



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

April 30, 2004

MORTGAGEE LETTER 2004-19

To: All Approved Mortgagees

Subject: Mandatory Electronic Submission of Annual Audited Financial Statements

I. General

- A.** As outlined in Mortgagee Letter 2003-03, issued February 25, 2003, all Title I and Title II Nonsupervised Lenders/Mortgagees and Loan Correspondents (collectively “lenders”) are now required to submit their annual financial reports electronically through the Lender Assessment Subsystem (LASS), using the FHA Connection at the internet URL: <https://entp.hud.gov/clas>. The electronically submitted lender’s annual report is due no later than 90 days after the end of a lender’s fiscal year. Lenders may request an extension for filing their electronic submission. Such requests must be made electronically no sooner than 45 days prior to the submission due date or no later than 15 days prior to the original due date. This provides a 30-day window for requesting extensions. All extension requests must be submitted through LASS and will be granted only for circumstances that were beyond the control of the lender or its auditor.
- B.** HUD will no longer accept a paper audit report for recertification except under the following circumstances:
- 1) Title II mortgagees that are also Ginnie Mae Issuers – To comply with FHA requirements, the lender must complete its electronic submission for FHA through LASS; however, the paper copy of the audited financial statements must also be submitted directly to Ginnie Mae to comply with Ginnie Mae requirements.
 - 2) Lenders included within consolidated financial statements – Currently lenders that are part of consolidated entities that do not have separate audited financial statements cannot submit through LASS. LASS is currently being updated to include this functionality with an expected completion date of April 30, 2004; however, until this functionality has been implemented, lenders with consolidated financial statements may continue to submit paper copy audited financial reports to FHA. Lenders with consolidated audits may check the status of this LASS system update via email at LASS@hud.gov or by calling (202) 755-7400 ext. 163.

- C. All paper copy financial reports submitted to FHA that do not fall within one of the two above exceptions will be returned to the lender along with a notification that the lender has failed to meet the electronic submission requirement.
- D. Lenders that do not submit their audit report electronically within 90 days after the end of their fiscal year will be notified of their non-compliance by certified mail and given an additional 30 days to complete an electronic submission. If the electronic submission is not completed within the additional 30-day period, the lender's FHA approval is subject to being withdrawn by the Department.

II. Planning Ahead

- A. In order for lenders to complete their electronic submission through LASS, they will need to obtain an FHA Application Coordinator User ID and password. Since the User ID and password are mailed to the lender for security reasons, this process can take up to 14 days to complete. Therefore, lenders that have not yet obtained a User ID and password should request them early enough to ensure they can log onto LASS to meet their submission deadline. The lender User ID registration is done at the FHA Connection Internet site: <https://entp.hud.gov/clas>.
- B. In addition, the lender's electronic submission must be reviewed and attested to on-line by an Independent Certified Public Accountant (CPA) before the audit data can be transmitted to FHA. The attestation may be completed by either the CPA that performed the audit or by a different CPA firm. This attestation must be completed within LASS. The individual at the CPA firm that will be designated to perform the attestation must first obtain an independent user ID and password. CPAs may register for their User ID at http://www.hud.gov/offices/reac/online/online_registration.cfm. Once a lender has assigned the role of Independent Public Accountant to the CPA who will be attesting to their audit, that CPA will need to register for a Unique IPA Identifier Number (UII Number) for the CPA firm, unless the CPA firm has previously obtained a UII. Instructions on how to obtain a UII are contained in Section 1.2.3 of the LASS User Manual at http://www.hud.gov/offices/hsg/sfh/lass/pdf/lass_sec_1-2.pdf. Auditors may access LASS by logging in through HUD's On-Line Secure System at: <http://www.hud.gov/offices/reac/online/reasyst.cfm> while lenders may access LASS through the Single Family Page of the FHA Connection: <https://entp.hud.gov/clas>. Frequently Asked Questions on LASS are located at: <https://entp.hud.gov/clas/faq-lass.html>.

III. Auditor Qualifications

- A.** The auditor must meet the auditor qualifications of Generally Accepted Government Auditing Standards (GAGAS, sometimes referred to as Government Auditing Standards or “Yellow Book”), including those relating to independence and continuing professional education. Additionally, the audit organization must meet the quality control requirements of GAGAS, including peer reviews. For more information, see Paragraph 1-2 of the Consolidated Audit Guide for Audits of HUD Programs, HUD Handbook 2000.04 Rev-2 and the Generally Accepted Government Auditing Standards as set forth by the General Accounting Office. If HUD accepts an audit based on the lender’s certification on the Data Collection Form as meeting GAGAS and later determines that the auditor was not qualified to perform such audits, HUD will rescind its acceptance and the lender may be subject to having its FHA approval withdrawn.

IV. Submission Errors

LASS has been the required method for the submission of audits beginning with lenders’ fiscal years ending September 30, 2002 and later. Since the implementation of LASS, the Department has noted certain common and re-occurring errors with lenders’ submissions that could easily be avoided in the future. The most common errors are noted below.

- A. Statement of Auditing Standards 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (SAS 29).**

Although the adjusted net worth calculation is not a part of the basic financial statements, the Consolidated Audit Guide for Audits of HUD Programs, HUD Handbook 2000.04 Rev-2 requires that the calculation be submitted and that the auditor opine on it. This opinion would fall under SAS 29. Numerous submissions were received this past year indicating that the SAS 29 opinion was omitted. However, when HUD staff contacted the lenders/auditors because these submissions were deemed deficient by LASS, it was noted that the auditor correctly issued an unqualified SAS 29 opinion but that the wrong box was marked in LASS. Accordingly, lenders/auditors should be sure to check the correct box with respect to the SAS 29 opinion.

- B. Financial Statements Prepared According to Generally Accepted Accounting Principles (GAAP).**

The Data Collection Form (DCF) contains a question asking if the financial statements were prepared using a basis other than GAAP. Numerous lenders answered yes to this question and their auditors attested to the answer. This caused LASS to flag those audits as being deficient since HUD Handbook 2000.04 requires that the financial statements be prepared in accordance with GAAP. When HUD staff contacted these lenders/auditors to resolve the deficiency, it was noted that in most cases the financial

statements were, in fact, prepared in accordance with GAAP but the question was incorrectly answered on the DCF.

C. Generally Accepted Government Auditing Standards (GAGAS).

Lenders are incorrectly answering the question on the DCF which states, “Financial Statements audit was conducted in accordance with:”. Many lenders have stated that their audits were conducted in accordance with Generally Accepted Auditing Standards (“GAAS”) which is a level below that required by HUD Handbook 2000.04 which states that the audits must be conducted in accordance with GAGAS. There are additional standards beyond GAAS that must be met in order for an audit to be conducted in accordance with GAGAS.

D. Adjusted Net Worth Requirement

Effective May 7, 2002, as noted in the Final Rule published December 7, 2001, the net worth requirement for nonsupervised loan correspondent lenders increased from a minimum of \$50,000 to \$63,000. Many lenders and auditors apparently were not aware of the new net worth requirement. If an auditor determines that a lender has failed to meet the net worth requirement, the auditor is required to report this as a material noncompliance and write it up as a finding in the Report on Compliance. This, in turn, means that the lender must prepare and submit with the audit a Corrective Action Plan setting forth the actions that have been or will be taken to correct all findings and instances of material noncompliance and how the requirement will be monitored throughout the year to ensure that the lender meets the minimum requirement in the future. If this corrective action is taken before the audit is issued, the auditor may include in the audit report a “subsequent event” citing the date and amount contributed by the lender to correct the deficiency. If the corrective action is not taken until after the audit report is issued, the lender will be required to submit a signed copy of the CPA’s certification showing when and how much additional paid in capital was deposited.

E. Liquid Assets Requirement

HUD regulations and HUD Handbook 4060.1 Rev-1 require lenders to maintain twenty percent of their adjusted net worth in cash and cash equivalents up to \$100,000. However, numerous lenders and auditors continue to treat accounts receivable and loans held for sale as cash equivalents when they are not. Paragraph 2-5 of Handbook 4060.1 Rev-1 states that lines of credit and loans or mortgages held for sale are not considered liquid assets. Liquid assets include cash on hand, checking accounts, savings accounts, certificates of deposit, and marketable securities. If an auditor determines that a lender has failed to meet the liquid asset requirement, the auditor is required to report this as a material noncompliance and write it up as a finding in the Report on Compliance. This, in turn, means that the lender must prepare and submit with the audit a Corrective Action Plan setting forth the actions that have been or will be taken to correct all findings and instances of material noncompliance and how the requirement will be monitored

throughout the year to ensure that the lender will meet the minimum requirement in the future. If this corrective action is taken before the audit is issued, the auditor may include in the audit report a “subsequent event” citing the date and amount contributed by the lender to correct the deficiency. If the corrective action is not taken until after the audit report is issued, the lender will be required to submit a signed copy of the CPA’s certification showing when and how the lender corrected the deficiency.

F. Deficient Submissions

Lenders may check their LASS “In Boxes” for the up-to-the-minute status of their audit submissions. If the Department determines that a submission is deficient, the lender will be sent a Notice of Violation via certified mail in addition to the “In Box” electronic notification. The Notice of Violation will specify in detail the deficiencies. The lender will be given 30 days from receipt of the certified mail to “cure” (i.e., correct) these deficiencies through LASS. Lenders that do not “cure” their deficiencies within the 30-day period will be subject to having their FHA approval withdrawn.

V. Technical Assistance

A step-by-step LASS User Manual with screen images is available at the web site: http://www.hud.gov/offices/hsg/sfh/lass/lass_doc.cfm. This user manual should be reviewed by all lenders and auditors to ensure that their submission is completed timely and correctly.

Lenders with questions not addressed by the user manual may call 202-755-7400 extension 163 or send an email to lass@hud.gov. HUD staff will return all calls or emails within two business days. Lenders and auditors are also encouraged to subscribe to the free LASS Listserve email service which will be used by HUD to send electronic notifications of LASS updates, problems, newsletters, or technical issues. The Listserve registration link is on the LASS website. Users may unsubscribe at any time.

Please provide a copy of this Mortgagee Letter to your auditors. For other lender approval issues, lenders may contact the Lender Approval and Recertification Division at 202-708-7400 extension 161 (These are not toll-free numbers).

Sincerely,

John C. Weicher
Assistant Secretary for Housing-
Federal Housing Commissioner