



Issue Date	April 30, 1998
Audit Case Number	98-NY-221-1003

TO: Art Agnos, Acting Assistant Secretary for Housing-Federal Housing  
Commissioner, and Chairman, Mortgagee Review Board

FROM: Alexander C. Malloy, District Inspector General For Audit  
New York/New Jersey

SUBJECT: Countrywide Home Loans, Inc.  
Buffalo Branch Office  
Non-Supervised Mortgagee  
Buffalo, New York

We completed an audit of the books and records of the Buffalo Branch Office of Countrywide Home Loans, Inc., a non-supervised mortgagee. The objective of the audit was to determine whether Countrywide originated loans in accordance with regulations and requirements of the U.S. Department Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices. The review covered the period between July 1, 1995, and June 30, 1997, and consisted of a review of 20 HUD/FHA loans.

Our review concluded that for six of the 20 loans we reviewed, Countrywide did not adhere to prudent lending practices when it underwrote the loans. Specifically, we found processing deficiencies that resulted from insufficient assets to close loans, discrepancies in the amount of earnest money on deposit, and income ratios that exceeded HUD/FHA standards. We believe these deficiencies occurred because Countrywide personnel did not assure that those loans were processed in accordance with HUD/FHA requirements. As a result, mortgages were approved for unqualified mortgagors causing HUD/FHA to assume unnecessary insurance risk.

If you or your staff have questions, please contact William H. Rooney, Assistant District Inspector General for Audit, on (212) 264-8000, extension 3976.

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# Executive Summary

We completed an audit of the books and records of the Buffalo Branch office of Countrywide Home Loans, Inc., a non-supervised mortgagee. The objective of the audit was to determine whether Countrywide originated loans in accordance with regulations and requirements of the U.S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA), which require adherence to prudent lending practices. The review covered the period between July 1, 1995, and June 30, 1997, and consisted of a review of 20 HUD/FHA insured loans. A summary of the results of our review is provided below:

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## Four loans in default

Our review concluded that for six of the 20 loans we reviewed, Countrywide did not adhere to prudent lending practices during the underwriting process. Our review disclosed that each of the six loans had at least one significant deficiency and that four were in default. Specifically, we found processing deficiencies that resulted from insufficient assets to close loans, discrepancies in the amount of earnest money on deposit, and income ratios that exceeded HUD/FHA standards. We believe these deficiencies occurred because Countrywide personnel did not assure that those loans were processed in accordance to HUD/FHA requirements. Consequently, mortgages were approved for unqualified mortgagors causing HUD/FHA to assume unnecessary insurance risk.

We recommend that the Mortgage Review Board take appropriate administrative action against Countrywide and indemnify HUD/FHA for any future losses on the six loans in question.

## Exit conference

The results of the audit were discussed with representatives of Countrywide during the course of the audit and at an exit conference held on February 4, 1998, attended by:

Countrywide Home Loans, Inc.

Sherri Young, Regional Vice President  
Leslie Eberhard, Branch Manager

Buffalo Area Office-HUD

Glenn Ruggles, Director Single Family Housing

Lambross Touris, Housing Specialist  
Joseph Hobot, Housing Specialist  
Mark Surdi, Production/Real Estate Owned Branch

Office of the Inspector General

William H. Rooney, Assistant District Inspector General  
For Audit

Garry Clugston, Senior Auditor  
Nancy Condren, Auditor

Countrywide representatives told us that their written comments would be forwarded to us shortly after the exit conference. On March 12, 1998, we received their written comments. Countrywide acknowledged the lack of documentation to close the HUD/FHA insured loans. We included their written comments as Appendix C to this report.

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## Abbreviations

HUD	U.S. Department of Housing and Urban Development
FHA	Federal Housing Administration

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# Introduction

Countrywide Home Loans Inc.(Countrywide) is a non-supervised mortgagee with its headquarters located in Pasadena, California. Countrywide originates loans nationwide with branches in nearly every state. The Buffalo Branch Office underwrites loans for the Buffalo and Western New York area and is located at 3061 Sheridan Drive, No. 5, Amherst, New York.

During our audit period, which covered the period between July 1, 1995, and June 30, 1997, Countrywide's Buffalo Branch Office originated 283 FHA insured loans under the Direct Endorsement Program. As of July 23, 1997, the mortgages for 19 of the 283 loans were in default. Countrywide originates and services FHA insured loans, Veterans Administration insured loans, and conventional loans. Also, Countrywide services loans that are sold on the secondary market, e.g., Government National Mortgage Association pools.

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## Audit objective

Our audit objective was to determine whether Countrywide originated HUD/FHA insured loans in accordance with HUD/FHA requirements, which require adherence to prudent lending practices.

To accomplish our objective, we performed a detailed examination of 20 loans. We reviewed the files of 13 loans whose mortgages went into default within one year after origination. The remaining 7 loans were judgmentally selected.

## Audit, Scope and Methodology

Our detailed examinations were intended to confirm the accuracy of all material information used as a basis for originating and closing the loans. Thus, we reconfirmed the mortgagors' income, assets and employment, and interviewed mortgagors. Also, we reconfirmed the amounts that were held in depositories, or by closing agents, employees and others who were involved in the loan origination and closing process.

For criteria, we used two changes to HUD Handbooks "Mortgage Credit Analysis for Mortgage Insurance on One-to-Four Family Properties": Handbook No. 4155.1 REV-4 and 4155.1 REV-4, CHG-1. The criteria that we used depended upon the date of the mortgagor's sales contract.

Our audit pertained to loans originated between July 1, 1995, and June 30,1997. The audit work was performed at Countrywide's Buffalo Branch Office. We performed the

audit field work from July 1997 through January 1998 in accordance with generally accepted government auditing standards.

A copy of this report was provided to Countrywide.

## Inadequate Loan Origination Practices Resulted in Approval of HUD/FHA Insured Loans for Unqualified Mortgagors

Our review disclosed that Countrywide did not adhere to prudent lending practices when processing six of the 20 loans that we examined during our audit. The deficiencies occurred because Countrywide personnel did not assure that the loans were processed in accordance with HUD/FHA requirements. As a result, mortgages were approved for unqualified mortgagors causing HUD/FHA to assume unnecessary insurance risk.

Section 5-1 of HUD Handbook 4000.2 REV-1, Mortgagee's Handbook Application Through Insurance requires mortgagees to develop HUD/FHA insured loans in accordance with accepted practices of prudent lending institutions. Also, HUD Handbook 4000.4 REV-1, Chapter 2, Section 2-5, provides that the mortgagee must obtain and verify information with at least the same care that would be exercised in originating the loan in which the mortgagee would be entirely dependent on the property as security to protect its investment.

In our opinion, the mortgagee did not adhere to the above requirements, as discussed below, when it underwrote six of the 20 loans we reviewed.

### Examined 20 loans

Our examination of 20 loans originated by Countrywide between July 1, 1995, and June 30, 1997, disclosed that in six cases Countrywide either did not follow HUD requirements or did not exercise the care expected of a prudent lender in underwriting the loans. Consequently, we found significant origination deficiencies in six cases, as shown below:

<u>Deficiency</u>	<u>No. of Loans</u>
Insufficient Assets to Close	3 of the 6 loans
Earnest Money Deposit Discrepancy	4 of the 6 loans
Ratios Exceeded HUD/FHA Standards	5 of the 6 loans

Additionally, the mortgages of four of the six cases were in default as of October 1, 1997, (See Appendix A).

Appendix A to this report provides a summary of the loan origination deficiencies noted during our review, while Appendix B-1 through B-6 provide an individual description of the origination deficiencies for each of the six loans that Countrywide did not adhere to prudent lending practices. In our opinion, the deficiencies resulted in the approval of mortgages for unqualified mortgagors, which has caused HUD/FHA to assume unnecessary risk.

Countrywide did not comply with prepayment requirements

In addition to the above, we noticed that Countrywide was not complying with HUD/FHA's requirements regarding the prepayment of items by the mortgagee and sellers. Specifically, Handbook 4155.1 REV 4, CHG 1 allows the mortgagee and the seller to prepay certain items on behalf of the mortgagor prior to closing. For example, the mortgagee and seller may prepay mortgage insurance, taxes and interim interest on behalf of the mortgagor; however, these items must be identified on the Good Faith Estimate and the HUD-1, Settlement Statement.

Our review disclosed 11 instances where just an amount was recorded on the Good Faith Estimate and the HUD-1 Settlement Statement, without identifying the items that were prepaid. As a result, the mortgagors may not have had a full and clear understanding of the closing costs. We believe this deficiency occurred because Countrywide's personnel may not have adequately reviewed closing documents or were not adequately familiar with HUD requirements concerning the prepayment of items.

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## Recommendations

We recommend that the Mortgagee Review Board require Countrywide to:

- 1A. Indemnify HUD/FHA against future losses on the six loans in question (FHA Case Nos. 372-2537173, 372-2515409, 372-2572435, 372-2525724, 372-249-8901 and 372-265-7293).
- 1B. Assure that all HUD/FHA guidelines regarding origination including requirements on prepayments of items are followed.



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# Internal Controls

In planning and performing our audit, we considered internal controls of Countrywide Home Loans, Inc., in order to determine our auditing procedures and not to provide assurance on internal controls. Internal controls consist of a plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports.

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## Internal controls assessed

We determined that the internal controls relative to our audit objective were:

- Procedures for taking mortgage loan applications for applicants seeking HUD/FHA insured loans.
- Procedures for verifying information included in applications for HUD/FHA insured loans.
- Procedures for conducting underwriter reviews of loans proposed for HUD/FHA mortgage insurance.

## Assessment results

It is a significant weakness if internal controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. As illustrated by the finding, Countrywide needs to strengthen internal controls in the three areas mentioned above.

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# Follow Up On Prior Audits

Grant Thornton, LLP, Certified Public Accountants, audited Countrywide for the year ended February 28, 1997. The accounting firm's audit report on Countrywide did not contain any findings related to the Buffalo Branch Office.

APPENDIX A

COUNTRYWIDE HOME LOANS INC.  
Buffalo, New York

SUMMARY OF LOAN ORIGINATION DEFICIENCIES

HUD/FHA Case Number	Mortgage Amount	Settlement Date	Insufficient Assets to close	Earnest money deposit discrepancy	Ratios exceeded HUD/FHA standards	Loan status as of 10/1/97	Appendix Reference
372-2537173	\$45,335	12/29/95	X	X	X	In Default	B-1
372-2498901	\$35,238	7/20/95		X	X	Loan is current.	B-2
372-2515409	\$34,330	11/30/95	X	X	X	In Default	B-3
372-2657293	\$43,418	3/7/97		X	X	Loan is current.	B-4
372-2572435	\$43,316	3/29/96	X			In Default	B-5
372-2525724	\$77,860	9/29/95			X	In Default	B-6
Totals	\$279,497		3	4	5		

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2537173  
Loan Amount: \$45,335  
Settlement Date: 12/29/95  
Status: Last payment 1/97

Summary

Countrywide approved the mortgage without verifying that the mortgagor had sufficient cash assets to obtain the loan, and without resolving a discrepancy that existed between the amount of earnest money held by the seller/broker and the amount reported on the HUD-1. Furthermore, the mortgagor's 38.9 percent ratio of mortgage payment expense to effective income exceeded HUD/ FHA's standard of 29 percent. Therefore, HUD/ FHA's decision to insure the loan was based on Countrywide's inaccurate representation that the mortgagor met requirements.

Pertinent Details

A. Insufficient Assets to Close

Countrywide did not verify that the mortgagor had sufficient funds to close the loan as required by Handbook 4155.1 Rev-4 , Paragraph 2-10. Countrywide verified that the mortgagor's daughter donated \$710 as a gift to the mortgagor and verified that earnest money of \$600 was held by the seller/broker as a deposit, which resulted in total assets of \$1,310. However, the amount needed to obtain the loan per the Mortgage Credit Analysis Worksheet was \$4,193.43. Also, the worksheet indicated that the mortgagor had zero assets. There was no explanation in the files indicating where the mortgagor would obtain the assets.

B. Questionable Verification of Earnest Money

In addition to the lack of verification of sufficient assets to close the loan, there was a discrepancy in the amount of earnest money on deposit. The seller/ broker provided verification that \$600 in earnest money was being held as a deposit from the mortgagor. However, the HUD-1, Settlement Statement listed only \$500 as the amount of earnest money that was on deposit.

C. Credit Analysis Ratio Exceeded HUD/FHA Standard

Countrywide approved the loan despite the fact that the Mortgage Credit Analysis Worksheet showed an excessive 38.9 percent ratio of mortgage payment expense to effective income. The HUD/ FHA standard in effect at the time specified a 29 percent limit on the mortgage payment expense to effective income ratio ( Handbook 4155.1 REV-4 CHG 1, Paragraph 2-12 ). The compensating factors used by Countrywide to justify using the higher ratio were that \$350 per month rent from a second unit was not used to qualify the mortgagor, there was no outstanding debt, and the mortgagor was an inner city minority. However, the Mortgage Credit Analysis Worksheet also indicated that the mortgagor's monthly housing expenses would increase from \$300 to \$508. In our opinion, the compensating factors did not offset the increase in housing expenses; therefore, we believe Countrywide did not have adequate justification to use the higher ratio.

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2498901

Loan Amount: \$35,238

Settlement Date: 7/20/95

Loan Status: Current

Summary:

Countrywide approved the mortgage without resolving a discrepancy between the amount of earnest money held by the seller/broker and the amount reported on the HUD-1, Settlement Statement. Also, both the mortgagor's 42.11 percent ratio of mortgage payment expense to effective income and 42.11 percent ratio of total fixed payment to effective income exceeded HUD/FHA's standards. Therefore, HUD/FHA's decision to insure the loan was based on Countrywide's inaccurate representation that the loan met requirements.

Pertinent Details

A. Questionable Verification of Earnest Money

Our review of the loan files showed that Countrywide verified that the seller/broker held \$1,400 in earnest money as a deposit from the mortgagor. However, the HUD-1 Settlement Statement listed \$100 as earnest money on deposit. In our opinion, the significant discrepancy between the amount of earnest money on deposit with the seller/broker and the amount stated on the HUD-1, Settlement Statement should have raised questions. In addition, our review disclosed that at the mortgage closing a check for \$223.90 in loan proceeds was issued to the mortgagor, but was endorsed over to the seller/broker. There is no explanation in the files as to why that transaction occurred.

B. Credit Analysis Ratios Exceeded HUD/FHA Standards

Countrywide approved the loan despite the fact that the Mortgage Credit Analysis Worksheet showed an excessive 42.11 percent ratio of mortgage payment expense to effective income, and an excessive 42.11 percent ratio of total fixed payment to effective income. HUD/FHA standards in effect at that time (Handbook 4155.1 REV-4 CHG-1)

specified a 29 percent limit on the mortgage payment expense to effective income ratio, and a 41 percent limit on the total fixed payment to effective income ratio. No compensating factors were provided on the Mortgage Credit Analysis Worksheet to justify approving the loan with ratios exceeding the standards.

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2515409  
Loan Amount: \$34,330  
Settlement Date: 11/30/95  
Status: Last payment 6/96

Summary

Countrywide approved the mortgage without verifying that the mortgagor had sufficient cash assets to obtain the loan. Also, the mortgage was approved with a discrepancy between the amount of earnest money held by the seller/broker and the amount stated on the HUD-1, Settlement Statement existed. Furthermore, the mortgagor's 36.75 percent ratio of mortgage payment expense to effective income exceeded HUD/FHA's standard. Therefore, HUD/FHA's decision to insure the loan was based on Countrywide's inaccurate representation that the mortgagor met requirements.

Pertinent Details

A. Insufficient Assets to Close

Countrywide did not verify that the mortgagor had sufficient funds to close the loan as required by Handbook 4155.1 Rev-4, Paragraph 2-10. Countrywide verified that the mortgagor's wife donated \$1,100 as a gift to the mortgagor and that earnest money of \$380 was held by the seller/broker for total assets of \$1,490. The amount needed at mortgage closing, per the Mortgage Credit Analysis Worksheet, was \$3,367.82. This worksheet also indicated that the mortgagor had zero assets. There was no explanation in the files indicating where the mortgagor would obtain additional assets.

B. Questionable Verification of Earnest Money

In addition to the lack of verification of sufficient asset to close the loan, was a discrepancy in the amount of earnest money on deposit. The seller/broker provided verification that it was holding \$380 in earnest money from the mortgagor. However, the HUD-1, Settlement Statement showed only \$100 as the amount of earnest money on deposit.



C. Credit Analysis Ratio Exceeded HUD/FHA Standard

Countrywide approved the loan despite the fact that the Mortgage Credit Analysis Worksheet showed an excessive 36.75 percent ratio of mortgage payment expense to effective income. The HUD/ FHA standard in effect at the time specified a 29 percent limit on the mortgage payment expense to effective income ratio (Handbook 4155.1 REV-4 CHG 1 Paragraph 2-12 ). The compensating factors used by Countrywide were: “ four years in same line of work and the mortgagor recently turned full time”. However, we noted that those factors had already been considered in computing the ratio and did not justify exceeding the HUD/FHA standard. In addition, the Mortgage Credit Analysis Worksheet showed that the mortgagor’s monthly housing expenses would increase from \$0 to \$378. This increase was not included in the mortgage credit calculations and there was no explanation in the files as to why it was not included.

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2657293

Loan Amount: \$43,418

Settlement Date: 3/7/97

Loan Status Current

Summary:

Countrywide approved the loan without verifying that the mortgagor had sufficient cash assets to close the loan, and without resolving a discrepancy between the amount of earnest money held by the seller/broker and the amount stated on the HUD-1, Settlement Statement. Also, the mortgagor's 34.19 percent ratio of mortgage payment expense to effective income exceeded HUD/ FHA's standard. Therefore, HUD/FHA's decision to insure the loan was based on Countrywide's inaccurate representation that the mortgagor met requirements.

Pertinent Details

A. Questionable Verification of Earnest Money

Our review of the loan files showed that Countrywide received documentation from the seller/broker indicating that \$2,400 was being held in earnest money as a deposit. However, the HUD-1, Settlement Statement had different numbers. It listed \$1,612.50 as earnest money on deposit under the Summary of Mortgagor's Transactions and \$1,700 as earnest money on deposit under the Summary of Sellers Transactions.

B. Credit Analysis Ratio Exceeded HUD/FHA Standard

Countrywide approved the loan despite the fact that Mortgage Credit Analysis Worksheet showed an excessive 34.19 percent ratio of mortgage payment expense to effective income. The HUD/FHA standard in effect at that time (Handbook 4155.1 REV-4 CHG-1) specified a 29 percent limit on the mortgage payment expense to effective income ratio. The compensating factors stated by Countrywide were "child support collection paid in full at closing". However, we noted that the mortgagor's monthly income had already been adjusted for the change in the child support payment and did not justify exceeding the HUD/FHA standard.

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2572435  
Loan Amount: \$43,316  
Settlement Date: 3/29/96  
Loan Status: Last Payment 8/96

Summary

Countrywide approved the loan without verifying that the mortgagor had sufficient cash assets to close the loan. Therefore, HUD/ FHA's decision to insure the loan was based on Countrywide's inaccurate representation that the mortgagor met all requirements.

Pertinent Details

A. Insufficient Assets to Close

Countrywide did not verify that the mortgagor had sufficient funds to close the loan as required by Handbook 4155.1 Rev-4 , Paragraph 2-10. Countrywide verified assets totaling \$2,502. However, the amount needed to close the loan per the Mortgage Credit Analysis Worksheet was \$3,817.04. This worksheet also indicted that the mortgagor had only \$200 of available assets. There was no explanation in the files indicating where the mortgagor was going to obtain the additional assets.

COUNTRYWIDE HOME LOANS, INC.  
BUFFALO, NEW YORK

NARRATIVE CASE PRESENTATION

FHA Case Number: 372-2525724  
Loan Amount: \$77,860  
Settlement Date: 9/29/95  
Status: Last payment 5/96

Summary

The mortgagor's 39.72 percent ratio of mortgage payment expense to effective income and the 45.05 percent ratio of total fixed payment to effective income exceeded HUD/ FHA's standards.

Pertinent Details

A. Credit Analysis Ratios Exceeded HUD/FHA Standards

Countrywide approved the loan despite the fact that the Mortgage Credit Analysis Worksheet showed an excessive 39.72 percent ratio of mortgage payment expense to effective income, and an excessive 45.05 percent ratio of total fixed payment to effective income. HUD/ FHA's standards in effect at the time specified a 29 percent limit on the mortgage payment expense to effective income ratio and a 41 percent limit on the total fixed payment to effective income ratio ( Handbook 4155.1 REV-4 CHG 1 Paragraph 2-12 ). No compensating factors were provided on the Mortgage Credit Analysis Worksheet. Also, the Mortgage Credit Analysis Worksheet indicated that the mortgagor's monthly housing expenses was going to increase from \$0 to \$828.64. This increase was not included in the mortgage credit calculations and there was no explanation in the files as to why it was not included.

Countrywide's Comments

Although the mortgage credit analysis did not provide any compensating factors, it appears that the underwriter approved the loan with high ratios due to the mortgagor's marital status, additional income, previous home ownership and excellent credit history.

OIG's Evaluation of Countrywide's Comment

At the time of the purchase the mortgagor was in the process of a divorce; therefore, any additional income resulting from the marital status ( income from spouse) in our opinion, should not have been a compensating factor to justify exceeding HUD/FHA's ratios.

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# Distribution

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Buffalo Area Coordinator, 2CS (2)  
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Countrywide Home Loans, Attention Leslie D. Eberhard, Buffalo, New York

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