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Report to the Congress; by Elmer B. Staats, Comptroller General.

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Authority: National Housing Act (12 U.S.C. 1701). Supplemental Appropriations Act of 1976 (P.L. 94-157). Government Corporation Control Act. Housing Act of 1948. P.L. 93-344.

The Federal Housing Administration (FHA) is a noncorporate, business-type agency which was made subject to the Government Corporation Control Act by the Housing Act of 1948. From its inception to September 30, 1976, FHA has acquired about 3,800 multifamily properties and mortgage notes representing about 407,000 housing units at a cost of about $4.4 billion and about 675,000 small homes and notes at a cost of about $11 billion. The four FHA insurance funds are intended to function as revolving funds that carry out the insurance operations provided for in the National Housing Act. Findings/Conclusions: The FHA reported a net loss of $1.1 billion in the operation of its mortgage insurance funds during the 15-month period ended September 30, 1976. The combined insurance reserves of these funds had a $1.3 billion deficit due to increased losses in the General Insurance and Special Risk Insurance Funds. Because of various types of procedural and other accounting problems, a determination could not be made as to whether the financial statements fairly presented the financial position of FHA at the end of the period, the results of its operations, and the changes in its financial position for the 15-month period examined. Recommendations: The Secretary of the Department of Housing and Urban Development should direct the FHA to strengthen its procedures for routine reconciliation of accounting transactions and account balances to detailed supporting records. In addition, the FHA should be directed to redesign its analysis procedures for determining probable loss on sales of its property so that a better loss percentage can be determined. (HTW)

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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Examination Of The Financial Statements Of FHA Insurance Operations For The 15-Month Period Ended September 30, 1976

The Federal Housing Administration reported a net loss of $1.1 billion in the operation of its mortgage insurance funds during the 15-month period ended September 30, 1976. The combined insurance reserves of these funds had a $1.3 billion deficit due to increased losses in the General Insurance and Special Risk Insurance Funds.

Because of various types of procedural and other accounting problems, GAO could not determine whether the financial statements fairly presented the financial position of the Federal Housing Administration at September 30, 1976, the results of its operations, and the changes in its financial position for the 15-month period then ended.

UNITED STATES GENERAL ACCOUNTING OFFICE

CED-78-95
APRIL 28, 1978

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114860

To the President of the Senate and the
Speaker of the House of Representatives

This report summarizes the results of our examination of the financial statements on the insurance operations of the Federal Housing Administration (Department of Housing and Urban Development) for the 15-month period ended September 30, 1976, and other information about the program's operation and financial condition.

We made our examination pursuant to the Government Corporation Control Act (31 U.S.C. 841).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of the Treasury and Housing and Urban Development; and the Assistant Secretary for Housing-Federal Housing Commissioner.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF THE FINANCIAL STATEMENTS OF FHA INSURANCE OPERATIONS FOR THE 15-MONTH PERIOD ENDED SEPTEMBER 30, 1976

D I G E S T

During the 15-month period ended September 30, 1976, the Federal Housing Administration reported a net loss of $1.1 billion in the operation of its mortgage insurance funds. This is a $327 million increase over the loss in the period ended June 30, 1975. The increase is due partly because of a 15-month reporting period instead of a 12-month period. At September 30, 1976, the Federal Housing Administration's combined insurance reserves had a $1.3 billion deficit--a result of losses in the General Insurance and Special Risk Insurance Funds. (See pp. 6 and 7.)

During the 15-month period, the Department of Housing and Urban Development borrowed $1.2 billion to cover the payment of insurance claims. Also, the Congress appropriated money to keep the General Insurance and Special Risk Insurance Funds solvent. The Supplemental Appropriations Act of 1976 made $42.5 million available to the General Insurance Fund and $100 million to the Special Risk Insurance Fund. (See pp. 9 and 10.)

GAO could not determine whether many of the Federal Housing Administration statement balances were stated fairly because year-end balances were not fully reconciled to supporting detail records. As a result of this and other accounting problems, GAO could not express an opinion on the Federal Housing Administration financial statements as of September 30, 1976. (See p. 27.)

The Department of Housing and Urban Development recognized that its current mortgage insurance accounting system had been less than effective in supporting its activities. In March 1975 it began to develop a computerized mortgage insurance accounting system referred to as the HUDMAP project. The project is a major undertaking and will virtually be a complete replacement for the existing system. (See p. 10.)

GAO's bases for disclaiming the opinion on the September 30, 1976, financial statements are:

--In many instances detailed listings or other back-up support for year-end financial statement balances were unavailable; in other instances the Federal Housing Administration had not reconciled differences between statement balances and detailed support. The Federal Housing Administration should strengthen its procedures for reconciling account balances to detailed records. (See p. 11.)

--Several financial accounts affecting fees and premiums are misstated by as much as $2.7 million at September 30, 1976. Accounting transactions pertaining to about 39,000 mortgage insurance transactions contained errors and were accounted for in a suspense file. Consequently the transactions were not included in the financial statements. There were also about 15,000 cases in the suspense file affecting premium accounts. Part or all of the $2.7 million in fees and premiums could have been amounts due to the Federal Housing Administration but unbilled. Federal Housing Administration officials said that they are trying to eliminate the large number of cases in the suspense file. (See p. 16.)

--The value of Housing and Urban Development-owned property as shown on the balance sheet--about $570 million--is overstated because of (1) an understatement of the allowance for future losses, (2) numerous buildings were razed but not accounted for as such in the records, (3) numerous properties were sold but still recorded as assets, and (4) property appraisals indicated high potential losses.

The Federal Housing Administration should revise its procedure for determining probable future losses on its acquired property. Further, the Federal Housing Administration began a procedure in December 1976 that was intended to reconcile its central computer records of properties on hand with records maintained in its area offices. Continuance of that procedure could improve its accountability of razed and sold property. (See p. 18.)

The Department of Housing and Urban Development disagreed with the conclusion that GAO could not determine whether the Federal Housing Administration's financial statements presented fairly its financial position at September 30, 1976. (See p. 23.)

The Department of Housing and Urban Development, however, did agree with certain of GAO's findings and intends to set up a task force to correct the problems brought out in this report in time for the fiscal year 1978 audit. GAO will continue to review the Federal Housing Administration financial statements during fiscal years 1977 and 1978 but will not issue an opinion on the statements until the fiscal year 1978 audit is complete. Federal Housing Administration officials said that corrections could not be completed for the fiscal year 1977 review. GAO will help Federal Housing Administration accounting personnel resolve the problems. (See p. 25.)

During fiscal year 1976 the Department of Housing and Urban Development Office of the Inspector General initiated a review of several account balances included in the Federal Housing Administration September 30, 1976, financial statements. GAO believes that the Inspector General's involvement in the review of the Federal Housing Administration accounts is essential to the Department of Housing and Urban Development in helping to correct current accounting problems. (See p. 26.)

Contents

ABBREVIATIONS

CMHIF Cooperative Management Housing Insurance Fund

FHA Federal Housing Administration

GAO General Accounting Office

GIF General Insurance Fund

HUD Department of Housing and Urban Development

MMIF Mutual Mortgage Insurance Fund

SRIF Special Risk Insurance Fund

CHAPTER I

INTRODUCTION

The Federal Housing Administration (FHA) was created by the President on June 30, 1934, under authority of the National Housing Act (12 U.S.C. 1701 et seq.). Its principal purposes are to improve home financing practices, act as a stabilizing influence in the mortgage field, encourage improvements in housing standards and conditions, facilitate home ownership, help eliminate slums and blighted conditions, and prevent residential properties from deteriorating. FHA, a part of the Department of Housing and Urban Development (HUD), is headed by the Assistant Secretary for Housing-Federal Housing Commissioner, who is appointed by the Secretary of HUD.

FHA is a noncorporate, business-type agency which was made subject to the Government Corporation Control Act by the Housing Act of 1948. Accordingly, we are required to audit FHA at least once every 3 years.

FHA administers mortgage insurance programs under which lending institutions (mortgagees) are insured against loss in financing first mortgages on various types of housing. Insurance is also provided on loans that finance property alterations, repairs and/or improvements, and mobile homes. Most FHA insurance, however, covers mortgages on small homes (one to four families) and on multifamily housing properties. From inception in 1934 to September 30, 1976, FHA has provided insurance amounting to almost $205 billion, of which about $89 billion was in force at September 30, 1976. About 25,700 multifamily properties and about 11.9 million small homes have been insured under FHA insurance programs. During the 15-month period ended September 30, 1976, about 700 multifamily projects and about 300,000 small homes had been insured for about $10 billion.

For administrative purposes HUD has divided the United States into 10 regions, including 76 area and insuring offices. Officials at these offices are responsible for writing all forms of FHA insurance required in their respective jurisdictions.

The mortgage insurance function gives rise to insurance claims by mortgagees who, because of mortgage defaults, have acquired properties through foreclosure or, as an alternative, have assigned their mortgage notes to FHA. In settling claims, titles to foreclosed properties or to mortgage notes are conveyed to FHA. Other FHA function. include maintaining and selling acquired properties and becoming the mortgagee in the case of assigned mortgage notes.

From its inception to September 30, 1976, FHA has acquired about 3,800 multifamily properties and mortgage notes representing about 407,000 housing units at a cost of about $4.4 billion. During the same period about 675,000 small homes and notes were acquired at a cost of about $11 billion. A summary of FHA property and mortgage note activity for fiscal year 1975 and the 15 months ended September 30, 1976, as reported by FHA, follows.

Property Acquisitions

	15 months ended September 30, 1976		Fiscal year 1975	
	Small homes	Multifamily properties	Small homes	Multifamily properties
Number of properties and lots on hand at beginning of fiscal year	66,370	362	77,565	305
Plus acquisitions (note a)	44,536	215	51,181	180
Less sales	-69,797	-199	-62,376	-123
Increase or decrease (-) in number on hand	-25,261	16	-11,195	57
Number of properties and lots on hand at end of fiscal year (notes b and c)	41,109	378	66,370	362

a/Acquisitions include 3,389 small homes and 183 multifamily properties for the 15-month period ended September 30, 1976, and 5,627 small homes and 139 multifamily properties for fiscal year 1975 on which FHA previously held assigned defaulted notes. Because of continued default in payments by the mortgagors, FHA foreclosed and acquired these properties.

b/According to FHA property records, the small homes balances include 3,968 vacant lots at September 30, 1976, and 4,735 at June 30, 1975. Homes previously located on these lots were razed. We found, however, that there may be substantially more razed properties at September 30, 1976. (See p. 19.)

c/Number of properties and lots on hand at September 30, 1976, includes a number of cases sold before September 30, but not taken out of the asset balance. (See p. 20.)

Mortgage Notes Assigned

	15 months ended September 30, 1976		Fiscal year 1975	
	Small homes	Multifamily properties	Small homes	Multifamily properties
Number of notes on hand at beginning of fiscal year	5,597	1,336	9,687	1,017
Plus assignments	1,171	556	1,626	466
Less liquidations and conversions (note a)	-3,501	-202	-5,716	-147
Increase or decrease(-) in number on hand	-2,330	354	-4,090	319
Number of notes on hand at end of fiscal year (note b)	3,267	1,690	5,597	1,336

a/Conversions refer to properties on which FHA held assigned notes, but because of continued defaults in payments by the mortgagors FHA foreclosed and acquired the properties. For the 15-month period ended September 30, 1976, there were 3,389 small home and 183 multifamily conversions; for fiscal year 1975 there were 5,627 conversions for small homes and 139 for multifamily properties.

b/Small home mortgage note balances at September 30, 1976, include 1,208 cases in which owners abandoned the properties. These cases should be converted into on hand property after legal proceedings or further processing is completed.

FHA insurance programs are conducted under four insurance funds authorized as separate financial entities by the National Housing Act. The four funds are the Mutual Mortgage Insurance Fund (MMIF), the General Insurance Fund (GIF), the Cooperative Management Housing Insurance Fund (CMHIF), and the Special Risk Insurance Fund (SRIF).

MMIF

MMIF was established under the authority of section 202 of the National Housing Act. Under this fund, only mortgages that finance the purchase of small homes are insured. Section 205 of the act authorized the establishment of a participating reserve account and a general surplus account 1/ in MMIF and provided that both accounts be available to meet losses arising from the MMIF insurance operations.

Section 205 also authorized allocating the income or loss from operations in any semiannual period to either or both accounts in accordance with sound actuarial and accounting practices. Shares of the participating reserve account are distributed as dividends to mortgagors upon payment of the MMIF insured mortgage loans. The mortgagors, however, do not have any vested rights in the reserve. Dividends declared to mortgagors from the participating reserve account during the 15-month period ended September 30, 1976, were $53 million compared with $43 million in fiscal year 1975.

GIF

GIF was established on August 10, 1965, under the authority of section 519 of the National Housing Act, as amended, to carry out the mortgage insurance programs authorized by a number of sections of the National Housing Act. GIF is used to insure mortgages under various programs, including some high-risk insurance programs that might have been made part of SRIF had it existed when these programs were enacted. The GIF deficit is attributable to the high-risk insurance programs. GIF is used to insure mortgages and notes that finance the purchase, construction, or improvement of small homes, multifamily property, nonresidential property, and commercial or farm structures.

CMHIF

CMHIF was established on August 10, 1965, under authority of section 213 of the National Housing Act, as amended. Under CMHIF, mortgages are insured that finance the purchase, construction, and/or rehabilitation of multifamily cooperative housing property. Also insured are supplementary loans that finance improvements and/or repairs of multifamily cooperative housing property or that provide funds for necessary community facilities.

1/Shown in the combined balance sheet (see sch. 3) as statutory reserve and insurance reserve, respectively.

Section 213 of the act authorized the establishment of both a participating reserve account and a general surplus account in CMHIF. 1/ The FHA Commissioner is authorized to allocate the income or loss from operations in any semi-annual period to either or both accounts, in accordance with sound actuarial and accounting policies.

The FHA Commissioner is further authorized to distribute shares of the participating reserve account to mortgagors as dividends upon completing payment of the mortgage, and at such times before payment as he may determine. The mortgagors do not, however, have any vested interest in the account. Both the general surplus account and the participating reserve account are available to meet losses arising from the CMHIF insurance in force. Dividends declared to mortgagors from the participating reserve account during the 15-month period ended September 30, 1976, amounted to $3.8 million, compared to $2 million in fiscal year 1975.

SRIF

SRIF was established on August 1, 1968, under authority of section 238(b) of the National Housing Act, as amended. Under this fund, mortgages are insured which finance (1) homes purchased by low-income families that are assisted with their mortgage payments by FHA, (2) homes purchased by low- and moderate-income families that, because of the nature of their credit histories or irregular income patterns, could not qualify for mortgage insurance under other FHA insurance programs, and (3) the repair, rehabilitation, construction, or purchase of property located in older, declining urban areas in which conditions are such that eligibility requirements for mortgage insurance could not be satisfied under other FHA insurance programs.

Section 238(b) provided that SRIF initially be funded with a $5 million advance from GIF to be repaid at such time and at such rates of interest as the Secretary of HUD deems appropriate. The Housing and Urban Development Act of 1969 (12 U.S.C. 1715z-3(b)) authorized additional funding from GIF in amounts that the Secretary determined necessary up to a total of $20 million, all of which had been advanced by the end of fiscal year 1971.

1/Shown in the CMHIF section of the combined balance sheet (see Sch. 3) as statutory reserve and insurance reserve, respectively.

CHAPTER 2

COMMENTS ON FINANCIAL STATEMENTS

The four FHA insurance funds are intended to function as revolving funds that carry out the insurance operations provided for in specific sections of the National Housing Act. Each fund consists of the assets, liabilities, and reserves of the specific sections. The insurance reserves of one fund are not available for the other funds' use except when authorized by the Congress.

Income to the funds includes fees and premiums from insurance operations and interest income derived from any investments of the funds. The funds' expenses include insurance losses, interest on borrowings from the Treasury, debenture interest, and administrative expenses. In addition, provision is made for estimated future losses on acquired properties, mortgage notes, notes for property improvement and mobile home loans, premiums, fees, and interest receivable. The results of operations (statement of income and expense) on a combined basis for all four funds are shown on schedule 2. Schedule 4 shows the separate results of operations for each fund.

The accumulated differences in each fund between the income of the fund and expenses, losses, and provisions for estimated future losses are considered to be the insurance reserves available to cover future insurance losses and administrative expenses of the individual funds. The financial position of the funds (balance sheet) at September 30, 1976, is shown on a combined basis on schedule 1. Schedule 3 shows the financial position of each fund.

RESULTS OF OPERATIONS

FHA reported that during the 15-month period ended September 30, 1976, a net loss in the operations of the four insurance funds of $1,080.2 million was incurred. The loss represents a $326.7 million increase over the loss of the previous year. It consisted of (1) an excess of expenses over income of $752.8 million and (2) increases from the previous year of $327.4 million in the allowances for estimated future losses on certain assets of the insurance funds. Increases in the allowances for estimated future losses from the prior year represent a net decrease in the value of FHA assets and, therefore, add to the net loss for the year.

Two insurance funds showed profits totaling $184.5 million during the 15-month period ended September 30, 1976, while the other two insurance funds together showed losses of $1,264.7 million. A breakdown by fund of the profit and loss for the 15-month period and a comparison to fiscal year 1975 follows.

Profit or loss (-)

Insurance Funds	15-months ended September 30, 1976	Fiscal year 1975
	----------millions----------	
MMIF	$ 179.8	$ 109.4
GIF	-711.8	-490.7
CMHIF	4.7	3.3
SRIF	-552.9	-375.5
Total	$-1,080.2	$-753.5

On a combined-fund basis the income increased during the 15-month period by $173.8 million, including an increase in premiums of $113.8 million and a $41.9 million increase from interest on U.S. Government securities, primarily from MMIF investments. Expenses increased by $420.4 million. The major increases in expenses were interest of $186.5 million paid on borrowed money and increased losses of $135.1 million on acquired security.

On July 12, 1974, Public Law 93-344 changed the fiscal year of the Treasury. Effective October 1, 1976, the fiscal year extends from October 1 of each year to September 30 of the following year. Through June 30, 1975, the fiscal period extended from July 1 through June 30. For the financial statements in this report, FHA reported its financial operations for 15 months and its financial position was stated as of September 30, 1976. When comparing results of operations for periods ending June 30, 1975, and September 30, 1976, recognition of the longer period reported at September 30, 1976, is necessary.

INSURANCE RESERVES

On the basis of actuarial studies of the risks underwritten, FHA annually estimates the reserves required to settle insurance claims that might be made by insured mortgagees under the amount of insurance in force at the end of each fiscal year.

These estimated reserve requirements are affected principally by the amount of insurance in force. An increase in the volume of new mortgage insurance increases the estimated reserve requirements because the insured mortgage balances are at their highest level at inception. As the mortgages age and balances are reduced, the reserve requirements decrease. Thus, the longer the insurance is in force, the lower the reserve requirements become.

A noteworthy difference exists in the bases on which life insurance and other insurance companies establish their insurance reserve requirements and those which FHA uses. Insurance companies generally consider reserve requirements in determining not only their solvency but also the amount of surplus funds that may be available for distribution to policyholders or stockholders.

In the case of life insurance companies, mortality experience has been well established and expected mortality--one of the major elements in the valuation of reserve requirements--can be predicted reasonably well. Consequently, the reserve requirements of life insurance companies can be determined with a fair degree of accuracy.

FHA estimated reserves are to provide for future losses and related expenses that will be, in large part, contingent upon future economic conditions that are not readily predictable. Therefore, FHA has established its reserve requirements on what it considers to be the most conservative basis--the range of probability of future losses and related expenses that might be incurred if an economic reversal were to develop immediately.

Thus, FHA insurance funds estimated reserve requirements are designed as a measure of the losses and expenses that may result from such a contingency and not as a measure of solvency of the funds according to its accepted meaning in the underwriting of conventional insurance risks.

FHA considers a balance status for a fund to exist when its insurance reserves--accumulated retained earnings--are equal to, or greater than, the estimated reserve requirements and that when a balance status is attained, the fund has sufficient resources to meet such future insurance losses and related expenses as might be expected within the range of probability.

At September 30, 1976, FHA estimated insurance funds reserve requirements amounted to $2,715.7 million. At the same date FHA total insurance reserves, as shown on the combined balance sheets (see schs. 1 and 3), were in a $1,307.5 million deficit position which resulted in a $4,023.2 million total estimated reserve deficiency--a $958.6 million increase from the deficiency at June 30, 1975.

The following table shows the estimated reserve requirements, the insurance reserves, and the estimated reserve deficiencies at September 30, 1976, and at June 30 for the prior 4 years.

Fiscal year	Estimated reserve requirements	Insurance reserve or deficit (-)	Estimated reserve deficiencies
	(millions)		
1972	3,091.0	1,630.3	1,460.7
1973	3,158.5	1,220.7	1,937.8
1974	3,192.0	612.1	2,579.9
1975	2,882.0	-182.6	3,064.6
1976	2,715.7	-1,307.5	4,023.2

The $958.6 million increase in the estimated reserve deficiency from the prior year is attributable to the net of the $1,124.9 million decrease in the insurance reserves resulting from insurance losses, offset by a $166.3 million decrease in the estimated reserve requirement resulting from the fact that the decrease in reserve requirements for older insured mortgages exceeded the increase in reserve requirements for newly insured mortgages.

BORROWINGS FROM TREASURY

Over the years, both GIF and SRIF have not earned sufficient income from operations to cover the insurance claims submitted. To make the necessary payments to mortgagees, funds have been borrowed from the Treasury.

On October 13, 1971, the Assistant Secretary-FHA Comissioner and the Secretary of the Treasury exchanged two notes dated November 25, 1970, which had been issued by the former and held by the latter, for two new notes dated October 13, 1971. The new notes are open end--that is, notes that do not stipulate the dollar amount that the Treasury could advance to GIF or SRIF. The November 25, 1970, notes had provided for advances up to a total of $200 million for GIF and $100 million for SRIF.

At June 30, 1975, funds borrowed totaled $2,037.3 million for GIF and $1,640 million for SRIF. By September

30, 1976, these figures had risen to $2,847.3 million and $2,031 million, respectively. (See sch. 3.) None of these funds had been repaid at September 30, 1976. 1/

APPROPRIATIONS

Funds were appropriated to FHA by the Congress for the first time during the 15-month period ended September 30, 1976. Under the Supplemental Appropriations Act of 1976 (Public Law 94-157), approved December 18, 1975, SRIF received $100 million and GIF received $42.5 million. 1/ (See sch. 3.)

ACCOUNTING PROBLEMS

Our examination disclosed that in several situations FHA had not reconciled its financial transactions and year-end balances to its supporting detailed records. In some of these situations accounts were not supported by detail records because of accounting system problems; in other situations adequate reconcilation procedures were not followed. Because of this and other accounting problems, we were unable to determine whether several year-end financial statement balances totaling millions of dollars were reasonably stated.

HUD has recognized that its current mortgage insurance accounting system has been less than adequate in supporting its mortgage insurance activities. In March 1975 HUD began to develop a new computerized mortgage insurance accounting system called the HUDMAP project. The project is a major undertaking and will almost completely replace the existing system. HUD estimates that the system could be in place by the fall of 1979.

1/Additional amounts were appropriated for fiscal year 1977. Effective October 1, 1976, the Congress appropriated $135 million for GIF and SRIF. This was approved August 9, 1976, under the Department of Housing and Urban Development -Independent Agencies Appropriations Act of 1977. An additional $1.8 billion was appropriated to the two funds on May 4, 1977, under the Supplemental Appropriations Act of 1977. $1,479.4 million of the latter amount has since been used for retirement of Treasury borrowings.

In justifying its new computer system, HUD cited the many modifications and conversions that have been made to its current computerized system since its inception in 1958 and our criticisms of the system. HUD hopes that the new system will help cure many of the control problems associated with the reconciliation of account balances to detail records. The following sections illustrate HUD's reconciliation and other accounting problems.

Numerous financial statement balances were not reconciled to detail records

Our examination of the financial statements included a verification of account balances and a review of internal controls over the financial transactions affecting such balances. We reviewed the validity of transactions affecting the accounts for a test period during the year and the validity of the totals in the accounts at yearend. Such verification requires a listing or other backup support for transactions and account balances. In numerous instances we were unable to obtain detailed listings or backup material that supported fully various account balances in the financial statements. We were therefore unable to determine whether the applicable accounts were fairly stated. Examples of this situation follow.

Insurance claims payable

Insurance claims payable at September 30, 1976, totaled about $65.2 million. These payables are part of the $83.6 million shown under accounts payable--acquired security and miscellaneous. (See sch. 1.) We found detailed records for about $25.8 million and summary records for another $32.8 million; but there was no support for the remaining $6.5 million--we were therefore unable to test the $6.5 million since no detail listing was available. We were also unable to test the $32.8 million because the summary records showed only that the payables pertained to specific insurance funds and were not broken down to show what projects made up the balances.

In their reply to our draft report and in subsequent discussions, FHA officials agreed that the insurance claims payable account was not reconciled to detail records at September 30, 1976, and that they would perform that reconciliation in the future.

Appraisal fees payable

Of the $83.6 million in accounts payable, $1.7 million pertains to fee expenses. This represents amounts due to private appraisers, inspectors, and mortgage credit examiners that appraise property and perform other services for HUD when cases are initially insured. Accounting personnel in Washington are notified by the various HUD area offices of the amounts payable; the payment is made in Washington. However, accounting personnel in Washington did not keep records of who was due the $1.7 million in payments at September 30, 1976, nor did they know the amounts payable that are applicable to each area office; we, therefore, could not test the $1.7 million in payables for accuracy.

FHA officials requested that this item be eliminated from our report. They said that the detail records of fee expenses are maintained in the various area and insuring offices of HUD and that each office provides a monthly activity report to FHA. They stated that, while the amounts payable are not maintained by area and insuring office, the monthly reports are available for our review and that there is no evidence that our Office reviewed those reports.

We agree that records maintenance could be decentralized, and that such decentralization could be acceptable for audit purposes. However, for that procedure to be effective the central accounting unit must maintain some detail or other backup supporting the account balances so that it is possible to audit and determine the reasonableness of the account balance. FHA did not maintain a list supporting the $1.7 million in the account. Further, FHA could not provide information about how much applied to various area offices; therefore, a test of area office records could not be made. The monthly report referred to by FHA shows activity but does not show account payable balances.

Dividends payable

When an insured mortgage under MMIF is paid in full, the mortgagor is entitled to a dividend from HUD for all or part of the insurance premiums paid to FHA over the life of the mortgage. The payable is set up by FHA when the mortgage is paid. However, HUD used two automated systems to account for amounts actually paid. One system set up a detailed list that was sent to Treasury for payment. Another system developed a payment summary that was sent to accounting. The amounts differed; as a result, the cash payments made by Treasury differed from amounts recorded in FHA accounting records. FHA would not adjust the accounting records until it determined specifically to which payees the differences applied. At September 30, 1976, the differences amounted to about $200,000, affecting cash and accounts payable. As of May 1977 this difference had grown considerably--to about $1.2 million. FHA officials agreed that the difference existed at September 30, 1976; they stated that the problem was resolved and corrected by September 30, 1977.

Reserve for foreclosure costs

A liability has been set up representing a reserve to pay foreclosure costs for defaulted multifamily mortgage notes assigned to HUD in settlement of insurance claims. The amount is an estimate of future cost in case the notes HUD owns remain unpaid and HUD has to acquire the properties through foreclosure. FHA did not maintain a list of notes and amounts in support of the reserve; we, therefore, could not test the accuracy of the account balance, at September 30, 1976, of about $24.6 million.

FHA officials requested that this item also be removed from our report. They said that the support for this account is reflected on individual account cards as of September 30, 1976, and that for the next fiscal year these items were listed and agreed with the trial balances at that time.

We believe, however, that this item demonstrates the weakness in FHA internal control procedures. The Comptroller General's accounting principles and standards (section 8.7) require that financial transactions shall be adequately supported in the agency files with pertinent documents available for audit, and that all transactions be so recorded that they can be readily traced from originating documents to summary records and to the issued financial reports. In this situation the amounts supporting the financial report balance were included on over 1,600 detailed subsidiary account cards. Because FHA did not list or otherwise add the balances on these cards, they could not be certain that such amounts supported the financial report.

Mortgage insurance premiums receivable

FHA has had considerable difficulty in controlling its premium receivable account over the past several years. Premiums are FHA's major source of income. Mortgagors pay mortgage insurance premiums to lending institutions that service their mortgage loans. These institutions are billed monthly by FHA for the premiums due on the insured mortgages. As of September 30, 1976, mortgage insurance premiums receivable totaled about $43.5 million.

There are two reconciliation problems associated with the premium receivable account. The first is with the detailed records--there are about $2.1 million more in individual receivable accounts than are shown in the financial statements.

Second, FHA has difficulty in reconciling premiums due from mortgagees. In this situation mortgagees disagree with FHA monthly premium billings and pay FHA an amount other than what is billed. There are a few major problems:

--Mortgages are frequently sold by one institution to another. FHA is supposed to receive notification from the banking institutions of such sales so that the records may be updated. However, for many reasons the records are not accurately updated and the premium notices are sent to the wrong bank.

--Mortgages are also frequently paid in full before the scheduled termination of the mortgage. FHA records do not always show such payments, and the banking institutions are billed for premiums on cases that have already been paid.

Because of these problems the FHA premium accounts receivable began to show major amounts of uncollectibles. We first found these delinquent receivables during our fiscal year 1972 audit when premiums due over 6 months totaled about $.8 million. By June 30, 1973, the 6-month-or-more delinquent category grew to about $6.2 million, and by June 30, 1974, it was about $11 million. At September 30, 1976, it was reduced to about $8.6 million. The effects of this accounting problem on premiums receivable are important.

We made a detailed review of FHA premium accounts receivable and in September 1977 issued a report entitled "Millions of Dollars in Delinquent Mortgage Insurance Premiums Should be Collected by the Department of Housing and Urban Development," (FGMSD 77-33).

In summary, the report showed that an average of $18 million in premiums due from lending institutions were delinquent from Janauary 1976 to March 1977. If HUD had used the accepted 15-day mortgage banking industry criterion to identify delinquent accounts each month,

$38 million would have been delinquent--including over $8 million due more than 6 months. One hundred and thirty-four institutions had not paid FHA over $2.2 million in delinquent premiums because FHA had not billed them. The report concluded that FHA had poor internal controls because documents submitted by banking institutions needed to update files were not being adequately controlled and there were ineffective controls over computer processing of mortgage insurance data. Recommendations to improve controls over premium collection were included in the report.

FHA recognizes in its financial statements the potential that not all of its premium receivables may be collected. As of September 30, 1976, FHA set up a $4.5 million allowance for estimated future losses for premiums receivable to cover premiums due over 6 months. This allowance has been set up by FHA in its statements for a number of years while it was trying to correct the accounting control problems.

Now a similar situation has also surfaced in the fee receivable account, where a $682,000 allowance has been set up at September 30, 1976 for the same problem.

FHA officials stated that reconciliation differences are related to automated data processing (ADP) system operational problems rather than accounting control problems. The officials stated that reconciliation of ADP records and financial statement balances is in process, and they anticipate completion of this work as resources can be directed to it.

<u>Other reconciliation problems</u>

There were a number of other accounts where detail listings were not available to support the account balances. The differences in account balances and detail listings were as follows:

--Deposits held for mortgagors	$248,800
--Title I premiums receivable	1/62,100
--Fees receivable	6[illegible],300
--Mortgage notes assigned	148,000
--Title I notes receivable	950,000

1/The account was also overstated on September 30, 1976, by about $3.6 million because FHA did not record cancellations of premiums due since 1972. The account was adjusted for the $3.6 million during fiscal year 1977.

Reconciliation of monthly accounting transactions and year-end balances to detailed records is an essential part of accounting control. Without such reconciliation FHA is unsure of the accuracy of its accounting because transactions are not fully supported. Even more important, this lack of accounting control could and has resulted in failure to collect receivables or pay bills on time and in a loss of income and other deficiencies that could be avoided where controls are adequate.

There were four items on reconciliation problems included in our draft report that were either eliminated or revised because of additional evidence from FHA. For the remaining items, however, FHA officials were in agreement that differences between detail records and financial statement amounts existed or that accounts and detail records were not reconciled at September 30, 1976. They have agreed to pursue these matters further.

RECOMMENDATION TO THE SECRETARY, HUD

We recommend that the Secretary direct FHA to strengthen its procedures for routine reconciliation of accounting transactions and account balances to detailed supporting records. Further, we recommend (1) that differences between year-end account balances and amounts of detailed support be researched, and any adjusting entries needed be made in the accounting records and (2) the cause for such differences be determined and corrective action taken.

Substantial numbers of transactions not entered into accounting records

Several accounts affecting fees and premiums are misstated in the FHA financial statements because about 39,000 accounting transactions pertaining to about 36,000 mortgage insurance applications and about 3,000 commitment extensions contained errors and, consequently, had not been entered into the financial accounts. Instead, these transactions were included in a suspense file until FHA accounting personnel could determine the reasons for the errors. As a result, fee income and fees receivable could each be understated by as much as $1.9 million at September 30, 1976. Also, premium income could be understated by as much as $.8 million. Premiums receivable and accrued premiums would also be affected by the same $.8 million.

When FHA processes an application for mortgage insurance, the data included on the application is subjected to an edit check before it is entered onto a computerized master file. If the edit check is passed successfully, the ADP system automatically prepares a bill to the applicable banking institution for various fees owed to FHA.

If there is a question about the data on the application, the case will be rejected during the edit check and the data will be entered onto a suspense file until it is corrected. Meanwhile, application fees owed to FHA will not be billed. If the case stays on the suspense file for over a year, premiums may also be due if the case becomes insured.

Our analysis of the 36,000 mortgage application transactions on the suspense file as of September 30, 1976, disclosed that most of the cases (about 32,500) were on the file 1 year or less. The remaining 3,500 cases were on the file for periods ranging up to 7 years or more, including 42 cases that were on the file for more than 85 months.

A further analysis of the 39,000 mortgage application and commitment extension transactions disclosed that as much as $1.9 million in fees could be owed to FHA for these cases because FHA computer coding of these cases indicated that fees were due. We cannot, however, be certain of the exact amount due without examining the specific reasons why these cases were initially rejected.

Further, our analysis of the suspense file showed that commitments for insurance had been issued for about 15,000 cases. Since these cases were not processed beyond the suspense file, premiums would not have been billed. We estimate that about $.8 million in premiums have either accrued to FHA or should have been billed. Those cases that remained in the suspense file for over a year after the insurance became effective should have been billed for premiums. Those cases that had not been on the file for a year after the effective date of insurance would not have been billed for premiums, but the amount of premiums applicable to a portion of the year would be included in the FHA financial statements as an asset account under accrued premiums. The FHA income and expense statement would also be affected. The fee income account would be increased by $1.9 million, and the premium income would be increased by $.8 million.

FHA officials stated that while they were aware of the problem, personnel shortages hampered FHA efforts to resolve the exceptions. In their reply to our draft report, these officials stated that a new procedure was established in April 1977 to monitor transactions on the suspense file for reentry to the computer. They stated that the procedures for processing and monitoring these transactions are continuously under review and will receive further refinement with the development of a new computer system.

Value of acquired property overstated

The value of HUD-owned property as shown in the balance sheet of about $570 million (cost of $1,309 million less allowance for future losses of $739 million) is in our opinion substantially overstated. The reasons contributing to the overstatement are:

--FHA estimates of the allowance for future losses on the sale of its property are too low.

--Many more buildings had been razed than were shown in the accounting records.

--There were numerous properties sold by FHA at September 30, 1976, but still included in the asset account.

--Property appraisals indicate high potential losses.

For balance sheet purposes HUD-acquired property is shown at acquisition cost, plus other costs incurred by FHA, less an estimate of an allowance for probable future losses. This presentation is to show a net amount that HUD may realize upon the disposition of its property.

FHA estimate of future losses did not consider the length of time HUD owned property

For small homes, FHA estimates the probable loss on future sales using the percentage of losses experienced on prior sales. This percentage is projected to the cost of the current inventory of FHA small homes to determine the amount of allowance for estimated future losses.

We believe, however, that while the rationale of relating prior loss percentages to unsold property to determine future losses is reasonable in general, the procedure could be refined to determine a better estimate. We found that sold property was held for shorter time periods prior to sale compared to the average holding period of onhand property and, the longer HUD holds property, the higher the loss. The FHA computation of estimated loss did not consider the higher losses it was sustaining on properties held for longer time periods.

We made a computer analysis of the losses sustained on the sale of small homes and added a factor relating to the time period they were held before sale. Projecting the new percentages to onhand properties, we estimate that the allowances for estimated future losses should have been about $26 million higher than shown in the financial statements when the age factor was considered.

FHA officials stated that this was an unfair criticism because (1) the practice has been accepted by our Office for years, (2) our report does not present any data to support the claim that the allowance for loss is actually understated, and (3) an analysis of property values in core areas of three large cities (see pp. 21 to 23) does not indicate that FHA is using an unsound accounting technique for estimating future losses.

We do not disagree with the general method of using prior year sales experience to generate an estimate for future losses; in fact, we believe the method is reasonable. However, through a detailed computer analysis of prior sales and a current inventory of onhand property we were able to determine that onhand properties are not quite equivalent to sold properties because onhand properties were held longer than the holding period of sold properties. The onhand properties, therefore, were subjected to more deterioration and vandalism than the sold properties. Further, our analysis showed that the longer properties are held, the higher the loss percentage. Our suggestion, therefore, to analyze probable losses through reference to the length of time held would, in our opinion, produce a better estimate of loss.

Our review of probable losses in New York, Chicago, and Detroit showed that potential losses up to 100 percent, well over the national average, tended to confirm our position. FHA officials, in their answer to our draft report, stated that the new ADP accounting system under development would consider grouping properties by area office and by blighted and nonblighted areas.

<u>Many more buildings were razed than were recognized in the accounting records</u>

According to FHA statistics as of September 30, 1976, almost 4,000 buildings of its inventory of about 41,000 small homes had been razed. Our review of HUD properties indicated that there were substantially more razed properties than shown in the accounting records. In estimating the allowance for future losses, FHA includes the total accumulated cost of razed properties in such allowance. Since, as indicated by our review, there are substantially more razed properties than shown in the statistics, the allowance for future losses is understated, thereby overstating the value of its acquired property.

To check the accuracy of the number of razed properties included in the accounting records, we reviewed the HUD inventory of small homes in Chicago, Detroit, and New York. We randomly selected 185 properties from a universe of about 9,600 properties in the three cities. These properties represented about 23 percent of all HUD-owned homes at September 30, 1976. The universe of 9,600 properties excluded all properties for which HUD computer records showed that the building had been razed. Through examination of accounting records and observation of the property itself, we found that for 20 of the 185 properties the buildings had been razed at September 30, 1976. Since the 20 razed properties represent over 10 percent of the 185 properties examined, it is possible that the additional loss in value of razed properties not included in the accounting records on a nationwide basis could be great.

Because of the understatement of the reserve for losses on acquired property, the income and expense statement would also be affected because the expense account, "Valuation allowance on acquired property," would also be too low.

In their reply to our draft report, FHA officials stated that our conclusion that many more properties in their inventory had been razed than were on record was factually incorrect. They indicated that there were less than 75 properties in that category, based on an inventory reconciliation made between ADP and field office records as of December 31, 1976.

The reconciliation reports referred to by FHA, however, showed substantially more than 75 razed properties not included on the ADP records and, in addition, some reports may have been nonresponsive. The reports showed almost 300 razed properties in New York City alone not included on ADP records, and 344 overall. However, FHA reports for the cities of Chicago and Detroit (where we observed that about 10 percent of the properties were razed but not shown on ADP records) did not show any such razed properties.

Substantial numbers of HUD properties were sold by September 30, 1976

Our review of the 185 cases in Chicago, Detroit, and New York disclosed that the acquired property account could be further overstated because there were properties sold as of September 30, 1976, which were not recognized as such in the accounts. Of the 185 cases examined, 9 (about 5 percent) of the properties were sold as of September 30, 1976.

Further, in a review by the HUD Office of the Inspector General of the sale of acquired property, a similar finding was made in that numerous property sales not recorded in the accounting records until after September 30, 1976, actually were sold before September 30, 1976. The Office selected at random 112 cases out of about 5,100 cases recorded in the accounting records as sales in October and November 1976; of those cases, 26 (about 23 percent) of the 112 tested were sold before September 30, 1976, but were not shown as sales until after September 30, 1976. These properties should not have been included as acquired property at yearend. Based on a projection of cases recorded as sales after September 30, 1976, approximately 1,200 properties may have been erroneously included as acquired property at yearend.

Any property sold at yearend but not recorded would also affect the FHA income and expense statement, because any profit or loss on each sale is included in the expense account "Loss on acquired security."

FHA officials agreed with our findings and have initiated additional procedures to identify sold properties.

Additional evidence indicating overvaluation of HUD-acquired property

Our review of the appraised value of HUD property and our discussions with HUD officials in Chicago, Detroit, and New York indicated further that HUD property may be substantially overvalued.

In Detroit our review of 60 properties included in the HUD inventory of acquired property at September 30, 1976, disclosed that it is likely that the loss on these properties will equal almost 100 percent of the HUD acquisition cost. In comparison, HUD nationally projected losses based on prior sales were only about 57 percent. The Detroit data on expected loss on the 60 cases is:

Property status	Acquisition cost	Estimated or actual dollar loss	Estimated or actual percent loss
6 sold	$100,571	$113,920	113
7 razed	88,582	116,663	132
16 sales in process	282,808	264,072	93
31 programmed for sale	504,877	462,681	92
Total 60	$976,838	$957,336	98

At yearend the New York area office had a total of about 3,250 small home properties. Of this total about 2,380, most of which had been in the HUD inventory for several years, were located in blighted core areas. We were informed by area officials that at least 1,000 of these properties had no market appeal or market acceptance at any price.

We reviewed 65 properties selected at random from the HUD inventory of properties in New York. These properties had a total acquisition cost of about $1.4 million. We computed the anticipated loss based on the New York area office's most current price expectancy valuations before September 30, 1976. Based on these valuations it was expected that the loss would be about $1.5 million--over 100 percent of acquisition cost. Losses over 100 percent of acquisition cost result because HUD incurs additional expenses on these properties after acquisition.

Our review of 60 properties in Chicago, using appraisals at about September 30, 1976, disclosed probable losses of approximately 55 percent, about equal to the national average.

FHA calculates its loss percentages on property sold on a national basis. However, the loss experience (as shown above) varies among cities and areas. Therefore, if property sold is weighted more heavily in areas with low loss ratios, that low loss ratio will be projected to all properties, even if the properties remaining in the FHA inventory are from high loss ratio areas. This situation would further distort the net value of properties in the HUD inventory.

We believe that FHA could be much more sophisticated than it now is in determining the estimated future losses on its acquired property. Such data can be analyzed by the use of well planned computer programs. For example, sales data can be analyzed by the length of time it is held before sale and by the section of the country where the property is located. The analysis could consider whether the property is within a core area of a city and any other factors that could affect property values.

Further, it is apparent that FHA should strengthen its procedures for keeping track of razed and sold properties at yearend. We believe this could be accomplished through the periodic reconciliation between field records and central computer records. FHA indicated in their reply to our draft report that this procedure would be continued in future years.

RECOMMENDATION TO THE SECRETARY, HUD

We recommend that the Secretary direct FHA to redesign its analysis procedures for determining probable loss on sales of its property so that a better loss percentage can be determined.

AGENCY COMMENTS AND OUR EVALUATION

HUD officials commented on our draft report in a letter dated January 27, 1978. (See app. I.) There were a number of comments directed specifically at various findings included in this chapter. We have incorporated HUD comments and our evaluation in the appropriate related sections of the report. There were also some general comments, and these are summarized here with our evaluation.

With regard to procedures followed in reconciling financial transactions and year-end balances, HUD officials stated that the procedures followed were the same as those that were followed in previous years. They said, however, that (1) in many areas, the level of detail desired by our Office could not be produced in the exact manner desired, although other forms were available and (2) audit trails were neither pursued nor accepted as an alternative to manually producing desired detail records. They stated that there were daily, weekly, and monthly records available to assure that data is summarized and recorded into the general accounting books, and that duplicating the reconcilement by producing manual, detailed listings of data for our convenience would require resources that are not available.

The level of detail necessary to support the amounts included in financial statements varies, and depends on what is necessary to provide assurance that such amounts are reasonably accurate. In general, a breakdown or listing of the account balance is necessary, and backup records are needed to prove the validity of the individual items of the list. These records are not only needed by auditors but are important to FHA so it knows that its records are accurate, and should be an essential part of its internal control procedures. As a final step, the totals of the listing must be compared to financial statement balances and, where differences occur, a reconciliation must be made to satisfactorily account for the difference.

For a number of the accounts discussed in this report, such listings had not been prepared by FHA; therefore, FHA did not know whether the accounts were accurate, and we had no reliable method to test the accuracy of the balances shown by FHA. In discussions with FHA accounting personnel subsequent to receipt of the January 27, 1978, response to our draft report, we were told that examples of accounts where we didn't accept detail records were the reserve for foreclosure and multifamily insurance claims payable.

In both these instances detail listings were not prepared and, therefore, FHA did not know whether the accounts were reasonably accurate. However, there were hundreds of individual account cards available for review that backed up the account balances. Minimum internal control procedures would require that these account cards be reviewed by FHA accounting personnel and reconciled to the financial statements. If the volume of detail is too large, the operation could easily be computerized. It is neither the responsibility of the auditor to perform that accounting function nor would it be acceptable auditing procedure for this Office to reconcile agency records to its own financial statements.

FHA officials suggested that there are numerous detail records, reflecting transactions during the year, that are available for review as an alternate audit trail to manually producing detail listings desired by our Office. Each month during the fiscal year, transactions occur that either increase or decrease the balances in the various accounts. For example, billings increase accounts receivable and collections decrease the receivables--there are listings that support these increases and decreases.

For test purposes, we select some of these transactions and test the listings for accuracy. This test is part of our review of internal controls and provides us with some degree of assurance that the year-end balances are reliable. We use these tests of monthly transactions to determine the amount of testing of the year-end balances. Such monthly transaction testing, however, is not an alternative to the actual test of support of financial statement balances on which we must give our opinion.

FHA officials also stated that our draft report fails to recognize the generally accepted accounting practice of permitting estimating for those items that cannot be fully documented and recorded in time to meet fiscal year-end closing deadlines.

A certain degree of estimating in financial statements is completely justified and is encouraged by our Office. The Comptroller General's principles and standards of accounting provide that the accounting process requires many estimates and judgments. In determining the degree of precision to be employed in making allocations of cost and income, and in computing items where estimates have to be employed, due consideration should be given to the materiality and relative significance of the items involved.

FHA financial reports include many such estimates that have been and still are accepted by us during the audit, if such estimates are reasonable. For example, allowances for estimated future losses are estimates, part of the property valuation is an estimate, and estimates are part of some income and expense accounts.

When estimates are used, however, there should be a sound basis employed that will produce a reasonable balance. Part of our audit work is evaluation of estimates used by FHA and, where we believe improvements could be made for more accurate reporting, we suggest changes in FHA methods. An example of this suggestion relates to the allowance for future losses on acquired property that we believe could be more accurate by the use of more sophisticated computer analysis. (See p. 23.)

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On March 2, 1978, we met with HUD officials at their request to further discuss our draft report. We were informed that FHA intends to launch an effort to correct the problems brought out in our report. They said that a task force will be formed to make these corrections in time for the fiscal year 1978 audit. They felt that, since the fiscal year 1977 books have already been closed, an effort to make corrections for that year would not be reasonable.

FHA officials stated that efforts to make these corrections are needed not only to properly support the financial statements but also to prepare their accounting system for conversion to the new computer system being developed under the HUDMAP project. At the point of conversion it is important that records contained on computer files be accurate and in agreement with financial reports.

On the basis of the FHA stated intention to make corrections to its accounting procedures, we have agreed to provide some necessary help to FHA for that effort. Further, we will continue to review FHA accounting records for fiscal years 1977 and 1978, but we will not issue an opinion on its statements until our audit of fiscal year 1978 is complete.

REVIEW OF FINANCIAL ACCOUNTS BY THE INSPECTOR GENERAL

During fiscal year 1976 the HUD Office of the Inspector General initiated a review of the mortgage insurance system's financial accounts. Its review was to verify several of the account balances included in the FHA September 30, 1976, financial statements. We examined its work as it pertained to the year-end financial statements and thus were able to limit the scope of our review. Furthermore, some of its work and findings have been incorporated in discussions in this report.

OUR RECENT REVIEWS OF THE HUD MORTGAGE INSURANCE ACCOUNTING SYSTEM

On May 11, 1977, we testified before the Subcommittee on Manpower and Housing, House Committee on Government Operations, on three reviews of the FHA mortgage insurance accounting system. The reviews pertained to the billing and collection of insurance premiums and payment of real estate taxes on HUD-owned property.

The first review concerned the need to take prompt action to collect millions of dollars of delinquent mortgage insurance premiums. The second, also related to insurance premiums, concerned opportunities for substantial savings in FHA insurance programs for servicemen.

The third review concerned improvements needed in the HUD accounting system for paying property taxes on single family residences. This is a followup review on a prior report issued to the Congress in November 1975 (FGMSD-76-24, Nov. 26, 1975). Our Office also reported on HUD responsiveness to real estate tax problems related to HUD-owned and insured multifamily projects (CED-77-125, Sept. 27, 1977).

CHAPTER 3

SCOPE OF EXAMINATION AND OPINION ON FINANCIAL STATEMENTS

We examined FHA's financial statements pertaining to its insurance operations for the 15-month period ended September 30, 1976. We made our examination in accordance with generally accepted auditing standards and included such tests of the accounting records and such auditing procedures as we considered necessary in the circumstances.

On the basis of actuarial studies of the risks underwritten, FHA estimated the reserves required to settle insurance claims that might be presented by insured mortgagees under the $89 billion of insurance in force on September 30, 1976. The estimate of $2.7 billion is shown as footnote 9 to the financial statements. The adequacy of the estimated reserve requirement is not predictable in our opinion, because it is contingent, to a great extent, on future economic conditions that are not predictable. (See p. 7.)

For the reasons explained in this report (see p. 10) we cannot express an opinion that FHA's financial statements present fairly the financial position of FHA at September 30, 1976, and the results of its operations and the changes in financial position for the 15-month period then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fiscal year.

FINANCIAL STATEMENTS

SCHEDULE 1

SCHEDULE 1

FEDERAL HOUSING ADMINISTRATION
COMBINED COMPARATIVE BALANCE SHEET AS OF SEPT. 30, 1976 AND JUNE 30, 1975

ASSETS

	September 30, 1976	June 30, 1975	Increase or Decrease (-)
CASH AND FUND BALANCES:			
Cash on hand and in transit	$ -17,291,704.75	$ -2,165,242.69	$ -15,126,462.06
Fund balances with U.S. Treasury	225,276,205.67	126,108,062.82	99,168,142.85
Total cash and fund balance	207,984,500.92	123,942,820.13	84,041,680.79
ACCOUNTS RECEIVABLE:			
Premiums:			
Public	42,180,025.64	40,601,255.87	1,578,769.77
Less: Allowance for estimated future losses	4,500,000.00	5,837,500.00	-1,337,500.00
Net premiums - public	37,680,025.64	34,763,755.87	2,916,269.77
Government agencies	5,673,116.35	6,207,244.23	-534,127.88
Fees	5,805,658.80	3,751,199.50	2,054,459.30
Less: Allowance for estimated future losses	682,000.00	-	682,000.00
Net fees	5,123,658.80	3,751,199.50	1,372,459.30
Sale of Secretary-held properties:			
Government agencies	-	-	-
Public	9,505,618.88	150,162,923.15	-140,657,304.27
Sale of Secretary-held mortgages:			
Public	1,337,578.39	663,900.00	673,678.39
Other:			
Government agencies	273,739.11	716,010.26	-442,291.15
Public	852,699.86	981,836.45	-129,136.59
Advances to SRI Fund from GI Fund	20,000,000.00	20,000,000.00	-
Total accounts receivable	80,446,417.03	217,246,869.46	-136,800,452.43
ACCRUED ASSETS:			
Premiums	146,764,148.39	152,148,209.28	-5,384,060.89
Interest on U.S. Government securities	24,067,523.19	34,160,857.79	-10,093,334.60
Interest on mortgage notes receivable	117,556,049.30	63,316,172.58	54,233,876.72
Total accrued assets	288,381,720.88	249,625,239.65	38,756,481.23
INVESTMENTS:			
U.S. Government securities at amortized cost	1,692,282,272.99	1,590,140,791.70 3/	102,141,481.29
Stock in rental and cooperative housing corporations: 127,084 shares--at cost	145,500.00	158,600.00	-13,100.00
Total investments	1,692,427,772.99	1,590,299,391.70	102,128,381.29
MORTGAGE NOTES AND CONTRACTS FOR DEED--UNPAID BALANCE	433,946,191.79	366,071,933.00	64,874,258.79
Less: Allowance for estimated future losses	24,573,217.00	21,579,637.00	2,993,580.00
Net mortgage notes and contracts for deed	406,372,974.79	344,492,296.00	61,880,678.79
ACQUIRED SECURITY OR COLLATERAL:			
Acquired property--at cost plus net expense to date	1,309,658,788.11	1,678,502,912.59	-368,844,124.48
Defaulted mortgage notes--at cost plus net expenses to date	2,715,793,842.48	1,958,767,084.18	757,026,758.30
Defaulted Title I notes--at unpaid principal balance	76,877,983.89	63,401,908.02	13,476,075.87
Total cost of acquired security or collateral	4,102,330,614.48	3,700,671,904.79	401,658,709.69
Less: Principal recoveries on defaulted mortgage notes	66,941,694.20	58,511,646.86	8,430,047.34
Less: Undisbursed mortgage proceeds	2,414,247.94	2,719,434.33	-305,186.39
Unrecovered cost	4,032,974,672.34	3,639,440,823.60 1/	393,533,848.74
Less: Allowance for estimated future losses on acquired properties	739,407,940.00	864,467,762.00	-125,059,822.00
Allowance for estimated future losses on defaulted mortgage notes	1,188,032,989.00	748,350,045.00	439,682,944.00
Allowance for estimated future losses on defaulted Title I notes	68,354,527.00	58,645,248.00	9,709,279.00
Total allowance for estimated future losses	1,995,795,456.00	1,671,463,055.00	324,332,401.00
Net acquired property and notes	2,037,179,216.34	1,967,977,768.60	69,201,447.74
Other notes receivable	1,158,351.55	1,291,722.55	-133,371.00
Less: Allowance for estimated future losses	332,994.00	346,494.00	-13,500.00
Net other notes receivable	825,357.55	945,228.55	-119,871.00
Net acquired security or collateral	2,038,004,573.89	1,968,922,997.15	69,081,576.74
OTHER ASSETS-HELD FOR THE ACCOUNT OF MORTGAGORS	2,539,607.28 2/	2,700,702.68 2/	-161,095.40
DEFERRED CHARGES	283,012.84	476,591.35	-193,578.51
Total assets	$4,716,440,580.62	$4,497,706,908.12	$ 218,733,672.50

1/ Includes 1 Department of Defense multifamily mortgage as follows:

Cost less net income	$197,905.68
Less: Principal recoveries	158,661.27
Unrecovered cost	$ 39,244.41

2/ Includes $2,573,500.00 value of U.S. Securities purchased by FHA from mortgagors' funds in the Reserve Fund for Replacements and/or Special Escrow Accounts.

3/ Investments include debentures of FHA insurance funds in the amount of $51,969,100.00 and GNMA participation certificates in the amount of $134,734,767.44 purchased as an investment by the Mutual Mortgage Insurance Fund.

The notes on page 40 are an integral part of this statement.

SCHEDULE 1

SCHEDULE 1

LIABILITIES

	September 30, 1976	June 30, 1975	Increase or Decrease (-)
ACCOUNTS PAYABLE:			
Acquired security, investments and miscellaneous:			
Government agencies	$ 9,247,576.95	$ 48,110,395.35	$ -38,862,818.40
Public	74,389,266.82	90,583,136.41	-16,193,869.59
MMI Fund participations payable	41,637,169.23	43,438,258.81	-1,801,089.58
Advances from GI Fund to SRI Fund	20,000,000.00	20,000,000.00	-
Total accounts payable	145,274,013.00	202,131,790.57	-56,857,777.57
ACCRUED LIABILITIES:			
Interest on debentures:			
Government agencies	1,094,571.93	1,600,768.55	-506,196.62
Public	10,015,748.99	12,537,905.79	-2,522,156.80
Interest on funds advanced:			
Government agencies	87,567,348.17	-	87,567,348.17
Total accrued liabilities	98,677,669.09	14,138,674.34	84,538,994.75
TRUST AND DEPOSIT LIABILITIES:			
Deposits held for mortgagors and lessees	30,608,164.20	26,793,561.98	3,814,602.22
Earnest money on pending sales	6,544,876.60	142,707,157.91	-136,162,281.31
General Fund receipts in process of deposit	-38.00	-1,354.21	1,316.21
Excess proceeds of sale:			
Government agencies	317,212.32	310,855.64	6,356.68
Public	3,869,381.97	4,548,053.42	-678,671.45
Total trust and deposit liabilities	41,339,597.09	174,358,274.74	-133,018,677.65
DEFERRED CREDITS:			
Unearned premium income	55,770,021.06	51,927,191.10	3,842,8[illegible]9.96
Unearned fee income	1,920,474.82	901,822.23	1,018,6[illegible]2.59
Unapplied credits	10,106,620.93	7,4[illegible]9,683.84	2,666,9[illegible]7.09
Total deferred credits	67,797,116.81	60,268,697.17	7,528,419.64
DEBENTURE OBLIGATIONS:			
Debentures issued and outstanding:			
Government agencies	88,754,300.00	66,345,550.00	22,408,750.00
Public	490,014,450.00	420,589,600.00	69,424,850.00
Total issued and outstanding	578,768,750.00	486,935,150.00	91,833,600.00
Debentures authorized for issue:			
Government agencies	1,284,150.00	393,350.00	890,800.00
Public	9,390,450.00	10,945,500.00	-1,555,050.00
Total authorized for issue	10,674,600.00	11,338,850.00	-[illegible],250.00
Debenture claims in process:			
Government agencies	1,971,750.00	7,865,450.00	-5,893,700.00
Public	34,052,750.00	30,338,100.00	3,714,650.00
Total in process	36,024,500.00	38,203,550.00	-2,179,050.00
Total debenture obligations	625,467,850.00	536,477,550.00	88,990,300.00
OTHER LIABILITIES:			
Reserve for foreclosure cost - defaulted mortgage notes	24,[illegible]	15,688,958.17	8,958,180.53
Total other liabilities	24,[illegible]47,138.70	15,688,958.17	8,958,180.53
Total liabilities	$ 1,[illegible],203,384.69	1,003,063,944.99	$ 139,439.70

APPROPRIATIONS, RESERVES AND BORROWINGS FROM U.S. TREASURY

	September 30, 1976	June 30, 1975	Increase or Decrease (-)
APPROPRIATED CAPITAL:			
Appropriated capital - loss on acquired securities	142,500,000.00	-	142,500,000.00
Total appropriated capital	142,500,000.00	-	142,500,000.00
RESERVES:			
Statutory reserve - for participation payments and future losses	559,695,[illegible]68.37	432,007,206.10	127,688,362.27
Insurance reserve - available for future losses and expenses	-1,867,226,372.44	-614,632,242.97	-1,252,594,129.47
Total reserves	-1,307,530,804.07	-182,625,036.87	-1,124,905,767.20
BORROWINGS FROM U.S. TREASURY	4,878,268,000.00	3,677,268,000.00	1,201,000,000.00
Total appropriations, reserves and borrowings from U.S. Treasury	3,713,237,195.93	3,494,642,963.13	218,594,232.80
Total liabilities, appropriations reserves and borrowings from U.S. Treasury	$ 4,716,440,580.62	$4,497,706,908.12	$ 218,733,672.50

SCHEDULE 2

FEDERAL HOUSING ADMINISTRATION
COMBINED COMPARATIVE STATEMENT OF INCOME AND EXPENSE
AND CHANGES IN RESERVES AND BORROWINGS
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1976 AND JUNE 30, 1975

INCOME AND EXPENSE	1976	1975	Increase or Decrease (-)
Income			
Fees	$ 44,473,890	$ 24,637,403	$ 19,836,487
Premiums	26,861,914	413,087,822	113,774,092
Interest on U. S. Government securities and dividends	146,686,795	104,794,568	41,8[illegible]2,227
Interest income	2,354,320	139,194	2,215,126
Income or expense (-) on settled properties	-5,693,911	-1,427,473	-4,266,438
Miscellaneous income	446,874	83,965	362,909
Total income	715,129,882	541,315,[illegible]	173,814,403
Expense			
Salaries and expenses	264,952,376	201,798,497	63,153,881
Interest on borrowings from U. S. Treasury	389,438,664	202,972,621	186,466,043
Interest on debenture obligations	42,621,658	30,150,803	12,470,855
Loss on acquired security	736,011,462	600,907,019	135,104,443
Loss on defaulted Title I notes	9,570,505	6,258,520	3,311,985
Discount on sale of Secretary-held mortgages	157,527	689,344	-531,817
Fee expenses	14,727,002	3,984,937	10,742,065
Structural defects	8,944,073	1,007,070	7,937,003
Miscellaneous expense	1,493,271	-282,625	1,775,896
Total expense	1,467,916,540	1,047,486,186	420,430,354
Net income or loss (-) before adjustment of valuation allowances	-752,786,658	-506,170,707	-246,615,951
Increase (-) or Decrease in Valuation Allowances			
Allowance for estimated future losses on:			
Purchase money mortgages	-3,168,669	-2,451,181	-717,488
Acquired properties	125,059,822	-9,102,252	134,162,074
Defaulted mortgage notes	-439,682,944	-225,403,232	-214,279,712
Defaulted Title I notes	-9,709,279	-9,824,771	115,492
Other notes receivable	13,500	-102,557	116,057
Insurance premiums receivable	775,000	-437,500	1,212,500
Fees receivable	-682,000	-	-682,000
Net adjustment of valuation allowances	-327,394,570	-247,321,493	-80,073,077
Net income or loss (-)	$-1,080,181,228	$ -753,492,200	$ -326,689,028
ANALYSIS OF APPROPRIATIONS, RESERVES AND BORROWINGS			
Appropriated Capital			
Appropriated capital - loss on acquired securities	$ 142,500,000	$ -	$ 142,500,000
Total appropriated capital	142,500,000	-	142,500,000
Statutory Reserve (participating reserve account):			
Balance at beginning of period	432,007,206	362,509,138	69,498,068
Net income allocated for the period 2/	184,538,568	112,736,027	71,[illegible]2,541
Transfer from general surplus account	-	1,736,902	-1,736,902
Total participating reserve	616,545,774	476,982,067	139,563,707
Participations declared (-)	-56,827,729	-44,964,367	-11,863,362
Participations available	559,718,045	432,017,700	127,700,345
Changes in participations held in escrow	-22,476	-10,494	-11,982
Balance at end of period	559,695,569	432,007,206	127,688,363
Insurance Reserve:			
Balance at beginning of period	-614,632,243	249,608,029	-864,240,272
Adjustments during the period 1/	12,125,666	3,724,857	8,400,809
Net loss for the period 2/	-1,264,719,796	-866,228,227	-398,491,569
Transfer to participating reserve account	-	-1,736,902	1,736,902
Balance at end of period	-1,867,226,373	-614,632,243	-1,252,594,130
Total reserves	-1,307,530,804	-182,625,037	-1,124,905,767
Borrowings from U. S. Treasury:			
Balance at beginning of period	3,677,268,000	2,462,000,000	1,215,268,000
Borrowings during the period	1,201,000,000	1,215,268,000	-14,268,000
Balance at end of period	4,878,268,000	3,677,268,000	1,201,000,000
Total appropriations, reserves and borrowings at end of period	$ 3,713,237,196	$3,494,642,963	$ 218,594,233

1/ Comprised of the following adjustments relative to prior years:	1976	1975	Increase or Decrease (-)
(a) Salaries and expenses	$ 8,936,000	$ 3,919,000	$ 5,017,000
(b) Interest on debenture obligations	2,452,077	-	2,452,077
(c) Allowance for insurance premiums receivable	562,500	-	562,500
(d) Allowance for purchase money mortgages	175,089	-	175,089
(e) Fee income	-	-437,159	437,159
(f) Loss on Title I notes	-	243,016	-243,016
	$ 12,125,666	$ 3,724,857	$ 8,400,809

2/ The net income was distributed to the statutory and/or the insurance reserve by the Assistant Secretary-Commissioner, HUD, FHA under authority of Sections 205 and 213 of the National Housing Act.

SCHEDULE 3

FEDERAL HOUSING ADMINISTRATION
COMBINED BALANCE SHEET: ANALYSIS BY FUND AS OF SEPT. 30, 1976

ASSETS	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund
CASH AND FUND BALANCES:						
Cash on hand and in transit	$ -17,291,704.75	$ 17,025.16	$ 361,333.13	$ 140,101.58	$ -	$-17,810,164.62
Fund balances with U. S. Treasury	225,276,205.67	71,885,014.93	81,740,712.19	780,804.90	50,584,481.30	20,285,192.35
Total cash and fund balances	207,984,500.92	71,902,040.09	82,102,045.32	920,906.48	50,584,481.30	2,475,027.73
ACCOUNTS RECEIVABLE:						
Premiums						
Public	42,180,025.64	24,743,550.44	8,654,691.34	190,648.63	8,591,135.23	-
Less: Allowance for estimated future losses	4,500,000.00	4,500,000.00	-	-	-	-
Net premiums - public	37,680,025.64	20,243,550.44	8,654,691.34	190,648.63	8,591,135.23	-
Government agencies	5,673,116.35	-	5,670,698.43	-	2,417.92	-
Fees	5,805,658.80	5,443,808.80	334,500.00	-	27,350.00	-
Less: Allowance for estimated future losses	682,000.00	682,000.00	-	-	-	-
Net fees	5,123,658.80	4,761,808.80	334,500.00	-	27,350.00	-
Sale of Secretary-held properties:						
Public	9,505,618.88	1,371.70	5,519,845.70	-	3,984,401.48	-
Sale of Secretary-held mortgages:						
Public	1,337,578.39	457,309.47	107,513.29	-	772,755.63	-
Other:						
Government agencies	273,719.11	1,478.37	258,463.62	-	-	13,777.12
Public	852,699.86	31,767.44	660,587.87	-	151,181.37	9,163.18
Advances to SRI Fund from GI Fund	20,000,000.00	-	20,000,000.00	-	-	-
Total accounts receivable	80,446,417.03	25,497,286.22	41,206,300.25	190,648.63	13,529,241.63	22,940.30
ACCRUED ASSETS:						
Premiums	146,764,148.39	109,635,411.92	19,824,515.83	-	17,304,120.64	-
Interest on U. S. Government securities	24,067,523.19	23,790,068.32	-	277,454.87	-	-
Interest on mortgage notes receivable	117,550,049.30	1,013,924.99	95,020,550.15	774,119.31	20,741,454.85	-
Total accrued assets	288,381,720.88	134,439,405.23	114,845,165.98	1,051,574.18	38,045,575.49	-
INVESTMENTS:						
U. S. Government securities at amortized cost	1,692,282,272.99 1/	1,663,686,560.53	-	28,595,712.46	-	-
Stock in rental and cooperative housing corporations: 127,084 shares at cost	145,500.00	-	123,900.00	21,600.00	-	-
Total investments	1,692,427,772.99	1,663,686,560.53	123,900.00	28,617,312.46	-	-
MORTGAGE NOTES AND CONTRACTS FOR DEED--UNPAID BALANCE	430,946,191.79	23,726,063.09	381,670,210.41	4,645,404.30	20,904,513.99	-
Less allowance for estimated future losses	24,573,217.00	613,986.00	22,840,343.00	232,270.00	886,618.00	-
Net mortgage notes and contracts for deed	406,372,974.79	23,112,077.09	358,829,867.41	4,413,134.30	20,017,895.99	-
ACQUIRED SECURITY OR COLLATERAL:						
Acquired property - at cost plus net expenses to date	1,309,658,788.11	265,971,220.14	587,552,137.93	3,255,439.24	452,879,990.80	-
Defaulted mortgage notes - at cost plus net expenses to date	2,715,793,842.48	15,058,761.53	1,958,584,674.68	12,639,468.99	729,510,937.28	-
Defaulted Title I notes--at unpaid principal balance	76,877,983.89	-	76,877,983.89	-	-	-
Total cost of acquired security or collateral	4,102,330,614.48	281,029,981.67	2,623,014,796.50	15,894,908.23	1,182,390,928.08	-
Less principal recoveries on defaulted mortgage notes	66,941,694.20	2,009,658.84	62,807,017.28	677,466.12	1,447,551.96	-
Less undisbursed mortgage proceeds	2,414,247.94	-	2,414,247.94	-	-	-
Unrecovered cost	4,032,974,672.34 2/	279,020,322.83	2,557,793,531.28	15,217,442.11	1,180,943,376.12	-
Less allowance for estimated future losses on acquired properties	739,407,940.00	135,486,909.00	349,931,174.00	1,955,465.00	252,034,392.00	-
Less allowance for estimated future losses on defaulted mortgage notes	1,188,032,989.00	8,775,912.00	811,473,080.00	3,776,968.00	364,007,029.00	-
Less allowance for estimated future losses on defaulted Title I notes	68,354,527.00	-	68,354,527.00	-	-	-
Total allowance for estimated future losses	1,995,795,456.00	144,262,821.00	1,229,758,781.00	5,732,433.00	616,041,421.00	-
Net acquired property and notes	2,037,179,216.34	134,757,501.83	1,328,034,750.28	9,485,009.11	564,901,955.12	-
Other notes receivable	1,158,351.55	268,775.00	49,064.55	-	840,512.00	-
Less allowance for estimated future losses	332,994.00	244,037.00	4,906.00	-	84,051.00	-
Net other notes receivable	825,357.55	24,738.00	44,158.55	-	756,461.00	-
Net acquired security or collateral	2,038,004,573.89	134,782,239.83	1,328,078,908.83	9,485,009.11	565,658,416.12	-
OTHER ASSETS-HELD FOR THE ACCOUNT OF MORTGAGORS	2,539,607.28 3/	-	2,443,537.88	-	96,069.40	-
DEFERRED CHARGES	283,012.84	42,442.85	14,855.29	-	221,143.08	4,571.62
Total assets	$4,716,440,580.62	$2,053,462,051.84	$1,927,644,560.96	$44,678,585.16	$ 688,152,823.01	$ 2,502,539.65

1/ Investment include debentures of FHA insurance funds in the amount of $51,969,100.00 and GNMA participation certificates in the amount of $134,734,767.44 purchased as an investment by the Mutual Mortgage Insurance Fund.

2/ Includes 1 Department of Defense multifamily mortgage as follows:

Cost less net income	$197,905.68
Less principal recoveries	158,661.27
Unrecovered cost	$ 39,244.41

3/ Includes $2,573,500.00 par value of U. S. Securities purchased by FHA from mortgagors' funds in the Reserve Fund for Replacements and/or Special Escrow Accounts.

The notes on page 40 are an integral part of this statement.

SCHEDULE 3

LIABILITIES	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund
ACCOUNTS PAYABLE:						
Acquired security and miscellaneous:						
Government agencies	$ 9,247,576.95	$ 808,305.95	$ 6,739,494.26	$ -	$ 1,699,776.74	$ -
Public	74,389,266.82	15,154,139.54	27,521,508.07	1,322.45	31,712,296.76	-
Participations payable	41,637,169.23	41,637,169.23	-	-	-	-
Advances from GI Fund to SRI Fund	20,000,000.00	-	-	-	20,000,000.00	-
Inter-fund (receivables(-))	-	-892,755.45	71,430.25	5,577.00	760,240.44	55,507.76
Total accounts payable	145,274,013.00	56,706,859.27	34,332,432.58	6,899.45	54,172,313.94	55,507.76
ACCRUED LIABILITIES:						
Interest on debentures:						
Government agencies	1,094,571.93	-	984,929.43	109,642.50	-	-
Public	10,015,748.99	51,007.58	9,646,123.88	318,617.53	-	-
Interest on funds advanced:						
Government agencies	87,567,348.17	-	51,888,258.46	-	35,679,089.71	-
Total accrued liabilities	98,677,669.09	51,007.58	62,519,311.77	428,260.03	35,679,089.71	-
TRUST AND DEPOSIT LIABILITIES:						
Deposits held for mortgagors and lessors	30,608,164.20	188,677.02	22,232,273.60	445,532.91	7,741,680.67	-
Earnest money on pending sales	6,544,876.60	3,365,299.90	648,892.48	4,200.00	2,526,484.22	-
General fund receipts in process of deposit	-38.00	-	-	-	-	-38.00
Excess proceeds of sale:						
Government agencies	317,212.32	-	272,097.12	44,649.61	465.59	-
Public	3,869,381.97	-	3,869,381.97	-	-	-
Total trust and deposit liabilities	41,339,597.09	3,553,976.92	27,022,645.17	494,382.52	10,268,630.48	-38.00
DEFERRED CREDITS:						
Unearned premium income	55,770,021.06	995,793.62	35,064,134.37	2,046,393.20	17,663,699.87	-
Unearned fee income	1,920,474.82	-	1,872,515.24	-	47,959.58	-
Unapplied credits	10,106,620.93	335,617.37	6,501,296.37	275,134.45	547,502.85	2,447,069.89
Total deferred credits	67,797,116.81	1,331,410.99	43,437,945.98	2,321,527.65	18,259,162.30	2,447,069.89
DEBENTURE OBLIGATIONS:						
Debentures issued and outstanding:						
Government agencies	88,754,300.00	-	81,671,800.00	7,082,500.00	-	-
Public	490,014,450.00	5,576,600.00	472,045,550.00	12,392,300.00	-	-
Total issued and outstanding	578,768,750.00	5,576,600.00	553,717,350.00	19,474,800.00	-	-
Debentures authorized for issue:						
Government	1,284,150.00	-	1,284,150.00	-	-	-
Public	9,390,450.00	-	9,390,450.00	-	-	-
Total authorized for issue	10,674,600.00	-	10,674,600.00	-	-	-
Debenture claims in process:						
Government agencies	1,971,750.00	-	1,971,750.00	-	-	-
Public	34,052,750.00	-	34,052,750.00	-	-	-
Total in process	36,024,500.00	-	36,024,500.00	-	-	-
Total debenture obligations	625,467,850.00	5,576,600.00	600,416,450.00	19,474,800.00	-	-
OTHER LIABILITIES:						
Reserve for foreclosure costs - defaulted mortgage notes	24,647,138.70	-	16,743,818.68	182,428.45	7,720,891.57	-
Total liabilities	$ 1,003,203,384.69	$ 67,219,854.76	$ 784,472,604.18	$22,908,298.10	$ 126,100,088.00	$2,502,539.65
APPROPRIATIONS, RESERVES AND BORROWINGS FROM U. S. TREASURY						
APPROPRIATED CAPITAL:						
Appropriated capital - loss on acquired securities	142,500,000.00	-	42,500,000.00	-	100,000,000.00	-
Total appropriated capital	142,500,000.00	-	42,500,000.00	-	100,000,000.00	-
RESERVES:						
Statutory reserve - for participation payments and future losses	559,695,568.37	554,819,845.39	-	4,875,722.98	-	-
Insurance reserve - available for future losses and expenses	-1,867,226,372.44	1,431,422,351.69	-1,746,596,023.22	16,894,564.08	-1,568,947,264.99	-
Total reserves	-1,307,530,804.07	1,986,242,197.08	-1,746,596,023.22	21,770,287.06	-1,568,947,264.99	-
BORROWINGS FROM U. S. TREASURY	4,878,268,000.00	-	2,847,268,000.00	-	2,031,000,000.00	-
Total appropriations, reserves and borrowings from U. S. Treasury	3,713,237,195.93	1,986,242,197.08	1,143,171,976.78	21,770,287.06	562,052,735.01	-
Total liabilities appropriations, reserves and borrowings from U. S. Treasury	$ 4,716,440,580.62	$2,053,462,051.84	$ 1,927,644,580.96	$44,678,585.16	$ 688,152,823.01	$2,502,539.65

FEDERAL HOUSING ADMINISTRATION
COMBINED STATEMENT OF INCOME AND EXPENSE AND CHANGES IN INSURANCE RESERVES
AND BORROWINGS: ANALYSIS BY FUND FOR THE FISCAL YEAR ENDED SEPT. 30, 1976

	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund
INCOME AND EXPENSE					
INCOME:					
Fees	$ 44,473,890	$ 25,131,100	$ 16,490,519	$ 48,424	$ 2,803,847
Premiums	526,861,914	304,603,417	131,397,800	4,573,717	86,286,980
Interest on U. S. Government securities and dividends	146,[illegible],795	144,442,466	1,069	2,243,260	-
Interest income	2,354,320	619,130	1,343,021	-	392,169
Income or expense (-) on settled properties	-5,693,911	-2,106,018	-2,232,857	-	-1,[illegible]
Miscellaneous income	446,874	181,987	170,151	-	94,736
Total income	715,129,882	472,872,082	147,169,703	6,865,401	88,222,696
EXPENSE:					
Salaries and expenses	264,952,378	136,398,152	69,813,134	258,099	58,482,993
Interest on borrowings from U. S. Treasury	389,438,664	-	223,231,446	-	166,207,218
Interest on debenture obligations	42,621,658	262,042	41,079,981	1,279,635	-
Loss on acquired security	736,011,462	175,185,755	259,877,523	-344,831	301,293,015
Loss on defaulted Title I notes	9,570,505	-	9,570,505	-	-
Discount on sale of Secretary-held mortgages	157,527	53,421	9,370	-	94,736
Fee expenses	14,727,002	13,411,270	967,047	-	348,685
Structural defects	8,944,073	97,926	4,930	-	8,841,217
Miscellaneous expense	1,493,271	69,047	1,[illegible]22,373	-	201,851
Total expense	1,467,916,540	325,477,613	605,776,309	1,192,903	535,469,715
Net income or loss (-) before adjustment of valuation allowances	-752,786,658	147,394,469	-458,606,606	5,672,498	-447,247,019
INCREASE (-) OR DECREASE (+) IN VALUATION ALLOWANCES:					
Allowance for estimated future losses on:					
Purchase money mortgages	-3,168,669	-24,627	-2,708,058	12,630	-448,614
Acquired properties	125,059,822	34,512,897	21,015,684	-959,454	70,490,695
Defaulted mortgage notes	-439,682,944	-1,681,500	-262,302,816	18,473	-175,717,101
Defaulted Title I notes	-9,709,279	-	-9,709,279	-	-
Other notes receivable	13,500	182	-	-	13,318
Insurance premiums receivable	775,000	275,000	500,000	-	-
Fees receivable	-682,000	-682,000	-	-	-
Net adjustment of valuation allowances	-327,394,570	32,399,952	-253,204,469	-928,351	-105,661,702
Net income or loss (-)	$-1,080,181,228	$ 179,794,421	$ -711,811,075	$ 4,744,147	$ -552,908,721
ANALYSIS OF APPROPRIATIONS, RESERVES AND BORROWINGS					
APPROPRIATED CAPITAL					
Appropriated capital - loss on acquired securities	$ 142,500,000	$ -	$ 42,500,000	$ -	$ 100,000,000
Total appropriated capital	142,500,000	-	42,500,000	-	100,000,000
STATUTORY RESERVE (PARTICIPATING RESERVE ACCOUNT):					
Balance at beginning of period	432,007,206	428,070,349	-	3,936,857	-
Net income allocated for the period 2/	184,538,568	179,794,421	-	4,744,147	-
Total participating reserve	616,545,774	607,864,770	-	8,681,004	-
Participations declared (-)	-56,827,729	-53,044,924	-	-3,782,805	-
Participations available	559,718,045	554,819,846	-	4,898,199	-
Changes in participations held in escrow	-22,476	-	-	-22,476	-
Balance at end of period	559,695,569	554,819,846	-	4,875,723	-
INSURANCE RESERVE:					
Balance at beginning of period	-614,632,243	1,445,860,695	-1,041,327,855	16,679,102	-1,035,844,185
Adjustments during the period 1/	12,125,666	-14,438,344	6,542,907	215,462	19,805,641
Net loss (-) for the period 2/	-1,264,719,796	-	-711,811,075	-	-552,908,721
Balance at end of period	-1,867,226,373	1,431,422,351	-1,746,596,023	16,894,564	-1,568,947,265
Total reserves or deficit (-)	-1,307,530,804	1,986,242,197	-1,746,596,023	21,770,287	-1,568,947,265
BORROWINGS FROM U. S. TREASURY					
Balance at beginning of period	3,677,268,000	-	2,037,268,000	-	1,640,000,000
Borrowings during the period	1,201,000,000	-	810,000,000	-	391,000,000
Balance at end of period	4,878,268,000	-	2,847,268,000	-	2,031,000,000
Total appropriations, reserves and borrowings at end of period	$ 3,713,237,196	$1,986,242,197	$ 1,143,171,977	$21,770,287	$ 562,052,735

1/ Comprised of the following adjustments relative to prior years:

	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund
1. Salaries and expenses	$ 8,936,000	$ -15,006,475	$ 3,987,704	$ 149,130	$ 19,805,641
2. Interest on debenture obligations	2,452,077	5,631	2,380,114	66,332	-
3. Allowance for insurance premiums receivable	562,500	562,500	-	-	-
4. Allowance for purchase money mortgages	175,089	-	175,089	-	-
	$ 12,125,666	$ -14,438,344	$ 6,542,907	$ 215,462	$ 19,805,641

2/ The net income was distributed to the statutory and/or the insurance reserve by the Assistant Secretary-Commissioner, HUD, FHA under authority of Section 205 and 213 of the National Housing Act.

SCHEDULE 5

FEDERAL HOUSING ADMINISTRATION

COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1976

SOURCE OF FUNDS	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund
Funds provided by operations:						
Income:						
Fees	$ 43,791,890.42	$ 24,449,150.00	$ 16,490,469.24	$ 48,[illegible]23.60	$ 2,803,847.58	$ -
Premiums	527,636,914.50	304,878,393.44	131,897,823.88	4,573,717.29	86,286,979.89	-
Interest on U.S. Government securities	146,685,726.27	144,442,465.81	-	2,243,260.46	-	-
Dividends received on stock held in rental and cooperative housing corporations	1,069.30	-	1,069.30	-	-	-
Interest on mortgage notes	1,245,310.39	619,129.53	234,011.92	-	392,168.94	-
Interest and other income on defaulted Title I notes	1,109,009.28	-	1,109,009.28	-	-	-
Miscellaneous income	446,873.39	181,987.31	170,150.55	-	94,735.53	-
Total income	720,916,793.55	474,571,126.09	149,902,534.17	6,865,401.35	89,577,731.94	-
Realization of assets:						
Proceeds from sale of properties	805,537,818.40	223,439,252.74	200,949,517.50	-36,000.00	381,185,048.16	-
Recoveries on assigned notes	18,396,986.31	661,608.13	15,794,798.73	172,691.86	1,767,887.59	-
Recoveries on defaulted Title I Notes	6,289,776.31	-	6,289,776.31	-	-	-
Proceeds from sale of purchase money mortgages	3,520,460.00	1,406,835.00	232,100.00	-	1,881,525.00	-
Collections of principal on purchase money mortgages	6,963,679.00	1,374,459.43	4,976,541.44	18,588.12	594,090.01	-
Redemption or transfer of stock in rental and cooperative housing corporations	13,100.00	-	13,100.00	-	-	-
Total realization of assets	840,721,820.02	226,882,155.30	228,255,833.98	155,279.98	385,428,550.76	-
Prior fiscal year adjustments	11,950,577.02	-14,438,343.62	6,367,817.72	215,462.17	19,805,640.75	-
Total funds provided by operations	$1,573,589,190.59	$687,014,937.77	$ 384,526,185.87	$ 7,236,143.50	$494,811,923.45	$ -
Funds provided by financing:						
Debentures issued	$ 163,369,100.00	$ -	$ 162,293,650.00	$ 1,075,450.00	$ -	$ -
U.S. Securities redeemed, sold and/or transferred (par)	149,410,000.00	143,388,000.00	1,694,000.00	4,328,000.00	-	-
Principal collections on Defense Family housing securities	19,053.97	-	19,053.97	-	-	-
Borrowings from U.S. Treasury	1,201,000,000.00	-	810,000,000.00	-	391,000,000.00	-
Appropriation	142,500,000.00	-	42,500,000.00	-	100,000,000.00	-
Total funds provided by financing	$1,656,298,153.97	$143,388,000.00	$1,016,506,703.97	$ 5,403,450.00	$491,000,000.00	$ -
Total source of funds	$3,229,887,344.56	$830,402,937.77	$1,401,032,889.84	$12,639,593.50	$985,811,923.45	$ -

	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund
APPLICATION OF FUNDS:						
Funds applied to operations:						
Expenses:						
Salaries and expenses	$ 264,952,377.60	$136,398,151.80	$ 69,813,134.11	$ 258,098.73	$ 58,482,992.96	$ -
Interest on borrowings from U.S. Treasury	389,438,663.86	-	223,231,446.02	-	166,207,217.84	-
Interest on debenture obligations	42,621,658.66	262,042.27	41,079,981.48	1,279,634.91	-	-
Repairs of structural defects	8,944,073.26	97,925.99	4,930.13	-	8,841,217.14	-
Discount on sale of Secretary-held mortgages	157,527.15	53,421.20	9,370.44	-	94,735.51	-
Fee expenses	14,727,001.84	13,411,270.48	967,046.50	-	348,684.86	-
Expense on settled properties	5,693,911.40	2,106,018.00	2,232,857.46	-	1,355,035.94	-
Miscellaneous expenses	1,493,270.65	69,047.11	1,222,372.60	-	201,850.94	-
Total expenses	728,028,484.42	152,397,876.85	338,561,138.74	1,537,733.64	235,531,735.19	-
Acquisition of assets:						
Real property acquired including net capitalized expenses	974,838,694.28	332,330,426.42	269,299,099.65	-227,225.35	373,436,393.56	-
Assigned notes acquired including net capitalized expenses	1,038,459,642.21	4,841,950.23	669,567,051.99	-526,298.83	364,576,938.82	-
Defaulted Title I notes acquired	29,336,356.70	-	29,336,356.70	-	-	-
Total acquisition of assets	2,042,634,693.19	337,172,376.65	968,202,508.34	-753,524.18	738,013,332.38	-
Mutual participations	56,850,205.61	53,044,923.92	-	3,805,281.69	-	-
Increase or decrease (-) in working capital applicable to operations	$ -23,320,181.51	$ 1,148,198.46	$ 24,057,713.96	$ -150,989.51	$ -28,433,026.83	$-19,942,077.59
Total funds applied to operations	$ 2,804,193,201.71	$543,763,375.88	$1,330,821,361.04	$ 4,438,501.64	$ 945,112,040.74	$-19,942,077.59
Funds applied to financing:						
Debentures redeemed	$ 72,104,000.00	$ 467,650.00	$ 70,538,050.00	$ 1,098,300.00	$ -	$ -
U.S. Securities acquired (par)	254,422,000.00	245,176,000.00	1,371,000.00	7,778,000.00	97,000.00	-
Increase or decrease (-) in working capital applicable to financing	99,168,142.85	40,996,161.89	-1,697,771.20	-675,208.14	40,602,882.71	19,942,077.59
Total funds applied to financing	$ 425,694,142.85	$286,639,811.89	$ 70,211,278.80	$ 8,201,091.86	$ 40,699,882.71	$ 19,942,077.59
Total application of funds	$ 3,229,887,344.56	$830,403,187.77	$1,401,032,639.84	$12,639,593.50	$ 985,811,923.45	$ -
Net budgetary receipts or expenditures (-)						
Total funds provided by operations	$ 1,573,589,190.59	$687,014,937.77	$ 384,526,185.87	$ 7,236,143.50	$ 494,811,923.45	$ -
Total funds applied to operations	2,804,193,201.71	543,763,375.88	1,330,821,361.04	4,438,501.64	945,112,040.74	-19,942,077.59
Net budgetary receipts or expenditures (-)	$-1,230,604,011.12	$143,251,561.89	$ -946,295,175.17	$ 2,797,641.86	$-450,300,117.29	$ 19,942,077.59

SCHEDULE 5

NOTES TO COMBINED BALANCE SHEETS

SEPTEMBER 30, 1976 AND JUNE 30, 1975

1. Investments include GNMA participation certificates in the amount of $134,734,767.44 at September 30, 1976 and $134,383,630.26 at June 30, 1975 plus debentures of FHA Insurance Funds in the amount of $51,969,100.00 at September 30, 1976 and June 30, 1975 purchased as an investment by the Mutual Mortgage Insurance Fund.

2. The following items are not recorded in the assets:

   (a) Properties and notes tendered by Mortgagees but not accepted by FHA in the amount of $207,451,050.27 at September 30, 1976 and $316,304,112.66 at June 30, 1975.

   (b) Estimated accrued interest receivable--collection doubtful--on defaulted Title I notes at September 30, 1976 and June 30, 1975.

		1976	1975
On notes with principal balances		$17,544,550.72	$14,469,135.83
On notes with principal balances paid - interest due		2,682,046.84	2,211,906.17
	Total	$20,226,597.56	$16,681,042.00

3. The following items are not recorded in the liabilities:

   (a) Unfilled orders and incompleted portion of contracts for property repairs in the amount of $4,348,682.22 at September 30, 1976 and $11,662,938.34 for incompleted portion of contracts for property repairs at June 30, 1975.

   (b) Contingent liability with respect to pending lawsuits in the amount of $1,213,063.21 at September 30, 1976 and $1,938,002.50 at June 30, 1975.

   (c) Pending claims on properties and notes tendered by mortagees but not accepted by FHA in the amount of $207,451,050.27 at September 30, 1976 and $316,304,112.66 at June 30, 1975.

   (d) Certificates of claim relating to properties and notes tendered by mortgagees but not accepted by FHA in the amount of $1,892,652.29 at September 30, 1976 and $2,671,182.54 at June 30, 1975.

   (e) Certificates of claim relating to acquired security on hand of $62,075,437.51 at September 30, 1976 and $40,237,274.39 at June 30, 1975.

4. The amount shown as "Borrowings from U.S. Treasury" includes $2,847,268,000 advanced to the General Insurance Fund and $2,031,000,000 advanced to the Special Risk Insurance Fund.

5. Residual of Reserves is equity of the Government upon the liquidation of all claims and settlement of contractual obligations.

6. The maximum liability for outstanding FHA insurance contracts in force at September 30, 1976 and June 30, 1975 was:

		1976	1975
Mortgage Insurance Programs		$86,037,469,584.00	$84,954,373,799.00
Modernization and Improvement Programs (Title I, Section 2)		490,177,921.00	469,185,711.00
	Total	$86,527,647,505.00	$85,423,559,510.00

7. The liabilities shown for the "Deposits held for mortgagors and lessees" is net of escrow advances by FHA in the amount of $19,672,731.74 at September 30, 1976 and $9,606,866.97 at June 30, 1975.

8. The FHA in special circumstances is indemnified against loss on certain insured mortgages and assigned mortgage notes up to $691,712.19 at September 30, 1976 and $600,419.23 at June 30, 1975.

9. The Estimated Insurance Reserve Requirements at September 30, 1976 are:

Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund
$2,715,707,000	$1,208,909,000	$804,300,000	$6,698,000	$696,800,000

APPENDIXES

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR ADMINISTRATION

JAN 27 1978

Mr. Henry Eschwege
Director
Community and Economic
Development Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

We have reviewed the findings and recommendations in the Draft Report on Examination of Financial Statements Pertaining to Insurance Operations of the Federal Housing Administration for the 15-Month Period Ended September 30, 1976. We do not agree with several of your audit findings and our comments in detail are set forth below in the same order as presented in the report.

1. The Report Cover Summary inaccurately states that GAO could not determine whether FHA's financial statements presented fairly the financial position of FHA at September 30, 1976 because accounts involving millions of dollars were not reconciled to detail supporting records. The Summary also implies that accounting failures resulted in a $1.1 billion loss during this period. It creates, perhaps unintended, a correlation between the millions of dollars involved in the alleged inadequate accounting procedures and the $1.1 billion loss. It further ignores the 25% inflation in the figures caused by the 15-month period under review as contrasted to normal 12-month periods and directs attention to profits and losses as a measure of accomplishment, or lack of accomplishment, although two of the four insurance funds were never intended to be self-supporting. In addition, the summary and the report overlook interest costs on money borrowed to pay insurance claims. Interest costs are approaching twice the income from all sources (total income) for the General Insurance and Special Risk Insurance Funds, thereby becoming a major factor in losses from operations. After consideration of our comments on the Report Cover Summary and our detail comments below, the Report Cover Summary and Digest should be substantially revised.

2. Page 15 of the report states that the GAO examination disclosed that FHA had not established and followed adequate internal control procedures for reconciling financial transactions and year-end balances to its supporting detail records. The procedures followed during the 15-month period were the same as those that have been followed for many years. These procedures were established with GAO guidance and have been acceptable to prior GAO audit teams. In many areas, the level of detail desired by the GAO could not be produced in the exact manner desired although other forms were available. Audit trails were neither pursued nor accepted as an alternate to manually producing detail listings desired. There are numerous detail records reflecting the transactions during the year. These daily, weekly and monthly records and reconcilements are available to assure that the data are summarized and recorded into the general books of account. To duplicate this reconcilement by producing manually detailed listings of data for the convenience of a GAO audit team would require resources not available.

3. We agree that $6.5 million of insurance claims payable were not reconciled at September 30, 1976. The total claims payable, claims paid and debenture transactions are reconciled to the asset accounts. Although these totals are in agreement, we are in the process of reconciling the individual accounts and will make this data available to your audit team.

4. The current and long-standing procedures for appraisal fees payable (page 16) requires the area/insuring offices to maintain the detail records of fee appraisals assigned and completed and they are also responsible for certifying as to the validity of the payment of the fees on SF-1034. Each field office furnishes a monthly summary report of activity to the Central Office. These reports are combined by insurance fund to develop the accounts payable for appraisal fees. It is an accepted GAO practice for detail records to be maintained in a decentralized location. Although the amounts payable are not maintained by area/insuring office, the reports are available for GAO to reconcile with the area/insuring office detail records. There is no evidence that GAO attempted to test these records. We request that this item be removed from the report.

5. There was, in fact, a $200,000 difference in the dividends payable (distributive shares) at September 30, 1976 (page 17). The discrepancy was caused by the incompatability of the two separate ADP systems processing this activity. Our employees and supervisory staff should have detected the discrepancies and taken timely

corrective action. These differences were resolved and the records were adjusted prior to September 30, 1977. Dividends payable are now reconciled monthly.

6. The reserve for foreclosure costs (page 17) is reflected on each individual mortgage account card maintained for multifamily mortgage notes assigned. This reserve represents 1% of the unpaid balance of the mortgage at assignment. As the amount of reserve is reflected on each subsidiary account record, it has been acceptable to GAO in past audits. The reserve for foreclosure item was added to the trial balance statements at September 30, 1977 and is in agreement with the general ledger account. We request that this item be removed from the report.

7. As indicated in our comments on a previous GAO report dated September 8, 1977 (FGMSD-77-33) on premiums receivable (pages 18 to 20), we have taken several steps to improve the controls and processing of premiums receivable. Controls have been established to assure the accuracy of our master premium billing records. A special task force has been set up to reduce or eliminate the delinquent premiums. The majority of the problems in premiums receivable are system operational problems, rather than accounting control problems. The general ledger entries are made from summary billing totals which are supported by the detail premium billing books. The liquidations and cancellations are made from summary ADP reports supported by detail listings. The unreconciled difference of $2.1 million referred to on page 18 represents a difference between the general books of account and an ADP system generated "Total Outstanding Billing" report. There have been considerable difficulties in this report and we are in the process of determining the accuracy of this report based on the actual outstanding receivable cards. We anticipate complete reconcilation of this difference as resources can be diverted to the process. These comments are also applicable to the difference stated for Title I premiums receivable.

8.

[See GAO note 1, p. 45]

9. The deposits held for mortgagors referred to on page 20 may reflect the difference indicated. In order to expedite the recording of certain home mortgage notes assigned and related transactions, the

unpaid principal balance and escrow amounts were entered in the ADP system on an estimated basis with appropriate adjustments made at the time of final settlement of the claim. However, in the accounting records the unpaid principal balance was the only amount recorded. This procedure was instituted in 1976 and was necessary to cope with the large volume of assigned mortgage notes which could not be entered into the ADP system due to the lack of incomplete fiscal data. We will review this procedure further to assure that the general books of account are fully supported by the subsidiary records and provide clear audit trails.

10.

[See GAO note 1 below.]

11. The difference in fees receivable, on page 20, represents a difference between the general ledger and a summary fee report generated by the ADP system. There have been intermittent problems with the development of this "Total Outstanding Fees Report" and we plan to develop the outstanding fees receivable from the individual fees receivable cards. This report will then be used to reconcile the ADP system reports with the general ledger.

12. We have again reviewed the various supporting detail listings of mortgage notes assigned and our detail records are in agreement with the general ledger at September 30, 1976. There was no single listing that accounts for the difference reflected in the report. This statement is factually incorrect and should be deleted from the GAO report.

13. There are differences between the ADP system reports and the general ledger as to the balance of Title I Notes Receivable. We assume that the difference referred to on page 20 is applicable to the Title I defaulted notes resulting from the payment of Title I

GAO note 1: The deleted comments related to matters which were discussed in the draft report but have been omitted in the final report.

claims. We cannot identify the difference reflected in the GAO report. Further information and elaboration on the audut finding is requested.

14. The footnote on page 20 apparently refers to the premium comments on pages 18, 19 and 20. The statement that FHA did not record cancellations of premiums since 1972 is correct. This matter was corrected with adjustments of $3.6 million made to the books of account in February 1977. The failure to record premium cancellations was a result of unintentional clerical oversight of this important activity.

15. We agree with the comment on page 20A that reconciliation of monthly accounting transactions is an essential part of accounting control. Procedures have been in effect to assure this reconciliation, and we have also taken further steps to strengthen areas that need more attention in the area of ADP processing. There are well-established audit trails as backup for the ADP systems. GAO failed to pursue these audit trails. Established procedures for daily, weekly, monthly and annual reconciliations are now and will continue to be followed by those responsible for such reconciliations.

16. The reference on pages 21 and 22 to a substantial number of transactions not entered into the accounting records is applicable to the "Fiscal Control System." It was our understanding, after meetings with the GAO audit team, that this comment would be removed from the report. All transactions that fail the validity and edit checks are rejected and returned to the responsible area/insuring office for correction. In April 1977 a new procedure was established to monitor these transactions for reentry to the computer by the area/insuring office. The "suspense" items referred to in the report are those transactions that pass all edit and validity checks and are not processed on the master record because of the systems requirement for sequential processing of transactions. An example is where a mortgage endorsement transaction will not be accepted until a commitment issued transaction has been processed. This sequential processing requirement, in some cases, results in several transactions on the same case being delayed where an earlier transaction is rejected, by the computer, or is not submitted by the insuring office. The procedures for processing and monitoring hold-tape transactions are continuously under review and will receive further refinement in the interface of the Fiscal Control System with the CHUMS ADP System presently under development.

17. The comments on the reserve for future losses, page 24, indicate that the current method of computing the reserve is insufficient and that the value of acquired properties is overstated by at least $26 million. The GAO further states that the accounting practice of relating losses incurred in a fiscal year to the cost of properties sold in that year is not a sound basis for estimating future losses. We firmly believe this is an unfair criticism for the following reasons:

    a. This method of developing the allowance for future losses is an accounting practice that has been accepted by GAO for years with no written indications that it was considered unsound.

    b. The GAO report suggests that the time a property is held in inventory prior to sale has a significant impact on the loss incurred. The report does not, however, present any data to support their claim that the allowance for loss is actually understated.

    c. To add weight to their opinion, GAO refers to property reviews made on pages 26 and 27 which indicate that some properties held in inventory have no value. This analysis was based on a survey of blighted core areas of three larger cities. While we do not question the accuracy or value of these findings, they represent an entirely different dimension, and they are not an indication that FHA is using an unsound accounting technique for estimating future losses on our acquired properties. The planned HUDMAP concept for establishing property reserves is also based on loss experience for the previous 12-month period. However, the HUDMAP proposal will group the on-hand properties by field office jurisdiction, and within each field office by blighted and nonblighted areas.

18. The GAO comment on page 24, indicating that many more buildings were razed than were recognized in the accounting records, is based on a small sampling of the three largest areas of razed properties. Our inventory records were reconciled with the individual field offices at December 31, 1976. Our records, which are available for your review, indicate that less than 75 properties in the inventory were identified by the field offices as razed. Obviously, 20 of the properties identified were the same ones identified by GAO in their sampling. Based on our inventory reconciliation, this statement is factually incorrect and should be deleted from the GAO report.

19. The GAO comment on pages 25 and 26, regarding sold cases which were not recorded as sold at September 30, 1976, was substantiated by our December 31, 1976 reconciliation of the on-hand property inventory. Although all cases sold prior to September 30, 1976, and reported to OFA prior to October 31, 1976, were recorded into the general ledger, there were a number of cases where the local field offices failed to submit closing documents and therefore were not properly recorded. The reconciliation uncovered approximately 5,000 properties sold by the various field offices, which had never been reported to the Office of Finance and Accounting. A notice is presently in departmental clearance for timely submission of sales closing packages. This notice will be furnished to all regional, area and insuring offices. Another property reconciliation will be performed as at December 31, 1977 and at least annually thereafter.

In general, we believe that the tone of the GAO audit report reflects unfairly on the Department's mortgage insurance operations. It presents items as deficiencies and refers to a lack of internal controls for various accounting practices that have been acceptable to the General Accounting Office on site audit teams for many years. The report fails to recognize the generally accepted accounting practice of permitting estimating for those items that cannot be fully documented and recorded in order to meet the fiscal year-end closing deadlines. The report also ignores the fact that the Office of Finance and Accounting is under strict and extremely tight deadlines for closing of the books and reporting required accounting data to the Treasury Department in an environment consisting basically of a manual accounting operation. Time and resources are not available to provide the level of detail and additional data requested by the present GAO audit team.

The comments in this reply have been prepared under an extremely tight deadline of 8 working days from the date of receipt of the report and in some areas we have not had adequate time to review the data and comment to the extent we would prefer. In this regard, we will continue our detail review of the draft report and include other appropriate comments in our response to your final report when it is issued.

Sincerely,

William A. Medina

William A. Medina
Assistant Secretary

PRINCIPAL HUD AND FHA OFFICIALS RESPONSIBLE FOR THE ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF HOUSING AND URBAN DEVELOPMENT:		
Patricia R. Harris	Jan. 1977	Present
Carla A. Hills	Mar. 1975	Jan. 1977
ASSISTANT SECRETARY FOR HOUSING-FEDERAL HOUSING COMMISSIONER: 1/		
Lawrence B. Simons	Mar. 1977	Present
Morton A. Baruch (acting)	Mar. 1977	Mar. 1977
Joseph Burstein (acting)	Jan. 1977	Feb. 1977
John T. Howley (acting)	Dec. 1976	Jan. 1977
James L. Young	June 1976	Dec. 1976
ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT-FHA COMMISSIONER: 1/		
David S. Cook	Aug. 1975	June 1976
David M. deWilde (acting)	Dec. 1974	Aug. 1975
ASSISTANT SECRETARY FOR ADMINISTRATION:		
William A. Medina	May 1977	Present
Vincent J. Hearing (acting)	Nov. 1976	May 1977
Thomas G. Cody	May 1974	Nov. 1976
DIRECTOR, OFFICE OF FINANCE AND ACCOUNTING:		
Thomas J. O'Connor	May 1974	Present
DIRECTOR, MORTGAGE INSURANCE ACCOUNTING:		
Benjamin C. Tyner	Jan. 1973	Present

1/On June 14, 1976, HUD combined the functions of the Assistant Secretary for Housing Production and Mortgage Credit-FHA Commissioner and the Assistant Secretary for Housing Management under a single Office of Assistant Secretary for Housing-Federal Housing Commissioner.

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