

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

Independent Auditors

August 1997

Consolidated Audit Guide for Audits of HUD Programs

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U.S. Department of Housing and Urban Development
Office of 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
Issued: August 25, 1997

1. **This Transmits** Handbook 2000.04 REV-2, Consolidated Audit Guide for Audits of HUD Programs.
2. **Summary.** This handbook is an update of Handbook IG 2000.04 REV-1 dated July 15, 1993. An update was necessary to reflect changes in program regulations, HUD Handbooks and Government Auditing Standards (1994 Revision). This Handbook serves as a reference to independent auditors of selected Housing and Ginnie Mae programs. It is effective for audits of fiscal years ending September 30, 1997 and thereafter.
3. Significant Changes
 - a. Incorporates the revised OMB Circular A-133. Audits of States, Local Governments and non-Profit Organizations.
 - b. Incorporates Mortgagee Letter 96-12.
 - c. Updates unacceptable assets for computation of adjusted net worth for Ginnie Mae, Title I and Title II.
 - d. Incorporates Government Auditing Standards (1994 Revision).
 - e. Updates net worth information for Ginnie Mae.

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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, 1994 Revision, 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 controls in place to provide reasonable assurance that it is managing HUD programs in compliance with applicable laws and regulations; and © 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 September 30, 1997 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. The areas of noncompliance and internal control weaknesses noted in these reports must be acted upon by program managers. 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 participants in the HUD programs identified in paragraph 1-4. As of the issuance of this audit guide, HUD is developing regulations to implement OMB Circular A-133, effective June 30, 1997. It is anticipated that nonprofit institutions which own individual properties receiving HUD assistance under specified housing programs ¹ will be required to complete project-specific audits because each project is deemed to be a separate entity. Those audits are

¹ HUD programs whose regulations are set forth in 24 CFR parts 207, 213, 221, 232, 236, 242, 277, 880, 881, 883, 884, 885, 886, 889, and 890

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 each contain a compliance supplement for a particular HUD program. Each audit should be conducted in accordance with requirements of Chapters 1 and 2 and the applicable compliance supplement included in Chapters 3 through 8 of this guide.

This guide is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgement 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 judgement 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 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).

According to HUD Handbook 4370.2 REV-1, Chapter 3, IA's performing audits of mortgagors having HUD-insured or Secretary held multifamily mortgages must have no business relationship with the auditee except for the performance of the audit, accounting systems work, and tax preparation. Accordingly, for these audits, an individual who acts as the mortgagor's "fee accountant" (i.e., an individual who performs manual or automated bookkeeping services and/or maintains the official accounting records) is prohibited by HUD policy from performing the audit of that mortgagor. Also, according to HUD Handbook 4470.1 REV-2, Chapter 11, IAs performing cost certification audits of mortgagors or general contractors must have no business or financial relationship with the mortgagor or general contractor except for the performance of the audit.

- 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 generally accepted accounting principles. 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 controls as part of planning and performing the audit and report on internal controls. The auditor should report on internal controls 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 an identification of total amounts questioned for each program, as a result of noncompliance. In addition, one program requires the reporting of all instances of noncompliance (see paragraph 1-6). Instances of noncompliance should be assigned a monetary value, if applicable.

1-4 Audit Authorization. Authority for audits covered by this audit guide and their respective due dates are as follows:

| <u>Auditees</u> | <u>Audit Authorization</u> | <u>Due Date</u> |
|--|---|---|
| Multifamily Housing Mortgagors with Insured, Coinsured or Section 236 Subsidized Loans | Regulatory Agreement 24 CFR Part 251.706 | Within 60 days after the end of the fiscal year |

| <u>Auditees</u> | <u>Audit Authorization</u> | <u>Due Date</u> |
|--|---|---|
| Insured Development Cost Certificate | 24 CFR Part 207.27 | Prior to final endorse- ment |
| Section 8 Assis- tance Payments: New Construction Substantial Rehabilitation | 24 CFR Part 880.601 24 CFR Part 881.601 | Within 60 days after the end of the fiscal year |
| Title II Nonsupervised Mortgagees Loan Correspondents Coinsuring Mortgagees | 24 CFR Part 202.14 24 CFR Part 202.15 24 CFR Part 203.5 | Within 90 days after the end of the fiscal year |
| Title I Nonsupervised Lenders Title I Loan Correspondents | 24 CFR Part 202.5 24 CFR Part 202.6 | Within 90 days after the end of the fiscal year |
| Ginnie Mae | GNMA Handbook 5500.1 REV 6 | Within 90 days after the end of the fiscal year |
| | GNMA Handbook 5500.2 | Within 90 days after the end of the fiscal year |

- 1-5 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 in accordance with the requirements of the Government Auditing Standards (Sections 5.18 - 5.20) 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 www.hud.gov/oig/oigindex.html and in the Appendix.

- 1-6 Planning the Audit. A letter of engagement between the auditee and the IA shall be prepared. The letter should state that the audit is to be performed in accordance with generally accepted auditing standards, the Government Auditing Standards, and this audit guide. It should specify that the scope of the audit and the contents of the financial report meet the requirements of this audit guide. It should also specify that the auditor is required to provide the Secretary of Housing and Urban Development, the HUD Inspector General and the GAO or their representatives access to working papers or other documents to review the audit. Access to working papers by HUD and GAO representatives includes making necessary photocopies.

Generally, the auditor should use professional judgement 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. In addition, one program (see Chapter 7) requires the auditor to report all instances of noncompliance as findings regardless of materiality. 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.

- 1-7 Consideration of Internal Controls and Compliance. Overall guidance for the consideration of internal controls, 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 controls 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 controls 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 controls 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 controls established for HUD-assisted activities. Tests may be omitted only in areas when internal controls are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or material weakness should be reported.

- 1-8 Quality Control Review for Audit Reports . The HUD Office of Inspector General (OIG) has 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. 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, as directed by Chapter 2 of this guide.

Whenever an evaluation of an audit report or working papers discloses inadequacies, the IA may be asked to take corrective action. If the OIG 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.

- 1-9 Corrective Action Plan . To assist the Department in resolving instances of noncompliance and material weaknesses in internal controls 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, which should be on the auditee's letterhead, 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 submission of the corrective action plan is considered a necessary part of the Project/Lender/Issuer's audit requirement and should be submitted to HUD together with the

auditor's reports and audited financial statements. HUD-required audit reports submitted without a corrective action plan will be considered incomplete and returned to the auditee for completion. There should be as many copies of the corrective action plan as there are copies of the audit report. Additional guidance concerning the corrective action plan is contained in Chapter 2 of this guide.

- 1-10 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 controls. 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) which were audited. The auditee should transmit copies of the audit report and its corrective action plan to the applicable HUD office according to the particular program requirements.

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 financial statements and any required supplementary schedules, according to the particular HUD program requirements, together with the auditor's report on the supplementary schedules stating whether that supplementary 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 controls as they relate 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 nonmajor HUD-assisted programs (Example D)

When performing tests of compliance requirements contained in Chapter 3 or 4, the IA should report on Fair Housing and Non-Discrimination. Where the HUD-assisted activity is nonmajor, fair housing reporting should be included in the auditor's report on nonmajor 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. Note that the Office of Lender Activities requires the reporting of all instances of noncompliance, for audits of applicable non-supervised mortgagees and loan correspondents, regardless of materiality.

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. size of the universe and corresponding dollar amount, size and dollar amount of the sample, and number and corresponding dollar amount of the instances of noncompliance (Example F)). Nonmaterial instances of noncompliance should be communicated to the auditee in accordance with the Government Auditing Standards.

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- D. In the auditor's comments on audit resolution matters, the auditor should determine if significant findings from previous HUD required annual audits, HUD-OIG audits, or HUD management reviews have been corrected and disclose those which remain uncorrected at the time of the review (Example G).
- 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 The auditor may issue the required reports (Examples A through G) separately or simultaneously to the auditee; however, all required elements must be submitted simultaneously to the Department. In addition, the following information is to be included by the auditor with the audit report in an accompanying transmittal letter:
- A. The name, office address and telephone number of the audit partner on the engagement.
- B. The IA's Federal employer ID number.
- 2-3 Auditor's Reports. The following are illustrations of auditors' reports on financial statements, on internal controls; 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
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professional judgement in tailoring their reports to the circumstances of individual audits. Guidance on modifications to reports on financial statements is included in AICPA SAS No. 58, Reports on Audited Financial Statements. Guidance on modifications to the report on internal controls and on compliance is included in AICPA SAS No. 60, Communication of Internal Control Structure Related Matters Noted in an Audit and AICPA SAS No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance, respectively.

Examples :

- A. Report on Audited Financial Statements and Supplemental Information.
- B. Report on Internal Controls.
- C. Opinion on Compliance with Specific Requirements Applicable to Major HUD Programs.
- D. Report on Compliance with Specific Requirements Applicable to Nonmajor 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. Auditor's Comments on Audit Resolution Matters Relating to HUD Programs.
- H. Corrective Action Plan (An Auditee Responsibility).

EXAMPLE AREPORT ON AUDITED FINANCIAL STATEMENTS AND SUPPLEMENTAL
INFORMATIONIndependent Auditor's Report

To the Partners
ABC Entity
Anytown, U.S.A.:

We have audited the accompanying balance sheet of [the Entity] as of June 30, 199X, and the related statements of income, and cash flows (and changes in partners' equity)(and analysis of net worth) for the year then ended. These financial statements are the responsibility of [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 generally accepted auditing standards and 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 June 30, 199X, and the results of its operations and its cash flows and its (analysis of net worth/changes in partners' equity) for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supporting information included in the report (shown on pages XX to XY) are presented for the purposes of additional analysis and are 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.

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

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE B

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROLS (COMBINED REPORT APPLICABLE TO THE FINANCIAL STATEMENTS AND HUD-ASSISTED PROGRAMS--REPORTABLE CONDITIONS WERE NOTED--NO MATERIAL WEAKNESSES)

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated [date of report]. We have also audited [the Entity's] compliance with requirements applicable to HUD-assisted programs and have issued our reports thereon dated [date of report].

We conducted our audits in accordance with generally accepted auditing standards and 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.

In planning and performing our audits, we obtained an understanding of the design of relevant internal controls and determined whether they had been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements of [the Entity] and on its compliance with specific requirements applicable to its (major) HUD-assisted programs and to report on internal controls in accordance with the provisions of the Guide and not to provide any assurance on internal controls.

The management of the [the Entity] is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of

internal controls. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles and that HUD-assisted programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal controls, errors, irregularities or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We performed tests of controls, as required by the Guide, to evaluate the effectiveness of the design and operation of internal controls that we considered relevant to preventing or detecting material noncompliance with specific requirements applicable to [the Entity's] HUD-assisted programs. Our procedures were less in scope than would be necessary to render an opinion on internal control policy and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving internal controls and their operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal controls that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements or 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 reportable 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 errors or irregularities in amounts that would be material in relation to the financial statements being audited or that noncompliance with laws and regulations that would be material 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 controls would not necessarily disclose all matters in internal controls 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.

[We also noted other matters involving internal controls and their operations that we have reported to the management of [the Entity] in a separate communication dated September 8, 199X]

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

[Firm Signature]

[Date]

EXAMPLE C

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

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X and have issued our report thereon dated [date of report]. In addition, we have audited [the Entity's] compliance 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 June 30, 199X. The management of [the Entity] is responsible for compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards, *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 Inspector General. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about [the Entity's] compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, [the Entity] complied, in all material respects, with the requirements described above that are applicable to each of its major HUD-assisted programs for the year ended June 30, 199X.

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

[Signature]

[Date]

EXAMPLE D

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO NONMAJOR HUD PROGRAM TRANSACTIONS

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated August 14, 199X.

In connection with our audit of the 199X financial statements of [the Entity] and with our consideration of [the Entity's] internal controls 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, we selected certain transactions applicable to certain nonmajor HUD-assisted programs for the year ended June 30, 199X.

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 for the information of the audit committee, management, and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

EXAMPLE E

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

To the Partners
ABC Partnership
Anytown, USA

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated August 14, 199X.

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 June 30, 199X.

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 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 for the information of the audit committee, management and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

EXAMPLE F**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

(Should be Attached to Auditor's Report on Compliance)

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable:

- (a) the size and corresponding dollar value of the population,
- (b) the size and dollar value of the sample tested, and (c) the size and dollar value of the instances of noncompliance.

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

- **Statement of condition** - the nature of the deficiencies, e.g., a regulation not being followed, a control procedure not followed or one which is inadequate.
- **Criteria** - what the auditee should be doing, e.g. the specific regulation, a prudent management practice, or an internal control procedure.
- **Effect** - what happened as a result of the condition; this should be monetized in all possible instances and described as thoroughly as possible.
- **Cause** - why the condition exists, e.g. the auditee was unaware of the regulation or internal control was not a high priority of the auditee.
- **Recommendation** - what the auditee should do to correct the condition, normally addresses the cause e.g. develop procedures to implement regulation or follow established procedures.

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

Example H) based on the auditor's findings and recommendations and including the plan when submitting the auditor's report. If corrective action is not necessary, a statement by the auditor describing the reason it is not should accompany the audit report.

EXAMPLE G

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

The Project 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 Project has not obtained the required documentation from third-party sources nor has the Project 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 the auditee.

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 Controls ReviewA. 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.)

Financial Statements and Supplemental Information Required for:

| Type of Statement | Section 8 | Insured & Multi-family | Ginnie Mae Issuers | Certificate of Actual Cost | Title II Mortgagees | Title I Lenders |
|---|-----------|------------------------|--------------------|----------------------------|---------------------|-----------------|
| Balance Sheet | X | X | X | X | X | X |
| Statement of Operations and Retained Earnings or Statement of Profit and Loss | X | HUD 92410 | X | X | X | X |
| Statement of Change in Partner's Equity | | X | | | | |
| FASB 95 Cash Flow ¹ | X | X | X | | X | X |
| Notes to F/S | X | X | X | X | X | X |
| Supplemental Data ² | | X | | | | |
| Statement of Receipts and Disbursements | | X | | | | |
| Issuers Adjusted Net Worth | | | X | | X | X |
| Parent's Adjusted Net Worth (if appropriate) | | | X | | | |
| Certificate of Actual Cost | | | | X | | |
| Insurance Requirement | | | X | | | |

¹The Statement of Receipts and Disbursements may be omitted if the Statement of Cash Flows is prepared using the Direct Method

²See HUD Handbook 4370.2 Rev-1

CHAPTER 3. SECTION 8 AUDIT GUIDANCE

3-1 Program Objectives. The objective of the Section 8 program is to provide lower-income families with decent, drug free, safe, affordable, and sanitary rental housing through use of a system of housing assistance payments. This assistance is provided to owners from HUD.

3-2 Program Procedures. HUD enters into the Housing Assistance Payment Contract with an owner. The owners rent housing to eligible low-income families, as defined by 24 CFR parts 812 and 813, who typically pay a portion of their housing costs. The remaining portion of the rent for the unit is paid to the owner by HUD in the form of a housing assistance payment. The Contract sets forth the rights and duties of the owner and the contract administrator with respect to the housing and the housing assistance payments. The owner is responsible for affirmative fair housing marketing and nondiscriminatory rental activities, management and maintenance functions, submission of relevant and reliable financial and operating statements, submission of accurate requests for Housing Assistance Payments, maintaining a replacement reserve, selection/reexamination of tenants with HUD approval, and determining the family's contribution toward rent. The owner may contract with another entity for marketing and management and maintenance.

3-3 Reference Material

| <u>HUD Handbook No.</u> | <u>Title</u> |
|-------------------------|---|
| 4350.2 | Section 8 Additional Assistance Program for Projects with HUD-Insured or HUD-Held Mortgages |
| 4350.3 | Occupancy Requirements of Subsidized Multifamily Housing Programs |
| Form HUD-9834 | Instructions for Completing Management Reviews of Multifamily Projects |

3-4 Reporting Requirements. 24 CFR Part 880 Section 8 - New Construction, and Part 881 Section 8 - Substantial Rehabilitation, both require project owners to submit

audited financial statements to the contract administrator within 60 days after the end of the project fiscal year. In addition to the basic financial statements, the auditor is required to submit a report on the consideration of the internal control structure and a report on compliance with specific requirements. The audit must be performed by an independent auditor, in a form required by HUD. The audit report can include other financial statements and supplemental information as to project operations, financial conditions and occupancy as HUD may require for contract administration and project monitoring. The financial statements to be audited for this program are the basic financial statements of the project. Audit reports and corrective action plans should be submitted to the appropriate HUD Field Office.

3-5 Compliance Requirements and Audit Areas

A. Fair Housing and Non-Discrimination

1. Compliance Requirement. Projects with Section 8 units under contract are required to have an Affirmative Fair Housing Marketing Plan (Plan) covering those units. Management and owners must comply with the requirements of their HUD-approved Plan. The Plan outlines the marketing strategies the owner must use to attract persons least likely to apply because of such factors as racial and ethnic composition of the neighborhood in which the project is located. The Plan is designed to promote equal housing choice for all prospective tenants regardless of race, color, religion, sex, national origin, age, familial status or disability. Management and owners are also 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." (Handbook 4350.3, Chapter 1 and 2 and 24 CFR 200 Subparts I and M).
2. Suggested Audit Procedures
 - a. Obtain a copy of the owner's approved Affirmative Fair Housing Marketing Plan.
 - 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 management's 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.

B. Management, Maintenance, and Replacement Reserve

- 1. Compliance Requirement. The owner is responsible for all management functions relating to repair, maintenance, and replacement of capital items. A replacement reserve must be established and generally maintained in an interest-bearing account to aid in funding extraordinary maintenance and repair and replacement of capital items (see Handbook 4350.1 REV-1 for additional requirements and exceptions). An amount, as required by HUD, will be deposited in the replacement reserve annually. The reserve must be built up to and maintained at a level determined by HUD to be sufficient to meet projected requirements. All earnings including interest on the reserve must be added to the reserve. Partially-assisted projects are exempt from the requirement for periodic deposits to a reserve account. For Section 8, a partially assisted project is defined as a project for non-elderly families which includes more than 50 units of which 20 percent or fewer are assisted (24 CFR 880.602 and 880.401).

2. Suggested Audit Procedures

- a. Determine that the replacement reserve has been established in an interest-bearing account and has received monthly deposits at the HUD-approved amount.
- b. Inquire whether owner/management has conducted routine unit and general property inspections, and if findings were identified, whether corrective action was taken.
- c. Test management's procedures for ensuring that subsidized units meet applicable housing quality standards.
- d. Determine that the replacement reserve is used only to fund extraordinary repair and maintenance items or the replacement of capital items and the uses have been approved by HUD.

C. Federal Financial Reports

1. Compliance Requirement. Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.
2. Suggested Audit Procedures
 - a. Identify all required financial reports by inquiry of the owner/manager.
 - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.
 - c. Select a sample of financial reports other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

-
- d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.
 - e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

D. Application, Eligibility, and Reexamination of Tenants

- 1. Compliance Requirement. Where tenants or projects are subsidized, the owner is responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy, determining initial tenant eligibility, completing annual recertification of tenant eligibility, and rectifying improper or inaccurate tenant information in accordance with the guidelines provided in HUD Handbook 4350.3 and the applicable Housing Assistance Payments Contract.
- 2. Suggested Audit Procedures
 - a. Compare the owner's procedures for accepting applications, determining initial eligibility, total tenant payment, and reexamination of eligibility with provisions in HUD Handbook 4350.3.
 - b. Review a sample of tenant files to determine that applications are complete, signed by the applicant, that tenants met the eligibility requirements pertaining to their subsidized unit for annual income and family composition, that the tenant payment was calculated correctly and that the family income was reexamined on an annual basis. Include in the sample some of the oldest and some of the most recently admitted tenants.
 - c. Review a sample of tenant files to determine if 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 followed-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 and allowances for adjusted income
 - (3) Lease/Lease addenda in the form as required by HUD
 - (4) Certification and recertification forms (Form HUD-50059)
 - (5) Move-In and Move-Out inspections
- e. Test Section 8 rents to ensure that those rents do not exceed the fair market rents.
- f. Compare the amount claimed per the HAP billing to the supporting documentation in the tenant files.
- g. Verify the mathematical accuracy of the billing, including the accuracy on the total number of units on the bill.

E. Security Deposits

- 1. Compliance Requirement. The owner is permitted to collect a security deposit from each family equal to one month's initial total tenant payment or \$50, whichever is greater. The security deposit may be adjusted if the tenant transfers to another unit in the project. If the project is bound by the Section 8 New Construction and Substantial Rehabilitation regulations published in 1979 and 1980, then the owner must place the security deposits in a segregated, interest-bearing account in a federally insured depository. The balance of this account must at all times be equal to the total

amount collected from the families then in occupancy, plus any accrued interest. Owners subject to the revised Section 8 regulations must consider interest income in calculating the amount of refund due a tenant and must comply with any applicable state and local laws concerning interest payments on security deposits.

The owner must follow applicable local refund procedures for the security deposit or provide a list of claims against the security deposit to the family within 30 days of move-out (24 CFR 888.608 and HUD Handbook 4350.3, Chapter 4).

2. Suggested Audit Procedures

- a. Compare the owner's procedures for collecting, depositing and refunding the families security deposit with the provisions in Handbook 4350.3, Chapter 4.
- b. Determine that a segregated interest-bearing account has been established in a federally insured depository institution for depositing security deposits if required by State or local law or Housing Assistance Payments Contracts and determine that the account balance is supported by the owner's records.
- c. Determine that the full amount of the security deposit account balance is insured by a Federal depository.
- d. Test whether refunds or an itemized list of claims when no refund is due is provided to families within 30 days after the family has moved out or a shorter time if required by State or local law.
- e. Test whether the account balance at year end was equal to the total amount collected from the tenants in occupancy, plus any accrued interest.

CHAPTER 4. INSURED AND COINSURED MULTIFAMILY PROJECTS, HUD-HELD MORTGAGES, SECTION 236 SUBSIDIZED PROJECTS, SECTION 232 NURSING HOMES AND SIMILAR FACILITIES AND SECTION 242 HOSPITALS AUDIT GUIDANCE AND SAMPLE FINANCIAL STATEMENTS

- 4-1 Program Objectives. The objectives of the mortgage insurance programs for multifamily housing are to assist in the construction, rehabilitation, or preservation of a broad cross section of rental or cooperative housing.
- 4-2 Program Procedures. The Department insures mortgages made by private lending institutions to help finance construction, rehabilitation, purchase, or refinancing of multifamily (five or more units) rental or cooperative housing. For insured and coinsured loans, the mortgagor may be a public entity, an individual, a partnership, trust, or corporation, either nonprofit or profit motivated. For its part, the mortgagor agrees to various controls and regulations of certain aspects of the project's operation, such as limits on rental amounts, rates of return, eligibility of tenants, fiscal management, etc. These requirements are contained in a Regulatory Agreement, a building loan agreement, or a corporate charter which are incorporated in, and made a part of, the mortgage or loan agreement. Many mortgagors contract with professional management firms (referred to as "management agents") to operate the projects. Agreements with management agents must conform to the pertinent requirements of the Regulatory Agreement.

Mortgage loans insured by HUD under the Section 236 program include a provision for HUD to make Interest Reduction Payments to the mortgagee on behalf of the mortgagor. These Interest Reduction Payments are shown as separate revenue on the books and records of these projects and on their annual financial statements. HUD statutes and regulations contain definitions and additional information on this program. Section 236 projects must submit Form HUD-93104 to HUD on a monthly basis along with any "Excess Income" generated by the project as required by the Regulatory Agreement.

 4-3 Reference Material

| <u>HUD Handbook No.</u> | <u>Title</u> |
|-------------------------|--|
| 4350.1 REV-1 | Multifamily Asset Management and Project Servicing |
| 4350.3 | Occupancy Requirements of Subsidized Multifamily Housing Programs |
| 4360.1 | HUD-Held Project Servicing Handbook |
| 4370.1 REV-2 | Reviewing Annual and Monthly Financial Reports |
| 4355.1 | Flexible Subsidy Handbook |
| 4370.2 REV-1 | Financial Operations and Accounting Procedures for Insured Multifamily Projects |
| 4381.5 REV-2 | The Management Agent Handbook |
| 4470.2 | Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects |
| 4561.2 | Management, Servicing, and Disposition Requirements for Projects with Section 221(d) Coinsured Loans |
| 4566.2 | Management, Servicing, and Disposition Requirements for Projects with Section 223(f) Coinsured Loans |
| 8025.1 | Implementing Affirmative Fair Housing Marketing Requirements |
| Form HUD-9834 | Instructions for Completing Management Reviews of Multifamily Projects |

4-4 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 60 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 the supplemental data reports in the list which follows. These statements must be certified to be accurate by the mortgagor, when the project is owned by an individual. It should be certified by two general partners, when the project is owned by a partnership or by two officers, when owned by a corporation. When circumstances prohibit the ideal number of partners' or officers' certifying signatures, explanatory information should be provided with the audit report. These statements must also be certified to by the CEO of the management agent, where applicable. The report shall include the Employer Identification Number assigned by the IRS. This number must be entered below the partner or corporate signatures. The report should include the following basic financial statements plus the following supplemental data prepared in accordance with generally accepted accounting principles (per Handbook 4370.2 REV-1, Chapter 3) and be submitted to the appropriate HUD Field Office. The Statement of Profit and Loss (HUD-92410) and the Computation of Surplus Cash, Distributions and Residual Receipts (HUD-93486) should be submitted on the preprinted forms provided in this Chapter.

A. Basic Financial Statements

1. Balance Sheet.
2. Statement of Profit and Loss (HUD-92410, with separate Schedule for Subaccounts, if applicable).
3. Statement of Retained Earnings or Undivided Profits.
4. Statement of Changes in Partners' Equity.
5. Statement of Cash Flows.
6. Notes to Financial Statements.

B. Supplemental Data (See HUD Handbook 4370.2 REV-2, Chapter 3)

1. Accounts and notes receivable (other than from regular tenants).
2. Delinquent tenant accounts receivable.

3. Mortgagor escrow deposits.
4. Tenant deposits.
5. Reserve funds.
6. Change in fixed asset accounts.
7. Accounts payable.
8. Accrued taxes payable.
9. Notes payable (other than mortgage).
10. Stock activity reports - initial submission.
11. Distributions to owners or stockholders.
12. Unauthorized distribution of project revenue.
13. Comments on statement of position (balance sheet) items.
14. Residual receipts.
15. Donations, subsidy payments, founders fees, etc. for non-profit elderly housing only.
16. Compensation of partners or officers.
17. Listing of identity of interest companies and activity.

Illustrative reports are included at the end of this Chapter.

4-5 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.

For example, Section 236 projects, which receive an Interest Reduction Payment, are required to submit a monthly report of excess income (Form HUD 93104) by the 10th of the month following the month covered by the report, per the Regulatory Agreement.

2. Suggested Audit Procedures

- a. Identify all required financial reports by inquiry of the owner/manager.
- b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.
- c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.
- d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.
- e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.
- f. For a Section 236 Interest 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.

B. Fair Housing and Non-Discrimination

1. Compliance Requirement. Management and owners of all insured projects 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. Additionally, each project insured since

1972 is required to have an Affirmative Fair Housing Marketing Plan (Plan) covering the project. Management and owners must comply with the requirements of their HUD-approved Plan. The Plan outlines the marketing strategies the owner must use to attract persons least likely to apply because of such factors as racial and ethnic composition of the neighborhood in which the project is located. The Plan is designed to promote equal housing choice for a prospective tenants regardless of race, color, religion, sex, national origin, age, familial status or disability. (24 CFR 200 Subparts I and M and Handbook 4350.3 Chapter 2).

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; 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 Requirements. Owners shall promptly make all payments due under the note and mortgage (Regulatory Agreement).
2. Suggested Audit Procedures
 - a. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage.
 - b. Test whether mortgage payments are made in accordance with terms of the mortgage.
 - c. If the project is operating under a mortgage modification agreement, workout agreement or a forbearance agreement, test whether the owner is complying with the terms and conditions.

D. Replacement Reserve

1. Compliance Requirement. Owners shall establish or maintain a reserve fund under the control of the mortgagee in a separate account in a federally insured depository with the mortgagee or in a federally insured depository designated by the mortgagee. The entire balance of the replacement reserve need not be federally insured throughout the period under audit (Handbook 4350.1 Rev-1, Chapter 4). An amount as required by HUD will be deposited monthly in the reserve fund. All disbursements from the fund must be approved by HUD (Regulatory Agreement and Handbook 4370.2 REV-1, Chapter 2). (A mortgage servicer may pool replacement reserves of various projects together. The mortgagor may not have control of a separate account or have funds commingled with the separate account.)
2. Suggested Audit Procedures
 - a. Obtain an understanding of the project owner's procedures 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 test whether the conditions were met for the funds not federally insured for the period (Ginnie Mae Handbook 5500.1, Section 11-7). Test whether periodic deposits in amounts as required by HUD, have been made to the fund.
- c. Test whether disbursements from the reserve fund were approved by HUD and were made for the HUD-approved purpose.

E. Residual Receipts

- 1. Compliance Requirement . For limited dividend projects, owners shall establish and maintain a residual receipts fund by depositing the residual receipts from the project with the mortgagee within the HUD-required number of days after the end of the period. Residual receipts is usually any cash remaining at the end of a semiannual or annual fiscal period after deducting from surplus cash the amount of all distributions of the project. "Surplus cash" and "distributions" and amounts required to be deposited into the residual receipts fund are defined in the Regulatory Agreement. All disbursements of residual receipts must be approved by HUD (HUD Handbooks 4370.2 REV-1, Chapter 2 and 4566.2, Chapter 3).
- 2. Suggested Audit Procedures
 - a. 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.
 - b. Test whether disbursements, if any, from the residual receipts account were approved by HUD.

F. Security Deposits

- 1. Compliance Requirement . There shall be one security deposit account per property. The amount the owner is permitted to collect as a security deposit is

dependent on the type of subsidy program in effect at the project. The owner must keep amounts collected as security deposits in a separate federally insured account apart from other project funds. Owners must comply with applicable State and local laws regarding investment of security deposits and distribution of any interest earned thereon. The entire balance of the security deposit account must be federally insured throughout the period under audit. The balance in the account must at all times be at least equal to all outstanding obligations under the account for security deposits. In cases where the funds in the project's security deposit account exceed the amount insured by Federal government deposit insurance, the project may open another bank account for the excess amounts (HUD Handbooks 4370.2 REV-1, Chapter 2, 4350.3, Chapter 4 4566.2, Chapter 3, and 4370.1 REV-2, Chapter 2).

2. Suggested Audit Procedures

- a. Compare the owner's procedures for collecting, depositing, and refunding security deposits with the provisions in HUD Handbook 4350.3, Chapter 4 and 4370.2 REV-1, Chapter 2.
- b. Determine that a segregated federally insured account has been established for depositing security deposits and that the account balance is supported by the owner's records. Determine that the account is fully insured. Determine whether at the end of the reporting period the amount on deposit is at least equal to the outstanding obligations under the security deposit account. If the account is interest bearing, test whether the disposition of interest earned conforms to State or local laws and HUD regulations.
- c. Test whether security deposits are collected at the time of the initial lease and agree with the amount required in the lease agreement.
- d. Test that refunds or an itemized list of claims when no refund is due is provided to tenants within 30 days after move-out or shorter if required by State or local law.

G. Cash Receipts and Disbursements

1. Compliance Requirements . All cash receipts must be deposited into an institution whose deposits are federally insured (not limited to banks), and must be identifiable to each project at all times. The entire balance of cash receipts account need not be federally insured (HUD Handbook 4370.2 REV-1, CHG-1, Chapter 2. Such funds shall be withdrawn only in accordance with the provisions for project expenses or for distributions of surplus cash (HUD Handbooks 4370.2 REV-1, Chapter 2 and 4566.2, Chapter 3).
2. Suggested Audit Procedures
 - a. Compare the owner's procedures for depositing all cash receipts from the project with the requirements of Handbook 4370.2 REV-1, CHG-1, Chapter 2.
 - b. Test whether established procedures for deposit of cash receipts into a federally insured bank are being followed through inquiry and examination of documentary evidence.
 - c. Test whether withdrawals were for allowable project expenses or distributions of surplus cash.

H. Distributions to Owners

1. Compliance Requirement . A distribution is any withdrawal or taking of cash or any assets of the project other than for the payment of reasonable expenses necessary to the operation and maintenance of the project. The term distribution includes, for example, supervisory fees paid to general partners and any salaries or other fees paid to the sponsor or owners, unless those salaries or fees have been approved by HUD as essential to the operation of the project. Distributions may be made only if owners have been in compliance with all provisions of the Regulatory Agreement, including that the project is in good repair and condition. Other allowable conditions for distributions of project assets are

described in the Regulatory Agreement. Distributions to limited dividend and profit-motivated owners are permissible, if the distributions adhere to guidelines contained in HUD Handbooks 4370.2 REV-1, 4370.1 REV-2, 4566.2 and the Regulatory Agreement. Additionally, owners may have waived their rights to accrue or pay distributions in return for subsidies or mortgage relief.

2. Suggested Audit Procedure. Review any distribution of assets to project owners to determine if it is permitted under ownership terms including any subsidy or mortgage relief contracts. Determine that any distribution is properly reflected in the project financial statements. Determine that for any distributions made, the owners were in compliance with all applicable provisions of the Regulatory Agreement relating to distributions to owners including the requirement for the project to be in good repair and condition (i.e., there was compliance with all outstanding notices of requirements for proper maintenance of the project). Report any unallowable distribution of project assets as a finding.

I. Tenant Application, Eligibility, and Recertification

1. Compliance Requirement. Where tenants or projects are subsidized, the owner is responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy, determining initial tenant eligibility, annual recertification of tenant eligibility, and rectifying improper or inaccurate tenant information in accordance with the guidelines provided in HUD Handbook 4350.3 and the applicable Regulatory Agreement.
2. Suggested Audit Procedures
 - a. Compare the owner's procedures for accepting applications, determining initial eligibility, total tenant payment, and reexamination of eligibility with the provisions in HUD Handbook 4350.3.

- b. Review a sample of tenant files to determine that applications are complete, signed by the applicant, that tenants met the eligibility requirements pertaining to their subsidized unit for annual income, and family composition, that the tenant payment was calculated correctly and that the family income was reexamined on an annual basis. Include in the sample some of the oldest and some of the most recently admitted tenants.
- c. Review a sample of tenant files for evidence of whether the owner noted any improper or inaccurate information while determining tenant eligibility or during tenant recertification. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow-up to suspected fraud.
- d. Review a sample of tenant files to determine that the tenant file contains the following documents as follows:
 - (1) Application
 - (2) Required verifications of social security numbers, disability status, waiting list preferences and allowances for adjusted income
 - (3) Lease/Lease addenda in the form as required by HUD
 - (4) Certification and recertification forms (Form HUD-50059)
 - (5) Move-In and Move-Out inspections

J. Management Functions

- 1. Compliance Requirements. Under HUD Handbooks 4370.2 REV-1 and 4566.2 and the Regulatory Agreement, the owner is responsible for performing or providing for certain management functions, such as obtaining fidelity bonds, maintaining accounting records in accordance with HUD guidance and performing

maintenance and management activities for the project. In addition, changes to project ownership and property without prior written HUD approval are prohibited.

2. Suggested Audit Procedures

- a. Determine that the owner's designated management agent has obtained a fidelity bond in an amount at least equal to two months potential collections. Where an agent has multiple projects, the coverage must be at least equal to two months of the highest potential collections. All principals of the management entity and all persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts and records must be covered.
- b. Review the financial operations and accounting procedures of the project to determine that they are in accordance with the significant requirements of Chapters 2, 3, and 4 of HUD Handbook 4370.2 REV-1 or Chapter 3 of Handbook 4566.2 and the Regulatory Agreement.
- c. 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).
- d. Compare management's inspection guidelines to Form HUD-9834.
- e. Determine that the management certificate has been approved by HUD, if required.
- f. Review the maintenance contracts and vendor invoices for identity of interest relationships with the owner/agent and agent/service contractor.
- g. 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, supplies, etc., in the geographic area.

- h. Review project records to determine if there have been any changes to project ownership, encumbrances or liens of personal property of the project including rents, or pay out of any funds except for operating expenses and necessary repairs to project structures, approved by HUD. If there have been any changes in project ownership or in beneficial interest in the project, determine that HUD approval has been obtained if required. Report all changes in project ownership or beneficial interest.

Illustrative Reports

(Sample)

ABC Partnership
075 44001

BALANCE SHEET

AS OF _____

Assets

CURRENT ASSETS

| | | | |
|------|--|----|-------|
| 1110 | Petty Cash | \$ | _____ |
| 1120 | Cash in Bank | \$ | _____ |
| 1130 | Tenant Accounts Receivable | \$ | _____ |
| 1140 | Accounts Receivable - Other | \$ | _____ |
| Less | 4220 Reserve for Collection Losses | \$ | _____ |
| | Net Accounts Receivable | \$ | _____ |
| 1150 | Notes Receivable - Other | \$ | _____ |
| 1151 | Notes Receivable - Stockholders, Officers | \$ | _____ |
| Less | 4230 Reserve for Doubtful Notes Receivable | \$ | _____ |
| | Net Collectible Receivables | \$ | _____ |
| 1160 | Accrued Receivables | \$ | _____ |
| 1170 | Investments (Short-Term) | \$ | _____ |
| 1190 | Miscellaneous Current Assets | \$ | _____ |
| 1210 | Fuel Inventory | \$ | _____ |
| 1230 | Supplies Inventory | \$ | _____ |
| 1240 | Property Insurance | \$ | _____ |
| 1250 | Mortgage Insurance | \$ | _____ |
| 1270 | Taxes | \$ | _____ |
| 1290 | Miscellaneous | \$ | _____ |
| | Total Current Assets | \$ | _____ |

DEPOSITS HELD IN TRUST - FUNDED

| | | | |
|------|-----------------------------------|----|-------|
| 1191 | Tenant Security Deposits (Contra) | \$ | _____ |
| 1192 | Other Deposits (Contra) | \$ | _____ |
| | Total Deposits Held in Trust | \$ | _____ |

RESTRICTED DEPOSITS AND FUNDED RESERVES

| | | | |
|------|--------------------------------------|----|-------|
| 1310 | Mortgagee Escrow Deposits (Schedule) | \$ | _____ |
| 1320 | Reserve for Replacements | \$ | _____ |
| 1340 | Residual Receipts Reserve | \$ | _____ |
| | Total Deposits | \$ | _____ |

(Sample)

ABC Partnership
075 44001

BALANCE SHEET

AS OF _____

Assets (Continued)

FIXED ASSETS

| | | | |
|------|-------------------------------|----|-------|
| 1410 | Land | \$ | _____ |
| 1420 | Buildings | \$ | _____ |
| 1430 | Building Equipment-Fixed | \$ | _____ |
| 1440 | Building Equipment-Portable | \$ | _____ |
| 1450 | Furniture | \$ | _____ |
| 1460 | Furnishings | \$ | _____ |
| | Total Fixed Assets | \$ | _____ |
| | Less Accumulated Depreciation | \$ | _____ |
| | (Sub-total) | \$ | _____ |

| | | | |
|---------------------|--------------|----|-------|
| <u>OTHER ASSETS</u> | (Scheduled) | \$ | _____ |
| | Total Assets | \$ | _____ |

(Sample)

ABC Partnership
075 44001

BALANCE SHEET

Liabilities

CURRENT LIABILITIES

| | | | |
|------|------------------------------------|----|-------|
| 2110 | Accounts Payable | \$ | _____ |
| 2115 | Accounts Payable - HUD | \$ | _____ |
| 2120 | Accrued Wages Payable | \$ | _____ |
| 2130 | Accrued Interest Payable | \$ | _____ |
| 2150 | Accrued Taxes | \$ | _____ |
| 2160 | Notes Payable (Short-Term) | \$ | _____ |
| 2190 | Miscellaneous Current Liabilities | \$ | _____ |
| 2320 | Mortgage Payable - Current Portion | \$ | _____ |
| 2210 | Rent Deferred Credits | \$ | _____ |
| 2220 | Interest Deferred Liabilities | \$ | _____ |
| 2230 | Payable to Other Projects | \$ | _____ |
| | Total Current Liabilities | \$ | _____ |

DEPOSIT LIABILITIES

| | | | |
|------|-----------------------------------|----|-------|
| 2191 | Tenant Security Deposits (Contra) | \$ | _____ |
| 2192 | Other Deposits (Contra) | \$ | _____ |
| | Total Deposit Liabilities | \$ | _____ |

LONG-TERM LIABILITIES

| | | | |
|------|-----------------------------|----|-------|
| 2310 | Notes Payable | \$ | _____ |
| 2320 | Mortgage Payable | \$ | _____ |
| | Less: Current Portion | \$ | _____ |
| | Total Long-Term Liabilities | \$ | _____ |

OTHER LIABILITIES (Schedule)

| | | | |
|--|--|----|-------|
| | | \$ | _____ |
|--|--|----|-------|

| | | |
|-------------------|----|-------|
| Total Liabilities | \$ | _____ |
|-------------------|----|-------|

Partners' Equity

| | | | |
|------|------------------|----|-------|
| 3130 | Partners' Equity | \$ | _____ |
|------|------------------|----|-------|

| | | |
|--|----|-------|
| Total Liabilities and Partners' Equity | \$ | ===== |
|--|----|-------|

See notes to financial statements

Statement of Profit and Loss

U.S. Department of Housing and Urban Development
Office of Housing
Federal Housing Commissioner

OMB Approval No. 2502-0052 (Exp. 9/30/98)

Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to the Reports Management Officer, Paperwork Reduction Project (2502-0052), Office of Information Technology, U.S. Department of Housing and Urban Development, Washington, D.C. 20410-3600. This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

Do not send this form to the above address.

| For Month/Period Beginning: | | Ending: | Project Number: | Project Name: |
|---|---|-----------|-----------------|---------------|
| Part I | Description of Account | Acct. No. | Amount* | |
| Rental Income 5100 | Apartments or Member Carrying Charges (Coops) | 5120 | \$ | |
| | Tenant Assistance Payments | 5121 | \$ | |
| | Furniture and Equipment | 5130 | \$ | |
| | Stores and Commercial | 5140 | \$ | |
| | Garage and Parking Spaces | 5170 | \$ | |
| | Flexible Subsidy Income | 5180 | \$ | |
| | Miscellaneous (specify) | 5190 | \$ | |
| | Total Rent Revenue Potential at 100% Occupancy | | | \$ |
| Vacancies 5200 | Apartments | 5220 | (|) |
| | Furniture and Equipment | 5230 | (|) |
| | Stores and Commercial | 5240 | (|) |
| | Garage and Parking Spaces | 5270 | (|) |
| | Miscellaneous (specify) | 5290 | (|) |
| | Total Vacancies | | (|) |
| Net Rental Revenue Rent Revenue Less Vacancies | | | \$ | |
| Elderly and Congregate Services Income—5300 | | | | |
| Total Service Income (Schedule Attached) | | 5300 | \$ | |
| Financial Revenue 5400 | Interest Income—Project Operations | 5410 | \$ | |
| | Income from Investments—Residual Receiptsd | 5430 | \$ | |
| | Income from Investments—Reserve for Replacement | 5440 | \$ | |
| | Income from Investments—Miscellaneous | 5490 | \$ | |
| | Total Financial Revenue | | \$ | |
| Other Revenue 5900 | Laundry and Vending | 5910 | \$ | |
| | NSF and Late Charges | 5920 | \$ | |
| | Damages and Cleaning Fees | 5930 | \$ | |
| | Forfeited Tenant Security Deposits | 5940 | \$ | |
| | Other Revenue (specify) | 5990 | \$ | |
| | Total Other Revenue | | \$ | |
| Total Revenue | | | \$ | |
| Administrative Expenses 6200/6300 | Advertising | 6210 | \$ | |
| | Other Administrative Expense | 6250 | \$ | |
| | Office Salaries | 6310 | \$ | |
| | Office Supplies | 6311 | \$ | |
| | Office or Model Apartment Rent | 6312 | \$ | |
| | Management | 6320 | \$ | |
| | Manager or Superintendent Salaries | 6330 | \$ | |
| | Manager or Superintendent Rent Free Unit | 6331 | \$ | |
| | Legal Expenses (Project) | 6340 | \$ | |
| | Auditing Expenses (Project) | 6350 | \$ | |
| | Bookkeeping Fees/Accounting Services | 6351 | \$ | |
| | Telephone and Answering Service | 6360 | \$ | |
| | Bad Debts | 6370 | \$ | |
| | Miscellaneous Administrative Expenses (specify) | 6390 | \$ | |
| Total Administrative Expenses | | \$ | | |
| Utilities Expense 6400 | Fuel Oil/Coal | 6420 | \$ | |
| | Electricity (Light and Misc. Power) | 6450 | \$ | |
| | Water | 6451 | \$ | |
| | Gas | 6452 | \$ | |
| | Sewer | 6453 | \$ | |
| | Total Utilities Expense | | \$ | |

* All amounts must be rounded to the nearest dollar; \$.50 and over,

| | | | | |
|---|---|---------|----|----|
| Operating and Maintenance Expenses 6500 | Janitor and Cleaning Payroll | 6510 | \$ | |
| | Janitor and Cleaning Supplies | 6515 | \$ | |
| | Janitor and Cleaning Contract | 6517 | \$ | |
| | Exterminating Payroll/Contract | 6519 | \$ | |
| | Exterminating Supplies | 6520 | \$ | |
| | Garbage and Trash Removal | 6525 | \$ | |
| | Security Payroll/Contract | 6530 | \$ | |
| | Grounds Payroll | 6535 | \$ | |
| | Grounds Supplies | 6536 | \$ | |
| | Grounds Contract | 6537 | \$ | |
| | Repairs Payroll | 6540 | \$ | |
| | Repairs Material | 6541 | \$ | |
| | Repairs Contract | 6542 | \$ | |
| | Elevator Maintenance/Contract | 6545 | \$ | |
| | Heating/Cooling Repairs and Maintenance | 6546 | \$ | |
| | Swimming Pool Maintenance/Contract | 6547 | \$ | |
| | Snow Removal | 6548 | \$ | |
| | Decorating Payroll/Contract | 6560 | \$ | |
| | Decorating Supplies | 6561 | \$ | |
| | Other | 6570 | \$ | |
| Miscellaneous Operating and Maintenance Expenses | 6590 | \$ | | |
| Total Operating and Maintenance Expenses | | | | \$ |
| Taxes and Insurance 6700 | Real Estate Taxes | 6710 | \$ | |
| | Payroll Taxes (FICA) | 6711 | \$ | |
| | Miscellaneous Taxes, Licenses and Permits | 6719 | \$ | |
| | Property and Liability Insurance (Hazard) | 6720 | \$ | |
| | Fidelity Bond Insurance | 6721 | \$ | |
| | Workmen's Compensation | 6722 | \$ | |
| | Health Insurance and Other Employee Benefits | 6723 | \$ | |
| | Other Insurance (specify) | 6729 | \$ | |
| Total Taxes and Insurance | | | | \$ |
| Financial Expenses 6800 | Interest on Bonds Payable | 6810 | \$ | |
| | Interest on Mortgage Payable | 6820 | \$ | |
| | Interest on Notes Payable (Long-Term) | 6830 | \$ | |
| | Interest on Notes Payable (Short-Term) | 6840 | \$ | |
| | Mortgage Insurance Premium/Service Charge | 6850 | \$ | |
| | Miscellaneous Financial Expenses | 6890 | \$ | |
| Total Financial Expenses | | | | \$ |
| Elderly & Congregate Service Expenses 6900 | Total Service Expenses—Schedule Attached | 6900 | | \$ |
| | Total Cost of Operations Before Depreciation | | | \$ |
| | Profit (Loss) Before Depreciation | | | \$ |
| | Depreciation (Total)—6600 (specify) | 6600 | | \$ |
| | Operating Profit or (Loss) | | | \$ |
| Corporate or Mortgagor Entity Expenses 7100 | Officer Salaries | 7110 | \$ | |
| | Legal Expenses (Entity) | 7120 | \$ | |
| | Taxes (Federal-State-Entity) | 7130-32 | \$ | |
| | Other Expenses (Entity) | 7190 | \$ | |
| | Total Corporate Expenses | | | \$ |
| Net Profit or (Loss) | | | | \$ |

Warning: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802) **Miscellaneous or other Income and Expense Sub-account Groups.** If miscellaneous or other income and/or expense sub-accounts (5190, 5290, 5490, 5990, 6390, 6590, 6729, 6890, and 7190) exceed the Account Groupings by 10% or more, attach a separate schedule describing or explaining the miscellaneous income or expense.

Part II

| | |
|---|----|
| 1. Total principal payments required under the mortgage, even if payments under a Workout Agreement are less or more than those required under the mortgage. | \$ |
| 2. Replacement Reserve deposits required by the Regulatory Agreement or Amendments thereto, even if payments may be temporarily suspended or waived. | \$ |
| 3. Replacement or Painting Reserve releases which are included as expense items on this Profit and Loss statement | \$ |
| 4. Project Improvement Reserve Releases under the Flexible Subsidy Program that are included as expense items on this Profit and Loss Statement. | \$ |

(Sample)

STATEMENT OF CHANGES IN PARTNERS' EQUITY

ABC Partnership
075 44001

For Year Ended _____ 19__

| | | |
|-------------------|----------|----------|
| Beginning of Year | | \$ _____ |
| Add: | | |
| Net Income | \$ _____ | |
| Contributions | | \$ _____ |
| Other | \$ _____ | |
| Deduct: | | |
| Distributions | \$ _____ | \$ _____ |
| End of Year | | \$ _____ |

See notes to the financial statements

SAMPLE COMPANY
HUD PROJECT NO. XXX-XXXXX

STATEMENT OF CASH FLOWS

Years Ended December 31, 1996 and 1995

| | <u>1996</u> | <u>1995</u> |
|---|------------------|------------------|
| Cash flows from operating activities: | | |
| Rental receipts | \$xxx,xxx | \$xxx,xxx |
| Interest receipts | x,xxx | x,xxx |
| Other receipts | <u>x,xxx</u> | <u>x,xxx</u> |
| | <u>xxx,xxx</u> | <u>xxx,xxx</u> |
| Administrative | (xx,xxx) | (xx,xxx) |
| Management fees | (xx,xxx) | (x,xxx) |
| Utilities | (xx,xxx) | (xx,xxx) |
| Salaries and wages | (xx,xxx) | (xx,xxx) |
| Operating and maintenance | (xx,xxx) | (xx,xxx) |
| Real estate taxes and escrow deposits | (xx,xxx) | (xx,xxx) |
| Property insurance | (x,xxx) | (x,xxx) |
| Miscellaneous taxes and insurance | (x,xxx) | (x,xxx) |
| Tenant security and other deposits | (xxx) | (xxx) |
| Interest on mortgage | <u>(xxx,xxx)</u> | <u>(xxx,xxx)</u> |
| | <u>(xxx,xxx)</u> | <u>(xxx,xxx)</u> |
| Net cash provided by (used in) operating activities | <u>(x,xxx)</u> | <u>xx,xxx</u> |
| Cash flows from investing activities: | | |
| Deposits into reserve for replacement | (x,xxx) | (xx,xxx) |
| Net deposits to residual receipts reserve | <u>(xx)</u> | <u>(xxx)</u> |
| Net cash used in investing activities | <u>(x,xxx)</u> | <u>(xx,xxx)</u> |
| Cash flows from financing activities: | | |
| Mortgage principal payments | <u>(x,xxx)</u> | <u>(x,xxx)</u> |
| Net cash used in financing activities | <u>(x,xxx)</u> | <u>(x,xxx)</u> |
| Net increase (decrease) in cash and cash equivalents | (xx,xxx) | xx,xxx |

(Continued)

SAMPLE COMPANY
HUD PROJECT NO. XXX-XXXXX

STATEMENT OF CASH FLOWS
(Continued)
Years Ended December 31, 1996 and 1995

| | <u>1996</u> | <u>1995</u> |
|---|-------------------|--------------------|
| Cash and cash equivalents: | | |
| Beginning of period | \$ <u>xx,xxx</u> | \$ <u>x,xxx</u> |
| End of period | \$ <u>(xxx)</u> | \$ <u>xx,xxx</u> |
| Cash flows from operating activities: | | |
| Net loss | \$(xx,xxx) | \$(xx,xxx) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation | xx,xxx | xx,xxx |
| Decrease (increase) in prepaid insurance | x,xxx | (x,xxx) |
| Decrease in prepaid mortgage payments | x,xxx | xx,xxx |
| Decrease (increase) in cash restricted for tenant security deposits | (xxx) | xx |
| Decrease (increase) in accounts receivable - other | x,xxx | (x,xxx) |
| Decrease (increase) in tax and insurance escrow | x,xxx | (xx,xxx) |
| Increase in accounts payable | xxx | x,xxx |
| Decrease in accrued liabilities | (x,xxx) | (x,xxx) |
| Increase in excess rent due to HUD | xxx | x,xxx |
| Increase (decrease) in tenants security deposits | xxx | (xxx) |
| Increase in deferred revenue | <u>xxx</u> | <u>xx,xxx</u> |
| Net cash provided by (used in) operating activities | <u>\$ (x,xxx)</u> | <u>\$ (xx,xxx)</u> |

See the notes to the financial statements

(sample)

ABC Partnership
075 44001

SUPPORTING DATA REQUIRED BY HUD

Accounts and notes receivable (other than from regular tenants) :

| <u>Name of Borrower</u> | <u>Original Date</u> | <u>Terms</u> | <u>Original Amount</u> | <u>Balance Due</u> |
|-------------------------|----------------------|--------------|------------------------|--------------------|
| | | | \$ _____ | \$ _____ |
| | | | \$ _____ | \$ _____ |
| Total | | | | \$ _____ |

Delinquent tenant accounts receivable :

| | <u>Number of Tenants</u> | <u>Amount Past Due</u> |
|-------------------------|--------------------------|------------------------|
| Delinquent 30 days | _____ | \$ _____ |
| Delinquent 31-60 days | _____ | \$ _____ |
| Delinquent 61-90 days | _____ | \$ _____ |
| Delinquent over 90 days | _____ | \$ _____ |
| Totals | _____ | \$ _____ |

Mortgage escrow deposits :

| | | |
|---|----------|----------|
| Estimated amount required as of (audit date) for future payment of: | | |
| City, State and County taxes | \$ _____ | |
| Property insurance | _____ | |
| Mortgage insurance | _____ | |
| Total | | \$ _____ |
| Total confirmed by mortgagee ^{1/} | | \$ _____ |
| Amount on deposit in excess (deficient) of estimated requirements ^{2/} | | \$ _____ |

^{1/} For instance, a project with a FY ending December 31, which makes annual tax and insurance payments on April 1, should have at least 9/12 of the total tax and insurance to be paid accumulated as of December 31.

^{2/} Any deficiency should be deducted from surplus cash computation.

(sample)

ABC Partnership
075 44001

SUPPORTING DATA REQUIRED BY HUD (Continued)

Tenant security deposits :

Tenant security deposits are held in a separate bank account in the name of the project. (NOTE: HUD requires that tenant security deposits be held in a separate bank account in the name of the project.)

Reserve for replacements :

In accordance with the provisions of the Regulatory Agreement, restricted cash is held by (name of depository) to be used for replacement of property with the approval of HUD as follows:

| | | |
|--|----|--|
| Balance, (date) | \$ | |
| Monthly deposits (\$ _____ x 12) | | |
| Withdrawals: | | |
| Balance, (date), confirmed by mortgagee | \$ | |

Accounts payable (other than trade creditors) :

| | | |
|------------------------------|----|--|
| Payable within 30 days | \$ | |
| Payable within 31-60 days | \$ | |
| Payable in more than 60 days | \$ | |
| Balance | \$ | |

Detail of payables due in more than 60 days :

| <u>Creditor</u> | <u>Purpose</u> | <u>Date Incurred</u> | <u>Terms</u> | <u>Original Amount</u> | <u>Amount Due</u> |
|-----------------|----------------|----------------------|--------------|------------------------|-------------------|
| | | | | \$ _____ | \$ _____ |
| | | | | | |
| | | | | | |

Computation of Surplus Cash, Distributions and Residual Receipts

U.S. Department of Housing
and Urban Development
Office of Housing
Federal Housing Commissioner

| | | |
|--------------|--|----------------|
| Project Name | Fiscal Period Ended: ____/____/____ | Project Number |
|--------------|--|----------------|

Part A – Compute Surplus Cash

| | | |
|--|----|--|
| Cash | | |
| 1. Cash (Accounts 1110, 1120, 1191, 1192) | \$ | |
| 2. Tenant subsidy vouchers due for period covered by financial statement | \$ | |
| 3. Other (describe) | \$ | |
| (a) Total Cash (Add Lines 1, 2, and 3) | \$ | |

| | | |
|--|----|--|
| Current Obligations | | |
| 4. Accrued mortgage interest payable | \$ | |
| 5. Delinquent mortgage principal payments | \$ | |
| 6. Delinquent deposits to reserve for replacements | \$ | |
| 7. Accounts payable (due within 30 days) | \$ | |
| 8. Loans and notes payable (due within 30 days) | \$ | |
| 9. Deficient Tax Insurance or MIP Escrow Deposits | \$ | |
| 10. Accrued expenses (not escrowed) | \$ | |
| 11. Prepaid Rents (Account 2210) | \$ | |
| 12. Tenant security deposits liability (Account 2191) | \$ | |
| 13. Other (Describe) | \$ | |
| (b) Less Total Current Obligations (Add Lines 4 through 13) | \$ | |
| (c) Surplus Cash (Deficiency) (Line (a) minus Line (b)) | \$ | |

Part B – Compute Distributions to Owners and Required Deposit to Residual Receipts

| | | |
|-----------------|--|----|
| 1. Surplus Cash | | \$ |
|-----------------|--|----|

| | | |
|---|----|----|
| Limited Dividend Projects | | |
| 2a. Annual Distribution Earned During Fiscal Period Covered by the Statement | \$ | |
| 2b. Distribution Accrued and Unpaid as of the End of the Prior Fiscal Period | \$ | |
| 2c. Distributions Paid During Fiscal Period Covered by Statement | \$ | |
| 3. Amount to be Carried on Balance Sheet as Distribution Earned but Unpaid (Line 2a plus 2b minus 2c) | \$ | |
| 4. Amount Available for Distribution During Next Fiscal Period | | \$ |
| 5. Deposit Due Residual Receipts (Must be deposited with Mortgagee within 60 days after Fiscal Period ends) | | \$ |

| | | | |
|--------------------|------|--------------------|------|
| Prepared By | | Reviewed By | |
| Loan Technician | Date | Loan Servicer | Date |

Instructions for Preparation of Form HUD-93486, Computation of Surplus Cash, Distributions and Residual Receipts

Part A

Line 1. Do not include escrow deposits or HUD required reserves. Do not include funds in Project Improvement Accounts required on Flexible Subsidy or other projects.

Line 2. Include amounts receivable on tenant subsidy vouchers only if the amounts were earned during the period covered by the financial statement. Do not include Section 8 vouchers submitted for the first month of the next fiscal year. Keep in mind that rent supplement and RAP vouchers are submitted on the 20th of the month they are earned while Section 8 vouchers are submitted on the 20th of the month before they are earned.

Line 3. Include amounts related to replacement reserve draws for items which have:

- Been paid from project funds, and
- Approved by HUD prior to the end of the fiscal year, but
- For which reimbursement has not been received from the mortgagee.

Line 4. For projects current under the mortgage, include the interest payment due the first of the next month (Account 2130). Remember interest is paid in arrears; interest for the month of December is payable January 1. **For projects in default under the mortgage,** include delinquent interest payments shown on the Form HUD-92426, Notice of Default; use the Form HUD-92426 for the month following the last month covered by the financial statement. **For HUD-held projects,** include delinquent interest shown on the Form HUD-92771, Notice of Mortgage Payment Due; use the HUD-92771 for the month following the last month covered by financial statements.

Line 5. Include principal delinquent under the mortgage. This should be the difference between the unpaid balance shown on the amortization schedule and the amount shown in Account 2320 as of the Balance Sheet date.

Line 6. Include any delinquent deposits to the reserve for replacement account (Account 1320). Be sure to include any lump-sum deposits required by special workout agreements or subsidy contracts.

Line 7. Exclude accounts payable related to replacement reserve draws which were:

- Approved by HUD prior to the end of the fiscal year, but
- Which have not yet been released by the mortgagee and deposited in the project account.

Include any excess income payments on Section 236 projects which should have been sent to HUD and were not as of the end of the fiscal year; excess income is calculated monthly on Form HUD-93104.

Line 9. Include any deficiency reported in the mortgage escrow deposits schedule of the Supplemental Data to the financial statement. Note that replacement reserve deposits are not included; delinquent replacement reserve deposits are included in Line 6.

Part B

Line 1. If the amount on Line 13(c) of Part A was zero or negative, enter zero. If the amount on Line 13(c) of Part A was positive, enter that amount here.

(For lines 2a, 2b, 2c and 3 use only on limited dividend projects.)

Line 2a. Enter zero if mortgagor agreed not to accrue distributions for the fiscal period covered by the financial statement. On limited dividend projects, the annual distribution earned is calculated by multiplying the distribution rate cited in the regulatory agreement by the initial owner's equity account. The owner equity figure is determined at the time of cost certification and should not be confused with the Owner's Equity Account reported annually on the project Balance Sheet. The annual distribution permitted is computed by multiplying the distribution rate cited in the regulatory agreement by the difference between the HUD-approved mortgage amount (Line 10) and the replacement cost (Line 6) of Form HUD-2580, Maximum Insurable Mortgage.

Note: If distribution is paid for a semi-annual period, divide annual distribution by 2.

Line 2b. Enter zero if mortgagor agreed to waive distributions that have **accrued** prior to period covered by the statement. On other limited-dividend projects, enter the amounts shown on previous year's balance sheet or Line 3 of last year's computation of surplus cash.

Line 2c. Enter amount shown as distributions paid in the Statement of Changes in Owner's Equity or the Statement of Receipts and Disbursements. Distributions are defined in paragraph 2-10 of Handbook 4370.1 Rev-1.

Line 3. Enter Line 2(a) plus Line 2(b) less Line 2(c).

Line 4. For non-profit projects enter zero. For limited-dividend projects, enter lesser of Line 1 or Line 3. For profit-motivated projects, enter the amount on Line 1.

Line 5. For non-profit projects, enter the amount on Line 1. For profit-motivated projects, enter zero. For limited-dividend projects, enter Line 1 less Line 4.

(sample)

ABC Partnership
075 44001

SUPPORTING DATA REQUIRED BY HUD (Continued)Accrued taxes (Account 2150) :

| <u>Description</u> <u>of tax</u> | <u>Basis</u> <u>For Accrual</u> | <u>Period</u> <u>Covered</u> | <u>Date</u> <u>Due</u> | <u>Amount</u> <u>Accrued</u> |
|-------------------------------------|------------------------------------|---------------------------------|---------------------------|---------------------------------|
| | | | | \$ _____ |

Total (should agree with AC 2150) \$ _____

Compensation of partners

| <u>Name of</u> <u>Recipient</u> | <u>Official</u> <u>Title</u> | <u>Time</u> <u>Devoted to</u> <u>Business</u> | <u>Interest</u> <u>Owned</u> | <u>Amount of</u> <u>Compen-</u> <u>sation</u> | <u>Expenses</u> <u>and</u> <u>Allowance</u> |
|------------------------------------|---------------------------------|---|---------------------------------|---|---|
| | | | | | |

(Note: If compensation was not paid to partners, a statement to that effect will meet the requirement for this schedule.)

(sample)
 ABC Partnership
 075 44001

SUPPORTING DATA REQUIRED BY HUD (Continued)

| Year Ended (Date) | Assets | | | Accumulated Depreciation | | | Net | |
|-----------------------|----------------|-----------|-------------------|--------------------------|--------------------|-------------------|----------------|-------------------|
| | Balance (Date) | Additions | Deductions (Date) | Balance (Date) | Current Provisions | Deductions (Date) | Balance (Date) | Book Value (Date) |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Land | | | | | | | | |
| Land Improvements | | | | | | | | |
| Buildings | | | | | | | | |
| Building Equipment | | | | | | | | |
| Fixed | | | | | | | | |
| Building Equipment | | | | | | | | |
| Portable | | | | | | | | |
| Maintenance Equipment | | | | | | | | |
| Furniture | | | | | | | | |
| Other | | | | | | | | |
| Totals | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |

(sample)

STATEMENT OF RECEIPTS AND DISBURSEMENTS

Project No. _____
 Project Name _____
 For Year Ending _____

SOURCE OF FUNDS

Operations:

Revenues

Rental income \$ _____
 Other income (Detail) \$ _____ \$ _____

Expenses

Administrative expenses (Exclude Officer Salaries)

Management fees

Operating expenses

Payrolls

Maintenance expenses

Rental expenses

Taxes - Real Estate

Taxes - Other

Insurance

Interest on building loan

Mortgage Insurance Premium \$ _____ \$ _____

Cash provided by operations before amortization

Amortization of Mortgage \$ _____

Cash provided by operations after debt service

Other:

Tenant security deposits \$ _____ \$ _____

Ownership advances \$ _____

APPLICATION OF FUNDS

Reserve for replacements - funded

Tenant security deposits - funded

Increase in taxes and insurance escrow

Increase in mortgage insurance escrow

Officer Salaries

Disbursements not shown above (Detail) \$ _____

INCREASE IN CASH \$ _____

UNRESTRICTED CASH AT BEGINNING OF YEAR \$ _____

UNRESTRICTED CASH AT END OF YEAR \$ _____

LISTING OF IDENTITY OF INTEREST
COMPANIES & ACTIVITIES
DOING BUSINESS WITH OWNER/AGENT FYE 9/30/XX

| Company Name | Type of Service | Amount Received |
|-----------------|------------------|-----------------|
| Ed's Electric | Heavy Up Service | \$1000. |
| Mike's Painters | Decorating | \$500. |
| Pat's Plants | Landscaping | \$200. |
| Woody's Workers | Kitchen Repairs | \$300. |

Note to IAs: This listing is required by Handbook 4370.2 REV-1, Chapter 3 on Supporting Data for the Mortgagor's financial statements. It should include a listing of Identity of Interest companies doing business with the mortgagor or agent, along with a breakdown of services and amounts received. It is required if the payments for services performed for the project totalled \$1000 in the aggregate during the operating period. See Handbook 4370.2 REV-1 for a specific definition of what relationships constitute an Identity of Interest between owners, officers, directors, project staff members and lender/vendors

(sample)

ABC Partnership
075 44001

Certificate of Partners

We hereby certify that we have examined the accompanying financial statements and supplemental data of ABC Partnership and, to the best of our knowledge and belief, the same is complete and accurate.

General Partners

(Name)

(Date)

(Name)

(Date)

Partnership Employer Identification Number

(sample)

ABC Partnership
075 44001

Management Agent's Certification

We hereby certify that we have examined the accompanying financial statements and supplemental data of ABC Partnership and, to the best of our knowledge and belief, the same is complete and accurate.

(Name)

(Firm Name)

(Date)

CHAPTER 5. INSURED DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE

- 5-1 Program Objectives. Multifamily insured loans are an integral part of HUD's housing program which has the objectives of providing decent, safe, affordable and sanitary housing for low and moderate-income families. Through the insured multifamily project loan program, HUD insures mortgage repayments, thereby reducing investor risk and encouraging the availability of a money supply for the housing market. For the insured loan program, the project is ordinarily HUD's only source for loss recovery in the event of a foreclosure. Therefore, it is essential that collateral value is commensurate with the insurance risk.
- 5-2 Program Procedures. The cost certification is the basis for HUD's determination of the maximum insurable mortgage which is necessary before the project may proceed to final endorsement, a critical factor to multifamily projects. Effective dates for the determination of actual costs are usually the date of the final project inspection report showing final completion and the mortgagor's cost certification cut-off date. The HUD Field Office Manager has the option to set an earlier date to halt the unnecessary accumulation of certain costs. A reasonable time is set for submission of the cost certification which must be in the Field Office 30 days before final endorsement/closing.
- HUD expects completed certifications, fully documented and in the prescribed format to be submitted by the mortgagor. If an identity of interest exists between the mortgagor and the contractor, or if a cost plus type construction contract was used, the contractor is also required to submit a cost certification. Similarly, if an identity of interest exists between a subcontractor, materials supplier, or an equipment lessor, then a cost certification must be submitted. Additional support for any cost items questioned by HUD is expected within 15 days of the request. Extended delays in the cost certification process which postpone final endorsement can cause substantial harm to the project's viability and eventual success.
- 5-3 Reference Material. The IA should obtain and become familiar with the following HUD Handbooks. If not available

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

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

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

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

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

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

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

5-5 Compliance Requirements and Audit Area

A. Federal Financial Reports

1. Compliance Requirement. Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.
2. Suggested Audit Procedures
 - a. Identify all required financial reports by inquiry of the owner/manager.
 - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

- c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.
- d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.
- e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

B. Accounting System.

- 1. Compliance Requirement. Mortgagors and contractors involved in projects that are to receive HUD-insured loans have agreed to maintain adequate records for the purpose of determining the eligible costs associated with the projects (HUD Handbook 4470.2, Chapter 3).
- 2. Suggested Audit Procedures
 - a. Obtain an understanding of the mortgagor's and contractor's, accounting system for identifying actual costs associated with a given project. Test the system to determine that it identifies the costs to be reported on the Form HUD-92330 on an individual project basis.
 - b. Review Form HUD-92330 for completeness and support by the accounting records.
 - c. Trace significant data from Form HUD-92330 to supporting documentation, ie. worksheets, ledgers, etc. Report all material differences between the amounts reported on the Form HUD-92330 and the supporting documents.

C. Cut-Off Timing and Eligibility of Costs

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

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

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

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

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

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

2. Suggested Audit Procedures

- a. Review the trip report Form HUD-5379 or similar notification to determine the final completion date.
- b. Based on the completion date, the mortgagor/borrower determines the project's

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

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

D. Identity of Interest

1. Compliance Requirement. HUD Handbooks 4430.1 REV-1, 4470.1 REV-2 and 4470.2, Chapter 3, describe several situations which constitute an identity of interest involving a mortgagor, a contractor, a subcontractor, or a materials supplier. Where an identity of interest exists the contractor must also submit a Certificate of Actual Cost or the party involved in the identity of interest is required to submit additional documentation as required by 4470.2 Chapter 3. The contractor is also required to submit a Certificate of Actual Cost if a cost plus construction contract was used.
2. Suggested Audit Procedures
 - a. Review mortgagor and project records such as contracts and vendor invoices to determine if an identity of interest exists between any of the parties involved in the project, from mortgagors to contractors, suppliers and equipment lessors.
 - b. Where an identity of interest exists, determine that the additional reporting requirements of HUD Handbook 4470.2 have been met.

5-6 Illustrative Report

Report of Independent Certified Public Accountants

To the Partners
Sample Company

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

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

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

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

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

Certified Public Accountant

[date of audit]

SAMPLE COMPANY
PROJECT NO. XXX-XXXXX

NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies

Basis of Presentation

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

- a. Costs are to be exclusive of kickbacks, rebates or trade discounts.
- b. Financing charges are limited to the lesser of amounts actually paid, or amounts approved by HUD, on the Mortgagee's Certificate. For this project, the financing charges are the amounts actually paid.
- c. The statement of rental operations reflects the rental activity and operating expenses of the Project from August 28, 1995. The statement does not include depreciation and amortization expenses and certain other expenses which are not incidental to the rental operation of the Project.
- d. Project equity represents the difference between the funds received by the Project from Sample Company, and the costs incurred to develop the Project, and the income from the Project. Furthermore, Partnership (non-project) obligations are classified as project equity. Accordingly, Project equity is not intended to reflect the equity of the Partnership and the financial statements are not intended to represent those of the Partnership.

SAMPLE COMPANY
PROJECT NO. XXX-XXXX

NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies

Organization

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

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

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

- 6-1 Program Objective. The Government National Mortgage Association, also known as Ginnie Mae, is a wholly-owned Government corporation. Created by Congress in 1968, Ginnie Mae's mission is to support expanded, affordable housing in America by providing an efficient government-guaranteed secondary market vehicle linking the global capital markets with the federal housing market. It does this by facilitating secondary market activities for packaged residential mortgages. Through its well known mortgage-backed securities (MBS) and multiclass programs, Ginnie Mae creates a vehicle for channeling funds from the securities markets into the mortgage market and helps to increase the supply of credit available for housing.
- 6-2 Program Procedures. The parties involved in the MBS program are Ginnie Mae, the securities issuer, the securities dealer, the investor, a custodian of mortgage documents, a mortgage servicer (often the issuer) and perhaps a transfer agent. Once approved by Ginnie Mae, the issuer of the mortgage-backed securities is responsible for acquiring eligible mortgages, creating a pool of mortgages to be held by a custodian, issuing the securities backed by a pool of mortgages, arranging for the marketing of the securities, servicing the mortgages in the pool, administering the securities outstanding and making the full and timely payment of all amounts due to the investors. The issuer is responsible for using its own resources to cover shortfalls in amounts due to investors that result from mortgage delinquencies or foreclosures.

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

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

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

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

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

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

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

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

Supplemental Information:

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

- A. Audited Financial Statements . Issuers are required to submit audited annual financial statements which include a balance sheet, statement of operations, cash flow statement, notes to the financial statements, and supplemental schedules as stipulated in Chapter 2 of this guide. The financial documents are to be submitted to Ginnie Mae's Review Agent using the Transmittal/Checklist presented in Attachment F.
- B. Other Reports . In addition to the financial statements, all issuers must submit a report on internal controls, and a report on compliance with specific requirements. A sample report on consideration of internal controls and report of compliance with specific requirements are included in Chapter 2.

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

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

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

1. For issuers that make up 40 percent or more of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided: the consolidating schedules, which distinguish the balance sheet and operating statement of the Ginnie Mae issuer are included with the parent's audit. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent.
2. For an issuer whose equity is less than 40 percent of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided the conditions in item (1) above are met and the issuer's parent enters into a Corporate Guarantee Agreement (Agreement) with Ginnie Mae to guarantee the performance of the issuer. The parent must meet the terms and conditions of the Agreement for the issuer to remain in good standing with Ginnie Mae.

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

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

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

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

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

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

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

- D. Single Auditor Approach

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

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

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

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

6-5 Compliance Requirements and Suggested Audit Procedures

A. Federal Financial Reports

1. Compliance Requirement. Issuers participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.
2. Suggested Audit Procedures
 - a. Identify all required financial reports by inquiry of the issuer.
 - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.
 - c. Select a sample of financial reports, other than those which are included in the audited

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

- d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and issuer records.
- e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

B. Eligibility to Issue Mortgage-Backed Securities

- 1. Compliance Requirement. To be approved and maintain eligibility to issue Ginnie Mae-guaranteed mortgage backed securities and act as administrator of such securities, an applicant must meet and maintain the following requirements:
 - a. Be an FHA-approved mortgagee in good standing. A State or local government instrumentality that is an FHA-approved mortgagee is eligible. Mortgagees approved by FHA only as loan correspondents are not eligible to be Ginnie Mae issuers.
 - b. For issuers approved by Fannie Mae or Freddie Mac, a loss of either approval may cause the issuer to become ineligible to issue and service Ginnie Mae mortgage-backed securities.
 - c. Have as a principal element of its business operation the origination or servicing of mortgage loans.
 - d. Conduct its business operations in accordance with accepted sound mortgage lending and servicing practices, ethics, and standards, and have the experience, management capability, and access to adequate facilities necessary to assure Ginnie Mae of its ability to issue and service mortgage-backed securities. Except in instances where the issuer can demonstrate that an alternative arrangement constitutes a sound business practice, the issuer must have at least

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

- e. Maintain policies that prohibit any discrimination of a borrower based on race, religion, color, sex, national origin, age, familial status or disability. The issuer shall comply with any applicable rules, regulations, and orders of general applicability issued under Title VI of the Civil Rights Act of 1964; Executive Order 11063, Equal Opportunity in Housing, issued November 20, 1962; Title VII of the Civil Rights Act of 1968, as amended; and with applicable rules and regulations of the Federal Housing Administration. Moreover, this section incorporates by reference section 202 of Executive Order 11246, Equal Employment Opportunity, issued on September 24, 1965, as amended. The issuer is required to comply with the implementing rules and regulations of the Department of Labor (41 CFR Part 60-1) and the Department of Housing and Urban Development (24 CFR Part 130).
- f. Have and maintain fidelity bond coverage and a mortgage servicing errors and omissions policy based on the issuer's total servicing portfolio in accordance with HUD Handbooks 5500.1, Chapter 2 and 5500.2, Chapter 3, which names Ginnie Mae as loss payee.
- g. Maintain a net worth based on an audited financial statement prepared in accordance with generally accepted accounting principles in assets acceptable to Ginnie Mae, as outlined in Section G. 2. of this Chapter.

2. Suggested Audit Procedures

- a. Determine that the issuer meets requirements covered in Section 6-5, paragraph B. above.
- b. Test whether the issuer has and follows an established policy which prohibits discrimination in housing and lending as provided by HUD Handbooks 5500.1, Chapter 2, 5500.2, Chapter 3 and Section 1-10 of this guide.
- c. Recompute the issuer's required fidelity bond and mortgage servicing errors and omissions coverage policy at the end of the fiscal year in accordance with Handbooks 5500.1, Chapters 2 and 6, and 5500.2, Chapter 3. Verify that Ginnie Mae is named as the loss payee. Also inquire that the required levels of insurance were maintained throughout the year, with testing of the adequacy of insurance at least on a quarterly basis. Also verify that the fidelity bond and errors and omissions policies are written by an insurance carrier which has a Best's rating of B+ or better, and is specifically licensed or authorized by law to transact business with the state or territory where the name insured has its corporate headquarters. Lloyd's of London, although not rated, is an acceptable insurer.

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

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

- (3) For issuers with a total mortgage servicing portfolio of more than \$500 million and up to \$1 billion: \$900,000, plus 0.125 percent of the amount of total servicing in excess of \$500 million.
- (4) For issuers with a total mortgage servicing portfolio of more than \$1 billion: \$1,525,000, plus 0.1 percent of total servicing in excess of \$1 billion.

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

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

- d. Determine whether the issuer is an affiliate (parent, subsidiary, or related party) of any other Ginnie Mae issuer(s). All affiliated Ginnie Mae issuers should be identified in the auditor's verification of insurance. If an affiliate(s) is covered by the same insurance policy, then the servicing of each issuer must be added to calculate the combined total servicing portfolio. The amount of this combined servicing portfolio should be used to determine the minimum required insurance coverage.
- e. Compare the issuer's adjusted net worth (net worth reported in the audited financial statements as adjusted for any Ginnie Mae unacceptable assets) to the minimum required net worth as discussed in Section 6-5, paragraph G.2 of this Chapter.

C. Review of Custodial Documents

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

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

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

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

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

2. Suggested Audit Procedures

- a. Determine if the issuer uses more than one custodial institution. If more than one custodian is used, at least one custodial institution must be reviewed each year and all custodial institutions must be reviewed within a three year cycle. Determine that the custodial institution meets the following eligibility requirements.
 - (1) Is a federally regulated financial institution in good standing with its primary regulator, and not in receivership, conservatorship, liquidation or any other

- management oversight by its primary regulator, unless operating under an approved management plan.
- (2) Maintains a secure, 1 and 1/2 hours fire resistant storage facility with adequate access controls.
 - (3) Utilizes knowledgeable employees in its custodial function to handle mortgage documents and perform custodial functions.
 - (4) Maintains for review annual financial statements audited by an independent auditor for itself or its parent.
 - (5) Maintains the minimum insurance requirements of its primary regulator and maintains coverage to indemnify against losses involving Ginnie Mae pools and loan documents custody.
 - (6) Maintains updated written procedures within its operation, in addition to the Document Custodian Manual.
 - (7) Satisfies eligibility requirements and other requirements as directed by Ginnie Mae.
 - (8) Self custodial issuers must maintain a separate trust department which is physically separate from the servicing area and operations. It must also have obtained prior approval to exercise fiduciary powers from its primary regulator. Such fiduciary powers must include ordinary trust services such as personal trust services, personal representative services (executor), guardianship, custodian services and/or investment advisory services offered to the public and not be limited to maintaining custody of valuable documents for Ginnie Mae issuers. The trust service function must be subject to periodic review or inspections by its primary regulator.

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- (9) If custody is by an affiliate, the custodial institutions must either meet all the requirements in paragraph C.2.a.(8) above, or if the custodial documents are not held in the trust department, the custodian must provide evidence that there is a vertical independence between the issuer and the custodial/warehouse institution.
- b. Verify that the custodial institution maintains or performs the following inventory accounting requirements:
- (1) Maintains an Issuer Master File which contains the Issuer Custodial Register, any blanket legal opinions, copy of the issuer's corporate resolution for a name change, and any other applicable issuer level documents.
 - (2) Maintains an Issuer Custodial Register which includes a list of pools currently in custody (must provide pool identification numbers), the actual and/or due dates for final certification and recertification, and a count of the total number of pools in custody.
 - (3) Maintains a Pool Master File for each pool in custody which contains a copy of the Master Custodial Agreement, Schedule of Pooled Mortgages, form HUD 11711B (Certification and Agreement), form HUD 11711A (Release of Security Interest) if applicable, original blanket interim assignment(s) (a copy of which is included in each individual loan file to which the blanket interim assignment applies), copies of opinion(s) from qualified outside legal counsel (originals maintained in the issuer master file), original pool level waiver letters from Ginnie Mae, and all forms HUD 11708 (Request for Release of Documents) for liquidated release codes.
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- (4) Has performed an Annual Physical Inventory of all pools held for the issuer, which will include at a minimum a reconciliation of the pool numbers on the issuer custodial register to a current issuer provided listing of pools, and the pool numbers on the issuer custodial register agree to the pool master files in custody.

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

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

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

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

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

and/or

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

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

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

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

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

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

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

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

- e. For sampled mortgages, review the custodial files for the following documents and compare the information shown on these documents to the information on the Schedule of Pooled Mortgages. Procedures for the custodian document review are contained in Paragraph 8-4 and Appendix 77 of Ginnie Mae Handbook 5500.1 and Paragraph 7-5 and Appendix 53 of Ginnie Mae Handbook 5500.2. Reconcile and report on any differences.
 - (1) The original note or other evidence of indebtedness endorsed in blank and without recourse.
 - (2) An assignment to Ginnie Mae of the mortgage or other security instrument in recordable form but not recorded. The assignments to Ginnie Mae can be in blanket form. The blanket assignments must apply to mortgages in the same pool and same recording jurisdiction. If the pool was issued after March 31, 1979, and if the mortgage was originated by a mortgagee other than the issuer, there also must be a recorded assignment, if state law requires recordation in order to make the assignment valid against all lien holders from the originating mortgagee to any intervening interest holder and from such holder to any further holders of mortgage ownership. An assignment to the issuer must immediately precede the unrecorded assignment to Ginnie Mae. These interim assignments must be either originals or certified copies of the originals and, if required by state law to assure validity, be either recorded or certified by the issuer to have been transmitted for recordation.
- f. Determine that within 12 months of the issuance of the securities, transfer of issuer and/or

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

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

- (1) Original evidence of insurance or guaranty signed by FHA, VA or RHS. If the loan is a VA vendee loan or contract, there will not be evidence of guaranty. If evidence of insurance or guaranty is not on file, determine from the issuer why the required documents are missing. Loans that cannot be insured or guaranteed must be withdrawn from the pool but only after obtaining Ginnie Mae's approval.
- (2) Original recorded mortgages (or other security instruments) signed by the mortgagor securing repayment of the indebtedness. (NOTE: Compare the mortgagor's name as it appears on the Schedule of Pooled Mortgages with that which appears on the recorded mortgage to assure identity). Copies of the recorded mortgage are acceptable if the copies clearly show the document recording information.
- (3) Evidence that a mortgagee title insurance policy has been obtained or other evidence of the title's acceptability to FHA, VA or RHS (not required in cases involving conveyance of HUD Secretary-owned property, if an exception has been authorized by Ginnie Mae, or VA vendee loans or contracts). Copies of mortgagee title insurance policies are acceptable.
- (4) A complete chain of original recorded interim assignments. These are not required if the mortgage is retained by the original lender. Copies of the recorded interim assignments are acceptable if the

copies clearly show the document recording information.

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

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

- (6) An updated endorsement on the promissory notes;
- (7) A recorded assignment of the mortgage to the issuer, and
- (8) All documents required in paragraphs C.2.d and C.2.e above are in the custodial files.

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

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

- g. Determine that documents and/or loan files released from custodial files are evidenced by a Request for Release of Documents (form HUD 11708). For the sampled mortgages:
 - (1) Ascertain whether the custodian is in possession of a form HUD 11708 for documents and/or files removed from the custodian's care.
 - (2) Prepare a list of missing documents and/or loan files not supported by a form HUD 11708. This listing should be reviewed with the custodian and subsequently with

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

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

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

- I. In lieu of an on site audit of the document custodian, the following procedures are acceptable, provided the conditions set forth in section C.1. above have been met.
- (1) Confirm that the document custodian meets all the eligibility requirements as stated in Section 6-5, paragraph C.2.a. above. A written certification from the document custodian that it meets all eligibility requirements is acceptable.
 - (2) Confirm that the document custodian maintains or performs the required inventory accounting required in Section 6-5, paragraph C.2.b. above. A certification from the document custodian that it (I) maintains the Issuer Master File for the issuer, (ii) maintains a Pool Master File for each pool in custody for the issuer, (iii) has performed and provided the date of the Annual Physical Inventory for all

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

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

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

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

D. ISSUER'S ADMINISTRATION OF POOLED MORTGAGES

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

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

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

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

2. Suggested Audit Procedures

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

- b. Review monthly collections of mortgage principal and interest and collections of claims on defaulted and liquidated mortgages to ascertain that funds have been deposited in the proper custodial accounts on a daily basis.
- c. Test whether the issuer is making payments of interest, principal, and unscheduled principal to securities holders by the 15th of the month. Test whether partial prepayments, prepayments in full, assignments, and foreclosures are passed through to the securities holders in the regular monthly payment following the month of receipt. Test that all such recoveries are recorded on Mortgage-Backed Securities report controls and the pool collateral is removed from the custodian's possession and the transaction is supported by documentation.
- d. Test whether disbursements from principal and interest custodial bank accounts are authorized pursuant to the Guaranty Agreement.
- e. Test whether the issuer is disbursing payments to Ginnie Mae I securities holders on a date that can be expected to result in receipt of the funds by the securities holders by the 15th of the month.
- f. Review a representative sample of payments to securities holders to determine that such payments were made to those shown in the securities holders register for the pools being tested.
- g. Compare mortgages listed in the issuer's Liquidation Schedule (Form HUD-11710E) to those identified on Form HUD-11708 held by the custodian as having been withdrawn from the pool to ensure proper pass-through of proceeds to securities holders.
- h. Test whether the issuer is using its own resources to:
 - (1) Make advances to the pool accounts to cover shortfalls in collections from mortgagors.

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

- (2) Cover principal amounts not recovered in claim settlements or which are due in connection with defective loans. (Issuers are required to "buy out" uninsured or otherwise defective loans from the pools in accordance with instruction in the Handbooks Ginnie Mae 5500.1 and 5500.2 using the issuer's own funds and only after receiving Ginnie Mae approval.)
- I. Obtain an understanding of the issuer's controls to project the need for and availability of funds. These controls should allow the issuer to make required advances to securities holders, as required under Section 4.02 of the Guaranty Agreement.
- j. Test whether the issuer incurred losses for pooled loans not fully insured such as coinsured multifamily loans, manufactured housing loans, and Department of Veterans Affairs guaranteed loans. Determine that the issuer has disclosed a contingent liability in the financial statements.
- k. Test that the issuer has a system to follow up on and obtain the required documents to enable the custodian to make its final certification in a timely manner. Ginnie Mae must receive the final certification, covering documents listed on the reverse side of the Schedule of Pooled Mortgages, within the timeframes identified in Handbooks Ginnie Mae 5500.1 and 5500.2.

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

- l. Test whether the issuer established a complete securities holders register in accordance with Ginnie Mae instructions and updated the register prior to paying holders each month. The register should include a record of all certificate transfers for the life of the pool.
- m. Test whether the issuer is servicing delinquent mortgages and managing foreclosures and assignments in accordance with the applicable requirements of the VA, FHA, RHS and the Ginnie Mae Guide.
- n. Test whether undelivered payments are deposited into the principal and interest custodial account and that checks which remain outstanding in excess of 6 months of the payment date are stopped and the funds are returned to the P&I custodial account. Undelivered payments should not be used as excess funds or used by the issuer to fund pool shortfalls.
- o. Test whether any transfer of the P&I or T&I custodial accounts, change of document custodian, change of mortgage servicer or transfer of issuer responsibility was accomplished after written approval from Ginnie Mae.

E. Review of Monthly Accounting Reports and Quarterly Submissions

- 1. Compliance Requirement. Ginnie Mae issuers of MBS are required to submit the following reports periodically throughout the year:
 - a. Form HUD-11710A, Form HUD-11710D and Form HUD-11710E
Issuers reporting: All Ginnie Mae issuers of record
Frequency of reporting: Monthly
Deadline for submission: 10th day of following month
 - b. Trial Loan Balance Information
Issuers reporting: All Ginnie Mae issuers of record

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

- c. Mortgage Bankers Quarterly Financial Reporting,
Form HUD-11750
Issuers reporting: Mortgage bankers not
federally regulated
Frequency of reporting: Quarterly
Deadline for submission: 60 days after end of
calendar quarters and 90 days after end of
calendar year
- d. Issuers must report to Ginnie Mae monthly on
each pool. Such reports must be provided on
Form HUD-11710A (Issuer's Monthly Accounting
Report), Form HUD-11710E (Liquidation Schedule)
and Form HUD-11710D (Issuer's Monthly Summary
Report). Issuers with more than 100 pools
(including Ginnie Mae I pools and Ginnie Mae II
pools and loan packages) are required to report
in electronic form using the procedures and
format specified in Handbook 5500.1, Chapter 11.

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

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

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

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

2. Suggested Audit Procedures

- a. Obtain an understanding of the issuer's procedures for collecting and entering all data relating to mortgage collections and securities payments on Form HUD-11710A. Test whether entries are made in accordance with instructions in the Ginnie Mae Handbooks.
- b. Select a sample of Form HUD-11710A's and trace delinquency information to the issuer's internal mortgage servicing delinquency reports.
- c. Compare the securities balance reported on the Form HUD-11710A to the Remaining Pool Balance (R.P.B.) reported to Ginnie Mae, or its agent, in accordance with Ginnie Mae MBS requirements.
- d. Test whether a Liquidation Schedule (Form HUD-11710E) is submitted to Ginnie Mae for each loan removed from the pool. Also, test that the unpaid loan balances passed through to securities holders and reported in the Liquidation Schedule, agree to the issuer's records.
- e. Compare the amount of checks sent to securities holders for the month to the amount reported to Ginnie Mae.
- f. Compare the custodial account balances reported on Forms HUD-11710A and 11710D to the actual balances (after reconciliation) of the disbursement clearing and custodial bank accounts as shown by the bank statements.

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

- (1) Pool Principal Balance (Section 1, Line D, Form HUD-11710A)
- (2) (plus) Prepaid Principal (Section 1, Line F)
- (3) (minus) Delinquent Principal (Section 1, Line G)
- (4) (minus) Concurrent Date (CD) Pools Only: Scheduled Principal (Section 1-A, Block C)
- (5) (plus) CD Pools Only: Last Liquidation Principal Installment (Principal portion of last installment reported on Liquidation Schedule, Form HUD-11710E)
- (6) (minus) CD Pools Only: Additional Principal Adjustment or FIC change for Graduated Payment Mortgage Pools (Section 2, Block D, Other)
- (7) (equals) Security Principal Balance (Section 3, Line D)

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

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

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

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

- (1) (IR only) plus payment to securities holders, to be distributed on the 15th of the following month. (Form HUD-11710A, Section 2, Item G).
- (2) (IR and CD) plus servicing fee, if taken after the cut-off date. If the issuer withdraws it servicing fee prior to the cutoff, this entry will be zero (Section 1, Item H).
- (3) (IR and CD) plus prepaid P&I, funds which have been collected but are not required to be distributed to holders at the next payment date (Section 1, Item F, Total).
- (4) (IR and CD) minus prepaid servicing fee, as calculated based on prepaid interest amounts (Section 1, Item F, Interest). Servicing fees collected on prepaid interest are already included in item (2) above.
- (5) (IR and CD) minus delinquent P&I, funds not yet collected but which have already been distributed to holders through calculation of scheduled payment (Section 1, Item G, Total).

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- (6) (IR and CD) plus delinquent servicing fee as calculated based on total delinquent interest (Section 1, Item G, Interest). Servicing fees are not distributed to holders, so this amount is not a shortage in the account.
 - (7) (CD only) plus additional principal payments. These are funds collected but not due holders until the 15th of the following month (Section 1, Line B-2).
 - (8) (CD only) plus additional principal adjustment, the issuer-funded adjustment which has been deposited to the custodial account but is not distributed until the following month (Section 1, Line C, Pool Interest).
 - (9) (CD only) plus liquidation principal. Similarly, funds collected but not due to be distributed until the following month (Section 1, Item C).
 - (10) (CD only) plus fixed installment on liquidations, because it is necessary to amortize a liquidating loan through one payment beyond the month during which pay-off or foreclosure funds are received on CD pools. This "extra" month payment, normally not due until the following month, is included in the scheduled P&I amount.
 - (11) (CD only) minus servicing fee from liquidations, as calculated on the interest portion of the last payment installment (based on last interest installment on the Form HUD-11710E).

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

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

delivery requirement by the tenth calendar day of each month.

- j. Test that loan level information is being reported quarterly to Ginnie Mae.
- k. For all issuers that are not federally regulated financial institutions, test that quarterly financial information is being submitted on the HUD-11750, a formatted disk.

F. Securities Marketing and Trading Practices

- 1. Compliance Requirement. Ginnie Mae has established securities marketing and trading requirements which are intended to assure that issuers carry out their securities marketing and trading activities in a manner consistent with prudent business practices and their own and others financial capacity. There are three components to these requirements: (a) a suitability rule, (b) prudent business practice rules, and © minimum forward delivery contract requirements relating to so-called mark to market deposit requirements. There also are recordkeeping and reporting requirements. These procedures must be implemented by all approved issuers, whether or not securities and/or commitments are outstanding. The applicable requirements are found in HUD Handbook 5500.1.
- 2. Suggested Audit Procedures
 - a. Obtain an understanding of the written procedures established by the issuer to determine the financial integrity of dealers, brokers, and investors, including an explanation of standards for, and steps taken in determining the financial capacity of dealers, brokers, or investors to complete transactions.
 - b. Test whether the issuer is following established procedures to determine the financial capacity of dealers, brokers, and investors to complete a transaction and to determine the business reputation of the dealers, brokers, and investors.

-
- c. Obtain copies of the resolution executed by the issuer's Board of Directors designating key persons responsible for overall supervision of issuer activities relating to the marketing and trading of securities.
 - d. Obtain an understanding of the procedures established by the issuer to maintain a record of all commitments entered into to deliver or acquire securities.
 - e. Test whether the issuer's records of such commitments include the following:
 - (1) Date of the transaction (trade date).
 - (2) Type of securities.
 - (3) Nature of the transaction: purchase, sale, optional or mandatory delivery, repurchase or other credit arrangement.
 - (4) Settlement date.
 - (5) Dollar amount of securities.
 - (6) Interest rate on the securities.
 - (7) "Price" of the securities.
 - (8) Name of the firm and individual with whom the transaction was executed.
 - (9) Current market price (value) of the contract.
 - f. For "regulated transactions" (see Note 1 at step h.) test whether the issuer's records include the following:
 - (1) A copy of the delayed delivery contract required by the Ginnie Mae Handbook.
 - (2) The name of the financial institution with which collateral is, or will be, deposited.
-

- (3) Records of mark to market computations, including: market value, amounts of deposits by issuer and by contra-party, type of collateral deposited.
 - (4) If the collateral used is a letter of credit, a copy of the letter of credit.
- g. Review the issuer's statement showing the computation of the issuer's "net position" and compare information to the issuer's accounting records. Prove the mathematical accuracy of the net position. The statement should identify amounts of loans and securities closed and held for sale, plus those expected to be acquired, less commitments the issuer has available for disposing of loans and securities. It also should include any positions involving repurchase, reverse-repurchase, or other credit transactions.
- h. Determine the potential impact on an issuer's net worth of any identified forward or future commitment contract entered into by the issuer to purchase or sell securities, if there are material potential effects on the issuer's net worth, determine whether they are disclosed in the appropriate footnotes to the financial statements.

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

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

-
- (2) A sale of securities guaranteed by Ginnie Mae and based on construction loans (construction loan securities) or project loans (project loan securities).
 - (3) A sale or purchase of securities pursuant to a contract which does not obligate the issuer to actually sell/purchase securities, that is, a put or call transaction in which the issuer has the option to perform.
 - (4) A purchase (or sale) of mortgage participation certificates directly from (or to) the Federal Home Loan Mortgage Corporation.

G. Adjusted Net Worth

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

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

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

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

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

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

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

2. Required Net Worth. Required Net Worth will be calculated as of the end of the issuer's fiscal year as follows:
 - a. For issuers approved to securitize mortgage-backed securities pools backed by single family level payment, graduated payment, growing equity or adjustable rate mortgages, the net worth is: \$250,000 base net worth plus one percent of the amount of securities outstanding in excess of \$5 million, but less than \$20 million; plus 0.2 percent of any additional securities, commitment authority and total pools funded ² in excess of \$20 million.
 - b. For issuers approved to securitize mortgage-backed securities pools backed by manufactured home loans, the net worth is: \$500,000 base net worth plus 0.2 percent of any additional securities, commitment authority and total pools funded in excess of \$35 million.
 - c. For issuers approved to securitize mortgage-backed securities pools backed by multifamily construction or permanent loans, the net worth is: \$500,000 base net worth plus 0.2 percent of any additional securities, commitment authority, total pools funded and dollar amount of unexpended construction loan draws ³ in excess of \$35 million.

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

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

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

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:
 - o A construction loan receivable, secured by a first mortgage, from a related entity.
 - o 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.
 - o A receivable from a related party where the affected parties have executed a cross-default agreement⁴ or corporate guarantee agreement⁵ with Ginnie Mae.
3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest⁶ unrelated to that person's position as an officer or stockholder of the mortgagee.

⁴A 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.

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

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

-
4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity, as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.
 5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.
 6. The value of any servicing contract not determined in accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities and SFAS No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent revisions thereto.
 7. Any asset not readily marketable and for which appraised values are very subjective. Examples include, but are not limited to, antiques, art work, and gemstones.
 8. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.
 9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.
 10. Any asset which is principally used ⁷ for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes automobiles and personal residences.
 11. "Other Assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or a schedule prepared by the issuer/mortgagee and signed by an officer of the issuer/mortgagee.

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

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

ATTACHMENT BREQUIRED FORMAT FOR PRESENTATION OF ADJUSTED NET WORTH
CALCULATION FOR ISSUERA. Adjusted Net Worth Calculation :

| | |
|---|----------|
| Stockholders Equity per Statement of Financial Condition at end of reporting period | \$ _____ |
|---|----------|

Less:

| | |
|--|----------|
| Itemized Unacceptable Assets ^{1/} | |
| 1. | \$ _____ |
| 2. | \$ _____ |
| 3. | \$ _____ |
| Total Unacceptable Assets | \$ _____ |

| | |
|--------------------|----------|
| Adjusted Net Worth | \$ _____ |
|--------------------|----------|

B. Required Net Worth Calculation :

| | |
|--|----------|
| Unpaid Principal Balance of Securities Outstanding (Note: Number of Pools _____) | \$ _____ |
|--|----------|

Plus:

| | |
|---|----------|
| Outstanding Balance of Commitments Authority Issued and Requested | \$ _____ |
|---|----------|

| | |
|--|----------|
| Total Outstanding Portfolio and Authority | \$ _____ |
|--|----------|

| | |
|--------------------|----------|
| Required Net Worth | \$ _____ |
|--------------------|----------|

| | |
|---|------------------------|
| C. <u>Excess (Deficit) Net Worth</u> | \$ _____ ^{2/} |
| (Adjusted Net Worth - Required Net Worth) | |

^{1/} Unacceptable assets are defined in Attachment A.

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

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

A. Adjusted Net Worth Calculation :

| | |
|---|----------|
| Stockholders Equity per Statement of Financial Condition at end of reporting period | \$ _____ |
| Less: | |
| Itemized Unacceptable Assets ^{1/} | |
| 1. | \$ _____ |
| 2. | \$ _____ |
| 3. | \$ _____ |
| Total Unacceptable Assets | \$ _____ |
| Adjusted Net Worth | \$ _____ |

B. Comparison of Net Worth Calculations :

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

C. Excess/(Deficit) : \$ _____

^{1/} Unacceptable assets are defined in Attachment A.

ATTACHMENT D

REQUIRED FORMAT FOR PRESENTATION OF INSURANCE REQUIREMENT

A. Identification of Affiliated ^{1/} Ginnie Mae Issuers :

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

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

B. Required Insurance Calculation :

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

C. Verification of Insurance Coverage :

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

D. Excess (Deficit) Insurance Coverage :

| | |
|--|----------|
| Fidelity Bond Coverage | \$ _____ |
| Required Mortgage Servicing Errors and Omissions Coverage | \$ _____ |

E. Ginnie Mae Loss Payable Endorsement :

Fidelity Bond Coverage \$ Yes/No

Mortgage Servicing Errors and
Omissions Coverage \$ Yes/No

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

ATTACHMENT EREPORT OF INDEPENDENT AUDITORS ON CONSOLIDATING
BALANCE SHEET AND STATEMENT OF INCOME

Board of Directors
ABC Financial Corporation

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

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

[Firm Signature]

[Date]

REQUIRED TRANSMITTAL/CHECKLIST FOR
ANNUAL SUBMISSION OF FINANCIAL DOCUMENTS

Address to: Ginnie Mae's Review Agent

To whom it may concern:

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

Complete Items 1 through 7

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

Place a Checkmark by Item(s) Submitted

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

Signature: _____ Date: _____

Type of Print Signature Name: _____

Title: _____

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

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

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

7-3 Reference Material

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

| | |
|------------------------------|--|
| Mortgagees Letters | Various |
| HUD Handbook 4000.2 REV-1 | Mortgagee's Handbook-Application Through Insurance (Single Family) |
| HUD Handbook 4000.4 | Single Family Direct Endorsement Program |
| HUD Handbook 4060.1 | Mortgagee Approval and Recertification |
| HUD Handbook 4060.3 | Field Office Guide for Mortgagee Monitoring |
| HUD Handbook 4110.2 | Mortgagee's Guide-Home Mortgage Insurance Fiscal Instructions |
| HUD Handbook 4155.1 | Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties |
| HUD Handbook 4205.1 | Single Family Coinsurance Program |
| HUD Handbook 4330.1 | Administration of Insured Home Mortgages |
| HUD Handbook 4330.4 | FHA Single Family Insurance Claims |
| HUD Handbook 4350.4 | Multifamily Mortgagees |
| 7-4 | <p><u>Reporting Requirements</u> . A Title II, nonsupervised mortgagee or loan correspondent is required by 24 CFR Part 202 annually to submit an audit report to the Commissioner within 90 days of the close of its fiscal year. The audit shall be performed under <u>Government Auditing Standards</u> and shall include the auditor's report on the basic financial statements and a computation of the mortgagee's Adjusted Net Worth. These reports are required for <u>every</u> Title II nonsupervised mortgagee or loan correspondent regardless of the number of loans originated or serviced during the fiscal year. <u>All</u> instances of noncompliance identified by the auditor must be reported as findings, even in those cases where corrective action was taken by the auditee after the end of the fiscal year. A suggested format for the computation of Adjusted Net Worth and the list of unacceptable assets are shown in paragraph 7-6 of this chapter.</p> |

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

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

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

Mailing address:

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

Delivery:

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

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

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

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

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

7-5 Compliance Requirements and Audit Areas

A. Quality Control Plan

1. Compliance Requirement

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

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

2. Suggested Audit Procedures

- a. Obtain a copy of the mortgagee's quality control plan and compare it to the general and specific requirements contained in Handbook 4060.1.
- b. Determine whether the mortgagee has a procedure in place which assures that all employees involved in loan origination and servicing understand the mortgagee's quality control policies and procedures.
- c. Inquire whether the mortgagee relies on an internal or external quality control review of its origination, underwriting, and servicing functions. If the mortgagee relies on the external review process and the IA's engagement includes the performance of the quality control review, the IA should report this as part of the additional information required under Chapter 2 of this guide. If the mortgagee relies on an internal review, determine that it was performed by knowledgeable personnel with no direct responsibilities in the areas they reviewed.
- d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample in accordance with guidance in HUD Handbook 4060.1. It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review as required by HUD Handbook 4060.1 and that the plan includes coverage for any loan correspondents and authorized agents of the mortgagee.
- e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4060.1 REV-2, Chapter 9 were included in the quality control review. The Quality Control Plan must provide for the written reverification of the mortgagor's

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

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

B. Branch Office Operations

- 1. Compliance Requirement. A mortgagee may maintain one or more branch offices for the submission of applications for mortgage insurance. A traditional branch office is a separately located unit of the mortgagee, in an office in which no business except that of the mortgagee is conducted. It may be located in the mortgagee's home office. In addition, a mortgagee may register a branch office that does not meet the requirements of a traditional branch office (non-traditional branch office). The mortgagee may determine the location and type of its branch office facilities. The non-traditional branch office facility may be located in either commercial or non-commercial space. Each branch office must be registered by HUD. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR Subsection 202.5(k) (HUD Handbook 4060.1 Chapter 5).
- 2. Suggested Audit Procedures
 - a. Determine that all branches are registered with HUD by review of the appropriate form or screen printout.
 - b. Through inquiry and/or physical observation, determine that the branch is a true branch and is not a subsidiary, net branch, independent contractor, agent of the auditee or separate

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

- c. Review auditee payroll records for indications of any branch office personnel, except the receptionist that are not employed exclusively for the auditee at any given time. Inquire of personnel to determine that branch employees conduct only the business affairs of that entity during normal business hours.
- d. Determine that the branch office is located in space which is separated by a partition from any other entity and is clearly identified to the public and that the branch office's operating costs are paid by the approved mortgagee or loan correspondent.
- e. Review company records for evidence that the present branch office manager is a corporate officer or an employee authorized to bind the corporation in matters involving loan origination and servicing and manages only one branch.

C. Loan Origination

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

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

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

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

2. Suggested Audit Procedures

- a. Obtain an understanding of the auditee's procedures for processing loan applications. Determine that the auditee's procedures provide that applicant's credit report, employment verification, and verification of deposits are sent directly to the auditee and do not pass through any third party.
- b. Obtain a sample of files for loans originated during the audit period to test areas c-f, which follow. This should include loans originated at the auditee's branch offices and by their loan correspondents as well as the central office. Where an auditee uses an independent third party to perform quality control over loan origination, the IA may rely on the testing of loan files performed by the independent third party, provided the IA has reviewed the independent reviewer's procedures, retested some of the same files chosen for testing, and the independent written reports indicate no significant discrepancies were identified.
- c. Review loan file documentation for evidence that a face-to-face interview with the loan applicant was conducted by a company employee and that the

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

- d. Review all files in the sample for any forms that have been signed by the mortgagee but not completed by the applicant.
- e. Determine that all employment and income data is supported by a verification of employment or other sources, especially for self-employed applicants and applicants with non-employment income. Review loan file documentation for evidence that the mortgagee reconciled any conflicting information prior to submitting the application package to the HUD Field Office for endorsement.
- f. Test that the applicant's cash assets, source of funds, and liabilities are supported by documentation such as verifications of deposits, gift letters, etc., and credit reports.
- g. Obtain a sample of files for rejected loans during the audit period. Review for the following:
 - (1) Determine that an individual review was provided for all applications denied due to a statistical category or score (e.g. credit score, debt/income ratio). Ensure that the score accurately reflected the financial status (e.g. loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.
 - (2) Determine that the rejection was made based on established criteria and the reason for the rejection was provided to the applicant. Ensure that all procedures for accepting and processing the loan were followed.

- h. Test whether loan correspondents are selling mortgages to other than their sponsors without prior HUD approval. In connection with the Direct Endorsement Program, to determine that the loan correspondent does not underwrite loans, review selected loan documentation for indications of underwriting by the loan correspondent.
- i. Review the agreements between the auditee and its staff appraisers and test for compliance with Handbook 4000.4 REV-1, Chapter 2.

D. Loan Settlement

- 1. Compliance Requirement. The mortgagee's responsibilities prior to and following loan settlement are minimal. The loan origination fee should normally compensate the mortgagee for the required services. However, HUD has specified the types and amount of additional charges and fees which the mortgagee may collect from the borrower. Additionally, the mortgagee is responsible for promptly submitting up-front mortgage insurance premiums to HUD following loan settlement and disbursing the funds and completing the transaction in accordance with the closing documents, without undue delay (HUD Handbook 4000.2 REV-1, and Chapter 7, 24 CFR 203.27).
- 2. Suggested Audit Procedures
 - a. Select a representative sample of loans for testing from those settled during the audit period.
 - b. Examine the signed settlement statement (Form HUD-1). Prove the mathematical accuracy of the Form. Compare amounts listed in the Form to other authentic loan documents.
 - c. Review the fees and charges collected from the mortgagors as shown on loan settlement statements to determine that they are equal to the mortgagee's actual out-of-pocket costs for the related service or the maximum charge allowed by HUD, whichever is lower. Determine

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

- d. Ensure points and closing costs are accurate. Determine whether the differences may be due to discriminatory practices.
- e. Review computations and supporting data for amounts collected to establish escrow accounts for taxes and hazard insurance. Reconcile and report on any differences.
- f. Review computations and supporting data for interest collected from the mortgagor at loan closing. Reconcile and report on any differences.
- g. The Form HUD-92900 contains the acquisition cost of the property. The HUD-1 contains the amount of the insured mortgage. Compare the amount of the insured mortgage to the acquisition cost to determine that the mortgagor made the minimum investment.
- h. Examine the canceled check or other supporting documentation for evidence that the mortgage insurance premium is submitted to HUD, in accordance with HUD policy at the time of closing, by the mortgagee. Test that payment reached HUD's depository within 15 days of closing.
- i. Compare the purchase contract and the HUD-1 for agreement as to sales price, earnest money and any seller concessions.

E. Loan Servicing

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

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

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

2. Suggested Audit Procedures

- a. Select a sample of delinquent and defaulted loans including loans in foreclosure for testing the mortgagee's loan servicing procedures.
- b. Review the loan file documentation for evidence that the auditee documents its records to reflect its servicing on delinquent and defaulted mortgages.
 - (1) Obtain an understanding of the auditee's servicing procedures.
 - (2) Ascertain whether the auditee maintains individual servicing records documenting collection (loan servicing) activities.
 - (3) Review the servicing records for recorded collection contacts attempted and completed.
- c. Review selected loan file documents for evidence that the auditee communicates with the mortgagor or makes a reasonable effort to do so in order to determine the cause of default.
 - (1) Review the individual loan servicing records for recorded collection contacts of more than one type (i.e., telephone, letter, face-to-face interview, etc.) if one type of contact effort is unsuccessful.
 - (2) Review the individual loan servicing records for mortgagor explanations of defaults and documented attempts by loan

servicing personnel to contact the mortgagors.

- (3) Based on the review of the individual loan servicing records, when the cause of delinquency appears to be temporary (i.e., illness, unemployment) test whether the auditee offers reasonable repayment plans.
- d. Review selected receipts for evidence that the auditee accepts partial or late mortgage payments offered by mortgagors as provided for in HUD Handbook 4330.1.
- (1) Review the servicing records for the recording of partial payments accepted, held in a pending file, or rejected. (Note: The decision to reject a late or partial payment must be a decision based on the individual circumstances.)
 - (2) Review the payment records of selected mortgagors to ascertain whether:
 - (a) The amount of the late charge, if any, was computed correctly.
 - (b) The late charge was assessed after 15 days of delinquency, or the 17th day of the month.
 - (3) Review the auditee's procedures for the handling of partial payments. Obtain a representation letter from the auditee concerning such procedures.
- e. Inquire whether the auditee has implemented steps to comply with the provisions of HUD's Loss Mitigation procedures. Such steps would include informal forbearance, workout agreements, acceptance of partial payments and deeds in lieu of foreclosure. Review selected claims files for evidence that such relief measures were considered (refer to Mortgagee Letters 96-11, 96-25, 96-32 and 96-61).

- f. Inquire whether the auditee sends notices to advise the mortgagor about HUD's foreclosure relief program once it has decided to foreclose. Review the loan files selected for evidence that such letters were sent prior to the initiation of foreclosure proceedings.
- g. Compare charges assessed to borrowers for servicing activities to allowable amounts. For the loans selected:
 - (1) Review charges to mortgagors for checks returned due to insufficient funds.
 - (2) Review charges to the mortgagor for attorney's fees and test whether:
 - (a) The charges were for services performed by someone other than salaried members of the auditee's staff.
 - (b) The charges were made only in those cases where the auditee made a decision to foreclose and referred the loan to an attorney for initiation of foreclosure proceedings.
- h. Obtain an understanding of the auditee's procedures for paying mortgage insurance premiums to HUD. Determine that the auditee follows one of the two acceptable methods of making mortgage insurance premium payments (electronic payment or bank check) and that its practices comply with HUD regulations.
- i. Review a representative sample of insurance claims submitted to HUD following mortgage defaults. Recalculate the net claim amount on the Single Family Application for Insurance Benefits (Form HUD-27011) and compare the claim amount information to the accounting records. Test the amounts included in the claim for preservation and protection expenses to determine that they are supported by documentation.

-
- j. Select a sample of adjustable rate HECMs and test that the limitations of the 2% annual and 5% lifetime caps are not being exceeded by the mortgagee.
 - k. Select a sample of HECMs and determine that the disbursements have been made in accordance with the mortgage note.

F. Escrow Accounts

- 1. Compliance Requirement. HUD requires that mortgagees establish escrow accounts and that mortgagors make monthly payments thereto, to insure that funds will be available to pay taxes and insurance premiums. Each month the mortgagee must collect from the mortgagor an amount which the mortgagee estimates will be sufficient to enable it to accumulate funds so as to pay all escrow obligations prior to delinquency, i.e., (a) mortgage insurance premiums, (b) taxes, special assessments, and ground rents, if any, (c) hazard insurance premiums, if any, and (d) flood insurance premiums where required. The mortgagee should analyze the escrow account, at least annually, to determine if projected escrow balances will be sufficient to fund escrow disbursements. Any projected escrow shortage should be collected by either (a) lump sum payment or (b) allocating the shortage over a 12-month period. The mortgage instrument provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills thirty days prior to the time the bills become delinquent (HUD Handbook 4330.1, Chapter 2).
- 2. Suggested Audit Procedures
 - a. Obtain an understanding of the policies and procedures for reconciling custodial trust accounts.
 - b. Obtain trial balances of individual escrow accounts and reconcile or review the reconciliation of the total with the auditee's control account and the related bank account. Test whether the auditee did not use escrow

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

- c. For selected mortgages, obtain the most recent escrow analysis, note whether it was prepared not more than one year ago, and whether monthly deposits appear adequate to provide for payments of taxes, insurance, etc., by review of actual payments or other evidence of amounts due (e.g., tax assessment notice or prospective rate adjustment notices from insurance companies). Also, test whether the most recent real estate tax bills for each account were paid. If not paid within the discount period, inquire as to reasons for the delay and test whether the mortgagor retained the benefit of the discount, and any late charges assessed were borne by the auditee at its expense. Test whether the mortgagor was furnished a statement of interest paid during the preceding year within 60 days after the end of the calendar year.
- d. On accounts selected for review, inspect supporting documents for escrow disbursements such as receipted invoices, tax bills, and canceled checks.
- e. Test whether escrow funds are deposited in accounts fully insured by the Federal Deposit Insurance Corporation (FDIC), or National Credit Union Administration (NCUA) and whether the auditee covered any overdrafts on selected accounts by advancing its own funds to custodial accounts so that FDIC or NCUA insurance protection was not impaired. HUD regulations neither require or forbid that escrow accounts bear interest. However, in those cases where accounts are interest bearing, test whether interest earned, less expenses, is passed on to the mortgagor.
- f. Test whether the auditee advises the mortgagor of the amount of any surplus escrow funds in accordance with HUD requirements.
- g. Review the policies and procedures that the auditee has established to ensure that bills

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

- h. For any bills paid late by the auditee, determine that any late charges/penalties assessed are paid out of the auditee's funds and not the mortgagor's funds.
- i. Inquire whether the auditee requires the mortgagor to purchase hazard insurance coverage from the auditee or from a specific company. This practice may fall within the purview of the Sherman Anti-Trust Act.
- j. Review selected loan payoffs for evidence that the auditee returns to the mortgagor the amounts held in escrow for taxes and hazard insurance within 30 days of receipt by the mortgagee of payoff funds.

G. Section 235 Assistance Payments

- 1. Compliance Requirement. Under Section 235, HUD sends assistance payments to the mortgagee on behalf of the mortgagor as long as the mortgagor is eligible for the payments. HUD executes a contract with the mortgagee for each mortgage. Once a mortgage is insured, many of the initial eligibility criteria cease their applicability, however, the mortgagor must meet other continuing eligibility criteria. In addition, the mortgagee must secure recertifications of income, family composition, occupancy and employment at least annually and as otherwise required by HUD (HUD Handbook 4330.1 REV-3, Chapter 10).
- 2. Suggested Audit Procedures
 - a. Select a representative sample of mortgagors receiving Section 235 Assistance Payments from the records of the mortgagee.
 - b. Review the mathematical accuracy of Form HUD-93102, Mortgagee's Certification and Application for Assistance of Interest Reduction Payments, and Form HUD-300, Monthly Summary of

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

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

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

- d. Select a sample of individual loan files and:
- (1) Examine documentary evidence that the mortgagee obtained and verified information concerning mortgagor income, family composition and occupancy of the property.
 - (2) Test the mathematical accuracy of assistance payments computed by the mortgagee and trace to the Form HUD-300 or computer printout. Tests should include both Formula I and Formula II computations and factors used in computations. Determine that the formula providing the greater/lesser amount of assistance was used.
 - (3) Ascertain that the recertification was completed in a timely manner by the mortgagor i.e., no sooner than 60 days before and no later than 30 days after the mortgage anniversary date. If the recertification was not completed timely, ascertain whether the auditee acted to suspend the assistance payments contract.

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

H. Federal Financial and Activity Reports .

1. Compliance Requirement . Mortgagees participating in HUD-assisted activities are required to ensure that financial status, Single Family Default Monitoring, and reports required under the Home Mortgage Disclosure Act contain reliable data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements, Handbooks and Mortgagee Letter contain the specific reporting requirements that the mortgagee is to follow (Handbooks 4330.1 REV-3, Chapter 7 and 4155.1 REV-4, Chapter 3; Mortgagee Letter 95-3).
 2. Suggested Audit Procedures
 - a. Identify all HUD-required financial and activity reports by inquiry of the mortgagee.
 - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the required reports.
 - c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.
 - d. Select a sample of activity reports and determine that the reports selected are prepared in accordance with HUD requirements.
 - e. For the samples, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between selected reports and mortgagee records.
-

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

I. Kickbacks

- 1. Compliance Requirement . HUD regulations prohibit mortgagees from paying any fee, kickback, compensation or thing of value, including a fee representing all or part of the lender's origination fee to any person or entity other than for services actually performed or to any person or entity for referral of the loan or as a finder's fee (24 CFR 202.5(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 a unreasonable amount in return for goods or services actually performed. Reconcile and report on any differences.
 - c. During the review of loan origination and loan settlement documents, the auditor should be alert for any fees or other types of payments which may represent kickbacks. If the auditor notes any kickbacks or indications of it, these should be reported as a finding.

J. Mortgagee Approval Requirements

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

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

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

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

2. Suggested Audit Procedure

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

7-6 ADJUSTED NET WORTH

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

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

B. UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community. These pledged assets are acceptable for supervised institutions only.
2. An asset due from an officer or stockholder of the mortgagee or from a related entity, except for:
 - o A construction loan receivable, secured by a first mortgage, from a related entity.
 - o 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.
 - o A receivable from a related party where the affected parties have executed a cross-default agreement ¹ or corporate guarantee agreement ² with Ginnie Mae.
3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest ³ unrelated to that person's position as an officer or stockholder of the mortgagee.

¹A 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.

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

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

4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity, as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.
5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.
6. The value of any servicing contract not determined in accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities and SFAS 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent revisions thereto.
7. Any asset not readily marketable and for which appraised values are very subjective. Examples include, but are not limited to, antiques, art work, and gemstones.
8. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.
9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.
10. Any asset which is principally used ⁴ for the personal enjoyment or benefit of an officer, director or stockholder and not for normal business purposes. This includes automobiles and personal residences.
11. "Other Assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or schedule prepared by the

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

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

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

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

Board of Directors
ABC Financial Corporation

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

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

[Firm Signature]

[Date]

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

| | | |
|--|----------|-------------------|
| Minimum Net Worth Required | | \$ <u>250,000</u> |
| Stockholders Equity (Net Worth) per Balance Sheet | \$ _____ | |
| Less Unacceptable Assets | \$ _____ | |
| Adjusted Net Worth for HUD Requirement Purposes | | \$ <u>_____</u> |
| Adjusted Net Worth ABOVE Amount Required | | \$ _____ |
| Adjusted Net Worth BELOW Amount Required | | \$ _____ |

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

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

Attachment D

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

| | | | |
|----|--|----------|----------|
| 1. | Servicing Portfolio* at: _____ (end of fiscal year under audit) | | \$ _____ |
| 2. | Add: | | |
| | Originated* during fiscal year | \$ _____ | |
| | Purchased* from Loan | \$ _____ | |
| | Correspondent during fiscal year | | |
| | Subtotal | | \$ _____ |
| 3. | Less: | | |
| | Amounts included in Line 2: | | |
| | Servicing retained | \$ _____ | |
| | Loan Correspondent purchases retained | \$ _____ | |
| | Subtotal | | \$ _____ |
| 4. | Total | | \$ _____ |
| 5. | 1% of Line 4 | | \$ _____ |
| 6. | Minimum Net Worth required (Greater of \$250,000 or Line 5) | | \$ _____ |
| 7. | Net Worth Required (Lesser of \$1,000,000 or Line 6) | | \$ _____ |
| | Stockholders Equity (Net Worth) per Balance Sheet | \$ _____ | |
| | Less Unacceptable Assets | \$ _____ | |
| | Adjusted Net Worth | | \$ _____ |
| | Adjusted Net Worth ABOVE Amount Required | | \$ _____ |
| | Adjusted Net Worth BELOW Amount Required | | \$ _____ |

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

E X A M P L ECOMPUTATION 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 | | \$ <u>291,357</u> |
| Adjusted Net Worth ABOVE Amount Required | | \$ 41,357 |
| Adjusted Net Worth BELOW Amount Required | | \$ _____ |

Attachment F**E X A M P L E**COMPUTATION OF ADJUSTED NET WORTH FOR APPROVAL AND
RECERTIFICATION OF NONSUPERVISED LOAN CORRESPONDENTS

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

E X A M P L E
 COMPUTATION OF ADJUSTED NET WORTH
 FOR RECERTIFICATION OF NONSUPERVISED MORTGAGEES
 OTHER THAN LOAN CORRESPONDENTS

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

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

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

8-1 Program Objective. 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, which are financial institutions that are members of the Federal Reserve System or whose accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration.
- B. Nonsupervised lenders, which are financial institutions whose principal activity is the lending or investment of funds in loans or mortgages, and which are neither supervised lenders nor governmental institutions.
- C. Loan correspondents, which 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, which are financial institutions approved by HUD to purchase, hold, and sell Title I loans that have been originated by another lender. 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 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/FHA mortgage insurance programs through the Lender Approval and Recertification Division at HUD Headquarters, following the

directions in HUD Handbook 4060.1, Mortgagee Approval and Recertification. After a review of the application and clearance through certain Headquarters systems, the applicant, if approved, will be assigned a unique HUD/FHA identification number and notified that it may now originate FHA insured mortgages.

8-3 Reference Material

| | |
|-----------------------------|---|
| 24 CFR Parts 201 and 202 | Regulations Relating to Title I Property Improvement and Manufactured Home Loans |
| HUD Handbook 4700.2 | Title I Lender Approval Handbook |
| HUD Handbook 1060.2 | Title I Property Improvement and Manufactured Home Loan Regulations, 24 CFR 201 and 202 |
| Title I Letters | Various |

If the program participant does not have this reference material, it may be obtained from HUD's Internet site (<http://www.hud.gov>) or may be ordered from HUD On Demand on the Internet web site, at 1-800-767-7468 (202-708-3151 in the Washington, DC area), or by fax at 202-708-7468.

8-4 Reporting Requirements. Every nonsupervised Title I lender or loan correspondent is required annually to submit one copy of the audit report to the Secretary within 90 days of the close of its fiscal year by 24 CFR Part 202. In addition to the report on the basic financial statements, the audit report should 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. In addition, an analysis of the lender's net worth is required. This net worth must be adjusted to reflect only those assets acceptable to the Secretary. A suggested format for the analysis of net worth and a list of unacceptable assets are shown in paragraph 8-6 of this chapter. The auditor's report on compliance and report on the internal control structure are required for every Title I lender or loan

correspondent, regardless of the number of loans originated during the audit period. 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. The report should be sent to:

Mailing address:

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

Delivery:

U.S. Department of HUD
Lender Approval and Recertification Division
Suite 3214
490 L'Enfant Plaza East
Washington, DC 20024-2118

A Title I lender who is also a Title II mortgagee may submit one set of audited financial statements for review, as long as they are clearly identified for both programs. Reports for Title I lenders who are also a Ginnie Mae issuers must be sent to both Ginnie Mae and the address above.

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 that HUD accepted the branch office as evidenced by a copy of Form HUD-92001LB, 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 should 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 that the branch office is located in space which is separated by a partition from any other entity and is clearly identified to the public, and that the branch office's operating costs are paid by the approved lender.
- e. Determine 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.

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 creditworthiness 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 creditworthiness 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.

- c. Determine that the lender obtains a separate dated credit application on a HUD-approved form from the borrower and any co-maker or co-signer, and verifies the validity of the borrower's Social Security Number in accordance with Title I Letter TI-414.
- d. Determine that all income and employment data is supported by written verification or other documentation, especially for self-employed applicants and those with non-employment income.
- e. Determine that the lender obtains a complete and current consumer credit report on the borrower and any co-maker or co-signer, and checks on any credit inquiries reported within the previous 90 days.
- f. Determine that the lender obtains written verification of the borrower's payment status on any senior mortgages or deeds of trust on the property to be improved.
- g. Determine that the lender checks HUD's Credit Alert System to verify whether the borrower is in default or a claim has been paid on any Federally insured or guaranteed loan, and records the Credit Alert Response Code for each person on the credit application.
- h. When the principal balance of the loan exceeds \$5,000 and the initial payment exceeds five percent of the loan amount, determine that the lender obtains written verification of the source of these funds through verifications of deposit, bank statements, gift letters or other evidence.
- i. 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 creditworthiness.

- j. Obtain a sample of files for rejected loans during the audit period. Review for the following:
 - (1) Determine that an individual review was provided for all applications denied due to a statistical category or score (e.g. credit score, debt/income ratio). Ensure that the score accurately reflected the financial status (e.g. loan and rent payments, current housing payments) of the applicant. A rejection should not be influenced by statistical categories or geographic location.
 - (2) Determine that the rejection was made based on established criteria and the reason for the rejection was provided to the applicant. Ensure that all procedures for accepting and processing the loan were followed.

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 dealer 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 the loan amount exceeds \$7,500), credit application, completion certificate, and the notice of HUD's role in the loan transaction required by 24 CFR 201.26(a)(6).
 - (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 that each file contains the following documents: note, security instrument, credit application, purchase contract, manufacturer's invoice, itemized statements of other costs, fees or charges, evidence of the borrower's initial payment, a placement certificate signed by the borrower and dealer, the notice of HUD's role in the loan transaction required by 24 CFR 201.26(b)(7), and copies of all other documents relating to the loan transaction. For each file reviewed, determine if the lender has documented a site-of-placement inspection within 60 days after disbursement of the loan proceeds.
- d. Where the lender approves dealer loans, determine that the lender supervises and monitors each dealer and visits the dealer periodically. Determine that each dealer's approval is documented on a HUD-approved form
-

signed and dated by both parties. Determine that each file contains the dealer's current financial statement, including a determination that the dealer meets the minimum net worth requirements of 24 CFR 201.27(a)(1), and credit reports on the dealership and its owners, principals and officers. The file should also contain documentation of the lender's experience with the dealer's Title I loans, including information on borrower defaults and borrower complaints and their resolution.

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 identifying, on a periodic basis, the payment status of delinquent loans to enable collection personnel to initiate and follow-up on collection activities, and shall document its records to reflect its collection activities on delinquent loans. Modification agreements and repayment plans are permitted on defaulted loans (24 CFR 201.41).

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

2. Suggested Audit Procedures
 - a. Select a sample of delinquent and defaulted loans.
 - b. Test whether the lender documents its records to reflect its servicing on delinquent and defaulted loans.

-
- (1) Obtain an understanding of the lender's servicing procedures.
 - (2) Test that the lender maintains individual servicing records documenting collection (loan servicing) activities.
 - (3) Review the servicing records for recorded collection contacts attempted and completed.
- c. Test whether the lender communicates with the borrower or makes a reasonable effort to do so in order to determine the cause of default to seek its cure and prior to accelerating the maturity of the loan. Review the individual loan servicing records for recorded contacts of more than one type (i.e., telephone, letter, face-to-face interview, etc.) if one type of contact effort is unsuccessful.
 - d. Test whether the lender offers special relief measures such as modification agreements or informal repayment plans where such measures are appropriate. Review the selected loan files to ascertain whether such relief measures were considered.
 - e. Test whether 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.
 - f. Obtain an understanding of the lender's procedures for paying loan insurance premiums to HUD. Determine that the lender follows the acceptable methods 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

- a. Obtain the lender's general ledger, cash journal, canceled checks and supporting invoices for at least two months of the audit period.
- b. Test disbursements to determine that they 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. 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 referral fees. If the auditor notes any such referral fees, it should be reported as a finding. Ensure points and closing costs are accurate. Determine whether the differences may be due to discriminatory practices.

F. Federal Financial Reports

- 1. Compliance Requirement. Lenders 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 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 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 lender records.
 - e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

G. Financial Approval Requirements

- 1. Compliance Requirements . A nonsupervised lender shall have and maintain a net worth, of not less than \$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 use in originating or purchasing Title I loans.

A loan correspondent shall have and maintain a net worth of not less than \$50,000 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 an external review, which may be performed by the independent auditor or other qualified organization. (24 CFR 202.5(h)).

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 assures 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 IA's engagement includes the performance of the quality control review, the IA should report this as part of the additional information required under Chapter 2 of this guide. If the 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 ten 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 that senior management officials promptly initiated corrective action for all deficiencies noted.

8-6 ADJUSTED NET WORTH

- A. 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. The required amount which must be maintained throughout the year, varies by program participant type and approval data per the guidance in paragraph 8-5 G, Financial Approval Requirements. If an entity is both Title II and Title I, the adjusted net worth for the Title II is the only statement necessary.

B. COMPUTATION

XYZ LENDER CORPORATION
COMPUTATION OF ADJUSTED NET WORTH
To Determine Compliance with
HUD Net Worth Requirements
March 31, 199X

| | | |
|---|----------------|-----------------------------------|
| 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 | <u>300,000</u> | <u>\$12,300,000</u> |
| Adjusted net worth for HUD requirement purposes | | <u>\$ 5,200,000</u> ^{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.

C. UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

Refer to Chapter 7, Section 7-6(C).

Appendix

HUD District Inspectors General for Audit

New England District Inspector General for Audit
Department of Housing and Urban Development
Thomas P. O'Neill, Jr. Federal Building
10 Causeway Street, Room 370
Boston, MA 02222-1092
Telephone number: (617)565-5259
FAX number: (617)565-6878

CT, ME, MA, NH, RI, VT

New York/New Jersey District Inspector General for Audit
Department of HUD
26 Federal Plaza
New York, NY 10278-0068
Telephone number: (212)264-4174
FAX number: (212)264-1400

NY, NJ

Mid-Atlantic District Inspector General for Audit
Department of HUD
The Wannamaker Building
Philadelphia, PA 19107-3390
Telephone number: (215)656-3401
FAX number: (215)656-3409

DE, DC, MD, PA, VA, WV

Southeast/Caribbean District Inspector General for Audit
Department of HUD
Richard B. Russell Federal Building
75 Spring Street, SW, Room 700
Atlanta, GA 30303-3388
Telephone number: (404)331-3369
FAX number: (404)730-2382

AL, FL, GA, KY, MS, NC, SC, TN

Midwest District Inspector General for Audit
Department of HUD
77 West Jackson Boulevard - 26th Floor
Chicago, IL 60604-3507
Telephone number: (312)353-7832
FAX number: (312)353-8866

IL, IN, MI, MN, OH, WI

Southwest District Inspector General for Audit
Department of HUD
1600 Throckmorton
P.O. Box 2905
Fort Worth, TX 76113-2905
Telephone number: (817)885-5551
FAX number: (817)885-2725

AR, LA, NM, OK, TX

Great Plains District Inspector General for Audit
Department of HUD
Gateway Tower II, 5th floor
Kansas City, KS 66101-2406
Telephone number: (913)551-5870
FAX number: (913)551-5877

IA, KS, MO, NE

Rocky Mountains District Inspector General for Audit
Department of HUD
First Interstate Tower
Denver, CO 80202-2349
Telephone number: (303)672-5452
FAX number: (303)672-5006

CO, MT, ND, SD, UT, WY

Pacific/Hawaii District Inspector General for Audit
Department of HUD
450 Golden Gate Avenue, Room 8-5139
San Francisco, CA 94102-3448
Telephone number: (415)436-8101
FAX number: (415)436-8107

AZ, CA, HI, NV

Northwest/Alaska District Inspector General for Audit
Department of HUD
909 First Avenue
Seattle, WA 98104-1000
Telephone number: (206)220-5360
FAX number: (206)220-5162

AK, WA, ID, OR