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BY THE COMPTROLLER GENERAL

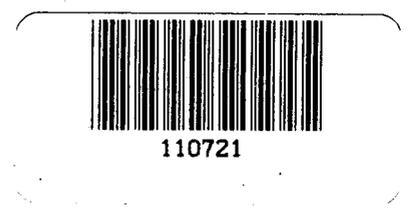
Report To The Congress

OF THE UNITED STATES

Examination Of The Financial Statements Of FHA Insurance Operations-- Fiscal Year 1978

GAO is not expressing an opinion on whether the financial statements pertaining to the insurance operations of the Federal Housing Administration present fairly its financial position at September 30, 1978. GAO made a similar report on FHA's financial statements for the 15-month period ended September 30, 1976.

GAO is not expressing an opinion because of problems relating to FHA's premium and fee accounts which have persisted for several years. FHA is trying to correct these problems and prevent their recurrence. FHA also needs to improve the accuracy of its accounting records.



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GED-80-6
OCTOBER 29, 1979



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 12-month period ended September 30, 1978. The report also includes 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 also 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 Secretaries for Housing--Federal Housing Commissioner and for Administration, Department of Housing and Urban Development.

James B. Stacks

Comptroller General
of the United States

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF THE FINANCIAL
STATEMENTS OF FHA
INSURANCE OPERATIONS--FISCAL
YEAR 1978

D I G E S T

During the fiscal year ended September 30, 1978, the Federal Housing Administration (FHA) reported a net loss of \$314.9 million in the operations of its four mortgage insurance funds. The loss is \$177.8 million less than the loss of the previous year. The insurance funds had a combined cumulative deficit of \$2.4 billion at September 30, 1978, primarily the result of cumulative losses in the General and Special Risk Insurance Funds. During fiscal year 1978 the Department of Housing and Urban Development borrowed \$440 million to pay claims filed against the General and Special Risk Insurance Funds and the Congress appropriated \$15 million to finance the cost of Urban Homestead Programs. (See p. 5 and sch. 4.)

GAO could not express an opinion on FHA's financial statements as of September 30, 1978. Similarly in the last report for the 15-month period ended September 30, 1976, GAO also did not express an opinion on the fairness of the financial position of the mortgage insurance funds because of a number of serious accounting deficiencies disclosed by the review. (See p. 18.)

GAO did not review the financial statements for fiscal year 1977 for the purpose of expressing an opinion because corrective actions could not be accomplished by September 30, 1977. Instead GAO monitored FHA's progress in correcting the accounting problems. During fiscal year 1978 FHA continued corrective action and improvements were made by September 30, 1978. Some of the financial statement balances previously not reconciled to detail records were reconciled and a large effort was initiated to review computerized premium and fee files to increase their accuracy and auditability. (See p. 6.)

However, FHA's major problems concerning the accountability of premiums and fees were not resolved at September 30, 1978, and substantial additional effort is needed before reliance on those accounting records may be achieved. Further, other accounting problems still persist despite efforts to make corrections. The problems resulted in over- or understatements of accounts and in undeterminable differences that need substantial research to correct. For the most part, the differences were caused by the many errors in accounting input data, large backlogs in processing accounting data, ADP problems, and to a degree, improper accounting procedures.

On August 21, 1979, GAO met with Department of Housing and Urban Development officials representing the Assistant Secretaries for Administration and for Housing. The officials agreed with GAO's findings. They explained that substantial efforts have been made to purify FHA's accounting data and that FHA has committed itself to additional substantial efforts and target dates to improve its accounting system. (See p. 7.)

A summary of the accounting deficiencies follows.

- The reasonableness of the \$35.8 million of premiums receivable and the \$469 million of premium income could not be established because the detailed records supporting these accounts were not adequate. (See p. 7.)
- The fees receivable and fee income account balances of \$8.6 and \$56 million, respectively, could not be verified because accounting input to these accounts contains numerous errors and because of a growing delinquency of fees receivable. (See p. 9.)
- FHA's defaulted home improvement loans recorded at \$107.2 million could not be verified because the centralized detailed records have not been reconciled to field detailed records and the computerized detailed listing was about \$1.1 million less than the financial statement balance. (See p. 10.)

- The value of the FHA's acquired property continues to be misstated because numerous property sales estimated at more than \$10 million were not recorded at September 30, 1978. (See p. 11.)
- Losses on the sale of the FHA's acquired property may be misstated because \$14 million of expenses paid by FHA cannot be matched to the applicable property. (See p. 11.)
- FHA's cash position at September 30, 1978, of about \$168.2 million does not agree with Treasury records as of year end. The difference amounted to about \$14 million. (See p. 12.)
- The \$22.5 million of receivables due from the sale of acquired property is overstated because many of the receivables had in fact been collected prior to September 30, 1978. (See p. 12.)
- FHA is unsure of the accuracy of its accounting entry for debenture interest expense and accrual of \$35.5 million and \$9.9 million because it did not reconcile the amounts to Treasury records. (See p. 13.)

The Department's Office of Inspector General performed a substantial amount of work on the mortgage insurance financial statements for the fiscal year ended September 30, 1978. GAO coordinated with the Office of Inspector General and utilized its review work, as appropriate. Several of the findings in this report resulted from the Office's efforts. As a result GAO was able to reduce the scope of its audit. (See p. 17.)

GAO does not plan to review FHA's financial statements for fiscal year 1979 for purposes of expressing an opinion. Instead GAO will concentrate on reviewing those areas where FHA is having difficulty with accounting controls or other accounting functions affecting its ability to produce reasonably accurate accounting records. (See p. 18.)

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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

Prospective home buyers had considerable difficulty arranging suitable financing terms before 1934. Home loans generally required large downpayments and offered short-term mortgages. As a result, few could afford to purchase a home and often many who did buy had problems making required payments. This situation prompted the Congress to pass the National Housing Act of 1934 (12 U.S.C. 1701 as amended) that created the Federal Housing Administration (FHA). FHA provided a much better way to buy a home. It offered mortgage lenders insurance on home loans that provided home buyers with low downpayments on long-term mortgages.

Although originally an independent agency, FHA is now a part of the Department of Housing and Urban Development (HUD). FHA's principal purposes are to

- encourage improvement in housing standards and conditions;
- provide an adequate home financing system through insurance of housing mortgages and credit; and
- exert a stabilizing influence on the mortgage market.

FHA is headed by the Assistant Secretary for Housing--Federal Housing Commissioner, who is appointed by the Secretary, HUD. For administrative purposes HUD has 10 regional offices including 80 area and service offices. Officials at these offices are responsible for writing all forms of FHA insurance.

FHA was made subject to the Government Corporation Control Act by the Housing Act of 1948. Accordingly we are required to audit FHA's financial statements at least once every 3 years.

THE MORTGAGE INSURANCE PROCESS

FHA's primary activity is to insure mortgage loans made by banks, savings and loan associations, mortgage companies and other FHA-approved lending institutions. FHA protects lenders against loss on mortgages which finance single-family homes, multifamily projects, and land development projects. It also provides insurance against loss on loans for property repairs and/or improvements. Borrowers are

charged annual mortgage insurance premiums, generally 0.5 percent of the outstanding principal balance.

Since 1934, FHA's records show that it has provided almost \$204 billion in insurance on more than 12.5 million small homes (one to four families) and about 27,800 multifamily projects. About \$13.3 billion of that amount was written during fiscal year 1978 to insure 319,450 small homes and 1,029 multifamily projects. As of September 30, 1978, FHA reported insurance in force of \$94 billion.

The mortgage insurance function gives rise to insurance claims by mortgagees. In settling claims, FHA obtains titles to foreclosed properties acquired by mortgagees after the home owners default. In other situations, FHA will obtain title to mortgage notes in lieu of foreclosure action. FHA maintains and sells acquired properties and in some cases becomes the mortgagee and takes back a mortgage on property it sells.

By September 30, 1978, FHA had acquired about 703,000 small homes and about 600 multifamily projects totaling about \$12.3 billion. In addition, FHA acquired mortgage notes at a cost of about \$4.8 billion on small homes and multifamily properties during the same period.

A summary of FHA property and mortgage notes on hand as of September 30, 1978 and 1977, as reported by FHA, follows.

Acquired Property and Assigned Mortgage Notes
On-Hand at

	<u>September 30, 1978</u>		<u>September 30, 1977</u>	
	<u>Small</u>	<u>Multifamily</u>	<u>Small</u>	<u>Multifamily</u>
	<u>homes</u>	<u>properties</u>	<u>homes</u>	<u>properties</u>
Number of acquired properties	28,701	443	29,164	409
Number of mortgage notes assigned	7,217	1,713	5,360	1,713

MORTGAGE INSURANCE FUNDS

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

MMIF

MMIF is the largest fund in terms of insurance written. It was established under section 202 of the act for insurance of mortgage loans on small homes. When the mortgages insured under this fund are paid in full, mortgagors are paid dividends from the premiums paid into the fund that are not required for expenses or losses. Thus the fund is "mutual." During fiscal year 1978 dividends were declared to homeowners of \$56.5 million, compared to \$37.9 million in fiscal year 1977.

CMHIF

CMHIF was established in 1965 under section 213 of the act. It insures mortgages that finance the purchase, construction, and/or rehabilitation of multifamily cooperative housing property. Also insured under this fund are supplementary loans that finance improvements or repairs of multifamily cooperative housing property or that provide funds for necessary community facilities. Like MMIF, CMHIF is a mutual fund. FHA-recorded dividends due to mortgagors from the participating reserve account amounted to \$3.5 million in fiscal year 1978, compared to \$3 million in fiscal year 1977.

GIF

GIF was established in 1965 under section 519 of the act. It includes single and multifamily programs. Its programs include insurance on loans for property repairs and improvements, basic and special purpose multifamily housing, and armed forces housing. This fund also insures loans for land development, group practice medical facilities, and nonprofit hospitals as well as insurance on supplemental loans for the financing of improvements and additions to multifamily projects and nursing homes. Many of the programs include high-risk insurance programs that might have been included in SRIF if it existed at that time.

SRIF

SRIF was created by the Housing and Urban Development Act of 1968. This fund carries out mortgage insurance obligations on mortgages covering property in older, declining urban areas that otherwise may not be eligible for mortgage insurance. Also covered are high-risk mortgagors who ordinarily may not be eligible for other FHA mortgage insurance. Mortgagors receiving interest reduction payments and mortgage loans on experimental housing, where State and local building regulations are not being strictly observed, also come under SRIF.

The deficits in both GIF and SRIF have been attributable to high-risk insurance programs covered under these funds.

CHAPTER 2

COMMENTS ON FINANCIAL STATEMENTS

The four FHA insurance funds function as revolving funds to 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. According to HUD, the insurance reserves of one fund are not available for the other funds' use except when authorized by the Congress.

Income to the funds is derived primarily from fees and premiums from insurance operations. In two funds that have cumulative earnings, interest income is earned from investments. The funds' expenses include insurance losses, interest on borrowings from the Treasury for two funds with operating deficits, debenture interest, and administrative expenses. In addition, provisions are made, as appropriate, for estimated future losses on various receivables and property owned by the funds. Schedule 2 shows the results of operation on a combined basis for all funds while schedule 4 presents the same data separately for each fund.

The accumulated difference between the income, including appropriations received, and items including expenses, losses, and provisions for estimated future losses on various assets, is considered to be the insurance reserves available to cover future insurance claims and administrative expenses of the individual funds. The financial position of the funds (balance sheet) at September 30, 1978, is shown on a combined basis on schedule 1. Schedule 3 shows the financial position of each fund.

RESULTS OF OPERATIONS

During the fiscal year ended September 30, 1978, FHA reported a net loss of \$314.9 million in the operations of the four insurance funds. The loss is \$177.8 million less than the loss of the previous year.

Two insurance funds showed profits totaling \$192.9 million during the period ended September 30, 1978, while the other two insurance funds showed losses of \$507.8 million. A breakdown by fund of the profit and loss, as reported by FHA, for the period and a comparison to fiscal year 1977 follows.

<u>Insurance fund</u>	<u>Fiscal year 1978</u>	<u>Fiscal year 1977</u>
	-----millions-----	
MMIF	\$188.0	\$152.6
GIF	- 282.4	- 359.8
CMHIF	4.9	4.1
SRIF	- <u>225.4</u>	- <u>289.6</u>
Total	- <u>\$314.9</u>	- <u>\$492.7</u>

On a combined basis the income increased during fiscal year 1978 by \$50.6 million, largely due to an increase in premiums of \$30.2 million and a \$12.8 million increase from interest received on investments in U.S. Government securities and dividends. Expenses decreased by \$212.6 million, primarily due to (1) a \$42.1 million decrease in interest paid on borrowed money and (2) a decrease in loss on acquired property of \$185.1 million.

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 claim payments to mortgagees, FHA has open-end borrowing authority from the Treasury. Funds borrowed for GIF and SRIF totaled \$1.9 billion and \$1.6 billion at September 30, 1977, and \$2.2 billion and \$1.8 billion at September 30, 1978, respectively.

ACCOUNTING DEFICIENCIES

In our report on FHA's financial statements for the 15-month period ended September 30, 1976, we did not express an opinion on the fairness of its financial position because of a number of serious accounting deficiencies disclosed during our review. The major weaknesses included a lack of reconciliation of several financial statement balances to detail supporting records, accounting control problems with regard to premiums and fees, and an overstatement of FHA's valuation of acquired properties.

We did not review FHA's financial statements for fiscal year 1977 for the purpose of expressing an opinion because corrective actions could not be accomplished by September 30, 1977. Instead we monitored FHA's progress in correcting the accounting problems discussed in our prior audit. During fiscal year 1978 FHA continued corrective action and improvements, such as reconciling financial statement balances

previously not reconciled to detail records and reviewing computerized premium and fee files to increase their accuracy and auditability.

We found, however, that FHA's major problems concerning the accountability of premiums and fees had not been resolved at September 30, 1978, and additional effort was needed before those accounting records could be reliable. Further, we found that some other accounting problems still persisted. The problems resulted in over- or understatements of accounts and in undeterminable differences that needed substantial research to correct. For the most part, the deficiencies are caused by large numbers of errors made entering accounting data, large backlogs in processing accounting data, ADP problems, and, to a degree, improper accounting procedures. For these reasons, we again cannot express an opinion on the reasonableness of FHA's financial statements for the 12-month period ended September 30, 1978.

On August 21, 1979, we met with agency officials representing the Assistant Secretaries for Administration and for Housing. The officials agreed with our findings and affirmed the seriousness of efforts to correct accounting deficiencies. They provided us with a document outlining in detail the current status, corrective actions taken, and actions proposed. Substantial efforts have been made to purify its accounting data and HUD has committed itself to additional substantial efforts and target dates to improve its accounting system.

A discussion of the accounting deficiencies and HUD's comments, including proposed corrective actions, follow.

Premiums

One of the FHA's major accounting deficiencies relates to the premium accounts. Premiums are FHA's major source of income. According to FHA's financial statements the balance of premiums due the Government totaled about \$35.8 million less an estimated allowance for future losses of about \$7.9 million. Premium income for fiscal year 1978 totaled about \$469 million.

We are unable, through our auditing techniques, to establish the reasonableness of FHA's premium receivable balance at September 30, 1978. Further, we are uncertain of the accuracy of billings to mortgagees for premiums due. Without such reliance on the premium accounting records we are also unable to establish the reasonableness of the amount of premium income shown on FHA's statement of income and expenses.

We cannot establish the reasonableness of FHA's premium receivable account because the detailed records are not sufficiently accurate to make an audit test. FHA is currently reviewing the premium records and trying to create an accurate file. Some of the major problems with the detailed records are:

- The detailed list of premiums contains over \$10 million in accounts that have been collected, but FHA did not know the accounts to which the payments apply.
- There were numerous premium billings for mortgages that have been paid in full that were erroneously included in the detailed receivable.
- There were numerous billings to the wrong mortgagee that resulted from sales of mortgages from one banking institution to another.

These problems have contributed to a large delinquent accounts receivable balance totaling more than one-half of the total receivable. About \$9.2 million of the balance due is over 6-months delinquent and substantial amounts are years overdue.

Because of these accounting problems we are unable to verify balances. Also, because an uncertainty exists as to the accuracy of FHA's billings for premiums due the Government, we cannot express an opinion as to the reasonableness of the amount of premium income derived from such billings.

Agency comments

HUD has undertaken a major accounting analysis effort to examine insurance data in its computerized master files. The effort referred to as "data purification" is scheduled to adjust the data base and produce more accurate billings by June 1980. In addition HUD has hired a contractor to review current processes and identify opportunities to improve them. System enhancements are also being considered to improve accounting accuracy.

According to HUD officials, improvements in premium accountability include reinstatement of delinquent premium billings, a significant reduction in delinquent premiums, and better control over the system.

Fees

Another serious accounting deficiency involves FHA's insurance fees receivable. Fees are another major source of FHA's income. Because accounting input to this account continued to contain so many errors and because of a growing delinquency problem with the receivables, we are unable to establish the reasonableness of the fee balance due the Government.

In our report to the Congress on FHA's financial statements for the 15-month period ended September 30, 1976, we reported that a suspense file resulting from accounting input errors contained about 39,000 fee transactions. Our analysis of that file showed that additional fees not shown in the financial statements could have been due to the Government. Further, we found that because the fee errors remained on the suspense file so long without resolution, in many instances the cases became insured, a year went by and FHA did not bill for premiums.

We also reported that FHA's fee receivable account contained substantial delinquent cases. At September 30, 1976, FHA also could not reconcile its detail records to its financial statement balances. Between September 30, 1976, and September 30, 1978, these problems intensified except that FHA's reconciliation to its detail records showed a smaller difference at September 30, 1978. Comparisons between September 30, 1976 and 1978, follow:

- The number of fee errors on the file increased from about 39,000 to about 72,000. Potential unbilled fees increased from an estimated \$1.9 million to about \$3.2 million.
- Unbilled premiums due the Government because of the length of time the cases remained on the file increased from an estimated \$0.8 million to about \$3.2 million involving an increase in cases from about 15,000 to about 21,000.
- Total delinquent fees increased from about \$1.4 million to about \$2.2 million.
- Differences between detailed records and the financial statement balance decreased from \$64,300 to about \$5,500. The \$5,500 is a net amount of many similar differences identified in FHA's fee subsidiary records.

Agency comments

HUD has established numerous new procedures to reduce errors and improve the fee accounting system. The large number of errors on the fee suspense file was reduced from the 72,000 level at September 30, 1978, to about 18,500 at July 31, 1979. By June 30, 1980, HUD intends to validate, collect, or write off delinquent fees. By March 1982, a new computer system utilizing computer tapes is scheduled to replace the current system using optical equipment.

As an interim step FHA estimated that about \$2.2 million in fees and about \$2.5 million in premiums were on the suspense file at September 30, 1978, and made adjusting entries in the financial statements of those amounts.

Title I notes receivable

FHA insures home improvement loans under the General Insurance Fund. If a borrower defaults on the loan, FHA pays the lending institution for its claim and the lending institution assigns the defaulted note to FHA. A computerized file contains the detailed listing of defaulted loans that supports the financial statement balance. The balance in the financial records at September 30, 1978, totaled about \$107.2 million. FHA estimated potential future losses on these notes at about \$89.4 million.

We found that the detail support did not agree with the financial statements. The computerized listing of defaulted loans totaled about \$106.1 million or \$1.1 million less than the financial statement balance. Further, the responsibility for servicing the defaulted title I notes is assigned to the field offices that maintain records of account balances with debtors. FHA did not reconcile its computerized records to its field records. Therefore, we have no reliable method to assure the reasonableness of FHA's stated account balance.

Agency comments

HUD officials told us that accounting system problems cause the automated reports to be out of balance and that until system corrections are made annual reconciliation of home office and field title I records will be postponed. Efforts to correct the system were scheduled to begin in September 1979.

Sales of acquired property

The value of HUD-owned property continues to be misstated because substantial numbers of small homes were sold by September 30, 1978, but were not recognized as such in the accounts. A test of the account by HUD's Office of Inspector General showed that of 102 sales recorded in October 1978, 26, or about 25.5 percent, were sold prior to September 30, 1978, and should have been eliminated from the property accounts at that date. Based on a projection of such sales, between 182 and 370 additional properties in the amount of \$2.3 million to \$4.8 million could have been erroneously recorded in the account at year end. Two multifamily property sales with acquisition costs of about \$8.5 million were also not recorded at September 30, 1978.

Any properties sold at yearend but not recorded would also affect FHA's income and expense accounts since certain data on each sale affects the expense account "Loss on Real Properties."

Further, the failure to record sales would also affect the allowance for estimated future losses on both the balance sheet and on the statement of income and expense.

Agency comments

Reporting delays by field offices of sales transactions was cited by HUD officials as the cause of sales not being recorded in the accounting records on time. Single family sales reports are about 30 days late and multifamily sales reports range from 1 to 9 months late. To correct this problem, HUD officials have met with area office representatives who have poor reporting track records to impress on them the importance of timely reporting. Additionally, memos have been sent to area offices to remind them of reporting requirements. HUD intends to closely monitor reporting performance.

Income and expense applicable to HUD property

The value of FHA's acquired property includes the acquisition cost of properties owned and the net of incurred income and expense applicable to such property after acquisition. Such items may include rental income, real estate taxes, maintenance of property, fixing-up expenses, etc. Those net expenses are referred to as capitalized expenses. When income is earned or expenses incurred the accounting system should identify the property to which the capitalized

expense applies in order that a profit or loss may be computed when the property is sold.

At September 30, 1978, however, the capitalized expenses included about \$14 million for which FHA cannot identify the property. Accurate amounts of profits and losses, therefore, cannot be calculated.

Agency comments

HUD officials agreed that certain capitalized expenses paid by HUD could not be matched against the appropriate property and had been allowed to remain in suspense accounts for years, in some cases, without research. HUD has revised its computer programs to process these transactions and avoid buildup of unidentified cases in the suspense accounts. Further about \$13.5 million of unidentified accounts were prorated to existing property accounts.

Cash reconciliation

FHA's cash position at September 30, 1978, as shown in its financial statements, totaled about \$168.2 million. However, FHA's cash balance does not agree with Treasury records. A difference of about \$14 million applicable to September 30, 1978, remained as of June 1979. These differences are applicable to conflicting internal reports on cash and a variance between FHA and Treasury balances.

Our review shows that FHA has not successfully found specific reasons for the \$14 million difference.

Agency comments

HUD officials stated that \$1.6 million of \$14 million unidentified as of September 30, 1978, remained to be supported and that the September 30, 1978, cash reconciliation started in March 1979 is expected to be complete by September 1979. HUD is exploring a more effective and economical way to perform its cash reconciliation.

Accounts receivable from the sale
of HUD properties and earnest
money on pending sales

FHA's balance sheet includes about \$22.5 million in accounts receivable resulting from the sale of Secretary-held properties to the public. We found that about 40 percent of the receivables included in our test sample were in fact collected by FHA prior to September 30, 1978,

and should not have been shown as receivables at year end. Further, FHA's liabilities included about \$10.2 million in trust and deposit liabilities representing earnest money held by FHA on pending sales. During our test of this account we found that over 90 percent of the sales we reviewed were completed and the liability, therefore, no longer existed at September 30, 1978.

Accounting entries for the accounts receivable and earnest money accounts are generated by the sale of Secretary-held properties. When FHA enters into a sales contract, it requires the buyer to pay a sum of money, referred to as earnest money, as a show of good faith to complete the sales transaction. At the date of settlement on the property--the day the sale is completed--the buyer pays the remaining amount due under the sales contract, usually to an attorney or settlement company handling the settlement.

An account receivable from the buyer would exist from the settlement date until FHA collects the sales proceeds from the attorney or settlement company. Payment to FHA generally is made a few days after settlement. A trust and deposit liability would exist for the earnest money FHA collected before the date of settlement until the sale was completed. On the basis of our tests, therefore, the accounts receivable and the trust and deposit liabilities were both overstated at September 30, 1978.

Agency comments

Agency officials informed us that as of June 1979 the accounts receivable balance was reduced from \$22.5 million to \$8.5 million and the balance in the earnest money account was also reduced to \$8.9 million from \$10.2 million. Efforts will continue to identify, validate, apply, or write off all accounts receivable and earnest money transactions by September 1979.

Interest on debenture obligations

Debentures are issued in settlement of insurance claims. Treasury pays interest on these debentures semiannually on January 1 and July 1, and FHA reimburses Treasury for those payments. FHA, however, is unsure of the accuracy of the debenture interest expense of about \$35.5 million that had been charged during fiscal year 1978. FHA officials informed us that they rely on the accuracy of Treasury payments because Treasury, acting as agent for FHA, has the responsibility for accuracy of payments. However, FHA, through

analysis of their own debenture records, cannot reconcile to the amount Treasury pays as interest on debentures. The FHA official who keeps records on the interest expense informed us that this problem has existed for many years. Without such reconciliation to Treasury records, we cannot assure the accuracy of the \$35.5 million expense. This problem would also affect the reasonableness of the \$9.9 million debenture interest payable account shown in the financial statements as accrued interest on debentures.

Agency comments

HUD officials changed their procedures to more accurately account for interest paid by the Treasury Department on FHA debentures.

Insurance reserve requirements

On the basis of actuarial studies of the risk underwritten, FHA estimated the amount of reserves required to settle insurance claims that might be presented by insured mortgagees under the more than \$94 billion of insurance in force at September 30, 1978. These estimated reserve requirements are affected by the amount of insurance in force and past experience of income and expenses charged to the fund. This is a change from prior years when FHA estimated income and expenses on the basis that an economic reversal would develop immediately.

The following table shows the estimated reserve requirements as compared to the actual insurance reserves or deficit at September 30, 1978, and for the prior 2 fiscal years.

<u>Fiscal year</u>	<u>Estimated reserve requirements</u>	<u>Insurance reserve or deficit (-)</u>
----- (millions) -----		
1976	\$2,715.7	b/ \$ -1,165.0
1977	a/	b/ 234.5
1978	5,946.4	b/ -288.3

a/FHA did not estimate its reserve requirements at September 30, 1977.

b/The amounts shown include the effect of appropriations received. Appropriation balances for fiscal years 1976 to 1978 were \$142.5 million, \$2,078.8 million, and \$2,093.8 million, respectively.

However, since FHA's 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, the adequacy of such reserves is, in our opinion, also not predictable.

CHANGES IN FHA'S FINANCIAL STATEMENTS

FHA made two significant changes, with which we agree, in its balance sheet presentation since September 30, 1976. The first change involved interest receivable from HUD-owned mortgage notes. It was shown on September 30, 1976, statements as accrued interest receivable but shown this year as interest receivable. The second change relates to advances to mortgagors primarily for real estate taxes. At September 30, 1976, the advances were accounted for as an offset to HUD's trust and deposit liability account-- "Deposits held for mortgagors and lessors." At September 30, 1978, they were shown separately as accounts receivable. An explanation of these changes follow.

FHA owns over \$2.6 billion in defaulted notes assigned by mortgagees in consideration of FHA's payment of insurance claims. After the assignment the mortgagor is required to pay FHA principal and interest payments on the notes. Interest due FHA at September 30, 1978, was about \$346.9 million. Prior to September 30, 1978, FHA accounted for interest due on the balance sheet as accrued interest receivable.

Accrued interest represents income earned that will not normally be billed until after an accounting period ends. The \$346.9 million due FHA, however, was not such an accrual and had been due FHA, for the most part, for months and in many cases years. In such instances the amount of interest due should be shown in the financial statements as a receivable.

At September 30, 1978, FHA set up the \$346.9 million as a receivable with an allowance for estimated future losses of about \$179.7 million, leaving a net receivable of \$167.2 million. At September 30, 1976, the net receivable shown as accrued interest was \$117.6 million.

The other change involved escrow funds paid to FHA monthly for real estate taxes. FHA would hold those funds until payment of the taxes was due. If the escrow fund was insufficient to pay the taxes, FHA would advance the money for that purpose. At September 30, 1978, the amount advanced was about \$42.6 million with an allowance for estimated future losses of about \$32.0 million.

At September 30, 1976, FHA accounted for such advances by reducing the trust and deposit liability account. The principles of accounting, however, require that where advances are made that result in a receivable, that amount should be shown as a receivable and not merely an offset to a liability.

PRIOR GAO REPORTS ON FHA'S MORTGAGE
INSURANCE ACCOUNTING OPERATIONS

We have issued numerous reports on deficiencies related to FHA's mortgage insurance accounting operations. These reports pertained to billing and collection of insurance premiums and fees, payment of real estate taxes on HUD-owned property, servicing of HUD-owned property, and weaknesses in controls of HUD's mortgage insurance computer tape files. A list of reports follow.

	<u>Title</u>	<u>Date issued</u>
1.	"Actions Being Taken To Correct Weakness in the System of Paying Taxes on HUD's Acquired Residential Properties" (FGMSD-76-24)	11/75
2.	"Large Savings Possible in Mortgage Insurance Premium Payment System" (FGMSD-77-12)	8/77
3.	"Millions of Dollars in Delinquent Mortgage Insurance Premiums Should be Collected by the Department of Housing and Urban Development" (FGMSD-77-33)	9/77
4.	Letter report on review of controls over use of HUD's computer tape library	11/77
5.	"Examination of the Financial Statements of FHA Insurance Operations for the 15-Month Period Ended September 30, 1976" (CED-78-95)	4/78
6.	Letter report on deficiencies in accounting for mortgage insurance operations	5/78
7.	Letter report on deficiencies in accounting for fee income	11/78
8.	"Weaknesses in Servicing and Accounting for Home Mortgages Held by HUD" (FGMSD-79-41)	8/79

REVIEW OF FINANCIAL ACCOUNTS BY THE
INSPECTOR GENERAL

HUD's Office of Inspector General performed a substantial amount of review work pertaining to FHA's financial statements for the fiscal year ended September 30, 1978. During our audit we coordinated with that Office and utilized its review work, as appropriate. Several of the findings in this report resulted from its efforts. As a result of its work we were able to reduce the scope of our audit.

CHAPTER 3

SCOPE OF EXAMINATION AND

OPINION ON FINANCIAL STATEMENTS

We examined FHA's financial statements pertaining to its insurance operations for the fiscal year ended September 30, 1978. We made our examination in accordance with the Comptroller General's standards for financial and compliance audits and included such tests of the accounting records and such auditing procedures as we considered necessary in the circumstances.

For the reasons explained in this report (see p. 6) we cannot express an opinion that FHA's financial statements present fairly the financial position of FHA at September 30, 1978, and the results of its operations and the changes in financial position for the 12-month period then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding fiscal year.

We do not plan to review FHA's financial statements for fiscal year 1979 for purposes of expressing an opinion. Instead, that year we will concentrate on reviewing those areas where FHA is having difficulty with accounting controls or other accounting functions affecting its ability to keep reasonably accurate accounting records.

FINANCIAL STATEMENTS

SCHEDULE 1

SCHEDULE 1

FEDERAL HOUSING ADMINISTRATION

COMBINED COMPARATIVE BALANCE SHEET

AS OF SEPTEMBER 30, 1978

ASSETS

	September 30, 1978	September 30, 1977	Increase or Decrease (-)
CASH AND FUND BALANCES	\$ 168,241,724	\$ 157,544,989	\$ 10,696,735
ACCOUNTS RECEIVABLE:			
Premiums	35,750,344	29,219,660	6,530,684
Less: Allowance for estimated future losses	7,884,957	6,400,000	1,484,957
Net premiums	27,865,387	22,819,660	5,045,727
Fees	8,586,069	7,035,419	1,550,650
Less: Allowance for estimated future losses	2,340,408	975,000	365,408
Net fees	7,245,661	6,060,419	1,185,242
Sale of Secretary-held properties	22,482,962	16,340,640	6,142,322
Sale of Secretary-held mortgages	1,567,700	1,708,050	-140,350
Secretary-held mortgages			
Advances to mortgagors	42,627,987	-	42,627,987
Less: Allowance for estimated future losses	32,025,194	-	32,025,194
Net advances to mortgagors	10,602,793	-	10,602,793
Interest receivable on mortgage notes	346,929,205	298,932,022	47,997,183
Less: Allowance for estimated future losses	179,676,226	162,907,179	16,769,047
Net interest receivable on mortgage notes	167,252,979	136,024,843	31,228,136
Other	267,698	5,680,854	-5,413,156
Advances to Special Risk Insurance Fund from General Insurance Fund	20,000,000	20,000,000	-
Interest on other notes receivable	17,995	13,796	4,199
Less: Allowance for estimated future losses	1,798	1,380	418
Net interest receivable on other notes	16,197	12,416	3,781
Total accounts receivable	257,301,377	208,646,882	48,654,495
ACCRUED ASSETS:			
Premiums	153,904,988	150,268,062	3,636,926
Interest on U.S. Government securities	29,176,329	27,664,527	1,511,802
Total accrued assets	183,081,317	177,932,589	5,148,728
INVESTMENTS:			
U.S. Government securities at amortized cost (note 1)	1,957,141,586	1,856,532,594	100,608,992
Stock in rental and cooperative housing corporations: 102,587 shares at September 30, 1978 and 114,093 shares at September 30, 1977--at cost	118,200	131,300	-13,100
Total investments	1,957,259,786	1,856,663,894	100,595,892
MORTGAGE NOTES AND CONTRACTS FOR DEED--UNPAID BALANCE	402,534,582	416,372,996	-11,838,414
Less: Allowance for estimated future losses	23,105,485	23,730,648	-625,163
Net mortgage notes and contracts for deed	379,429,097	392,642,348	-13,213,251
ACQUIRED SECURITY OR COLLATERAL:			
Acquired property--at cost plus net expense to date	1,205,398,176	1,124,438,829	80,959,347
Defaulted mortgage notes--at cost plus net expenses to date	2,639,625,663	2,822,258,526	-182,632,863
Defaulted Title I notes--at unpaid principal balance	107,187,197	91,733,889	15,453,308
Total cost of acquired security or collateral	3,952,211,036	4,038,431,244	-86,220,208
Less: Principal recoveries on defaulted mortgage notes	78,842,441	69,555,992	9,286,449
Less: Undisbursed mortgage proceeds	3,672,324	2,945,339	726,985
Unrecovered cost	3,869,696,271	3,965,929,913	-96,233,642
Less: Allowance for estimated future losses on acquired properties	687,000,130	661,377,418	25,630,712
Allowance for estimated future losses on defaulted mortgage notes	1,300,683,770	1,277,151,151	23,532,619
Allowance for estimated future losses on defaulted Title I notes	89,350,844	79,486,749	9,864,095
Total allowance for estimated future losses	2,077,042,744	2,018,015,318	59,027,426
Net acquired property and notes	1,792,653,527	1,947,914,595	-155,261,068
Other notes receivable	3,079,573	1,354,878	1,724,695
Less: Allowance for estimated future losses	524,940	352,747	172,193
Net other notes receivable	2,554,633	1,002,131	1,552,502
Net acquired security or collateral	1,795,208,160	1,948,916,726	-153,708,566
OTHER ASSETS--HELD FOR THE ACCOUNT OF MORTGAGORS	7,328,180	2,867,312	4,460,868
UNAPPLIED CHARGES	74,190	276,048	-201,858
Total assets (note 2)	\$4,747,923,831	\$4,745,490,788	\$ 2,433,043

The notes on page 28 are an integral part of this statement. The opinion of the General Accounting Office on these statements appears on page 18.

SCHEDULE 1

SCHEDULE 1

LIABILITIES

	September 30, 1978	September 30, 1977	Increase or Decrease (-)
ACCOUNTS PAYABLE:			
Acquired security and miscellaneous	\$ 95,691,002	\$ 63,544,284	\$ 32,146,718
Participations payable	53,177,305	39,066,218	14,111,087
Advances from General Insurance Fund to Special Risk Insurance Fund	20,000,000	20,000,000	-
Total accounts payable	168,868,307	122,610,502	46,257,805
ACCRUED LIABILITIES:			
Interest on debentures	9,927,593	10,144,827	-217,234
Interest on funds advanced from U.S. Treasury	75,889,581	68,383,331	7,506,250
Total accrued liabilities	85,817,174	78,528,158	7,289,016
TRUST AND DEPOSIT LIABILITIES:			
Deposits held for mortgagors and lessors	61,008,431	33,784,631	27,223,800
Earnest money on pending sales	10,219,447	16,615,265	-6,395,818
General Fund receipts in process of deposit	-1,234	-	-1,234
Excess proceeds of sale	5,519,090	4,992,795	526,295
Total trust and deposit liabilities	76,745,734	55,392,691	21,353,043
DEFERRED CREDITS:			
Unearned premium income	75,521,798	64,350,728	11,171,070
Unearned fee income	-	214,226	-214,226
Unapplied credits	12,951,124	12,098,135	852,989
Total deferred credits	88,472,922	76,663,089	11,809,833
DEBENTURE OBLIGATIONS:			
Debentures issued and outstanding	600,772,100	579,255,950	21,516,150
Debentures authorized for issue	3,920,950	94,150	3,826,800
Debenture claims in process	15,563,350	43,585,600	-28,022,250
Total debenture obligations	620,256,400	622,935,700	-2,679,300
OTHER LIABILITIES:			
Reserve for foreclosure cost - defaulted mortgage notes	27,204,892	26,016,186	1,188,706
Total liabilities	\$1,067,365,929	\$ 982,146,326	\$ 85,219,603
APPROPRIATIONS, RESERVES AND BORROWINGS FROM U. S. TREASURY			
APPROPRIATED CAPITAL:			
Appropriated capital - loss on acquired securities	\$2,063,844,000	\$2,063,844,000	\$ -
Appropriated capital - Urban Homesteading Program	30,000,000	15,000,000	15,000,000
Total appropriated capital	2,093,844,000	2,078,844,000	15,000,000
RESERVES:			
Statutory reserve - for participation payments and future losses (note 5)	798,562,346	675,567,007	122,995,339
Insurance reserve - available for future losses and expenses (note 5)	-3,180,669,444	-2,519,887,545	-660,781,899
Total reserves	-2,382,107,098	-1,844,320,538	-537,786,360
BORROWINGS FROM U.S. TREASURY (note 4)			
	3,460,221,000	3,528,821,000	440,000,000
Total appropriations, reserves and borrowings from U.S. Treasury	3,880,557,902	3,763,344,462	117,213,440
Total liabilities, appropriations, reserves and borrowings from U.S. Treasury (notes 3, 4, 5, 6, and 7)	\$4,747,923,831	\$4,745,490,788	\$ 2,433,043

**FEDERAL HOUSING ADMINISTRATION
COMBINED COMPARATIVE STATEMENT OF INCOME AND EXPENSE
AND CHANGES IN APPROPRIATIONS, RESERVES AND BORROWINGS
FOR THE FISCAL YEARS ENDED SEPTEMBER 30, 1978 AND 1977**

<u>INCOME AND EXPENSE</u>	1978	1977	Increase or Decrease (-)
Income			
Fees	\$ 56,029,562	\$ 54,946,723	\$ 1,082,839
Premiums	468,987,016	438,820,214	30,166,802
Interest on U.S. Government securities and dividends	138,472,292	125,657,694	12,814,598
Interest income	10,754,224	3,751,867	7,002,357
Income on settled properties	535,913	922,398	-386,485
Miscellaneous income	852,865	888,011	-35,146
Total income	675,632,872	626,986,907	50,645,965
Expenses			
Salaries and expenses	235,079,443	225,780,938	9,298,505
Interest on borrowings from U.S. Treasury	286,313,332	328,410,000	-42,096,668
Interest on debenture obligations	35,675,831	35,717,488	-41,657
Loss on acquired security	286,237,092	471,336,427	-185,099,335
Loss on defaulted Title I notes	7,949,487	5,743,022	2,206,465
Discount on sale of Secretary-held mortgages	338,235	269,774	68,461
Fee expenses	19,881,330	16,475,908	3,405,422
Structural defects	8,551,373	7,307,386	-756,013
Miscellaneous expense	2,800,576	2,611,887	188,689
Expense on settled properties	672,286	783,133	389,153
Total expense	881,300,935	1,093,936,163	-212,635,228
Net income or loss (-) before adjustment of valuation allowances	-205,668,063	-668,949,256	263,281,193
Increase (-) or Decrease (+) in Valuation Allowances			
Allowance for estimated future losses on:			
Mortgage notes and sales contracts	625,163	672,584	-47,421
Acquired properties	-25,630,712	78,030,522	-103,661,234
Defaulted mortgage notes	-23,532,619	-89,118,162	65,585,543
Defaulted Title I notes	-9,864,095	-11,132,222	1,268,127
Other notes receivable	-172,193	-19,753	-152,440
Insurance premiums receivable	-1,484,957	-1,900,000	415,043
Fees receivable	-365,408	-293,000	-72,408
Advances to mortgagees	-32,025,195	-	-32,025,195
Interest receivable on mortgage notes	-16,769,047	-	-16,769,047
Interest receivable on other notes	-116	-	-116
Net adjustment of valuation allowances	-109,219,681	-23,760,031	-85,459,650
Net income or loss (-)	\$ -314,887,544	\$ -692,709,287	\$ 177,821,743
ANALYSIS OF APPROPRIATIONS, RESERVES AND BORROWINGS			
Appropriated Capital:			
Balance at beginning of period	\$ 2,078,844,000	\$ 142,500,000	\$ 1,936,344,000
Loss on acquired security	-	1,921,344,000	-1,921,344,000
Urban Homesteading Program	15,000,000	15,000,000	-
Total appropriated capital	2,093,844,000	2,078,844,000	15,000,000
Distribution of Net Income			
Statutory Reserve (participating reserve account):			
Balance at beginning of period	675,567,007	559,695,568	115,871,439
Net income allocated for the period 2/	182,923,197	136,733,015	26,190,182
Total participating reserve	858,490,204	716,428,583	142,061,621
Participations declared (-)	-59,968,636	-40,861,838	-19,106,798
Participations available	798,521,770	675,566,745	122,955,025
Changes in participations held in escrow	40,576	282	40,314
Balance at end of period	798,562,346	675,567,007	122,995,339
Insurance Reserve:			
Balance at beginning of period	-2,519,887,545	-1,867,226,372	-652,661,173
Adjustments during the period 1/	-162,971,157	-3,218,871	-159,752,286
Net loss (-) for the period 2/	-497,810,742	-649,442,302	151,631,560
Balance at end of period	-3,180,669,444	-2,519,887,545	-660,781,899
Total reserves or deficit (-)	-2,382,107,098	-1,844,320,538	-537,786,560
Borrowing From U.S. Treasury			
Balance at beginning of period	\$ 3,528,821,000	\$ 4,878,268,000	\$ -1,349,447,000
Borrowings during the period	440,000,000	130,000,000	310,000,000
Repayments during the period	-	-1,479,447,000	1,479,447,000
Balance at end of period	3,968,821,000	3,528,821,000	440,000,000
Total appropriations, reserves and borrowings at end of period	\$ 3,680,357,902	\$ 3,763,344,662	\$ -82,786,760
1/ Comprised of the following adjustments relative to prior years:			
(a) Allowance for estimated future losses on mortgage notes and sales contracts	\$ -	\$ 169,985	\$ -169,985
(b) Premium income	-62,398	-3,388,856	3,326,258
(c) Allowance for estimated future losses on interest receivable on mortgage and other notes	-162,908,559	-	-162,908,559
Total	\$ -162,971,157	\$ -3,218,871	\$ -159,752,286
2/ The net income was distributed to the statutory and/or the insurance reserve by the Assistant Secretary for Housing-Federal Housing Commissioner, HUD, FHA under authority of Sections 205 and 213 of the National Housing Act.			

The notes on page 28 are an integral part of this statement. The opinion of the General Accounting Office on these statements appears on page 18.

FEDERAL HOUSING ADMINISTRATION

COMBINED BALANCE SHEET

ANALYSIS BY FUND

AS OF SEPTEMBER 30, 1978

ASSETS	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund	Urban Homesteading Program
CASH AND FUND BALANCES	\$ 188,261,724	\$ 37,157,517	\$ 87,441,528	\$ 519,038	\$ 17,369,690	\$ 2,164,510	\$ 21,009,233
ACCOUNTS RECEIVABLE:							
Premiums							
Less: Allowance for estimated future losses	35,750,344	17,397,619	10,798,190	419,028	7,155,307	-	-
Net premiums	7,884,954	6,150,266	946,195	-	768,470	-	-
Fees	27,863,387	11,247,353	9,857,195	419,028	6,346,811	-	-
Less: Allowance for estimated future losses	8,186,069	7,516,471	530,985	-	136,615	-	-
Net fees	1,340,408	1,340,408	-	-	-	-	-
Sale of Secretary-held properties	7,265,661	6,578,063	530,985	-	136,611	-	-
Sale of Secretary-held mortgages	22,482,962	8,573,068	6,507,165	10,261	7,392,456	-	-
Secretary-held mortgages:	1,567,700	890,030	94,940	-	582,700	-	-
Advances to mortgagors	42,627,987	2,455,338	31,356,306	4	8,816,334	-	-
Less: Allowance for estimated future losses	32,025,194	880,161	23,204,327	2	7,940,724	-	-
Net advances to mortgagors	10,602,793	1,575,177	8,151,979	2	875,610	-	-
Interest Receivable on Mortgage Notes	346,929,205	7,559,105	266,370,460	787,342	72,212,279	-	-
Less: Allowance for estimated future losses	179,676,226	3,072,091	132,933,765	174,258	43,496,132	-	-
Net interest receivable on mortgage notes	167,252,979	4,487,014	133,436,735	613,084	28,716,146	-	-
Other	267,698	69,515	121,531	-	31,826	41,526	-
Advances to SRI Fund from GI Fund	20,000,000	-	20,000,000	-	-	-	-
Interest on other notes receivable	17,995	4,766	13,098	-	131	-	-
Less: Allowance for estimated future losses	1,798	476	1,309	-	13	-	-
Net interest receivable on other notes	16,197	4,290	11,789	-	118	-	-
Total accounts receivable	257,301,377	33,424,530	178,707,629	1,042,342	44,056,310	42,526	-
ACCRUED ASSETS:							
Premiums	153,904,988	114,968,425	19,281,424	-	15,654,739	-	-
Interest on U.S. Government securities	29,176,329	28,882,078	-	294,253	-	-	-
Total accrued assets	183,081,317	147,850,501	19,281,424	294,253	15,654,739	-	-
INVESTMENTS:							
U.S. Government securities at amortized cost (note 1)	1,957,141,586	1,928,408,378	-	28,733,208	-	-	-
Stock in rental and cooperative housing corporations:							
102,587 shares at cost	118,200	-	96,700	31,500	-	-	-
Total investments	1,957,259,786	1,928,408,378	96,700	28,734,708	-	-	-
MORTGAGE NOTES AND CONTRACTS FOR DEED--UNPAID BALANCE							
Less: Allowance for estimated future losses	402,536,582	20,486,704	359,473,537	4,966,711	17,610,630	-	-
Net mortgage notes and contracts for deed	23,105,485	532,080	21,576,923	248,336	748,146	-	-
Net mortgage notes and contracts for deed	379,429,097	19,952,624	337,895,614	6,718,375	16,862,484	-	-
ACQUIRED SECURITY OR COLLATERAL:							
Acquired property - at cost plus net expenses to date	1,205,398,176	275,738,907	591,863,197	2,775,969	335,040,103	-	-
Defaulted mortgage notes - at cost plus net expenses to date	2,639,625,663	66,664,497	1,865,737,365	9,571,539	697,432,262	-	-
Defaulted Title I notes--at unpaid principal balance	107,187,197	-	107,187,197	-	-	-	-
Total cost of acquired security or collateral	3,952,211,036	342,403,404	2,564,787,759	12,347,508	1,032,472,365	-	-
Less principal recoveries on defaulted mortgage notes	78,841,441	2,932,971	71,278,408	1,282,089	3,348,973	-	-
Less undisbursed mortgage proceeds	3,672,324	-	3,672,324	-	-	-	-
Unrecovered cost	3,869,696,271	339,470,433	2,469,837,027	11,065,419	1,029,323,392	-	-
Less allowance for estimated future losses on acquired properties	687,008,130	124,380,661	369,983,132	673,993	191,970,344	-	-
Less allowance for estimated future losses on defaulted mortgage notes	1,300,683,770	34,723,349	862,306,911	3,786,250	399,367,260	-	-
Less allowance for estimated future losses on defaulted Title I notes	89,350,844	-	89,350,844	-	-	-	-
Total allowance for estimated future losses	2,077,062,744	159,104,010	1,322,140,887	6,460,243	591,337,604	-	-
Net acquired property and notes	1,792,652,522	180,366,423	1,167,698,140	6,605,176	437,985,788	-	-
Other notes receivable	3,079,573	910,035	813,195	-	1,356,323	-	-
Less allowance for estimated future losses	524,940	307,988	81,320	-	135,632	-	-
Net other notes receivable	2,554,633	602,047	731,875	-	1,220,691	-	-
Net acquired security or collateral	1,795,208,180	180,968,470	1,168,428,015	6,605,176	439,206,479	-	-
OTHER ASSETS - HELD FOR THE ACCOUNT OF MORTGAGORS	7,328,180	-	7,095,873	97,646	34,661	-	-
DEFERRED CHARGES	74,190	32,725	22,692	-	34,202	4,571	-
Total assets (note 2)	\$ 4,747,923,831	\$ 2,367,795,165	\$ 1,798,969,475	\$ 42,031,578	\$ 516,308,745	\$ 2,211,615	\$ 21,009,233

The notes on page 28 are an integral part of this statement. The opinion of the General Accounting Office on these statements appears on page 18.

SCHEDULE 3

SCHEDULE 3

FEDERAL HOUSING ADMINISTRATION
 Combined Balance Sheet
 Analysis by Fund
 As of September 30, 1978

LIABILITIES	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund	Urban Homeownership Program
ACCOUNTS PAYABLE:							
Acquired securities and miscellaneous	\$ 21,691,002	\$ 36,425,026	\$ 37,024,730	\$ 364,050	\$ 21,877,196	\$ -	\$ -
Participations payable	20,000,000	-	-	-	20,000,000	-	-
Advances from CI Fund to SRI Fund	-	-	-	-	-	-	-
Total accounts payable	168,669,307	40,602,331	37,226,730	364,050	41,877,196	-	-
ACCRUED LIABILITIES:							
Interest on debentures	9,827,661	-	9,899,404	203,310	9,600	-	-
Interest on funds advanced	2,127,111	-	21,344,200	-	34,494,280	-	-
Total accrued liabilities	23,127,111	21,344,200	21,344,200	203,310	34,494,280	-	-
TRUST AND DEPOSIT LIABILITIES:							
Deposits held for mortgagors and lessors	41,008,431	2,260,911	44,704,324	948,213	11,474,943	-	-
Earnest money on pending sales	10,219,444	1,404,032	2,741,813	-	2,273,601	-	-
General fund receipts in process of deposit	91,214	-	-	-	-	-	-
Excess proceeds of sale	2,315,090	-	5,346,230	46,656	36,163	-	-
Total trust and deposit liabilities	76,748,239	7,064,944	52,632,377	634,869	13,784,707	-	-
DEFERRED CREDITS:							
Unearned premiums income	75,521,724	506,576	54,536,021	2,028,160	18,433,043	-	-
Unapplied credits	12,851,624	208,300	9,130,841	96,283	311,269	3,212,649	-
Total deferred credits	88,673,348	714,876	63,676,862	2,124,443	18,744,312	3,212,649	-
DEBENTURE OBLIGATIONS:							
Debentures issued and outstanding	600,772,100	5,074,650	579,913,500	15,085,800	608,111	-	-
Debentures authorized for issue	3,920,950	-	3,920,950	-	-	-	-
Debentures claims in process	15,263,350	-	15,263,350	-	-	-	-
Total debenture obligations	620,256,400	5,074,650	599,397,800	15,085,800	608,120	-	-
OTHER LIABILITIES:							
Reserve for foreclosure costs - defaulted mortgage notes	27,204,692	-	18,396,464	172,704	8,635,744	-	-
Total liabilities	\$ 1,067,365,924	\$ 103,083,304	\$ 622,189,330	\$ 18,587,268	\$ 130,294,332	\$ 3,212,649	\$ -
APPROPRIATIONS, RESERVES AND BORROWINGS FROM U.S. TREASURY							
APPROPRIATED CAPITAL:							
Appropriated capital - loss on acquired securities	\$ 2,063,444,000	\$ -	\$ 1,340,476,000	\$ -	\$ 723,170,000	\$ -	\$ -
Appropriated capital - Urban Homeownership	30,000,000	4,653,072	1,709,850	-	2,227,845	-	21,609,233
Total appropriated capital	2,093,444,000	4,653,072	1,342,185,850	-	725,397,845	-	21,609,233
RESERVES:							
Statutory reserve - for participation payments and future losses	799,902,340	191,136,761	-	7,425,543	-	-	-
Insurance reserve - available for future losses and expenses (note 5)	-3,120,867,444	-1,249,123,368	-2,222,258,405	16,018,785	-4,123,551,672	-	-
Total reserves	-2,320,965,104	-1,057,986,607	-2,222,258,405	23,444,328	-4,123,551,672	-	-
BORROWINGS FROM U. S. TREASURY (note 4)	1,968,821,000	-	2,156,455,000	-	1,812,160,000	-	-
Total appropriations, reserves and borrowings from U.S. Treasury	1,040,339,900	1,244,114,151	974,719,645	23,444,328	414,014,173	-	21,609,233
Total liabilities, appropriations, reserves and borrowings from U.S. Treasury (Notes 1, 4, 5, 6, and 7)	\$ 4,747,923,851	\$ 2,347,297,455	\$ 1,799,969,475	\$ 41,031,596	\$ 534,308,745	\$ 3,212,649	\$ 21,609,233

FEDERAL HOUSING ADMINISTRATION
COMBINED STATEMENT OF INCOME AND EXPENSE
AND CHANGES IN APPROPRIATIONS, RESERVES AND BORROWINGS
ANALYSIS BY FUND
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1978

INCOME AND EXPENSE	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Housing Management Insurance Fund	Special Risk Insurance Fund	Urban Homestead Program
INCOME						
Fees	\$ 56,029,562	\$ 29,490,434	\$ 25,042,542	\$ 16,869	\$ 1,474,697	\$ -
Premiums	468,987,016	267,020,759	130,571,529	4,016,870	67,375,858	-
Interest on U.S. Government securities and dividends	138,472,297	136,673,976	900	1,797,416	-	-
Interest income	10,754,224	5,398,849	3,234,813	-	2,120,522	-
Income on settled properties	535,913	499,368	18,404	-	20,739	-
Miscellaneous income	853,865	8,467	470,794	-	378,104	-
Total income	675,632,872	439,059,393	159,339,404	5,811,155	71,372,920	-
EXPENSE						
Salaries and expenses	235,079,443	112,117,046	68,424,242	809,911	51,328,225	-
Interest on borrowings from U.S. Treasury	286,313,312	-	156,708,109	-	129,605,203	-
Interest on debenture obligations	15,477,831	185,890	34,416,183	800,788	75,170	-
Loss on acquired security	286,217,092	96,508,085	85,975,040	-294,566	104,048,513	-
Loss on defaulted Title I notes	7,944,487	-	7,949,487	-	-	-
Discount on sale of Secretary-held mortgages	138,235	220,312	31,454	-	87,465	-
Fee expenses	19,881,300	14,202,714	1,268,273	-	410,123	-
Structural defects	6,551,173	4,865,235	952,974	-	733,159	-
Miscellaneous expense	2,800,526	482,642	1,923,275	-	394,609	-
Expense on settled properties	672,286	-	150,269	-	522,017	-
Total expense	893,300,945	232,581,744	358,188,555	1,316,133	289,204,503	-
Net income or loss (-) before adjustment of valuation allowances	-205,668,063	206,507,649	-198,859,151	4,515,022	-217,831,583	-
INCREASE (-) OR DECREASE (+) IN VALUATION ALLOWANCES:						
Allowance for estimated future losses on:						
Mortgage notes and sales contracts	625,161	45,813	466,231	1,696	111,423	-
Acquired properties	-25,630,712	-1,204,040	-25,948,853	752,308	2,770,871	-
Defaulted mortgage notes	-23,532,619	-10,768,408	-15,054,786	-449,078	2,739,654	-
Defaulted Title I notes	-9,864,095	-	-9,864,095	-	-	-
Other notes receivable	-172,191	-59,624	-70,126	-	-42,443	-
Insurance premiums receivable	-1,484,957	-2,650,266	653,805	-	511,504	-
Fees receivable	-365,408	-365,408	-	-	-	-
Advances to mortgagees	-32,023,195	-880,141	-23,404,327	-2	-7,940,322	-
Interest receivable on mortgage notes	-16,769,047	-600,721	-10,529,160	54,132	-5,693,298	-
Interest receivable on other notes	-418	-111	-311	-	4	-
Net adjustment of valuation allowances	-109,219,481	-18,482,906	-83,532,622	359,056	-7,543,009	-
Net income or loss (-)	\$ -314,887,544	\$ 188,024,743	\$ -282,391,773	\$ 4,874,078	\$ -225,374,592	\$ -
ANALYSIS OF APPROPRIATIONS, RESERVES AND BORROWINGS						
APPROPRIATED CAPITAL						
Balance at beginning of period	\$ 2,078,844,000	\$ 847,870	\$ 1,341,002,423	\$ -	\$ 721,540,837	\$ 13,452,870
Loss on acquired securities	-	-	-	-	-	-
Urban Homestead Program	15,000,000	3,605,202	1,181,427	-	1,857,008	8,156,363
Total appropriated capital	2,093,844,000	4,453,072	1,342,183,850	-	723,397,845	21,609,233
DISTRIBUTION OF NET INCOME						
Statutory Reserve (participating reserve account):						
Balance at beginning of period	675,567,007	869,556,076	-	6,010,931	-	-
Net income allocated for the period 2/	182,923,197	176,049,119	-	4,874,078	-	-
Total participating reserve	858,490,204	1,045,605,195	-	10,885,009	-	-
Participations declared (-)	-59,868,434	-58,488,434	-	-3,500,000	-	-
Participations available	798,621,770	987,116,761	-	7,385,009	-	-
Changes in participations held in escrow	40,576	-	-	40,576	-	-
Balance at end of period	798,562,346	987,116,761	-	7,425,585	-	-
Insurance Reserve:						
Balance at beginning of period	-2,319,887,545	1,441,618,460	-2,117,378,931	16,247,175	-1,860,374,229	-
Adjustments during the period 1/	-162,971,157	-2,471,735	-122,468,181	-228,390	-37,802,851	-
Net loss (-) for the period 2/	-497,810,742	9,975,623	-282,481,773	-	-225,374,592	-
Balance at end of period	-3,180,669,444	1,449,122,348	-2,522,338,905	16,018,785	-2,123,551,672	-
Total reserves or deficit (-)	-2,382,107,098	2,240,259,109	-2,522,338,905	23,444,370	-2,123,551,672	-
BORROWINGS FROM U.S. TREASURY						
Balance at beginning of period	3,528,821,000	-	1,911,655,000	-	1,617,166,000	-
Borrowings during the period	440,000,000	-	243,000,000	-	193,000,000	-
Balance at end of period	3,968,821,000	-	2,154,655,000	-	1,810,166,000	-
Total appropriations, reserves and borrowings at end of period	\$ 3,680,557,902	\$ 2,240,259,109	\$ 976,779,945	\$ 23,444,370	\$ 414,012,173	\$ 21,609,233
1/ Comprised of the following adjustments relative to prior years:						
(a) Premium income	\$ -62,908	\$ -	\$ -62,598	\$ -	\$ -	\$ -
(b) Allowance for estimated future losses on interest receivable on mortgage and other notes	-162,908,559	-2,471,735	-122,468,181	-228,390	-37,802,851	-
Total	\$ -162,971,467	\$ -2,471,735	\$ -122,468,181	\$ -228,390	\$ -37,802,851	\$ -
2/ The net income was distributed to the statutory and/or the insurance reserve by the Assistant Secretary for Housing-Federal Housing Commissioner, HUD, FHA under authority of Section 205 and 213 of the National Housing Act.						

The notes on page 28 are an integral part of this statement. The opinion of the General Accounting Office on these statements appears on page 18.

FEDERAL HOUSING ADMINISTRATION

COMBINED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

(STATEMENT OF CHANGES IN FINANCIAL POSITION)

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1978

	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund	Urban Homesteading Program
SOURCE OF FUNDS							
Funds provided by operations:							
Income:							
Fees	\$ 55,664,154	\$ 29,125,026	\$ 25,042,562	\$ 16,869	\$ 1,479,697	\$ -	\$ -
Premiums	467,502,059	264,370,493	131,227,334	4,016,870	67,887,362	-	-
Interest on U.S. Government securities and dividends	138,472,292	136,673,976	900	1,797,416	-	-	-
Interest income	4,192,660	4,737,040	2,352,777	-	1,602,843	-	-
Income on settled properties	594,378	559,496	18,393	-	14,659	-	-
Miscellaneous income	853,647	6,856	470,483	-	376,108	-	-
Total income	✓ 672,277,190	✓ 435,472,887	✓ 159,612,449	✓ 5,831,255	✓ 71,360,699	-	-
Realization of assets:							
Proceeds from sale of properties	339,803,100	143,766,842	93,412,614	-	102,623,644	-	-
Recoveries on assigned notes	49,894,424	2,476,470	41,175,035	297,660	5,945,259	-	-
Recoveries on defaulted Title I Notes	6,820,246	-	6,820,246	-	-	-	-
Proceeds from sale of purchase money mortgages	7,164,730	4,594,030	687,500	-	1,883,200	-	-
Collections of principal on purchase money mortgages	26,924,729	1,507,809	22,762,987	33,926	2,620,007	-	-
Redemption or transfer of stock in rental and cooperative housing corporations	13,100	-	13,000	100	-	-	-
Total realization of assets	✓ 430,620,329	✓ 152,345,151	✓ 164,871,382	✓ 331,686	✓ 113,072,110	-	-
Prior fiscal year adjustments	-162,971,157	-2,471,735	-122,468,181	-228,390	-37,802,851	-	-
Total funds provided by operations	\$ 939,926,362	\$ 585,346,303	\$ 202,015,650	\$ 5,934,451	\$ 146,629,958	\$ -	\$ -
Funds provided by financing:							
Debentures issued	\$ 96,985,100	\$ -	\$ 95,780,050	\$ -	\$ 1,205,050	\$ -	\$ -
U.S. Securities redeemed, sold and/or transferred (par)	4,773,500	32,000	821,500	3,915,000	5,000	-	-
Principal collections on Defense Family Housing securities	14,741	-	14,741	-	-	-	-
Borrowings from U.S. Treasury	440,000,000	-	245,000,000	-	195,000,000	-	-
Appropriation	15,000,000	3,605,202	1,381,427	-	1,857,007	-	8,156,364
Total funds provided by financing	✓ 556,773,341	✓ 3,637,202	✓ 342,997,718	✓ 3,915,000	✓ 198,067,057	\$ -	✓ 8,156,364
Total source of funds	✓ \$ 1,496,699,703	✓ \$ 588,983,505	✓ \$ 545,013,368	✓ \$ 9,849,451	✓ \$ 344,697,015	\$ -	✓ \$ 8,156,364

The notes on page 28 are an integral part of this statement. The opinion of the General Accounting Office on these statements appears on page 18.

FEDERAL HOUSING ADMINISTRATION

COMBINED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

(STATEMENT OF CHANGES IN FINANCIAL POSITION)

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1978

	Combined	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund	Salaries and Expenses Fund	Urban Homesteading Program
APPLICATION OF FUNDS:							
Funds applied to operations:							
Expenses:							
Salaries and expenses	\$ 235,079,443	\$112,117,046	\$ 68,824,262	\$ 809,911	\$ 53,328,224	\$ -	\$ -
Interest on borrowings from U.S. Treasury	286,313,332	-	156,708,309	-	129,605,023	-	-
Interest on debenture obligations	35,477,831	185,690	34,416,183	800,788	75,170	-	-
Repairs of structural defects	6,551,373	4,865,235	952,979	-	733,159	-	-
Discount on sale of Secretary-held mortgages	338,235	220,312	30,458	-	87,465	-	-
Fee expenses	19,881,330	18,202,734	1,268,273	-	410,323	-	-
Expense on settled properties	672,286	-	150,269	-	522,017	-	-
Miscellaneous expenses	2,800,526	482,642	1,923,275	-	394,609	-	-
Total expenses	587,114,356	136,073,659	264,274,008	1,610,699	185,155,990	-	-
Acquisition of assets:							
Real property acquired including net capitalized expenses	593,073,148	278,153,023	154,800,159	-286,751	160,406,717	-	-
Assigned notes acquired including net capitalized expenses	-9,748,402	27,980,117	-29,726,375	-1,288,119	-6,714,025	-	-
Defaulted Title I notes acquired	30,223,041	-	30,223,041	-	-	-	-
Other notes receivable	1,724,695	599,003	701,260	-	424,432	-	-
Total acquisition of assets	615,272,482	106,732,143	155,998,085	-1,574,870	154,117,124	-	-
Mutual participations	59,927,859	56,468,434	-	3,459,425	-	-	-
Increase or decrease (-) in working capital applicable to operations	43,009,321	-18,925,540	49,176,161	-82,343	12,372,255	468,788	-
Total funds applied to operations	\$1,305,324,018	\$480,348,696	\$ 469,448,254	\$3,412,911	\$ 351,645,369	\$ 468,788	\$ -
Funds applied to financing:							
Debentures redeemed	\$ 75,468,950	\$ 112,600	\$ 73,271,550	\$ 1,577,900	\$ 506,900	\$ -	\$ -
U.S. securities acquired (par)	105,210,000	98,796,000	743,000	5,640,000	31,000	-	-
Increase or decrease (-) in working capital applicable to financing	10,696,735	9,726,209	1,550,564	-781,360	-7,486,254	-468,788	8,156,364
Total funds applied to financing	\$ 191,375,685	\$108,634,809	\$ 75,565,114	\$ 6,436,540	\$ -6,948,354	\$-468,788	\$8,156,364
Total application of funds	\$1,496,699,703	\$588,983,505	\$ 545,013,368	\$ 9,849,451	\$ 344,697,015	\$ -0-	\$8,156,364
Net budgetary receipts or expenditures (-)							
Total funds provided by operations	\$ 939,926,362	\$585,346,303	\$ 202,015,650	\$ 5,934,451	\$ 146,629,958	\$ -	\$ -
Total funds applied to operations	1,305,324,018	480,348,696	469,448,254	3,412,911	351,645,369	468,788	-
Net budgetary receipts or expenditures (-)	\$ -365,397,656	\$104,997,607	\$-267,432,604	\$ 2,521,540	\$-205,015,411	\$-468,788	\$ -

NOTES TO COMBINED BALANCE SHEETS

SEPTEMBER 30, 1978 AND SEPTEMBER 30, 1977

1. Investments include GNMA participation certificates in the amount of \$135,357,350 at September 30, 1978, and \$135,036,136 at September 30, 1977, plus debentures of FHA Insurance Funds in the amount of \$51,820,100 September 30, 1978, and September 30, 1977, 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 \$53,387,423 at September 30, 1978, and \$107,565,519 at September 30, 1977.
 - (b) Estimated accrued interest receivable--collection doubtful--on defaulted Title I notes at September 30, 1978, and September 30, 1977.

	<u>1978</u>	<u>1977</u>
On notes with principal balances	\$24,461,506	\$20,934,860
On notes with principal balances paid - interest due	<u>3,739,446</u>	<u>3,200,326</u>
Total	<u>\$28,200,952</u>	<u>\$24,135,186</u>

3. The following items are not recorded in the liabilities:
 - (a) Unfilled orders and incompletd portion of contracts for property repairs in the amount of \$15,440,110 at September 30, 1978, and \$11,636,989 for incompletd portion of contracts for property repairs at September 30, 1977.
 - (b) Contingent liability with respect to pending lawsuits in the amount of \$164,413,920 at September 30, 1978, and \$3,057,227 at September 30, 1977.
 - (c) Pending claims on properties and notes tendered by mortgagees but not accepted by FHA in the amount of \$53,387,423 at September 30, 1978, and \$107,565,519 at September 30, 1977.
 - (d) Certificates of claim relating to properties and notes tendered by mortgagees but not accepted by FHA in the amount of \$486,109 at September 30, 1978, and \$1,125,006 at September 30, 1977.
 - (e) Certificates of claim relating to acquired security on hand of \$72,326,849 at September 30, 1978, and \$68,057,791 at September 30, 1977.
4. The amount shown as "Borrowings from U.S. Treasury" includes \$2,156,655,000 advanced to the General Insurance Fund and \$1,812,166,000 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, 1978, and September 30, 1977 was:

	<u>1978</u>	<u>1977</u>
Mortgage Insurance Programs	\$93,868,907,749	\$89,640,699,037
Modernization and Improvement Programs (Title I, Section 2)	<u>663,241,536</u>	<u>599,992,636</u>
Total	<u>\$94,532,149,285</u>	<u>\$90,240,691,673</u>

7. The FHA in special circumstances is indemnified against loss on certain insured mortgages and assigned mortgage notes up to \$472,881 at September 30, 1978, and \$626,133 at September 30, 1977.
8. The Estimated Insurance Reserve Requirements at September 30, 1978

	Mutual Mortgage Insurance Fund	General Insurance Fund	Cooperative Management Housing Insurance Fund	Special Risk Insurance Fund
<u>Combined</u>				
\$ 5,946,400,000	<u>\$ 1,987,900,000</u>	<u>\$ 2,741,600,000</u>	<u>\$ 20,300,000</u>	<u>\$ 1,196,600,000</u>

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