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

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

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

7-3 Reference Material

Document	Title
24 CFR Part 202	Regulations Relating to the Office of Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development
Mortgagees Letters	Various
HUD Handbook 4000.2 REV-1	Mortgagee's Handbook-Application Through Insurance (Single Family)
HUD Handbook 4000.4	Single Family Direct Endorsement Program
HUD Handbook 4060.1	Mortgagee Approval and Recertification

HUD Handbook 4060.3 Field Office Guide for Mortgagee Monitoring

HUD Handbook 4110.2 Mortgagee's Guide-Home Mortgage Insurance Fiscal Instructions

HUD Handbook 4155.1 Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties

HUD Handbook 4205.1 Single Family Coinsurance Program

HUD Handbook 4330.1 Administration of Insured Home Mortgages

HUD Handbook 4330.4 FHA Single Family Insurance Claims

HUD Handbook 4350.4 Multifamily Mortgagees

7-4 Reporting Requirements. A Title II, nonsupervised mortgagee or loan correspondent is required by 24 CFR Part 202 annually to submit an audit report to the Commissioner within 90 days of the close of its fiscal year. The audit shall be performed under Government Auditing Standards and shall include the auditor's report on the basic financial statements and a computation of the mortgagee's Adjusted Net Worth. These reports are required for every Title II nonsupervised mortgagee or loan correspondent regardless of the number of loans originated or serviced during the fiscal year. All instances of noncompliance identified by the auditor must be reported as findings, even in those cases where corrective action was taken by the auditee after the end of the fiscal year. A suggested format for the computation of Adjusted Net Worth and the list of unacceptable assets are shown in paragraph 7-6 of this chapter.

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

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

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

Mailing address:

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

Delivery:

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

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

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

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

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

7-5 Compliance Requirements and Audit Areas

A. Quality Control Plan

1. Compliance Requirement

HUD-approved mortgagees are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and comply with all relevant Departmental rules and regulations. Each HUD-approved mortgagee is required to establish and maintain a written quality control plan in accordance with HUD Handbook 4060.1 REV-2, Chapter 9 or the latest HUD guidance for loan origination and servicing. Each approved mortgagee must develop and implement a quality control plan consistent with its needs, and the above referenced guidance, to assist corporate management in determining whether HUD requirements and the mortgagee's policies and procedures are being followed by its personnel. The monthly quality control procedures may be conducted by the entity itself internally or an external review, which may be performed by the independent auditor or other qualified organization.(24 CFR Subsection 202.5(h)).

2. Suggested Audit Procedures

   a. Obtain a copy of the mortgagee's quality control plan and compare it to the general and specific requirements contained in Handbook 4060.1.

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

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

d. Review the supporting documentation of the most recent quality control review to determine that it included a review of a representative sample in accordance with guidance in HUD Handbook 4060.1 . It should also include a random sample of insured loans being serviced by the mortgagee or its agent. Determine that any branch offices received an on-site review as required by HUD Handbook 4060.1 and that the plan includes coverage for any loan correspondents and authorized agents of the mortgagee.

e. Review the supporting documentation to determine that the required general and specific elements included in Handbook 4060.1 REV-2, Chapter 9 were included in the quality control review. The Quality Control Plan must provide for the written reverification of the mortgagor's employment, deposits, gift letter or other sources of funds.

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

g. Determine that senior management officials promptly initiated corrective action for all deficiencies noted.

B. Branch Office Operations

1. Compliance Requirement. A mortgagee may maintain one or more branch offices for the submission of applications for mortgage insurance. A traditional branch office is a separately located unit of the mortgagee, in an office in which no business except that of the

mortgagee is conducted. It may be located in the mortgagee's home office. In addition, a mortgagee may register a branch office that does not branch office mortgagee may branch office branch office commercial or meet the requirements of a traditional (non-traditional branch office). The determine the location and type of its facilities. The non-traditional facility may be located in either non-commercial space. Each branch office must be registered by HUD. A loan correspondent is also permitted to establish branch offices in accordance with 24 CFR Subsection 202.5(k) (HUD Handbook 4060.1 Chapter 5).

2. Suggested Audit Procedures

   a. Determine that all branches are registered with HUD by review of the appropriate form or screen printout.

   b. Through inquiry and/or physical observation, determine that the branch is a true branch and is not a subsidiary, net branch, independent contractor, agent of the auditee or separate entity. A mortgagee with a separate tax ID number is required to have approval as a mortgagee in its own right. A branch must have at least one employee, including a branch manager, that serves only that branch. The branch office should have its own telephone and maintain its own accounting records.

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

   d. Determine that the branch office is located in space which is separated by a partition from any other entity and is clearly identified to the public and that the branch office's operating costs are paid by the approved mortgagee or loan correspondent.

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

C. Loan Origination

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

   Information on the auditee's copy of Form HUD-92900, HUD/FHA Application for Commitment for Insurance Under the National Housing Act must be supported by documents in the auditee files (HUD Handbook 4000.2 REV-1). Mortgagees may not require, as a condition of providing an insured loan, that the principal amount of the loan exceed a minimum amount established by the mortgagee (24 CFR 203.18d).

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

2. Suggested Audit Procedures

   a. Obtain an understanding of the auditee's procedures for processing loan applications. Determine that the auditee's procedures provide that applicant's credit report, employment verification, and verification of deposits are sent directly to the auditee and do not pass through any third party.

b. Obtain a sample of files for loans originated during the audit period to test areas c-f, which follow. This should include loans originated at the auditee's branch offices and by their loan correspondents as well as the central office. Where an auditee uses an independent third party to perform quality control over loan origination, the IA may rely on the testing of loan files performed by the independent third party, provided the IA has reviewed the independent reviewer's procedures, retested some of the same files chosen for testing, and the independent written reports indicate no significant discrepancies were identified.

c. Review loan file documentation for evidence that a face-to-face interview with the loan applicant was conducted by a company employee and that the completed loan application was reviewed with the loan applicant. A face-to-face interview is required only when the applicant puts down less than ten percent and does not have homeownership counseling.

d. Review all files in the sample for any forms that have been signed by the mortgagee but not completed by the applicant.

e. Determine that all employment and income data is supported by a verification of employment or other sources, especially for self-employed applicants and applicants with non-employment income. Review loan file documentation for evidence that the mortgagee reconciled any conflicting information prior to submitting the application package to the HUD Field Office for endorsement.

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

g. Obtain a sample of files for rejected loans during the audit period. Review for the following:

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

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

h. Test whether loan correspondents are selling mortgages to other than their sponsors without prior HUD approval. In connection with the Direct Endorsement Program, to determine that the loan correspondent does not underwrite loans, review selected loan documentation for indications of underwriting by the loan correspondent.

i. Review the agreements between the auditee and its staff appraisers and test for compliance with Handbook 4000.4 REV-1, Chapter 2.

D. Loan Settlement

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

4000.2 REV-1, and Chapter 7, 24 CFR 203.27).

2. Suggested Audit Procedures

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

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

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

   d. Ensure points and closing costs are accurate. Determine whether the differences may be due to discriminatory practices.

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

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

   g. The Form HUD-92900 contains the acquisition cost of the property. The HUD-1 contains the amount of the insured mortgage. Compare the amount of the insured mortgage to the acquisition cost to determine that the mortgagor made the minimum investment.

   h. Examine the canceled check or other supporting documentation for evidence that the mortgage insurance premium is submitted to HUD, in accordance with HUD policy at the time of closing, by the mortgagee. Test that payment reached HUD's depository within 15 days of closing.

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

E. Loan Servicing

1. Compliance Requirement. Mortgagees and loan correspondents which service HUD/FHA insured loans are permitted to collect certain fees from the borrowers in accordance with HUD regulations (HUD Handbook 4330.1, Chapter 4). Mortgagees which service insured Home Equity Conversion Mortgages (HECM), with adjustable rate mortgages are responsible for adjusting those rates in accordance with the annual and lifetime caps as established by Handbook 4235.1 . Loan servicing procedures are to be followed consistently and should not vary based on any of the prohibited bases.

2. Suggested Audit Procedures

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

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

(1) Obtain an understanding of the auditee's servicing procedures.

(2) Ascertain whether the auditee maintains individual servicing records documenting collection (loan servicing) activities.

(3) Review the servicing records for recorded collection contacts attempted and completed.

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

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

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

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

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

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

(2) Review the payment records of selected mortgagors to ascertain whether:

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

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

(3) Review the auditee's procedures for the handling of

partial payments. Obtain a representation letter from the auditee concerning such procedures

e. Inquire whether the auditee has implemented steps to comply with the provisions of HUD's Loss Mitigation procedures. Such steps would include informal forbearance, workout agreements, acceptance of partial payments and deeds in lieu of foreclosure. Review selected claims files for evidence that such relief measures were considered (refer to Mortgagee Letters 96-11 , 96-25, 96-32 and 96-61).

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

g. Compare charges assessed to borrowers for servicing activities to allowable amounts. For the loans selected:

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

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

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

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

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

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

j. Select a sample of adjustable rate HECMs and test that the limitations of the 2% annual and 5% lifetime caps are not being exceeded by the mortgagee.

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

F. Escrow Accounts

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

2. Suggested Audit Procedures

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

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

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

d. On accounts selected for review, inspect supporting documents for escrow disbursements such as receipted invoices, tax bills, and canceled checks.

e. Test whether escrow funds are deposited in accounts fully insured by the Federal Deposit Insurance Corporation (FDIC), or National Credit Union Administration (NCUA) and whether the auditee covered any overdrafts on selected accounts by advancing its own funds to custodial accounts so that FDIC or NCUA insurance protection was not impaired. HUD regulations neither require or forbid that escrow accounts bear interest. However, in those cases where accounts are interest bearing, test whether interest earned, less expenses, is passed on to the mortgagor.

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

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

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

i. Inquire whether the auditee requires the mortgagor to purchase hazard insurance coverage from the auditee or from a specific company. This practice may fall within the purview of the Sherman Anti-Trust Act.

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

G. Section 235 Assistance Payments

1. Compliance Requirement. Under Section 235, HUD sends assistance payments to the mortgagee on behalf of the mortgagor as long as the mortgagor is eligible for the payments. HUD executes a contract with the mortgagee for each mortgage. Once a mortgage is insured, many of the initial eligibility criteria cease their applicability, however, the mortgagor must meet other continuing eligibility criteria. In addition, the mortgagee must secure recertifications of income, family composition, occupancy and employment at least annually and as otherwise required by HUD (HUD Handbook 4330.1 REV-3, Chapter 10).

2. Suggested Audit Procedures

a. Select a representative sample of mortgagors receiving Section 235 Assistance Payments from the records of the mortgagee.

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

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

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

d. Select a sample of individual loan files and:

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

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

(3) Ascertain that the recertification was completed

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

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

H. Federal Financial and Activity Reports

1. Compliance Requirement. Mortgagees participating in HUD-assisted activities are required to ensure that financial status, Single Family Default Monitoring, and reports required under the Home Mortgage Disclosure Act contain reliable data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements, Handbooks and Mortgagee Letter contain the specific reporting requirements that the mortgagee is to follow (Handbooks 4330.1 REV-3, Chapter 7 and 4155.1 REV-4, Chapter 3; Mortgagee Letter 95-3).

2. Suggested Audit Procedures

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

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

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

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

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

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

I. Kickbacks

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

2. Suggested Audit Procedures

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

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

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

J. Mortgagee Approval Requirements

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

Entity Type	Amount

Loan Correspondent	$50,000 plus $25,000 per branch, up to maximum of $250,000.
Direct Endorsement	$250,000 plus 1% of mortgage
Nonsupervised Mortgagees	volume in excess of $25 million, up to maximum net worth of $1 million.
Multifamily only Nonsupervised Mortgagees	$250,000

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

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

2. Suggested Audit Procedure

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

7-6 ADJUSTED NET WORTH

A. REQUIREMENT. An FHA computation of Adjusted Net Worth is required for all nonsupervised mortgagees and loan correspondents even if there were no loans originated or serviced during the audit period. The required amount, which must be maintained throughout the year, varies by program participant type and approval date per the guidance in Section J, Mortgagee Approval Requirements. Where the mortgagee/loan correspondent is a subsidiary, the adjusted net worth computation must focus on the assets and liabilities of the individual (non-consolidated) entity with the HUD audit requirement.

B. UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are

sometimes required by State law to pledge their assets for the benefit of the community. These pledged assets are acceptable for supervised institutions only.

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

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

   - 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.

   - A receivable from a related party where the affected parties have executed a cross-default agreement 1/ or corporate guarantee agreement 2/ with Ginnie Mae.

3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest3/ unrelated to that person's position as an officer or stockholder of the mortgagee.

1/ 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.

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

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

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

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

management contract renewals.

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

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

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

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

10. Any asset which is principally used 4/ for the personal enjoyment or benefit of an officer, director or stockholder and not for normal business purposes. This includes automobiles and personal residences.

11. "Other Assets" unless the financial statements are accompanied by a schedule prepared by the independent auditor or schedule prepared by the

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

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

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

ATTACHMENT A

REPORT OF INDEPENDENT AUDITORS ON CONSOLIDATING BALANCE SHEET AND

STATEMENT OF INCOME

Board of Directors
ABC Financial Corporation

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

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

(Firm Signature]

[Date]

Attachment B

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 C

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

1. Home Office $ 50,000

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)

Owners' Equity (Net Worth) per Balance Sheet $ ________

Less Unacceptable Assets $ ________

Adjusted Net Worth for HUD Requirement Purposes $

Adjusted Net Worth ABOVE Amount Required $ ______

Adjusted Net Worth BELOW Amount Required $ ______

Attachment D

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

1. Servicing Portfolio* at: ________ ________ $
(end of fiscal year under audit)

2. Add:
Originated* during fiscal year $ ________
Purchased* from Loan Correspondent during fiscal year $ ________
Subtotal $ ________

3. Less:
Amounts included in Line 2:
Servicing retained $ ________
Loan Correspondent purchases retained $ ________
Subtotal $ ________

4. Total $

5. 1% of Line 4 $ ________

6. Minimum Net Worth required $ ________
(Greater of $250,000 or Line 5)

7. Net Worth Required $
(Lesser of $1,000,000 or Line 6)

Stockholders Equity (Net Worth) $ ________
per Balance Sheet

Less Unacceptable Assets $ ________

Adjusted Net Worth $

Adjusted Net Worth ABOVE Amount $ ________
Required

Adjusted Net Worth BELOW Amount $ ________
Required

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

Attachment E

E X A M P L E

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

Minimum Net Worth Required $ 250,000

Stockholders Equity (Net Worth) $ 345,678
per Balance Sheet

Less Unacceptable Assets $ 54,321

Adjusted Net Worth for HUD $ 291,357
Requirement Purposes

Adjusted Net Worth ABOVE Amount $ 41,357
Required

Adjusted Net Worth BELOW Amount $ ________
Required

Attachment F

E X A M P L E

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

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

Attachment G

E X A M P L E

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

1. Servicing Portfolio* at: 6/30/97 ________ (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			$ 25,000,000

retained
Subtotal $ 38,000,000

4. Total $120,054,321

5. 1% of Line 4 $ 1,200,543

6. Minimum Net Worth required $ 1,200,543
(Greater of $250,000 or Line 5)

7. Net Worth Required $ 1,000,000
(Lesser of $1,000,000 or Line 6)

Stockholders Equity (Net Worth) $ 3,456,789
per Balance Sheet

Less Unacceptable Assets $ 345,678

Adjusted Net Worth $ 3,111,111

Adjusted Net Worth ABOVE Amount $ 2,111,111
Required

Adjusted Net Worth BELOW Amount $ ___________
Required

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