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TO: Ronald Rosenfeld, President, Government National Mortgage Association, T

FROM: Nancy H. Cooper   
Regional Inspector General for Audit, Region 4, 4AGA

SUBJECT: Government National Mortgage Association  
Review of Internal Controls  
Washington, DC

### INTRODUCTION

We have completed an audit of the Government National Mortgage Association (Ginnie Mae). We initiated the review because a recent Office of the Inspector General's (OIG) investigation of a defaulted issuer identified weaknesses in Ginnie Mae's internal controls. Our primary objective was to determine if Ginnie Mae had adequate internal controls to ensure loans in its portfolio were properly insured by the Federal Housing Administration (FHA)<sup>1</sup>. We also assessed Ginnie Mae's automated database of loans to determine the accuracy of loan information and evaluated other management controls.

Our review primarily focused on loans that were active according to Ginnie Mae's automated database as of May 20, 2002. We performed our work between July 2001 and December 2002. We conducted our audit in accordance with generally accepted government auditing standards.

To accomplish our objectives, we used Computer Assisted Auditing Techniques to perform an electronic data comparison between loans in Ginnie Mae's MBSIS database and HUD's Single Family Insurance System (SFIS). The purpose of the comparison was to determine if all loans entered into the MBSIS between January 1, 1990, and May 20, 2002, had current FHA insurance endorsement. We also reviewed a statistical sample of loans at Chase Manhattan Mortgage

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<sup>1</sup> Our review focused only on those single family loans identified in Ginnie Mae's Mortgage Backed Securities Information System (MBSIS) as FHA insured.

Corporation in Columbus, OH, Homeside Lending, Inc. in San Antonio, TX, and Wells Fargo Home Mortgage, Inc., in Des Moines, IA. Further, we evaluated the data to identify issuers who may have included uninsured loans in Ginnie Mae pools. We also:

- Interviewed Ginnie Mae officials, document custodians, and issuers;
- Evaluated Ginnie Mae's policies and procedures for monitoring, issuers, document custodians and contractors;
- Reviewed Ginnie Mae's defaulted issuer files to determine the causes for the defaults;
- Reviewed Ginnie Mae's procedures for matching its loan portfolio with FHA's endorsed loan portfolio;
- Reviewed information obtained from document custodians/issuers, including Mortgage Insurance Certificates (MIC), monthly accounting reports, and Pool Trial Balance reports; and,
- Reviewed Klynveld, Peat, Marwick, Goerdeler audit workpapers.

Should you or your staff have any questions, please contact me at (404) 331-3369, or Gerald Kirkland, Assistant Regional Inspector General for Audit, at (865) 545-4368.

### **SUMMARY**

Several control weaknesses existed in Ginnie Mae's operations. These included: (1) not requiring issuers to accurately report FHA case numbers or use the FHA case numbers as its primary management control tool, (2) inadequate controls to ensure the reliability of automated data, (3) inadequate procedures for matching information in Ginnie Mae's systems to information in FHA's systems, and (4) an unreasonable amount of time allowed for issuers to provide the MIC to the document custodian. Because Ginnie Mae officials did not recognize the need to implement the controls, its database contained incomplete and inaccurate loan information and its risk of fraud was increased. In fact, one issuer was able to submit over \$21 million of uninsured and fraudulent loans into Ginnie Mae pools. Subsequently, several individuals were convicted of criminal charges, including bank fraud related to the loans.

We discussed the weaknesses with Ginnie Mae officials throughout the review. Both in response to our discussions and through its own assessments of its controls, Ginnie Mae implemented several new procedures designed to strengthen controls and improve operations.

However, through our use of Computer Assisted Auditing Techniques, we identified several issuers who may have included loans in Ginnie Mae pools that were not insured by FHA<sup>2</sup>. As such, we will initiate reviews of selected issuers and notify Ginnie Mae of the results.

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<sup>2</sup> These loans were placed in pools prior to implementation of new procedures.

## **BACKGROUND**

Ginnie Mae is a wholly owned corporate instrumentality of the United States within the Department of Housing and Urban Development (HUD). Ginnie Mae was established through a 1968 amendment to Title III of the National Housing Act. The Secretary of HUD and the President of Ginnie Mae administer it. The President of the United States appoints the Ginnie Mae President.

Ginnie Mae is authorized by section 306(g) of the National Housing Act to guarantee the timely payment of principal and interest on securities that are based on and backed by trusts or pools composed of mortgages submitted by issuers. The loans are insured or guaranteed by FHA, the Department of Agriculture under the Rural Housing Service Program, or the Department of Veterans Affairs, or guaranteed by the Secretary of HUD under section 184 of the Housing and Community Development Act of 1992.

Ginnie Mae's mission is to support expanded affordable housing by providing an efficient government-guaranteed secondary market vehicle linking the capital markets with Federal housing markets.

Approved issuers create pools of mortgages that they originated or acquired. The issuers submit the pools in electronic form using the GinnieNET system. GinnieNET is an integrated system of databases used to maintain essential information including issuer data, loan commitment authority, pool processing, and loan information. The issuer posts the pool information to GinnieNET and sends the physical documents for each pooled loan to a document custodian.

The document custodian reviews the loan documents for each pool and certifies to Ginnie Mae that they accurately represent the pooled mortgages in accordance with Ginnie Mae requirements. The document custodian certifies to Ginnie Mae that the issuer has submitted the minimum documents required to allow a Ginnie Mae security to be issued. The document custodian also holds the loan documents in safekeeping for the life of the pool.

The issuers are responsible for marketing and administering the securities and making the monthly payments to the security holders. Issuers are also responsible for servicing the pooled mortgages until maturity or termination. The issuer collects the mortgagors' monthly principal, interest, and escrow payments and all other payments and recoveries with respect to the pooled mortgages and deposits them into its custodial accounts for the pool.

All loan information including the FHA case number, property location, mortgagor name and social security number, loan balance, and other information is maintained in MBSIS.

## **FINDING 1 – INTERNAL CONTROL WEAKNESSES EXISTED IN GINNIE MAE'S OPERATIONS.**

Several control weaknesses existed in Ginnie Mae's operations. These included: (1) not requiring issuers to accurately report FHA case numbers or use the FHA case numbers as its primary management control tool, (2) inadequate controls to ensure the reliability of automated data, (3) inadequate procedures for matching information in Ginnie Mae's systems to information in FHA's systems, and (4) an unreasonable amount of time allowed for issuers to provide the MIC to the document custodian. Because Ginnie Mae officials did not recognize the need to implement the controls, its database contained incomplete and inaccurate loan information and its risk of fraud was increased. In fact, one issuer was able to submit over \$21 million of uninsured and fraudulent loans into Ginnie Mae pools. Subsequently, several individuals were convicted of criminal charges, including bank fraud related to the loans.

Ginnie Mae's Mortgage Backed Securities Guide, 9-2: (A) Insurance/Guaranty reads that each mortgage must be, and must remain, insured or guaranteed under the National Housing Act, Title V of the Housing Act of 1949, the Servicemen's Readjustment Act of 1944, chapter 37 of Title 38, United States Code, or section 184 of the Housing and Community Development Act of 1992, and must at all times comply with the requirements for obtaining and maintaining such insurance or guaranty.

Office of Management and Budget Circular No. A-127, Section 7(j), Revised, reads in part, "Internal Controls. The financial management systems shall include a system of internal controls that ensure resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and disclosed in reports. Appropriate internal controls shall be applied to all system inputs, processing, and outputs. Such system related controls form a portion of the management control structure required by Office of Management and Budget Circular A-123."

Based on our review, we believe Ginnie Mae did not have adequate controls in some areas.

### **Ginnie Mae did not require accurate reporting of FHA case numbers.**

Ginnie Mae did not monitor or enforce issuers' accurate reporting of FHA case numbers. It also did not use the FHA case number as a primary management control tool. Instead, each issuer assigned its own internal loan number and used this number to identify and track loans. Ginnie Mae pools included FHA, Department of Veterans Affairs, and other loans. Every FHA insured loan is assigned a unique case number. As such, Ginnie Mae should use the case number as a primary management control for identifying and tracking those loans. This would also allow Ginnie Mae to more easily compare information with HUD's systems. Because Ginnie Mae did not require issuers to accurately report the FHA case numbers, issuers placed no emphasis on accurately inputting, maintaining, or reporting a loan's FHA case number.

Our preliminary data match between Ginnie Mae's database of loans and insured loans in HUD's SFIS indicated there were loans in Ginnie Mae pools that were not FHA insured. We selected a statistical sample of 69 of those loans for review to verify the results of the data match. We selected several samples based on the type of anomaly discovered during the data matching. One of the anomalies we identified was "terminations." "Terminations" were those loans that showed

its FHA insurance had been terminated according to SFIS, yet GinnieMae's database showed the loans as active. We used the "Status" and "FHA Case Number" data fields to perform the "terminations" match. We believed the status field would be a valid field upon which to perform a secondary data match.

Our review of the sample showed that all 69 of the loans were FHA insured. They appeared to be uninsured based on the data match because issuers did not update the FHA case numbers in MBSIS when changes occurred, such as upon termination or cancellation of the insurance. For example, a borrower may have refinanced or paid off a mortgage loan, or sold the home. The loan was then removed from the Ginnie Mae pool. At that point, a new loan (refinanced, new home owner, etc.) on the same property may have been insured by FHA. Thus, a new FHA case number was assigned. FHA would then update the information in its SFIS to reflect the change. However, when the issuer placed the new loan in a pool, it did not update MBSIS to show the new FHA case number. Instead, issuers reported the new borrower information, but used the old FHA case number (assigned to the original FHA loan).

We discussed our concerns with Ginnie Mae management. During the course of the review, Ginnie Mae management was aggressively seeking improvements and enhancements to its internal control procedures to address the cited deficiency. Ginnie Mae issued an "All Participants Memo" (02-17), dated July 2, 2002, updating the requirements issuers must follow with respect to the maintenance and submission of pooled loan information. Ginnie Mae issued another "All Participants Memo" (02-21), dated August 16, 2002, which further explained the new requirements. The subject of the memos was the new standards for reporting loan information to Ginnie Mae with an emphasis placed on the accurate reporting of FHA case numbers. The memos stressed that each participant would be held accountable for accumulating, maintaining, and reporting accurate information related to the loans. The memos point out that each issuer is responsible for maintaining information that is timely, accurate, complete, and in the correct format. The memos highlighted common reporting problems and outlined the new reporting requirements.

Ginnie Mae did not have adequate controls to ensure reliability of automated data.

Ginnie Mae did not have adequate controls to ensure issuers accurately input data into its database. As a result, Ginnie Mae issuers input inaccurate loan information into the database resulting in unreliable data. We found loans where data fields were blank, contained all zeros, had alphanumeric characters in numeric fields, or had other improper entries.

Ginnie Mae did not have controls to check the syntax and format of data to ensure it was in proper format. For example, edit checks could have been implemented to ensure, only numeric entries were input into the zip code and case number fields, no post office box numbers were input in the address field, and no required fields were blank.

During our review, we discussed our concerns with Ginnie Mae management. As a result, they began taking positive steps to address data input errors. For example, in an "All Participant's Memo" (02-17) dated July 2, 2002, Ginnie Mae management communicated new reporting

guidelines to issuers. In part, the memo required issuers to use a standard format when reporting case number/loan number information on FHA insured loans and complete additional fields on quarterly reports that will assist in documenting the history of the loans.

Further, the GinnieNET system will be enhanced to verify that the FHA case numbers reported are complete and in the proper format. The system will flag incorrect FHA case numbers. For example, the system will ensure the data field contains the correct number of digits. Ginnie Mae reserves the right to reject loan pools containing loans with incomplete or improperly formatted FHA case numbers. While this improvement alone will not ensure loans are insured by FHA, it will at least ensure issuers input complete, properly formatted numbers. Ginnie Mae could then perform data matches with SFIS, using the FHA case numbers, to ensure the loans are insured.

Memo 02-17 also highlighted common reporting problems, including incorrect or duplicate case numbers, incorrect loan types, missing borrower names, incorrect or incomplete social security numbers, and missing or incomplete borrower addresses and/or zip codes. The memo allowed issuers until October 1, 2002, to make changes to their processes and perform testing. Ginnie Mae later extended the deadline to December 1, 2002.

Ginnie Mae expanded follow up procedures with issuers to determine why duplicate and missing records existed. Ginnie Mae will perform additional analysis of issuers with high occurrences of data anomalies.

By requiring issuers to report accurate data and improving its control procedures, Ginnie Mae will improve program integrity and decrease its risk of loss.

#### Ginnie Mae did not have adequate procedures for matching automated loan data.

Ginnie Mae requires that each mortgage be, and remain, insured or guaranteed. To test issuer compliance, Ginnie Mae implemented quarterly matching procedures. However, because the matching procedures did not match on the loan's "Status" field, Ginnie Mae did not identify loans with cancelled insurance (loans that were terminated or loans where claims were paid).

In addition, the matching procedures were not applied to all loans. Rather only loans placed in Ginnie Mae pools during the last 24 months were included in the matches. Failing to match 100 percent of the loans increased the possibility of not identifying uninsured loans.

This matching procedure also produced reports that identified "mismatches" between Ginnie Mae's data and FHA's data. Ginnie Mae used the results of these reports were used only as a planning tool. It did not use the results to correct invalid data.

We suggested Ginnie Mae: (1) use the "Status" field in its matching procedures, (2) ensure that all loans are periodically matched with FHA data, and (3) perform follow up procedures when invalid data is discovered. These additional procedures would help ensure that all loans are actively insured and the loans meet all other Ginnie Mae requirements.

We discussed our concerns with Ginnie Mae management. During the course of our review, Ginnie Mae took action to address the concerns. Ginnie Mae enhanced its matching process. This enhancement will allow for ongoing matching as frequently as monthly and will also include matching of the "Status" field.

Ginnie Mae was also expanding its procedures to not only ensure that data reported by issuers is accurate, complete and timely, but expanding procedure to follow up on data mismatches. These procedures include: determining why issuers report duplicate, incorrect, and missing records; identifying issuers with high occurrences of data anomalies for further review; and matching current loan level data to the previous quarter's loan level data. These procedures will highlight issuers that may intentionally report incorrect data.

Ginnie Mae was also planning a data match of 100 percent of the loans. This will allow Ginnie Mae to determine if all loans in its pools are insured, not just those included in the last 24 months. This match will also serve as a baseline for comparison purposes for future matches.

#### Ginnie Mae did not ensure timely submission of MICs

When FHA insures loans, it provides a MIC to the issuer to document the insurance. Ginnie Mae allowed issuers 12 months or longer to provide a MIC to the document custodian. Issuers usually received the MIC from FHA within 4 months. As such, we suggested Ginnie Mae implement procedures to identify loans that have been in pools for more than 6 months, but no MIC was on file.

To address this concern, Ginnie Mae enhanced its "Ginnie Mae Portfolio Analysis Database System" to identify loans for which no MIC was provided after 6 months of a loan being input into a pool. Ginnie Mae will contact issuers to determine why no MIC was provided.

Ginnie Mae plans to perform a one-time update of information on file with document custodians to obtain a valid baseline of information. Future comparisons to the baseline data will then be performed to identify exceptions. In addition, Ginnie Mae is attempting to implement a system whereby MICs can be transmitted electronically, further reducing the time needed to obtain the MIC.

These improvements will greatly reduce the risk of uninsured loans in pools going undetected for long periods.

#### **AUDITEE COMMENTS**

We discussed our concerns with Ginnie Mae officials throughout the review. We also met with them on December 18, 2002, to discuss the issues we intended to include in the draft audit memorandum report and to obtain their verbal comments to those issues. Because of the continuous discussions, we obtained general agreement with Ginnie Mae officials to all of the concerns prior to issuance of the draft report. We provided the draft report to Ginnie Mae on February 12, 2003, and received its written comments on February 26, 2003. Because we had already discussed the issues and reached agreements throughout the review, Ginnie Mae agreed it was not necessary to conduct an exit conference.

In its written response to the draft report, Ginnie Mae provided details of the improvements it has taken or plans to take in the near future. It has improved the case number reporting by electronically confirming that all case numbers are in proper format and the case number string and check digit match. It has improved the loan level edits to identify syntax and format errors so that Ginnie Net will not allow pooling of loans that are not in the proper format. It is beginning to follow-up with issuers to improve the reliability of information on existing portfolios.

Ginnie Mae expects to have reconciled 100 percent of its data to FHA data based upon the case number by December 2003. In ongoing efforts to provide assurance that all loans in Ginnie Mae pools are insured, Ginnie Mae will work on matching several different data strings with FHA (e.g., FHA Case Number, opening principle balance, social security number, etc.). Exceptions will be researched, reconciled, and corrected. This reiterative process will be fully implemented by December 30, 2003. Ginnie Mae plans to integrate this matching process as an ongoing component of its analysis.

Ginnie Mae continues to improve its tracking of timely MIC recognition. Its Monitoring Division targets issuers with a high percentage of pooled loans that do not appear to be endorsed by FHA. It will then contact the issuers for an explanation or target them for field review. Ginnie Mae expects these procedures will improve the timeliness of assurance matches by intervention within the first 4 months from loan origination. It expects this process to be fully implemented by December 30, 2003.

#### **OIG EVALUATION OF AUDITEE COMMENTS**

Ginnie Mae has made, or is in the process of making, sufficient improvements to address our concerns and to significantly reduce the likelihood of uninsured loans being placed in its pools. We concur with Ginnie Mae's management decision to integrate its matching process and to have a process fully implemented, including follow-up procedures, by December 30, 2003.

#### **RECOMMENDATION**

We recommend you:

- 1A. Perform an immediate 100 percent match of all FHA loans in MBSIS with FHA's SFIS to ensure data is accurately reported and loans are insured. Subsequently, perform 100 percent matches at least annually.



## **FOLLOW-UP ON PRIOR AUDITS**

Klynveld, Peat, Marwick, Goerdeler audits of Ginnie Mae's financial statements for fiscal years 1999, 2000, and 2001, had unqualified opinions. None of the reports had findings. The OIG had not issued audit reports of Ginnie Mae during the last 3 years.

**AUDITEE COMMENTS**



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D.C. 20410-9000

THE GOVERNMENT NATIONAL  
MORTGAGE ASSOCIATION

February 27, 2003

MEMORANDUM FOR: Nancy H. Cooper, Regional Inspector General for Audit, Region 4,  
4AGA

*for George S. Anderson*  
FROM: Ronald A. Rosenfeld, President, T

SUBJECT: Ginnie Mae Response to Inspector General's Review of Internal  
Controls Draft Report

Ginnie Mae did not require accurate reporting of FHA case numbers.

In All Participants Memoranda ("APMs") 02-17, dated July 2, 2002, and 02-21, dated August 16, 2002, Ginnie Mae announced new guidelines for reporting case numbers (FHA, VA, RHS, and PIH) to Ginnie Mae. The new process was fully implemented by December 31, 2002.

Ginnie Mae improved the case number reporting by electronically confirming that all case numbers are in the proper format, and the case number string and check digit match. Ginnie Mae expects to have reconciled 100% of its data to FHA data based upon the Case Number using September 2003 data. In ongoing efforts to provide assurance that all loans in Ginnie Mae pools are insured, Ginnie Mae will work on matching several different data strings with FHA (e.g., FHA Case Number, opening principle balance, social security number, etc.). Exceptions will be researched, reconciled, and corrected. This reiterative process will be fully implemented by December 31, 2003.

Ginnie Mae did not have adequate controls to ensure reliability of automated data.

The reliability of Ginnie Mae's automated loan level data has improved with the loan level edit enhancements outlined in APMs 02-17 and 02-21. As part of these enhancements, Ginnie Mae improved the edits within GinnieNET and MBSIS update processes to include the identification of syntax and format errors. GinnieNET will not allow the pooling of loans that are not in the proper format.

Ginnie Mae will follow-up with issuers quarterly to enhance the reliability of information on its existing portfolio. Contractor staff will initially contact issuers that appear to have data problems. Ginnie Mae's staff will analyze and monitor issuers that appear to have misrepresented loans and issuers that cannot improve the quality of their data from quarter to quarter. This process began earlier this month, based upon the matching FHA's A43 endorsement information to Ginnie Mae's December 31, 2002, loan level data.

Ginnie Mae did not have adequate procedures for matching automated loan data.

Ginnie Mae began implementing the three improvements cited in the Inspector General's report in the last quarter of calendar year 2002, based on concerns raised by the IG. The report suggests: 1) matching on FHA's status field; 2) ensuring all loans are periodically matched with FHA's data; and 3) follow-up on invalid data.

Ginnie Mae acquired an extract from FHA's A43 system that profiles all FHA loans. Throughout January and February 2003, Ginnie Mae's portfolio has been analyzed and matched against the loans in the A43 database. Included in the analysis is an assessment of the loans status. Ginnie Mae will integrate this match as an ongoing component of its analysis.

A more detailed follow-up to assure reporting compliance (which will begin next month) is being created in which Ginnie Mae's data analysis contractor contacts issuers with data anomalies in order to correct those errors. Data issues that could suggest misrepresentation will be referred immediately to Ginnie Mae's staff for analysis and follow-up.

Ginnie Mae did not ensure timely submission of MICs.

Ginnie Mae continues to improve its tracking of timely MIC recognition. The matching of Ginnie Mae's originations to FHA's endorsement file is the basis for a new analysis screen within Ginnie Mae's GPADS monitoring system. On GPADS, issuers' matching percentages are profiled by quarter, measuring an issuer's performance against national averages. Over 90% of loans are insured within the first six months of origination.

Ginnie Mae's Monitoring Division targets issuers with a high percentage of pooled loans that do not appear to be endorsed by FHA. These issuers may be contacted directly by Ginnie Mae staff for explanation, or be targeted for a field review. The expectation is that these procedures will improve the timeliness of assurance matches by facilitating intervention within the first four months from origination. This process will be fully implemented by December 31, 2003, for the September 30, 2003, data reporting.

**DISTRIBUTION OUTSIDE OF HUD**

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