



U.S. DEPARTMENT OF
HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL

September 24, 2013

MEMORANDUM NO:
2013-LA-0804

Memorandum

TO: Charles S. Coulter
Deputy Assistant Secretary, Single Family Housing, HU

FROM: Tanya E. Schulze
Regional Inspector General for Audit, Los Angeles, 9DGA

SUBJECT: Corrective Action Verification, Underwriting Review of 15 Lenders, Report
2011-CF-1801

INTRODUCTION

We completed a corrective action verification of a recommendation made to the U.S. Department of Housing and Urban Development's (HUD) Office of Single Family Program Department pertaining to our underwriting review of 15 Federal Housing Administration (FHA) lenders in Audit Memorandum 2011-CF-1801, issued March 2, 2011. The review demonstrated that HUD missed critical opportunities to recover losses to the FHA insurance fund. The purpose of the corrective action verification was to determine whether the Office of Housing appropriately implemented corrective actions to close recommendation 1A.

METHODOLOGY AND SCOPE

The corrective action verification focused on recommendation 1A from the subject audit memorandum. To accomplish our objective, we

- Reviewed the audit memorandum and supporting documentation, as well as HUD's management decision and the supporting documentation used by HUD to close the recommendation.
- Interviewed officials from HUD's Office of Single Family Housing.

- Analyzed HUD’s claim case selection tool from October 2012 to April 2013 by independently pulling data from HUD’s Single Family Data Warehouse¹ and comparing the results to the claims selected by HUD’s new tool to determine whether the tool worked correctly.
- Analyzed the timeliness of the assignment and review of claims provided by HUD for loans selected by the claim case selection tool.

Due to our inability to obtain accurate loan-tracking data, we could not determine the status of the loans in the claim review process. However, we determined that there was enough information to support our finding and recommendations.

We did not conduct the review in accordance with generally accepted government auditing standards. This report is significantly reduced in scope and should not be considered a detailed analysis or assessment of HUD’s internal controls and operations. These facts do not affect the significance of the condition identified in this memorandum.

BACKGROUND

On March 2, 2011, we issued Audit Memorandum 2011-CF-1801, which summarized our underwriting review of 15 FHA lenders. The audit memorandum noted that HUD missed critical opportunities to recover losses on loans that did not meet FHA requirements and did not pursue civil remedies when lenders improperly certified to using due diligence in approving FHA loans when due diligence was not practiced. The audit memorandum attributed these failures to the fact that HUD did not have a formal process established to review all claims paid on defaulted mortgages or at least all such claims paid that met high-risk criteria, resulting in unrecovered losses to the insurance fund for loans that should not have been insured.

The audit memorandum contained the following recommendation for HUD’s Deputy Assistant Secretary of Single Family Housing:

- 1A. Develop and implement procedures to review a statistical or risk-based selection of loans for which FHA paid a claim on the mortgage insurance within the first two years of endorsement, to verify that the loans met FHA requirements and were qualified for insurance. These procedures should include a requirement for HUD to seek appropriate civil and administrative remedies to recover losses incurred on loans not qualified for FHA insurance.

In response to recommendation 1A, HUD’s management decision stated that it would alter its claim case selection tool to select all loans for which FHA paid a claim on the mortgage insurance within the first 24 months from the beginning amortization date. HUD stated that its Quality Assurance Division² personnel would review these loans to ensure that each loan was

¹ HUD’s Single Family Data Warehouse is a large and extensive collection of database tables organized and dedicated to support analysis, verification, and publication of single-family housing data.

² The Quality Assurance Division is responsible for ensuring that FHA-approved lenders comply with requirements that govern lender practices. It monitors the performance of lenders and how well their loans perform on an ongoing basis.

underwritten in compliance with FHA requirements and was eligible for FHA insurance endorsement. Any material violation of FHA requirements would result in an indemnification request or referral to the Mortgagee Review Board for imposition of civil money penalties or other administrative action.

On May 18, 2012, HUD's Office of Inspector General (OIG) concurred with the proposed management decision. HUD's Deputy Assistant Secretary, Department of Single Family Programs, signed the final action certification on November 2, 2012, certifying that final actions on recommendation 1A were complete. To evidence its implementation of the corrective action, HUD submitted (1) a copy of the business requirements and the change order request to alter the loan selection tool, (2) documentation showing implementation of the revised tool in HUD's Neighborhood Watch system,³ and (3) a copy of the portion of the Quality Assurance Division's standard operating procedures for lender monitoring reviews describing the Division's procedures for requesting indemnifications and referring lenders to the Mortgagee Review Board.

RESULTS OF REVIEW

Our corrective action verification found that HUD's Office of Housing did not adequately implement corrective action to close recommendation 1A of Audit Memorandum 2011-CF-1801. Specifically, (1) HUD's claim case selection tool did not select all claims for review, (2) HUD did not have adequate systems in place for tracking the status of the claim file review and indemnification requests, and (3) HUD did not review loans in a timely manner.

HUD's Claim Case Selection Tool Did Not Select All Claim Files for Review

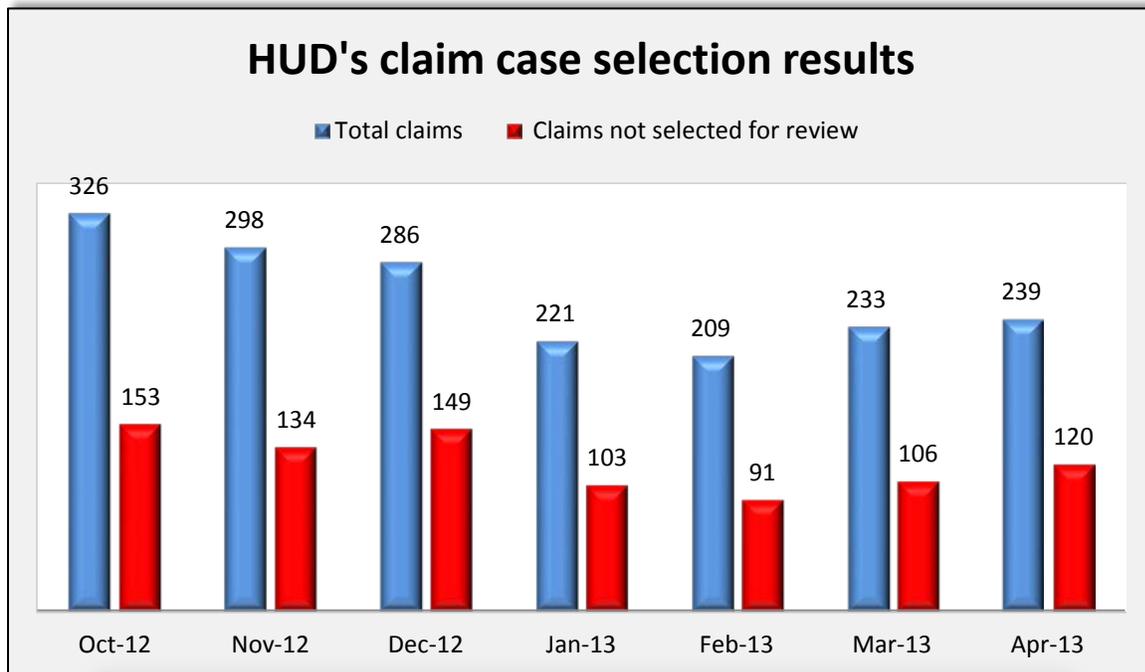
HUD's claim case selection tool did not select all claims. As part of the final corrective action certification provided by HUD to close the management decision, HUD stated that its tool would select all loans for which it paid a claim within 24 months from the beginning amortization date. HUD stated that the system would select loans based on the following criteria: (1) loans with an insurance status code of C (claims), 2) loans with a beginning amortization date in the 2-year period up to and including the current month, (3) loans with a termination date in the current month, and (4) loans with a claim type of 01 (conveyance) or 07 (pre foreclosure). In addition, the system should exclude loans that were (1) previously reviewed during a lender monitoring review with an associated Approval and Recertification, Review Tracking System (ARRTS)⁴ file number or (2) selected for postendorsement technical reviews, as well as home equity conversion mortgages.

We pulled data independently in HUD's Single Family Data Warehouse, using the criteria explained above. HUD's new claim case selection tool did not select all claims as required. For

³ The Neighborhood Watch system displays loan performance data for lenders and appraisers, by loan types and geographic areas using FHA-insured single family loan information. The loans selected by HUD's new claim case selection tool are displayed in Neighborhood Watch.

⁴ HUD uses ARRTS to track incoming application and recertification packages from mortgagees seeking FHA branch approval and to monitor the status of compliance reviews conducted on those institutions that are already approved to participate in FHA programs.

example, in December 2012, HUD provided data showing that the claim case selection tool selected 45 loans for review. When we ran our query in the Single Family Data Warehouse, there were 286 claims that met HUD’s criteria. After removing the 45 loans that HUD’s claim case selection tool selected, the 79 loans that had postendorsement technical reviews, and the 13 loans with lender monitoring reviews, there were 149 loans with more than \$11.5 million in paid claims unaccounted for. This type of result was consistent for each month as shown in the figure below.



We determined that the gap in data was due to HUD’s use of the termination date as its criterion for pulling loans, which HUD did not enter until it processed the claim. This date could be several months after the termination date. Due to the timing difference, HUD’s claim case selection tool did not select all loans. HUD agreed that the termination dates in the system could be backdated, which caused the inconsistencies in the data pulled. Also, HUD stated that once the claim case selection tool was up and running, it did not perform testing to ensure that the claims selected monthly were accurate because it tested the system before activation and did not find any issues. Due to the timing gap, from October 2012 through April 2013, HUD’s claim case selection tool did not select 856 loans with approximately \$65.6 million in paid claims.

HUD Did Not Have an Effective System To Track Reviews Performed

HUD’s standard operating procedures states that once the claim case selection tool selects a loan for review HUD will add it to the claim file tracking log and then assign the loan for review. After HUD assigns the loan for review, it tracks the review in ARRTS. We asked HUD to provide a listing of reviews performed. Initially, HUD was unable to provide these data because it was unable to pull the data by FHA case number. The data it could pull showed ARRTS file numbers; however, some file numbers had multiple FHA case numbers. Eventually HUD was able to extract data from ARRTS using the FHA case number. However, the data provided were

not consistent and contained irregularities. For example, HUD stated that it reviewed 91 loans. However, the listing provided from ARRTS contained duplicate FHA case numbers and showed that only 73 loans were reviewed. HUD stated that the 91 reviews were correct but that because of data entry errors, the report did not accurately reflect the number of loans reviewed.

Without an effective tracking system, HUD cannot adequately monitor the claim case review process, and some files assigned may not get reviewed. HUD stated that it was working with its contractor to develop a better tracking system in ARRTS.

HUD Did Not Perform File Reviews in a Timely Manner

From September 2012 through May 16, 2013, HUD assigned 291 claim case files for review. The tracking spreadsheet provided by HUD on July 25, 2013, showed that 91 (31 percent) of the reviews had been completed. HUD stated that this was a new process and the lack of resources made it difficult to increase the workload capacity of employees. HUD also stated that the delay in data refresh in its Neighborhood Watch system and a delay in obtaining the paper case files caused a delay in assigning the file reviews to staff. However, even after HUD assigned the files, there seemed to be a delay in the reviews. For example, HUD headquarters assigned claim file reviews to the Atlanta Homeownership Center (HOC) on May 16, 2013. We spoke to the HOC on August 6, 2013, at which time the HOC was unaware of the status of the loan file reviews and stated that the claim case reviews were low on its list of priorities. According to the tracking document provided by HUD headquarters, the HOC had not completed any of the reviews assigned. The Atlanta HOC stated that it would complete the reviews by the end of the fiscal year. In contrast, the Santa Ana HOC showed that the reviews could be performed in a timely manner if the right emphasis was placed on the reviews and there was proper planning. The Santa Ana HOC received the claim case review assignment on May 16, 2013, the same date as the Atlanta HOC. The Santa Ana HOC quickly developed a plan and was able to complete all 32 reviews assigned by July 1, 2013, only 46 days after assignment.

HUD stated that the management decision states that it will review all of the loans but does not state when it will perform the reviews. However, if HUD wants to meet the intent of the new processes and wants each of the HOCs and headquarters personnel to review loans in a timely manner, it needs to implement timeframes for completing the claim case file reviews. Timely reviews are essential to ensuring timely action on claim loans that did not meet FHA requirements and reimbursing the funds to the FHA insurance fund. The longer it takes to review the claim loans, the longer it takes to get the potential reimbursement to the FHA insurance fund. Also, if HUD selects and assigns loan reviews monthly, it is important to stay current on the reviews; otherwise, it may cause a backlog that will create an even bigger demand on HUD's already limited resources.

CONCLUSION

Our corrective action verification found that HUD's Office of Housing did not adequately implement corrective action to close recommendation 1A of Audit Memorandum 2011-CF-1801. The claim case selection tool that HUD created to select all loans meeting its criteria did not select all claims as designed. This condition resulted in more than 856 loans meeting HUD's criteria, with more than \$65.6 million in claims paid, not being selected for review. Also, HUD did not have an adequate system in place for tracking the status of the claim file reviews and indemnification requests, which may result in claim files slipping through the process without a review. In addition, HUD did not implement timeframes for completing the assigned file reviews. As a result, HUD did not complete claim file reviews in a timely manner, causing a delay in potential reimbursements to the FHA insurance fund and increased demands on its already limited resources.

RECOMMENDATION

We recommend that HUD's Deputy Assistant Secretary for Single Family Housing

- 1A. Reopen Audit Memorandum 2011-CF-1801 recommendation 1A in HUD's Audit Resolution Corrective Action Tracking System (ARCATS) and that it remain open until fully implemented.

Appendix A

AUDITEE COMMENTS

We provided HUD an opportunity to respond to this report in writing, which would be included as an appendix to the report, with a submission due date of September 19, 2013. HUD notified us on September 19, 2013 that it was not submitting written comments.