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

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

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

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

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

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

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

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

8-3 Reference Material.

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

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

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

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

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

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

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

8-4 *Audit and Reporting Requirements.

A. Audit Requirements.

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

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

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

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

B. Electronic Submission of Audited Financial and Compliance Data.

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

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

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

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

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

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

C. Auditor Involvement in the Electronic Submission Process.

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

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

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

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

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

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

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

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

By clicking the "Agrees" option button, the auditor will be attesting to the statements listed in the second paragraph of the independent auditor's report. These exhibits address situations in which (a) a lender has a stand-alone audit performed of its financial statements, and (b) a lender is a subsidiary of a parent or is a parent and a stand-alone audit of the lender's financial statements has not been performed. It* *should be noted that the "agreed-upon procedures" attestation report could be submitted by the auditor who audited the financial statement or by another independent auditor who did not perform the financial statement audit.

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

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

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

8-5 Compliance Requirements and Suggested Audit Procedures.

A. Branch Office Operations.

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

2. **Suggested Audit Procedures.**

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

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

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

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

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

B. Loan Origination.

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

2. **Suggested Audit Procedure.**

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

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

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

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

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

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

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

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

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

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

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

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

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

C. Loan Disbursement.

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

2. **Suggested Audit Procedures.**

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

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

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

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

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

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

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

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

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

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

e. When the lender approves dealer loans, determine whether

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

E. Eligible Fees and Charges.

1. Compliance Requirement. Title I Letter TI-440, dated May 2, 1996, lists all fees and charges allowed in the program.

2. Suggested Audit Procedures.

*Obtain the lender's general ledger, cash journal, canceled checks, and supporting invoices for at least two months of the audit period and determine whether

a. The fees and charges were within the allowable amounts contained in Title I Letter TI-440 and report amounts paid in excess of the allowable amounts.

b. Disbursements are supported by invoices and were not for unreasonable amounts in return for goods or services actually performed in connection with a Title I loan. Review and report on any differences.

c. Referral fees are being paid. During the review of loan origination and loan settlement documents (paragraphs 8-5B and C), the auditor should be alert for any fees or other types of payments, which may represent referral fees. If the auditor notes any such referral fees, they must be reported as a finding.

d. Points and closing costs are accurate. Determine whether any differences may be due to discriminatory practices and report any problems noted.*

F. Federal Financial Reports.

1. Compliance Requirement. Lenders participating in HUD-assisted activities are required to submit various reports in accordance with the terms of applicable agreements between the entity and HUD. The following specific reports are required:

a. ***Originating Lenders:** Submission of annual Home Mortgage Disclosure Act reports by March 1 of each year pursuant to Title I Letter TI-479.

b. **All Lenders:** Reporting of any noncompliance by borrowers, contractors, or other parties related to a Title I-insured loan pursuant to Title I Letter TI-447.*

2. Suggested Audit Procedures.

a. Identify all HUD-required activity reports by inquiry of the lender.

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

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

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

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

G. Financial Approval Requirements.

1. Compliance Requirements. A nonsupervised lender shall have and maintain an adjusted net worth of not less then $250,000 in assets acceptable to the Secretary. It shall also have a reliable warehouse line of credit or other funding program acceptable to the Secretary of not less than $500,000 for uses in originating or purchasing Title I loans.

A loan correspondent shall have and maintain an adjusted net worth of not less than *$63,000* in assets acceptable to the Secretary, plus an additional $25,000 for each branch office authorized by the Secretary, up to a maximum requirement of $250,000.

2. Suggested Audit Procedures.

a. Test whether the nonsupervised lender or loan correspondent maintained the required levels for adjusted net worth.

b. Test whether the nonsupervised lender maintained the required level for its warehouse line of credit.

H. Quality Control Plan.

1. Compliance Requirement. HUD-approved lenders are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and comply with all relevant departmental rules and regulations. Each HUD-approved lender is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4700.2 or the latest HUD guidance. Each approved lender must develop and implement a quality control plan, consistent with its needs and the above referenced guidance, to assist corporate management in determining whether HUD requirements and the lender's policies and procedures are being followed by its personnel. The monthly quality control procedures may be conducted by the entity itself internally or by an external review, which may be performed by the independent auditor or other qualified organization (24 CFR 202.5(h)). The following suggested audit procedures are to be followed whether the quality control review was performed by the entity or by an external source.

2. Suggested Audit Procedures.

a. Obtain a copy of the lender's quality control plan and compare it to the general and specific requirements contained in Handbook 4700.2.

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

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

d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample of at least 10 percent of the number of insured mortgages originated or a statistically derived sample. It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review at least once during the year and that the plan includes coverage for any loan correspondents and authorized agents of the lender.

e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4700.2 were included in the quality control review. The quality control plan must provide for the written reverification of the lender's employment, deposits, gift letter, or other sources of funds.

f. Obtain a written copy of the latest quality control report and determine that senior management officials also received a copy, which included any deficiencies identified during the review. Determine that the lender also notified the Quality Assurance Division of any violations, false statements, or program abuses in the report.

g. *Determine whether the files evidenced the actions taken by senior management to correct all deficiencies noted and that the corrective action was promptly initiated.

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

8-6 <u>Adjusted Net Worth</u>.

A. <u>Audit Requirement</u>.

*An FHA computation of adjusted net worth is required for all nonsupervised Title I lenders and loan correspondents, even if there were no loans originated during the period.

B. <u>Computation</u>.

The required amount that must be maintained throughout the year varies by program participant type and approval data according to the guidance in this chapter, paragraph 8-5 G, Financial Approval Requirements. If an entity is both a Title I and Title II lender, the adjusted net worth under Title II is the only statement necessary. When the lender is a parent or a subsidiary to a parent, the adjusted net worth computation must focus on the * *assets and liabilities of the individual (nonconsolidated) entity with the HUD audit requirement.*

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XYZ Lender Corporation
Computation of Adjusted Net Worth
to Determine Compliance with
HUD Net Worth Requirements
March 31, XXXX

Stockholders equity (net worth) per balance sheet		$17,500,000
Less unacceptable assets: construction loans to related company – not secured by first mortgage	$12,000,000	
Other – goodwill	300,000	$12,300,000
Adjusted net worth for HUD requirement purposes		$ 5,200,000 [1]

[1] In the event adjusted net worth does not meet or exceed the minimum HUD requirement, an explanation of the steps taken to correct the adjusted net worth deficiency, along with any relevant documentation, must be submitted as part of the corrective action plan.

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C. Unacceptable Assets for Computation of Adjusted Net Worth.

*The following are unacceptable assets and are not to be used in the computation of adjusted net worth.

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

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

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

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

c. A receivable from a related party when the affected parties have executed a cross-default agreement[2] or corporate guarantee agreement[3] with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagee has a personal interest[4] unrelated to that person's position as an officer or stockholder of the mortgagee.

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

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

6. The value of any servicing contract not determined in accordance with Statement of Financial Accounting Standards (SFAS) No. 65, <u>Accounting for Certain Mortgage Banking Activities</u>, and SFAS 125, <u>Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities</u>, or revisions thereto.

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

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

[3]A corporate guarantee agreement is an agreement in which the issuer's parent guarantees the performance of the issuer.

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

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

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

10. Any asset, which is principally used[5] for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes automobiles and personal residences.

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

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

8-7 <u>Audit Finding Reporting.</u>

All material instances of noncompliance with any HUD requirement, regulation, including adjusted net worth and/or liquidity deficiencies, deficiencies in internal control, instances of fraud or illegal acts, or contract violations that were disclosed during the audit process must be reported as findings in the audit report. All nonmaterial instances of noncompliance, deficiencies in internal control, instances of fraud or illegal acts, or contract violations disclosed during the audit process may be reported separately to management. Such reporting must be in writing in a Management Letter or other type of written auditor communication and must be mentioned in the Independent Auditor's Report including the date of the Management Letter or other written communication. Non compliances, deficiencies, instances or violations that were corrected during the audit process, after the fiscal year under audit, or if they were disclosed as a part of the audit process before the end of the fiscal year under audit, and/or prior to the issuance of the audit report, must be included in the report as resolved findings or in a management letter depending on their materiality.

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

Findings are to be presented in accordance with the standards and requirements of the "Yellow Book." A finding should be supported by sufficient, competent, and relevant

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

evidence; be presented in a manner to promote adequate understanding of the matters reported; and provide convincing but fair presentations in proper perspective.

Please refer to chapter 2 for the information that is to be included in a finding.*

B. *Corrective Action in Process.

Many times when auditees are presented with draft findings, they will start to take action to correct the deficient condition. When this action is underway and the auditor has completed his/her fieldwork, the auditee can include the action completed and the action remaining to be taken in the auditee's comments and in the corrective action plan. Regardless of whether the auditee is in the process of correcting the finding, the auditor is to include the finding in the report with all required elements.

C. **Corrective Action Completed.**

Many times when auditees are presented with draft findings, they will start to take action and complete that action, correcting the deficient condition, prior to the completion of the fieldwork. When this occurs, the finding is still to be included in the audit report with all required elements. The action taken/completed should be included in the auditee's comment section and should be validated by the auditor. The recommendation section should follow the auditee's comment section, and the auditor should state whether he/she tested the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on the testing of that action.

8-8 **Technical Assistance Needed.** The Office of Lender Approval and Recertification Division receives, reviews, and acts on audit reports conducted using this chapter. It is important that the report meet its requirements and expectations. For this reason, questions on audits performed using this chapter should be referred to that office's help desk at (202) 755-7400, extension 163; or by sending an e-mail to lass@hud.gov.*