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Audit Report Number 2003-AO-0003

MEMORANDUM FOR: George Rabil, Deputy Comptroller, Federal Housing Administration, HWA

Saundra G. Elion

FROM: Saundra G. Elion, Director, Headquarters Audits Division, GAH

SUBJECT: Title I Loan Remittances Processed by HUD's Cash Management Branch
Washington, DC

INTRODUCTION

In response to an anonymous hotline complaint, we completed an audit of the cash management practices used by the Cash Management Branch (CMB) to process Title I loan remittances. The complaint contained several unrelated allegations; however, we determined that the allegations pertaining to CMB's handling of the Title I remittances paid by check were credible.

Our objective was to evaluate CMB's and the lockbox depository's (Bank of America) cash management and monitoring practices as those practices relate to Title I remittances. To accomplish the audit objective, we reviewed the account balances of the undistributed credit account and miscellaneous income account; reviewed the collection register maintained by CMB; interviewed responsible staff in CMB, the Albany Financial Operations Center, and the lockbox depository; observed CMB processing "lockbox packages;"¹ and conducted a site visit of the lockbox facility. We also reviewed applicable cash management and handling requirements identified in HUD handbooks and the Treasury Financial Manual as well as the Memorandum of Understanding (MOU) between HUD, Treasury, and Bank of America.

¹The lockbox depository routinely sends "lockbox packages" to CMB as evidence of activities performed. The lockbox packages include copies of Title I remittance deposit slips, reports, correspondence, processed documents, copies of checks received without a billing stub, unprocessable payments, and adjustments.

During the audit period, Bank of America processed 158,555 checks for the Title I program totaling \$55,473,784. We reviewed a nonrepresentative selection of 512 checks sent to CMB for research. The dollar value of checks included in our selection totaled \$164,389.

We evaluated CMB's and Bank of America's handling of Title I remittances paid by check during the period October 1998 through January 2003. Our fieldwork was conducted between February and April 2003. Our audit was conducted in accordance with Generally Accepted Government Auditing Standards.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (202) 708-1342.

SUMMARY

CMB has made significant progress in improving its cash management practices as a result of our review. However, during the audit period, CMB did not ensure that Title I remittances were properly handled, processed, and applied. Specifically, \$602,608 was not applied to debtors' accounts during the past 4 fiscal years; at least \$87,979 in payments were not deposited timely; and CMB did not adequately account for negotiable instruments or monitor the process used by Bank of America to process Title I payments.

BACKGROUND

Title I Loan Remittances. When debtors default on their Title I loans, HUD becomes liable to the lending institution for the outstanding principal. HUD will pay off the loan and then seek restitution from the debtor for the remaining payments. HUD arranges the payment terms with the debtor which includes sending the agreed upon payments to a lockbox depository in Atlanta, Georgia.

Treasury Lockbox System. The Treasury Department's Financial Management Service (FMS) has lockbox arrangements with commercial banks, which allow FMS to collect payments made to the Federal Government. The banks establish post office boxes and electronic accounts to receive payments and process the funds sent to the lockbox. However, before the bank can perform lockbox services it must enter into an MOU with the respective agency and FMS. The MOU is a three-party agreement incorporating the terms and requirements for lockbox services. HUD and FMS entered into an agreement with NationsBank (currently the Bank of America) in Atlanta, Georgia on November 9, 1995, to collect and deposit Title I remittances on HUD's behalf.

HUD debtors making recurring Title I payments must send their payments directly to one of the post office boxes maintained by Bank of America. Each type of remittance has a different post office box address. Currently, Bank of America maintains five lockboxes for the Title I program: one lockbox for check payments, two for credit card payments, and two for automated clearing house payments.

Bank of America deposits the funds into a clearing account for subsequent (next business day) transfer to the Treasury's main account at the Federal Reserve Bank of New York. The transfer advice identifies HUD as the Federal agency to which the funds are remitted. Documentation accompanying the remittance is sent to CMB daily. This documentation (generally referred to as lockbox packages) includes adjustments and any unprocessable payments.

Cash Management Branch. CMB, a division of the Federal Housing Administration (FHA), consists of a Branch Chief and 13 staff members. CMB staff performs a myriad of functions in support of HUD's cash receipts and disbursement activity. The key individuals within CMB responsible for the Title I program are the Government Technical Monitor (GTM) and the Collection Officer (CO). The GTM is responsible for overseeing Bank of America and ensuring its compliance with the MOU; and the CO is responsible for processing the daily lockbox packages and researching "unprocessable" payments.

Unprocessable Payments. HUD defined unprocessable payments in the MOU with Bank of America and required all such payments to be sent to CMB for research. Unprocessable payments are (1) stale dated checks, checks that are more than 6 months old, (2) postdated checks, dated more than 3 days after receipt, (3) checks with incorrect payees, (4) checks with "paid in full notations" without agency stamp, (5) foreign checks, (6) third-party checks, (7) unbalanced multiples, one check received for multiple debtors, (8) checks remitted with a non-scannable document that does not include the Title I Reference (TIR) number², and (9) "Check Only" without a valid account number.

² The TIR number is a unique identification number assigned to HUD employees who provide customer service functions for the Title I program.

FINDING 1

ACCOUNTS NOT ACTIVELY RESEARCHED

Title I payments were not always applied to the appropriate debtors' accounts. This condition occurred because CMB did not assign personnel to routinely and actively research the undistributed credit and miscellaneous income account transactions to identify debtors. As a result, over the last 4 fiscal years debtors did not receive credit for \$602,608³ remitted for payments on Title I loans.

The MOU outlines the lockbox operational requirements of the Billing Agency (HUD) and clearly assigns HUD the responsibility for updating its internal accounts receivable systems.

As specified in the MOU, the lockbox depository posted payments that could not be identified to a specific Title I loan to HUD's undistributed credit account. CMB was responsible for researching these transactions to identify the debtor and apply the payment to the debtor's account. If the debtor could not be identified, the transaction remained in the undistributed credit account. During the audit period, the monthly balances of the undistributed credit account ranged from \$21,619 to \$235,987. Transactions in the undistributed credit account that had not been identified within 18 months were automatically transferred to the miscellaneous income account. The miscellaneous income account was then closed to retained earnings at the end of each fiscal year.

Although the undistributed credit and miscellaneous income accounts should have been routinely and actively researched, CMB only researched payments when the CO had free time or when debtors notified HUD of a discrepancy in their account balances. No one in CMB was assigned to routinely research the two accounts and update debtors' accounts. As a result, not all payments were properly posted to debtors' accounts.

In effect, payments in the miscellaneous income account totaling \$602,608 were transferred to HUD's general funds and were not applied to the respective debtors' accounts during FY 1999 through FY 2002. Therefore, some debtors did not receive credit for payments remitted. Table 1 shows the amount of the miscellaneous income account at the end of each of the last 4 fiscal years.

³ This represents about 1 percent of the checks Bank of America processed during FY 1998 through 2002.

**Table 1: Miscellaneous Income Account
Closed to Retained Earnings**

Fiscal Year Ending	Amount Closed Out
September 1999	\$177,428
September 2000	158,085
September 2001	170,647
September 2002	96,448
Total	<u>\$602,608</u>

Prior to the completion of our audit, CMB implemented a policy to resolve payments posted to the undistributed credit account within 60 days; assigned a staff member to routinely research the undistributed credit account; and either posted or cleared 103 of the 131 transactions from the past 18 months. These changes, if consistently adhered to, should result in the timely application of payments to the appropriate debtor's account.

AUDITEE COMMENTS

The Deputy Comptroller for FHA agreed with our audit finding and concurred with our recommendations. The Deputy Comptroller also provided us with management decisions and has taken action to implement the recommendations.

OIG EVALUATION OF AUDITEE COMMENTS

We concur with the Deputy Comptroller's management decisions and proposed corrective actions.

RECOMMENDATIONS

We recommend that the Deputy Comptroller, Federal Housing Administration, ensure that CMB:

- 1A. Adheres to procedures by routinely researching the undistributed credit and miscellaneous income accounts to ensure that payments are timely applied to the appropriate debtor's account.
- 1B. Identifies and credits all debtors' accounts for payments posted to the undistributed credit and miscellaneous income accounts.

FINDING 2

CHECKS NOT DEPOSITED TIMELY

CMB did not ensure that Title I remittances were promptly deposited. This condition occurred because Bank of America unnecessarily sent checks to CMB for research and CMB subsequently returned the checks to Bank of America for deposit. As a result, payments totaling \$87,979 were deposited as much as 57 days after initial receipt and the Federal Government's interest earnings were not maximized.

HUD Handbook 1911.1, "Handling and Protecting Cash and Other Negotiable Instruments" provides that collections should be deposited as soon as possible, to minimize the number of cash handling and deposit activities, to reduce "float" to the lowest possible level, and to adequately control and account for cash collections. Specifically, "collections shall be deposited within 24 hours of being received to maximize interest earnings or minimize borrowing expense with Treasury."

The Treasury Financial Manual provides that delays in deposits results in loss to the Federal Government. The amount of loss is equal to the dollar amount delayed multiplied by the (1) daily federal funds rate for the period of delay and (2) number of days delayed.

Checks remitted by debtors were not deposited in a timely manner. As specified in the MOU, Bank of America mailed to CMB all negotiable instruments (primarily checks and some money orders) that were unprocessable so that CMB could determine whether the payments were Title I remittances. CMB researched each payment and either returned the instrument to Bank of America with the appropriate Title I loan number or returned the instrument to the remitter. Neither CMB nor Bank of America maintained records of the negotiable instruments ("live" checks) sent to CMB. However, CMB did photocopy checks returned to Bank America for deposit and posting.

Prior to returning the checks to Bank of America for deposit CMB would research the checks and identify the account. Bank of America then deposited the checks and posted the payments to the debtor's account. Of the 512 checks selected from the collection register, we identified 267 checks, totaling \$87,979 that Bank of America could have immediately deposited into HUD's undistributed credit account. The checks that could have been deposited were either made payable to HUD Title I or included the post office box number for the lockbox (which is used exclusively for Title I loan remittances). The inclusion of "HUD Title I" and the post office box number are clear indicators that the payment was for a Title I loan. Nevertheless, Bank of America sent the "live" checks (not copies) to CMB for research, thereby delaying the deposit by as many as 57 days.

Bank of America could have immediately deposited the 267 checks into the undistributed credit account while CMB conducted research to identify the specific loan account. However, the MOU instructed Bank of America not to process checks remitted with non-scannable documents. In addition, in early 1997, a CMB official directed Bank of

America to send checks submitted without a coupon and a valid account number to CMB for research.⁴ This directive, although never incorporated into the existing MOU, was implemented by Bank of America.

Our analysis also showed that many of the “unprocessable” checks were from the same remitters. Specifically, 49 remitters accounted for 198 of the 267 checks. This illustrates that instructions on the type of information to include with payments should be provided to these remitters.

By researching the payments before depositing the check, HUD not only delayed applying the payment to the debtors’ accounts but did not maximize the interest it could have earned on the deposits.

AUDITEE COMMENTS

FHA concurred with our finding and will provide the OIG with a copy of the amended MOU when it is complete. FHA has also implemented a process to, when necessary, provide remitters with instructions on the proper method for remitting payments.

OIG EVALUATION OF AUDITEE COMMENTS

We believe the corrective actions taken by FHA will ensure that payments are processed and deposited timely.

RECOMMENDATIONS

We recommend that the Deputy Comptroller, Federal Housing Administration, ensure that CMB:

- 2A. Executes the proposed amendments to the MOU that will allow Bank of America to process and deposit checks with clear indicators that the payment is for a Title I loan.
- 2B. Identifies remitters who routinely send checks to the lockbox without adequate documentation and instruct them to include account numbers on future remittances.

⁴ The two directives and subsequent action taken by CMB are further discussed in Finding 3.

FINDING 3

INADEQUATE MONITORING

CMB did not adequately account for negotiable instruments received for research or monitor the Title I activities performed by Bank of America. These conditions occurred because CMB did not establish controls to monitor the Title I remittance process. As a result, there is no assurance that negotiable instruments sent to CMB for research were properly accounted for and CMB and Bank of America employees adhered to processing requirements.

HUD Handbook 1911.1 provides that “once a remittance is received, it shall be endorsed, recorded, or noted.” Whatever method is used, it must also contain the fund symbol or other disposition and be maintained in numerical sequence by fiscal year.

The MOU provides that HUD monitor the lockbox depository’s performance and conduct periodic on-site security and quality reviews. In addition, 31 CFR 206, “Management of Federal Agency Receipts, Disbursements, and Operation of the Cash Management Improvements Fund” provides that “an agency shall periodically perform cash management reviews to identify areas needing improvement.”

Controls over negotiable instruments

CMB did not adequately account for negotiable instruments, specifically “live” checks (1) received from Bank of America for research; (2) returned to remitters, when the account could not be identified; or (3) returned to Bank of America for deposit. It is Bank of America’s practice not to account for individual checks mailed to the lockbox each day. As instructed in the MOU, Bank of America sent all unprocessable payments to CMB for research. However, Bank of America did not keep a record (of the number and amount) of the checks mailed to CMB.

The CO had sole responsibility for opening the lockbox packages sent to CMB. However, the CO did not maintain a record of the number of checks received from or returned to Bank of America for deposit. The only records maintained by CMB were photocopies of checks the CO placed in the collection register binders before returning the actual checks to Bank of America. The registers did not contain pertinent information such as the number of checks received, total dollar amount of the checks, or final disposition of the checks. In addition, the CO did not verify that returned checks were actually applied to the respective remitter’s account.

The lack of controls did not allow us to ascertain the composition or disposition of the checks sent to CMB. While the CO estimated that about 10 percent of the checks were returned to the remitter, we could not verify the accuracy of the percentage because the CO did not keep records of the returned checks. On the other hand, although the collection register contained copies of checks returned to Bank of America no one verified that those payments were accurately applied to the accounts specified by the CO.

We found three instances where payments were not properly applied. As a result, one debtor inappropriately received credit for payments not made while the other debtor received no credit for payments made.

Oversight of lockbox depositary activities

Site visits. CMB did not perform a site visit of Bank of America facilities during the past 4 years as required by the MOU. Moreover, CMB was unfamiliar with the procedures used by Bank of America to process checks. CMB attributes its failure to perform an on-site quality review to a lack of funding. However, subsequent to our site visit, an FHA official conducted a site visit of Bank of America and identified areas needing improvement. Our site visits disclosed similar deficiencies.

Memorandum of Understanding. CMB had not substantially revised the MOU with Bank of America in over 5 years. As a result, the MOU contained outdated requirements that caused inefficiencies and unnecessary delays. Specifically, a limited batch range caused Bank of America to duplicate work and the unprocessable list caused checks to be unnecessarily sent to CMB for research.

Batch Range. The batch ranges were insufficient to process checks received at various delivery times. To accommodate additional checks the depositary would (1) delete an already processed batch, (2) cover the audit trail sprayed on the checks processed earlier, and (3) re-run the previously processed checks with the new checks. CMB was unaware, and the depositary did not inform them, of the need to increase the batch range. Processing time could be improved if the batch range is increased.

Unprocessable Items. Two of the nine items on the unprocessable list should be removed from the list so that those payments could be processed immediately. The two items are checks received with non-scannable documents that do not include the TIR number, and checks without a coupon and a valid account number. Mailing these checks to CMB for research increased the risk of loss and decreased interest earning potential (discussed in Finding 2).

CMB agreed that overall accountability and efficiencies could be achieved by implementing procedures to maintain records of checks mailed to CMB for research, periodically observing the procedures used by Bank of America to process checks, and reviewing and amending the MOU when necessary. As a result, CMB implemented procedures for logging checks received from the lockbox and checks returned to remitters because they were not for Title I. CMB stated other site visits of Bank of America would be performed in the future. In addition, CMB prepared an amendment to the MOU. The amendment⁵ increases the batch ranges and requires Bank of America to: immediately process the two items (checks received with non-scannable documents that do not include the TIR number, and checks without a coupon and a valid account number) originally earmarked as

⁵ As of July 23, 2003, Treasury had not approved the amendment to the MOU, however, CMB instructed Bank of America to implement the changes during June.

“unprocessable;” and to include a transmittal (listing the total number and dollar amount) along with the checks returned to CMB for research.

AUDITEE COMMENTS

FHA agreed with our finding and will ensure that CMB and Bank of America adhere to proposed and implemented procedures.

OIG EVALUATION OF AUDITEE COMMENTS

We believe the actions FHA has taken and plans to take should correct the identified deficiencies.

RECOMMENDATIONS

We recommend that the Deputy Comptroller of the Federal Housing Administration require CMB to:

- 3A. Continue to record all negotiable instruments received from and returned to the lockbox and returned to remitters.
- 3B. Verify that Bank of America properly applies researched payments to the appropriate Title I account.
- 3C. Perform periodic site visits to ensure the lockbox depository is following prudent cash management practices.

MANAGEMENT CONTROLS

In planning and performing our audit, we considered the management controls relevant to Cash Management Branch's (CMB) management and cash handling practices of Title I loan remittances to determine our audit procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined that the following management controls were relevant to our audit objectives:

- Compliance with the Memorandum of Understanding;
- Compliance with Handbook 1911.1, "Handling and Protecting Cash and Other Negotiable Instruments;"
- Compliance with 31 CFR 26 "Management of Federal Agency Receipts, Disbursements, and Operation of the Cash Management Improvements Fund;" and
- Controls and procedures to monitor CMB staff and the lockbox depository's performance.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organization's objectives.

Based on our review, we believe the following items are significant weaknesses:

- Checks not adequately accounted for and deposited timely;
- Undistributed Credit and Miscellaneous Income Accounts not routinely and actively researched; and
- CMB and lockbox depository staff's performance not adequately monitored.

These weaknesses are discussed in the findings.



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

July 28, 2003

MEMORANDUM FOR: Sandra G. Elion, Director, Headquarters Audits Division,
GAH

George Rabil
FROM: George Rabil, Deputy Comptroller, Federal Housing Administration, HWA

SUBJECT: Response to Draft Report on Title I Loan Remittances Processed by HUD's
Cash Management Branch

Federal Housing Administration (FHA) appreciates the opportunity to provide comments on the Office of Inspector General (OIG) Draft Report **Title I loan Remittances Processed by HUD's Cash Management Branch**. FHA is pleased the OIG noted that significant progress has been made in improving cash management practices since the review.

FHA concurs with all of the findings and recommendations listed in the report. Following is our detailed response to each recommendation.

Recommendation 1A.

Adheres to procedures by routinely researching the undistributed credit and miscellaneous income accounts to ensure that payments are timely applied to the appropriate debtor's account.

Management Response

As noted in the draft report, FHA has implemented a policy to resolve payments posted to the undistributed credit account within 60 days.

Recommendation 1B.

Identifies and credits all debtors' accounts for payments posted to the undistributed credit and miscellaneous income accounts.

Management Response

FHA's revised procedures will ensure that payments are applied to the appropriate debtors' accounts.

Recommendation 2A.

Executes the proposed amendments to the MOU that will allow Bank of America to process and deposit checks with clear indicators that the payment is for a Title I loan.

Management Response

FHA will provide the OIG with a copy of the signed amended Memorandum Of Understanding (MOU) as soon as it is received from Treasury.

Recommendation 2B.

Identifies remitters who routinely send checks to the lockbox without adequate documentation and instruct them to include account numbers on future remittances.

Management Response

FHA has implemented a process whereby the Cash Management Branch will notify Albany Financial Operations Center (FOC) staff of repeat offenders and the FOC provides the remitters with instructions on the proper method for remitting payments.

Recommendation 3A.

Continue to record all negotiable instruments received and returned to the lockbox and returned to remitters.

Management Response

As noted in the draft report, FHA has implemented procedures to record all negotiable instruments received and returned and will ensure that these procedures are enforced.

Recommendation 3B.

Verify that Bank of America properly applies researched payments to the appropriate Title I account.

Management Response

FHA will document a process to validate that Bank of America properly applies researched payments to the appropriate Title I account.

Recommendation 3C.

Perform periodic site visits to ensure the lockbox depository is following prudent cash management practices.

Management Response

FHA will ensure that periodic site visits are performed in accordance with the provisions of the MOU.