

FHA Lender Update

Fall 2017

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HUD Acronym Listing

ACRONYM	DEFINITION
A/E	Architect and Engineering
AAFB	Area Approved for Business
ABA	Annual Budget Authority
ACC	Annual Contributions Contract
AcSEC	Accounting Standards Executive Committee
AFHMP	Affirmative Fair Housing Marketing Plan
AFS	Annual Financial Statement
AHACPA	Affordable Housing Association of CPAs
AICPA	American Institute of Certified Public Accountants
AMP	Asset Management Project
ARC	Annual Required Contribution
ARQ	Audit Required Questions
ARRA	American Recovery and Reinvestment Act
BLI	Budget Line Item
BTA	Business-Type Activities
CA	Contract Administrator
CAAF	Coordinator Access Authorization Form
CAC	EIV Role - Contract Admin. Coordinator (HUD Staff)
CAIVRS	Credit Alert Interactive Voice Response System
CAU	EIV Role - Contract Administrator User (Non-HUD)
CEO	Chief Executive Officer
CFDA	Catalog of Federal Domestic Assistance
CFFP	Capital Fund Financing Program
CFP	Capital Fund Program
CFR	Code of Federal Regulation
CMA	Computer Matching Agreement
COCC	Central Office Cost Center
COSO	Committee of Sponsoring Organizations
CPA	Certified Public Accountant
CPE	Continuing Professional Education
DAS	Deputy Assistant Secretary
DBA	Doing Business As
DCF	Data Collection Form
DE	Direct Endorsement
DEC	Departmental Enforcement Center
DHAP	Disaster Housing Assistance Program
DVP	Disaster Voucher Program
EC	Enforcement Center (see DEC)
EIV	Enterprise Income Verification
ELI	Extremely Low Income
eLOCCS	Electronic Line of Credit Control System
FAIN	Federal Award Identification Number
Fannie Mae	Federal National Mortgage Association

ACRONYM	DEFINITION
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FASS	Financial Assessment Subsystem
FASSMF	See FASSUB
FASS-PHA	Financial Assessment Subsystem - Public Housing Administration
FASSUB	Financial Assessment Subsystem - Submission
FDIC	Federal Deposit Insurance Corporation
FDS	Financial Data Schedule
FDT	Financial Data Template
FHA	Federal Housing Administration
FHA/MF	Federal Housing Administration/Multifamily
FMC	PIH Financial Management Center
FMD	Financial Management Division
FRAG	Financial Reporting and Auditing Guide
Freddie Mac	Federal Home Loan Mortgage Corporation
FSS	Family Self Sufficiency
FYE	Fiscal Year End
GAAFR	Governmental Accounting, Auditing, and Financial Reporting ('The Blue Book')
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	General Accounting Office
GAS	Government Auditing Standards (see GAGAS)
GASB	Governmental Accounting Standards Board
Ginnie Mae	Government National Mortgage Association
HAP	Housing Assistance Payment
HCV	Housing Choice Voucher
HDK	EIV Role - Helpdesk Personnel
HECM	Home Equity Conversion Mortgage (Reverse mortgage)
HEREMS	Housing Enterprise Real Estate Management System
HFU	EIV Role - HUD Field Office User
HHS	Health and Human Services
HMDA	Home Mortgage Disclosure Act
HOC	HUD Homeownership Center (FHA)
HOH	Head of Household
HQA	EIV Role - HQ User Administrator
HQU	EIV Role - HUD HQ User
HSC	EIV Role - Housing Coordinator (HUD staff)
HSU	EIV Role - Non-HUD User
HUD	U.S. Department of Housing and Urban Development
HUD OIG	HUD Office of Inspector General

ACRONYM	DEFINITION
HUD PM	HUD Project Manager
HUDCAPS	HUD Central Accounting and Program System
IAR	Independent Auditor Report
IG	Inspector General
IP	Improvement Plan
IPA	Independent Public Accountant (See CPA)
KDHAP	Katrina Disaster Housing Assistance Program
LASS	Lender Assessment Subsystem
LDP	Limited Denial of Participation
LI	Low Income
LIHTC	Low-income Housing Tax Credit
LLC	Limited Liability Company
LOCOM	Lower of cost or market
M2M	Market to Market-OHMAR Restructured Loans
MAHRA	Multifamily Assisted Housing Reform and Affordability Act
MASS	Management Assessment Subsystem
MCAW	Mortgage Credit Analysis Worksheet
MD&A	Management Discussion and Analysis
MF	Mixed Finance
MFH	Multifamily Housing
MINC	Management Interactive Network Connection (Rural Housing)
MIP	Mortgage Insurance Premium
MOR	Management & Occupancy Review
MRB	Management Review Board
MTW	Moving-to-Work
NASS	iNtegrated Assessment Subsystem
NCGAS	National Council on Governmental Accounting Statement
NCUA	National Credit Union Administration
NDNH	National Directory of New Hires
NH	Nursing Home
NPO	Non Profit Organization
NRA	Net Restricted Assets
O/A	Owners / Management Agent
OAHP	Office of Affordable Housing Preservation
OCBOA	Other Comprehensive Basis of Accounting
OIG	Office of Inspector General
OIG	EIV Role - OIG User
OMB	Office of Management and Budget
ONAP	Office of Native American Programs
OPEB	Other Post Employment Benefits
P&U Division	Processing & Underwriting Division in an HOC
PASS	Physical Assessment Subsystem
PCAOB	Public Company Accounting Oversight Board
PEL	Project expense level

ACRONYM	DEFINITION
PHA	Public Housing Authority
PHAS	Public Housing Assessment System
PIC	PIH Information Center
PIH	(Office of) Public and Indian Housing
PUM/PUPM	Per-Unit per Month
QAD	Quality Assurance Division
QAR	Quality Assurance Review
QASS	Quality Assessment Subsystem
QC	Quality Control
QWHRA	Quality Housing & Work Responsibility Act
R&O	Regulatory & Operating Agreement
RA	Rental Assistance
RAD	Rental Assistance Demonstration Program
RASS	Residential Assessment Subsystem
RDA	Rural Development Agency
REAC	Real Estate Assessment Center
REMS	Real Estate Management System
RESPA	Real Estate Settlement Procedures Act
RHIIP	Rental Housing Integrity Improvement Project
RHS	Rural Housing Services
RMCR	Residential Mortgage Credit Reports
RRH	Rural Rental Housing
RSI	Required Supplementary Information
SAA	Single Audit Agency
SAC	Special Application Center
SAS	Statement on Auditing Standards
SEFA	Schedule of Expenditures of Federal Awards
SFAS	Statements of Financial Accounting Standards issued by FASB
SKE	Skills, Knowledge, Experience
SOP	Statement of Position
SSAE	Statements on Standards for Attestation Engagements
SSN	Social Security Number
SUB	REAC AFS Submitter
TAC	Technical Assistance Center
TFAE	Total Federal Awards Expended
TIN	Tax Identification Number
TPA	Transfer of Physical Assets
TRACS	Tenant Rental Assistance Certification System
TSP	Tenant Selection Plan
UAAF	User Access Authorization Form
UEL	Utility Expense Level
UFRS	Uniform Financial Reporting Standards
UI	Unemployment Benefits
UII	Unique IPA Identifier

ACRONYM	DEFINITION
URL	Uniform Resource Locator
VASH	HUD Veterans Affairs Supportive Housing Program
V-Form	Yearly Verification Report for Lender
VLI	Very Low Income
VMS	Voucher Management System
WASS	HUD's Secure Connection / Secure Systems
Yellowbook	Government Auditing Standards issued by GAO (See GAGAS)

about AHACPA

Submission Services



ABOUT AHACPA

HISTORY:

AHACPA was founded in 1998 to offer electronic submission services for multifamily housing as well as training. In January of 2002 Mike Olsen & Les Sparks purchased AHACPA. Since that time we have expanded submission and training services to include HUD-approved lenders and Public Housing Authorities. We increased membership from 200 member firms to over 500, and we have quadrupled the number of courses we offer.

SUBMISSIONS:

AHACPA is nationally recognized for its training, technical support, troubleshooting and electronic submission of HUD annual financial statements. Since 1998 AHACPA has submitted thousands of annual financial statements for owners, agents, and CPAs. Our submission service is efficient, timely, and cost effective. We perform the complete submission process for you, within HUD's required time frame, at a competitive fee.

TRAINING:

AHACPA has been offering continuing professional education courses throughout the United States for over 15 years. Our Multifamily courses provide audit training and HUD updates for auditors, owners & managers of HUD-subsidized multifamily properties. Lender courses provide audit training and HUD updates for auditors & owners of HUD-Approved lenders. The PHA conference provides audit training and HUD updates for PHA financial personnel, fee accountants, financial managers & auditors. AHACPA is NASBA certified.

MEMBERSHIP:

AHACPA currently has over 500 member firms. Members' benefits include technical support, access to templates & tools, and discounts at our trainings.

THE PEOPLE

LES SPARKS, PRESIDENT

Les is President of the Affordable Housing Association of Certified Public Accountants. Prior to this, Les was involved in various capacities in the software manufacturing for governmental "Case Management" systems for governmental agencies. He was the Chief Financial Officer for Professional Staff Management, a large employment services firm. Les began his career with the international accounting firm of Ernst & Young. He spent over 13 years at E&Y providing accounting, auditing and consulting services to variety of clients in many industries. Les is an accomplished trainer in both software and accounting issues. Les has a Masters of Accounting.

As president of AHACPA, Les provides support to the more than 600 members of the association. This support includes the interpretation of accounting and auditing and financial statement requirements as specified by the Department of Housing and Urban Development. Such support is provided either by phone, email or other means and is designed to assist the members in correctly reporting financial information to HUD's Real Estate Assessment Center.

Les is responsible for the development and presentation of training programs which provide continuing professional education (CPE) to auditors and other users of the relevant REAC systems. Les also supervises the

preparation of over 700 annual financial statement submissions under multifamily, public housing and FHA lender requirements.

MIKE OLSEN, CFO

Mike brings twenty-six years of experience in accounting, auditing, tax planning and educational program development and delivery. Mike has a Master's of Business Administration and is a Certified Public Accountant. Mike also has 12 years of specialized experience in the housing industry with a specific emphasis on the audit, financial reporting and submission requirements specifically required by the Department of Housing and Urban Development for HUD-approved lending, multifamily and public housing areas. Prior to joining AHACPA, Mike was employed by the international accounting firm of Ernst & Young for approximately 2 years and most recently has been self-employed with his own accounting and tax practice for the past 18 years. Prior to that he spent five years as Chief Financial Officer and Accounting Manager for Skaggs Management Company.

KATHY CHRISTENSEN, OFFICE MANAGER

Kathy has been with AHACPA from its very beginning. With over 15 years in experience with the REAC system she is one of the country's foremost experts on the submission process. She is frequently called upon by REAC for testing and trouble shooting of the multifamily submission system. Kathy has extensive background in office software solutions and is also responsible for the company's website as well as audit tools and other application development. Kathy's submission responsibilities include the receipt, logging and tracking of all multifamily submissions. She makes assignments to the keying staff and ensures that all client submitted packages are in the proper format for keying. Kathy uses her many HUD contacts to work out any submission problems that arise to ensure prompt resolution of issues preventing submission.

SUSAN HARRIS, ACCOUNTING SUPERVISOR

Susan has been with AHACPA full time for 7 years, and for 3 years prior as data entry during peak busy season. Susan processes all the invoicing and receipts for AHACPA, and correlates all bookings and logistics for private classes. She handles all the FHA submissions, from receipt, logging and tracking until acceptance. She also assists with PHA submissions.

OTHER STAFF:

AHACPA will also utilize other staff to assist in the timely submission of financial statements during our peak busy season time. Such individuals are selected based on the team's personal knowledge of the required skill sets including, prompt and accurate data entry as well as the judgment required to make decisions regarding issues that may arise during the submission process. Such decision making is critical in being able to complete the volume of submissions timely. These individuals are also trained to communicate any such issues to the client or the CPA for proper resolution of the matter. Each of these individuals has a minimum of 5 years experience performing multifamily submissions with AHACPA. It is likely that your account will be serviced by one dedicated staff for the majority of the submissions to ensure a consistent approach throughout.



Membership

The Affordable Housing Association of Certified Public Accountants (AHACPA) is the premier national association providing support, training, and services for professionals of the Affordable Housing Industry and HUD-Approved Lending Industry. Our objective is to inform you of the latest HUD requirements and provide specific guidance on how to implement those requirements.

Membership Benefits

Technical Support

As a Premium AHACPA member, you have access to AHACPA's technical support. This invaluable resource can save you hours of tracking down information or trying to get guidance, direction or assistance from HUD. We have probably experienced any HUD problem you are facing. Please use the [AHACPA Support Center](http://support.ahacpa.org) (<http://support.ahacpa.org>) to post any questions. We receive tech support requests from members and non-members alike. **Our new support system will automatically give priority to AHACPA members.**

Continuing Professional Education

AHACPA offers a variety of CPE Courses. Members attending courses receive a \$50 discount off the registration fee.

The Affordable Housing Conferences are held annually. These two-day Conferences feature nationally recognized speakers and representatives from HUD Multifamily and Public Housing. These speakers and representatives present sessions on the latest affordable housing revisions.

We also offer one-day update courses for Multifamily and Lenders. Course descriptions, dates and locations can be found at our Website.

AHACPA Templates

Templates are downloadable standard document files. These templates provide illustrations and workable files you can customize when producing these documents. If there is a template that you are looking for and can't locate on our website please let us know.

Analytical Review

AHACPA conducts a bi-yearly multifamily analytical review project. We collect copies of REAC submissions and compile the data for your analytical review purposes. Access to this data is limited to those that provide us with submission copies and *AHACPA members*.

Referrals

AHACPA frequently receives calls requesting referrals for a CPA firm to perform audits and peer reviews. When providing referrals we always first refer to our membership list: <http://ahacpa.org/aMember/directory>

Membership Dues

Membership dues are \$300 annually, per office location. To sign up for membership in the AHACPA complete the Membership Registration form attached, or register online: <https://ahacpa.org/aMember/signup>

Other AHACPA Benefits

AHACPA Forms, Publications and Guides

Forms, Publications and Guides contain current affordable housing & lender documents. These can be found on our website separated in three sections: HUD Multifamily, Public Housing and Lenders.

Submission Services

AHACPA has submitted thousands of annual multifamily and lender financial statements for owners, agents, and CPAs. Our submission service is efficient and cost effective. We perform the complete submission process for you, within HUD's required time frame. We offer this service for multifamily and lenders. For more information on multifamily submissions contact Kathy (kathy@ahacpa.org). For more information on lender submissions contact Susan (susan@ahacpa.org).

AHACPA Newsletter

AHACPA keeps you informed of the latest affordable housing and HUD-approved lender news and updates. This news is via email in our newsletter. If you know of anyone that would like to be added to our email list please send their name and email address to info@ahacpa.org.

For more information concerning these and other services please visit our website at www.ahacpa.org.

AHACPA



459 N 300 W #11 | KAYSVILLE, UT | 84037 | (800) 532-0809

Membership Application

Fee of \$300 per Office Location

Membership Main Contact (this is the person that will receive the renewal notice):

Name:	_____	Title:	_____
Firm pName:	_____		
Address:	_____	City:	_____
State:	_____	Zip Code:	_____
Phone Number:	_____	Fax:	_____
Email:	_____		

Please list name and email address of co-workers that want to receive AHACPA email news:

Method of Payment:

TOTAL \$ _____ MasterCard Visa Discover American Express Check (address above)

Cardholder's Name _____

Card Number _____ CVV _____ Exp: _____

Billing Address _____

Signature _____

Email for CC Receipt _____

Announcing AHACPA's EZsub Service

AN INNOVATIVE SOLUTION FOR HUD'S MULTIFAMILY ELECTRONIC SUBMISSION PROCESS

AHACPA Submission Services	EZsub	Platinum
Client fills out the EZsub Excel template.	✓	
AHACPA processes the information through our innovative/proprietary EZsub upload software.	✓	
AHACPA provides client with a status report. Client continues the remaining submission steps.	✓	
AHACPA assists with ID registration and setup		✓
AHACPA assists with iREMS problems (iREMS = HUD's database of property information)		✓
AHACPA enters Data into HUD's Multifamily Financial Assessment Subsystem (FASSUB)		✓
AHACPA clears any errors and validates the submission		✓
AHACPA communicates with client regarding additional information that may be needed and updates the submission		✓
AHACPA provides a copy of the submission report & Auditor's Agreed-Upon Procedures Report in pdf format (using a secure file portal)		✓
AHACPA makes client requested updates or corrections to the electronic submission		✓
Upon client approval, AHACPA fills out the online Agreed-Upon Procedures Report on behalf of the audit firm		✓
Upon client approval, AHACPA finalizes the electronic submission		✓
AHACPA provides client with a final copy of the submission in pdf format. This includes the Submission Confirmation Page, the Agreed-Upon Procedures Report & the Final Submission Report.		✓
Pricing	\$150	\$500

Benefits of AHACPA's EZsub Service

Fast

Using AHACPA's new **EZsub** service will save you time. You can enter your financial information directly into the **EZsub** Excel template or map the data from another spreadsheet. Regardless of your method of data entry, there will be no more struggling with HUD's Multifamily Financial Assessment Subsystem (FASSUB) sluggishness and outages. You just fill out the **EZsub** Excel template and send it to AHACPA. AHACPA will upload your data using the **EZsub** proprietary software. We will run the program at night. Since fewer people are on the system at night, submissions can be processed more efficiently. Your submission is entered while you rest! After AHACPA has processed your **EZsub** Excel template, you just log into HUD's FASSUB, review the submission, make any necessary changes and finalize.

Accurate

The AHACPA **EZsub** Excel template has multiple error checking methods. Comments/errors pop up as you enter the data. When you have entered all data just click on the "check errors" button and any outstanding errors are listed. The **EZsub** Excel template checks for all of the FASSUB business rules, required accounts, required subordinate accounts, required subtotals, additional details (when necessary), proper date formats, correct number formats, it informs you when an account is off *and by how much*, and more!

Efficient

The FASSUB system has 11 main data entry pages and 60+ details pages. Moving from one page to the next requires saving your information, going back to the previous page, and then moving to the next page. When validating your submission and clearing the errors it can be particularly time consuming and frustrating. Each of those steps means you have to wait for the page to load. During peak usage times this process is especially laborious.

The AHACPA **EZsub** Excel template has all of the accounts from the 11 main FASSUB pages on one single worksheet. Another worksheet has all of the details. Unlike the FASSUB system, there is no saving and waiting for the next step to load. [Although we do recommend you save frequently]. Hyperlinks are contained throughout the **EZsub** Excel template to aid in quickly navigating to and from the details.

Economical

It can be costly paying staff to wrestle with the ins & outs of HUD's system. Don't waste your money and your staff's time. Give the AHACPA **EZsub** Service a try today.

Application for **EZsub** Service

AN INNOVATIVE SOLUTION FOR HUD'S MULTIFAMILY ELECTRONIC SUBMISSION PROCESS

How the Process Works

- ✓ Client fills out **EZsub** application.
 - ✓ AHACPA creates an account for client in *ShareFile*, our secure file portal (256-bit encryption).
 - ✓ AHACPA provides client with the **EZsub** Excel Template.
 - ✓ Client fills out information in **EZsub** Excel Template and uploads completed file to secure file portal.
 - ✓ AHACPA processes the file using the proprietary **EZsub** software.
 - ✓ AHACPA provides the client with status report.
 - ✓ Client logs into REAC/FASSUB and continues with the submission process as though they have personally entered the data.
 - ✓ AHACPA invoices client.
-

Pricing

The price is \$150 per project, per upload.

Limitations

Please check each item to indicate you are aware of the following limitations:

- EZsub** does not handle consolidated submissions (multiple projects under one Tax ID Number).
 - EZsub** has a limit of 10 details per miscellaneous account. Client can manually enter after upload.
 - EZsub** works with Excel version 2007 and up.
-

Conditions

Please check each item to indicate you agree to the following conditions:

- Do not change any formulas in the **EZsub** Excel Template.
 - Do not password protect the **EZsub** Excel Template.
 - Do clear all errors before sending to AHACPA.
 - Do verify your username is correct and the password is current, working, and will not expire soon.
-

I have read, acknowledge, and agree to the limitations and conditions listed above.

(Signature & Date)

Billing Information – *We will send you an invoice after your submission has been uploaded*

Name: _____ Title: _____

Company: _____

Address: _____

City: _____ State: _____ Zip Code: _____

Phone: _____ Fax: _____

Email: _____

Project Information

Please provide the following for each of the project(s) for which you will be using this service. Or attach a separate list with the pertinent information.

Project Name	Year End	Tax ID Number
_____	_____	_____
_____	_____	_____
_____	_____	_____
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_____	_____	_____

AHACPA is nationally recognized for its training, technical support, and troubleshooting regarding FHA annual recertification requirements and electronic submission service of HUD required annual financial statements. Since 2002 AHACPA has submitted thousands of annual financial statements for CPAs and Lenders. Our submission service is efficient, timely, and cost effective. We perform the complete submission process for you, within HUD's required time frame, at a competitive fee.

Submission Service Process in Nine Easy Steps:

1. The mortgagee forwards the audited financial statement packet, including the LEAP FDT template to AHACPA.
2. AHACPA enters the data and uploads required items.
3. AHACPA emails the auditor a copy of the submission report along with a copy of the IPA Procedures report generated by the LEAP system.
4. The auditor reviews the reports and informs AHACPA of any necessary changes.
5. When everything is in agreement, the auditor marks the "Agrees/No Such Document Issued" circles on the IPA Procedures report, signs and sends it back to AHACPA.
6. AHACPA completes IPA Procedures report on behalf of the auditor.
7. AHACPA completes and submits the submission.
8. AHACPA emails both the auditor and the mortgagee a confirmation of the completed submission.
9. AHACPA monitors the submission until it's accepted.

Information Needed for Submission:

- Information sheet COMPLETELY filled out
 - FHA Coordinator ID, and Current Password (they change every 21 days)
 - Copy of entire financial statement package, including supplemental data:
 - Applicable Auditor's Reports, HAND signed, on letterhead.
 - Computation of Adjusted Net Worth.
 - Schedule of Audit Findings – whether there are any findings or not.
 - Corrective Action Plan, if applicable, submitted on the mortgagee letterhead and signed.
 - Management Letter if referenced in reports, and if required, a corrective action plan.
 - LEAP Financial Data Template, filled out for specified Lender type: Supervised – Large, Small, Non-Supervised, Investing http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/SFH_Lenders_LEAP
 - CPA Certification and other items, Call Report, Consolidating schedules, etc. as required from info sheet
-

Submission Fee:

The fee for AHACPA HUD FHA electronic submissions is \$400 per submission. Invoices payable upon receipt.

REQUIRED SUBMISSION INFORMATION

PLEASE fill out LEGIBLY, AND COMPLETELY – thanks!

LENDER Information:

FHA Connection Coordinator ID: _____

ID should start with an Mxxxxx, have 6 digits.

FHA Connection 8 digit password: _____

Effective Nov 30, 2013 passwords required to be 8 characters in length and include at least one uppercase letter, one number, and one special character (e.g., @, \$, &).

Title I/II Number: _____

Lender Name: _____

LENDER Owner / Comptroller Information:

First Name: _____ Last Name: _____

Job Title: _____ Phone #: _____ x _____

Fax #: _____ Email: _____

AUDITOR Information:

Name: _____ Title: _____

Firm: _____ EIN #: _____

Address: _____ UII#: _____

City: _____ State: _____ Zip Code: _____

Phone: _____ Fax: _____ Email: _____

AUDITORS, Please ANSWER ALL:

FINANCIAL STATEMENT INFO:

Is the FHA approved lender a subsidiary in a parent-subsidary relationship? Y / N **IF Y**, then: Are you submitting audited consolidated Financial Statements of the parent company, or subsidiary? Consolidated / Subsidiary

[Supervised Lenders only:

IF Consolidated, then: Is subsidiary 40%> of parent? Y / N (**IF Y**, then unaudited consolidating schedules or call report is required).

IF N, then: Does the subsidiary have a guarantee by the parent? Y / N (**IF Y**, then corp guarantee needs to be attached and unaudited consolidating schedules or call report req.) (**IF N**, then audited consolidating schedules required).]

Audit was conducted in accordance with which auditing standards? AICPA/GAGAS PCAOB/GAGAS

Type of Audit Opinion Issued: Unqualified/Unmodified Opinion Other, please list: _____

Type of Audit Opinion on supplemental info: Unqualified/Unmodified Opinion Other, please list: _____

Is a going concern paragraph included in auditor's report? Y / N

Reported Findings – Significant Deficiencies? (Related to IC over financial reporting) Y / N

Reported Findings – Material Weaknesses? (Related to IC over financial reporting) Y / N

Reported Findings – Material Non-Compliance? (Related to the financial statement audit) Y / N

HUD COMPLIANCE AUDIT:

Type of Audit Opinion Issued: Unqualified Opinion Other, please list: _____

Reported Findings – Significant Deficiencies? (Related to IC over compliance) Y / N

Reported Findings – Material Weaknesses? (Related to IC over compliance) Y / N

Reported Findings – Material Non-Compliance? (Related to HUD compliance audit) Y / N

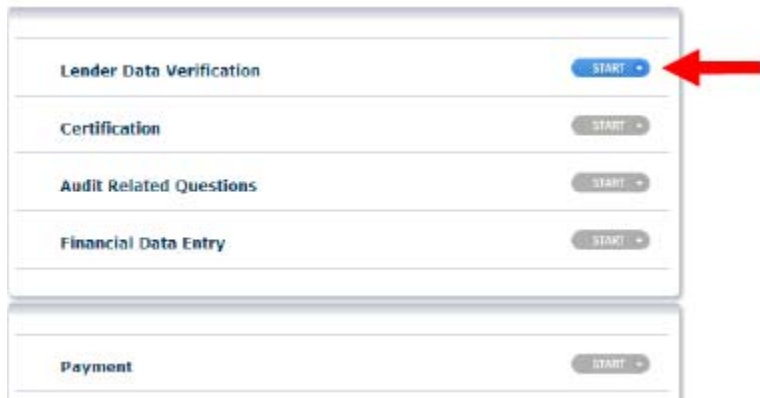
MANAGEMENT LETTER:

Were certain matter communicated to management not disclosed in audit reports? Y / N (IF Y, this letter HAS to be uploaded, along with a CAP).

CPA Firm or Practitioner License: Evidence is **INCLUDED** indicating that the CPA Firm or practitioner is licensed in the state where the FHA approved entity's home office is located (or books and records are kept).

LENDER CHECKLIST:

FIRST: These 3 items are **COMPLETED** in LEAP – Lender Data Verification, Certification & Payment.



SECOND: To Susan (via email or [Send a Secure File](#))

FINAL Audited package, including Reports on Internal Control and Compliance – on letterhead and hand signed, and a schedule of Findings, whether there are any or not – it's a required upload.

FDT – filled out per specific lender type

Computation of Adjusted Net Worth

CPA Certification

SUPERVISED only – Additional items as per questions answered on previous page:

Unaudited consolidating schedules

Audited consolidating schedules

Signed, final 4th quarter Call Report

Corporate Guarantee

SECTION





Office of Lender Activities and Program Compliance

Federal Housing Administration (FHA): Financial Audit Requirements for FHA Lenders

December 12, 2016

Presented by:

Monique R. White-Chisolom

Supervisory Auditor, Lender Recertification Branch

The information in this document is current as of the Last Update date noted above. This document does not establish or modify the policy contained in FHA's Handbooks and Mortgage Letters in any way.



Overview

- Initial Federal Housing Administration (FHA) Approval
- Annual Recertification
- What's New in FHA Recertification?
- Helpful References





Initial FHA Approval

An applicant must fully comply with all of the following requirements **in order to be approved** by FHA to participate in the origination, underwriting, closing, endorsement, servicing, purchasing, holding, or selling of FHA-insured Title I or Title II mortgages.



Preparing for FHA Approval

- Meet all eligibility requirements, including net worth, liquidity, principal activity, in order to obtain FHA approval.
- Audited financial statements cover 12 months of operation.
- End date of audited financial statements aligns with fiscal year end.
- End date of audited financial statements more than six months old, submit most recent unaudited financial statements signed by a corporate officer.
- Operating for fewer than 12 months, submit audited financial statements to cover all months of operation.
- Income statement and cash flow statement not required if new institution.





Preparing for FHA Approval (cont.)

- Small Supervised institutions must submit signed, unaudited regulatory report (call report) that aligns with fiscal year end.
- Large Supervised, Non-Supervised, or Investing institutions submit audited financial statements.
- Government institutions are not required to provide financial documentation.
- Audited financial statements must be in accordance with Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS).
- Independent Auditor's Report must include opinion on Supplementary Information (Computation of Adjusted Net Worth) and Computation of Adjusted Net Worth.



5



Preparing for FHA Approval (cont.)

- Minimum adjusted net worth of at least \$1,000,000 at fiscal year end.
- No less than 20 percent of institution's required adjusted net worth must be in liquid assets.
- Meet FHA's principal activity requirement by deriving at least 50 percent of its activities from:
 - Real estate mortgages, consumer installment notes, or similar advances of credit;
 - Purchasing consumer installment contracts or a directly related field.
 - A directly related field is something directly related to the investing or lending of mortgages, not simply actions relating to real estate in general.
- Corrective action plans are not acceptable.



6



Initial FHA Approval: Common Deficiencies

- Minimum adjusted net worth of \$1,000,000 not met.
- Capital contributions do not meet FHA requirements – fail to provide documentation to support contributions.
- Financial statements do not align with fiscal year end.
- Interim financial statements not provided.
- Most recent signed call report not provided.
- Failed to include audited, consolidated schedules or call reports with consolidated financial statements.
- Audited financial statements disclose unacceptable assets.



Annual Recertification

A mortgagee must fully comply with all of the following requirements **in order to retain** FHA approval to participate in the origination, underwriting, closing, endorsement, servicing, purchasing, holding, or selling of FHA-insured Title I and Title II mortgages.





General Requirements

- Complete FHA's recertification process on an annual basis.
- Submit annual recertification packages through the Lender Electronic Assessment Portal (LEAP).
- Mortgagee must submit:
 - Online certification
 - Recertification fee
 - Financial statements
- Each recertification package is due within 90 days after its fiscal year end.
 - Example: If a mortgagee's fiscal year end is December 31, 2016, the recertification package is due by March 31, 2017.



Preparing for Annual Recertification

- Confirm and/or update administrative contact information.
- Ensure corporate officer information is accurate.
- Verify that corporate officers have access to LEAP and are assigned the certifying official role (maximum of three).
- Review notices of material events previously submitted to FHA.
- Report lender segment changes.
- Preview certification statements.
- If unable to certify is anticipated—gather supporting documentation for all events that will prevent lender from certifying (i.e. consent orders, MOUs, settlements, agreements, etc.).





What's New in FHA Annual Recertification Certification Statements

- FHA implemented revised certification statements for all mortgagee types on August 1, 2016.
- The changes were applied starting with mortgagees with July 2016 Fiscal Year End.
- The revised certification statements can be found in the Annual Recertification Section at www.hud.gov/lenders.



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Annual Recertification: Common Deficiencies

Mortgagees

- Audited, consolidated schedules or call reports
- Financial Data Template
 - Whole dollars instead of rounded to thousands
 - Data for consolidated entity, not FHA approved entity only

Small Supervised Mortgagees

- Signed call report
- FDT

Adjusted Net Worth

- Computation does not include FHA activity
- Computation based on consolidated entity instead of FHA approved entity
- Capital contributions not supported properly
- Audited, consolidated schedules or call reports



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Annual Recertification: Common Deficiencies (cont.)

Notice of Material Event (NME)

- Failure to submit NME
- Failure to submit NME within 10 business days
- Report all changes, including but not limited to:
 - Liquid Assets or Net Worth Deficiency
 - Operating Loss
 - Principal Activity
- Lack of detailed explanation and supporting documentation



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What's New in FHA – Multifamily Mortgagees

Quality Control Plan (QC)

- Quality Control (QC) requirements are based on the mortgagee's FHA lender approval—Single Family and/or Multifamily.
- Mortgagees approved to conduct Multifamily Housing activities *only*, should adhere to the QC requirements described in the Multifamily Accelerated Processing (MAP) Guide.
- Mortgagees approved to conduct with Multifamily and Single Family Housing activities must implement QC requirements for both programs. The QC requirements for Single Family Housing are outlined in the *Single Family Housing Policy Handbook* 4000.1 (SF Handbook).



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Helpful References

- FHA Connection user registration details:
<https://entp.hud.gov/clas/reginfo.cfm>
- SF Handbook 4000.1, *Doing Business with FHA*:
<http://portal.hud.gov/hudportal/documents/huddoc?id=40001HSGH.pdf>
- LEAP User Manual:
http://portal.hud.gov/hudportal/documents/huddoc?id=SFH_LEAP_user_manual.pdf
- HUD Audit Guide:
<http://www.hudoig.gov/reports-publications/audit-guides/consolidated-audit-guides>



Helpful References (cont.)

- ***Lender Insight***:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/SFH_Lender_Insight
- ***Single Family Housing News (FHA INFO) emails***:
 - Provides the lending industry with updates on new Mortgagee Letters, Handbooks, and other notices, as well as a FHA Housing Industry Training.
 - To sign up go to:
[http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/FHA INFO subscribe](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/FHA_INFO_subscribe)





Helpful References (cont.)

The FHA Resource Center

- www.hud.gov/answers: FHA's Online Knowledge Base helps you find answers 24/7; with **2000+ Qs and As** addressing 90 percent of our phone calls **and** announcements of policy changes and training opportunities.
- **Email:** answers@hud.gov
- **Phone:** **(800) CALL-FHA** or (800) 225-5342
Monday through Friday, 8:00 am – 8:00 pm ET on all non-Federal holidays



Questions?





2017 Developments

- Answering Certification Questions
 - Q7 – Findings related to Handbook 4000.1
 - Section I – Doing Business With FHA
 - Section V – Quality control, Oversight and Compliance

- 3 Key Compliance Requirements
 - Deficiency at Y/E automatic referral to Mortgagee Review Board
 - Net Worth
 - Liquidity
 - Principal Activity



2017 Developments

- Notice of Violation (NOV) mailed out 1st of each month
 - Certified letter
 - Respond within 30 days



SECTION



FHA Lender Annual Certifications – Supervised and Nonsupervised Mortgagees
Active as of 8/1/2016

Capitalized terms in the following statements refer to those terms as used in HUD Handbook 4000.1.

1. I certify that I am a Corporate Officer of the abovementioned Mortgagee (hereinafter referred to as “the Mortgagee”); that I am authorized to execute these certifications and acknowledgements on behalf of the Mortgagee; and that throughout the Certification Period I have known, or been in the position to know, whether the operations of the Mortgagee conformed to all HUD regulations and requirements necessary to maintain the Mortgagee’s FHA approval as codified in 24 CFR § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between the Mortgagee and HUD.
2. I acknowledge that the Mortgagee is responsible for all actions of its officers, partners, directors, principals, managers, supervisors, loan processors, loan underwriters, loan originators, and other employees of the Mortgagee, and for the actions of any Affiliates participating in FHA programs for or on behalf of the Mortgagee.
3. I certify that, to the best of my knowledge and after conducting a reasonable investigation, during the Certification Period, neither the Mortgagee nor any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator employed by or under contract with the Mortgagee:
 - (a) Was subject to a suspension, debarment, Limited Denial of Participation (LDP) or other restriction imposed under 24 CFR Part 24, and 2 CFR Part 180 as supplemented by 2 CFR Part 2424, or any successor regulations to such parts, or under similar provisions of any other federal or state agency;
 - (b) Was under indictment for, or convicted of, an offense that reflects adversely upon the Mortgagee’s integrity, competence, or fitness to meet the responsibilities of an FHA-approved Mortgagee;
 - (c) Was subject to Unresolved Findings as a result of a HUD or other governmental audit, investigation, or review;
 - (d) Was refused, or had revoked, any license necessary to conduct normal operations in the real estate or mortgage loan industry;
 - (e) Was in violation of provisions of the Secure and Fair Enforcement (SAFE) Mortgage Licensing Act of 2008 (12 U.S.C. 5101 et seq.) or its equivalent under state law, including all Nationwide Multistate Licensing System and Registry requirements;

except for those occurrences, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.

4. I certify that, to the best of my knowledge and after conducting a reasonable investigation, neither the Mortgagee nor any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator employed by or under contract with the Mortgagee:

- (a) Was convicted of, or pled guilty or *nolo contendere* to, a felony related to participation in the real estate or mortgage loan industry during the Certification Period or the 7-year period preceding the first day of the Certification Period;
- (b) Was ever convicted of, or ever pled guilty or *nolo contendere* to, a felony related to participation in the real estate or mortgage loan industry that involved an act of fraud, dishonesty, or a breach of trust or money laundering;

except for those occurrences, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.

5. I certify that, to the best of my knowledge and after conducting a reasonable investigation, during the Certification Period or the 3-year period preceding the first day of the Certification Period, neither the Mortgagee nor any officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator employed by or under contract with the Mortgagee:

- (a) Was convicted of, indicted for, or otherwise criminally or civilly charged by a governmental entity (federal, state or local) with commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public transaction or contract under a public transaction;
- (b) Was convicted of, indicted for, or otherwise criminally or civilly charged by a governmental entity with violation of federal or state antitrust statutes or commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property;
- (c) Had one or more public transactions terminated for cause or default;

except for those occurrences, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.

6. I certify that, to the best of my knowledge and after conducting a reasonable investigation, during the Certification Period the Mortgagee was not sanctioned by any federal, state, or local government agency or by any other regulatory or oversight entity with jurisdiction over the Mortgagee, except for those sanctions, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.
7. I certify that, to the best of my knowledge and after conducting a reasonable investigation, the Mortgagee does now, and did at all times throughout the Certification Period, comply with all HUD regulations and requirements necessary to maintain the Mortgagee's FHA approval as codified in 24 CFR § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between the Mortgagee and HUD, except for those instances of non-compliance, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.
8. Each of my certifications is true and accurate to the best of my knowledge. I understand that if I have made any false, fictitious, or fraudulent statement(s), representation(s), or certification(s) knowingly on this form, I may be subject to administrative, civil and/or criminal sanctions, including damages, penalties, fines, imprisonment, and debarment under applicable federal law.
9. I acknowledge that the Mortgagee is now, and was at all times throughout the Certification Period, subject to all applicable HUD regulations, Handbooks, Guidebooks, Mortgagee Letters, Title I Letters, policies and requirements, as well as Fair Housing regulations and laws including but not limited to 24 CFR § 5.105, Title VIII of the Civil Rights Act of 1968 (the Fair Housing Act) and Title VI of the Civil Rights Act of 1964.

FHA Lender Annual Certifications – Investing and Government Mortgagees
Active as of 8/1/2016

Capitalized terms in the following statements refer to those terms as used in HUD Handbook 4000.1.

1. I certify that I am a Corporate Officer of the abovementioned Mortgagee (hereinafter referred to as “the Mortgagee”); that I am authorized to execute these certifications and acknowledgements on behalf of the Mortgagee; and that throughout the Certification Period I have known, or been in the position to know, whether the operations of the Mortgagee conformed to all HUD regulations and requirements necessary to maintain the Mortgagee’s FHA approval as codified in 24 CFR § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between the Mortgagee and HUD.
2. I certify that, to the best of my knowledge and after conducting a reasonable investigation, the Mortgagee does now, and did at all times throughout the Certification Period, comply with all HUD regulations and requirements necessary to maintain the Mortgagee’s FHA approval as codified in 24 CFR § 202.5, HUD Handbook 4000.1 Sections I and V, as amended by Mortgagee Letter, and any agreements entered into between the Mortgagee and HUD, except for those instances of non-compliance, if any, that the Mortgagee reported to HUD and for which the Mortgagee received explicit clearance from HUD to continue with the certification process.
3. Each of my certifications is true and accurate to the best of my knowledge. I understand that if I have made any false, fictitious, or fraudulent statement(s), representation(s), or certification(s) knowingly on this form, I may be subject to administrative, civil and/or criminal sanctions, including damages, penalties, fines, imprisonment, and debarment under applicable federal law.
4. I acknowledge that the Mortgagee is now, and was at all times throughout the Certification Period, subject to all applicable HUD regulations, Handbooks, Guidebooks, Mortgagee Letters, Title I Letters, policies and requirements, as well as Fair Housing regulations and laws including but not limited to 24 CFR § 5.105, Title VIII of the Civil Rights Act of 1968 (the Fair Housing Act) and Title VI of the Civil Rights Act of 1964.

SECTION






Program Objective **2**

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- HUD insures loans and mortgages
- Institutions must be approved to participate in FHA
- Types of approval
 - ◆ Title I
 - ▶ Manufactured housing loans
 - ◆ Title II
 - ▶ Single Family Mortgages
 - ▶ Multifamily Mortgages
- Recertify annually to maintain FHA approval



Lender Approval Types

3

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- Supervised Lenders
 - ◆ Banks and Credit Unions
 - ◆ Small Supervised Lenders
 - ▶ Assets less than \$500,000,000
 - ◆ Large Supervised Lender
- Nonsupervised Lenders
 - ◆ Principal activity of lending or investing of funds in real estate mortgages, consumer installment notes, etc.
- Investing Lenders
 - ◆ May purchase, hold or sell FHA loans
 - ◆ May not originate
- Governmental Lenders

Audit and Reporting Requirements, continued

4

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Scenario	Level of financial statements	Audited consolidating schedules	Financial data templates, including net worth schedule	Net worth schedule (audited)
Supervised lenders				
Stand-alone bank	Bank	N/A	Bank	Bank
Bank ≥ 40% of consolidated entity; no guarantee by parent	Consolidated	Not required	Consolidated	Bank
Bank <40% of consolidated entity; guarantee by parent	Consolidated	Not required	Consolidated	Bank
Bank <40% of consolidated entity; no guarantee by parent	Consolidated	Required	Bank	Bank
Multiple banks, each <40% of consolidated entity; no guarantee by parent	Consolidated	Required	Each Bank	Each Bank
Non-supervised lenders				
Stand-alone lender	Lender	Lender	Lender	Lender
Lender in a parent/subsidiary structure	Lender	Required	Lender	Lender

Audit and Reporting Requirements, continued

5

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- Small Supervised Lender
 - ◆ Submit unaudited regulatory report
 - ◆ Signed by corporate officer
 - ◆ Aligns with fiscal year end

Audit and Reporting Requirements, continued

6

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- Audited Financial Statements & Supplementary Information
 - ◆ Required regardless of number of loans originated or serviced
 - ◆ GAAP
 - ◆ GAAS and GAGAS
 - ◆ Supplementary Information in Relation to the Financial Statements as a Whole
 - ▶ Adjusted Net Worth
 - ▶ Hardcopy of Electronic Submission
 - ▶ Consolidating schedules – if applicable

Audit and Reporting Requirements, continued

7

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- Internal Control Report
 - ◆ Report on Internal Control over Financial Reporting
 - ◆ Report on Internal Control over Compliance with HUD-assisted programs
 - ◆ May use a combined report

Audit and Reporting Requirements, continued

8

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- Compliance Report
 - ◆ Listing of compliance areas tested
 - ◆ Opinion on compliance with specific program requirements
 - ◆ Major program (No non-major programs)
 - ▶ If combined originations and servicing portfolio less than 2 million
 - Quality Control Plan
 - Lender Annual Recertification, Adjusted Net worth Liquidity, and Licensing

Audit and Reporting Requirements, continued

9



- Schedule of Findings and Questions Costs
 - ◆ All material instances of non compliance, significant deficiencies, and material weaknesses in internal control
 - ◆ Management Letter on all immaterial instances of noncompliance
 - ▶ Referenced in Audit Report
 - ▶ Included in LEAP submission
 - ◆ Need schedule even if no material findings
 - ▶ No Findings required to be reported
 - ▶ Must be uploaded in LEAP
 - ◆ Schedule of Prior Audit Findings

- ◆ See Sample

Audit and Reporting Requirements, continued

10



- Corrective Action Plan
 - ◆ See Sample

Electronic Submission

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- LEAP
- 90 Days end of fiscal year
- Reports MUST be signed – All reports
- Upload complete audit package
- Lender approved by both FHA and Ginnie Mae
 - ◆ Must submit through each system
- Auditor Involvement
 - ◆ AUP that submission agrees to hard copy AFS
- Extensions
 - ◆ Submitted through LEAP 45 days before due date
- Operating Loss Reporting
 - ◆ Operating loss of 20% or greater of ANW
 - ▶ Submit audited or unaudited financial statements
 - ▶ 30 days after end of each quarter
 - ▶ Profit 2 consecutive quarters or next annual recertification
 - ▶ Submitted as a “Notice of Material Event” in LEAP

Quality Control Plan

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- Maintain QC Plan
 - ◆ Must be up to date
- Quality control reviews are performed on regular and timely basis
- QC function must be independent of origination and service functions

- See Quality Control Plan Checklist

Sponsored Third Party Originators

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- Mortgagee must be Unconditional DE to sponsor TPO
- Mortgagee responsible for TPO
 - ◆ TPO meets all state license, registration approval requirements
 - ◆ Officers, partners, directors, principals, managers, supervisors, loan processors, and loan originators are not ineligible
- TPO does not purchase or hold FHA Mortgages and may not close Mortgages in their own name
- Only HUD approved Mortgagees acting as TPO's have direct access to FHA Connection (FHAC)
- Semiannual reverify compliance with all laws relating to licensing, qualification and eligibility

Branch Office Operations

14

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- Business Forms Allowed
 - ◆ Standard
 - ▶ Corporation
 - ▶ LLC (2 or more members; 10 year minimum existence from date of application; succession)
 - ▶ Series LLC - Comply with all LLC rules, plus:
 - NO series may participate in FHA programs unless the approved mortgagee owns 100% of the membership interest in the series; and
 - The approved mortgagee remains fully liable for the debts, liabilities, obligations and expenses of any and all series that participate in FHA programs
 - ▶ Partnership
 - ▶ Non-Profit

Branch Office Operations, continued

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- Home Office
 - ◆ Two full-time employees
 - ◆ May not use a shared receptionist
 - ◆ Located in Commercial space
 - ◆ Clearly identified (permanently affixed signage)
 - ◆ Display the fair Housing poster
- Branch (must register all branches conducting FHA business)
 - ◆ 1 full-time employee (no receptionist or contractor)
 - ◆ Fair housing poster
 - ◆ Cannot register a new branch within a HUD Field Office which it has withdrawn a branch in last 6 months – NEW
 - ◆ Must have branch and/or regional manager

Branch Office Operations, continued

16

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- Mortgagees must pay operating expenses
 - ◆ Home office expenses
 - ◆ Branch office expenses
- Net Branching Prohibition
 - ◆ May not engage a legally separate mortgage company or broker to function as Mortgagee's branch office
 - ◆ Lender with separate EIN must have its own FHA approval

Branch Office Operations, continued

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■ Principals, not suspended or debarred

Business Form	Principal Owners
Publicly Traded Corporation	10% or more ownership
Private or Close Corporation	25% or more ownership
Limited Liability Company	All Members
Partnerships	All Partners

- Identify all Principal Owners
- Must ensure that only represents 1 approved mortgagee unless:
 - ◆ Entities have some or all of the same officers/principals
 - ◆ Clear & effective separation of entities. Borrowers always know which entity is being represented
 - ◆ Officer in charge who only conducts mortgagee business during business hours (requires a 7 year resume)

Branch Office Operations, continued

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■ Employees

- ◆ No suspension or debarment
- ◆ Report all compensation on W-2
- ◆ Dual employment – prohibited unless other employment is not a conflict of interest
- ◆ Conflicts of interest – prohibited having multiple sources of compensation from FHA transaction

Branch Office Operations, continued

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- Staffing
 - ◆ Mortgagee responsible for actions of staff and ensuring compliance with licensing and registrations
- Use of Contractors
 - ◆ Cannot contract with TPO's, real estate brokers, or similar entities
 - ◆ Entity or persons may not be suspended, debarred, etc.
- Affiliates
 - ◆ Contractors, agents, vendors, subservicers, sponsored TPO's
 - ◆ Mortgagee must ensure they are eligible, trained and follow FHA requirements

Branch Office Operations, continued

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- Must be a registered FHA branch
- Fair Housing Notice
- Advertising
 - ◆ Mortgagee and Affiliates advertising must comply with FHA, state and regulatory requirements
 - ◆ Only Mortgagee may use official FHA-Approved Lending Institution logo on advertising
 - ◆ Sponsored TPO's cannot use FHA logo

Loan Origination

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- Originate loans in accordance with HUD requirements
- Obtain and verify information with the same care used if lender was responsible for the loan
- Information on HUD forms supported by documents in lender’s files
- Mortgagee must ensure that the aggregate charges do not violate FHA’s Tiered Pricing rules
 - ◆ Variance in Mortgage Change Rates of more than 2% points from Mortgagee’s reasonable and customary rate for insured Mortgages within the area

Loan Origination, continued

22

Requirement	Pre-Closing Review	Post-Closing Review
Appraisal	✓	✓
Mortgage application, eligibility, and underwriting documents	✓	✓
Disclosures and legal compliance	✓	✓
Mortgage origination documents	✓	✓
Handling of mortgage documents	✓	✓
Borrower occupancy		✓
Credit reports	✓	✓
Outstanding debt obligations	✓	✓
Verifications of employment and deposit	✓	✓
Self-employed Borrowers	✓	✓
Borrower’s source of funds	✓	✓
Underwriting accuracy and completeness, including compensating factors	✓	✓
Property Flipping restrictions	✓	✓

Loan Origination, continued

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Requirement	Pre-Closing Review	Post-Closing Review
Prohibited restrictive covenants	✓	✓
Qualified Mortgage (QM)	✓	✓
Good Faith Estimate (GFE)	✓	✓
Discrepancies in the loan file	✓	✓
Condition clearance	✓	✓
Closing procedures and documents		✓
Settlement Statement or other similar legal document		✓
Pre-endorsement review		✓
Timely submission for insurance		✓

Loan Origination, continued

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■ Loan Origination Documents

- ◆ May not be more than 120 days old at disbursement date
 - ▶ Tax returns and divorce decrees may be older
- ◆ Appraisals may be extended for 30 days
- ◆ Employment, income, assets or credit of Borrowers
 - ▶ May not accept if handled by, or transmitted from or through equipment of Unknown or Interested Parties
 - ▶ Information sent electronically or via internet must be authenticated
 - Document name, telephone number of individual who validated document
 - Examine ULR address, date and time documents were printed

Loan Origination, continued

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- Forms completed by applicant and signed & dated
 - ◆ Power of Attorney (POA)
 - ▶ Military personnel – used for only 1 application (initial or final) not both
 - ▶ Incapacitated borrowers unable to sign
 - ◆ Electronic signatures
 - ▶ Allowed when meets Performance Standards (E-Sign Act)
 - ▶ Indication of ES and date should be clearly visible when viewed electronically and in paper copies
- Disclosures and Legal Compliance
 - ◆ Informed Consumer Choice Disclosure
 - ◆ Form HUD 92900-B – Important Notice to Homebuyers
 - ◆ Lead-Based Paint
 - ▶ Property built before 1978
 - ◆ Form HUD 92564-CN – For Your Protection: Get a Home Inspection

Loan Origination, continued

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- Appraiser
 - ◆ Must be independent
 - ▶ Compensation, withholding payment, valuation, etc.
 - ◆ Effective date cannot be before FHA case number.
 - ◆ Second appraisal is prohibited unless DE Underwriter determines 1st appraisal is materially deficient and the Appraiser is unable or uncooperative in resolving deficiency
 - ◆ Update to an Appraisal
 - ▶ Mortgagee listed as intended user on original and permission from client
 - ▶ Performed by same Appraiser
 - ▶ Property has not declined in value
 - ▶ Ordered and completed before exp. of initial 120 day
 - ▶ Not previously updated

Loan Servicing

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- Fees collected from borrowers are in accordance with HUD rules
 - ◆ Reasonable and customary for the local jurisdiction
 - ◆ Based on actual cost of work performed or actual out-of-pocket expenses and not a percentage of the face amount or unpaid principal balance of the mortgage
 - ◆ Within the maximum amount allowed by HUD
 - ▶ Post-Endorsement Fees and Charges by HOC table
- Identify payment status of delinquent loans to enable personnel to initiate and follow up on collection activities
- Accept partial payments

Loan Servicing, continued

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- Servicing Loan File Compliance Review
 - ◆ All aspects of servicing operations
 - ◆ Subserviced mortgages must be reviewed
 - ◆ Servicing loan file to include (See complete list in handbook)
 - ▶ Servicing records
 - ▶ Transfer servicing notifications
 - ▶ Documentation of purchased mortgages
 - ▶ MIPs
 - ▶ Mortgage Record Changes
 - ▶ Qualifying assumptions
 - ▶ Borrower requests, complaints
 - ▶ Escrow account functions
 - ▶ Fees
 - ▶ Collection activities
 - ▶ Loss mitigation
 - ▶ Foreclosure proceedings

Federal Financial And Activity Reports

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- Obtain a list of HUD programs participating in and related reporting requirements
- Determine financial and activity reports are prepared in accordance with HUD instructions and filed timely
- HMDA report is required

Lender Annual Recertification

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- Due 90 days after fiscal year end
- Online Certification
 - ◆ Corporate Officer granted Certifying Official authorization
 - ◆ Unable to certify
 - ▶ Explanation for each item unable to complete
 - ▶ FHA will review and render a final decision
 - ◆ False certification
 - ▶ Mortgagee & Corporate Officer referred for criminal, civil or administrative action

Lender Annual Recertification, continued

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- Annual Recertification Fee
 - ◆ Pay online
 - ◆ Based on home and each branch office
 - ◆ If terminating a branch, must be done before last day of year
- Financial Data Submission
 - ◆ Small Supervised Mortgagees
 - ▶ Unaudited Regulator Report
 - ▶ Signed by Corporate Officer

Lender Annual Recertification, continued

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- ◆ Supervised, Nonsupervised, and Investing Mortgagees
 - ▶ Audited financial statements
 - HUD Audit Guide
 - GAAP
 - GAGAS (Yellow Book)
 - ▶ Audit Related Questions
 - Type of audit and any findings
 - ▶ Attestation of Independent Public Accountant
 - Agreed Upon Procedures of compliance with required audit procedures
 - ▶ Recertification Extension Requests
 - Submit through LEAP at least 45 days prior to due date
 - ▶ Failure to Recertify
 - Referred to MRB

Lender Annual Recertification, continued

33

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- New approval
 - ◆ Audited Financial Statements – Complete set
 - ◆ AFS over 6 months old – submit unaudited financials, signed, less than 3 months old
 - ◆ New institution – Income statement and cash flow not required

Lender Annual Recertification, continued

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- Other Requirements
 - ◆ Fidelity Bond
 - ▶ \$300,000
 - ▶ Fidelity bond that is acceptable to Ginnie Mae, Fannie Mae, or Freddie Mac, will meet FHA's requirement
 - ◆ Errors and Omissions Insurance
 - ▶ \$300,000
 - ◆ Funding Program
 - ▶ \$1,000,000 warehouse line of credit minimum
 - ▶ Fund average 60 day originations

Lender Annual Recertification, continued

35

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- Principal Activity of Nonsupervised Mortgagees
 - ◆ 50% of activities (revenue) from real estate mortgages, consumer installment notes or similar credit, or from a directly related field

Adjusted Net Worth & Liquidity

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AHACPA



- Net Worth
 - ◆ 1,000,000 plus 1% total volume in excess of \$25,000,000 up to max of 2,500,000
 - ◆ Multifamily programs without servicing
 - ▶ 1,000,000 plus ½% of volume in excess of \$25,000,000
 - ◆ Net Worth computation required for ALL lenders, even if no loans originated or serviced
- Liquidity
 - ◆ 20% of required adjusted net worth
 - ▶ 200,000 – 500,000 max
- Test compliance at year-end AND representative points of time during audit period

Adjusted Net Worth & Liquidity, continued

37

AHACPA



■ Unacceptable assets

- ◆ Asset pledged to secure obligations of another entity or any person. Pledged assets that provide financial services to incorporated communities are acceptable for supervised institutions only.
- ◆ Asset due from an officer or stockholder or related entity, except for:
 - ▶ Construction loan receivable secured by 1st mortgage.
 - ▶ Mortgage loan receivable established in the normal course of business in an arm's length transaction secured by 1st mortgage.
 - ▶ Receivable from related party when there is a cross-default agreement or corporate guarantee agreement with Ginnie Mae.
 - ▶ Receivable from officer or stockholder of a publicly traded supervised institution that owns less than 5% of shares.

Adjusted Net Worth & Liquidity, continued

38

AHACPA



- ◆ Investment in a related entity in which any officer or stockholder of the lender has a personal interest unrelated to that person's position as a officer or stockholder of the lender.
- ◆ Any intangible asset, including
 - ▶ Goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals or property management contract renewals
- ◆ Value of any servicing contract not determined in accordance with FASB Accounting Standards
- ◆ Portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock.
- ◆ Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.

Adjusted Net Worth & Liquidity, continued

39

AHACPA



- ◆ Asset used principally for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. Includes vehicles and personal residences.
- ◆ “Other assets” on financial statements unless a schedule is included covered by the audit opinion or signed by an officer.
- ◆ That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution, determined by an independent appraisal. Property contributed without the related mortgage or debt, value of contributed property should be reduced by that obligation.

Licensing

40

AHACPA



- License or Registration
 - ◆ Entity
 - ▶ Active state license, registration for home office
 - ▶ Each branch office is licensed or registered
 - ▶ Certify has not been refused a license or sanctioned by any state in which it will originate FHA Mortgages
 - ◆ Personnel Licenses
 - ▶ Corporate Officers
 - ▶ Employees
 - ▶ Affiliates
 - Ensure have all state and federal licenses and registrations

Licensing, continued

41

AHACPA



- Area Approved for Business (AAFB)
 - ◆ Initially granted nationwide AAFB – NEW
 - ◆ Originate and Underwrite in states licensed and meet approval requirements

Licensing, continued

42

AHACPA



- Compliance with all applicable federal, state, and local laws
- Must be FHA approved to service FHA Mortgages
 - ◆ Mortgagee must ensure subservicer is FHA approved
 - ◆ Mortgagee responsible for actions of subservicer

Loan Settlement

43

AHACPA



- Loan origination fee should compensate lender for settlement services
 - ◆ No limit on origination fee
- Fees and charges collected from borrowers are reasonable and in accordance with HUD guidelines
 - ◆ Agree to HUD settlement statements including GFE
 - ◆ Agree to amounts charged to Mortgagee
- MIP submitted to HUD timely
- Disbursing funds and completing transaction in accordance with closing documents without undue delay

Escrow Accounts

44

AHACPA



- Lenders required to establish escrow accounts
 - ◆ Must be separate account
 - ◆ MIP
 - ◆ Taxes, special assessments
 - ◆ Insurance premiums
 - ◆ Flood insurance premiums when required
- Analyze escrow at least annually to determine amount is sufficient
 - ◆ Shortage collected by either lump sum or over 12 month period
- Escrow bills paid timely
- Escrow funds used only for purposes received

Kickbacks

45

AHACPA



- Prohibited Payments
 - ◆ Pay or receive any fee, kickback or compensation except for services actually performed
 - ◆ No-interest loans or low interest loans to real estate agents, brokers, etc. as advance of anticipated commissions
 - ◆ Any payments represented as kickbacks are reported in a finding

Multifamily Insured Loans Reporting Requirement

46

AHACPA



- Loan fees in excess of 5% on loans more that \$2,000,000 must be reported

Schedule of loan fees for multifamily lenders

FHA loan number	Dollar amount of endorsed loan	Loan fees earned that exceed 5% of insured loan amount	
		Percentage of insured loan amount	Amount in dollars

AHACPA



- SAMPLE - FINDING
- SAMPLE - CORRECTIVE ACTION PLAN

SECTION



QUALITY CONTROL PLAN CHECKLIST

(Reference: HUD Handbook 4000.1 Quality Control, Oversight and Compliance - Effective 09/14/15)

All approved mortgagees must adopt and implement a QC Program that fully complies with the requirements of SF Handbook 4000.1. The Mortgagee must maintain and update its QC Program as needed to ensure it is fully compliant with all applicable FHA requirements at all times.

The QC Program must cover the lifecycle of an FHA-insured Mortgage, including origination, underwriting, closing, endorsement, and servicing functions that are conducted by the Mortgagee.

The QC Program must cover all policies and procedures, whether performed by the Mortgagee or outsourced to a contractor, to ensure full compliance with FHA requirements for Loan Administration.

The QC Program must provide the Mortgagee’s management with information sufficient to adequately monitor and oversee the Mortgagee’s compliance, and measure performance as it related to the Mortgagee’s FHA mortgage activity.

	Yes / No	
1.	<input type="checkbox"/> <input type="checkbox"/>	<p>Independence / Qualified Staff – Personnel must be properly trained & qualified to conduct the QC reviews. Are independent of all Loan Administration process and have no direct loan processing, origination, or underwriting responsibilities or any chain of reporting or management directly connected to Loan Administration staff. (A2ai)</p> <p>Mortgagee must maintain a list of all training provided to staff, including a summary of the content covered. (A2bi(A))</p> <p>If mortgagee uses an outside source to perform the QC function, including its sponsor, Mortgage assumes full responsibility for contractor’s compliance with FHA requirements, must have a valid contractual agreement in place defining the roles and responsibilities of each party and Mortgagee must have a written QC Plan that fully complies with FHA requirements. (A2aii)</p> <p>Access to FHA Guidance – Mortgagee must provide all Loan Administration and QC staff with access to current FHA guidance including Handbooks, Mortgagee Letters, Frequently Asked Questions, and other guidance issued by FHA. (A2b(2)a)</p>
2.	<input type="checkbox"/> <input type="checkbox"/>	<p>Restricted Participation – Confirm it verified through HUD systems that designated employees and/or Affiliates were permitted to participate in FHA programs. If any of the designated employees and/or Affiliates are found to be ineligible, they are restricted from participating in FHA programs. (A2bi(B)(1))</p>
a.	<input type="checkbox"/> <input type="checkbox"/>	<p>Employees – Maintain copies of each employee’s eligibility verification print-outs. Eligibility verification must be conducted at least semiannually. (A2bi(B)(2))</p>
b.	<input type="checkbox"/> <input type="checkbox"/>	<p>Affiliate Quality Control Reviews – Mortgagee must perform QC reviews of its Affiliates in the same manner and under the same conditions as required for the Mortgagee’s own operations. Procedures used to review and monitor a Mortgagee’s Affiliates must be included. Re-verification of Affiliate’s compliance must be done semiannual at a minimum. (A2bii)</p>

	Yes / No	
3.	<input type="checkbox"/> <input type="checkbox"/>	Rejected Mortgage Applications – Review a random statistical sample of rejected applications within 90 days from the end of the month in which the decision was made. Reviews must be conducted monthly and ensure that: (1) reasons given for rejection were valid, (2) each rejection has the concurrence of an officer of someone with sufficient approval authority, (3) requirements of the ECOA are met and documented in each file, and (4) no civil rights violations were committed in the rejections of the application. (A2biii(A))
4.	<input type="checkbox"/> <input type="checkbox"/>	Fair Housing and Fair Lending – Operations must comply with applicable state and federal fair lending laws. Verify that Fair Housing Poster and the Equal Housing Opportunity Logo are prominently displayed in the Mortgagee’s home office and any branch offices that deal with borrowers and the general public. (A2biii), (A2biii(B))
5.	<input type="checkbox"/> <input type="checkbox"/>	Fair Housing or Discrimination Violations – Potential fair housing violations or instances of discrimination must be reported to HUD’s office of FHEO immediately. (A2biii(C))
6.	<input type="checkbox"/> <input type="checkbox"/>	Escrow Funds – Funds received from borrowers were used only for the purpose which they were received, comply with Consumer Financial Protections Bureau (CFPB) escrow requirements. (A2biv)
7.	<input type="checkbox"/> <input type="checkbox"/>	Mortgage Insurance Premiums – Remitted to FHA within the required time period or, if not, the remittance included late charges and interest penalties. (A2bv)
8.	<input type="checkbox"/> <input type="checkbox"/>	Timely and Accurate Submission for Insurance – Mortgages are being submitted to FHA for insurance within the required time frames. (A2bvi)
9.	<input type="checkbox"/> <input type="checkbox"/>	Advertising – Review all advertisements generated by the Mortgagee or on its behalf to verify compliance with HUD/FHA advertising requirements. Mortgagee must retain copies of any Advertising device the Mortgagee produces, or that is produced on the Mortgagee’s behalf, that is related to FHA programs. (A2bvii)
10.	<input type="checkbox"/> <input type="checkbox"/>	Reporting & Corrective Action – Must contain a process for QC staff to report Findings identified through the QC process to senior management. Initial review findings must be reported to senior management within 30 days of completion of the initial Findings report. Mortgagee’s final report must be issued within 60 days from initial review. Senior management must review and respond to each instance of fraud, material misrepresentation, or other Material Finding. The Mortgagee’s final report must identify the corrective and curative actions being taken, the timetable for completion and any planned follow-up activities. (A2diii)
11.	<input type="checkbox"/> <input type="checkbox"/>	Notification to HUD - The mortgagee reports any findings of fraud or material misrepresentation to FHA immediately. All other material findings not mitigated must be reported no later than 90 days after completion of report. (A2div)
12.	<input type="checkbox"/> <input type="checkbox"/>	File Retention - The QC Review results, including all selection criteria, review documentation, findings, actions taken to mitigate findings must be retained for two years from the initial QC review or from the last action taken to mitigate findings, whichever is later. (A1di)
13.	<input type="checkbox"/> <input type="checkbox"/>	Identify Patterns - Mortgagees must review its loan performance data to identify patterns of non-compliance. Procedures used to review patterns of non-compliance must be included in QC Plan. (A2c)
14.	<input type="checkbox"/> <input type="checkbox"/>	Fraud, Misrepresentation, and Other Findings – Mortgagee must monitor all FHA-insured mortgages it originated, underwrites, services, or purchases, including those mortgages originated by sponsored TPO’s. (A2d)

	Yes / No	
		Loan Level Quality Control Program Requirements:
15.	<input type="checkbox"/> <input type="checkbox"/>	Timeliness -
a.	<input type="checkbox"/> <input type="checkbox"/>	Pre-Closing Reviews – Select sample of mortgages approved by DE underwriter and prior to closing. Must be reviewed on a monthly basis. (A3ai(A))
b.	<input type="checkbox"/> <input type="checkbox"/>	Post-Closing Reviews Select loans closed in the prior one-month period. Must be reviewed on a monthly basis. Mortgages must be reviewed within 60 days from end of prior month. (A3ai(B))
c.	<input type="checkbox"/> <input type="checkbox"/>	Early Payment Default Reviews – Select for review on a monthly basis. Must be reviewed within 60 days from end of month in which loan was selected. (A3ai(C))
d.	<input type="checkbox"/> <input type="checkbox"/>	Servicing Reviews - Select for review on a monthly basis. Must be reviewed within 60 days from end of month in which loan was selected. (A3ai(D))
16.	<input type="checkbox"/> <input type="checkbox"/>	Frequency - Mortgagees must perform reviews on a monthly basis.
17.	<input type="checkbox"/> <input type="checkbox"/>	Scope and Sampling – QC Plan must provide for the thorough evaluation of all Loan Administration functions the Mortgagee is responsible. Procedures exist for expanding the scope of the QC review when fraud or patterns of deficiencies are uncovered. (A3aii)
18.	<input type="checkbox"/> <input type="checkbox"/>	<p>Sample Size –The mortgagee reviews EITHER: 1) 3,500 or fewer FHA loans per year - 10% of all loans closed; OR 2) More than 3,500 FHA loans per year – either 10% of all loans OR a random sample that provides 95% confidence level with 2% statistically valid confidence interval.</p> <p>Combination of both per-closing and post-closing reviews.</p> <p>Pre-closing reviews - 10% or less of sample size.</p> <p>Post-closing reviews – 90% of more of sample size.</p> <p>Early Payment Defaults (EPDs) – Must review all EPDs underwritten by the Mortgagee. (A3aiii)</p>
19.	<input type="checkbox"/> <input type="checkbox"/>	Sample Composition Standard – Provisions to select FHA-insured Mortgages for review via random, EPDs and discretionary sample selection methods. (A3aiv)
20.	<input type="checkbox"/> <input type="checkbox"/>	Random Sample – Each FHA-insured mortgage has an equal chance of being selected. Sample must be drawn from all FHA mortgages regardless of origination source or program type. Document how the sample size and selections were determined. (A3aiv(A))
21.	<input type="checkbox"/> <input type="checkbox"/>	Early Payment Defaults – All EPDs underwritten by the mortgagee, regardless of which Mortgagee services the Mortgage must be reviewed. (A3aiv(B))

	Yes / No																																																																						
22.	<input type="checkbox"/> <input type="checkbox"/>	<p>Loan Sample Risk Assessment – Method of evaluating loans selected for QC on the basis of the severity of the violations found during QC reviews. Compare one month’s QC sample to previous QC samples in order to conduct trend analysis. (A3b)</p> <p>Document methodology used to establish the loan sample risk assessment and conduct trend analysis. Methodology must include the following risk categories:</p> <p style="padding-left: 40px;">Low Risk – No issues or minor variances were identified.</p> <p style="padding-left: 40px;">Moderate Risk – Records contained unresolved questions or missing documentation. Issues were identified pertaining to processing, documentation, or decisions made, but none were material.</p> <p style="padding-left: 40px;">Material Risk – Material findings which represent an unacceptable level of risk.</p>																																																																					
23.	<input type="checkbox"/> <input type="checkbox"/>	<p>Origination and Underwriting Loan File Compliance Review – At a minimum, Mortgagees must include the following areas in their QC review: (A3ci)</p>																																																																					
		<table border="1"> <thead> <tr> <th data-bbox="331 770 1133 835">Requirement</th> <th data-bbox="1138 770 1333 835">Pre-Closing Review</th> <th data-bbox="1338 770 1516 835">Post-Closing Review</th> </tr> </thead> <tbody> <tr><td data-bbox="331 835 1133 873">Appraisal</td><td data-bbox="1138 835 1333 873">✓</td><td data-bbox="1338 835 1516 873">✓</td></tr> <tr><td data-bbox="331 873 1133 911">Mortgage application, eligibility, and underwriting documents</td><td data-bbox="1138 873 1333 911">✓</td><td data-bbox="1338 873 1516 911">✓</td></tr> <tr><td data-bbox="331 911 1133 949">Disclosures and legal compliance</td><td data-bbox="1138 911 1333 949">✓</td><td data-bbox="1338 911 1516 949">✓</td></tr> <tr><td data-bbox="331 949 1133 987">Mortgage origination documents</td><td data-bbox="1138 949 1333 987">✓</td><td data-bbox="1338 949 1516 987">✓</td></tr> <tr><td data-bbox="331 987 1133 1024">Handling of mortgage documents</td><td data-bbox="1138 987 1333 1024">✓</td><td data-bbox="1338 987 1516 1024">✓</td></tr> <tr><td data-bbox="331 1024 1133 1062">Borrower occupancy</td><td data-bbox="1138 1024 1333 1062"></td><td data-bbox="1338 1024 1516 1062">✓</td></tr> <tr><td data-bbox="331 1062 1133 1100">Credit reports</td><td data-bbox="1138 1062 1333 1100">✓</td><td data-bbox="1338 1062 1516 1100">✓</td></tr> <tr><td data-bbox="331 1100 1133 1138">Outstanding debt obligations</td><td data-bbox="1138 1100 1333 1138">✓</td><td data-bbox="1338 1100 1516 1138">✓</td></tr> <tr><td data-bbox="331 1138 1133 1176">Verifications of employment and deposit</td><td data-bbox="1138 1138 1333 1176">✓</td><td data-bbox="1338 1138 1516 1176">✓</td></tr> <tr><td data-bbox="331 1176 1133 1213">Self-employed Borrowers</td><td data-bbox="1138 1176 1333 1213">✓</td><td data-bbox="1338 1176 1516 1213">✓</td></tr> <tr><td data-bbox="331 1213 1133 1251">Borrower’s source of funds</td><td data-bbox="1138 1213 1333 1251">✓</td><td data-bbox="1338 1213 1516 1251">✓</td></tr> <tr><td data-bbox="331 1251 1133 1327">Underwriting accuracy and completeness, including compensating factors</td><td data-bbox="1138 1251 1333 1327">✓</td><td data-bbox="1338 1251 1516 1327">✓</td></tr> <tr><td data-bbox="331 1327 1133 1365">Property Flipping restrictions</td><td data-bbox="1138 1327 1333 1365">✓</td><td data-bbox="1338 1327 1516 1365">✓</td></tr> <tr><td data-bbox="331 1365 1133 1402">Prohibited restrictive covenants</td><td data-bbox="1138 1365 1333 1402">✓</td><td data-bbox="1338 1365 1516 1402">✓</td></tr> <tr><td data-bbox="331 1402 1133 1440">Qualified Mortgage (QM)</td><td data-bbox="1138 1402 1333 1440">✓</td><td data-bbox="1338 1402 1516 1440">✓</td></tr> <tr><td data-bbox="331 1440 1133 1478">Good Faith Estimate (GFE)</td><td data-bbox="1138 1440 1333 1478">✓</td><td data-bbox="1338 1440 1516 1478">✓</td></tr> <tr><td data-bbox="331 1478 1133 1516">Discrepancies in the loan file</td><td data-bbox="1138 1478 1333 1516">✓</td><td data-bbox="1338 1478 1516 1516">✓</td></tr> <tr><td data-bbox="331 1516 1133 1554">Condition clearance</td><td data-bbox="1138 1516 1333 1554">✓</td><td data-bbox="1338 1516 1516 1554">✓</td></tr> <tr><td data-bbox="331 1554 1133 1591">Closing procedures and documents</td><td data-bbox="1138 1554 1333 1591"></td><td data-bbox="1338 1554 1516 1591">✓</td></tr> <tr><td data-bbox="331 1591 1133 1629">Settlement Statement or other similar legal document</td><td data-bbox="1138 1591 1333 1629"></td><td data-bbox="1338 1591 1516 1629">✓</td></tr> <tr><td data-bbox="331 1629 1133 1667">Pre-endorsement review</td><td data-bbox="1138 1629 1333 1667"></td><td data-bbox="1338 1629 1516 1667">✓</td></tr> <tr><td data-bbox="331 1667 1133 1688">Timely submission for insurance</td><td data-bbox="1138 1667 1333 1688"></td><td data-bbox="1338 1667 1516 1688">✓</td></tr> </tbody> </table>	Requirement	Pre-Closing Review	Post-Closing Review	Appraisal	✓	✓	Mortgage application, eligibility, and underwriting documents	✓	✓	Disclosures and legal compliance	✓	✓	Mortgage origination documents	✓	✓	Handling of mortgage documents	✓	✓	Borrower occupancy		✓	Credit reports	✓	✓	Outstanding debt obligations	✓	✓	Verifications of employment and deposit	✓	✓	Self-employed Borrowers	✓	✓	Borrower’s source of funds	✓	✓	Underwriting accuracy and completeness, including compensating factors	✓	✓	Property Flipping restrictions	✓	✓	Prohibited restrictive covenants	✓	✓	Qualified Mortgage (QM)	✓	✓	Good Faith Estimate (GFE)	✓	✓	Discrepancies in the loan file	✓	✓	Condition clearance	✓	✓	Closing procedures and documents		✓	Settlement Statement or other similar legal document		✓	Pre-endorsement review		✓	Timely submission for insurance		✓
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24.	<input type="checkbox"/> <input type="checkbox"/>	<p>Credit Report - A new credit report is obtained on all post-closing loans in the QC sample (using a RMCR, TRMCR, or a business credit report when appropriate). (A3cii(A))</p>																																																																					

	Yes / No	
25.	<input type="checkbox"/> <input type="checkbox"/>	<p>Income, Employment, Asset, and Housing Expense Information Reverification – Documents contained in the loan file should be analyzed for validity and sufficiency. The following items that MUST be re-verified in writing or electronically if available:</p> <ul style="list-style-type: none"> • Employment • Income • Assets • Gift funds • Source of funds • Mortgage payments or rental payments <p>If the written or electronic re-verification is not returned to the mortgagee, a documented attempt must be made to conduct a telephone re-verification. All discrepancies must be evaluated to ensure that the original documents were completed before being signed, were as represented, were not handled by interested third parties and that all corrections were proper and initialed. (A3cii(B))</p>
26.	<input type="checkbox"/> <input type="checkbox"/>	<p>Appraisals – A review of the property appraisal must be conducted on all loans chosen for QC review. The following areas MUST be included in the review:</p> <ul style="list-style-type: none"> • Appraisal data • Validity of the comparables • Value conclusion (as required by FHA guidance) • Gift funds • Source of funds <p>Field Reviews - MUST perform targeted field review on 10% of mortgages selected for the monthly post-closing QC sample, as well as on all EPDs. Field reviews must be performed by licensed appraisers listed on FHA’s Roster of Appraisers. (A3cii(C))</p>
27.	<input type="checkbox"/> <input type="checkbox"/>	<p>Specialized Mortgage Programs – MUST monitor compliance with FHA requirements specific to specialized mortgage programs (e.g., 203(k), Home Equity Conversion Mortgages (HECM), Energy Efficient Mortgages (EEF), etc.). (A3d)</p>

	Yes / No	
28.	<input type="checkbox"/> <input type="checkbox"/>	<p>Servicing Loan File Compliance Review – All aspects of servicing operations must be reviewed, including a review of subserviced mortgages. At a minimum, the following elements must be included in the QC review to ensure they meet requirements outlined in the Servicing and Loss Mitigation and Claims and Dispositions sections of SF Handbook: (A3e)</p> <ul style="list-style-type: none"> • Servicing records • Document retention and legibility • Non-discrimination policies • Borrower requests, complaints, and escalated cases • Fees • Transfer of servicing notification and records • Documentation of purchased or acquired mortgages • Mortgage record changes • Escrow account functions • Force-placed insurance • Prepayments • MIP • Early default intervention • Loss mitigation • Collection activities • Reporting to credit repositories • Home retention option priority order (waterfall) • Home disposition options • Claims for insurance benefits • Claims Without Conveyance of Title (CWCOT) • Foreclosure proceedings • Property preservation and conveyance • Deficiency judgments • Single Family Default Monitoring System (SFDMS) reporting • Adjustable Rate Mortgages (ARM) • Assumptions • Presidentially-Declared Major Disaster Areas (PDMDA) • Hawaiian Home Land Mortgages (Section 247 Mortgages) • Section 184 Indian housing loans • Section 222 Mortgages • Good Neighbor Next Door • Servicemembers Civil Relief Act (SCRA) • Section 235 Mortgages • Section 203(k) Mortgages • Servicing of HECM

	Yes / No	
29.	<input type="checkbox"/> <input type="checkbox"/>	<p>Ineligible Participants – (A3f)</p> <p>Origination and Underwriting Reviews - <i>MUST</i> verify none of the participants in the mortgage transactions reviewed were debarred, suspended, under an LDP for the FHA program and jurisdiction, or otherwise ineligible to participate in an FHA transaction. This included participants in an assumption transaction. Must verify participant eligibility using the SAM Excluded Parties List, the LDP list, and the NMLS, as applicable. (A3fi)</p> <p>Participants in a mortgage transaction may include, but are not limited to, the:</p> <ul style="list-style-type: none"> • Seller (excluding the seller of a Principal Residence) • Listing and selling real estate agent • Loan officer • Loan processor • Underwriter • Appraiser • 203(k) Consultant
30.	<input type="checkbox"/> <input type="checkbox"/>	<p>Servicing Reviews - <i>MUST</i> verify none of the participants in the servicing transactions reviewed were debarred, suspended, under an LDP for the FHA program and jurisdiction, or otherwise ineligible to participate in an FHA transaction. This included participants in a loss mitigation transaction. Must verify participant eligibility using the SAM Excluded Parties List, the LDP list, as applicable. (A3fii)</p> <p>Participants in a servicing transaction may include, but are not limited to, the:</p> <ul style="list-style-type: none"> • Borrowers • Underwriters • Real estate brokers • Closing agent • Title company • Employees of the Mortgagee, or Affiliates participating in HUD programs for or on behalf of the Mortgagee, who have influence or control over the evaluation, approval, or outcome of the servicing loss mitigation, or claims transaction.
31.	<input type="checkbox"/> <input type="checkbox"/>	<p>Data Integrity – Completeness and accuracy of the information obtained for each mortgage for all aspects of the Loan administration process for which the QC sample is selected. All findings must be reported internally to senior management and to FHA where appropriate. (A4a)</p>
32.	<input type="checkbox"/> <input type="checkbox"/>	<p>Origination and Underwriting Information – Validate all data elements submitted through AUS, TOTAL Mortgage Scorecard, and FHA Connection (FHAC), and validate that documentation exists in the loan file to support all data used to underwrite the Mortgage. (A4ai)</p>
33.	<input type="checkbox"/> <input type="checkbox"/>	<p>Endorsement and Insurance Information – Validate all data submitted through FHAC and validate that documentation exists in the loan file to support all data used to endorse and insure the Mortgage. (A4aii)</p>
34.	<input type="checkbox"/> <input type="checkbox"/>	<p>Servicing Information – Validate mortgage information submitted through FHAC, SFDMS, or Home Equity Reverse Mortgage Information Technology (HERMIT), as applicable. (A4aiii)</p>

SECTION



LENDER LETTERHEAD

CORRECTIVE ACTION PLAN

Name of auditee: _____

HUD auditee identification number: *(FHA 5-digit number)* _____

Name of audit firm: _____

Period covered by the audit: _____

CAP prepared by

Name: _____

Position: _____

Telephone number: _____

A. Current Findings on the Schedule of Findings, Questioned Costs, and Recommendations.

1. Finding 201X -1

a. Comments on the Finding and Each Recommendation:

The auditee is to provide a statement of concurrence or nonconcurrence with each finding. The auditee is also to provide a statement of agreement or disagreement with each recommendation in the finding.

b. Action(s) Taken or Planned on the Finding

The auditee should detail actions taken or planned to correct each finding identified in the report. Appropriate documentation should be submitted for actions taken. For planned actions, the auditee should provide the projected date for completion of all required action. The auditee should provide information on the task(s), subtask(s) and projected completion date(s) for the correction of the deficient condition and repayment of funds if appropriate. The names of the auditee officials or supervisor responsible for completing the proposed task(s) and subtask(s) should also be identified. If the auditee believes corrective action plan is not required, a statement describing the reasons should be included.

2. Finding 201X -2

a. Comments on the Finding and Each Recommendation:

b. Action(s) Taken or Planned on the Finding

B. Status of Corrective Actions on Findings Reported in the Prior Audit Schedule of Findings, Questioned Costs, and Recommendations.

The auditee should comment on the status of corrective actions taken on all prior findings that were reported as open or action not completed on the auditor's prior schedule of findings, questioned costs, and recommendations and remain open. The auditee should also update the planned date(s) for completion of task(s) and subtask(s) and responsible entity supervisor or official(s) to complete the task(s) or subtask(s). In addition, documentation should be submitted in support of any portions of the action plan that the auditee considers completed.

Schedule of Findings, Questioned Costs,
And Recommendations

Option 1: If the audit resulted in no findings, the schedule should still be included in the audit report package and should include only the following statement:

Our audit disclosed no findings that are required to be reported herein under the HUD Consolidated Audit Guide.

Option 2: If the audit resulted in findings to be reported, the following is the format that is to be used.

1. Corrective Actions Not Started or in Process.

Finding 201X-1. Each finding is to be listed and must contain the required information:

Questioned Costs.

Information on Universe and Population Size.

Sample Size Information.

Noncompliance Information.

Condition.

Criteria.

Cause.

Effect or Potential Effect.

Recommendations:

201X-1- a.

201X-1- b.

Management comments:

2. Corrective Action Completed.

Finding 201X-2.

Each finding is to be listed and contain the required information.

Recommendations:

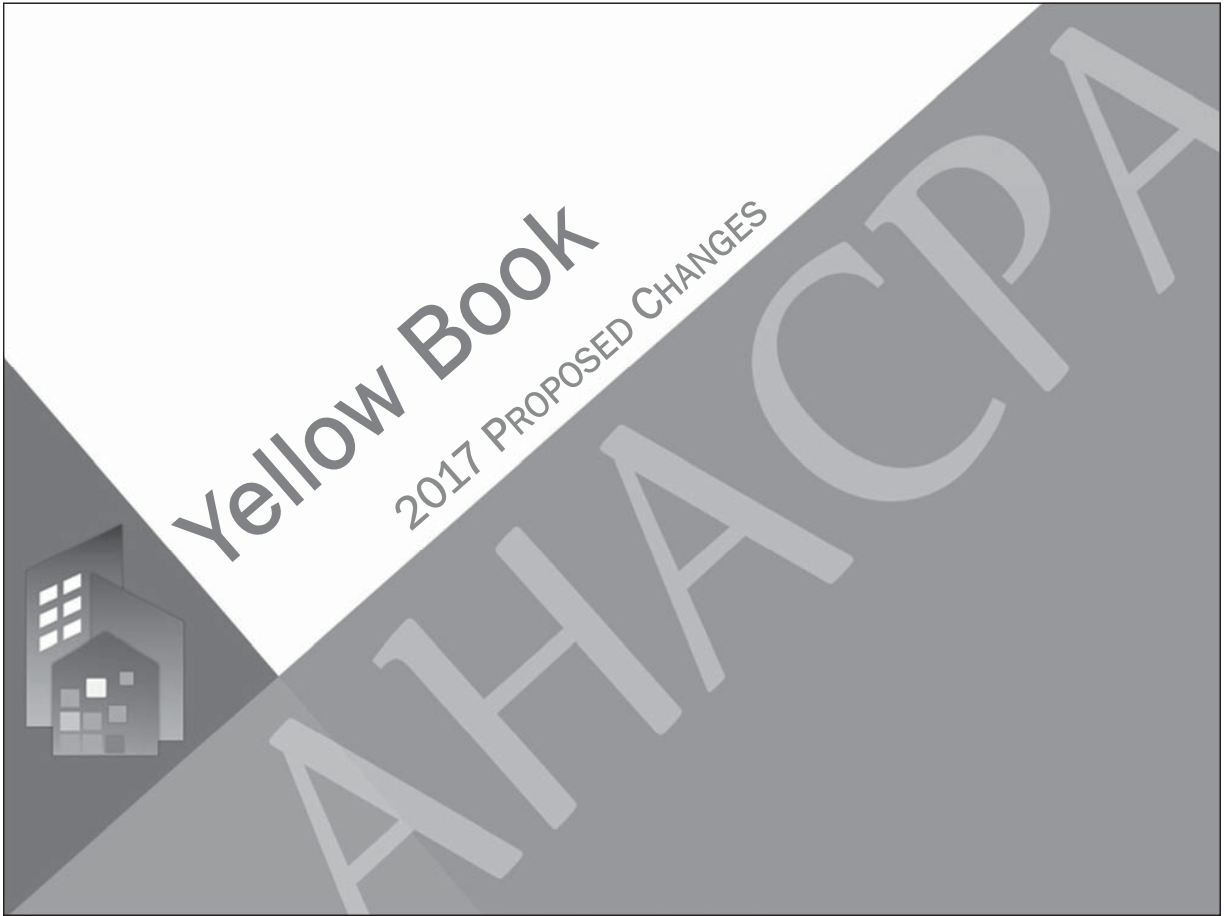
201X-2- a.

201X-2- b.

Management comments:

SECTION





Requirements: General

3

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- **All audit work must be independent and remain objective and impartial.**
- Except under limited circumstances, auditors should be independent from an audited entity during:
 - ◆ Any period of time covered by the financial statements or subject matter of the engagement
 - ◆ Period of professional engagement
- Independence is comprised of:
 - ◆ Independence of Mind
 - ◆ Independence of Appearance

Conceptual Framework

4

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- GAGAS's consideration of independence consists of 4 related sections, providing
 - ◆ A conceptual framework for making determinations unique to specific environments; requirements
 - ◆ Guidance on independence for organizations structurally located within the entities; requirements
 - ◆ Guidance on independence for auditors providing non-audit services; and requirements
 - ◆ Guidance on documentation necessary to support adequate consideration of independence

Conceptual Framework, continued

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- GAGAS's conceptual framework helps auditors identify, evaluate, and apply safeguards to address threats to independence.
- Auditors should reevaluate threats to independence, including safeguards, whenever new information rises or changes.
- If the work of specialists are used, their independence should be assessed.
- Auditors should conclude that independence is impaired if the safeguards are not effective.
- If impaired, auditors should decline engagement.

Identifying & Evaluating Threats to Independence

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- At a minimum, auditors should identify, asses, and evaluate the following broad categories of threats to independence:
 - ◆ Self-interest threat
 - ◆ Self-review threat
 - ◆ Bias threat
 - ◆ Familiarity threat
 - ◆ Undue influence threat
 - ◆ Management participation threat
 - ◆ Structural threat (not applicable to CPA firms)

Applying Safeguards to Eliminate or Reduce Threats

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- Safeguards are controls designed to eliminate or reduce to an acceptable level threats to independence.
- Under the conceptual framework, the auditor applies safeguards that address the specific facts and circumstances under which threats to independence exist.
- The Yellow Book lists two safeguard categories:
 - ◆ Safeguards in the work environment
 - ◆ Safeguards created by the profession, legislation, or regulation

Examples of Circumstance Threats

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Self –Interest Threats	Self-Review Threats	Bias Threats	Familiarity Threats
Audit organization having undue dependence on income from a particular audited entity.	Audit organization issuing a report on the effectiveness of the operation of the systems after design or implement.	Member of the engagement team having preconceptions about the objectives of a program under audit that are strong enough to affect the auditor’s objectivity.	Member of engagement team having a close/immediate family member who is a principal or senior manager of the audited entity.
Member of audit team entering employing negotiations with audited entity.	Audit organization having prepared data used to generate records that are the subject of the engagement.		Member of engagement team having close/immediate family who’s employed by the entity in a position of significant influence.
Significant error found when evaluating results of previous service provided by auditor’s audit organization.	Audit organization providing service or audited entity directly affecting the subject matter of the engagement.	Member of the engagement team having biases associated with political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, entity, or level of government that could affect the auditor’s objectivity.	Principal/employee of audited entity recently served on the engagement team.
Member of the audit team has direct financial interest in the audited entity.	A member of the engagement team being/recently been, employed by audited entity in a position to significantly influence the subject matter of the engagement.		Auditor accepting gifts or preferential treatment from an audited entity. Senior audit personnel having a long association with the entity.

Examples of Circumstance Threats, continued

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Undue Influence Threats	Management Participation Threats
Influence that could improperly limit/modify the scope of an engagement or threaten to do so, including pressure to reduce the extent of work performed to reduce costs/fees.	Member of the engagement team being, have been, a principal or senior manager of the audited entity.
External interference with selection/application of audit procedures or the selection of transactions examined.	Audit organization principal or employee serving as a voting member, making policy decisions affecting future direction of the program.
Unreasonable restrictions on time allotted to complete an engagement or issue the report.	Audit organization principal/employee recommending a single individual for a specific position key to the entity or program under audit.
External interference over assignment, appointment, compensation, and promotion of audit personnel.	Auditor preparing management's corrective action plan to deal with deficiencies detected in the engagement.
Restrictions on funds or resources provided to the audit organizations adversely affecting the ability to fulfill responsibilities.	Structural Threats
Authority to overrule/inappropriately influence auditors' judgment as to the appropriate content of the report.	External/internal auditor organizations, structural placement of the audit function within the reporting line of the areas under audit.
Threat of replacing the auditors over audit report disagreement, conclusions, or application of accounting principle or other criteria.	
Influences that jeopardize the auditors' employment for reasons other than incompetence, misconduct, or the audited entity's need for GAGAS engagement.	For internal audit organizations, administrative direction from the audited entity's management.

Acceptable Threat Level

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- A threat to independence is not an acceptable level if it either:
 - ◆ Could affect the auditors' ability to conduct an engagement without being affected by influences compromising judgment or
 - ◆ Could expose the auditors/audit organization to circumstances that would cause a third party to conclude the organization has been compromised.
- Auditors may place limited reliance on safeguards but they should not rely solely on them to eliminate or reduce threats.

Requirements: Identifying Prohibited Non-audit Services

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- Before providing non-audit service to an audited entity, auditors should determine if the service provided is a threat to independence and if the entity has an individual that can assume the responsibilities.
- If the entity is unable/unwilling to assume these responsibilities, auditors should conclude that these services are an impairment to independence.
- Auditors should conclude that management responsibilities are impairments to independence.

Application: Identifying Prohibited Non-audit Services

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- Auditors, while having a range of nonaudit services consistent with their skills/expertise, may create threats to independence.
- Effectively overseeing the service provided is a critical component of determining independence.
- The individual responsible for overseeing the management is required to have sufficient expertise, however, the management is not required to possess a specific skill to re-perform the service

Management Responsibilities

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- Management responsibilities include:
 - ◆ Setting policies and strategic direction for the audited entity;
 - ◆ Directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
 - ◆ Having custody of an audited entity's assets;
 - ◆ Reporting to those charged with governance on behalf of management;
 - ◆ Deciding which of the audit organization's or outside third party's recommendations to implement;
 - ◆ Accepting responsibility for designing, implementing, or maintaining internal control;
 - ◆ Providing services intended for use as management's primary basis for making decisions significant to the engagement;
 - ◆ Developing an audited entity's performance measurement system when significant to the engagement; and
 - ◆ Serving as a voting member of an audited entity's management committee or board of directors

Routine Activities

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- Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project/engagement or formal report.
- Routine activities include:
 - ◆ Providing advice to the audited entity on accounting matters
 - ◆ Providing advice on routine business matters
 - ◆ Educating the audited entity on matters within technical expertise
 - ◆ Providing information to the entity that is readily available to the auditors

Non-Audit Services

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- For recurring engagements, having another independent audit organization audit areas affected by the non audit service may provide a safeguard to mitigate a threat to independence.
- A non-audit service otherwise prohibited by GAGAS during the period covered by financial statements may not threaten auditors' independence provided that the following exist:
 - ◆ Non-audit service was provided before the period of professional engagement;
 - ◆ Non-audit service related only to period prior to the time covered by the financial statements; and
 - ◆ The financial statements for the period to which the non-audit service relates were audited by other auditors

Non-Audit Services, continued

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Auditors providing services for entities conducting GAGAS engagements need assurance that the following functions are performed in connection with non-audit services:	In connection with non-audit services, auditors should establish & document their understanding of the management regarding:
Assumes all management responsibilities	Objectives of the non-audit service
Oversees services, designating an individual, with suitable experience	Services provided
Evaluate the adequacy and results of the services provided	Entity's acceptance of responsibilities
Accept responsibilities for the results of the services	Auditors' responsibilities
	Limitations on the provision of non-audit services



- Some non-audit services directly support an entity's operation, and may threaten the auditor's ability to maintain independence.
- Auditors may provide non-audit services without impairing independence: (1) services are not prohibited by GAGAS, (2) specific requirements are met, and (3) significant threats have been eliminated/reduced to an acceptable level.



- The following services involving preparation of accounting records impair independence:
 - ◆ Determining or changing any records without approval; authorizing/approving the entities transactions; and preparing or making changes to source documents without approval
- Apart from those defined as impairments, related services create significant threats and should be documented to eliminate/reduce. These include:
 - ◆ Recording transactions or posting coded transactions; preparing financial statements based in trial balance; posting entries approved to the entity's trial balance; and preparing account reconciliations that identify reconciling items for evaluation.
- Management is responsible for the preparation and fair presentation of financial statements.
- Consequently, an auditor's acceptance of responsibility would impair the auditor's independence.

Preparing Accounting Records and Financial Statements, continued

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- The following internal audit assistance activities impair independence:
 - ◆ Setting internal audit policies/strategic direction of activities; performing procedures that form part of the internal control; and determining the scope of the internal audit function and resulting work.
- Providing/supervising ongoing monitoring procedures impairs independence because of the management participation threat is significant.
- Some non-audit services are provided by individuals not directly involved in the operation, making possible for the auditor to provide an objective analysis.

Information Technology Services

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- IT services impair independence if they include:
 - ◆ Designing/developing an entity's financial information or IT system that will play a significant role in the management;
 - ◆ Making significant modifications to source code;
 - ◆ Supervising audited entity personnel in the daily operation; or
 - ◆ Operating an audited entity's network, financial information system, or other IT system
- IT services may aggregate data, form part of internal control, or generate information affecting the subject matter of the engagement.



- Auditors should conclude independence is impaired (if services involve significant subjectivity, or when combined with other services are material to the financial statements) if activities include:
 - ◆ Advisory service
 - ◆ Benefit plan administration
 - ◆ Business risk consulting
 - ◆ Executive or employee recruiting
 - ◆ Investment advisory or management

DOCUMENTATION





- While insufficient documentation does not impair independence, auditors should prepare appropriate documentation under GAGAS requirements. Independence standard includes:
 - ◆ Document threats to independence requiring safeguards;
 - ◆ Document specific safeguards if an audit organization is located within a government entity and considered independent of said safeguards;
 - ◆ Document consideration of management’s ability to effectively oversee the service; and
 - ◆ Document the auditor’s understanding with an audited entity for which the auditor provides non-audit service

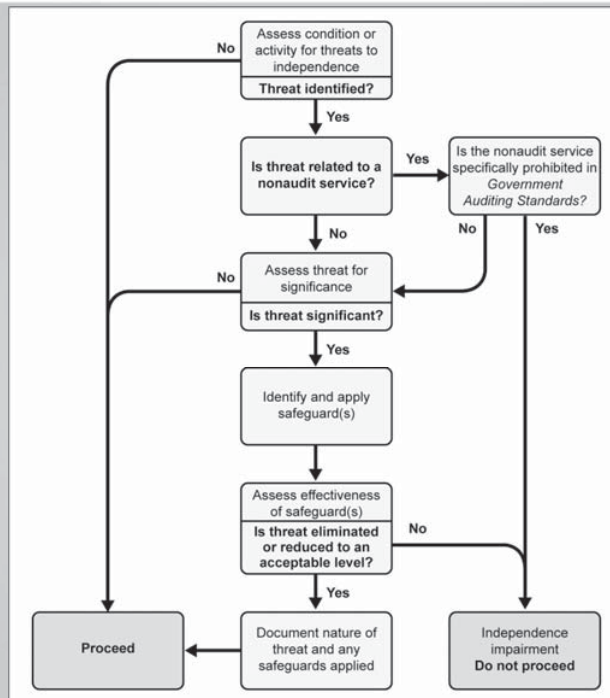
PROFESSIONAL JUDGEMENT





- Professional judgment includes exercising reasonable care and professional skepticism.
- Professional judgment represents the application of all involved individuals.
- Professional judgment is important in:
 - ◆ Carrying out all professional responsibilities
 - ◆ Applying the conceptual frame work to determine independence
 - ◆ Determining the necessary level of understanding of the subject matter and circumstances
- Professional judgment does not mean eliminating all limitations/weaknesses, but rather identifying, assessing, mitigating, and concluding on them.

GAGAS Conceptual Framework for Independence



Source: GAO.

COMPETENCE



General Competence

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- Competence is knowledge about specific GAGAS requirements and having the skills/abilities to proficiently apply said knowledge to engagements.
- Audit organizations are responsible in assigning staff who are adequately trained to perform their duties.
- Specialists, if needed, are to be vetted in the same manner as general auditors in their areas of specialization.

Competence Application

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- Competence enables auditors to make sound professional judgements gained through education and experience
 - ◆ Education is developing skills, knowledge, & abilities typically conducted in academic environment.
 - ◆ Experience refers to workplace activities relevant to developing professional proficiency
- Competence is not measured by years of experience, but by a consistent commitment to on-going training throughout your career

Indicators of Competence

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- Technical knowledge and skills are needed to conduct engagements to proficiently apply:
 - ◆ GAGAS
 - ◆ Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing/objectives for the engagement
 - ◆ Techniques, tools, and guidance related to professional expertise applicable to performed work



- There are varying roles on the engagement team that require different levels of proficiency:
 - ◆ Entry level
 - ◆ Supervisory
 - ◆ Partners and directors
- Competently performing engagements involve certain key terms auditors need to follow:
 - ◆ Planning
 - ◆ Directing
 - ◆ Performing
 - ◆ Reporting



- Conducting engagements may require the use of specialized techniques or methods and the skill of specialists.
- Specialists may include actuaries, appraisers, attorneys, engineers, etc.
- Qualifications for specialists include:
 - ◆ Professional certification, license, other recognition
 - ◆ Reputation/standing of specialist in the views of peers
 - ◆ Previous experience and work in the subject matter
 - ◆ Auditor's prior experience in using the specialist's work
 - ◆ Knowledge of technical performance standards or other requirements in specialist field etc.

CONTINUING PROFESSIONAL EDUCATION



GAGAS Qualification

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- Auditors working on an engagement conducted in accordance with GAGAS need to complete GAGAS qualification requirements.
 - ◆ Auditors need to complete 4 hours of CPE in GAGAS topics for qualification.
- Each level of the engagement team has varying GAGAS qualification requirements.
- For a CPE to complete the GAGAS Qualification requirement, the provider should include course content relevant to GAGAS topics to indicate the purpose to fulfill the CPE requirement.

Updating GAGAS Qualification

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- To update, auditors should complete at least 4 hours of CPE each revision of GAGAS and should be completed by the end of the 2-year CPE period.
- Auditors should complete at least 20 hours of CPE each year.
- Auditors maintain their professional competence and GAGAS Qualification completing at least 80 hours of CPE every 2 years as follows:

CPE HOURS	Subject matter categories of CPE
24 hours	Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the GAGAS engagement(s) being conducted (includes the 4 hours of GAGAS topics for GAGAS Qualification when applicable)
56 hours	Subject matter or topics that directly enhance the auditors' professional expertise to conduct GAGAS engagements

Subject Matter Categories of CPE

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- Auditors determine which subjects satisfy CPE requirements by considering what is needed to competently perform their assigned roles.
- Auditors taking the 4 hours in GAGAS topics may count toward the 24-hour requirement.
- Auditors need to consider future engagements when selecting specific CPE subjects to satisfy 4, 24, and 56-hour requirements.

Exemptions and Exceptions

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- Auditors hired/assigned to GAGAS engagements after the beginning of the 2-year CPE period may prorate the 24, and 56-hour requirements but not the 4-hour.
- College/university students employed on a temporary basis or enrolled in a formal program may be exempt from CPE requirements.
- With discretion, audit organizations may grant exemptions for circumstances such as ill health, maternity/paternity leave, military service, etc.

Programs/Activity Qualifying for CPE Requirements

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- CPE programs are structured activities/programs with learning objectives to maintain or enhance auditors' competence and perform work in accordance with GAGAS.

Examples of structured programs/activities qualifying for CPE

- | | |
|--|---|
| <ul style="list-style-type: none">• Internal training programs• Education/development programs presented at professional organizations• Training programs• Web-based seminars/individual-study programs• Audio conferences• Accredited university and college courses (credit and noncredit)• Meetings where a structured educational program with learning objectives presented | <ul style="list-style-type: none">• Correspondence courses, individual-study guides, workbooks• Serving as a speaker, panelist, instructor, or discussion leader at programs qualifying as CPA hours• Developing materials for programs qualifying as CPE hours• Publishing articles/books contributing directly to the author's professional proficiency to conduct engagements |
|--|---|

Measurement of CPE

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CPE credits can be earned through:

- ▲ 50 minutes of participation in group programs
- ▲ ½ CPE hours (25 minutes) but only after the 1st CPE hours has been earned
- ▲ Attending actual classroom time
 - ◆ 15 CPE hours each semester credit
 - ◆ 10 CPE hours each quarter credit
- ▲ 1 CPE hour for every 50 minutes of presentation time

HOURS EARNED MAY NOT EXCEED 40 HOURS

- ▲ 2 CPE hours for developing, writing, or preparing each 50 minutes of presentation
- ▲ 1 CPE hour for each hour auditors write/publish during the published year

HOURS EARNED MAY NOT EXCEED 20 HOURS

Measurement of CPE, continued

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- Auditors hired/assigned to a GAGAS engagement after the beginning of the 2-year CPE period may complete a prorated number of CPE hours.
- Prorated hours – based on the number of full 6-month intervals remaining in the CPE period.
- Example:
 - ◆ 2-year CPE January 1, 2015- December 31, 2016 assigns a new staff member in May 2015. Prorated CPE requirements can be calculated as follows:
 - a. Full 6-month intervals remaining in the CPE period: 3
 - b. Number of 6-month intervals in full 2-year period: 4
 - c. Newly assigned auditor's CPE requirement: $\frac{3}{4} \times 80$ hours = 60 hours

Measurement of CPE, continued

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- For newly assigned auditors subject to 24-hour requirement, prorated hours can be calculated: $\frac{3}{4} \times 24 = 18$ hours.
- Auditors who do not complete the CPE requirements may be given additional time to do so at the audit organization's discretion.
- If the deficiency is not made up, auditors may not be able to participate in GAGAS engagements.
- If auditors charge less than 20% of their time annually, the audit organization may base the 20% on total historical or estimated changes in a year.

CPE Policies

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- If the audit organization discontinues GAGAS engagements or reassigns to non-GAGAS assignments, auditors do not need to satisfy the CPE requirements.
- Some programs/activities do not meet CPE requirements:
 - ◆ On-the-job training
 - ◆ Basic/elementary courses
 - ◆ Programs designed for basic personal development
 - ◆ Programs generally not used in engagements
 - ◆ Programs providing training on admin. Operations
 - ◆ Business sessions with lack of learning objectives
 - ◆ Conducting external quality control reviews
 - ◆ Sitting for professional certification examinations



- Audit organization's policies/procedures for CPE may address:
 - ◆ Identifying all auditors required to meet CPE requirements
 - ◆ Providing auditors the opportunity to attend internal CPE, external CPE, or both
 - ◆ Determining which programs qualify for CPE
 - ◆ Document number of CPE hours completed
 - ◆ Monitoring auditor compliance
- Policies/procedures for documenting may address the documentation of CPE hours to satisfy requirements.



- Documenting CPE hours can be the responsibility of the individual auditors as long as there is supporting documentation.
- Documentation involves:
 - ◆ Organization name providing CPE
 - ◆ Title of program and subject matter/field of study
 - ◆ Dates attended or completed
 - ◆ Number of CPE hours earned
 - ◆ Reasons for specific exceptions granted
 - ◆ Evidence of completion
- Audit organizations do not need to prepare reports on CPE but may consider periodic reports to monitor progress.

GOING CONCERN ASU 2014-15



ASU 2014-15

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- Presentation in Financial Statements
- Identifying, assessing and evaluating evidence to support management's assertion
- Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern.
- Effective for ALL reporting periods ending AFTER DECEMBER 15, 2016

Prior vs. New Requirements

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▲ GAAP (per FASB statements) = NONE

▲ GAAS (per AU-C 570)

- ◆ Auditor **MUST** evaluate whether there is substantial doubt about an entity's ability to continue as a going concern
- ◆ For a reasonable period of time not to exceed one year beyond the balance sheet date of the financial statements being issued.
- ◆ Auditor must also consider the possible financial statement effects, including footnote disclosures on uncertainties about an entity's ability to continue as a going concern for a reasonable period of time after the balance sheet date.

▲ NEW GAAP = ASU 2014-15

- ▲ Management is responsible to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern
- ▲ For a reasonable period of time not to exceed one year beyond the date that the financial statements are issued, or are available to be issued
- ▲ Management makes an assertion which must be audited based on evidence pertaining to relevant conditions and events that are known or knowable at the date that the F/S are issued or available to be issued

Differences are Significant

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- Auditor no longer performs the going concern evaluation / assessment
- Auditor no longer determines whether or not to include footnote disclosures in the F/S
- Management makes an assertion, based on evidence (which has to be auditable) that the entity is or isn't a going concern
- Management develops the appropriate footnote disclosure(s)
- Determination date is when the F/S are issued, NOT the balance sheet date!

Evidence to be Developed by Management

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- QUANTITATIVE
 - ◆ Current financial condition (B/S) including its liquidity sources at the date the F/S are issued
 - ◆ Projected income and cash flows
 - ◆ Unconditional and conditional obligations due or anticipated to be due within 1 year after the F/S are issued, regardless of whether those obligations are currently recognized in the F/S about to be issued
 - ◆ The funds necessary to maintain operations,
 - ▶ Current financial condition (B/S)
 - ▶ Obligations
 - ▶ Other cash flows

Evidence to be Developed by Management, continued

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- QUALITATIVE
 - ◆ Other conditions / events when considered in conjunction with the Quantitative data listed in slide #18, which may adversely affect the entity's ability to meet its obligations within 1 year after the date that the F/S are issued.
 - ▶ Negative financial trends
 - ▶ Financial difficulties
 - ▶ Internal matters
 - ▶ External matters
 - See detailed discussion in ASC 205-45-55-2

Evidence to be Developed by Management, cont.

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- Plans to dispose of assets or segment(s)
- Plans to borrow money or restructure debt
- Plans to reduce or delay expenditures
- Plans to increase owners equity

SAS 132



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Current GAAS (pre-SAS 132) vs. ASU 2014-15

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Issue	Current Auditing Standard	ASU 2014-15
Assessment Period	Reasonable Period of Time: Defined as a <u>period not to exceed one year from the balance sheet date</u>	One year from the date the financial statements are issued
Definition of Substantial Doubt	Undefined	Probable that the entity will be unable to meet its obligations as they become due
Assessment	Annually	<u>Annual and interim</u> periods

Current GAAS (pre-SAS 132) vs. ASU 2014-15, continued

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Disclosure	Current Auditing Standard	ASU 2014-15
Disclosures: Substantial doubt alleviated by management's plans	Considered (but not required)	Required
Disclosures: Substantial doubt NOT alleviated by management's plans		Required statement that there is "substantial doubt about the entity's ability to continue as a going concern"

SAS 132: The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

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- Auditor should –
- Conclude whether substantial doubt exists about the ability to continue as a going concern for a reasonable period of time which is defined as
 - ◆ The period of time required by the applicable financial reporting framework
 - ▶ FASB = 12 months from the date of issuance or, the date that the financial statements were available to be issued
 - ▶ GASB = 15 months from the balance sheet date
 - ◆ Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time.

What does it mean to “Conclude?”

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- There must be an assertion from management or those charged with governance
- There must be audit evidence (not forms, checklists, and practice aids) provided by
 - ◆ The entity
 - ◆ Third parties
 - ◆ Direct auditor knowledge
- Appropriate, necessary, and sufficient audit procedures must have been performed on the audit evidence to form a basis for a conclusion.



- Issued in response to ASU 2014-15
 - ◆ Applies to all audits of a complete set of financial statements (GAAP or SPF)
 - ◆ Effective for audits of financial statements covering reporting periods ending on or after December 15, 2017.



- The auditor should consider whether there are conditions or events, considered in the aggregate, which raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The auditor should determine whether management has performed an evaluation of whether such conditions or events exist.
 - ▶ If such an evaluation has been performed, then the auditor should discuss the evaluation with management, determine whether management has identified relevant conditions or events, perform appropriate audit procedures on evidence prepared by management and, if so, gain an understanding of the plans to address them
 - ▶ If such an evaluation has NOT yet been performed, then the auditor should discuss with management the justification for the intended use of the going concern basis of accounting, and inquire of management as to whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Auditor Requirements

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- Audit management's assertion
 - ◆ Checking the box on a practice aid IS NOT auditing
 - ◆ Inquiry of management is necessary BUT
 - ▶ Is not sufficient
 - ▶ Nor is it audit evidence
 - ▶ It is information needed to assess the risk that management's assertion re going concern is materially misstated.
 - ◆ Obtain schedules, calculations, worksheets and interim financial statements and cash flow analysis from the date the F/S are issued to 1 year out.
 - ▶ Audit the integrity of management's evidentiary materials
 - ▶ Audit the completeness of evidence provided by mgt.
 - ▶ Audit the mathematical accuracy

Auditor Requirements, continued

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- Audit management's assertion, continued
 - ◆ Work paper Documentation must contain
 - ▶ Evidence prepared by management
 - ▶ Draft of the footnote disclosure written by management
 - ◆ Work paper documentation must show what audit procedures and testing were performed and by whom
 - ◆ Work paper documentation must show who reviewed and approved the audit procedures performed
 - ◆ Conclusions reached.

Example of Audit Documentation

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- **Management's Assertion = Entity XYZ Co. IS a going concern**
- **Positive Evidence Provided by Management**
 - Budgeted or projected income statement -cash basis [See W/P #1]
 - Budgeted or projected cash flow statement [See W/P #2]
 - Schedule of monthly obligations [See W/P #3]
 - Other
- **Auditing procedures performed**
 - Ascertain the reasonableness and feasibility of the assumptions underlying the budgeted/projected information
 - Determine that assumptions are properly built into the spreadsheets
 - Check the mathematical accuracy and completeness of all calculations
 - Evaluate any other data provided by the client
- **Document the audit work paper reference where the above-listed evidence and procedures are located**

REMEMBER

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NO DOCUMENTATION MEANS THAT
AUDIT WORK WAS NOT PERFORMED

FORMS, CHECKLISTS & PRACTICE AIDS
ARE NOT AUDIT EVIDENCE

Summary of the Guidance: Auditor's Requirements

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- The auditor's evaluation should
 1. address management's assessment of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern,
 2. cover the same period as that used by management in its evaluation, as required by the applicable financial reporting framework, &
 3. consider whether management's evaluation includes all relevant information of which the auditor is aware.

Summary of the Guidance: Auditor's Requirements, continued

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- The auditor should also inquire of management as to its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern.
- When events or conditions have been identified, the auditor should obtain sufficient appropriate audit evidence to determine whether such conditions and events, when considered in the aggregate, raise substantial doubt about an entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors.

Summary of the Guidance: Auditor's Requirements, continued

65

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- When management's plans include financial support by third parties or the entity's owner-manager (the supporting parties) and such support is necessary to support management's assertions about the entity's ability to continue as a going concern, the auditor should obtain sufficient appropriate audit evidence regarding
 1. the intent of the supporting parties to provide the necessary financial support, including written evidence of such intent, and
 2. the ability of the supporting parties to provide the necessary financial support.
- Note that failure to obtain the written evidence of the intentions of the supporting parties to provide financial support constitutes a lack of sufficient appropriate audit evidence, in which case the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern.

Summary of the Guidance: Auditor's Requirements, continued

66

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- If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances, but substantial doubt exists about the entity's ability to continue as a going concern, then the auditor should evaluate the adequacy of the financial statement disclosures, as required by the applicable financial reporting framework.
- If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern, but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans, then the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework.

Summary of the Guidance: Auditor's Report

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- If the financial statements have been prepared using the going concern basis of accounting, but, in the auditor's judgment, management's use of the going concern basis is inappropriate, then the auditor should express an adverse opinion.
- If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern remains, the auditor should include an emphasis-of-matter paragraph in the auditor's report, which should be expressed in terms consistent with those included in the applicable financial reporting framework.

Summary of the Guidance: Auditor's Report, continued

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- If adequate disclosure about an entity's ability to continue as a going concern is not made in the financial statements, then the auditor should express a qualified opinion, or an adverse opinion, as appropriate.
- If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior-period financial statements that are presented for comparative purposes and that doubt has been removed in the current period, then the emphasis-of-matter paragraph included in the auditor's report on the financial statements of the previous period should not be repeated.

Summary of the Guidance: Auditor's Report, continued

69

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- Management may request that the auditor reissue an auditor's report and eliminate a going concern emphasis-of-matter paragraph contained therein.
- Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, then the auditor should reassess the going concern status of the entity.

Summary of the Guidance Other Matters

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- Unless such individuals are involved in managing the entity, the auditor should communicate with those charged with governance regarding conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.
- If there is significant delay in the expected issuance of the financial statements by management or those charged with governance, and the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, then the auditor should perform additional audit procedures as necessary.

Summary of the Guidance Other Matters, continued

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- Documentation requirements when there is substantial doubt about the entity's ability to continue as a going concern:
 1. the conditions or events that led the auditor to conclude that substantial doubt exists,
 2. the elements of management's plans that the auditor considered to be particularly significant in overcoming conditions or events that raised doubts about the entity's ability to continue as a going concern,
 3. the audit procedures performed to evaluate the significant elements of management's plans and the evidence obtained,
 4. the auditor's conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern remains or is alleviated, and
 5. the effect of the auditor's conclusion on the auditor's report.

Example Emphasis-of-Matter Paragraph: Management's Plans Do Not Alleviate Substantial Doubt

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The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Example Emphasis-of-Matter Paragraph:
Management's Plans Alleviate the Substantial
Doubt (optional)

73

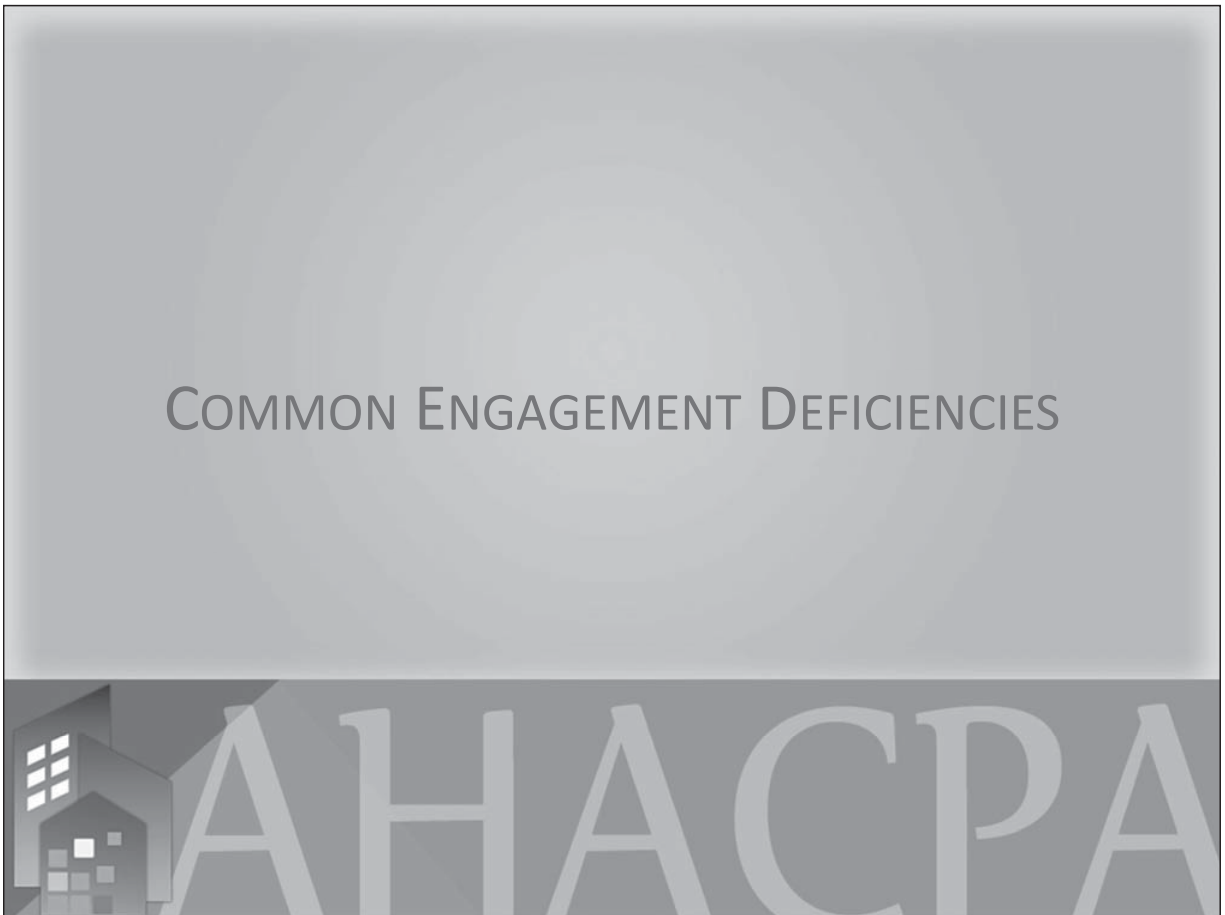
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As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

SECTION





Professional Standards

3

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- Failure to appropriately document planning procedures, including:
 - ◆ Risk assessment (and linkage of risks to procedures performed)
 - ◆ Planning analytics
 - ◆ Understanding of IT environment
 - ◆ Internal control testing

FASB Codification

4

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- Failure to disclose the date through which subsequent events were evaluated
- Failure to correctly classify cash flows, present gross amounts instead of net, and identify non-cash transactions on the cash flow statements
- Failure to appropriately disclose related-party transactions, debt maturation schedules and significant estimates
- Failure to appropriately disclose fair value hierarchy of investments, description of the levels, description of the assumption methods used and tabular presentation of amounts
- Failure to perform sufficient procedures or sufficiently document the procedures to obtain assurance of the fair value measurements

Yellow Book Independence Deficiencies (Peer Review Guidance)

5

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If there is a failure to document **one or more** of the elements of the independence evaluation required by the 2011 Yellow Book, ordinarily the engagement should be considered as not performed in conformity with applicable professional standards in all material respects. If there is marginal documentation of a particular element required by professional standards, the peer reviewer should use judgment to determine the degree of noncompliance on the conclusion of the engagement.

Single Audit Peer Review Deficiencies

6

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Examples of the issues that arise that cause the team captain to consider whether a firm should perform additional audit procedures and reissue the prior year single audit reporting include the following:

1. Missed major program due to using preliminary expenditures when final numbers were higher.
2. Improper clustering of programs resulting in a missed major program
3. Failure to include and audit all programs with same catalog for domestic federal assistance (CFDA) number when determining major programs
4. Failure to properly perform Type A & B program risk assessments
5. Failure to properly compute the program type A/B threshold determination resulting in a missed major program or incorrect program selection
6. Improperly classifying an entity as a low-risk auditee resulting in missed major programs due to percentage of coverage audited as major (watch the 30 day rule)

Single Audit Peer Review Deficiencies, continued

7

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7. Inadequate testing of internal over compliance (for example, not testing to support a low assessed level of control risk, not testing controls relating to some direct and material compliance requirements, or inappropriate sample sizes or related documentation) or compliance (for example, failure to test compliance for all direct and material compliance requirements or inappropriate sample sizes or related documentation) to support the major program opinion
8. Failure to document an understanding of internal control over compliance of federal awards sufficient to plan the audit to support low assessed level of control risk for major programs, including consideration of risk of material noncompliance (materiality) related to each applicable compliance requirement and major program
9. Failure to document the adequacy of the planned sample size for test of controls over compliance to achieve a low level of control risk
10. Failure to document the testing of controls and compliance for the relevant assertions related to each applicable compliance requirement with a direct and material effect for the major program, including insufficient documentation and usage of dual-purpose testing.
11. Failure to document internal controls over the preparation of the Schedule of Federal Awards (SEFA).

Peer Reviewer Focus – Inherent Risk

8

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■ **Guidance**

- ◆ In large, major accounts and audit areas, the inherent risk is rarely low. Low risk may come from a relatively small balance or it may be low on a specific assertion (for example, currency valuation risk when only one currency is involved). Note: Unless controls are tested and determined to be effective, the risk of material misstatement is, essentially, equivalent to inherent risk, even though they may be assessed as required in AU-C sec. 315.

■ **Question**

- ◆ *Revision for 2016:* Where RMM for any relevant assertions or significant accounts is indicative of an IR assessment set at less than high, is there a reasonable basis for that assessment? [AU-C sec. 315.03 and AAG-ARR sec.3.23 and 5.70] Consider: discussions amount the engagement team, key elements of their understanding obtained regarding each aspect of the entity and its environment, and any significant decisions reached or a separately documented IR assessment, if applicable.

Peer Reviewer Focus – Control Risk

9

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Guidance

An assessment of control design and implementation is required on every audit, whether or not controls are tested and relied on. Specifics regarding the account being reviewed should consider the inherent risks and whether specific controls exist to address the inherent risk by assertion.

Question

Consider the relevant assertions and risks related to the account or audit area. Did the auditor evaluate the design and implementation of relevant controls in this area? [AU -C sec. 315] Consider the following:

- Documentation includes actual controls and **not just process descriptions**
- In addition, are all the following present in the documentation:
 - ◆ Who performed the procedure and when
 - ◆ Who in the client organization was interviewed
 - ◆ What evidence regarding the control was examined during the procedure

Peer Reviewer Focus – Control Risk, continued

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Question

If control risk is assessed at less than high, has evidence been obtained to support the level of reliance planned, as follows:

- ◆ If the auditor is relying on a service auditor's report, did the auditor substantively meet professional requirements regarding internal control, including those detailed at AI35 of this checklist? [AU-C sec. 402]
- ◆ For controls where sampling is planned, is the level of testing sufficient to support the level of planned reliance (considering the parameters of risk, tolerable rate, expected rate, and population size) [AU-C sec. 330.07-.10] [AAGARR sec. 5.69]
- ◆ For controls not involving sampling (for example, governance assessments) has sufficient evidence been gathered to support the level of planned reliance? [AUC sec. 330.07-.10, AAG-ARR sec. 5.70]

AU-C 315 Paragraph 13

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The auditor should obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit

Q & A on Paragraph 13

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- Does the understanding of internal control relevant to the audit encompass more than control activities?
 - ◆ All components
 - ◆ AU-C is Framework neutral (however, there is only 1 framework – COSO) So it is mandatory to use something, but nothing is mentioned
 - ◆ AU-C 315 does identify as requirements all 5 components of COSO

AU-C 315 Paragraph 14

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When obtaining an understanding of controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel.

Q & A on Paragraph 14

14

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Does an understanding of controls relevant to the audit require an assessment of design and confirmation of implementation for all relevant controls every year?

- ◆ Yes
- ◆ Combination of inquiries and other corroborating procedures
- ◆ Flexibility in what is performed each year

AU-C 315 Paragraph 19

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- The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:
 - a. The classes of transactions in the entity's operations that are significant to the financial statements.
 - b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.
 - c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.

AU-C 315 Paragraph 19, continued

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- The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:
 - d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
 - e. The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.
 - f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments.

Q & A on Paragraph 19

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- Does the auditor have to obtain an understanding of business processes relevant to financial reporting and communication in every engagement?
 - ◆ Yes!
 - ◆ Processes versus controls

AU-C 315 Paragraph 21

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- *Control activities relevant to the audit.* The auditor should obtain an understanding of control activities relevant to the audit, which are those control activities the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. However, the auditor should obtain an understanding of the process of reconciling detailed records to the general ledger for material account balances.

Q&A on Paragraph 21

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- What are control activities relevant to the audit (CARA)?
 - ◆ Judgment
 - ▶ Factors to consider include, among others, materiality, risk and complexity of systems
 - ▶ Auditor's knowledge
 - ▶ Management's review controls
 - ▶ Controls around data and information produced by the entity
 - ◆ Requirement
 - ▶ Controls that address significant risks of material misstatement
 - ▶ Controls that address risks of material misstatement for which substantive procedures alone are not sufficient
 - ▶ Controls on which the auditor plans to rely to design substantive procedures
 - ▶ Controls over journal entries

AU-C 315 Paragraph 26

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- To determine the further audit procedures the auditor should identify the risks of material misstatement at:
 - ◆ The financial statement level and,
 - ◆ The relevant assertion level for classes of:
 - ▶ Transactions
 - ▶ Account balances
 - ▶ Disclosures

AU-C 315 Paragraph 27

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- For the risk assessment the auditor should:
 - ◆ Identify risk throughout understanding of the entity and its environment, including controls by considering classes of transactions, account balances and disclosures in the AFS
 - ◆ Assess the identified risks and evaluate whether they relate more pervasively to the AFS as a whole and potentially many assertions
 - ◆ Relate the risks to what can go wrong at the relevant assertion level
 - ◆ Consider the likelihood of material misstatement, including the possibility of multiple misstatements, and whether the potential misstatement could result in material misstatement

AU-C 315 Paragraph 28

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- As part of the risk assessment described in paragraph .26, the auditor should determine whether any of the risks identified are, in the auditor's professional judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk.

AU-C 315 Paragraph 29

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- In exercising professional judgment about which risks are significant risks, the auditor should consider at least:
 - ◆ Whether there is a risk of fraud
 - ◆ Whether the risk is related to recent significant economic, accounting or other developments
 - ◆ Complex transactions
 - ◆ Involves significant related party transactions
 - ◆ Degree of subjectivity in the measurement of financial information related to the risk, especially those related to uncertainties
 - ◆ Significant transaction outside the normal course of business

Testing Controls

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- Five elements of COSO
 - ◆ Evaluate design
 - ◆ Test effectiveness of key control attributes (not processes)
 - ▶ Inspection and re-performance
 - ▶ Procedures consistently performed, by the right person, in accordance to policy, and prevents management override
 - ▶ Must test throughout the period
 - ▶ Deviations must be defined and documented in advance of the test
 - ▶ Determine if expansion of the sample will provide evidence of containment of the error

Sample Sizes

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- Size of population has little impact on sample sizes, except for smaller populations
- Controls Testing
 - ◆ Identify characteristics indicating performance of control
 - ◆ Deviation is a departure from the expected performance of the control (departure from Federal rules or contract conditions)
 - ◆ Defined for each audit objective
- Compliance Testing
 - ◆ Determine whether deviations constitute a finding and its effect on compliance opinion

Dual Purpose Sampling

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- Covers both testing of effectiveness of internal control over compliance and whether auditee complied with relevant compliance requirements
- Same sampling unit
- Size will generally be the larger of the two required samples
- Failure of a control may not lead to noncompliance
- Findings evaluated separately
- Documentation clearly distinguishes between controls and compliance testing

Combining Compliance and AFS Samples (paragraph 21.56)

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21.56

Another example of using a sample for multiple purposes is when auditors wish to use a single sample for testing for both Uniform Guidance compliance audit objectives and financial statement audit objectives. Such an approach may present additional complexities to consider because often there are different characteristics, and even different appropriate populations, for single audit and financial statement audit tests. Although many auditees record federal award transactions within their general ledgers, populations used for financial statement purposes often do not align well with sampling populations for testing in a Uniform Guidance compliance audit. The same principles described previously for a dual purpose sample apply when a single sample is used to achieve both Uniform Guidance compliance audit and financial statement audit objectives.

Combining Compliance and AFS Samples (paragraph 21.56), continued

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21.57

Although it is challenging to select samples that achieve both Uniform Guidance compliance audit and financial statement objectives, they do occur. An example of a sample that achieves both Uniform Guidance compliance audit and financial statement audit objectives is a sample of transactions inspected to determine the following:

- Indications of compliance with relevant federal statutes, regulations, and compliance requirements over allowable costs and cost principles
- Indications of performance of internal controls over both allowable costs and cost principles and appropriateness of the expense for financial reporting
- Evidence that the recorded amount, account, and period are correct for financial reporting

Controls Sample Size

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- Planned to a low assess level of risk
- Accordingly, a 90-95% confidence level
- High level of assurance
- Appropriate for populations of greater > 250

*Significance of Control and Inherent Risk of Compliance Requirement
0 deviations expected*

Minimum Sample Size

Very significant and higher inherent risk	60
Very significant and limited inherent risk	40
or	
Moderately significant and higher inherent risk	
Moderately significant and limited inherent risk	25

Significance of Control Being Tested

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- Amount of evidence may vary based on the significance of the control
 - ◆ Example – Loan File QC is the only control over the production of loans. Therefor the significance of the control is great due to the magnitude of risk of noncompliance
- May consider the subsequent information from other procedures that may limit the severity of the impact of noncompliance



■ Key Risk factors for Compliance

- ◆ New Program / place in the life cycle
- ◆ Complexity in of program
- ◆ Complex processing
- ◆ Involvement of third parties
- ◆ Previous significant deficiencies and mater weaknesses
- ◆ High employee turnover
- ◆ High volume of activity
- ◆ Substantial change in policies, processes
- ◆ Significant changes in federal statutes, regulations

REPORTING TO THE BOARD – A NEW WORLD
OF GOVERNANCE



CFPB requires a CMS

33

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- The Owner or the Board of the Company Must:
 - ◆ Establish the company's compliance responsibilities
 - ◆ Communicates those responsibilities to employees
 - ◆ Ensures legal requirements are included in all business processes
 - ◆ Reviews operations to ensure responsibilities and legal requirements are met
 - ◆ Takes corrective action; updates tools, systems, and materials, as necessary
- HOW ARE THESE RESPONSIBILITIES ACCOMPLISHED?

The New World of Governance

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- OCC/FDIC Banks have always had Structured Governance
- Governance:
 - ◆ Establish Policy for Regulatory Compliance
 - ◆ Establish Operating Policy
 - ◆ Establish Operating Objectives
 - ◆ Approve Budget
 - ◆ Create Compensation Standards
 - ◆ Select and Supervise CEO
 - ◆ Measure Results Monthly

8 Fundamental Areas of Risk

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- Credit Risk – Repurchase Tracking & Loss Reserve
- Interest Rate Risk – BE vs Hedging, Lock Policy
- Liquidity Risk – Cash Flow Forecast
- Price Risk – Gain on Sale Baseline and Reconciliation
- Operational Risk – Poor Training, U/W Quits, Branch Quits
- Compliance Risk – forgot about TRID
- Strategic Risk – Growth Exceeds Warehouse Funding Support
- Reputation Risk – Negative Events

The Board Report Content

36

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- Cash Flow Results and Projections
- Revenue – Gain on Sale, Origination Income
- Expenses – COGS, Operating, Unusual Items
- Budget Variance
- Internal Audit Results
- Reporting
 - GAAP reporting with MTM of IRLC
 - Management reporting Excludes IRLC
- KPIs
- Dashboards

What the Board Really Wants to Know

37



- What happened during the last quarter?
- How do the results compare to what was expected?
- Why was there a difference?
- How do the results compare to last year?
- Why was there a difference from last year?
- How do the results compare to the future?
- What are you doing today to make things different tomorrow?

Use of Key Performance Indicators (KPIs)

38

- ▲ Mortgage Pull-through Rate
- ▲ Average Mortgage Loan Value
- ▲ Mortgage Application Approval Rate
- ▲ Percentage of Loans Abandoned
- ▲ Average Applicant Income
- ▲ Percentage of Loans Declined
- ▲ Percentage of Applications Closed for Incompleteness
- ▲ Amount Collected per Collections Employee
- ▲ Mortgage Loans Closed per Originator
- ▲ Mortgage Production Mix - Purchases
- ▲ Applications per Underwriter
- ▲ Unit Cost per Loan Serviced
- ▲ Unit Cost – Loans Originated
- ▲ Loans 90+ Days Past Due
- ▲ Total Volume Originated
- ▲ Loans Serviced Per Employee
- ▲ Loan Production Revenue per Loan
- ▲ Production Labor Expense per Loan Originated
- ▲ Average Loan Balance
- ▲ Loan Cycle Time (origination)
- ▲ Apps per Processor
- ▲ Closing per year
- ▲ Closings per FICO Score Category

CFPB MANDATED CONTROLS AND COMPLIANCE



Ability-To-Repay

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- Under the Ability-To-Repay (ATR) rule, a creditor must make a reasonable, good-faith determination that the consumer has a reasonable ability to repay the loan.
- What is a **reasonable, good-faith determination**? Courts would likely consider:
 - ◆ Underwriting standards
 - ◆ Consumer payment history
 - ◆ Inconsistency in applying underwriting standards

Ability-To-Repay, continued

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A creditor must consider 8 specific underwriting factors:

1. Currently or reasonably expected income or assets other than the value of the dwelling that secures the loan;
2. Current employment status if employment income is relied on in determining repayment ability;
3. Monthly payment on the covered transaction;
4. Monthly payment on any simultaneous loan;
5. Monthly payment for mortgage-related obligations;
6. Current debt obligations, alimony, and child support;
7. Monthly debt-to-income ratio or residual income; and
8. Credit history.

Qualified Mortgages (QM)

42

	Types of QM Mortgages			
	General	Temporary	Small Creditor	Balloon Payments
Points and Fees < 3%	X	X	X	X
No Interest only loans or negative amort.	X	X	X	X
Loan terms not < 30 year	X	X	X	X
Higher-priced (APR > APOR by 1.5 points) for first lien and 3.5 popints for second-lien	X	X		
Higher-priced (APR > APOR by 3.5 points) for both first and secondary lien loans			X	X
Rural/Underserved				X
Term of at least 5 years				X
Debt to Income Ratio	43%	Meet GSE Requirements	Not specified	Not specified
Small creditor - originates fewer than 500 first-mortgage per year and less than \$2 billion in assets				

Loan Originator Compensation

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On January 20, 2013 the CFPB issued a final rule on LO Comp under TILA, as amended by Dodd-Frank. Revised the Federal Reserve Board's LO Comp Rule.

- ◆ LO defined as: “a person who takes an application, offers, arranges, a assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person.”
 - ▶ Excludes persons who perform administrative or clerical tasks
 - ▶ Teller/Receptionist: not an LO as long as this person does not discuss credit terms that may be available to that person selected based on the person's financial characteristics and does not refer the consumer, based on the LO's assessment of the consumer's financial characteristics, to a particular LO

Loan Originator Compensation, continued

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The rules prohibit:

- Compensating a LO based on a term of a transaction or a “proxy” for a term of a transaction
 - ◆ Proxy for a term: (i) consistently varies with a factor or term over a significant number of transactions, and (ii) the LO has the ability to manipulate the factor.
 - ◆ Examples from the final rule on what a proxy is
- Dual Compensation: a LO receives compensation from the consumer and an additional party
- “Steering,” or directing a consumer to execute a transaction based on the fact that doing so will result in higher compensation for the LO from the creditor

Loan Originator Compensation, continued

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Exception to term of transaction prohibition

- Compensation under a non-deferred profits-based compensation plan is permitted IF:
 - ◆ The compensation paid does not exceed 10% of the LO's total compensation, or
 - ◆ The LO served in that role for ten or fewer transactions during the 12-month period preceding the date of compensation determination.

Loan Originator Qualifications

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- LOs must comply with licensing, registration and other provisions of the Secure and Fair Enforcement of Mortgage Licensing Act (SAFE Act).
- Pursuant to Dodd-Frank, for employees not covered by the SAFE Act or state implementing laws, loan originator organizations must:
 - ◆ Obtain a state and national criminal background check
 - ◆ Obtain a credit report
 - ◆ Obtain information from the National Mortgage Licensing System and Registry
- The rule establishes standards for determining employee qualification that are mostly consistent with those in the SAFE Act

Consumer Protections

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Pursuant to Dodd-Frank, it is unlawful for any provider of consumer financial products or services or a service provider to engage in any unfair, deceptive or abusive act or practice(UDAAP).

- Examples of UDAAPs:
 - ◆ Collecting fees not expressly authorized by the agreement creating the debt or permitted by law
 - ◆ Falsely representing the character, amount, or legal status of the debt
 - ◆ Misrepresenting to consumers that their debts would be waived or forgiven if they accepted a settlement offer

TILA-RESPA Integrated Disclosure

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- These forms will “ _____ ”



TILA-RESPA Integrated Disclosures

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- Consolidates four existing disclosures required under TILA and RESPA for closed-end credit transaction into two forms:
 - ◆ Loan Estimate issued no later than the 3rd business day after the app
 - ◆ Closing Disclosure issued at least 3 business days prior to closing
- Forms retained for 5 years
- Must be used on loans with APPs after 10/3/2015
- Applies to most closed-end consumer credit transactions except, HELOC, HECMs, chattel dwelling loans

Fee Variances

50

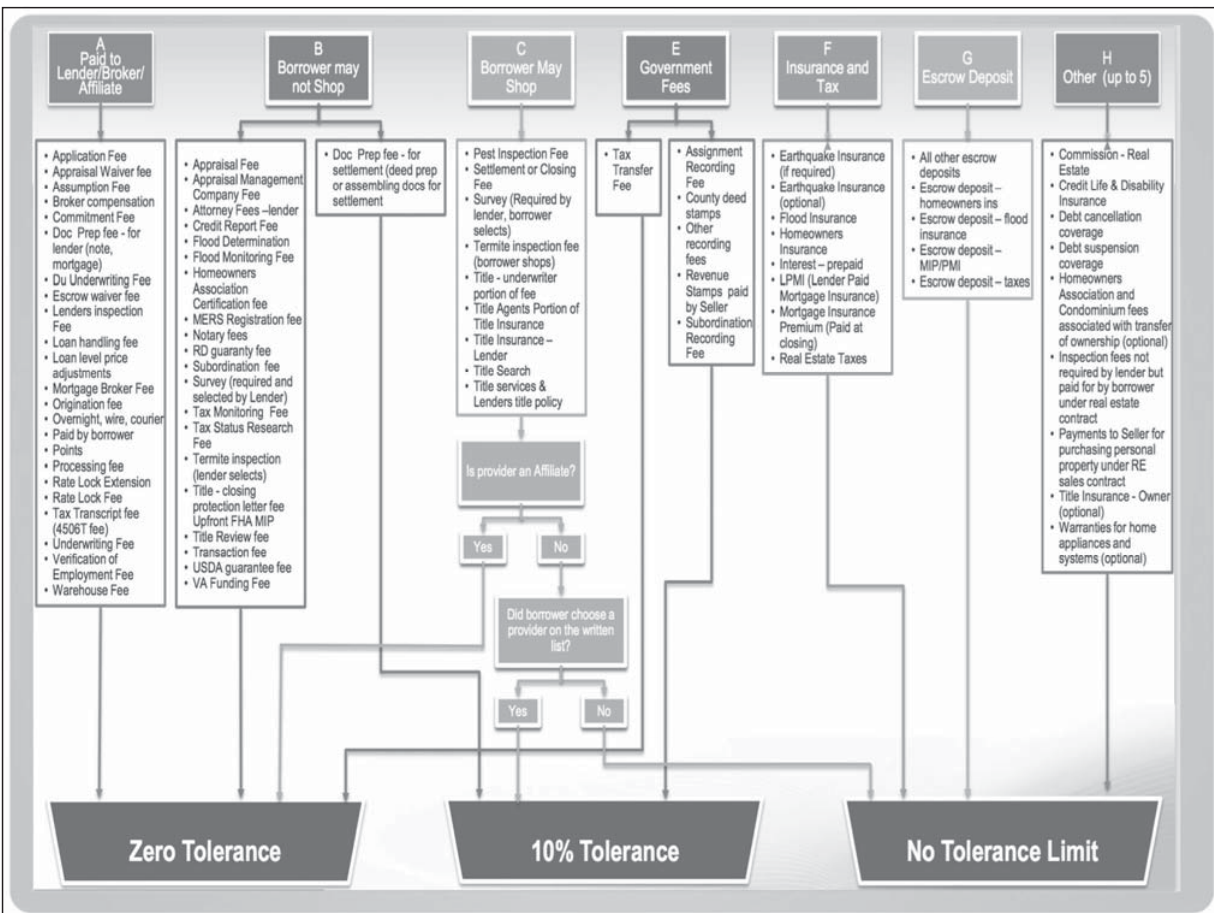
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- Three categories with differing variances allowed
 - ◆ Zero % Variance
 - ▶ Fees that cannot increase
 - ▶ Credits that cannot decrease
 - ◆ 10% Variance
 - ◆ Charges that change (any variance)



- Borrower Cannot Shop for Services:
 - ◆ No Variance is allowed
 - ◆ Any estimated closing cost disclosure must be honored
- 2.a Borrower Can Shop for Service:
 - ◆ Picks Your Recommended Provider. 10% Limit applies.
 - ◆ Be careful who is on Settlement Provider List
- 2.b) Borrower Can Shop for Service:
 - ◆ Picks Provider NOT on Lender's list
 - ◆ No Limit to Fee Estimate Change



Charges excluded from the finance charge

The following charges are not finance charges:

1. Application fees charged to all applicants for credit, whether or not credit is actually extended.
2. Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or a similar occurrence.
3. Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.
4. Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis
5. Seller's points.
6. Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.

7. REAL-ESTATE RELATED FEES

The following fees in a transaction secured by real property or in a residential mortgage transaction, if the fees are bona fide and reasonable in amount:

- i. Fees for title examination, abstract of title, title insurance, property survey, and similar purposes.
- ii. Fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents.
- iii. Notary and credit-report fees.
- iv. Property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood-hazard determinations.
- v. Amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

Servicing

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CFPB Bulletin 2013-12 - -Effective January 10, 2014
Impacts Virtually All Mortgage Loan Servicing Activity

Important Note: Interim Servicing is Servicing
Mortgage banks collecting first payments is Interim Servicing and is subject to all federal regulations of servicers and specifically:

- FDCPA
- FCRA
- CFPB Servicing Rules



Monthly billing statements – Periodic Statements

- Servicers are required to provide additional loan information in customers' monthly billing statements.
- If these statements aren't clear and concise, customers can be confused and overwhelmed about the information they receive

Adjusted rate mortgage (ARM) loan notices

- The first rate change notice, must be sent to customers 210 days before the payment change is due.

Note: In some cases, the information provided to the customer will be only an estimate.



QWR – Qualified Written Response

Error notice (resolution) and information Requests –

- Within 5 days, acknowledge the request or notice of error.
- Within 30 to 45 days, correct the error and provide the consumer written notification of the correction, or conduct an investigation and provide the consumer written notification that no error occurred.
- Within 30 to 45 days, provide the information or conduct a reasonable search for the requested information and provide the consumer with a written notification explaining why the information is not available.

Servicing Rules from CFPB 2013-12

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Loss Mitigation Procedures

- Work with consumers to address loss mitigation options
- Evaluate loss mitigation applications within 30 days
- Inform consumers of whether the servicer will offer the consumer a loss mitigation option and,
 - if the consumer is denied a loan modification option, of the reasons for the denial
- Evaluate timely appeals submitted by eligible consumers by different personnel who denied the application
- Halt all foreclosure process during modification process

Servicing Rules from CFPB 2013-12

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Prompt Payment Crediting and Payoff Statements

- Periodic payments must be promptly credited as of the day of receipt.
- If you receive a payment that is less than the amount due for a periodic payment, you may place the payment in a suspense account.
- In addition, creditors, assignees, and servicers must provide an accurate payoff balance to a consumer no later than 7 business days after receipt of a written request from the consumer for that information.



Forced Placed Insurance

- You must have a reasonable basis to believe that a consumer has failed to maintain required hazard insurance before charging for force-placed insurance.
- You must send 2 notices to the consumer that you have not received evidence before you charge for force-placed insurance.
- You must cancel force-placed insurance within 15 days of receiving evidence that the consumer has required hazard insurance in place and refund to the consumer any fees or charges for periods of overlapping coverage.



Early Intervention with Delinquent Customers

- Services must make a good faith efforts to establish live contact with consumers by the 36th day of their delinquency and,
- promptly inform them of loss mitigation options that may be available
- In addition, servicer must provide the consumers with written information about any available loss mitigation options by the 45th day of delinquency
- The rules contain model language servicers may use for the written notice.



Continuity of contact with Delinquent Customers

- Servicers must assign personnel to delinquent consumers by the 45th day of the consumers' delinquency.
- Help the consumer to pursue loss mitigation options and applicable timelines.
- Servicers must retrieve the complete record of the consumer's payment history and all of the written information for evaluating a consumer loss mitigation options.
- Servicers must provide a timely live response to consumers who call and leave a message



Servicing Policies and Procedures

- Accessing and providing timely and accurate information
- Properly evaluating loss mitigation applications
- Facilitating oversight of, and compliance by, service providers - TPM
- Facilitating transfer of information during servicing transfers
- Informing consumers of the written error resolution and information request procedures
- Record retention
- Servicing file creation

Servicing Rules from CFPB 2013-12

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Servicing Exemptions

- CFPB rules exempt small servicers
- Less than 5,000 loans
- Do not servicing for anyone else
- Items never exempt
 - ◆ QWR – Error resolution
 - ◆ Force Placed insurance
- Several other items

Third-Party Vendor Management

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OCC

OCC Bulletin 2013-29

- OCC Bulletin 2001-47
- OCC Bulletin 2002-16: Foreign-Based Third-Party Service Providers

CFPB

Bulletin 2012-03 Service Providers

Federal Reserve Board

SR 13-19 Guidance on Managing Outsourcing Risk

- SR 00-4 (SUP): Outsourcing of Information Technology and Transaction Processing

FDIC

Letter: Guidance For Managing Third-Party Risk

- FDIC Compliance Manual, December 2012
- FL-44-2008: Guidance for Managing Third-Party Risk
- FL-50-2001: Bank Technology Bulletin: Technology Outsourcing Information Documents

NCUA

Supervisory Letter No.: 07-01

Fortunately expectations are similar among regulators

MBS' "Best Practices" Definition of Service Provider

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Unofficial definition of Service Provider is:

a "service provider" is a company or person who provides a material service to a mortgage lender offering a consumer financial product including anyone who:

- talks to the borrower about personal information,
- has access to borrower information,
- transmits and holds borrower data,
- reviews borrower data or
- in any other way can access or capture borrower information

Identifying Service Providers

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If a Vendor can see a social security number, then they are a CFPB Service Provider because they could potentially harm a consumer.

A Vendor may be considered a Service Provider if they are placed in a position to potentially harm the consumer arising out of data/communications they received about the customer/mortgagor's financial distress received directly or indirectly from Mortgage Lender

The Mortgage Lender is responsible to protect borrowers from harm by validating that third party service providers (Vendors) have the ability to comply with all federal consumer protection laws.

Service Providers are an extension of the Lender as it relates to compliance with federal consumer laws.

12 Key Dimensions

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- ★ Risk Classification
- Due Diligence
- On-Boarding
- ★ Contracts
- Compliance
- Audits

- MIS / Reporting
- ★ Scorecards
- ★ Annual Certifications
- Complaint Handling
- Escalations
- ★ Governance

Execute these well... satisfy your Regulators

Risk Weighting of CFPB Service Providers, continued

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★ Risk Classification

- Risk-based segmentation
- Scope and intensity of oversight is defined here
- Must consider risks to...

- Legal & Regulatory
- Reputation
- Sensitivity of data
- Process complexity
- Customer interface/ impact
- Public or private vendor

Other Considerations

- Domestic
- Offshore

- Core Bank Function
- Non- Core

- Number of similar suppliers
- Percent of volume handled

- Strategic (High)
- Major (Med)
- Basic (Low)

Due Diligence of Vendors

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Due Diligence

- Assess the process of how suppliers are...
 - Sought
 - Vetted
 - Selected (and retained)
- Consider vendor questionnaire and evaluation matrix



On-Boarding

- Have a plan to implement the vendor relationship
 - Technology, telecom, recruit, train (including compliance), etc.
- Critical: System Entitlements
 - Limit vendor access to only what is "required"
 - Have a revocation process
 - Consider revoking within 24- hours of leaving

Due Diligence Scope of Work

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Primary Objective: protecting consumers from harm.

- ◆ Obtain a **Letter of Assurance** from the vendor representing that they follow the requirements of the CFPB relating to consumer protection
- ◆ Review Vendor's Procedures, Internal Controls and Training
- ◆ Test Vendor's Compliance with Procedures

The CFPB bulletin says that you must:

1. conduct Due Diligence of the vendor's operation to verify they understand and are capable of complying with federal law and
2. review their Policies and Procedures, their Internal Controls, and their Training relating to protecting consumer data.

On-Site or Remote Due Diligence

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High-risk vendor due diligence assessment must:

- ◆ result in obtaining reasonable assurance that the Vendor has the wherewithal to comply with consumer protection laws,
- ◆ confirm the vendor has implemented procedures based on best practices in the industry to comply with consumer financial protection laws,
- ◆ test to validate that the vendor has implemented testing to identify violations of consumer financial protection laws.

The FFIEC rules require Due Diligence is unique to:

- ◆ The Covered Person and
- ◆ The Specific Service Provider

Contracts

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Contracts

- Regulators have specific expectations regarding vendor contracts
- Examples of often-overlooked clauses:

- Use of subcontractors
- Termination for default
- Compliance with laws
- Privacy policy (sensitive info)
- Electronic Transportable Media
- Right to audit
- Licensing
- Indemnification
- Notification of complaints
- Handling of media inquiries
- Service level monitoring
- Limitation of liability
- GSA "Excluded Party List"
- HUD's "Limited Denial of Participation"

What is required of you...

Is required of all members of your supply chain

MAKE IT CONTRACTUAL!!

Vendor Monitoring & Reporting

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Compliance

- Identify all relevant compliance requirements and document how requirements are being met
- Regulatory updates and change management process effectiveness
 - Flow down to vendors (operations, contracts, scorecards, etc.)

Audits

- Do your vendors...
 - "Say what they do?" (via Policy & Procedure Manual)
 - "Do what they say?" (can vendors demonstrate it?)
- Have an audit schedule and comprehensive plan
- Ensure risks are documented and controls are in place.

How Frequent ?

Risk Classification

- Strategic (High)
- Major (Med)
- Basic (Low)

"Potential" Audit Frequency

- Twice per year
- Once per year
- Every other year

Example

Vendor Monitoring & Reporting, continued

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MIS / Reporting

- You need timely and effective reporting in all supplier relationships.
- Demonstrate you have sufficient visibility and control.
Hard to achieve safety and soundness without robust reporting !

Scorecards

- Identify key performance indicators (KPIs), track and report on them.
- Document vendor improvement plans.
 - Drive accountability.
- Regular reviews.
 - Evidence of follow-up and actions
 - Warning notices
 - Training, certification
 - Volume adjustments
 - Expanded or decreased scope of work





Governance

"General awareness" of vendors...
No longer acceptable

- Senior executive and/or Board Member engagement
 - "Fingerprints everywhere"
 - Drive and approve policy
 - Monitor vendor platform (via regular readouts)
 - At-will access to vendor results
 - Sign-off on vendor selection and recertification (and action/ exit)
 - Audit trail of their engagement
- Proposed: Two Tier Governance Model

Sets "TONE at the TOP"

- Strategic Alignment
- Risk appetite
- Policy
- Verify adequate oversight
- Ask questions
- Approve, Suspend & Terminate

Executive Committee

Operations Committee

Drive Vendor...

- Performance / Quality
- Control & Compliance
- Risk & Change Mgmt.
- Audits
- Volume Allocations
- Contingency plans

MARGIN PRESERVATION & HEDGING FOR ACCOUNTANTS



Hedging Off-Set

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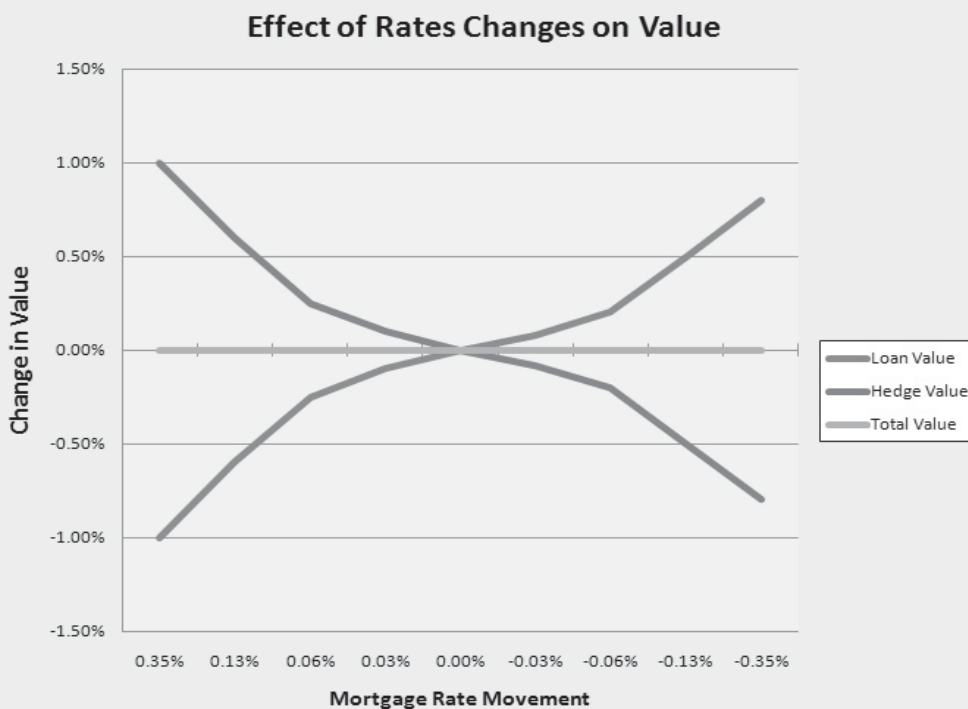
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- The hedge transaction:
 - ◆ Establish a financial transaction that possess the same sensitivity to changes in the interest rate environment
 - ◆ But behaves with the opposite impact from rate changes
- The LONG position or originating a loan behaves with an inverse relationship to the changes in interest rates
- The SHORT position or selling an MBS has a positive correlation to changes in interest rates. If rates go up, the value of the "short" position goes up
- Being Long and Short in the same transaction offsets or cancels the impact of changes in value from changes in the interest rate environment
- This results in preserving the value of the underlying asset

Risk Assessment of Hedging

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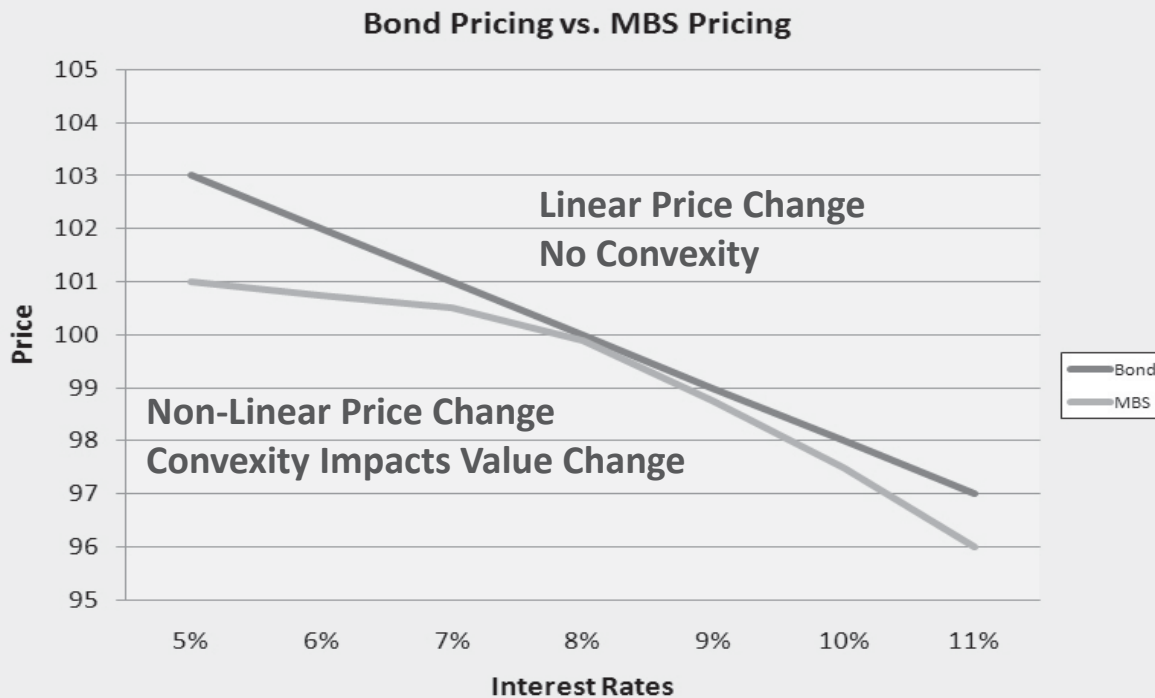


Value of the loan and hedge react inversely to changes in rates.

Focus is margin preservation.

Risk Assessment Hedging Interest Rates

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Hedge Activity Measurement

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■ Hedge Reports

- ◆ The hedge reports display the estimated pipeline profit and loss over a range of interest rates:
 - ▶ Factoring expected changes in market prices and
 - ▶ pipeline fallout at each level of interest rate movement

■ Rate Shock Analysis

- ◆ Graphically presents the results of the gain or loss net position across a range of interest rate movements as of a specific “snap shot” in time
- ◆ The impact of new locks, canceled locks, loan sales and price movement impact the calculation of this net position

Accountants must understand the shock report!!!

Hedge Rate Shock Report

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Rates Decline left to right. Pink line is loan value rising.

The dashboard includes a 'Current Position Rate Shock' chart with a pink line representing loan value rising as rates decline. The chart shows a downward trend in the rate shock metric from 0.0% to 0.0%.

Loans up
Hedge down

Exhibit B
Hedge Risk Model Sample Reports
Rate Shock Report

Rates Decline >>>

REFERENCE TOOLS SCALES OF BALANCE & UNBALANCE



Scales of Coverage - Balanced

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No Adjustment Needed



**Pull-Thru Adjusted
Outstanding
Interest Rate
Lock Commitments**

**Current TBA-MBS
Hedge Coverage**

Scales of Coverage - UnBalanced

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IRLC more than Hedge Sell more TBA-MBS



**Pull-Thru Adjusted
Outstanding
Interest Rate
Lock Commitments**

**Current TBA-MBS
Hedge Coverage**

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**IRLC less than Hedge
Pair-off TBA-MBS**

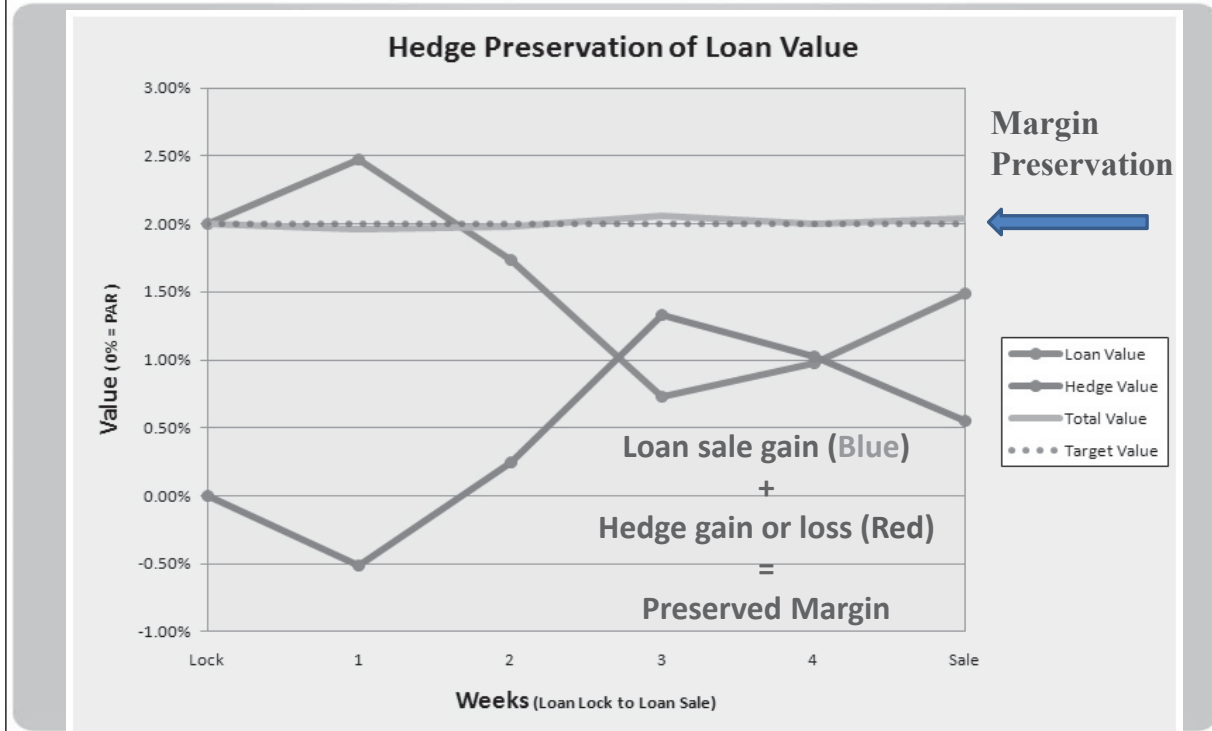


**Pull-Thru Adjusted
Outstanding
Interest Rate
Lock Commitments**

**Current TBA-MBS
Hedge Coverage**

PERFECT HEDGE
WHEN IT ALL WORKS





ACCOUNTING FOR MORTGAGE HEDGE ACTIVITY





- Accounting Standards
 - ◆ ASC 815 – Derivatives
 - ◆ ASC 820 – Fair Value Measurement
 - ◆ ASC 825 – Fair Value Option
 - ◆ ASC 860 – MSR

SFAS 133/149 ASC 815-25 HEDGE & DERIVATIVE ACCOUNTING

Objective is to
Avoid Material Misstatement
from off Balance Sheet Commitments including
Derivatives and Hedging Activity



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SFAS 157 ASC 820 MEASUREMENT
SFAS 159 ASC 825-10-25 FAIR VALUE

Mark to Market Accounting
Objective is to
Report Based on Fair Value



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SFAS 140 ASC 860-50-25-1 MSR

Mortgage Servicing Rights
Objective is to
Recognize Value of Future Cash-Flows
PV of Discounted NET Future Cash-flows
Amortization Method or Fair Value Method
ASC 860-50-35-9



IRLC under ASC 815

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- An IRLC (Interest Rate Lock Commitment)
 - ◆ is an off balance sheet financial commitment
 - ◆ subject to market risk and a
 - ◆ derivative under SFAS 149 ASC 815 and
 - ◆ subject MTM under SFAS 159 ASC 825

- All IRLC are Derivatives
 - ◆ An IRLC hedged with Best Efforts is a derivative
 - ◆ An IRLC hedged with a short MBS is a derivative
 - ◆ The hedge strategy does not change the derivative

ASC 815 – Commitments

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- Mandatory Delivery Commitments
 - ◆ Derivatives under GAAP
 - ◆ Recorded at Fair Value

- Best Efforts Commitments
 - ◆ Do not have a penalty for legitimate cancelation
 - ◆ If loan is not closed, the BE is canceled without cost
 - ◆ Avoidance of pair-off risk is not a derivative. (most agree)
 - ◆ Optional derivative under ASC 825-10-25

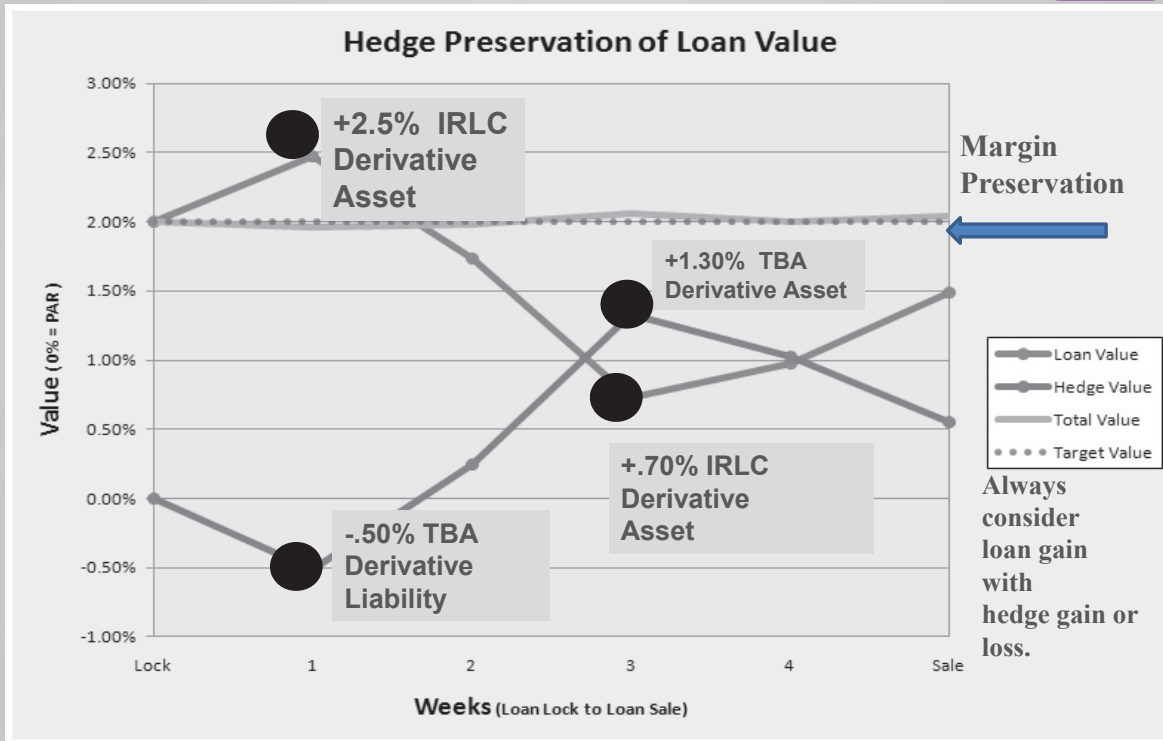
- If IRLC is MTM and BE locks are not MTM
 - ◆ Potential misrepresentation of gain position
 - ◆ Recommend: all commitments are Derivatives/MTM

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- The Interest Rate Lock Commitments – IRLC –
 - ◆ IRLCs are initially issued to generate a profit
 - ◆ The imbedded profit is valued at each reporting period
 - ◆ The resulting gain is recorded as a Derivative Asset
 - ◆ It is very unlikely an IRLC will be a Derivative Liability

- Hedge Position
 - ◆ TBA-MBS can generate a gain or loss depending upon interest rate activity since the date of sale
 - ◆ A TBA-MBS gain is reported as a Derivative Asset
 - ◆ A TBA-MBS loss is reported as a Derivative Liability



DERIVATIVE ASSET & COSTS TO COMPLETE



Derivative Asset

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- ASC 815-25 requires recognition in current earnings of the unrealized gain or loss (Fair Value) from off-balance sheet commitments
- IRLC is an off-balance sheet commitment (Derivative) subject to market risk and recorded at Fair Value
- Common application of Fair Value of the IRLC is the trading assessment from Investor or Hedge Advisor less Cost to Complete.
- Application of Cost to Complete is the challenge. More Later

Is IRLC Always a Derivative Asset?

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- An IRLC is almost always a Derivative Asset because it is highly unlikely for the rates to raise fast enough for the gain on sale to be eroded to less than zero.
- Once since 1933 in February 1980
- If rates rise quickly and there is an extensive application of Costs to Complete it is possible for an IRLC to be a Derivative Liability



Warehouse Lender Capital Leverage

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- Derivative Asset Increases Capital
 - ◆ DR Asset, CR Gain on Sale
- GAAP Capital in CPA Audited Financial is essential
- Warehouse Lenders establish Lending Limit on Capital
- 15 times Capital is common
- More Capital means is More Warehouse Line
- The DA increases when Costs to Complete decrease
- Mortgage CFO will fight for nominal Costs to Complete

Cost to Complete

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- CPA Common Practice for Cost to Complete is to extend FAS91, ASC 310 and ASC 820 to include only direct and incremental loan costs
- The degree to which Cost to Complete includes Indirect Costs is hotly debated because the ASC Guidance is Fuzzy

Warehouse Lenders observe CPA firms:

- Apply Cost to Complete calculation differently
- Most significant variation related to which if any Indirect Costs are applied to Cost to Complete

Non-Authoritative Guidance

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- The Mortgage Bankers Association believes... Cost to Complete should include:
 - ◆ direct costs to closing date, variable portion of branch manager's salary, pre-funding quality control costs
- Cost to Complete should exclude:
 - ◆ corporate overhead, branch fixed, branch depreciation, fixed portion of branch manager's salary

Lack of Guidance results in CPA Report inconsistency

Warehouse Lenders are significantly impacted by variability

Warehouse Lenders Complain

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- CPA Audits are used to confirm Capital Level
- CPA overstate Capital by under-applying Cost to Complete
- CPAs inconsistently apply Costs to Complete

- Warehouse Lender recalculate Derivative Asset
- Warehouse Lenders apply IRLC times pretax profit to determine Net Realizable (cash-flow) Value
- Recalculated Derivative Asset is included in Capital

- Your client calls because banks reject CPA Capital
- Why should a FS User have to recalculate GAAP?

Loan Size creates Different Ratio

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	Large Loans Hawaii	Small Loans Texas	
Average Loan Size	450,000	180,000	
Gain on Sale	2.85%	5.55%	
Gross Revenue	12,825	9,990	
1) Direct Cost per loan %	1.40%	1.90%	1) LO Commission
Direct Cost per loan \$	6,300	3,420	Direct File Expense
			Branch Processor
Gross Margin	6,525	6,570	
Gross Margin %	1.45%	3.65%	
2) Indirect Costs per loan	4,950	5,940	2) Rent (highly variable)
Indirect Costs per loan %	1.10%	3.30%	Underwriters (4x more)
Relative Indirect cost	25%	75%	Closing (3x more)
			Management
Profit before Tax	1,575	630	
Profit before Tax %	0.35%	0.35%	

Identical IRLC: Uncorrelated

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	Large Loans Hawaii	Small Loans Texas	
IRLC after pull-thru	50,000,000	50,000,000	
IRLC Revenue	1,425,000	2,775,000	Gain on Sale
IRLC cost to complete	<u>700,000</u>	<u>950,000</u>	Direct Costs
Derivative Asset	725,000	1,825,000	
Net Realizable Value			IRLC times PreTax Profit
Cash less all costs	175,000	175,000	Perference of Warehouse Banks

Indirect Cost Variability

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	Large Loans Hawaii	Small Loans Texas
Example Monthly Indirect Costs Variability		
Monthly Closing	25,000,000	25,000,000
Number of loans	56	139
Number of UW	0.93	3.47
Other Indirect staff	2.78	6.94
Costs per month	\$21,219	\$62,211
Relative Indirect cost	25%	75%

IRLC is not Inventory... but

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- Inventory Absorption Costing Improves Validity of Derivative Asset by including indirect costs
- Work in process cannot be worth more than finished good
- Front-loading of expected future net cash flows should include administrative functions “related to production.”
- The closer the reported value of the IRLC is to the net profit margin, the better it correlates to future cash flows
- Warehouse Lenders want to include all indirect costs to directly correlate to Net Realizable (cash-flow) Value
- They are petitioning FASB to provide specific guidance
- See me if you want to contribute to FASB letter

Derivative Asset: Bottom-line

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- Continued Confusion –
 - ◆ Gain on Sale is recognized when the loan Locked
 - ◆ Expense is inconsistently recognized as Cost to Complete or when Loan is Closed
- How can the same \$50,000,000 IRLC generates vastly different Derivate Asset with Identical Cash Realization?

	Large Loans Hawaii	Small Loans Texas	
IRLC after pull-thru	50,000,000	50,000,000	
IRLC Revenue	1,425,000	2,775,000	Gain on Sale
IRLC cost to complete	<u>700,000</u>	<u>950,000</u>	Direct Costs
Derivative Asset	725,000	1,825,000	
Net Realizable Value			IRLC times PreTax Profit
Cash less all costs	175,000	175,000	Perference of Warehouse Banks



- Warehouse Lenders as “User of Financial Statements” reject Direct Cost Only Method
- At Best, CPAs are inconsistent
- At Worst, CPA Overstate Capital
- Opinion Risk –
 - ◆ Warehouse Lenders complain CPA Auditor overstate Capital
 - ◆ Overstated Capital places Warehouse Lenders at greater lending exposure
 - ◆ What happens when Warehouse Lenders have loss?

GOING CONCERN
ASU 2014-15





- Presentation in Financial Statements
- Identifying, assessing and evaluating evidence to support management’s assertion
- Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.
- Effective for ALL reporting periods ending AFTER DECEMBER 15, 2016

Prior vs. New Requirements

▲ GAAP (per FASB statements) = NONE

▲ GAAS (per AU-C 570)

- ◆ Auditor **MUST** evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern
- ◆ For a reasonable period of time not to exceed one year beyond the balance sheet date of the financial statements being issued.
- ◆ Auditor must also consider the possible financial statement effects, including footnote disclosures on uncertainties about an entity’s ability to continue as a going concern for a reasonable period of time after the balance sheet date.

▲ NEW GAAP = ASU 2014-15

- ▲ Management is responsible to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern
- ▲ For a reasonable period of time not to exceed one year beyond the date that the financial statements are issued, or are available to be issued
- ▲ Management makes an assertion which must be audited based on evidence pertaining to relevant conditions and events that are known or knowable at the date that the F/S are issued or available to be issued

Differences are Significant

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- Auditor no longer performs the going concern evaluation / assessment
- Auditor no longer determines whether or not to include footnote disclosures in the F/S
- Management makes an assertion, based on evidence (which has to be auditable) that the entity is or isn't a going concern
- Management develops the appropriate footnote disclosure(s)
- Determination date is when the F/S are issued, NOT the balance sheet date!

Evidence to be Developed by Management

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- QUANTITATIVE
 - ◆ Current financial condition (B/S) including its liquidity sources at the date the F/S are issued
 - ◆ Projected income and cash flows
 - ◆ Unconditional and conditional obligations due or anticipated to be due within 1 year after the F/S are issued, regardless of whether those obligations are currently recognized in the F/S about to be issued
 - ◆ The funds necessary to maintain operations,
 - ▶ Current financial condition (B/S)
 - ▶ Obligations
 - ▶ Other cash flows

Evidence to be Developed by Management, *continued*

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■ QUALITATIVE

- ◆ Other conditions / events when considered in conjunction with the Quantitative data listed in Slide #18, which may adversely affect the entity's ability to meet its obligations within 1 year after the date that the F/S are issued.
 - ▶ Negative financial trends
 - ▶ Financial difficulties
 - ▶ Internal matters
 - ▶ External matters
 - See detailed discussion in ASC 205-45-55-2

Evidence to be Developed by Management, *continued*

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- Plans to dispose of assets or segment(s)
- Plans to borrow money or restructure debt
- Plans to reduce or delay expenditures
- Plans to increase owners equity

