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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FIFTH FLOOR  
803 WEST BROAD STREET  
FALLS CHURCH, VIRGINIA 22046

093554

FEB 15 1974

Mr. John L. Burke  
Vice-President Fiscal Management  
Government National Mortgage Association  
Department of Housing and Urban Development



LM093554

Dear Mr. Burke:

As you know, we place considerable reliance on the work the Federal National Mortgage Association's (FNMA) internal auditors perform at FNMA Regional Offices when we make our annual audit of the Government National Mortgage Association (GNMA). During our 1973 audit we observed and tested the work of the internal auditors at FNMA's Chicago Regional Office.

Our observations of the work performed in Chicago indicated certain aspects of the internal audit coverage can be improved. The audit program itself needs to be reexamined and brought up-to-date with current practices. Furthermore, FNMA may wish to examine into the validity of the comment of the FNMA auditor-in-charge of the review in Chicago that insufficient time was allowed by his Headquarters for a satisfactory performance of the audit work programmed. In this connection FNMA may wish to require its auditors to obtain written consent from Washington when they wish to deviate significantly from the program, as for example, in the number of transactions to be examined. In accordance with our discussion, we are sending you and FNMA our specific comments as an enclosure, keyed to a copy, also enclosed, of the program used by FNMA's auditors in Chicago.

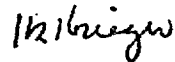
The appropriateness of the confirmation methodology was another matter of concern to us. In 1972 less than 50 percent of the multifamily mortgages selected responded to confirmation requests. These unconfirmed accounts were not further reviewed by the FNMA auditors nor were other steps taken to establish their validity. Further, this year's audit contained no selection of accounts for confirmation that were unconfirmed the previous year. We are aware that FNMA experienced major changes in its internal audit organization at about the time a followup to the prior year's confirmations would normally have been made. Nevertheless, we believe that it is important that confirmations should have been sent this year to mortgagors who had not responded last year or FNMA should have reviewed the accounts for other evidence of validity at the start of this year's review. Because of the significance of this step we expanded our work and were able to satisfy ourselves on this point.

~~7/31/73~~

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We are aware of the importance you attach to the work of the internal auditors as a basis for assuring yourself that GNMA's assets entrusted to FNMA are being properly managed and accounted for by FNMA. You indicated your intentions to discuss our observations with FNMA officials. We would appreciate hearing from you on the outcome of these discussions. Should you or FNMA wish, we would be glad to discuss in detail this letter and the enclosures.

Sincerely yours,



H. L. Krieger  
Regional Manager

Enclosures - 2

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Internal Audit Manual

I. Mortgages - Single Family

The review of Single Family Mortgages will be done in accordance with the following program.

A. Examination of Purchases - Home Mortgages

- 1) During the quarter ending June 30, 1974, select for examination loan submissions received for GNMA mortgages. The selection should consist of loan submission for five days but should not exceed 50 loans nor be less than 25 loans. List the mortgages on a columnar working paper to show the items involved and to show legends indicating the extent of the examinations.
- 2) Arrange to have the selected mortgage files available, and examine them to:
  - a. Determine that the Seller is eligible to sell mortgages to GNMA.
  - b. Obtain a copy of the GNMA Home Loan Document check list and determine that it has been completed and signed by the Documents Examiner.
  - c. Verify that the mortgage is in agreement with the note or bond and with the Mortgage Submission Voucher and that FHA Mortgage Insurance Certificate or VA Loan Guaranty Certificate is on file and in agreement with the appropriate documents. For spin-offs check that mortgage agrees with original note and applicable sections of Mortgage Submission Voucher (original loan amount, term, due date of first installment).
  - d. Verify that the Mortgage Submission Voucher is completed and signed.
  - e. Examine title evidence and determine that:
    - (i) Title policy covers the mortgaged property.
    - (ii) The amount of policy equals at least the amount of the note or bond.
    - (iii) GNMA, prior or original lender, is named as insured.
    - (iv) Policy and all endorsements are signed.
    - (v) Effective date of policy is not more than one year before submission.
    - (vi) Exceptions, if any, were waived by an attorney.

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- f. Verify that the other non-custodial documents are completed and signed where applicable (assignment, survey, and other documents are required). Where no assignment is required, verify that note has been endorsed to GNMA.
  - g. Determine that the mortgage was submitted prior to the expiration of the contract and, if submitted after the 15th of the month, is current or not more than one month delinquent if submitted prior to the 15th.
  - h. Determine that the Mortgage Submission Voucher shows (i) property occupied at date of submission; (ii) property is new, if mortgage submitted under a commitment for proposed construction (constructed in same year as date of commitment or later).
  - i. For mortgages purchased under Program No. 18, determine that the file contains FNMA Form 418 (Refund of Excess Discounts).
- 3) Verify that the commitment contract had not expired and that the price is in agreement with the terms of the contract.
  - 4) Indicate by appropriate symbols on the working papers that the above examinations have been completed.
  - 5) ~~By a cross reference indicate working paper and the number of FNMA mortgages examined during the period 7/1/71 - 6/30/72.~~

B. Custody Items

- 1) A listing of mortgages for which custody items are to be examined will be furnished by the Washington Office. The listing will consist of a random selection of 200 loans.

C. Confirmation

- 1) The confirmation of Single Family loans will be accomplished by the Washington Office.

D. Liquidations

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- 1) A listing of GNMA loans four or more months delinquent will be furnished for this review.
- 2) Using the summary of the foreclosure requirements for each state that is available in the Regional Office, review selected items on the listing for excessive delays in foreclosure proceedings.
- 3) Comment on the control over foreclosure procedures and the timeliness of follow-up of the various aspects of the foreclosure procedures.

E. Sales

- 1) Sales of mortgages will be reviewed in the Washington Office. Any work necessary by Regional staffs will be requested by the Washington Office at a later date.

F. Property Acquired and Claims Receivable

- 1) Review the reconciliations of the Property Acquired and Claims Receivable Accounts and agree to the Receivable Subsidiary Run furnished by the Washington Office.
- 2) Scan the Property Acquired Subsidiary Ledger for uncleared balances in cases where final claims have been filed and investigate such balances.
- 3) On a test basis analyze charge-offs for propriety and proper approval.

G. Cash

- 1) Review the procedures in effect for cash receipts and disbursements. In this regard it is suggested that the review of procedures performed for the FNMA Internal Audit for fiscal year 1971 be used and updated where necessary. Comment on any control weaknesses.
- 2) On June 30, 1973, after the cut-off hour for deposit obtain, control, and count and list all cash and cash items in the presence of a representative of the Controller's Division. The count should include unvouchered cash receipts, undeposited vouchered cash receipts, dishonored checks, and undelivered disbursement checks.
- 3) Subsequent to the count, determine that timely and proper disposition was made of the items counted.

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GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Internal Audit Manual

II Mortgages - Multifamily

The review of Multifamily Mortgages will be done in accordance with the following program.

A. Commitment Contracts

- 1) Review the reconciliation of the memorandum accounts - 9,000 series - schedule balances and trace to the Receivable Subsidiary Run furnished the Regional Controller by the Washington Office. Investigate any differences.
- 2)
  - a. Select for review and schedule ten percent or a minimum of six of the contracts executed during the fiscal year.
  - b. Determine that the term of the contract did not exceed the number of months permitted by the Sellers Guide, Sellers Agreement (Supplement) or other applicable directives. Extensions, cancellations, or conversion, if applicable, should be included in this review.
  - c. Trace the items to the subsidiary ledger memorandum accounts and determine that the amounts did not exceed the FHA commitment.
  - d. Determine that the proper amount of commitment fees were received. If contract and related fees were subject to the provisions of FNMA/GNMA Tandem Plans, determine that any transfers were timely, in the correct amounts and handled in accordance with currently applicable directives.
  - e. In all cases where a portion of the fee may be refundable, determine by computation that the amount taken into income and liability accounts was correct.
- 3) Review the reconciliations of Accounts 3833 and 3850 - Commitment Deposits and trace to the Receivable Subsidiary Run. Investigate any differences.
- 4) Test Commitment Fees Earned - Account 6301 - as of April 30, 1972. Apply the rate of Commitment Fee to contracts executed during the year for the various programs and compare to income recorded and to Commitment Deposits where applicable. Extensions for which additional fees are collected should be included in the test. Investigate substantial differences.

B. Mortgage Purchases:

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- 1) Select for review and schedule ten percent, but not to exceed 30, mortgages purchased during the fiscal year.

- 2) Determine that the mortgagor's name on the note, mortgage and certification of insurance or guaranty is the same as that listed.
- 3) Enter the date and review the mortgage submission voucher for the following:
  - a. Seller's signature
  - b. The required deposits have been received and posted to the correct accounts.
  - c. The fund for replacements conforms to requirements of the charter or FHA Regulatory Agreement.
  - d. The mortgage was current at the time it was submitted.
  - e. The principal purchased did not exceed the amount of the commitment.
  - f. The contract had not expired. Verify any extensions or increases to the original contract.
  - g. The mortgage submission vouchers have been properly certified by authorized signatures. Verify all items on the voucher. Trace the mortgage to the Daily Record of Mortgage Purchases.
- 4) Examine the hazard insurance policies to determine that insurance meets FHA requirements, is adequate and in force, applies to the mortgaged property and contains the appropriate mortgagee clause.
- 5) Verify that tickler files for taxes and insurance and ledger cards are set up and that the items of permanent reference nature are entered on the mortgage ledger card.
- 6) Verify that there is title evidence which covers that property referred to in the mortgage and determine the following:
  - a. GNMA and the Secretary of Housing and Urban Development are named as insured.
  - b. Policy is signed and dated either on or after the date of recording the assignment or on or after the date of execution of the assignment in jurisdictions where recording of assignments is not required. If the title company is other than a well-known firm, determine that the Regional Office has determined that the title policies issued are acceptable.
  - c. The amount of the title insurance policy is at least equal to the amount of the note.
  - d. The amount of the policy does not exceed 50% of the net worth of the carrier.

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- e. Determine that any exceptions were waived or cleared by Regional or other FNMA/GNMA legal counsel.
- 7) If a title policy has not been obtained, determine the reason for not obtaining a policy and describe the details fully in the work papers.
- 8) In cases of examination by fee counsel, determine and describe the extent to which the Company's Legal Counsel Division is checking the fee counsel's examination.
- 9) If the mortgage purchased involved the FNMA/GNMA Tandem Plan Agreement, determine that the purchase complied with applicable directives.
- 10) If a mortgage has been purchased under Program Nr. 11 (BMIR), determine the following:
  - a. Any additional provisions to the commitment contract were properly executed.
  - b. The necessary documents were on hand at the date of payment.
  - c. The disbursement was made on the day the mortgage was delivered to GNMA or the date agreed upon by FHA and the seller.
  - d. Any additional documents requested were received.
  - e. Any supplemental reviews of the voucher occasioned by the above were completed properly.

C. Portfolio Administration

- 1) Review the regional office reconciliation of the unpaid principal balance, accrued interest, escrow deposits, cash collateral, reserve for replacement and other related accounts as of April 30, 1972. Subsidiary ledger balances should be reconciled to the Receivable Subsidiary Run furnished monthly to the Regional Office by the Washington office. Investigate any differences. This work should be coordinated with work to be done in the loan confirmation section of the program.
- 2) Select for review and schedule approximately 10 percent of the number of mortgages in the portfolio. The sample should consist of mortgages not audited within the past two years, mortgages under forbearance or modification agreements and mortgages with delinquency problems.
- 3) Enter the amount of monthly installment. If there has been any change in amount since purchase or since the last review, investigate the change and determine that it was properly authorized and reasonable.

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- 4) Determine if the mortgage is current or show the number of prepaid or delinquent installments. In the case of prepaid installments, determine that the Regional Counsel's Office has given an opinion that the prepayments have not resulted in an effective usurious interest rate.
- 5) Enter the number of the cash receipt voucher covering the latest payment and indicate that the voucher was audited with all postings traced to the proper subsidiary ledger accounts. Scan the mortgage ledger card for recent late payments and indicate that either there were none or that the Regional Office had complied with instructions:
  - a. Determine that delinquent accounts are reviewed and that appropriate collection follow-up is initiated.
  - b. Determine that any explanation for non-payment was reasonable, substantiated by supporting evidence and accompanied by a satisfactory plan to bring the account current.
  - c. If there was no satisfactory plan to bring the account to a current status by the 35th day, determine that consideration was given to securing rental income and the issuance of a tenday letter to the mortgagor.
  - d. If there was no satisfactory payment plan by the 50th day, determine that the delinquency and appropriate recommendations were reported to the Washington Office. Evaluate the adequacy and accuracy of the report.
  - e. Determine that a Notice of Default status report was sent to FHA when 50 days delinquent or in case of a breach of any covenant providing for acceleration. Determine that necessary actions had been taken to meet the 45-day FHA time limitation for obtaining an extension of time for foreclosure or assignment action.
  - f. Determine that Notice of Payment Due was not sent in cases of acceleration or foreclosure.
  - g. Determine that no action on foreclosure or assignment to FHA was taken without the approval of the Washington Office.
  - h. Determine that any income from securities held has been retained and not disbursed to the delinquent mortgagor.
- 5) If the mortgage contains a late charge provision:
  - a. Investigate any cases of payments subject to late charges on which no late charge was collected.

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- b. If late charges have been imposed, verify the computation of one such charge and trace the posting to the ledger. Investigate any cases where late charges differ materially in amount from the item that was verified.
- 6) Determine that an adequate follow-up system is established to record FHA inspection reports and to insure necessary action. Evaluate the follow-up action taken by the Regional Office.
- 7) Determine that the chattel mortgage or financing statement was recorded and/or reviewed within the statutory time, if required.
- 8) Examine hazard insurance policies for any changes since they were reviewed at the time of purchase, and determine that they are in force, cover the mortgaged property, contain the appropriate mortgagee clause and are sufficient to cover the unpaid principal balance.
- 9) If there were any fire or other losses, determine that loss drafts were handled properly. If over \$2,500.00, see that the Regional Office has received a written statement from FHA as to satisfactory restoration.
- 10) Where applicable, determine that releases of Section 213 mortgages were approved by the Regional Vice President and Regional Counsel. If other, describe in detail, giving full particulars as to Washington and FHA approval.
- 11) Determine that financial statements conform to requirements of the mortgage, are adequate and have been reviewed by the Regional Office.
- 12) In cases of forbearance or modification agreement, prepare a separate working paper summarizing the agreement and show that the following determinations have been made:
  - a. The Regional Office inspected the property before the agreement was finalized.
  - b. The Regional Office obtained the data required for the MFH mortgages (Form 375) and reported the information to the Washington Office.
  - c. The final agreement was prepared in accordance with instructions from the Washington Office.
  - d. The Mortgagor submitted monthly statements of income during the period of forbearance or modification in accordance with the agreement.
  - e. The Regional Office properly reviewed these statements.

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- f. The mortgagor remitted funds to the Regional Office for the net income in accordance with the agreement.
  - g. If the forbearance or modification agreement represents an extension or renewal of an existing agreement, determine that the mortgagor has submitted a statement of cash receipts and disbursements for the preceding period.
13. If this is the first review after purchase or acquisition of the mortgage, look for any special provisions contained in the mortgage or other documents (such as certificates or articles of incorporation, by-laws, etc.) which have a bearing on the mortgage indebtedness (for example, a case may require that income above a certain amount be applied to principal). Summarize these provisions in the work-papers and determine that the special provisions are being followed.
  14. On subsequent reviews determine that any special provisions noted are being followed.
  15. Determine that escrow deposits for pending liabilities are adequate and that the reserve for replacements, where applicable, are proper. Evaluate the Regional Office procedures for collection and payment of escrow funds.
  16. Determine that conditions applicable only to a particular program are complied with in accordance with Washington directives.
  17. Determine that custody items are on file for each item included in the test sample.
  18. Review the Loan Division tickler file for the payment of taxes and insurance and verify that the bills were paid on or before the due date. Investigate any cases of late payment or cases where amounts paid vary materially from prior disbursements.
  19. For a selected number of disbursements (based on experience, judgment and adequacy of the tickler file and controls), audit the latest tax bill, hazard insurance premium payment and FHA mortgage insurance premium payment.
  20. For those accounts having a reserve for replacements, examine the latest disbursement from the account for apparent reasonableness and proper authorization by FHA (if required). See that necessary inspections have been made.
  21. Comment on the overall condition of the administration of mortgages as a result of the review.

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D. Confirmations and Verification of Reserve for Replacements

- 1) As of May 31, 1971, all Multifamily mortgages in the GNMA portfolio were

confirmed at least once in the preceding two-year period. For fiscal year 1973, the selection for confirmation should consist of all mortgages purchased in fiscal year 1973 through April 30, 1972, and 50% of the mortgages confirmed in fiscal year 1970 *that were not confirmed in 1971*. Mortgages will be confirmed as of April 30, 1972. A standard letter confirmation form, similar to those used in prior years *has been furnished for your review.*

- 2) Prepare a control sheet of the mortgages selected for confirmation.
- 3) The reconciliation of the subsidiary ledger balances for mortgage and related accounts to the control accounts should be coordinated with audit step C.1. under Portfolio Administration.
- 4) Positive confirmations will be used and second requests will be sent ~~certified mail, "return receipt requested."~~ *will be sent by the Washington Office.*
- 5) As of date of confirmation, count all of the securities held in custody as Reserve for Replacements in the presence of authorized Regional Office personnel and show a description of the items on this working paper.
- 6) If the securities are "bearer" type, investigate any past due coupons still attached.
- 7) If the securities are registered, determine that the endorsement or assignment has an authorized signature.
8. Verify that the sum of the securities counted is the same as the total shown in the control account.
9. Cash Deposits for Replacements will have been reviewed in conjunction with step 3 above, in the review of portfolio administration, and confirmed above. Make any additional tests believed necessary as a result of the above reviews.

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GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Internal Audit Manual

III. Other Account Verifications

- 1) For those subsidiary accounts not reviewed in connection with other sections of the program, determine that reconciliations have been prepared, review the reconciliation and, on a test basis, determine that entries are proper.

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GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Internal Audit Manual

IV Internal Control

- 1) During the course of the audit the system of internal control over the operations reviewed should be observed and evaluated. Any weaknesses noted should be commented upon and discussed with appropriate regional officials.

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I. MORTGAGES--SINGLE FAMILY

A. Examination of purchases--home mortgages

We suggest that this section of the work program be reviewed with a view toward eliminating obsolete steps and steps that are automatically checked by the computer. We understand, for example, that the computer is programmed to disclose whether a seller is eligible to sell mortgages to FNMA. It is therefore redundant to have an auditor manually verify a seller's eligibility (step 2c). We noted also that the Chicago regional office does not make use of the GNMA Home Loan Document checklist (step 2b). Also step 2 h.(II) indicates that the Mortgage Submission Voucher shows for new property that a mortgage is submitted under a commitment for proposed construction. The Mortgage Submission Voucher does not provide this information.

B. Custody items

The GAO staff observed that custody items related to multifamily housing were not safeguarded adequately. The matter was brought to the attention of the Director of Staff Services in Chicago and the multifamily documents were moved to the single-family document control room.

FNMA may wish to examine into the controls over multifamily documents at other FNMA regional offices.

F. Property acquired and claims receivable

We understand that this section of the program is being eliminated as the result of procedural changes involving the computerization of the claims receivable account applicable to small homes.

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We wish to call attention to the fact that the current work program does not include a review of multifamily assignments/foreclosures and related claims receivables. Since computerization is not at present planned for these activities as they relate to multifamily mortgages, we suggest consideration be given to revising the work program to cover this matter.

G. Cash

There was no evidence that FNMA auditors reviewed the procedures in effect for cash receipts and disbursements or commented on weaknesses in controls as required by step G1.

The Chicago GAO staff were of the opinion that direct distribution of mail, including checks to the various departments, was not conducive to a satisfactory control of cash. They suggest that consideration be given to establishing accounting control over incoming cash at a central location before the checks and accompanying documents are delivered to the appropriate departments. Accounting control could be established by having a listing prepared of all incoming checks.

Step G2 requires the auditor to include in his count of cash such items as unvouchered cash receipts, undeposited vouchered cash receipts, dishonored checks, and undelivered disbursement checks. We believe that an auditor cannot independently determine the existence of such items unless he can rely on a system under which all incoming checks are listed by someone other than the person who controls their disposition.



II. Mortgages--multifamily

B. Mortgage purchases

Step 3g requires that the mortgage be traced to the Daily Record of Mortgage Purchases. Because there are so few multifamily mortgages purchased, the Chicago Regional Office no longer keeps a daily record. We were told that in other FNMA regions a weekly or continuous listing may be in use. We suggest that the audit step be modified to require that the mortgage be traced to the Record of Mortgage Purchases and from there to the General Ledger.

Under step 4 the FNMA auditor examined the hazard insurance policies but failed to note that a property which should have been listed on the insurance policy was omitted.

Under step 6e the FNMA auditor was required to determine that any exceptions were waived or cleared by the regional attorney. In one case the FNMA auditor failed to note that the attorney had not signed off that the documentation had cleared his review.

C. Portfolio administration

Steps 1, 3, and 9 require the auditor to review the regional office reconciliations of the unpaid principal balance, accrued interest, escrow deposits, cash collateral, reserve for replacement, and other related accounts. Although the FNMA auditors included copies of the reconciliations in their working papers, there is no evidence that the reconciliations were checked to the general ledger.

Step 2 requires a review of about 5 percent of mortgages in the portfolio which in this case would have amounted to 25 mortgages. Only

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five mortgages were reviewed. In our opinion, the FNMA auditor should have sought approval from Washington for such a major deviation from the program.

Steps 5c and 5d require the auditor to determine whether certain follow-up action was taken on delinquent reports. We were told that because of verbal understanding reached with FHA these steps are no longer appropriate. It is our opinion that the FNMA auditor should have noted this information and brought it to the attention of FNMA Headquarters personnel so that the program could be modified.

Step 6 requires the auditor to determine that an adequate follow-up system is established to record FHA inspection reports and to insure necessary action. We were told that because of a backlog FHA has not been making required inspections. The FNMA auditor listed the date of the last inspection report but he did not explain why he could not fully accomplish the audit step,

Step 7 requires a determination that the chattel mortgage was recorded. We found that in one instance that the FNMA auditor failed to note that a chattel mortgage had been allowed to expire.

Step 11 requires a determination that the financial statements conform to the requirements of the mortgage, are adequate, and have been received by the regional office. We were informed by a FNMA official in Chicago that there are no requirements that GNMA receive financial statements unless there has been a default. We believe that this audit step should be reexamined and dropped if it is not applicable to GNMA.

Step 21. In response to a requirement for a comment on the overall condition of the administration of the mortgages the FNMA auditor wrote

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"no comment" in his working papers. We consider the auditor's notation as not responsive

D. Confirmations and verifications of  
reserve for replacement

Aside from new purchases, FNMA planned to confirm all of the multi-family mortgages in GNMA's portfolio over a 2-year period, 50 percent of the mortgages to be confirmed in 1972 and 50 percent of the mortgages in 1973. We found that confirmation requests were not sent in 1973 to 85 mortgagees who had not responded to the requests sent to them in 1972. Furthermore, FNMA auditors did not verify by other means that the 85 loans were valid. The 85 mortgages not confirmed were a significant proportion of the total of 160 mortgages selected for confirmation.

To satisfy ourselves with respect to these mortgages, GAO verified that 76 loans were credited with payments received in 1973 and that taxes were paid in 1972 and 1973. The remaining nine loans were either sold to a mortgage company or assigned to FHA.

In connection with step 8 of the program, FNMA's checked serial numbers and bond denominations. We noted that the auditors failed to tick off two serial numbers and the denomination of 108 bonds.

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON REGIONAL OFFICE  
FIFTH FLOOR  
803 WEST BROAD STREET  
FALLS CHURCH, VIRGINIA 22046

FEB 15 1974

Mr. Robert J. Mahn, Jr.  
Vice President and Controller  
Federal National Mortgage Association

Dear Mr. Mahn:

In accordance with our discussion with you and as agreed to by Mr. Burke of the Government National Mortgage Association, we are sending you a copy of our letter to Mr. Burke and the enclosures referred to in our letter.

Should you wish to discuss any of the matters we will make ourselves available. We greatly appreciate the fine cooperation that you and your staff have extended to our representatives.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "H. L. Krieger".

H. L. Krieger  
Regional Manager

Enclosure

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