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

7-1 **Program Objective.** The U.S. Department of Housing and Urban Development (HUD) insures mortgages made by private lending institutions to finance the purchase of single-family and multifamily homes. HUD approves the mortgagees for participation in the mortgage insurance programs for single-family and multifamily homes as evidenced by the mortgagees' receipt of the yearly verification report in the last month of its fiscal year. HUD can approve the following institutions for participation in the program.

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

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

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

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

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

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

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

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

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

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

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7-3 **Reference Material.** The following is the reference material that was in effect at the time this handbook chapter was issued. It is the auditor's responsibility to use the appropriate reference material that was in effect during the period covered by the audit.

Through out this chapter reference is made to handbooks using the base handbook number without the revision number (i.e., REV-1, REV-6, etc.). This will enable periodic updates to paragraph 7-3 rather than revising the references in the entire handbook/chapter. Also, the auditor should assure that the updated reference is used for performing the audit. If reference to the handbook is needed in the audit report, the auditor should assure that the entire updated reference, including the revision number is used.*

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

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

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

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

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

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

7-4 Audit and Reporting Requirements.

A. Audit Requirements.

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

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

For all lenders the audit report shall also cover internal controls and compliance with specific requirements that have a direct and material effect on HUD-assisted mortgages, including an opinion on compliance with specific requirements applicable to major or nonmajor HUD-assisted programs.

An independent auditor's report on compliance with specific requirements applicable to major/nonmajor HUD programs is required. Major program mortgagees are subject to an audit of their compliance with HUD major programs. Nonmajor program mortgagees are subject to a review of their compliance with HUD nonmajor programs. Major program means an individual assistance program or a group of programs in a category of federal financial assistance, which exceeds $300,000 during the applicable year. A project, which has an outstanding HUD-insured or guaranteed loan balance exceeding $300,000 as of the reporting date, shall be considered a major program. A mortgagee or loan correspondent, which originates and/or services an aggregate of FHA-insured loans exceeding $300,000 during the period under audit, is considered a major program (HUD Handbook 4060.1, paragraph 4-4A1e). Guidelines for determining major and nonmajor programs are also contained in chapter 1 of this guide.

For Title II loan correspondents, the requirement for the auditor to review and report on the mortgagee’s compliance has been modified under the condition that the sponsor agrees to assume the responsibility of assuring compliance for each loan correspondent under its sponsorship. In those instances in which the sponsor agrees to assume the responsibility of assuring compliance of loan correspondents under its sponsorship, the sponsor must communicate annually in writing to the individual loan correspondents its intent to assume responsibility for their compliance, indicate the areas of compliance that it will be assuming, issue annually a written report summarizing the results of its compliance testing, and accumulate and retain the supporting information that served as the basis for the written annual compliance report issued to the loan correspondent. In accordance with the Yellow Book, it is incumbent upon the auditor to test and report on those areas of compliance not assumed by the sponsor. In addition, the auditor must determine where applicable that the sponsors are testing and reporting the results of their compliance reviews. Accordingly, when meeting the requirements of Yellow Book, the auditor should issue a report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with government auditing standards. The report may vary depending on whether there are reportable instances of noncompliance or material weaknesses. However, if the nonsupervised loan correspondent is also approved under the Title I program, separate reports on * *internal control and compliance will have to be issued for that program (Handbook 4060.1, Paragraph 4-4A2e).

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

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

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

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

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

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

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

Many mortgagees/loan correspondents are subsidiaries to a parent company and the information on its assets, liabilities and results of operation are included in the consolidated financial statements of the parent entity. The LASS templates only* *require the financial information of the approved mortgagee and not the consolidated entity. However, HUD will accept the audits of the consolidated financial statements of the parent if it includes consolidating schedules, audited by the auditor, which distinguish the balance sheet, operating statement and computation of adjusted net worth of the mortgagee/loan correspondent subject to the HUD audit requirement. These amounts are the amounts entered into LASS. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent, and the auditor's opinion must cover the financial statement accounts of the subsidiary.

C. Auditor Involvement in the Electronic Submission Process.

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

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

2. Data Collection Form (DCF) – Collection of certain basic information regarding the lenders recertification submission, such as, fiscal year end data, audit period covered, lender and auditor information, and the type and details of the audit opinions and findings. Also, the signed audit opinion report, internal control report, and compliance reports must be attached as portable document in a PDF file format.

3. Notes and Finding – Collection of the lender's footnotes accompanying the financial statements, and if applicable, the schedule of findings and questioned costs and lender's corrective action plan. These documents must be attached as portable document in a PDF file format.

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

engagement letter may be expanded to include this separate attestation engagement, which may involve additional costs.

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

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

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

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

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

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

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

D. Extension Requests.

Extensions for submission of the audit report are granted only in cases of catastrophic events beyond the control of lender or auditor. Extension requests must be submitted through LASS. The request must be received no earlier than 45 days before the submission due date and no later than 15 days before the submission due date (HUD Handbook 4060.1, paragraph 4-4C). *

7-5 Compliance Requirements and Suggested Audit Procedures.

A. 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 to comply with all relevant HUD rules and regulations. Each HUD-approved mortgagee is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4060.1, chapter 7, or the latest HUD guidance for loan origination and servicing. Each approved mortgagee must develop and implement a quality control plan consistent with its needs and the above referenced guidance to assist corporate management in determining whether its personnel are following HUD requirements and the mortgagee's policies and procedures. The monthly quality control procedures may be conducted by the entity itself internally, by personnel not involved in any aspect of mortgage origination or servicing, or by an external reviewer, such as the independent auditor or another qualified organization (24 CFR 202.5(h)).

2. **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 HUD Handbook 4060.1.
   b. Determine whether the mortgagee has a procedure in place, which assures that all employees involved in loan origination and servicing understand the mortgagee's quality control policies and procedures.

c. Inquire whether the mortgagee relies on an internal or external quality control review of its origination, underwriting, and servicing functions.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

g. Review the supporting documentation of the most recent review to determine whether all the required general and specific elements included in HUD Handbook 4060.1, chapter 7 were included in the quality control review. The quality control plan must provide for the written reverification of the mortgagor's employment, deposits, gift letter or other sources of funds.

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

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

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

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

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

B. Sponsor Responsibility over Title II Loan Correspondents.

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

2. **Suggested Audit Procedures.**

   a. Determine whether the sponsor

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

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

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

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

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

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

C. Branch Office Operations.

1. **Compliance Requirement.** A mortgagee may maintain one or more branch offices for the submission of applications for mortgage insurance. A traditional branch office is a separately located unit of the mortgagee in an office in which no business except that of the mortgagee is conducted. It may be located in the mortgagee's home office. In addition, a mortgagee may register a branch office that does not meet the requirements of a traditional branch office (nontraditional branch office). The mortgagee may determine the location and type of its branch office facilities. The nontraditional branch office facility may be located in either

commercial or noncommercial space. Each branch office must be registered by HUD. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR 202.5(k) (HUD Handbook 4060.1, paragraph 2-11 B and C).

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

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

2. Suggested Audit Procedures.

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

b. Through inquiry and/or physical observation, determine whether the branch is a true branch and is not a subsidiary, independent contractor, agent of the auditee, or separate entity. A mortgagee with a separate tax ID number is required to have approval as a mortgagee in its own right. A branch must have at least one employee *(a W-2 employee)* including, a branch manager. The branch manager can manage more than one branch except if the branch is a direct lending branch, which must have a separate manager. The branch office must have its own telephone and maintain its own accounting records.

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

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

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

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

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

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

D. Loan Origination.

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

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

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

Regulations at 24 CFR 202.12 prohibit lenders from originating insured mortgages if it is the customary lending practice of the lender to engage in “tiered pricing” of its loans (for discount points, origination fee and other such fees) of more than 2 percent in an area (metropolitan statistical area or county in rural areas). The regulation further requires HUD to ensure that any variations in mortgage charge rates be based only on the actual variations in costs to the lender to make the loan. The 2 percent limitation on variation in “mortgage charge rates” shall be applied to all Section 203 mortgages by loan type.

2. Suggested Audit Procedures.

a. Obtain an understanding of the auditee’s procedures for processing loan applications. Determine whether the auditee’s procedures provide for applicant’s credit report, employment verification, and verification of deposits to be sent directly to the auditee and not pass through any interested third party (e.g., realtor).

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

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

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

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

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

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

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

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

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

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

E. Loan Settlement.

1. Compliance Requirement. The mortgagee's responsibilities before and following loan settlement are minimal. The loan origination fee should normally compensate the mortgagee for the required services. However, HUD has specified the types and amount of additional charges and fees, which the mortgagee may collect from the borrower. Additionally, the mortgagee is responsible for promptly submitting up-front mortgage insurance premiums to HUD following loan settlement, disbursing the funds, and completing the transaction in accordance with the closing documents without undue delay (24 CFR 203.284).

2. Suggested Audit Procedures.

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

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

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

(2) Review the fees and charges collected from the mortgagors as shown on loan settlement statements to determine whether they are equal to the mortgagee's actual out-of-pocket costs for the related service or the maximum charge allowed by HUD, whichever is lower. Determine whether the origination fee did not exceed 1 percent of the loan amount. Compare the fees and charges to the guidelines contained in HUD Handbook 4000.2. Report any differences as findings.

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

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

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

(6) The Form HUD-92900 contains the acquisition cost of the property. The HUD-1 contains the amount of the insured mortgage. Compare the amount of the insured mortgage to the acquisition costs to determine whether the mortgagor made the minimum investment.

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

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

F. Loan Servicing.

1. Compliance Requirement. Mortgagees that service HUD/FHA-insured loans are permitted to collect certain fees from the borrowers in accordance with HUD regulations (HUD Handbook 4330.1, chapter 4). * Loan correspondents are not allowed to service loans. *

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

Loan servicing procedures are to be followed consistently and should not vary. *The lender shall have an organized means of periodically identifying the payment status of delinquent loans to enable personnel to initiate and follow up on collection activities and shall document its records to reflect its collection activities on delinquent loans. The lender shall accept partial payments under an executed modification agreement or an acceptable repayment plan (refer to 24 CFR 201.41 for more details). A modification agreement may be used to increase or reduce monthly payments but not to increase the term or the interest rate to assure that the delinquent or defaulted loan is brought current before or by the end of the loan term. A modification agreement may also be used to effect a reduction in the interest rate and in the monthly payment for current loans, 24 CFR 203.500.*

2. Suggested Audit Procedures.

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

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

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

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

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

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

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

(2) Review the individual loan servicing records for mortgagor explanations of defaults and documented attempts by loan servicing personnel to contact the mortgagors.

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

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

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

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

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

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

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

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

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

h. Compare charges assessed to borrowers for servicing activities to allowable amounts. For the loans selected,

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

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

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

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

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

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

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

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

G. Escrow Accounts.

1. Compliance Requirement. HUD requires that mortgagee**e**s establish escrow accounts and that mortgagors make monthly payments thereto, to ensure that funds will be available to pay taxes and insurance premiums. Each month the mortgagee must collect from the mortgagor an amount which the mortgagee estimates will be sufficient to enable it to accumulate funds to pay all escrow obligations before delinquency i.e., (a) mortgage insurance premiums; (b) taxes, special assessments, and ground rents, if any; (c) hazard insurance premiums, if any; and (d) flood insurance premiums where required. The mortgagee should analyze the escrow account, at least annually, to determine whether projected escrow balances will be sufficient to fund escrow disbursements. Any projected escrow shortage should be collected by either (a) lump sum payment or (b) allocating the shortage over a 12-month period. The mortgage instrument provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills 30 days before the time the bills become delinquent (HUD Handbook 4330.1, chapter 2).

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

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

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

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

c. Obtain trial balances of individual escrow accounts and reconcile or review the reconciliation of the total with the auditee's control account and the related bank account. Test whether the auditee did not use escrow funds for late charges, assumption fees, or any purpose other than specified above.

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

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

f. Test whether escrow funds are deposited in accounts fully insured by the FDIC or NCUA and whether the auditee covered any overdrafts on selected accounts by advancing its own funds to custodial accounts so that FDIC or NCUA insurance protection was not impaired. HUD regulations neither require nor forbid that escrow accounts bear interest. However, in those cases in which accounts are interest bearing, test whether interest earned, less expense, is passed on to the mortgagor.

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

h. Review the policies and procedures that the auditee has established to ensure that bills payable from the escrow fund or the information needed to pay such bills is obtained in advance of the due date.

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

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

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

H. Section 235 Assistance Payments.

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

2. Suggested Audit Procedures.

a. Select a representative sample of mortgagors receiving Section 235 assistance payments from the records of the mortgagee.

b. Review the mathematical accuracy of Form HUD-93102, Mortgagee's Certification and Application for Assistance of Interest Reduction Payments, and Form HUD-300, Monthly Summary of Assistance Payments Due Under Sections 235(b), 235(j), or 235(i) or of Interest Reduction Payments Due Under Section 236, or equivalent computer printout. Report on any discrepancies.

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

*Office of the CFO - HUD
Assistant CFO for Accounting
Division of Accounting, Monitoring and Analysis*
451 Seventh Street, SW, Room 3222
Washington, DC 20410-4500

d. Select a sample of individual loan files and

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

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

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

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

I. Federal Financial and Activity Reports.

1. **Compliance Requirement.** Mortgagees participating in HUD-assisted activities are required to ensure that financial status, single-family default monitoring, and reports required under the Home Mortgage Disclosure Act contain reliable data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements, handbooks and mortgagee letters contain the specific reporting requirements that the mortgagee is to follow (HUD Handbooks 4330.1, chapter 7 and 4155.1, chapter 3; Mortgagee Letter 95-3).

2. **Suggested Audit Procedures.**

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

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

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

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

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

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

J. Kickbacks.

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

2. Suggested Audit Procedures.

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

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

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

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

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

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

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

K. Mortgagee Approval Requirements.

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

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

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

Supervised or nonsupervised mortgagees or loan correspondents, approved by HUD for program participation, must maintain liquid assets of 20 percent of the adjusted net worth. The adjusted net worth must be in liquid assets (cash, cash equivalents or marketable securities)[3] up to a maximum of $100,000 (24 CFR 202.7(b)(2) and 202.8(b)(4)).

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

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

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

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

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

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

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

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

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

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

7-6 Adjusted Net Worth.

A. Requirement. An FHA computation of adjusted net worth is required for all nonsupervised mortgagees and loan correspondents even if there were no loans originated or serviced during the audit period. The required amount, which must be maintained throughout the year, varies by program participant type and approval date according to the guidance in HUD Handbook 4060.1 paragraph 2-5. When the mortgagee/loan correspondent is a parent or a subsidiary to a parent, the adjusted net worth computation must focus on the assets and liabilities of the individual (non consolidated) entity with the HUD audit requirement.

B. Unacceptable Assets for Computation of Adjusted Net Worth.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7-7 *Audit Finding Reporting.*

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

A. Content of Finding.

Findings are to be presented in accordance with the standards and requirements of the "Yellow Book." A finding should be supported by sufficient, competent, and relevant evidence; be presented in a manner to promote adequate understanding of the matters reported; and provide convincing but fair presentations in proper perspective.*

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

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

B. Corrective Action in Process.

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

C. Corrective Action Completed.

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

7-8 Technical Assistance Needed.

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

Attachment A

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

Minimum net worth required		$ 250,000
Stockholders equity (net worth) Per balance sheet	$	
Less unacceptable assets	$ ___________	
Adjusted net worth for HUD Requirement purposes		$ ___________
Adjusted net worth above amount Required		$ ___________
Adjusted net worth below amount Required		$ ___________

Attachment B

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

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

Attachment C

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

1.	Servicing portfolio* at: ______________ (End of fiscal year under audit)			$
2.	Add: Originated* during fiscal year	$		
	Purchased* from loan correspondent During fiscal year	$ ______________		
	Subtotal		$	
3.	Less: Amounts included in Line 2: Servicing retained	$		
	Loan correspondent purchases retained	$ ______________		
	Subtotal		$ ______________	$
4.	Total			$ ______________
5.	1% of Line 4			$ ______________
6.	Minimum net worth required (Greater of $250,000 or line 5)			$ ______________
7.	Net worth required (Lesser of $1,000,000 or line 6)			$ ______________
	Stockholders equity (net worth) Per balance sheet		$ ______________	
	Less unacceptable assets		$ ______________	
	Adjusted net worth			$ ______________
	Adjusted net worth above amount Required			$ ______________
	Adjusted net worth below amount Required			$ ______________

* HUD/FHA-insured single-family mortgages only. Include HECMs at maximum claim amount.

Attachment D

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

Minimum net worth required		$ 250,000
Stockholders equity (net worth) Per balance sheet	$ 345,678	
Less unacceptable assets	$ 54,321	
Adjusted net worth for HUD Requirement purposes		$ 291.357
Adjusted net worth above amount Required		$ 41,357
Adjusted net worth below amount Required		$ ______

Attachment E

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

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

Attachment F

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

1.	Servicing portfolio* at: June 30. 1997 (End of fiscal year under audit)			$ 87,654,321
2.	Add:			
	Originated* during fiscal year	$ 23,900,000		
	Purchased* from loan correspondent During fiscal year	$ 46,500,000		
	Subtotal		$ 70,400,000	
3.	Less:			
	Amounts included in Line 2:			
	Servicing retained	$ 13,000,000		
	Loan correspondent purchases retained	$ 25,000,000		
	Subtotal		$ 38,000,000	$ 32,400,000
4.	Total			$ 120,054,321
5.	1% of line 4			$ 1,200,543
6.	Minimum net worth required (Greater of $250,000 or line 5)			$ 1,200,543
7.	Net worth required (Lesser of $1,000,000 or line 6)			$ 1,000,000
	Stockholders equity (net worth) Per balance sheet		$ 3,456,789	
	Less unacceptable assets		$ 345,678	
	Adjusted net worth			$ 3,111,111
	Adjusted net worth above amount Required			$ 2,111,111
	Adjusted net worth below amount Required			$ ________

* HUD/FHA-insured single-family mortgages only. Include HECMs at maximum claim amount.