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Audit Report Number	2006-SE-0001
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TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal Housing  
Commissioner, H

*Joan S. Hobbs*

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, OAGA

SUBJECT: Significant Weaknesses in HUD's Oversight of Single Family Mortgage  
Insurance Claims are Costly

## **HIGHLIGHTS**

### **What We Audited and Why**

We reviewed the U.S. Department of Housing and Urban Development's (HUD) controls over the payment of Federal Housing Administration Mutual Mortgage Insurance Fund single family claims. We wanted to know whether HUD had controls in place to ensure paid claims were reviewed to determine if the mortgage loans met program requirements.

### **What We Found**

HUD did not independently determine mortgage loans insured under the Mutual Mortgage Insurance Fund met program requirements after paying billions in single family insurance claims. During the period October 1, 2003 through June 3, 2005, HUD received and paid claims on loans for which the lender did not show the borrower 1) was able to make the required monthly payments, 2) made the minimum investment in the property, and 3) was creditworthy. Our tests of FHA loan files determined that 44 of 175 randomly selected claims were paid for

mortgages that, based on HUD's loan file, did not meet these program requirements. HUD paid the claims and did not subsequently review the loan files for compliance with the program requirements, fraud and/or misrepresentations. HUD relied upon lender certifications that loans were eligible and contained all required supporting documents, a pre-endorsement review of the insurance applications for key documents, and risk-based compliance testing of recently insured loans. We estimate final HUD costs for claims that did not meet program requirements during the period reviewed totaled \$356 million on those claims for which all revenues and expenses were finalized.

### **What We Recommend**

We recommend the Assistant Secretary for Housing - Federal Housing Commissioner require the Office of Single Family Housing to: (1) establish procedures to review paid claims associated with early defaulted loans and unsupported final costs (projected as totaling about \$214 million annually), and independently verify that loans met HUD-FHA program requirements and were therefore eligible for insurance, (2) seek recovery or adequate support for final HUD costs for the 44 unsupported claims identified in our sample totaling \$1,301,230 in losses, and (3) based on the results of (2), assess costs and benefits associated with reviewing claims on early defaulted loans received since the beginning of our audit period ( October 1, 2003 ) to the current date, and if feasible, independently determine that loans comply with program requirements and seek, from lenders, recovery or adequate support for final HUD costs associated with those claims.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

### **Auditee's Response**

We provided the Office of Single Family Housing a discussion draft on March 10, 2006, and held an exit conference with the Office of Single Family Housing on March 17, 2006. We received written comments from the Assistant Secretary for Housing-Federal Housing Commissioner on April 14, 2006. The Assistant Secretary generally disagreed with our conclusions and recommendations. We evaluated the Assistant Secretary's comments and made appropriate changes to the report. However, we did not substantially change our conclusions and recommendations. The complete text of the auditee's response, along with our evaluation of that response, can be found in Appendix B of this report.

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## BACKGROUND AND OBJECTIVES

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The Federal Housing Administration provides mortgage insurance on single-family home loans made by Federal Housing Administration-approved lenders throughout the United States and its territories. Federal Housing Administration mortgage insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. When a borrower defaults and the lender is unable to bring the loan current through loss mitigation, the lender can submit a claim for single-family mortgage insurance benefits to the U.S. Department of Housing and Urban Development (HUD). There are many types of single-family claims, but conveyance claims are the most common. All claims must be submitted on HUD form HUD-27011, Single Family Application for Insurance Benefits. HUD encourages lenders to send all claim forms (parts A and B) to HUD electronically through the Electronic Data Interchange or the Federal Housing Administration Connection<sup>1</sup>.

During a conveyance claim, the lender obtains the property through foreclosure and deeds the property to HUD. Either the holder<sup>2</sup> or the servicer<sup>3</sup> of the mortgage may submit the claim. In either case, the claim payment will be made to the holder of the mortgage.

HUD processes the electronic claims information by computer at HUD Headquarters. The data are pre-screened before processing to determine whether certain essential data are missing or incomplete. If the information is complete, it passes through system edits and control checks. If there aren't any hard errors<sup>4</sup>, the system will compute and generate an electronic payment to the holder. If there is a fatal error<sup>5</sup>, the lender must submit a corrected claim to resolve the fatal error before further processing can occur. The system edits are designed to permit prompt payment of most claims by accepting costs encountered in routine claims. If unusually high disbursements are reported, the claim payment will be reduced, and the holder may file a supplemental claim for the part of the claim disallowed, with documentation to support the amount of and the need for the higher payment. The advice of payment with the initial claim reimbursement will identify amounts and reasons for a reduced claim payment.

Our objective was to determine whether HUD had controls in place to ensure paid claims were reviewed to determine if the mortgage loans met program requirements.

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<sup>1</sup> Home Equity Conversion Mortgage, supplemental, and reconveyance claims cannot be submitted electronically and need to be submitted on paper. Loss mitigation claims can be submitted electronically, via Federal Housing Administration Connection or on paper. Conveyance and preforeclosure sale claims can be submitted on paper, however they are subject to a \$100 processing fee.

<sup>2</sup> Holder – lenders who are holders of the credit instruments issued under a trust indenture, mortgage or deed of trust pursuant to which such holders act by and through a trustee therein named.

<sup>3</sup> Servicer - a HUD-approved lender who services HUD-insured mortgages.

<sup>4</sup> Hard error – indicates that the field contains an error that must be corrected before further processing can occur.

<sup>5</sup> Fatal errors - cannot be pay-authorized (overridden) by the Claims Branch.

## RESULTS OF AUDIT

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### Finding 1: Significant Weaknesses in HUD Oversight of Single Family Claims are Costly

HUD did not independently determine mortgage loans insured under the Mutual Mortgage Insurance Fund met program requirements after paying billions in single family insurance claims. During the period October 1, 2003 through June 3, 2005, HUD received and paid claims on loans for which the lender did not show the borrower 1) was able to make the required monthly payments, 2) made the minimum investment in the property, and 3) was creditworthy. Our tests of FHA loan files determined that 44 of 175 randomly selected claims were paid for mortgages that did not meet these program requirements. HUD paid the claims and did not subsequently review the loan files for compliance with the program requirements, fraud and/or misrepresentations. HUD relied upon lender certifications that loans were eligible and contained all required supporting documents, a pre-endorsement review of the insurance applications for key documents, and risk-based compliance testing of recently insured loans. We estimate final HUD costs for claims that HUD's files did not support meeting program requirements during the period reviewed totaled \$356 million on those claims for which all revenues and expenses were finalized.

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#### **HUD Must Determine Lenders Meet Financial and Programmatic Requirements**

The Office of Management and Budget's Circular A-129, Policies for Federal Credit Programs and Non-tax Receivables, Appendix A section I-4 requires HUD to manage the single family insurance program in accordance with statutory and provisions of this Circular to protect the Government's assets and to minimize losses in relation to social benefits provided. Further, section 4a states that agencies shall ensure that lenders participating in guaranteed loan programs meet applicable financial and programmatic requirements.

The Circular addresses loan documentation requirements and lender agreements. Appendix A section III A 2 requires HUD to ensure loan origination files contain the documents needed to conform to private sector standards and states that accurate and complete documentation is critical to processing claim payments. Appendix A section III B 2 b provides that HUD should include due diligence requirements for originating, servicing, and collecting loans in its agreements with lenders. Further, the Circular provides that HUD should ensure through the claims review process, that lenders meet the performance standards and suggests HUD reduce claim amounts or reject claims for lender non-performance.

HUD's single family insurance program requirements provide that only approved lenders agreeing to follow HUD requirements may participate in the program. The requirements include those that lenders must meet for originating and servicing loans. Additionally, the requirements specify the documentation lenders must maintain.

The statutory requirements for HUD's single family insurance program will not allow HUD to reduce or reject claims for lender non-performance except for fraud or misrepresentation on the part of the lender holding the mortgage<sup>6</sup>. This in effect prohibits HUD from rejecting claims for non-performance of underwriting requirements because most insured loans are sold after loan insurance endorsement. However, this does not prohibit HUD from reviewing claims to ensure lenders comply with program requirements. The claim can be paid and HUD can then review the loan for compliance with program requirements (additional information on HUD's program requirements is presented in Appendix E). HUD's program provides for actions that can be taken when lenders do not meet the program requirements. Those actions include referral to the Mortgagee Review Board. The Mortgagee Review Board is authorized by Section 202(c) of the National Housing Act to take administrative action when lenders do not comply with HUD's requirements.

### **HUD Lacked Adequate Support for Paid Claims**

HUD does not have the required documentation to support compliance with program requirements for an estimated \$1.3 billion in paid Mutual Mortgage Insurance Fund claims made during the period October 1, 2003 through June 3, 2005. We reviewed a random sample of 175 claims received during the period and found HUD did not have the required documentation to show 44 mortgage loans complied with program requirements. The mortgage insurance applications for the 44 mortgage loans did not include the required documents showing the borrower (1) was able to make the required monthly payments, (2) made the minimum investment in the property, and (3) was creditworthy.

We determined the total claims and actual losses to date for the 44 claims for which HUD did not have the required documentation to show program requirements were met. The 44 claim payments for unpaid principal and interest totaled \$4,112,905 and the actual losses to date totaled \$1,301,230 after recognizing the revenue from the disposal of houses conveyed to HUD. Our review results for the 44 loans are summarized in Appendix C followed by a narrative description of documentation requirements not met for each case in Appendix D.

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<sup>6</sup> Section 203(e) of the National Housing Act provides that an executed insurance contract is conclusive evidence of the eligibility of the loan for insurance and the contract of insurance is incontestable in the hands of an approved lender except for fraud or misrepresentation by the lender making the claim.

Based on our analysis of paid claims shown in HUD's systems, Mutual Mortgage Insurance Fund claims for unpaid principal and interest totaled \$7.9 billion during the period October 1, 2003, through June 3, 2005, for loans that defaulted in no more than three years after endorsement. We estimate HUD had adequate support for \$6.6 billion of the claims leaving \$1.3 billion inadequately supported during the 20-month period, an average of \$796 million annually. We estimate the actual losses incurred to date for the claims received during the 20-month period after recognizing the revenue from the disposal of houses conveyed to HUD would be \$356,012,207, an average of \$213,607,324 annually.

**HUD Did Not Review Paid Claims to Determine Whether Program Requirements Were Met**

HUD did not independently determine mortgage loans insured under the Mutual Mortgage Insurance Fund met program requirements after paying single family insurance claims. The single family insurance claims process does not include a review of the mortgage loan for a paid claim to independently determine that Direct Endorsement lenders complied with program requirements. Specifically, HUD does not review the application for mortgage insurance before endorsement or after a claim is paid to determine whether the lender and underwriter certifications required by the contract of insurance accurately represented the mortgage loans eligibility for insurance, compliance with underwriting requirements, and required supporting documentation.

HUD's program requires approved lenders to apply for mortgage insurance after determining that a proposed mortgage is eligible for insurance under the applicable program regulations. The application must include required documents supporting the mortgage eligibility and lender certification the loan is eligible and supported by the required documents. Once the application is received HUD performs a pre-endorsement review to ensure specific documents are included in the application, including the lender certification. After loans are endorsed for insurance, HUD employs a risk-based monitoring program to evaluate lender compliance with program requirements. The monitoring includes post endorsement technical reviews performed on 5 to 10 percent of mortgage loans endorsed and lender monitoring performed by the Quality Assurance Division<sup>7</sup>. However, the monitoring does not provide for the review of all insured mortgages or claims, and while risk-based, would likely include a high percentage of loans that will perform well given that the vast majority of insured loans perform well.

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<sup>7</sup> The purpose of the Quality Assurance Division is to protect HUD/FHA from unacceptable risk by assessing lender performance, internal controls and compliance with HUD/FHA origination and servicing requirements; and, as appropriate, requiring corrective measures or initiating enforcement actions.

### **HUD Receives Claims and Evaluates Them Electronically Before Payment**

HUD's claims process requires lenders to submit claims through HUD's electronic claims system. The claims system processes the submitted information through HUD computer systems and determines whether claims meet system requirements for payment. The system then computes and generates an electronic claim payment. This ensures that claims are paid promptly.

Although a claim may be processed and paid by the computer, HUD's claim process provides for both post claim review and property inspections. As a result, HUD may require reimbursement of any amounts that are found to be excessive or not supported by appropriate documentation or work done to the property. However, HUD's post claim review does not include a review of the loan origination to determine if the loan complied with program requirements. Accordingly, paid claims are effectively exempted from routine review to determine whether the mortgage loan origination complied with program requirements.

### **HUD Should Determine Loans Comply With Program Requirements After Claims Payment**

HUD should change its claims procedures to include an independent post claim determination that lenders submitted loans in compliance with program requirements. HUD could consider procedures using statistical sampling methods as authorized for claim review under 24 CFR 203.365 d. When HUD determines the application for mortgage insurance submitted by the lender does not demonstrate compliance with the program requirements, HUD should (1) request additional information from the lender, (2) evaluate the information received, and (3) if necessary, decide on the appropriate action to take. The decision on appropriate action could include referring identified lender noncompliance with HUD requirements to the Mortgagee Review Board. Based on our sample results for the 20 months ended June 3, 2005 paid claims that did not meet program requirements totaled an estimated \$796 million annually.



## Recommendations

We recommend the Assistant Secretary for Housing – Federal Housing Commissioner

- 1A. Establish procedures to review paid claims associated with early defaulted loans and unsupported final costs (projected as totaling about \$214 million annually), and independently verify that loans met HUD-FHA program requirements and were therefore eligible for insurance.

Our recommendation contemplates that HUD management would evaluate sampling options and review procedures and select one that it determines effectively and efficiently addresses program requirements. For example, similar to our audit methodology, the review should be risk-based and focus on early defaulted loans. In addition, HUD could adopt sampling procedures similar to those under the existing claims review process regulations including use of a statistical sample of claims paid. Independent of the sampling method, the review procedures would also need to provide for (1) review of the HUD case file, (2) requesting additional information from the lender when necessary, (3) evaluating the information, and (4) if necessary, deciding on the appropriate action to take, including recovery of the loss amount and referral to the Mortgagee Review Board.

- 1B. Seek recovery or adequate support for final HUD costs for the 44 unsupported claims identified in our sample totaling \$1,301,230 in losses.
- 1C. Based on the results of 1B, assess costs and benefits associated with reviewing claims on early defaulted loans received since the beginning of our audit period ( October 1, 2003 ) to the current date. If feasible, independently determine that loans comply with program requirements and seek, from lenders, recovery or adequate support for final HUD costs associated with those claims. This should employ risk-based selection and could consider sampling options as contemplated in recommendation 1A.

## SCOPE AND METHODOLOGY

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Our audit testing related to insurance claims for principal and interest on the Federal Housing Administration Mutual Mortgage Insurance Fund and processed during the period October 1, 2003, through June 3, 2005. HUD's Single Family Data Warehouse showed HUD received 128,478 claims totaling \$11.3 billion during this period. However, our testing was limited to those claims for loans that went into final default within three years of endorsement. For the period reviewed, HUD received 80,352 claims totaling \$7.9 billion for loans that went into final default within three years of endorsement. We conducted our work from January, 2005 through November, 2005.

To accomplish our audit objectives we examined HUD records and interviewed HUD officials from HUD's Office for Single Family Housing in Washington, DC and the Homeownership Centers in Atlanta, GA, Denver, CO, Philadelphia, PA, and Santa Ana, CA. We also analyzed information from the Single Family Data Warehouse and Single Family Insurance System. We assessed the reliability of the data from these systems to ensure the data were sufficiently reliable to use as a basis for our audit conclusions. The methodologies used included

- Reviewing applicable HUD policies and procedures at 24 CFR Parts 202 and 203; Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance, One to Four Family Properties; Handbook 4060.1 REV-1, Mortgage Approval Handbook; and Handbook 4000.2, Mortgagees Handbook – Application Through Insurance.
- Reviewing applicable federal requirements for credit programs included in Office of Management and Budget Circular A-129, Policies for Federal Credit Programs and Non-Tax Receivables and in the Department of the Treasury Financial Manual Managing Federal Receivables.
- Interviewing HUD officials responsible for insurance endorsement, claims and lender monitoring.
- We sampled claims paid to determine whether HUD had controls in place to ensure claims were for mortgage loans meeting program requirements. In support of this objective, we employed an unrestricted variable sampling plan that allowed statistical projections of the dollar amount of the (i) insurance claims that were not supported by the documentation required by the contract of insurance and (ii) the dollar amount of HUD's net profit or loss after the insurance claim was paid for those claims that were not properly supported by required documentation. A full description of our sampling methodology and results is contained in appendix F.
- We reviewed prior audits of the Federal Housing Administration's single family insurance program and claims to obtain information on the internal controls in place and interviewed HUD officials to confirm our understanding.

We performed our review in accordance with generally accepted government auditing standards, which included tests of internal controls that we considered necessary to our audit objectives.

# INTERNAL CONTROLS

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Internal Controls are an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined the following internal control was relevant to our audit objectives:

- HUD's policies and procedures for ensuring paid Federal Housing Administration insurance claims were for loans that met program requirements.

We assessed the relevant controls identified above.

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

## Significant Weaknesses

Based on our review, we believe the following is a significant weakness:

- HUD's controls were not adequate to ensure paid Federal Housing Administration claims were for loans that met program requirements (finding 1).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation Number	Unsupported <u>1/</u>	Funds To Be Put to Better Use <u>2/</u>
1A		\$214 million <u>3/</u>
1B	\$1,301,230	

1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

2/ “Funds to be put to better use” are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. This amount represents our estimate of the potential additional amount HUD could recover annually through implementation of our recommendation. This amount does not reflect any offsetting costs associated with accomplishing these recoveries as there was insufficient data available to reasonably estimate such costs.


3/ We estimated the actual losses incurred to date for the claims received during the period October 1, 2003 through June 3, 2006 after recognizing the revenue from the disposal of houses conveyed to HUD would be \$356 million. We used this estimate to develop a monthly average loss and used that average to estimate an annual loss totaling \$214 million.

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

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

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

APR 14 2006

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

FROM: Brian D. Montgomery, Assistant Secretary for Housing-  
Federal Housing Commissioner, H

SUBJECT: Response to Draft Report, HUD's Oversight of Single Family  
Mortgage Insurance Claims Allows Costly Ineligible Payments  
for Defaulted Mortgage Loans

Thank you for the opportunity to review and comment on your draft audit report on the Federal Housing Administration's (FHA) Oversight of Claim Payments. The attachment to this memorandum is the Office of Housing's detailed response to the recommendations outlined in the subject report dated March 10, 2006.

The Office of Housing carefully reviewed the findings and recommendations contained in the report. The following organizations and individuals collaborated on the attached response: the Office of General Counsel, the Office of Chief Financial Officer, the Office of the FHA Comptroller, the Secretary to the Mortgagee Review Board, Office of Evaluation, Office of Single Family Asset Management, Office of Program Development and the Office of Lender Activities and Program Compliance. Each of these offices disagreed with the audit findings, conclusions, and recommendations. We further believe that the audit demonstrates the OIG's basic misunderstanding of FHA's direct endorsement program and claim payment process.

Our joint position is as follows:

1. The OIG's primary recommendation for FHA to only pay claims for eligible mortgage loans is statutorily prohibited under Section 203(e) of the National Housing Act (NHA). The incontestability clause in Section 203(e) of the NHA does not allow HUD to deny a claim after it has endorsed a loan for insurance. Also, HUD must prove fraud or material misrepresentation on the part of the holder of the loan that currently is the beneficiary of the FHA mortgage insurance;
2. The OIG's recommendation for FHA to establish procedures to review all claims and independently determine that loans comply with the contract of insurance to address projected unsupported claims and final costs totaling \$213,607,324 annually is neither cost effective nor efficient. FHA believes that costs associated with a 100 percent post claim review process will far exceed the amount HUD could potentially save by looking for cases that may have been improperly underwritten;

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Comment 1

Comment 2

Comment 3

**Comment 4**

3. The OIG recommended that FHA review claims received during the period October 1, 2003, through June 3, 2005, to independently determine that loans comply with the contract of insurance and seek, from lenders, recovery or adequate support for final HUD costs that could include \$354,710,977 for noncompliant claims. This recommendation is impractical and costly to implement, and would yield minimal benefits to the Department;

**Comment 5**

4. The OIG's recommendation for FHA to seek recovery or adequate support for final HUD costs totaling \$1,301,230 for the 44 unsupported claims identified in its sample is overstated. Upon re-examination of the facts associated with 43 of the 44 loans, FHA determined that only 11 loans had possible material deficiencies. Of these 11 loans, only 2 might be attributable to underwriting issues. These 2 claims represent \$78,100 rather than the \$1,301,230 in ineligible claims identified in the audit; and

**Comment 5****Comment 6**

5. Inasmuch as FHA was only able to identify 2 defaulted loans that may have been attributed to underwriting issues, the OIG's methodology used to derive at the projected loss of \$356,012,207 is flawed. The OIG was inefficient in its approach of selecting a statistically valid sample of cases representing FHA's entire claim portfolio and that inefficiency increased the OIG's risk of being inaccurate.

In light of the foregoing, the Office of Housing respectfully requests that the Office of the Inspector General consider not issuing this audit report. If you have any questions regarding this response, or need further clarification, please contact Joseph McCloskey, Director, Office of Single Family Asset Management at (202) 708-1672.

Attachment

**Office of Housing's Response to the Discussion Draft, "Significant Weaknesses in HUD's Oversight of Single Family Mortgage Insurance Claims are Costly"**

The Office of the Inspector General (OIG) reviewed HUD's controls over the payment of Federal Housing Administration (FHA) claims. The purpose of its review was to determine if controls were in place to ensure that mortgage insurance claims were only paid for eligible loans. The OIG reviewed 175 claims paid during the period of October 1, 2003 through June 3, 2005. The OIG concluded, "HUD did not independently determine mortgage loans insured under the Mutual Mortgage Insurance Fund were eligible for insurance benefits when paying billions in Single Family Insurance Claims."

The OIG further concluded that, from the sample of 175 cases, 44 were found to contain underwriting errors. In each of the 44 cases cited, OIG found that the lender did not demonstrate that the borrower: (1) was able to make the required monthly payments; (2) made a minimum investment in the property at the time of loan origination; and/or (3) was creditworthy. These are origination program requirements that the OIG believes make the lender ineligible to receive mortgage insurance benefits after default of an FHA-insured loan. Using its sample size, the OIG projected that HUD incurred losses of \$356,012,207 during the review period due to the failure of loans (associated with claims) meeting FHA's insurance eligibility requirements. OIG estimated quantifiable savings (a.k.a. "funds to be put to better use") at \$213,607,324 annually, if FHA establishes "procedures to review all claims and independently determine that loans comply with the contract of insurance."

The OIG recommends that FHA establish procedures to review all origination files either before or after claim payment.

**Finding 1: Significant Weaknesses in HUD Oversight of Single Family Claims are Costly**

**Recommendation 1A:** OIG recommends that the FHA Commissioner establish procedures to review all claims and independently determine that loans comply with the contract of insurance to address projected unsupported claims and final costs totaling \$213,607,324 annually.

**FHA's Response:**

The OIG's conclusion of costly weaknesses in the current claims process is based upon a random sampling of 175 paid claims. Of that sample, the report states that there were 44 loans (associated with the claims) for which FHA did not have the required documentation at origination. Therefore, per the OIG, the claims should have been denied as they were not eligible for insurance benefits.

**Comment 7**

**Comment 7**

**Comment 3**  
**Comment 5**  
**Comment 8**

FHA strongly disagrees with this audit finding. FHA staff only found potential material errors in 11 of the 44 cases; found deficiencies in the process OIG used to project losses; and identified legal restrictions in implementing OIG's recommendation to deny claims. Moreover, FHA demonstrates in this report that the OIG's recommendation is neither cost effective nor practical.

**Comment 9**

Initially, the OIG identified 52 case files containing underwriting errors. These cases were re-examined by Housing staff prior to the issuance of the draft report. Based on FHA's review and subsequent discussion with the audit team members, the OIG agreed to eliminate 8 cases from its final reporting sample. Of the remaining 44 cases, FHA staff re-examined 43 of the files (one file was not made available for review) and concluded:

**Comment 10**

- On one loan, a claim was never paid. Therefore, this loan should have been excluded from the OIG's sample because there was no loss to the Department.

**Comment 11**

- On one loan, ABN/AMRO had already agreed to repay the Department the associated loss based on a separate settlement agreement. Therefore, this loan should have been excluded from the OIG's sample.

**Comment 5**  
**Comment 12**

- Six loans were reviewed by HUD staff as part of a Post-Endorsement Technical Review or during a Quality Assurance On Site Review. A determination had already been made that there were no material violations with respect to these loans.

**Comment 5**  
**Comment 13**

- Single Family and the OIG's auditors reviewed the underwriting of 35 loans and cited deficiencies, which were found to be non-material in 24 cases. Thus, there were possible material deficiencies associated with only 11 cases. A subsequent review of these 11 cases revealed that 9 of the 11 cases have reasons for default that are unrelated to underwriting.

**Underwriting Review**

**Comment 5**

Of the 44 loans cited in the draft report, FHA may agree with the OIG's audit team findings that material risks exists for 11 loans (see Attachment I). Attachment II identifies the specific basis for Housing's determination of material risk. However, we believe that this number could be further reduced if the lender had the opportunity to respond to the issuance of a deficiency letter, producing documents missing from the actual case file. Therefore, it is not appropriate to unilaterally conclude that a missing document or poor underwriting increased the loan risk and was ultimately the root cause of default and a claim payment.



**Comment 14**

**Comment 15**

**Comment 13**

**Comment 5**

**Servicing Review**

A servicing review of the 11 loans for which FHA may agree that there is missing documentation, revealed that:

- for 9 of the 11 loans, at least 12 monthly mortgage payments were made, reducing the likelihood that underwriting errors caused the loans' default; and
- for 6 of the 11 loans, the default was clearly due to events unrelated to deficiencies in underwriting (e.g., divorce, death of a family member, loss of income).

This information is evidence that there is no absolute link between errors in origination and default. Based on an examination of the findings in this audit, it is FHA's contention that there is no economic benefit to the Department performing a 100 percent origination review during the claim payment process to ensure claims are only paid on eligible loans.

**Summary of the 11 Cases Studied**

Case Number	Servicer	Days from Closing to Endorsement	Loan To Value	Number Payments before 1st Default	Default Definition
031-2828498	Chase Bank	62	97.74	23	06 = Curtailment of borrower income
094-4228774	Midland Mortgage	74	97.75	12	04 = Death of mortgagor's family member
105-0166660	WAMU	46	97.49	12	06 = Curtailment of borrower income
161-1977109	Countrywide	27	97.74	6	15 = Other
221-3161897	Standard Mortgage	87	96.97	9	06 = Curtailment of borrower income
381-6044141	Chase Bank	28	96.92	18	07 = Excessive obligations - same income
412-4550756	Bank of America	19	97.74	17	07 = Excessive obligations - same income
491-7376910	Wells Fargo	168	96.99	17	07 = Excessive obligations - same income
491-7690756	Wells Fargo	86	96.98	18	15 = Other
492-5910648	WAMU	235	97.19	24	05 = Marital difficulties
521-4634287	Utah Housing Corp	27	96.99	27	05 = Marital difficulties

## Comment 16

### FHA's Control Process

FHA believes that its existing claims payment controls process represents an effective management control structure. FHA strives to ensure that HUD-approved lenders are originating and servicing FHA-insured loans in compliance with the Department's requirements. Single Family's approach to quality assurance is to emphasize lender accountability and quality control throughout its program offices, and to rely on automated systems to assist in identifying lenders representing higher risks to FHA programs. FHA's oversight is designed to protect the Department from unacceptable risk by assessing lender performance, internal controls and compliance with origination and servicing requirements; and as appropriate, requiring corrective measures or initiating enforcement actions.

FHA's comprehensive three-pronged quality control approach includes the following: (1) a 100 percent automated review of all new loan insurance applications, supplemented by post endorsement reviews using a sampling methodology; (2) a 100 percent automated review of all insurance claims, supplemented by a post claim payment review; and (3) Quality Assurance Reviews. Layered on top of this approach are the OIG's reviews of lender origination practices. The combination of these quality control endeavors clearly demonstrates that FHA takes appropriate actions to limit risk to the Mutual Mortgage Insurance Fund.

The following is more detailed information relative to FHA's quality control process:

FHA selects endorsed files for Post Endorsement Technical Reviews (PETRs) using a risk-based methodology. Unless otherwise indicated, at least five percent (5%) of lender files are subject to review. Currently, PETRs are completed on seven to ten percent (7%-10%) of all endorsed files. The focus of the PETR process is to effectively achieve an evaluation of risk to the Department without compromising these reviews as a means for providing useful feedback to the lenders. The PETR process continues to evolve based on file reviews, audit reports and analyses of other data.

Based on the continued review of files, audit reports and analyses of other data, effective November 19, 2005, the PETR rating terms were changed to more clearly define the actual findings of loan reviews. Further, an additional code was added to capture any data quality deficiencies noted during PETRs of lender-insured files.

The current ratings are as follows:

- Conforming - for mortgages rated "Conforming", the overall decision to approve the mortgage is considered sound and the level of risk acceptable, and there were no deficiency findings noted in the file review, either for the property or credit.
- Deficient - for mortgages rated "Deficient", the mortgage is considered sound and the level of risk acceptable, but there may be one or more deficiencies noted, either for the property or credit.

- **Unacceptable** - for mortgages rated “Unacceptable”, the mortgage exhibits such serious violations of FHA requirements and, therefore, poses such a level of risk to the Department, that it should not have been approved, either for the property or credit.
- **Mitigated Rating** - for mortgages rated “Unacceptable”, the lender is sent a deficiency letter and requested to respond within 30 days. If the lender submits additional documentation that removes the risk factor(s), the “Unacceptable” rating is changed to a “Mitigated Rating”. If an “Unacceptable” rating is sustained, the lender is requested to indemnify HUD.

Instructions were issued to Single Family Housing’s Homeownership Centers (HOCs) on January 31, 2005, delineating requirements to complete a quarterly review of the performance under the PETR process of all lenders doing business within each HOC’s respective jurisdiction. Any lender’s branch or single office, which received ten percent or more of its reviewed cases rated “Unacceptable” under the new PETR rating system for at least two consecutive quarters, loses unconditional Direct Endorsement (DE) authority for the branch office jurisdiction and will be returned to a DE pre-closing review status. Such lenders (i.e., branch offices or single office) must have had at least 50 cases reviewed during the stated time period of two consecutive quarters. Headquarters may modify the percentage and number of reviews to trigger this action if it deems such action necessary.

#### **Insurance Endorsement Review Process**

Direct Endorsement (DE) cases are submitted for insurance endorsement after a loan is closed. The submitting lender has the responsibility of ensuring all documentation is appropriate and conforms to the requirements of HUD Handbook 4165.1, Endorsement for Insurance for Home Mortgage Programs (Single Family). The lender must assemble the processing and closing documents and place them in the case binder in the order prescribed in the handbook.

The lender shall submit the case binder to FHA so that it is received within 60 days after closing. Receipt of the case is indicated by the date of entry into the Computerized Homes Underwriting Management System (CHUMS) or FHA Connection if the lender is eligible to insure loans under the Lender Insurance Program. The lender is responsible for verifying that the input in the FHA Connection is consistent with the documents submitted in the case binder.

The lender must initiate insurance endorsement processing by completing the Insurance Application function in FHA Connection prior to sending the case binder to the appropriate HOC or insuring the loan using Lender Insurance. After receiving the case binder, the HOC will perform its internal pre-endorsement review functions and complete insurance endorsement processing using the logging and endorsement functions in FHA Connection.

For loans that will be insured using Lender Insurance, the lender completes the internal pre-endorsement review function and completes the insurance endorsement processing using the endorsement functions in FHA Connection.

There are edits built into the data entry process used by FHA and lenders to insure mortgage loans. The types of system edits are as follows:

- Was the case submitted within 60 days of closing? If the case wasn't submitted timely, has the lender included the late endorsement certification letter?
- If the borrower information is changed (e.g. name and/or social security number), did the changes pass the social security number validation edits?
- Is the mortgage amount within range based on the sales price, interest rate, principal and interest, and the inclusion of upfront mortgage insurance premium and loan type?
- Case warnings must be cleared, (e.g. any previous mortgage credit reject must be cleared).

The pre-endorsement review is confined to the documents specified in the handbook for DE processing. A limited review of each document is done to ascertain compliance, e.g. the HUD-1 Addendum is provided, signed and dated by applicable parties. No further review is required or authorized unless FHA or the lender has reason to suspect fraud or misrepresentation (including negligent misrepresentation), in any of the documents submitted. During the pre-endorsement review, FHA or the lender is authorized to determine if there is any information indicating that any certification or required document is false, misleading, or constitutes fraud or misrepresentation on the part of any party, or that the mortgage fails to meet a statutory or regulatory requirement. If following this review, the mortgage is determined to be eligible, the loan will be insured and an electronically issued MIC will be available for the lender to download from FHA Connection.

If the mortgage is determined to be ineligible for insurance endorsement, FHA will electronically indicate a Non-Endorsement Notice/Notice of Return (NOR) on the Case Query screen and include the reasons for non-endorsement and any corrective actions that must be taken by the lender. For loans that will be insured using Lender Insurance, if the case has one or more severe case warnings (CAIVRS, failed Social Security Number Validation or text is entered by the HOC indicating a risk to HUD), the file will be forwarded to HUD for review.

**Conclusion:**

**Comment 17**

In order to comply with the OIG's recommendation that a detailed evaluation of every loan for which a claim is filed is necessary, FHA would need to dramatically increase its operational and financial resources. Of course, such a massive endeavor would be inefficient and cost prohibitive. Furthermore, the OIG's recommendation is contrary to the risk-based approach advocated by GAO and the OIG itself in previous audits. Additionally, FHA believes every loan is already reviewed before payment; not physically, but electronically so as to be cost effective. Under our automated review, every claim must pass pre-established system edits. If an error is detected, the lender has to correct the problem and re-submit its claim to HUD.

**Comment 18**  
**Comment 19**

**Comment 2**

The OIG's recommendation fails to recognize the realities of a high-volume production environment. In order to implement this recommendation, all claims would have to be put into suspense, pending an independent determination that the loans, associated with the claims, comply with the contract of insurance. The implementation costs of this effort will include automated system modification and development expenses, additional debenture interest payments to lenders due to delays in claim settlements, and the cost associated with establishing an organization that can independently verify loan eligibility on a case-by-case basis.

**Comment 2**

FHA has no way of estimating the length of the time required to verify loan eligibility on a case-by-case basis; but we can estimate the cost of a one-month delay per case. Using the OIG's average claim amount of \$98,150 and the average debenture rate for FY04 of 5 percent, a one-month delay in claim settlement adds approximately \$410 to an average claim payment. Having paid claims, which would require debenture interest to settlement on over 84,000 cases in FY04 (the only complete fiscal year included in the audit), the additional debenture interest would have been \$34.4 million.

**Comment 2**

In FY04, claims were paid on more than 162,000 cases. Given a 250 workday year, that is more than 648 cases a day that will need to be examined. In order to handle the added workload of a 100 percent underwriting review prior to claim payment, and a review of past claims (IG Recommendations 1B & 1C), a new contract activity would need to be established, at an estimated cost of \$2.5 million.

**Comment 20**

Underwriting and quality control is not a 100 percent quantitative process. It requires looking at numbers, check sheet items, and the application of logic, rationality, and interpretation when making an underwriting decision. When determining risk, FHA takes into account whether or not a loan is performing and how material a violation is relative to FHA's entire portfolio.

**Comment 20**

FHA looks at the various layers of risk, how such layers interact with and affect one another. For example, a lone missing piece of documentation, such as a Verification of Employment (VOE), may have little or no affect on the performance of a loan, if other documentation in the file is acceptable and no remedy is required other than a notation to the lender to be sure file documentation is complete. However, if that missing documentation was also combined with other layers of risk such as no VOE, no pay stubs, no W2s and poor credit, the borrower's ability and likelihood to repay a mortgage is questionable. In other words, these multiple layers of risk would trigger indemnification or monetary remedial actions due to the materiality of the violation and the impact of such violation on a loan's performance.

**Comment 21**

On Page 7 of the draft report, the OIG's reference to the Quality Assurance Division's (QAD) monitoring activity is inaccurate. The purpose of the QAD is to mitigate FHA from unacceptable risk as an insurer by assessing lender performance, internal controls, and compliance with written origination and servicing requirements; and as appropriate, to require corrective measures or initiate enforcement action. QAD's purpose is not to re-underwrite closed loans or perform audits in anticipation of claims being filed.

**Comment 22**

The audit also suggests that FHA is not complying with the Office of Management and Budget (OMB) Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables", which "requires HUD to ensure lenders met program requirements, including origination, before making a claim payment". The Office of General Counsel (OGC) differed with the OIG and concluded that Housing is complying with OMB Circular A-129 (see Attachment III). The OGC points out that FHA, in various handbooks and other directives, require lenders to maintain and follow quality control plans when originating loans. Therefore, FHA believes that the case-by-case loan eligibility standards that the auditors suggest FHA assess before paying a claim are excessive and far too costly. As noted above, FHA does review every case through an automated process prior to the issuance of insurance and it conducts reasonable due diligence using its sampling methodology when determining the cases on which it will focus its attention.

**Comment 4**

**Recommendation 1B:** Review claims received during the period October 1, 2003, through June 3, 2005, to independently determine that loans comply with the contract of insurance and seek from lenders, recovery or adequate support for final HUD costs that could include \$354,710,977 for noncompliant claims (\$356,012,207 less \$1,301,230 addressed in 1C).

**Comment 5**  
**Comment 23**

**FHA's Response:**

As stated earlier, FHA may agree with the audit team findings that 11 cases had underwriting deficiencies. However, these 11 cases do not represent a statistically valid sample on which to project additional losses. Therefore, FHA refutes the OIG's projected loss of \$354,710,977 reported in the audit.

**Recommendation 1C:** Seek recovery or adequate support for final HUD costs totaling \$1,301,230 for the 44 unsupported claims identified in our sample.

**FHA's Response:**

**Comment 2**  
**Comment 9**

The OIG report suggests that FHA recover the total amount paid to lenders on the 44 cases listed in the draft report. The report also concludes that by extrapolating the losses on the 44 cases to the universe of claims paid, HUD could recover over \$200 million annually. This is not a supportable conclusion.

Single Family Housing's program attorneys in the OGC met with the OIG on January 18, 2006, to discuss the auditors' initial draft report. In that meeting, the OGC informed your office that, due to the incontestability clause in Section 203 (e) of the National Housing Act (NHA), HUD would be prohibited from denying a claim payment on the basis that loan eligibility criteria had not been met, unless HUD can establish fraud or material misrepresentation on the part of the claiming mortgagee. On March 17, 2006, in the Exit Conference for this draft audit report, your staff verbally stated that they no longer were suggesting that claims be conditioned on verification of loan eligibility. Instead, OIG suggested that FHA review all claims before or after payment to determine loan eligibility, for the purpose of seeking recoveries against the originating lender, not the claiming lender, unless they are the same entity. Single Family Housing's program counsel also disagreed with this recommendation.

**Comment 2**

OGC has stated in a memorandum regarding this audit (Attachment III), that the incontestability clause in Section 203 (e) of the NHA, means that after HUD endorses a loan for insurance, HUD cannot later deny a claim payment for that loan on the basis that the loan was not eligible for insurance at the time of endorsement, except for fraud or material misrepresentation on the part of the claiming mortgagee. Under the incontestability clause, HUD would have to prove fraud or material misrepresentation on the part of the holder of the mortgagee loan that currently is the beneficiary of the FHA mortgage insurance contract. To deny payment of an insurance claim, HUD would have to prove that the claiming mortgagee, not the originating mortgagee, had committed, or participated in, fraud or material misrepresentation which induced FHA to provide the insurance endorsement. OGC disagrees with the OIG suggesting that HUD should have, or could have denied paying any of the 44 claims listed in the subject report since there was no indication or concrete evidence that the claiming mortgagees had committed fraud or material misrepresentation.

**Comment 3**  
**Comment 24**

Although the Mortgage Review Board (MRB) does have an authority to demand indemnification or agreements with lenders to recover claim losses, before attempting to recover losses from lenders who are determined to be noncompliant, lenders must be afforded due process, which would require HUD to present its findings to a mortgagee and provide the mortgagee with the opportunity to respond to such findings. Some lenders could possibly locate the missing documents the OIG references in its draft report and be able to prove the loan was properly originated. The report, however, does not indicate that mortgagees were given this opportunity. Whether the loan was originated properly or not, the mortgagee could still successfully argue that the default, and therefore, HUD's loss, was not caused by improper underwriting. Further, the Mortgage Review Board's ability to impose sanctions is based on a pattern of practice, not individual case violations. In the 11 cases where material underwriting violations were detected, eight different lenders originated the loans. Therefore, none of these cases would rise to a level that would warrant a referral to the MRB, which is the only entity authorized to impose sanctions and/or penalties against a lender.

**Comment 17**

**COMMENTS ON THE OIG'S SAMPLING METHODOLOGY**

**Comment 25**

Appendix F of the OIG Audit Report details the methodology used to determine the potential dollar amount of unsupported claims and the ultimate cost (loss) to HUD on those claims. HUD is concerned with the lack of specificity regarding the OIG's sampling methods and the way in which the sample results are projected and applied to the entire portfolio of claim payments.

**Comment 23**

The OIG reviewed 175 loan-origination case binders for FHA single-family MMI loans that went to full claim in either FY2004 or FY2005. The objective was to determine what percentage of claims might have warranted denial because the case binder did not have complete and/or fully accurate information. The OIG applied its case-binder results to the entire portfolio of claim payments, and it then reported confidence bounds for the total dollar value of "Supported" and "Unsupported" claim payments. The type of sampling performed can be used to test whether the true "event" rate in a population might be equal to a hypothesized rate. However, the OIG chose a sample size that would permit testing whether or not the true, but unknown, error rate might be equal to 50 percent. Though not clearly demonstrated in the report, HUD staff verified that, indeed, the OIG could conclude with a high degree of confidence, that the error rate is something far less than 50 percent.

**Comment 26**

**Claim Value Projections**

The OIG, however, did not set out to prove or disprove an error rate of 50 percent, but rather chose to create confidence bounds around the sample error rate. Doing this requires great circumspection when using a single sample. It is not clear that the OIG understood how to properly transition from what can be said about a potential 50 percent error rate to what can be said from the actual sample error rate. To fully evaluate confidence intervals for the true population error rate—and resulting dollar claims



involved—one should rely upon either repeated sampling so that the distribution of possible values of the true population error rate can be estimated with some level of accuracy.

**Comment 4**

The more important question, not addressed by OIG, is, at what error rate does the balance between the cost of more intensive claims auditing procedures and the benefits associated with identifying potential underwriting errors begin to tilt toward investing resources for increased audits? That is much more important than establishing confidence bounds around an estimate derived from a fairly small sample. The OIG could ask, however, what is the chance - given sample results - that the actual population error rate is high enough that it would be cost effective to engage in more intensive case-level reviews? To fully address that question, however, the OIG would first need to establish the cost of intensive case-level analyses of claim payments.

**Profit/Loss Projections**

**Comment 27**

The OIG utilized the same confidence-bound-estimation to compute a lower-bound confidence limit on the dollar value of profit/loss from unsupported claims. At that point, however, the OIG changed, without explanation, its confidence interval from 95 percent to 90 percent.

**Comment 26**

The OIG now has one point estimate of the rate of (full) claim payments for which there are missing elements in the loan underwriting case binders, which is 25.14 percent. If that is high enough to warrant concern then the OIG should perform repeated sampling in order to verify that its initial result is truly representative of the universe of claim-payment cases. Absent such additional research or sampling, the OIG should not attempt to estimate confidence bounds around dollar values involved. Rather, it should only report its point estimate and caution the reader that such point estimate is based upon only one sample.

**Comment 28**

The OIG should also carefully detail and communicate its analytical procedures and assumptions in appendices to its reports. That is an important part of providing an audit trail and allows third parties to validate the research that was done. Lacking that information in Appendix F, HUD staff relied upon conversations with OIG staff to learn what was done. The OIG answered many, but not all questions asked of them in phone calls and emails.

**Comment 6**

Finally, the OIG was inefficient in its approach of choosing a sample of cases for its audit and that inefficiency increases the OIG's risk of being inaccurate. Rather than downloading entire data tables with millions of records from HUD data sources, and then querying those tables locally to create the samples of interest, the OIG should instead obtained information on insurance cases directly from HUD's electronic data warehouse.

**Comment 29**

**Conclusion:**

Based on the foregoing and the fact that the audit did not provide proof that any of the loans, included in the sample, went into default as a result of underwriting deficiencies, Housing does not believe that the audit findings and conclusions are fully supported. Therefore, the Office of Single Family Housing respectfully requests that the Office of the Inspector General reconsider issuance of this audit.

The Office of Housing, the Office of General Counsel, and the Office of the Chief Financial Officer, met with and had subsequent discussions with you and members of your staff regarding this audit. Our joint concerns were raised in those discussions and are reflected in this memorandum. Should you wish further clarification, or require additional information, please contact Joseph McCloskey at (202) 708-1672.

Attachment I

Comment 5

Monetary Value of 11 Case Study Summary

Case Number	Servicer ID	Servicer	Amount of Claim Paid
031-2828498	34400	Chase Bank	\$ 30,136.00
094-4228774	39276	Midland Mortgage	\$ 20,500.00
105-0166660	73815	WAMU	\$ 24,494.00
161-1977109	64141	Countrywide	\$ 44,949.00
221-3161897	17158	Standard Mortgage	\$ 33,151.00
381-6044141	30141	Chase Bank	\$ 22,359.00
412-4550756	13064	Bank of America	\$ 49,769.00
491-7376910	22995	Wells Fargo	\$ 30,734.00
491-7690756	22995	Wells Fargo	\$ 31,425.00
492-5910648	47219	WAMU	\$ 39,404.00
521-4634287	52167	Utah Housing Corporation	\$ 29,579.00
Total			\$ 356,500.00

Attachment II

SCHEDULE OF MORTGAGE LOAN DEFICIENCIES

Case number	Missing mortgage credit analysis worksheet	Unsupported/overstated income	Missing verification of employment, written or telephonic; employment 2 years not verified	Missing/inconsistent W2 forms	Understated liabilities	Inaccurate/excessive qualifying ratios without adequate compensating factors	Missing verification of deposit/3 months of bank statements	Minimum borrower investment not collected	Missing gift letter/evidence funds received	Sweat equity not documented as required	Questionable/false Social Security number	Missing explanation of derogatory credit	Identified past due federal debt not shown current	Final HUD (costs)/revenue from the Single Family Housing Enterprise Data Warehouse
761-7470567														(\$31,548)
011-4901556		X						X						(\$38,965)
412-6862913														(\$46,989)
562-1671096			X											(\$35,581)
153-0039866														(\$21,822)
104-9393956													X	(\$18,328)
461-3438725														(\$95,131)
032-0021400														\$0
231-9053403			X											(\$26,165)
221-15161697														(\$33,152)
201-2963675														(\$24,803)
484-2754289			X											(\$19,346)
151-5921038														(\$56,459)
381-6044141														(\$22,359)
351-3813158			X											\$24,955
482-8019745														\$0
151-8032420								X						(\$52,119)
083-5034730			X											\$6,839
482-6510888							X							(\$38,341)
484-2853980														(\$59,902)
105-0166680					X									(\$24,484)
151-6530561											X			\$0
581-2205307												X		(\$27,284)
1971-425185														\$0
221-3436556														(\$35,672)
483-2828013														(\$80,143)
1371-624016														(\$21,794)
561-7914834														\$0
521-4742471														\$0
031-2828498														(\$29,711)
412-4560756			X											(\$48,769)
052-2112308														(\$18,203)
491-7960115														\$0
084-4228774			X											(\$20,500)

1  
 DRAFT - USE RESTRICTED  
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Case number	Missing mortgage credit analysis worksheet	Unsupported/overstated income	Missing verification of employment written or telephonic; employment of 2 years not verified	Missing/inconsistent W2 forms	Understated liabilities	Inaccurate/excessive qualifying ratios without adequate compensating factors	Missing verification of deposit/3 months of bank statements	Minimum borrower investment not collected	Missing gift letter/evidence funds received	Sweat equity not documented as required	Questionable/false Social Security number	Missing explanation of derogatory credit	Identified past due federal debt not shown current	Final HUD (costs)/revenue from the Single Family Housing Enterprise Data Warehouse
492-5910648		X												(\$39,404)
521-4634287									X					(\$29,579)
491-7690756														(\$31,425)
411-3107034			X										X	(\$31,604)
263-3411287														(\$25,655)
493-7150295									X					\$0
431-3927735									X					(\$74,366)
023-1142563									X					(\$31,147)
521-4596354										X				\$0
591-0896391		X												(\$23,222)
461-7376910		X												(\$30,734)
262-1196752		X			X									(\$57,497)
161-1917109											X			(\$44,549)
023-0876344		X												(\$7,922)
221-3150986			X											(\$71,511)
151-6125279					X									(\$37,265)
352-4051203									X					(\$28,412)
106-0341995									X					(\$30,837)
Total	1	5	13	2	3	6	1	3	19	1	1	4	2	(\$1,491,604)
Percentage of 52 loans	2%	10%	25%	4%	5%	12%	2%	6%	37%	2%	2%	8%	4%	

2  
**DRAFT - USE RESTRICTED**  
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**Comment 30**

NOTE: All reviewed cases are closed prior to issuance of 4155.1 Rev-5.

**Comment 31**

**Appendix D**

**NARRATIVE OF MORTGAGE LOAN DEFICIENCIES**

**Case number 261-7470567 Philadelphia 1**

There was no documentation in the file to support the transfer of funds from the donor, the borrower's sister in law, to the borrower as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10. C., Gift Funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Comment 32**

1. No gift funds are involved or needed to close in this transaction, even though stated on 1003.  
\*Findings for this case should be removed\*

**Case number 011-4901558 Atlanta 2**

There was no documentation in the file to support that the lender obtained a written or telephone verification of employment as required. Additionally, the file only included 1 pay stub covering a 2 week period rather than 30 days as required. The automated underwriting program requirements for pay stubs, verbal verification of employment, and Internal Revenue Service Form W-2s were not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 33**

1. Concur with findings regarding no VOE in the file. \*No Risk\*  
2. File contains a bi-weekly pay stub of which covers one-full month and YTD gross earnings.  
\*This finding should be removed\*  
\*\*Request to have all findings removed\*\*

**Case number 412-4605213 Philadelphia 3**

The borrower did not make the required minimum investment of \$2,490. The Settlement Statement form HUD-1 shows the borrower contributed \$2,990 at closing. However, the Settlement Statement form HUD-1 shows \$1,105 was paid to the borrower at closing which reduced the borrower's investment to \$1,885, \$605 less than the required minimum investment amount. Handbook 4155.1 REV-5, 1-7 and Mortgagee Letter 98- 29 require the borrower to make a cash investment at least equal to 3 percent of the contract sales price.

1

**DRAFT – USE RESTRICTED**  
**For Discussion and Comment Only – Subject to Review and Revision**

**Comment 34**

1. Based on the HUD-1, borrower did make the required minimum investment of \$2,490. Additionally "cash to borrower" of \$1105.32 included the earnest deposit of \$500, prorate for taxes of \$380.70, and appraisal and credit report of \$283.00. \*\*Findings for this case should be removed\*\*

**Case number 562-1671096 Santa Ana 4**

There was no mortgage credit analysis worksheet in the mortgage loan file as required. HUD Handbook 4155.1 REV-4, CHG-1 4-4, C., and Rev-5, 3-1, B., requires the lender to provide a mortgage credit analysis worksheet.

**Comment 35**

1. The lender must have left it out when they copied the file – Missing MCAW has no bearing on the borrower’s qualification \*No Risk – This item should not be considered a finding for the purpose of this audit\*  
\*\*Request to have all findings removed\*\*

**Case number 153-0079869 Atlanta 5**

The Settlement Statement form HUD-1 showed \$2,335 in down payment assistance funds. There was no gift letter in the file for the down payment assistance funds or documentation of the transfer of the funds to the borrower as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 36**

1. Concur with finding regarding no gift letter in the file.  
2. Documentation of gift transfer was provided. Please see HUD-1 in the file.  
\*No Risk – Gift was deposited in Escrow and from Indiana Housing, a Non-Profit\*  
\*\*Request to have all findings removed\*\*

**Case number 101-9333255 Atlanta 6**

The borrower credit report showed a \$1,108 debt to the Department of Defense for a salary overpayment. There was no documentation in the mortgage loan file that the overpayment was repaid, a repayment agreement entered, or otherwise satisfied by the borrower and the Department of Defense. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-5, B., delinquent federal debts, states, if the borrower is presently delinquent on any federal debt or has a lien, including taxes, placed against his or her property for a debt owed to the United States, the borrower is not eligible until the delinquent account is brought current, paid or otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the federal agency owed and is verified in writing.

**Comment 37**

1. Department of Defense debt was paid off thru escrow at closing as shown on the HUD-1.  
\*\*Finding for this case should be removed\*\*

**Case number 461-3488725 Atlanta 7**

The debts used in the ratio computation on the mortgage credit analysis worksheet were not supported by the credit reports, the automated underwriting system results, or the uniform residential loan application. The mortgage credit analysis worksheet used expenses of \$1,232, the automated underwriting system results adjusted for coborrower and General Motors Acceptance Corporation debts would yield \$1,375, the credit reports for both borrowers adjusted for General Motors Acceptance Corporation debt yields \$1,360, and the Uniform Residential Loan Application yields \$895. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-11, types of liabilities, states, in computing the debt-to-income ratios, the lender must include the monthly housing expense, and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending 10 months or more.

Using \$1,360 for the amount of debt, the resulting recalculation of total fixed payment to income ratio is 46.7 percent, which exceeds the HUD requirements. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

1. The total recurring expenses \$1232.00 is reflected on the MCAW.
  2. The URLA (1003) states \$895.00 but MCAW shows the correct figure
  3. This case was not an AUS case as indicated in the write-up.
  4. Total debts I came up with matches underwriter's calculation of \$1232. Duplicate accounts should not have been included in total debts.
- \*\*Findings for this case should be removed\*\*

**Comment 38**

**Case number 032-0021400 Denver 8**

The verification of employment documentation does not meet HUD requirements for alternative verification. The lender conducted a verbal verification, obtained Internal Revenue Service Form W-2s for 2000, and a partial tax return for 1999. The HUD requirement for Internal Revenue Service Form W-2s covering two years was not met and the partial tax return for 1999 does not include the signature section. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

1. A verbal VOE and a written VOE covering the 2 yrs employment were provided. HB 4155.1 Rev. 4 only requires the most recent pay stub.

**Comment 39**



**Comment 39**

\*\*Findings for this case should be removed\*\*

**Case number 241-6083403 Philadelphia 9**

The Settlement Statement form HUD-1 shows a "SELP LOAN" and the mortgage credit analysis worksheet show a "CITY SELP" as the source of essentially the entire borrower investment. There is no other mention of the "SELP" in file. Since there is no evidence in the file of a lien on the property, as required for secondary financing, we concluded that the funds should be categorized as a gift. There is no indication the "SELP LOAN" was considered by the automated underwriting program used. Also, there was no documentation in the file of the transfer of funds from the donor to the borrower or a gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 40**

1. "SELP Loan" is a silent or forgivable 2<sup>nd</sup> Trust Deed, not a gift.

\*\*Findings for this case should be removed\*\*

**Case number 221-3161897 Denver 10**

The Settlement Statement form HUD-1 shows \$2,578, "BOND ASSISTANCE AMT". There is no other mention of the bond assistance in the file. Since there is no evidence in the file of a lien on the property, as required for secondary financing, we concluded that the funds should be categorized as a gift. There is no indication the "BOND ASSISTANCE AMT" was considered by the automated underwriting program used. Also, there was no documentation in the file of the transfer of funds from the donor to the borrower or a gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 41**

1. Concur with findings - Bond assistance documentation was not provided.

\*\* The HUD-1 indicates \$2,578 is bond assistance and it should not be treated as a gift.

**Case number 201-2963675 Atlanta 11**

The file did not contain required documentation showing a two year work history or written or telephone verification of employment. The automated underwriting program requirement for verbal verification of employment was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-6, stability or income, states, we do not impose an arbitrary minimum length of time a borrower must have held a position to be eligible. However, the lender must verify the borrower's employment for the most recent two full years. Further, HUD Handbook 4155.1

**Comment 42**

REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

- 1. Concur with this finding - no VOE in the file. \*No Risk – Pay stubs and W2's are provided\*
  - 2. Loan was approved by AUS; and therefore, alternate documentation rule does not apply.
- \*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 494-2754299 Denver 12**

The file did not contain required documentation showing a two year work history or written or telephone verification of employment. The automated underwriting program requirement for verbal verification of employment was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-6, stability or income, states, we do not impose an arbitrary minimum length of time a borrower must have held a position to be eligible. However, the lender must verify the borrower's employment for the most recent two full years. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 43**

- 1. Concur with this finding regarding no VOE. \*No Risk - 4 pay stubs, W2's and tax returns are in the file\*
- \*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 151-5921039 Atlanta 13**

The Settlement Statement form HUD-1 shows "Nehemiah Gift Funds" for \$3,453 but there was no documentation in the file of a gift letter as required and no gift funds are included on the mortgage credit analysis worksheet. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 44**

- 1. Concur with findings regarding no Nehemiah Gift letter in the file.
- \*No Risk - HUD-1 clearly indicated Nehemiah gift\*
- \*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 381-6044141 Atlanta 14**

The borrower's application showed a \$5,000 gift from parents, and the mortgage credit analysis worksheet shows \$2,300 gift from parents, but the Settlement Statement form HUD-1 does not show any gift funds. The file did not contain a gift letter or documentation showing the transfer of gift funds from the donor to the borrower as required. Additionally, the verification of deposit did not show the borrower had the needed funds to close the transactions without the gift. The verification of deposit shows \$2,212 available while the mortgage credit analysis worksheet included the \$5,000 gift in assets to close, and the Settlement Statement form HUD-1 showed \$5,694 cash from borrower at closing. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 45**

1. No evidence of gift from parents – No gift involved in this transaction \*This finding should be removed\*
2. Concur with this finding regarding an insufficient fund verified.

**Case number 351-3813158 Philadelphia 15**

The file did not contain required documentation showing the lender obtained a written or telephone verification of employments as required. The automated underwriting program requirement for verbal verification of employment was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 46**

1. Borrower's employment is verified on the Residential Mortgage Credit Report.  
\*\*All findings on this case should be removed\*\*

**Case number 492-6015745 Denver 16**

The borrower was required to make a minimum investment of \$3,921. The Settlement Statement form HUD-1 shows the borrower only paid \$3,179 plus earnest money of 500, for a total of \$3,679. This amount is \$242 below the required minimum investment. Handbook 4155.1 REV-5, 1-7 and Mortgagee Letter 98-29 require the borrower to make a cash investment at least equal to 3 percent of the contract sales price.

**Comment 47**

1. Borrower did bring in enough money to escrow. Auditor did not include \$350.00 appraisal fee POC and all the prorated taxes from seller.

**Comment 47**

**\*\*All findings on this case should be removed.\*\***

**Case number 151-6032420 Atlanta 17**

The Employer Identification Number and the Employer State Identification Number for the borrower's employer "Preferred, Inc." was different on the Internal Revenue Service Form W-2's for 1998 and 1999. No explanation was provided. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, section 3-1E states, if the Internal Revenue Service Form W-2 indicates inconsistencies (e.g., FICA payments not reflecting earnings), standard employment documentation must be used.

**Comment 48**

1. The EIN being different for 1998 and 1999 should not be a finding because EIN may be changed at anytime, i.e. change of ownership. Also, all figures on W2's are calculated correctly.

**\*\*All findings on this case should be removed\*\***

**Case number 093-5034730 Atlanta 18**

The mortgage credit analysis worksheet shows "Down Payment Assistance Pasco County" in the amount of \$2000. The Settlement Statement form HUD-1 shows a "SHIP loan" in the amount of \$2000. Since there is no evidence in the file of a lien on the property, as required for secondary financing, we concluded that the funds should be categorized as a gift. There was no documentation of the transfer of funds from the donor to the borrower or a gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 49**

1. The SHIP Loan \$2,000 as indicated on the HUD-1 is a silent or forgivable 2<sup>nd</sup>, not a gift and should not be treated as a gift.

**\*\*Request to have all findings on this case removed due to no risk\*\***

**Case number 492-6510888 Denver 19**

The borrower was required to make a minimum investment of \$3,716. The Settlement Statement form HUD-1 shows the borrower only contributed \$3,346. This amount is \$370 below the required minimum investment. The automated underwriting program requirement for funds required was not met. Also, Handbook 4155.1 REV-5, 1-7 and Mortgagee Letter 98- 29 require the borrower to make a cash investment at least equal to 3 percent of the contract sales price.

**Comment 50**

1. Borrower did make the requirement investment of \$3,716.00 at COE. Auditor did not include the proration from seller. See HUD-1

**\*\*All findings on this case should be removed\*\***

**Comment 51**

**Case number 494-2853598 Denver 20**

The Settlement Statement form HUD-1 shows gift funds in the amount of \$4,675. However, there is no gift letter, documentation showing a transfer of funds or a bank statement showing receipt of funds. There is no indication gift funds were considered by the automated underwriting program used. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5 & 5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

1. Concur with this finding regarding no gift letter from Neighborhood Gold. However, both sales contract and HUD-1 clearly indicate seller's participation in Neighborhood Gold Program.

\*No Risk\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 105-0166660 Atlanta 21**

The borrower's fixed payment to income ratio was 47.2 percent. There were no compensating factors documented in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

Alternative verification of deposit requirements were not met. There is only one bank statement in the file. This bank statement does not cover the require three month period. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 3-1, F., verification of deposit, states, As an alternative to obtaining a verification of deposit, the lender may choose to obtain from the borrower original bank statement(s) covering the most recent three month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent consecutive statements.

The bank statement does not show that the borrower had adequate funds for the minimum borrower investment. The Settlement Statement form HUD-1 shows the sale price of the property at \$146,500. The required minimum borrower investment amount would have been \$4,395. The borrower's bank statement shows a balance of \$2,603, \$1,792 short of the minimum borrower investment amount. Handbook 4155.1 REV-5, 1-7 and Mortgage Letter 98- 29 require the borrower to make a cash investment at least equal to 3 percent of the contract sales price.

1. Back-End ratio 47.2, exceeded w/o compensating factors. – Concur with finding

2. Alt. VOD. Bank statement in the file does cover three months period. \*\*This finding should be removed\*

**Comment 52**

**Comment 52**

3. Concur with finding - Borrower does not have adequate funds verified, needed \$4,395 however only \$2,603 was verified.

**Case number 151-6530561 Atlanta 22**

The borrower's credit report shows two Citibank accounts with numerous late payments, many 90 or more days past due. In addition the credit report shows six other accounts with delinquent payments during the last two years. The borrower's credit history shows a pattern of delinquency and there is no explanation in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-3, analyzing the borrower's credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

**Comment 53**

1. Borrower's explanation letter is in the file. During that period, borrower participated in a Consumer Credit Counseling Payment Plans. CCC made payments to a different account in error instead of Citibank.

\*\*All findings on this case should be removed\*\*

**Case number 581-2205307 Denver 23**

The borrower's credit report shows six collections without explanation as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-3, analyzing the borrower's credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

**Comment 54**

1. Concur with finding - collection accounts are not explained. All collection accounts are for very small amounts. However, borrower's major installment and revolving accounts were paid as agreed.

\*No Risk\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 197-1425165 Santa Ana 24**

There was no documentation in the file of the transfer of funds from the donor, the borrower's sister in law, to the borrower as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Comment 55**

1. Borrower did not need the \$16,000 gift to close the loan.

\*\*All findings on this case should be removed \*\*

**Case number 221-3436265 Denver 25**

The file did not contain required documentation showing a written or telephone verification of employment. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

Also, the file showed the borrower worked on a commission basis. There were no copies of the borrowers tax returns in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-11, D., commission income, states, the borrower must provide his or her last two years tax returns.

\*Concur with findings

**Comment 56**

**Case number 483-2828013 Atlanta 26**

The HUD 1 shows Nehemiah as the source of the gift funds but there is no gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

I. Concur with findings – No Nehemiah gift letter in the file; however, the HUD-1 clearly indicates a gift from Nehemiah to borrower. \*No Risk\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Comment 57**

**Case number 137-1624016 Atlanta 27**

The file did not contain required documentation showing written or telephone verification of employment. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

I. Concur with findings regarding no verbal VOE.

\*No Risk - Pay stubs and W2's provided, borrower works for City of Chicago\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Comment 58**

**Case number 561-7914634 Santa Ana 28**

**Comment 59**

There was no documentation in the file showing the transfer of gift funds, \$1,500, from the donor, the co borrower's father, to the borrower as required. The automated underwriting program used required verification of the gift funds. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

1. This gift fund was not needed to close the loan. Further, the borrower actually received \$1,900 cash back at closing.

\*\*All findings on this case should be removed\*\*

**Case number 521-4742471 Denver 29**

The lender omitted \$53 in borrower monthly payments. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-11, types of liabilities, states, in computing the debt-to-income ratios, the lender must include the monthly housing expense, and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending 10 months or more. Recalculation shows the total fixed payment to income ratio changes from 43.4 percent to 45.36 percent. Also, there was no documentation in the file of any compensating factors for the lender computed ratio. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

**Comment 60**

1. Lender omitted \$53.00 - Dillard account \$53.00/mo with balance of \$479.00 (less than 10 mos), lender is not required to include this amount in total fixed payment ratio.

2. Ratio exceeded no compensating factors - Borrower has more than 3+ month cash reserves

\*\*All findings on this case removed\*\*

**Case number 031-2828498 Denver 30**

The file did not contain required documentation showing the lender obtained a written or telephone verification of employment, pay stubs, or Internal Revenue Service Form W-2s as required. The automated underwriting program requirements for pay stubs, verbal verification of employment and Internal Revenue Service Form W-2s were not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 61**

\*\*Concur with findings - No income documentation provided in the file.



**Case number 412-4550756 Philadelphia 31**

The income was not calculated correctly. The explanation found in the case binder on the computation states that overtime of nine hours was calculated. There is no history of two years of overtime and no explanation from the underwriter justifying the inclusion of the overtime income. Without adequate justification, the overtime income should have been excluded from the ratio calculation. Also there was no explanation for the other earnings totaling \$283. Our calculations show that with night differential the monthly amount of income should have been \$1,716. A recalculation of the total fixed payment to income ratio based on the revised income amount showed a ratio of 48 percent. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-7, A., overtime and bonus income states both may be used to qualify if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. The lender must develop an average of bonus or overtime income for the past two years and the employment verification must not state categorically that such income is not likely to continue. Periods of less than two years may be acceptable provided the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes.

**Comment 62**

\*\* Concur with findings \*\*

**Case number 052-2112308 Denver 32**

The file did not contain required documentation showing written or telephone verification of employment. The automated underwriting program requirement for verbal verification of employment was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 63**

1. Concur with finding - Missing verbal VOE. \*No Risk\*
2. Most recent pay stub – this is an AUS case, only a recent pay stub covering 1 full month is required and was provided in file.

\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 491-7360115 Denver 33**

There was no documentation in the file of the transfer of funds from the donor, the borrower's father, to the borrower as required. The automated underwriting program requirement for verification of gift funds deposit was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Comment 64**

1. On Desktop Underwriter (DU) condition reads, if the gift funds were already deposited in the borrower's account, evidence of the transfer is not required.  
\*\*All findings on this case should be removed\*\*

**Case number 094-4228774 Atlanta 34**

We did not find documentation in the file that showed the lender verified the borrower's employment for the most recent two year period. The file did not include verifications of employment, Internal Revenue Service Form W-2s, or pay stubs covering the most recent two years nor did the file contain information on the two month gap in employment shown on the residential loan application. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 65**

1. Concur with findings - 2 years employment and income doc (W2's & YTD pay stubs) were not provided.

**Case number 492-5910648 Denver 35**

The file did not contain required documentation showing written or telephone verification of employment was received for either the borrower or coborrower. Additionally, there were no Internal Revenue Service Form W-2s for the coborrower. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

There was no documentation of compensating factors for a total fixed payment to income ratio of 48.90 percent as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented. There were no compensating factors documented in the file.

**Comment 66**

1. Concur with findings - No VOE for both borrowers and missing W2's for co-borrower.  
2. Back end ratio 48.9 no compensating factors. - Borrower has \$9,374 in reserves \*\*This finding should be removed\*\*

**Case number 521-4634287 Denver 36**

**Comment 67**

The file showed the borrowers' cash investment included sweat equity valued at \$4,655 by the builder seller. There is no indication sweat equity was considered by the automated underwriting program used. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, O. 2, states, the lender must document the contributory value of the labor through either the appraiser's estimate or through a cost estimating service.

1. There is no requirement to include sweat equity in AUS submission; sweat equity is to be treated as cash investment. **\*\*This finding should be removed\*\***
2. Concur with finding - The contributory value of the labor was provided by the builder and not from a third party.

**Case number 491-7690756 Denver 37**

The borrower had \$4,709 in collection for a past due government student loan and there was no documentation in the file to show the loan had been paid or otherwise satisfied, brought current, or placed under a repayment agreement. There is no indication past due federal debts were considered by the automated underwriting program used. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-5, B., delinquent federal debts, states, if the borrower is presently delinquent on any federal debt or has a lien, including taxes, placed against his or her property for a debt owed to the United States, the borrower is not eligible until the delinquent account is brought current, paid or otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the federal agency owed and is verified in writing.

**Comment 68**

**\*\* Concur with findings \*\***

**Case number 411-3107034 Philadelphia 38**

The file did not contain required documentation showing written or telephone verification of employment was received for the coborrower. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Comment 69**

I. Loan is 94.5% LTV with \$26,000 in reserves. And even without the co-borrower's income, the ratios are 36/36%. Co-borrower's income may also be used as compensating factors.

**\*\*All findings on this case should be removed\*\***

**Case number 263-3411287 Philadelphia 39**

Based on the conflicting documentation in the mortgage loan file, we could not make a determination on the accuracy of the borrower's monthly income. However, we did determine the lender did not verify the child support income as required. The required automated

underwriting documentation was not included, so we used HUD requirements. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-7, F., alimony, child support or maintenance income, states, the borrower must provide a copy of the divorce decree, legal separation agreement, or voluntary payment agreement and evidence that payments have been received during the last twelve months. We recalculated the total fixed payment to income ratio after revising the income amount for the unsupported child support and arrived at a total fixed payment to income ratio of 47.65 percent. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented. Additionally, the lender did not include the automated underwriting system documentation as required.

The borrower's credit report shows serious delinquencies and the majority of the accounts were in collection status. The credit report also showed three judgments and one lien. Many of the collection accounts were within two years of closing. There is no explanation in the file regarding the borrower's delinquent credit history as required. The required automated underwriting documentation was not included, so we used HUD requirements. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-3, analyzing the borrower's credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

**Comment 70**

1. AUS – This is not an AUS approved file (\*\*See Insurance Application and MCAW)
  2. Concur with findings on child support documentation. No documentation was provided in the file. However, even without child support income, the ratios are 26.5 / 47.6%. \*No Risk\*
  3. Concur with finding on no collection account explanation. However, overall major credits installments and revolving account are paid as agreed. Collections and judgments were all medical bills. \*No Risk\*
- \*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 493-7150295 Denver 40**

There was no gift letter or documentation showing the transfer of funds attributed to a community savings plans for the two gifts of \$2,000 and \$1,200 as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 71**

1. The HUD-1 does not show any gifts were used to close transaction. There was no gift involved in this transaction.
- \*\*All findings on this case should be removed\*\*

**Case number 431-3925735 Santa Ana 41**

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**DRAFT – USE RESTRICTED  
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**Comment 72**

There was no gift letter for funds from Dreamhouse Charity as required. HUD Handbook 4155.1, REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

1. Concur with findings - No Dream House Gift letter. However, both sales contract and HUD-1 indicate seller's participation in the program. \*No Risk\*  
\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 023-1142953 Santa Ana 42**

**Comment 73**

There was no documentation in the file of the transfer of funds from the donor, the borrower's cousin, to the borrower as required. The automated underwriting program requirement for verification of gift funds deposit was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

\*\*\*Case binder was not available for review, TP \*\*\*

**Case number 521-4598354 Denver 43**

**Comment 74**

The borrower's credit history appears to comply with HUD requirements. However, the credit report shows an invalid SSN for the borrower. Handbook 4155.1 REV-5, 3-1, requires the lender to verify the borrower's Social Security number. The lender is also required to resolve any inconsistencies or multiple Social Security numbers for individual borrowers that are revealed during loan processing and underwriting.

1. Loan closed in 2000. HB 4155.1 Rev. 4 only requires an evidence of SSN, which were provided in the file. The cited requirement is from Rev. 5 issued October 20, 2003. \*\*All findings on this case should be removed\*\*

**Case number 591-0896391 Denver 44**

**Comment 75**

The lender did not provided documentation showing why the mortgage loan was approved when the verification of employment showed that the borrower had terminated their position. Handbook 4155.1 REV-4, CHG-1, & 5, 2-7, salaries, wages, and other forms of effective income, states, the income of each borrower to be obligated for the mortgage debt must be analyzed to determine whether it can reasonably be expected to continue through at least the first three years of the mortgage loan.

1. Borrower obtained a new job prior to close of escrow. Pay stub for her new job is in the file  
\*\*All findings on this case should be removed\*\*

**Case number 491-7376910 Denver 45**

The file did not contain required documentation showing written or telephone verification of employment was received. Also, the total income used on the Mortgage Credit Analysis Worksheet included \$1,533 co borrower income, while the Uniform Residential Loan Application showed no co borrower or corresponding income. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

There was no documentation in the file supporting additional child support on the mortgage credit analysis worksheet as required. The file contained information on two child support payments but did not include information showing ongoing child support. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-7, F., alimony, child support or maintenance income, states, the borrower must provide a copy of the divorce decree, legal separation agreement, or voluntary payment agreement and evidence that payments have been received during the last twelve months.

We recalculated the total fixed payment to income ratio after eliminating unsupported co borrower income and reducing child support to the amount shown on the two payments. The recalculation resulted in a total fixed payment to income ratio of 60.15 percent. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

\*\* Concur with findings

**Case number 262-1198752 Philadelphia 46**

The lender did not provide required compensating factors for a mortgage loan that had a total fixed payment to income ratio of 46.39 percent. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

There was no documentation in the file of the transfer of funds from the donor, the borrower's sister, to the borrower as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Comment 76**

**Comment 77**

The credit report shows a collection and two judgments from 1997 (one year before the mortgage loan) and several late payments. The file has no written explanation from the borrowers as to the nature of the problem. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-3, analyzing the borrower's credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

1. Ratios 8.28 / 46.40 with no compensating factors. - \*\* LTV 89.8% and borrower lowered payment by \$80/mo.
  2. Gift Transfer not documented – \*\* Loan closed in 1998. Gift documentation in file was acceptable back then. Donor used cash advance from Discover card to purchase cashier's check.
  3. Collections/Judgments explanation provided. \*\* Explanations are provided in the file.
- \*\*All findings on this case should be removed\*\*

**Case number 161-1977109 Denver 47**

The sales contract shows that the sale is contingent on the sale of the borrowers existing property, but there is no documentation in the file that the borrower's property was sold. Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10 E states, the net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. A fully executed Settlement Statement form HUD-1 must be provided as satisfactory evidence of the cash sales proceeds accruing to the borrower. If the property has not sold by the time of underwriting, loan approval must be conditioned upon verifying the actual proceeds received by the borrower. The lender must document both the actual sale and the sufficiency of the net proceeds required for settlement.

Also, in the absence of required sales information, the lender did not included the borrowers mortgage payment of \$1,162 for there current residence in the calculation of the borrower's total monthly payments. A recalculation showed the total fixed payment to income ratio changed from 46.39 percent to 66.99 percent. There was no documentation of compensating factors in the mortgage loan file. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

\*\* Concur with findings

**Case number 023-0876344 Santa Ana 48**

The lender included overtime and bonus income in the borrower's calculation of monthly income, but did not (1) establish that the borrower had been receiving the overtime and bonus income for approximately the past two years, or justify a shorter period in writing, (2) develop an

**Comment 78**

**Comment 79**

average of overtime and bonus income for the past two years, or (3) develop an earnings trend for overtime and bonus income. After excluding overtime and bonuses income, the borrower's monthly income would have been \$2,894 not \$3,449 shown on the mortgage credit analysis worksheet. The recalculated shows 48.22 percent for the total fixed payment to income ratio. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-7, A., overtime and bonus income states both may be used to qualify if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. The lender must develop an average of bonus or overtime income for the past two years and the employment verification must not state categorically that such income is not likely to continue. Periods of less than two years may be acceptable provided the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes.

I. Average income of 22.5 months should be considered. YTD gross earnings (Wage, Overtime, Bonus) ending 11/16/01 and 2000 W2s of \$3,370. Ratios are still in line at 28/41%.  
\*\*All findings on this case should be removed\*\*

**Case number 221-3150986 Denver 49**

There was no documentation in the file that the lender verified the borrower's employment as required. The automated underwriting program requirement for verbal verification of employment was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, paragraph



**Comment 80**

3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

1. Concur with findings - No VOE in the file. However, W2's and pay stubs are provided instead. \*No Risk\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 151-6125279 Atlanta 50**

The total fixed payment to income ratio was 45.2 percent. There was no documentation of compensating factors in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

The sales contract states seller to pay 3.5 percent of sales price for AmeriDream program participation and the Settlement Statement form HUD-1 shows a gift from AmeriDream Charity, but there is no documentation of a gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Comment 81**

1. Back end ratio 45.2% without compensating factors. – Borrower has 3+ months reserves \*This finding should be removed\*

2. Concur with finding - Ameridream gift letter not in the file. However, the HUD-1 clearly indicates gift from Ameridream to the borrower and the seller's participation in the program \*No Risk\*

\*\*Request to have all findings on this case removed due to no risk\*\*

**Case number 352-4051203 Philadelphia 51**

The file did not contain an executed gift letter as required. The file contains a memo from Home Jersey, a community based not for profit organization, showing the amount of the grant but is not signed by either the donor or the borrower. Additionally, the memo was faxed from the real estate agents office per the fax banner and the Settlement Statement form HUD-1 does not identify the source of grant funds. HUD Handbook 4155.1 REV-4 CHG-1 and REV-5, 2-10, C., gift funds, states, the file must also contain a

**Comment 82**

gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

1. Grant approval letter provided in the case binder is acceptable as many non-profits do them this way. Grant is not a typical/traditional gift often seen from family members.  
\*\*All findings on this case should be removed\*\*

**Case number 105-0341995 Atlanta 52**

The file did not include adequate documentation of a gift of equity. The sales contract showed a 3 percent gift of equity from a related seller. However, the addendum to the contract included certification the sale was arms length with no relationship between buyer and seller. Handbook 4155.1 REV-4, CHG-1 & 5, 2-10, C., gift funds, states, only family members may provide equity credit as a gift on a property being sold to other family members.

**Comment 83**

1.The Sales Contract indicates the borrower is son-in-law of the seller. And co-borrower driver's license shows her maiden name as Goodsons (seller's last name)  
\*\*All findings on this case should be removed\*\*

**Attachment III**  
**(Memorandum Attached)**



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

April 1, 2006

MEMORANDUM FOR: Joseph McCloskey, Director,  
Office of Single Family Asset Management, HUF  
FROM: *John J. Daly*  
John J. Daly, Associate General Counsel for Insured Housing, CI  
SUBJECT: Inspector General Draft Audit Report:  
"Significant Weaknesses in HUD's Oversight of Single Family  
Mortgage Insurance Claims are Costly"

**Comment 84**  
**Comment 85**

This memorandum responds to your request for our comments on the captioned draft audit report. The draft report still suggests that Housing should review all single family mortgage insurance claims to determine whether the loans meet FHA loan eligibility requirements at endorsement. We met with the Office of Inspector General auditors on January 18, 2006 to discuss the auditors' initial draft audit report. In that initial report, the auditors suggested that claim payment should be conditioned on HUD's verification that loan insurance eligibility criteria had been met. We informed the auditors orally (and later by E-mail) that the incontestability clause in section 203(e) of the National Housing Act (NHA) would prohibit HUD from denying a claim payment on the basis that loan eligibility criteria had not been met unless HUD can establish fraud or material misrepresentation on the part of the claiming mortgagee. When you and I met with the auditors on March 17, 2006, the auditors stated that they no longer were suggesting that claims be conditioned on verification of loan eligibility. They instead suggested that HUD should review all claims *before or after* payment to determine loan eligibility for the purpose of seeking recoveries against the originating lender, not the claiming lender (except where they are the same entity). The final draft report, however, continues to imply in several places that HUD should condition claim payment on loan eligibility. We disagree with this implication for the reasons discussed below.

**Comment 84**

**Comment 85**

Several sections of the report imply that HUD should condition claim payment on loan eligibility. For example, under the "What We Audited and Why" section on page 1, the draft report states: "We wanted to know whether HUD had controls in place *to ensure claims were only paid* for eligible mortgage loans." (emphasis added). Under the "What We Found" section on page 1, in the Finding 1 section on page 5 and in the first full paragraph of page 7, the report states: "HUD did not independently determine mortgage loans insured under the Mutual Mortgage Insurance Fund were eligible for insurance benefits *when paying* billions in single family insurance claims." (emphasis added).<sup>1</sup> The paragraph on page 7 states that "HUD does not review the application for

**Comment 86**

<sup>1</sup> We assume that the auditors intended to suggest that all single family claims be reviewed for loan eligibility whether paid from the Mutual Mortgage Insurance Fund (MMIF) or from the other funds from which single family claims may be paid.

mortgage insurance . . . *when the claim is filed to determine whether the lender and underwriter certifications . . . accurately represented the mortgage loans [sic] eligibility for insurance . . .*" (emphasis added). The second full paragraph of page 8 states that "HUD officials told us that . . . claims were automatically *paid without a review* for eligibility." (emphasis added). The next paragraph states that, when HUD determines that a lender cannot demonstrate compliance with [loan origination] requirements, "HUD should *reject the claim* or recover claim payments already made." (emphasis added). The 4<sup>th</sup> bullet on page 10 states: "We sampled claims to determine whether HUD had controls in place to ensure *claims were only paid* for eligible mortgage loans." (emphasis added). Similar statements were made in the Relevant Internal Controls and Significant Weaknesses sections on page 11. Finally, the very title of the audit report, referring to weaknesses in the *claims process*, implies that HUD could deny claims based on loan ineligibility.

**Comment 85**

We disagree with the implication that claim payments can be conditioned on loan eligibility without proof of fraud or material misrepresentation. Section 203(e) of the NHA provides:

Any contract of insurance heretofore or hereafter executed by the Secretary under this title shall be conclusive evidence of the *eligibility* of the loan or mortgage for insurance, and the validity of any contract of insurance so executed shall be incontestable in the hands of an approved financial institution or approved mortgagee from the date of the execution of such contract, except for fraud or misrepresentation on the part of such approved financial institution or approved mortgagee. (emphasis added).

**Comment 85**

This "incontestability" clause, which is common in the insurance industry, simply means that, after HUD endorses a loan for insurance, HUD cannot later deny a claim payment for that loan on the basis that the loan was not eligible for insurance at the time of endorsement, except for fraud or material misrepresentation on the part of the claiming mortgagee. If a review of a loan file reveals that the loan was not eligible for FHA endorsement, HUD might be able to show that the originating lender had committed fraud or material misrepresentation when submitting the loan to HUD for insurance. The contract of insurance, however, is incontestable in the hands of a mortgagee except for fraud or material misrepresentation of *such* mortgagee. Under the incontestability clause, HUD would have to prove fraud or material misrepresentation on the part of the holder of the mortgagee loan that currently is the beneficiary of the FHA mortgage insurance contract. Most FHA insured loans are sold by an originating mortgagee to another mortgagee (*i.e.*, an assignee mortgagee). To deny payment of an insurance claim, HUD would have to prove that the claiming mortgagee, not the originating mortgagee, had committed (or participated in) the fraud or material misrepresentation which induced FHA to provide the insurance endorsement.

**Comment 24**

The audit report does not appear to suggest or provide proof that the *claiming* mortgagees had committed fraud or material misrepresentation with respect to the audited claims.<sup>2</sup> Therefore,

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<sup>2</sup> In some cases, the originating mortgagee does not sell a loan in which case the claiming mortgagee is the same entity as the originating mortgagee. For our discussion, we assume that the claiming mortgagee is not the same entity as the originating mortgagee. If the claiming mortgagee were the originating mortgagee, HUD could deny an insurance claim if HUD could prove fraud or material misrepresentation by that

**Comment 85**  
**Comment 87**

we disagree that HUD could have denied paying those claims. The bottom of page 5 of the draft audit cites 24 CFR 203.363, presumably for the proposition that HUD could deny the claims. Section 203.363(b) provides, in part:

If for any reason, the mortgagee fails to comply with the regulations *in this subpart*, the Secretary may hold processing of the application for insurance benefits in abeyance . . . [o]r . . . may reconvey title to the property to the mortgagee, in which event the application for insurance benefits shall be considered as cancelled and the mortgagee shall refund the insurance benefits to the Secretary . . . (emphasis added).

**Comment 87**

This regulation cannot be interpreted as the auditors' suggest. The regulation provides that HUD can hold a claim in abeyance or cancel a claim if the mortgagee fails to comply with the regulations in "this subpart." Since section 203.363 is found in subpart B of part 203, "this subpart" must be referring to subpart B. Subpart B does not contain any loan eligibility requirements which are found in subpart A of part 203. Subpart B primarily contains various post-endorsement matters such as the payment of mortgage insurance premiums and the insurance claim procedures.<sup>3</sup> For example, if a mortgagee had not properly complied with the claim procedures, HUD could refrain from paying the claim until the mortgagee complied.

**Comment 88**

The first paragraph on page 6 of the draft report states that the Office of Management and Budget (OMB) Circular A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," "requires HUD to ensure lenders met program requirements, including origination, *before* making a claim payment."<sup>4</sup> (emphasis added). The second full paragraph of page 8 of the draft report states

mortgagee in the origination of the loan. The audit, however, focuses primarily on the mere absence of documentation in HUD's mortgage insurance application case binders, and the auditors did not give the originating mortgagees an opportunity to respond to the OIG findings. We do not understand how the mere absence of documentation in HUD's files would be *prima facie* evidence of fraud or material misrepresentation that could result in cancellation of the FHA mortgage insurance contract. Perhaps a mortgagee originated a loan properly but failed to include the relevant paperwork in the file when submitting the loan for insurance. We understand that a mortgagee must certify that the insurance application includes all the relevant documentation. A violation of this certification, however, may not always rise to the level of fraud or material misrepresentation that would permit HUD to cancel a mortgage insurance contract.

**Comment 87**

<sup>3</sup> Section 203.255 of the regulations, concerning the *procedural* aspects for submitting loans for insurance, also is found in subpart B. For example, this regulation provides the mortgagee must submit certain enumerated documents to HUD with its application for insurance, such as a property appraisal and an underwriter certification that the mortgage complies with HUD underwriting requirements. The actual underwriting requirements, however, are found in subpart A. To comply with subpart B, the mortgagee must *submit* only the enumerated documents. If the documents proved to be false, there would be a violation of subpart A, not necessarily subpart B. We understand that the auditors are alleging that, in some cases, the mortgagee did not submit the documents required by section 203.255. Although this may be a violation of a requirement in subpart B, section 203.363 could not be interpreted to mean that HUD could deny a claim payment on that basis since this regulation cannot override the statutory incontestability clause.

<sup>4</sup> The draft report then states that the applicable program requirements are included in the contract contained in 24 CFR 203 subpart B. As noted above, loan origination requirements are provided in subpart A, not subpart B.

that HUD officials “told us they were not familiar with OMB Circular A-129 requirements that claims be reviewed for eligibility before payment.” The report does not identify which part of the Circular requires the pre-claim review, but we assume the report is referring to Section B.2. of the Circular, which provides as follows:

Performance Standards. Agencies should include due diligence requirements for originating, servicing, and collecting loans in their lender agreements. This may be accomplished by referencing agency regulations or guidelines. Examples of due diligence standards include collection procedures for past due accounts, delinquent debtor counseling procedures and litigation to enforce loan contracts.

Agencies should ensure, through the claims review process, that lenders have met these standards prior to making a claim payment. Agencies should reduce claim amounts or reject claims for lender non-performance.

The Circular suggests that agencies *should* (not shall) ensure that lenders have met “these standards.” The “standards” apparently are those found in the prior paragraph (*i.e.*, the “Performance Standards”) with respect to which the circular states that agencies should include “due diligence” requirements for originating loans. HUD has various handbook provisions requiring lenders to maintain and follow quality control plans when originating loans. Therefore, the circular’s suggestion that agencies ensure that lenders meet the “standards” before claim payment may be referring to the due diligence (*i.e.*, quality control standards) and not the case-by-case loan eligibility standards that the auditors suggest are required before claim payment.

The statutory incontestability clause would prevent HUD from denying a claim based on the loan’s ineligibility for endorsement, unless there was fraud or material misrepresentation. An OMB circular could not override this statutory provision. Therefore, the circular cannot be read to permit HUD to deny claim payments based on improper origination in the absence of fraud or material misrepresentation. We suggest that you contact OMB for clarification of the circular in light of the incontestability clause. Another consideration to discuss with OMB or the auditors would be that the NHA<sup>3</sup> requires HUD to pay debenture interest on the claim through the claim payment date. If Housing were to review all claims (before payment) for compliance with eligibility requirements, this process would take a significant amount of time since case binders would have to be ordered from the archives and reviewed for compliance. Mortgagees also would have to be given an opportunity to respond. These procedures would delay the claim payment date and cause HUD to pay substantial amounts of additional debenture interest. The resulting delay and additional debenture interest would be incurred for all insurance claims cases, even for those in which an insurance claim that still must be paid due to the incontestability clause.

Assuming the auditors now intend that HUD seek post claim payment recovery only from the originating, not the claiming, mortgagee, the report concludes that HUD would be able to

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<sup>3</sup> Sections 204 and 520 of the NHA.

**Comment 3**  
**Comment 88**  
**Comment 22**

**Comment 88**

**Comment 89**

**Comment 2**

**Comment 2**

recover substantial sums based on the findings in the report. The third paragraph on page 6 of the draft report states:

HUD does not have the required documentation to support compliance with the contract of insurance for an estimated \$1.3 billion in Mutual Mortgage Insurance Fund claims paid during the period October 1, 2003 through June 3, 2005. We reviewed a random sample of 175 claims received during the period and found HUD did not have the required documentation to show 44 mortgage loans complied with the contract of insurance and were eligible for insurance benefits.<sup>6</sup>

**Comment 90**

The report concludes that, extrapolating the losses on the 44 cases to the universe of claims paid, HUD could recover over \$200 million annually.

**Comment 90  
Comment 2**

We disagree with this conclusion. The required documentation purportedly missing from HUD's files consisted primarily of verifications of employment, explanations of excessive qualifying ratios, missing gift letters, etc. as described in Appendix C of the draft report. Assuming that the absence of the required documentation in HUD's files is proof that the mortgagee did not submit the required documentation, the failure to submit the required documentation would not necessarily mean that HUD would be able to recover HUD's claims loss from the originating mortgagee. The report fails to explain what legal basis or procedures HUD would use to recover this money. Regardless of the method used to pursue such recovery, due process would require HUD to present its findings to a mortgagee and provide the mortgagee with an opportunity to respond. The report does not indicate that mortgagees were given this opportunity. A mortgagee may find the required documentation in its own files to show that the mortgage was originated properly, even if the documentation had not been submitted with the insurance application. In such a case, HUD may not be able to recover HUD's claims loss. If the underwriting was proper, the mortgagee's failure to submit the documentation did not cause HUD's loss. Assuming improper underwriting, the mortgagee may argue successfully that the default, and HUD's loss, nevertheless was not caused by the improper underwriting. We suggest that you consult with attorneys in OGC's Office of Program Enforcement to obtain more information about whether HUD could recover the amounts suggested in the report.

**Comment 91**

Finally, we are not clear about the purpose of Appendix E, entitled "Requirements for Payment of Insurance Claims." The appendix quotes from a variety of origination, servicing, and claims statutes, regulations, and handbooks but does not explain how these citations would support the recommendations in the audit.<sup>7</sup> Most references in the appendix were discussed in the main text

**Comment 85  
Comment 86**

<sup>6</sup> Loan origination requirements are found in subpart A, not subpart B. The contract of mortgage insurance is found only in subpart B. It is not clear whether the auditors intended to refer only to the MMIF. Single family claims may be paid out of other insurance funds too.

**Comment 91**

<sup>7</sup> The appendix cites section 203.363 without explanation. As noted above, that section would not override the incontestability clause as the draft report seems to suggest. In addition, the appendix cites section 203(r) without explanation. It appears to be improperly cited as authority for the proposition that lenders assess the creditworthiness of FHA borrowers at origination. That section requires lenders to assess creditworthiness of persons acquiring ownership of a single family property "encumbered by a mortgage insured under this title." In other words, lenders should assess the creditworthiness of persons acquiring properties that *already are*



of the report, and we have addressed them above. There were references to 24 CFR 203.432 and Handbook 4060.1, paragraph 6-12, that were not discussed in the report's main text. Section 203.432 provides that, when an insured mortgage is sold to another approved mortgagee, the buyer succeeds to all the rights and becomes bound by all the obligations of the seller under the contract of mortgage insurance. Handbook 4060.1 provides that the mortgagee's servicing quality control plan should include measures to ensure that purchased loans contain all necessary documents. It is not clear what point is being made with the recitation of these provisions in the appendix. Based on the title of the appendix, the auditors apparently believe that these provisions provide the prerequisites for claim filing. We disagree with this conclusion. Under the incontestability clause, HUD cannot deny the claim payment without proving fraud or material misrepresentation against the claiming mortgagee. Neither the regulation nor handbook can override this statutory provision.

Please contact Matthew Forman at ext. 5217 if you have any questions or desire further assistance.

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*encumbered* with a FHA insured mortgage and who are assuming that mortgage. The draft report omitted this critical distinction.

**Attachment IV**

An Examination of the Methodology Used in the OIG draft audit report on  
**Significant Weaknesses in HUD's Oversight of Single Family  
Mortgage Insurance Claims**

March 23, 2006  
revision: April 3, 2006

Introduction

**Comment 25**

Appendix F of the HUD OIG Audit Report, *Significant Weaknesses in HUD's Oversight of Single Family Mortgage Insurance Claims are Costly* (undated, c. March 2006), details the methodology used to determine the potential dollar amount of unsupported claims and the ultimate cost (loss) to HUD on those claims. The description of those methods is incomplete and the Report attempts to do more than is supportable by their single sample.

Case Sampling

**Comment 23**

The HUD OIG reviewed 175 loan-origination case binders for FHA single-family MMI loans that went to full claim in either FY2004 or FY2005. The objective was to determine what percentage of claims might have warranted denial because the case binder did not have complete and/or fully accurate information. The OIG projected from case-binder results to the entire portfolio of claim payments, and it then reported confidence bounds for the total dollar value of "Supported" and "Unsupported" claim payments. The Report does not explain how the sample was chosen and the final confidence bounds are suspect. Phone calls and Emails to OIG personnel involved in the audit resulted in details concerning how the population of claims cases were identified, but the OIG did not respond to requests for information on how the sample was chosen or how the confidence interval determinations were made.

**Comment 92**

The OIG started with a population of 80,352 cases for which a full claim had been paid in the FY2004-FY2005 period, and where the date of default prior to claim was within three years of loan endorsement. Those cases were selected from the *claims\_case\_record* table in the Single Family Data Warehouse (SFDW).<sup>1</sup> Then the OIG chose 175 cases for review of the loan origination case binders. That number of cases for review appears to have been chosen using a methodology designed for Bernoulli random variables.<sup>2</sup> If the

<sup>1</sup> In discussions with OIG personnel in Seattle, it was discovered that the case selection involved use of three data elements: due date of the last paid installment that preceeded the default (*dflt\_dt*), insurance endorsement date (*endrsmt\_dt*), and fiscal year of initial claim payment processing (*fiscal\_yr*).

<sup>2</sup> The OIG report does not state the actual methodology used but rather only references what appears to be a procedure in the RATS software package ("unrestricted variable sampling").

**Comment 92**

chance of errors occurring in any one case binder is a Bernoulli random variate (think, yes/no) with some expected probability of occurrence,  $\hat{p}$ , then the distribution of the event rate in a sample of size  $n$  is a binomial distribution with mean  $\hat{p}$  and variance  $\hat{p}(1 - \hat{p})$ .<sup>3</sup> Fortunately, there is a standard formula for determining the sample size,  $n$ , necessary to verify one's prior expectation of the error rate,  $\hat{p}$ , with a chosen level of statistical confidence, and for a pre-determined interval around the expected rate. That formula is:<sup>4</sup>

$$\text{Minimal Sample Size} = n = \left( \frac{z_{\alpha/2} \sqrt{\hat{p}(1-\hat{p})}}{d} \right)^2 \quad (1)$$

Where:  $z_{\alpha/2}$  = standard normal statistic for  $(1 - \alpha)$  level of confidence in a two-tailed test.  
 $\hat{p}$  = prior expectation of the error rate in the population (all claims).  
 $d$  = the distance from  $\hat{p}$  for which the researcher desires to have a  $(1 - \alpha)$  level of confidence that one will not unnecessarily reject the null hypothesis that  $\hat{p}$  is the true population error rate.

The OIG draft report states that the sample size of 175 was chosen with  $(1 - \alpha) = 0.95$  and  $\hat{p} = 0.50$ . The report says nothing about the desired value of  $d$ . However, if one solves equation (1) for  $d$  as a function of  $n = 175$ ,  $\hat{p} = 0.50$ , and  $z_{0.025} = 1.96$ , one finds that  $d = 0.0741$ . Thus, if the error rate found in the sample of case binders is within  $\pm 0.0741$  of  $\hat{p} = 0.50$ , then one cannot reject the null hypothesis that the true, population error rate is 0.50, with a 95 percent level of confidence.<sup>5</sup>

Within the sample of 175 cases the OIG identified 44 with errors, as it defined them (see Appendix C).<sup>6</sup> The sample error rate is then 25.14 percent, which is far enough from  $\hat{p} = 0.50$  that the chance that the true population error rate is as high as 50 percent is very close to zero and the OIG can reject the (null) hypothesis that the true, population error rate could be 50 percent.

<sup>3</sup> A random variable,  $p$ , with this Binomial distribution is denoted by,  $p \sim BN(\hat{p}, \hat{p}(1 - \hat{p}))$ .

<sup>4</sup> The Report does not give this formula.

<sup>5</sup> That level of statistical confidence implies that there still is a 5% chance the sample error rate will fall outside of those bounds even if the true, population error rate really is 50%. In statistical parlance, such an experimental mistake is called a Type I error: rejecting the null hypothesis when it actually is true. Thus, if the sample error rate is below 42.6%, there is still a 2.5% chance that the true error rate is 50%, and if the sample error rate is above 57.4% there is also a 2.5% chance that the true error rate is 50%. The reason for choosing  $\hat{p} = 0.50$  in this test is that if the true population error rate is unknown, using  $\hat{p} = 0.50$  in equation (1) will force the largest possible  $n$  for any given values of  $\alpha$  and  $d$ . As the OIG does not give any reason for choosing  $\hat{p} = 0.50$  we must presume that it was simply to produce a conservative value of  $n$ .

<sup>6</sup> Recent discussions between Office of Housing personnel and OIG staff on the definition of errors has apparently led to a reduction in the number of identified errors from what was reported in the Draft Report analyzed here.

**Comment 23  
Comment 92**

**Comment 26**

### Claim Value Projections

The OIG, however, did not set out to prove or disprove an error rate of 50 percent, but rather to create confidence bounds around the sample error rate. That is something that cannot be done from a single sample. The OIG can only use the single-sample results to project point estimates for the number and dollar of errors, and not to provide any confidence interval around those point estimates. To do the latter requires repeated sampling so that the distribution of possible values of the true population error rate can be estimated with some level of accuracy.

**Comment 93**

With that said, the confidence bounds developed in the Report (see table on p. 35) do not correspond to the confidence interval defined by the value of  $d = 0.0741$  we calculated using equation (1). The final line item on page 35 is purported to be a lower-bound dollar estimate of unsupported claims, using a 95-percent confidence level. That dollar figure, however, is 16.8 percent of the dollar amount of all claims. The lower bound indicated by  $d = 0.0741$  would rather be 17.7 percent.

**Comment 93**  
**Comment 26**

If one were to recompute  $d$  for the value associated with the sample error rate of 25.14 percent, one would get  $d = 0.064$ . That yields a lower bound expectation of 18.74 percent, and an upper bound of 31.74 percent. The question then becomes whether the difference between 18.74 and 31.74 percent is material enough that the OIG should increase its sample size in order to get a more accurate assessment of the true population error rate. At what error rate does the balance between the cost of more intensive claims auditing procedures and the benefits associated with catching potential underwriting errors begin to tilt toward investing resources into increased auditing? The OIG does not address this central question. If that rate is somewhere in the interval of 19 to 32 percent, then the OIG needs to increase its sample size in order to provide a more accurate assessment. Simply attempting to report confidence intervals around one small-sample error-rate estimate does not answer this crucial question.

**Comment 4**

**Comment 26**

### Profit/Loss Projections

OIG next restricted its analysis to 59,975 claims for which a final profit/loss figure had been computed by HUD and was available in the SFDW at the time of the data extract (January 4 and 5, 2006).<sup>7</sup> Of the 175 case binders reviewed in the first analysis, 125 corresponded to cases for which the profit/loss calculation was available. The lack of a profit/loss calculation on the remaining 50 cases was likely to do the combination of time lags in property disposition and computation of the profit/loss amount.<sup>8</sup>

<sup>7</sup> The data element name is `p_l_amt` and is found in the `idb_1` table. This information, and dates that the data extracts were taken, were provided by the OIG in a series of phone calls and Emails, but they do not appear in the Draft Report.

<sup>8</sup> At the time of the OIG data extract there would be just two months of data available after the cutoff date claim payments included in the analysis. Because property disposition takes close to six months, on average, and it takes an additional two months for the profit/loss calculations to all appear in the SFDW, this rate of cases with missing profit/loss values is reasonable.

**Comment 27**

The OIG then attempted the same type of exercise to estimate a lower-bound confidence limit on the dollar value of profit/loss from unsupported claims as it did for the value of the claims themselves. Here the OIG changed, without explanation, to a 90-percent confidence interval. Yet, again, the Report fails to show how the results are in any way substantiated by the underlying sample design or sample data.

Recommendations

**Comment 26**

The HUD OIG now has one point estimate of the rate of (full) claim payments for which there are missing elements in the loan underwriting case binders, which is 25.14 percent. If that is high enough to warrant concern then the OIG should perform repeated sampling in order to verify that this initial result is truly representative of the universe of claim-payment cases. Absent such additional research, the OIG should not attempt to estimate confidence bounds around dollar values involved. Rather, it should only report its point estimate and caution that it is based upon one sample.

**Comment 28**

The OIG should also be careful to fully spell out its analysis procedures and assumptions in appendices to its reports. That is an important part of providing an audit trail and allows third parties to validate the research that was done.

**Comment 6**

Finally, the OIG should learn how to use SQL queries to obtain information on insurance cases of interest directly from HUD's electronic data warehouse, rather than downloading entire data tables with millions of records and then querying those tables locally to create the samples of interest. Downloading an excessive amount of information that is potentially Privacy Act privileged only increases the burden on the OIG for secure storage facilities, the burden on local computer resources, and the personnel time involved in performing audits of HUD programs.

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Contact:

Charles Capone, Office of Housing/Finance and Budget/Evaluation, 202-755-7500 x7537

## OIG Evaluation of Auditee Comments

**Comment 1** The Report and our responses to HUD's comments demonstrate our understanding of the FHA's Direct Endorsement program and show how the differing methodologies used by OIG and HUD to address the issues could give the impression of a misunderstanding where none existed.

HUD's methodology as described in the Office of Housing's response contemplates action only when a material underwriting error is directly related to the reason for default and claim. This method uses non-authoritative standards and accepts paid claims for loans that were not originated in accordance with program requirements. In contrast, we applied the published HUD program requirements and identified action was needed on paid claims for loans that did not comply with the requirements. This represents a significant difference and can result in the impression of a misunderstanding.

**Comment 2** The joint position does not properly characterize the OIG recommendation. OIG recommended that Housing establish procedures to review all claims and independently determine that loans comply with the contract of insurance to address projected unsupported claims and final costs totaling \$213,607,324 annually. The recommendation does not specify when the review should take place nor state that claims should be denied. Additionally, we revised the report to eliminate any inference that FHA needs to review claims before payment.

Our recommendation allows HUD management to evaluate approaches and select one that it determines effectively and efficiently addresses program requirements. For example, HUD could adopt procedures similar to those under the existing claims review process regulations, currently used for but not restricted to the fiscal data associated with claims, where a claims review is conducted including use of a statistical sample after claims are paid. Independent of the selection, the procedures would also need to provide for developing the issue through (1) review of the case file, (2) requesting additional information from the lender when necessary, (3) evaluating the information, and (4) if necessary, deciding on the appropriate action to take.

**Comment 3** The Office of Management and Budget Circular A-129 states that agencies shall ensure lenders participating in guaranteed loan programs meet all applicable financial and programmatic requirements. Further, the circular notes agencies should ensure compliance with the program requirements during the claims review process. Supplementing the department's existing control structure with a paid claims review to determine program requirements are met would ensure program requirements were met for claims and may be useful for evaluating the program requirements. As noted in comment 2, HUD management would select

the procedures for such review and they could use sampling to ensure a cost effective and efficient process.

**Comment 4** As noted above, OMB requires agencies to ensure lenders meet all applicable program requirements and notes the claims review process should include such a determination. Further, sampling could be used to make the review practical and cost effective.

**Comment 5** HUD's review of the 43 claims confirmed that 37 of the FHA case binders do not show program requirements were met. For the remaining six FHA case binders we revised our narrative description of the deficiencies in response to HUD's review of the narrative deficiency description obtained prior to the draft report. HUD's comments do not address the revised narratives and HUD did not provide review results for one FHA case binder that was returned to HUD's archive before HUD's review of the narrative descriptions completed prior to the draft report. Additionally, as described in Appendix F, we utilized the lower limit of loss on supported claims to project a conservative loss of \$356,012,207.

HUD's comments are based on a methodology using non-authoritative standards to evaluate loan underwriting and determine if a request for indemnification is appropriate. This evaluation attempts to apply FHA's after-the-fact judgment on whether the loan represents and increased risk to the insurance fund, rather than an objective application of the regulatory-based requirements in effect at the time the loan was originated. HUD's comments make no provision for action on 41 instances of noncompliance with published program requirements, including 9 of the 11 material deficiencies identified by HUD. Accordingly, HUD's analysis shows the lenders did not meet HUD's minimum standard of due diligence in underwriting mortgages.

As noted in the recommendation, HUD needs to request the missing documents from the lender to show program requirements were met to support HUD's payment of the claim, or if the documents cannot be obtained, determine the appropriate action to take. Also, the above analysis used by HUD would be most efficiently and effectively used when determining the appropriate action to take after attempts to obtain required documentation are exhausted.

**Comment 6** As described in the finding and in Appendix F, we obtained the universe of claims data from the Single Family Data Warehouse. The warehouse is a large and extensive collection of database tables organized and dedicated to support the analysis, verification, and publication of HUD Single Family Housing data. The warehouse consists of datamarts developed to support specific business units/communities within the HUD family. Each datamart comprises one or more database tables structured to provide HUD users easy and efficient access to Single Family Housing case-level data on properties and associated loans, insurance, claims, defaults, and demographics. The warehouse is populated and routinely updated with data from 11 HUD single family related systems.

Contrary to HUD's assertion that we only downloaded entire data tables from the Single Family Data Warehouse, we used a mix of downloading complete tables and only items of interest selected with SQL queries. We selected the method to be used based on how the data would be used. For example, the information from the claims\_case\_record was obtained during the survey phase of the audit. This is the planning phase of the audit and by obtaining the entire table we were able to run numerous queries against the data through out the audit planning process. After the audit plan was completed, we used SQL queries to updated the claims\_case\_record for subsequent claims data for use in selecting our sample. Further, our use of Microsoft Access to process the data is consistent with the Users Manual for the Single Family Data Warehouse provisions for obtaining and processing information. Also, we conducted validation analyses of the data obtained from the warehouse prior to use. We determined there was zero audit risk associated with inaccurate data.

- Comment 7** HUD erroneously concluded that OIG believes that lender noncompliance with the origination program requirements cited in the report make the lender ineligible to receive mortgage insurance benefits after default of an FHA insured loan. OIG's position is that FHA lacks evidence to show lender compliance with the origination program requirement cited in the report and that FHA is required to obtain the needed evidence from lenders to show compliance or take appropriate action in accordance with the program requirements. The program requirement provisions for action include placing a lender on Direct Endorsement probation or referring the matter to the Mortgagee Review Board for action that could include reimbursing FHA for the amount of the loss resulting from the payment of the claim and sale of the related property.
- Comment 8** HUD did not correctly characterize our sampling methodology and reached the conclusion that deficiencies existed in our projection of losses. Comments 21 through 26 address HUD's specific concerns, and clarify the validity of our projections.
- Comment 9** HUD chose not to review one FHA case binder that was returned to HUD's archive before HUD's review of the narrative descriptions completed prior to the draft report. HUD was advised that the FHA case binder was returned to its archive.
- Comment 10** There was a claim made for the insured loan but no claim was paid. Without established HUD procedures for reviewing claim compliance with program requirements, the timing of such a review was unknown. Accordingly, because there was a claim made we included it in our universe and sample with a claim amount of \$0. However, such claims were excluded from the evaluation of net loss because no net loss was determined.



- Comment 11** The ABN AMRO agreement to repay the Department occurred six months after the audit sample was drawn and case binders requested, and 22 months after the claim was processed. Accordingly, the settlement could not have been foreseen at the time the sample was drawn or claim processed. It is appropriate to retain the case in our analysis.
- Comment 12** We determined 8 of the 44 loans with identified deficiencies were also reviewed by HUD as part of a post endorsement technical review or quality assurance review. HUD completed post endorsement technical reviews for 6 of the loans included in the 44 identified in Appendix D. HUD's post endorsement technical reviews did not result in requests for the documentation needed to show the loans met HUD program requirements or other HUD actions. HUD completed quality assurance reviews for 2 of the loans included in the 44 identified in Appendix D. HUD's quality assurance reviews did not result in requests for the documentation needed to show the loans met HUD program requirements or other HUD actions. However, the quality assurance reviews include the review of lender files and the needed documentation may have been present in the lender files. Nevertheless, the FHA case binders do not show the loans met HUD program requirements.
- Comment 13** The Office of Housing's discussion of the reason for default is not relevant to the discussion of lender compliance with HUD program requirements for underwriting. Further, the Office of Housing does not provide details on what is believed to be the reason for default. The Office of Housing provided vague descriptions including "Other", "Curtailed of borrower income", "Death of mortgagor's family member", "Excessive obligations - same income", and "Marital difficulties" without any explanation of their significance or direct relationship to the default.
- Comment 14** The published HUD requirements for the mortgage credit analysis that is needed to determine a loan eligible, do not provide that 12 months of mortgage payments excuse the lender from meeting the requirements. The issue is that HUD has no assurance the loan was made in accordance with HUD requirements.
- Comment 15** The published HUD requirements for the mortgage credit analysis that is needed to determine a loan eligible, do not provide that a default caused by events unrelated to deficiencies in underwriting excuse the lender from meeting the requirements. The issue is that HUD has no assurance the loan could have been made in accordance with HUD requirements.
- Comment 16** The loans selected for review under HUD's quality control processes will likely include a high percentage of loans that will perform well given that the vast majority of insured loans perform well. Accordingly, the selection method limits HUD's effectiveness at identifying claims for loans that were not underwritten in accordance with HUD program requirements. Further, HUD lacks the

information needed to evaluate lender compliance with program requirements for those loans that resulted in claims.

- Comment 17** Our recommendation allows HUD management to evaluate approaches and select one that it determines effectively and efficiently addresses program requirements. For example, HUD could adopt procedures similar to those under the existing claims review process regulations, currently used for but not restricted to the fiscal data associated with claims, where a claims review is conducted including use of a statistical sample after claims are paid. The use of sampling would require dramatically fewer resources than contemplated by HUD.
- Comment 18** Our recommendation is that HUD bring its claims process into compliance with OMB Circular A-129 requirements that agencies ensure lenders meet all applicable program requirements including the claims review process which should include such a determination. Further, there is no conflict with the risk based approaches recommended by GAO and the OIG in previous audits. The recommended review of claims would supplement, not replace HUD's risk based controls.
- Comment 19** While FHA's process does include a review of each loan, the process does not include procedures to ensure the lenders met all loan due diligence requirements for loan origination as required by the OMB Circular A-129.
- Comment 20** The issue is that the FHA case binders do not show the published minimum acceptable HUD mortgage credit underwriting requirements were met. Accordingly, HUD has no assurance the loan was underwritten in accordance with HUD requirements. The determination of risk discussed by HUD does not excuse the fact that loan documentation does not support that the loans were underwritten in accordance with the published requirements.
- Comment 21** Our draft report did not state the Quality Assurance Division's purpose is to re-underwrite closed loans or perform audits in anticipation of claims being filed. However, to minimize misunderstandings we added a footnote to the report describing the purpose of the Quality Assurance Division.
- Comment 22** We have added a citation to the specific Office of Management and Budget Circular A-129 paragraph being cited. We cited paragraph A. 2. in Appendix A III. This is not the same Section of the Circular the Office of General Counsel commented on. While the sections differed, they were consistent in the use of the word should not shall. However, use of should needs to be interpreted in the context of the agencies responsibilities as stated in the Circular. The Circular Appendix A I Responsibilities of Department and Agencies paragraph 4a. states agencies shall ensure that lenders participating in guaranteed loan programs meet all applicable financial and programmatic requirements

The Office of General Counsel also suggested that HUD requirements for lenders to maintain and follow quality control plans may satisfy the circulars suggestion that agencies ensure that lenders meet the standards before claim payment. We do not believe requirements placed on the lenders that will profit on the transactions can satisfy the requirement for HUD to ensure that lenders meet all applicable financial and programmatic requirements, particularly when HUD's response to this audit makes it clear that HUD controls address risk not programmatic requirements.

**Comment 23** HUD's characterization of our sampling methodology is not correct. Our sampling plan was not designed to test for the occurrence of an "event" and evaluate it against a hypothesized rate. Instead, our statistical sampling objective was to estimate the value of the entire population by analyzing the difference between the sampled transaction's actual claim amount and the amount that was adequately supported (as determined by detailed audit review of the relevant case binder) using straightforward variable sampling techniques in conjunction with the federal auditing and industry accepted EZ-Quant statistical software application. Additionally, instead of "choosing" a sample size that would permit testing whether or not the true error rate was equal to 50 percent as HUD suggests, we used universally accepted scientific means to calculate the sample size using a desired 95 percent confidence level and 7.6 precision materiality threshold. Because historical data was not available to identify the number of claims that were not adequately supported with proper documentation, we estimated the expected universe error rate at 50 percent, effectively maximizing the computed sample size. This represented the most conservative approach since it resulted in an increased sample size when compared to using an expected error rate of less than 50 percent. Because we used variable sampling and difference estimation techniques to calculate the dollar projections, the 50 percent expected error rate used to determine the sample size was not a factor in the sample evaluations and was not used to make dollar projections.

**Comment 24** Our audit objective was to determine if HUD had controls in place to ensure paid claims were reviewed to determine if mortgage loans met program requirements. Accordingly, we reviewed HUD's controls and the FHA case binders. We determined that HUD did not have the controls in place to ensure paid claims were for mortgage loans meeting program requirements. Our recommendation was that HUD seek recovery or adequate support for the final costs to HUD. Accordingly, we did not attempt to obtain the information missing from HUD's files.

**Comment 25** As described in Appendix F, we implemented an unrestricted variable sample plan and provided specific details concerning the sampling plan methodology, parameters, sample size determination, and evaluation of the sample results. In designing, implementing, and evaluating our sampling plan, we used the EZ-Quant statistical software application and applied standard audit and universally

accepted sampling procedures and techniques that were ideally suited to accomplish our audit objectives. Our plan allowed us to conduct substantive testing on sampled items, evaluate errors in dollar amounts, and make scientifically supported projections on the dollar amount of the claims in the universe.

**Comment 26** Contrary to HUD’s assertion, our sampling plan was not designed, nor was the sample evaluated, by creating confidence bounds around a sampling error rate. It appears that HUD’s comments were made in reference to a sampling methodology other than the variable sampling techniques we employed. Our sampling objective was to estimate the value of the population of claims that were sufficiently documented in accordance with prescribed guidance. It was not to substantiate the existence of a 50 percent error rate, as HUD suggests. As previously stated, the expected error rate of 50 percent was used to calculate a conservative sample size - - to err on the side of over-sampling. Contrary to HUD’s position that repeated sampling is necessary to ensure projected results are accurate and reliable, the variable sampling and difference estimation approach we adopted (a widely used and generally-accepted audit technique), does not require implementing multiple samples to validate results. Instead, the actual sampling precision is used to measure the accuracy and meaningfulness of the sample results. As clearly stated in Appendix F, the actual precision results of our samples ranged between 12 and 13 percent and were determined to be within acceptable audit tolerance and were used to compute the point estimate and the upper and lower range projections. Accordingly, there was no need to further increase the sample size. In an effort to further our conservative approach, instead of using the projected point estimate as the basis to compute the estimated unsupported claim amounts, we used the more conservative upper limit estimate of claims that were supported thereby reporting only the minimum monetary impact. In other words, we are not reporting the “point estimate” of our statistical projection, but rather are stating the monetary impact is “at least” the amounts noted in our report.

**Comment 27** The statistical calculations used to make variable projections can be made using a number user defined confidence intervals. Under normal circumstances, using a confidence interval of 90 percent is a widely-accepted audit standard. In our opinion, no explanation is required since we clearly identify the confidence interval used and present the sample results accordingly.

**Comment 28** It appears that HUD has attempted to cast doubt on a commonly used audit technique and an industry accepted statistical sampling approach by basing their analyses and comments on a methodology that was unrelated to the sampling techniques we actually used, mischaracterizing the parameters used to determine the sample size, suggesting that our sample size was too small to provide accurate and meaningful results, and questioning the sample evaluation techniques and projections. Not only do our statistical results show that a significant dollar amount of paid claims were for loans that did not meet program requirements,

they also can be scientifically and objectively supported. We have provided ample detail in Appendices D and E for an independent assessment of not only the specific case-level details of the questioned sampled items, but also all the statistical parameter data to allow a quality control review of the calculations used to determine the sample size and make statistical projections.

- Comment 29** As noted above, we do not agree with HUD's conclusion and responded to each comment individually, including the requirement for HUD to assess lender compliance with program requirements.
- Comment 30** The audit report provided to Housing for comment did not contain references to 4155.1 REV-5 in the narrative of mortgage loan deficiencies.
- Comment 31** This is not a copy of the Appendix D Narrative of Mortgage Loan Deficiencies as presented in the draft report provided for Housing's comment. The narrative of deficiencies is from a preliminary Narrative of Mortgage Loan Deficiencies provided to Housing for comment prior to preparing the draft report for comment. Also, Housing's comments shown following our preliminary narrative are the same as previously provided. We reviewed the comments when originally received and revised the narrative as appropriate for inclusion in the draft report provided to Housing for comment.
- Comment 32** The comment and recommendation address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 33** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. The comment and recommendation on the bi-weekly pay stub address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 34** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 35** The comment on the Mortgage Credit Analysis Worksheet confirms the draft report narrative of deficiencies for this loan. The Worksheet is a required part of the application and is important to understanding the underwriting decision.
- Comment 36** The comment on the gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for a gift were not met.

- Comment 37** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 38** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 39** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 40** The comment and recommendation address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 41** The comment on bond assistance documentation confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, neither secondary financing or gift requirements were met.
- Comment 42** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 43** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 44** The comment on the gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for a gift were not met. Additionally, in relation to risk, the Mortgage Credit Analysis Worksheet indicates the borrower had no housing expenses and projecting total monthly mortgage payments were \$1,035.40 with cash reserves of \$101.79. There is no indication the large increase in housing costs was considered and the available information on savings did not show increasing balances.
- Comment 45** The comment and recommendation address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan. However, the comment on the gift confirms the draft report narrative on missing documentation.

- Comment 46** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 47** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 48** The comment on the Employer Identification Number confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, inconsistencies require use of standard documentation.
- Comment 49** The comment the SHIP Loan documentation confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, neither secondary financing or gift requirements were met.
- Comment 50** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 51** The comment on the gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for a gift were not met.
- Comment 52** The comment on the payment to income ratio confirms the draft report narrative of deficiencies for this loan. The comment on verification of deposit and recommendation addresses a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 53** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 54** The comment on collection accounts confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements to explain credit problems were not met.
- Comment 55** As noted in the narrative, the HUD requirements for a gift were not met. The HUD-1 showed \$17,000 in earnest money was the borrower's gross investment in the property with cash to the borrower at closing totaling \$8,586.80. In the absence of properly documented gift funds, the source of the earnest money was not documented.

- Comment 56** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 57** The comment on the gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for a gift were not met.
- Comment 58** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 59** The comment on gift funds confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 60** The loan was not included in the draft report narrative of deficiencies. Based on Housing's comments on a preliminary version as discussed in comment 29 we determined a deficiency did not exist. Accordingly, the comment and recommendation are not responsive to the draft report narrative of deficiencies.
- Comment 61** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 62** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for determining income were not met.
- Comment 63** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 64** The comment on gift funds confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 65** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 66** The comments on verification of employment and payment to income ratios confirm the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income and compensating factors for excessive ratios were not met.



- Comment 67** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements of the automated underwriting program were not met.
- Comment 68** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the documentation requirements for satisfaction of past due government loans were not met.
- Comment 69** The comment on the co-borrower's verification of employment confirms the draft report narrative of deficiencies for this loan. Also, the underwriter noted the payment to income ratio as high even with co-borrower income included and developed compensating factors. Elimination of the co-borrowers income would make the ratio higher.
- Comment 70** The comments on child support, payment to income ratios and collection account explanation confirm the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income, compensating factors for excessive ratios, and explanation of collection accounts were not met.
- Comment 71** The comment and recommendation address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 72** The comment on the gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for a gift were not met.
- Comment 73** The FHA case binder was returned to HUD's archive before HUD's review of the narrative descriptions completed prior to the draft report. HUD was made aware that the case binder was returned.
- Comment 74** The comment and recommendation address a preliminary version as discussed in comment 29 and are not responsive to the draft report narrative of deficiencies for this loan.
- Comment 75** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 76** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, HUD requirements for verification of income were not met.

- Comment 77** The comment and recommendation address a preliminary version as discussed in comment 29 and are not completely responsive to the draft report narrative of deficiencies for this loan. However, the comments on the payment to income ratios confirm the draft report narrative of deficiencies for this loan. As noted in the narrative, HUD requirements for payment to income ratios were not met.
- Comment 78** The comment on the loan confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, HUD requirements for use of sale proceeds from sale of a currently owned property and impacts on payment to income ratios were not met.
- Comment 79** The comment on earnings during 2000 confirms the draft report narrative on missing information but does not specifically address the loans lack of documentation showing, for the 22.5 month period, the borrower has been receiving the overtime and bonus income throughout the period, the average over time and bonus income, or the overtime and bonus earnings trend over the period. As noted in the narrative, HUD requires documentation demonstrating these three analyses.
- Comment 80** The comment on verification of employment confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements for verification of income were not met.
- Comment 81** The comments on the payment to income ratio and gift letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements were not met.
- Comment 82** The comment on the grant approval letter confirms the draft report narrative of deficiencies for this loan. As noted in the narrative, the HUD requirements were not met.
- Comment 83** The driver's license for the borrower's wife, who was not a co borrower, does not include a maiden name. There is no documentation in the case binder to resolve the conflicting information on existence of a relationship between the borrower and seller. As noted in the narrative, the HUD requirements for a gift of equity were not met.
- Comment 84** We revised the report to eliminate any inference that FHA is required to review a claim before payment.
- Comment 85** We revised the report to refer to compliance with program requirements rather than eligible mortgage loans and contract of insurance. Also, we made revisions to clarify that the determinations on compliance with program requirements and action may occur subsequent to claim payment. However, we did not revise the

report subject or title, because with the revisions noted we believe it is clear that the claim process should extend past payment.

- Comment 86** The scope of the audit was restricted to the Mutual Mortgage Insurance Fund. Accordingly, our report addresses only single family claims under the Mutual Mortgage Insurance Fund.
- Comment 87** We deleted the report references to 24 CFR 203.363 to further our effort to eliminate implications that HUD could deny claims in the absence of fraud or misrepresentation by the lender holding the mortgage at the time of claim.
- Comment 88** We revised the report to clarify the Office of Management and Budget's requirements in Circular A-129. The revision included the citations to the specific sections of the Circular and impact of Section 203(e) of the National Housing Act.
- Comment 89** We contacted the Office of Management and Budget during our audit to clarify the circular in light of Section 203(e) of the National Housing Act. Office of Management and Budget officials told us that the requirements of Circular A-129 and Section 203(e) of the National Housing Act can be read consistently. They advised us that HUD has to review claims while noting HUD may have to pay the claim to be in compliance with Section 203(e) of the National Housing Act.
- Comment 90** Our report does not state HUD could recover over \$200 million annually. The report portrays the amount as unsupported and recommendation 1A includes a HUD determination that loans comply with the contract of insurance to address projected unsupported claims and final costs totaling \$213,607,324 annually. Such a determination could include (1) review of the case file, (2) requesting additional information from the lender when necessary, (3) evaluating the information, and (4) if necessary, deciding on the appropriate action to take.
- Comment 91** We revised the report to clearly show that Appendix E is presented to provide a reader additional information on HUD program requirements not deemed necessary for presentation in Finding 1. A reference to Appendix E was added to the Finding and the title was changed to Requirements for Insurance Endorsement and Payment of Insurance Claims. Additionally, we removed the references to 24 CFR 203.363 and Section 203(r) of the National Housing Act.
- Comment 92** HUD's fundamental premise that our audit results were based on dichotomous observations associated with only two possible outcomes (an approach often modeled as Bernoulli random variables) was not applicable to our review. Accordingly, HUD's conclusions regarding the sample size, expected probability, rates of occurrence, and the formula used to compute the sample size were not relevant to the methodology we used and have no bearing on our reported results. HUD's comments are suggestive of hypothesis testing. However, as stated in Comment 21, we used difference estimation and standard variable sampling

methodologies in conjunction with the federal auditing and industry accepted EZQuant statistical software application to develop our sample plan, calculate the sample size, and evaluate the results. As such, we estimated the value of the entire population by analyzing the difference between the sampled transaction's actual claim amount and the amount that was properly supported in accordance with prevailing guidance and calculated the range of projections and actual sampling precision using standard variable sampling techniques. It appears that HUD is offering commentary on an alternative sampling methodology and does not provide any meaningful analyses on the actual sampling techniques and standard audit procedures we used to answer our audit objectives.

**Comment 93** Because HUD has computed results using a methodology inconsistent with the sampling techniques we used, the basis for questioning the projected confidence bounds is flawed and unfounded.

# Appendix C

## SCHEDULE OF MORTGAGE LOAN DEFICIENCIES

Case number	Missing verification of employment, written or telephonic; employment of 2 years not verified	Missing justification for use of overtime or other income	Inaccurate/excessive qualifying ratios without adequate compensating factors	Missing verification of deposit/3 months of bank statements	Missing gift letter/evidence gift, or other assistance funds received	Missing derogatory credit explanation	Missing documentation - mortgage credit residence, credit report, sale or prior W-2s - one occurrence each	Final HUD (costs)/revenue from the Single Family Housing Enterprise Data Warehouse
261-7470567			X					(\$31,548)
011-4901558	X							(\$38,955)
562-1671096						X		(\$35,391)
153-0079869				X				(\$21,822)
241-6083403				X				(\$35,165)
221-3161897				X				(\$33,151)
201-2963675	X							(\$24,803)
494-2754299	X							(\$15,546)
151-5921039				X				(\$58,439)
381-6044141				X				(\$22,359)
351-3813158	X							\$24,955
151-6032420						X		(\$52,119)
093-5034730				X				\$6,839
494-2853598			X	X				(\$59,902)
105-0166660		X	X					(\$24,494)
581-2205307					X			(\$27,264)
197-1425165				X				\$0
221-3436265	X							(\$35,672)
483-2828013				X				(\$80,143)
137-1624016	X							(\$21,794)
561-7914634				X				\$0
031-2828498	X							(\$30,136)
412-4550756		X						(\$49,769)
052-2112308	X							(\$18,203)
491-7360115				X				\$0
094-4228774	X							(\$20,500)
492-5910648	X		X					(\$39,404)
521-4634287						X		(\$29,579)
491-7690756						X		(\$31,425)
411-3107034	X							(\$31,604)
263-3411287		X			X			(\$25,655)
493-7150295				X				\$0
431-3925735				X				(\$74,366)
023-1142953				X				(\$31,147)
521-4598354						X		\$0
591-0896391	X							(\$23,222)
491-7376910	X	X	X					(\$30,734)
262-1198752			X					(\$57,497)
161-1977109			X			X		(\$44,949)
023-0876344		X						(\$7,922)
221-3150986	X							(\$71,911)
151-6125279			X	X				(\$37,285)
352-4051203				X				(\$28,312)
105-0341995				X				(\$30,837)
Total	14	4	6	2	17	2	6	(\$1,301,230)
Percentage of 44 loans	32%	9%	14%	5%	39%	5%	14%	

## **Appendix D**

### **NARRATIVE OF MORTGAGE LOAN DEFICIENCIES**

#### **Case number 261-7470567**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no documentation in the file to support the source of the borrower's investment in the property made at closing. The file contains documentation showing verified funds on deposit of \$188.25 and the most recent bank statement showed \$28 on deposit. The file also contained a gift letter for \$3,000 from the borrower's sister in law, however, there is no evidence the gift was actually received. The uniform residential loan application showed \$13 savings and \$3,000 gift available for investment at closing, equal to the assets available on the mortgage credit analysis worksheet. However, the Settlement Statement form HUD-1 showed no gift and the borrower paying cash totaling \$1,078.98 at closing. Accordingly, the borrower's source of investment at closing is not documented as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-10 states, all funds for the borrower's investment in the property must be verified. Additionally, 2-10 C. states that the transfer of gift funds from donor to borrower must be documented.

#### **Case number 011-4901558**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. There was no documentation in the file to support that the lender obtained a written or telephone verification of employment as required. HUD Handbook 4155.1 REV-4 CHG-1 paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

#### **Case number 562-1671096**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. There was no mortgage credit analysis worksheet in the mortgage loan file as required. HUD Handbook 4155.1 REV-4, CHG-1 4-4, C., requires the lender to provide a mortgage credit analysis worksheet.

**Case number 153-0079869**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 showed \$2,335 in down payment assistance funds. There was no gift letter in the file for the down payment assistance funds or documentation of the transfer of the funds to the borrower as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 241-6083403**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 shows a "SELP LOAN" \$4,500 and the mortgage credit analysis worksheet shows a "CITY SELP" \$4,500 as the source of essentially the entire borrower investment. There is no other mention of the SELP in the file, however, the uniform residential loan application shows subordinate financing \$4,500. The mortgage application does not show the source or repayment terms for the subordinate financing, nor does it show the borrower acknowledged the terms were understood and agreed to. HUD Handbook 4155.1 REV-4 CHG-1, 1-13, A. 3), states the source, amount, and repayment terms must be disclosed in the mortgage application and the borrower must acknowledge that he or she understands and agrees to the terms.

**Case number 221-3161897**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 shows \$2,578, "BOND ASSISTANCE AMT" and the uniform residential loan application shows bond assistance will be used for downpayment and settlement charges but does not show any subordinate financing. There is no other mention of the bond assistance in the file. Without information indicating whether the bond assistance is secondary financing or a gift the applicable HUD requirements cannot be specifically determined. However, the (1) mortgage application does not show the source or repayment terms for the subordinate financing, nor does it show the borrower acknowledged the terms were understood and agreed to; and (2) file does not contain an executed gift letter. HUD Handbook 4155.1 REV-4 CHG-1, 1-13, A. 3), states for secondary financing, the source, amount, and repayment terms must be disclosed in the mortgage application and the borrower must acknowledge that he or she understands and agrees to the terms. Paragraph 2-10, C., states for gift funds, the lender must document the transfer of the funds from the donor to the borrower, and the file must contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 201-2963675**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing a written or telephone verification of employment. The automated underwriting program requirement for telephone verification of employment was not met.

**Case number 494-2754299**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing a written or verbal verification of employment. The automated underwriting program requirement for verbal verification of employment was not met.

**Case number 151-5921039**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 shows "Nehemiah Gift Funds" for \$3,453 but there was no documentation in the file of a gift letter as required and no gift funds are included on the mortgage credit analysis worksheet. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 381-6044141**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The borrower's application showed a \$5,000 gift from parents, and the mortgage credit analysis worksheet shows \$2,300 gift from parents, but the Settlement Statement form HUD-1 does not show any gift funds. The file did not contain a gift letter or documentation showing the transfer of gift funds from the donor to the borrower as required. Additionally, the verification of deposit did not show the borrower had the needed funds to close the transactions without the gift. The verification of deposit shows \$2,212 available while the mortgage credit analysis worksheet included the \$5,000 gift in assets to close, and the Settlement Statement form HUD-1 showed \$5,694 cash from borrower at closing. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.



**Case number 351-3813158**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing the lender obtained a written or verbal verification of employment as required. The automated underwriting program requirement for verbal verification of employment was not met. The lender did obtain a residential mortgage credit report showing verification of income. However, this does not meet the stated automated underwriting program requirement nor would it meet the HUD documentation requirements in Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E.

**Case number 151-6032420**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The Employer Identification Number and the Employer State Identification Number for the borrower's employer "Preferred, Inc." was different on the Internal Revenue Service Form W-2's for 1998 and 1999. No explanation was provided. HUD Handbook 4155.1 REV-4 CHG-1, section 3-1E states, if the Internal Revenue Service Form W-2 indicates inconsistencies (e.g., FICA payments not reflecting earnings), standard employment documentation must be used.

**Case number 093-5034730**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 shows "SHIP loan" in the amount of \$2000. The uniform residential loan application shows checking and savings will be used for downpayment and shows no subordinate financing. The mortgage credit analysis worksheet shows "Down Payment Assistance Pasco County" in the amount of \$2000. There is no other mention of the assistance in the file. Without information indicating whether the assistance is secondary financing or a gift the applicable HUD requirements cannot be specifically determined. However, the (1) mortgage application does not show the source or repayment terms for the subordinate financing, nor does it show the borrower acknowledged the terms were understood and agreed to; and (2) file does not contain an executed gift letter. HUD Handbook 4155.1 REV-4 CHG-1, 1-13, A. 3), states for secondary financing, the source, amount, and repayment terms must be disclosed in the mortgage application and the borrower must acknowledge that he or she understands and agrees to the terms. Paragraph 2-10, C., states for gift funds, the lender must document the transfer of the funds from the donor to the borrower, and the file must contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 494-2853598**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The Settlement Statement form HUD-1 shows gift funds in the amount of \$4,675. However, there is no gift letter, documentation showing a transfer of funds or a bank statement showing receipt of funds. There is no indication gift funds were considered by the automated underwriting program used. Also, HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 105-0166660**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The borrower's fixed payment to income ratio was 47.2 percent. There were no compensating factors documented in the file as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. Alternative verification of deposit requirements were not met. There is a transaction history in the file that covers transactions and a running account balance during the one month period 7/13/2001 through 8/13/2001 and presents the account balance on 9/12/2001. It also shows the account balance totaling \$751.61 on 7/13/2001, \$828.82 on 8/13/2001, and \$2,602.97 on 9/12/2001. However, there is no detail on the \$1,774.15 increase between 8/13 and 9/12 or explanation of the source of those funds. HUD Handbook 4155.1 REV-4 CHG-1, 3-1, F., verification of deposit, states, As an alternative to obtaining a verification of deposit, the lender may choose to obtain from the borrower original bank statement(s) covering the most recent three month period. Provided the bank statement shows the previous month's balance, this requirement is met by obtaining the two most recent consecutive statements. Paragraph 2-10 B, requires an explanation and evidence of source of funds if there is a large increase in an account.

The bank statement does not show that the borrower had adequate funds for the minimum borrower investment. The Settlement Statement form HUD-1 shows the sale price of the property at \$146,500. The required minimum borrower investment amount would have been \$4,395. The borrower's bank statement shows a balance of \$2,603, \$1,792 short of the minimum borrower investment amount. Mortgagee Letter 98- 29 requires the borrower to make a cash investment at least equal to 3 percent of the contract sales price.

**Case number 581-2205307**

The lender did not meet HUD's minimum standard for showing the borrower was creditworthy. The borrower's credit report shows six collections without explanation as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-3, analyzing the borrower's credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

**Case number 197-1425165**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no documentation in the file of the transfer of funds from the donor, the borrower's brother in law, to the borrower as required. Use of funds from the borrower's brother in law is shown on the Settlement Statement form HUD-1. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Case number 221-3436265**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing a written or telephone verification of employment. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

Also, the file showed the borrower worked on a commission basis. There were no copies of the borrower's tax returns in the file as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-11, D., commission income, states, the borrower must provide his or her last two years tax returns.

**Case number 483-2828013**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The HUD 1 shows Nehemiah as the source of the gift funds but there is no gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 137-1624016**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing written or telephone verification of employment. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Case number 561-7914634**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no documentation in the file showing the transfer of gift funds, \$1,500, from the donor, the co borrower's father, to the borrower as required. The automated underwriting program used required verification of the gift funds. Also, HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Case number 031-2828498**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing the lender obtained a written or telephone verification of employment, pay stubs, or Internal Revenue Service Form W-2s as required. The automated underwriting program requirements for pay stubs, verbal verification of employment and Internal Revenue Service Form W-2s were not met. Also, HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Case number 412-4550756**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The income was not calculated correctly. The explanation found in the case binder on the computation states that overtime of nine hours was calculated. There is no history of two years of overtime and no explanation from the underwriter justifying the inclusion of the overtime income. Without adequate justification, the overtime income should have been excluded from the ratio calculation. Also there was no explanation for the

other earnings totaling \$283. Our calculations show that with night differential the monthly amount of income should have been \$1,716. A recalculation of the total fixed payment to income ratio based on the revised income amount showed a ratio of 48 percent. HUD Handbook 4155.1 REV-4 CHG-1, 2-7, A., overtime and bonus income states both may be used to qualify if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. The lender must develop an average of bonus or overtime income for the past two years and the employment verification must not state categorically that such income is not likely to continue. Periods of less than two years may be acceptable provided the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes.

**Case number 052-2112308**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing written or telephone verification of employment. The automated underwriting program requirement for verbal verification of employment was not met.

**Case number 491-7360115**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The documentation in the file of the transfer of funds from the donor, the borrower's father, to the borrower did not include the verification of the 10/5/2001 gifts deposit to borrower accounts nor verification the 10/29/01 gift came from the donor's own funds. The automated underwriting program stated that if the gift funds are not already verified in the borrower's accounts, you must document the transfer of the gift funds in accordance with HUD ML 00-28. Mortgagee Letter 00-28 states regardless of when the gift funds are made available to the homebuyer, the lender must be able to determine that the gift funds were not ultimately provided from an unacceptable source and were indeed the donor's own funds. Further, when the transfer occurs at closing, the lender remains responsible for obtaining verification the closing agent received funds from the donor for the amount of the purported gift.

**Case number 094-4228774**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. We did not find documentation in the file that showed the lender verified the borrower's employment for the most recent two year period. The file did not include verifications of employment, Internal Revenue Service Form W-2s, or pay stubs covering the most recent two years nor did the file contain information on the two month gap in employment shown on the residential loan application. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the

borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Case number 492-5910648**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing written or telephone verification of employment was received for either the borrower or coborrower. Additionally, there were no Internal Revenue Service Form W-2s for the coborrower. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

There was no documentation of compensating factors for a total fixed payment to income ratio of 48.90 percent as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented. There were no compensating factors documented in the file.

**Case number 521-4634287**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The file showed the borrowers' cash investment included sweat equity valued at \$4,655 by the builder seller. There is no indication sweat equity was considered by the automated underwriting program per the feedback certificate. The feedback certificate stated the lender is responsible for documenting any situation not addressed on the feedback certificate according to the LP User Guide and /or HUD handbook 4155. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, O. 2, states, the lender must document the contributory value of the labor through either the appraiser's estimate or through a cost estimating service.

**Case number 491-7690756**

The lender did not meet HUD's minimum standard for showing the borrower was creditworthy. The borrower had \$4,709 in collection for a past due government student loan and there was no documentation in the file to show the loan had been paid or otherwise satisfied, brought current, or placed under a repayment agreement. There is no indication past due federal debts were considered by the automated underwriting program

used. Also, HUD Handbook 4155.1 REV-4 CHG-1, 2-5, B., delinquent federal debts, states, if the borrower is presently delinquent on any federal debt or has a lien, including taxes, placed against his or her property for a debt owed to the United States, the borrower is not eligible until the delinquent account is brought current, paid or otherwise satisfied, or a satisfactory repayment plan is made between the borrower and the federal agency owed and is verified in writing.

**Case number 411-3107034**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing written or telephone verification of employment was received for the coborrower. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

**Case number 263-3411287**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. Based on the conflicting documentation in the mortgage loan file, we could not make a determination on the accuracy of the borrower's monthly income. However, we did determine the lender did not verify the child support income as required. HUD Handbook 4155.1 REV-4 CHG-, 2-7, F., alimony, child support or maintenance income, states, the borrower must provide a copy of the divorce decree, legal separation agreement, or voluntary payment agreement and evidence that payments have been received during the last twelve months. We recalculated the total fixed payment to income ratio after revising the income amount for the unsupported child support and arrived at a total fixed payment to income ratio of 47.65 percent. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented. Additionally, the lender did not include the automated underwriting system documentation as required.

The lender did not meet HUD's minimum standard for showing the borrower was creditworthy. The borrower's credit report shows serious delinquencies and the majority of the accounts were in collection status. The credit report also showed three judgments and one lien. Many of the collection accounts were within two years of closing. There is no explanation in the file regarding the borrower's delinquent credit history as required. The required automated underwriting documentation was not included, so we used HUD requirements. HUD Handbook 4155.1 REV-4 CHG-1, 2-3, analyzing the borrower's

credit, states, while minor derogatory information occurring two or more years in the past does not require explanation, major indications of derogatory credit, including judgments and collections, and any other recent credit problems, require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

**Case number 493-7150295**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no documentation showing the accumulation or withdrawal of funds attributed to a community savings plan for \$2,000 and \$1,200 as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, R., states if a homebuyer claims that the cash to close a FHA-insured mortgage is from savings held with a private savings club, the borrower must be able to adequately document the accumulation of those assets with the club. Additionally, it states the underwriter must be able to make a determination that it was reasonable for the borrower to have saved the money claimed and that there is no evidence these funds were borrowed with an expectation of repayment.

**Case number 431-3925735**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no gift letter for funds from Dreamhouse Charity as required. HUD Handbook 4155.1, REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower. The file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 023-1142953**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. There was no documentation in the file of the transfer of funds from the donor, the borrower's cousin, to the borrower as required. The automated underwriting program requirement for verification of gift funds deposit was not met. Also, HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the lender must document the transfer of the funds from the donor to the borrower.

**Case number 521-4598354**

The lender did not meet HUD's minimum standard for showing the borrower was creditworthy. The file does not contain a credit report for the borrower. The file contains a credit report that warns it is incomplete, presents credit information only for the coborrower, and identifies the borrowers Social Security number as invalid. Handbook 4155.1 REV-4 CHG-1, 3-1, requires the lender to obtain a credit report for each borrower.



**Case number 591-0896391**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The lender updated the verification of employment and determined the borrower had terminated their position. The lender obtained a pay stub from the borrower's new job, but did not obtain a written or verbal verification of employment. Handbook 4155.1 REV-4, CHG-1, paragraph 3-1 E. requires the verification of current employment.

**Case number 491-7376910**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The file did not contain required documentation showing written or telephone verification of employment was received. Also, the total income used on the Mortgage Credit Analysis Worksheet included \$1,533 co borrower income, while the Uniform Residential Loan Application showed no co borrower or corresponding income. HUD Handbook 4155.1 REV-4 CHG-1, paragraph 3-1 E states a verification of employment and the borrower's most recent pay stub are to be provided. As an alternative to obtaining a verification of employment, the lender may (1) obtain the borrower's original pay stub(s) covering the most recent 30-day period, along with original Internal Revenue Service Form W-2s from the previous two years, (2) verify by telephone all current employers, and (3) obtain a signed document from the borrower that is appropriate for obtaining tax returns directly from the Internal Revenue Service.

There was no documentation in the file supporting additional child support on the mortgage credit analysis worksheet as required. The file contained information on two child support payments but did not include information showing ongoing child support. HUD Handbook 4155.1 REV-4 CHG-1, 2-7, F., alimony, child support or maintenance income, states, the borrower must provide a copy of the divorce decree, legal separation agreement, or voluntary payment agreement and evidence that payments have been received during the last twelve months.

We recalculated the total fixed payment to income ratio after eliminating unsupported co borrower income and reducing child support to the amount shown on the two payments. The recalculation resulted in a total fixed payment to income ratio of 60.15 percent. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

**Case number 262-1198752**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The lender did not present required compensating factors for a mortgage loan that had a total fixed payment to income ratio of 46.39 percent. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

**Case number 161-1977109**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The sales contract shows that the sale is contingent on the sale of the borrowers existing property, but there is no documentation in the file that the borrower's property was sold. Handbook 4155.1 REV-4 CHG-1, 2-10 E states, the net proceeds from an arms-length sale of a currently owned property may be used for the cash investment on a new house. A fully executed Settlement Statement form HUD-1 must be provided as satisfactory evidence of the cash sales proceeds accruing to the borrower. If the property has not sold by the time of underwriting, loan approval must be conditioned upon verifying the actual proceeds received by the borrower. The lender must document both the actual sale and the sufficiency of the net proceeds required for settlement.

Also, in the absence of required sales information, the lender did not included the borrowers mortgage payment of \$1,162 for there current residence in the calculation of the borrower's total monthly payments. A recalculation showed the total fixed payment to income ratio changed from 46.39 percent to 66.99 percent. There was no documentation of compensating factors in the mortgage loan file. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

**Case number 023-0876344**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The lender included overtime and bonus income in the borrower's calculation of monthly income, but did not (1) establish that the borrower had been receiving the overtime and bonus income for approximately the past two years, (2) document the basis for a shorter period in writing, or (3) develop an earnings trend for overtime and income. After excluding overtime and bonuses income, the borrower's monthly income would have been \$2,894 not \$3,449 shown on the mortgage credit

analysis worksheet. The recalculated shows 48.22 percent for the total fixed payment to income ratio. HUD Handbook 4155.1 REV-4 CHG-1, 2-7, A., states overtime and bonus income may be used to qualify if the borrower has received such income for approximately the past two years and there are reasonable prospects of its continuance. The lender must develop an average of bonus or overtime income for the past two years and the employment verification must not state categorically that such income is not likely to continue. Periods of less than two years may be acceptable provided the underwriter adequately justifies and documents his or her reason for using the income for qualifying purposes. Additionally, an earnings trend must also be established for either source of income. If either type of income shows a continual decline, the lender must provide a sound rationalization for including the income for borrower qualifying. If bonus income varies significantly from year-to-year, a period of more than two years must be used in calculating the average income.

**Case number 221-3150986**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. There was no documentation in the file that the lender verified the borrower's employment as required. The automated underwriting program requirement for verbal verification of employment was not met.

**Case number 151-6125279**

The lender did not meet HUD's minimum standard for showing the borrower was able to make the required monthly payments. The total fixed payment to income ratio was 45.2 percent. There was no documentation of compensating factors in the file as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-12, B., debt to income ratios, states, if the total mortgage payment and all recurring charges do not exceed 41 percent of gross effective income, the relationship of total obligations to income is considered acceptable. A ratio exceeding 41 percent may be acceptable if significant compensating factors are presented.

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The sales contract states seller to pay 3.5 percent of sales price for AmeriDream program participation and the Settlement Statement form HUD-1 shows a gift from AmeriDream Charity, but there is no documentation of a gift letter in the file as required. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 352-4051203**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The file did not contain an executed gift letter as required. The file contained four memos from Home Jersey, a community based not for

profit organization, showing grants for \$14,997, \$9,000, \$4,627 and \$4,377, but none were signed by either the donor or the borrower. Additionally, three of the memos were faxed from the real estate agents office per the fax banner. The Settlement Statement form HUD-1 does not identify the source of grant funds and shows two amounts, \$14,997 and \$4,627. HUD Handbook 4155.1 REV-4 CHG-1, 2-10, C., gift funds, states, the file must also contain a gift letter specifying the dollar amount, signed by the donor and the borrower, stating no repayment is required, and showing the donor's name, address, telephone number, and relationship to the borrower.

**Case number 105-0341995**

The lender did not meet HUD's minimum standard for showing the borrower made the minimum investment in the property. The file did not include adequate documentation of a gift of equity. The sales contract showed a 3 percent gift of equity from a related seller. However, the addendum to the contract included certification the sale was arms length with no relationship between buyer and seller. Handbook 4155.1 REV-4, CHG-1 & 5, 2-10, C., gift funds, states, only family members may provide equity credit as a gift on a property being sold to other family members.

## Appendix E

### **REQUIREMENTS FOR INSURANCE ENDORSEMENT AND PAYMENT OF INSURANCE CLAIMS**

Section 203(a) of the national Housing Act (Act) authorizes HUD to insure mortgages that meet the requirements established by the Act. Section 203(b) of the Act lists the requirements a mortgage must meet to be eligible for insurance under the section. The requirements under section 203(b) of the Act include those requiring a mortgage to

- (1) Have been made to and held by a lender approved by the Secretary,
- (2) Require periodic payments that do not exceed the borrowers reasonable ability to pay, and
- (3) Be executed by a borrower who paid the minimum required 3 percent down payment.

Once an eligible mortgage is endorsed and insured, Section 203(e) of the Act states any contract of insurance executed by HUD shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and the validity of the contract of insurance so executed shall be incontestable in the hands of an approved lender, except for any fraud or misrepresentation on the part of such approved lender.

Under the Direct Endorsement program, HUD does not review applications for mortgage insurance before the mortgage is executed or issued conditional or firm commitments. The lender determines the proposed mortgage is eligible for insurance under the applicable program regulations, and submits the required documents to the Secretary in accordance with the procedures set forth in 24 CFR 203.255. The required documents include the lender's certification the mortgage is eligible for insurance under the applicable program regulations. The procedures also require the lender to submit underwriter and lender certifications. These certifications represent to HUD that the approving lender properly performed and documented compliance with applicable HUD single family insurance program requirements, including those in HUD handbooks, and that the mortgage met the HUD underwriting requirements.

HUD endorses the mortgage for insurance based on the approved lender's representation that the proposed mortgage is eligible for insurance. The approved lender's performance is subject to pre-endorsement and post-endorsement review by the Secretary under 24 CFR 203.255 (c) and (e). Section 203.255(e) authorizes HUD to conduct post endorsement reviews and take action against lenders when the review shows they did not comply with Direct Endorsement program requirements. The actions authorized range from terminating participation in the Direct Endorsement program to referral to the Mortgagee Review Board for action. The Mortgagee Review Board was established by

section 202(c) of the National Housing Act and empowered to take administrative action when lenders violate HUD requirements. The actions available to the Mortgagee Review Board range from withdrawal from the program to settlement agreements that can include indemnification.

The contract rights and obligations established by the contract of insurance are specified in 24 CFR Part 203 Subpart B. The sale of an insured mortgage to another approved lender does not change the contract. 24 CFR 203.432 states that when an insured mortgage is sold to another approved lender, the buyer succeeds to all the rights and becomes bound by all the obligations of the seller under the contract of insurance and the seller is released from its contractual obligations other than paying mortgage premiums until HUD receives notice of the sale.

Lenders approved to participate in the single family mortgage insurance program certified they would comply with the HUD regulations and requirements. The HUD program regulations require approved lenders to have quality control plans that ensure lenders comply with requirements for underwriting mortgage loans, submitting those loans for insurance, and selling and buying insured mortgage loans. HUD's quality control plan requirements, included in HUD handbook 4060.1 paragraph 6-12 specify the required elements for the servicing portion of a quality control plan. Paragraph 6-12 includes a requirement for lenders to determine whether loans purchased contain all necessary documents, including the Mortgage Insurance Certificate. The necessary documents include the entire origination file as provided for in Handbook 4000.2 paragraph 5-8. Paragraph 5-8 requires that upon sale or transfer of servicing, the entire origination file accompany the transfer and that either the holding or servicing lender, by arrangement between them, retains the file for the life of the insurance, plus two years, whether the mortgage has been satisfied by payment-in-full, voluntary termination, or a claim for insurance benefits. Additionally, lenders need to ensure the loan files contain all the required documents that will be required in the event of a claim. The Single Family Insurance Claims handbook 4330.4 REV-1 and the regulations at 24 CFR 203.365 (a) and (c) specify the documents to be submitted to HUD and those to be kept in a claim file and provide for HUD review any time within three years of claim payment.

In summary, approved lenders participating in the HUD Single Family Direct Endorsement Program are responsible for the adequacy of documentation supporting the eligibility of loans for insurance. The original lender certifies loans are eligible for insurance and that the application includes all required supporting documentation. Subsequent purchasers are required to ensure all required supporting documentation is included in their files.

Section 204(a) of the National Housing Act (Act) authorizes HUD to pay insurance benefits for defaulted mortgages insured under section 203 of the Act. The regulations at 24 CFR 203.365 (a) and (c) specify the documents and information to be provided to HUD when a claim is made and require the lender to maintain a claim file containing all

information submitted for claim payment. The provisions for HUD review of the claim file in 24 CFR 203.365 (c) do not address review of the documents related to the application for mortgage insurance.

In addition to the specific program requirements discussed above, there are federal requirements applicable to all federal agencies. The Office of Management and Budget's Circular A-129, Policies for Federal Credit Programs and Non-Tax Receivables, is applicable to HUD's single family mortgage insurance program. The Circular requires HUD to ensure loan origination files contain the documents needed to conform to private sector standards and states accurate and complete documentation is critical to processing claim payments. As noted above, HUD's program requirements provide for loan origination files to contain required documentation. The Circular notes, the documents are critical to claim processing and requires HUD to ensure lenders meet program requirements through a claims review process, including origination, before making a claim payment. Additionally, the Circular defers to the National Housing Act when conflicting requirements arise.

Accordingly, mortgages endorsed for insurance and eligible for claim payment must have the required lender certifications on origination supported by required documentation showing compliance with the contract of insurance. If upon review of a paid claim HUD determines the FHA loan file lacks the required documentation to show the lender complied with program requirements, HUD has an obligation to request the missing documentation. If the required information cannot be produced, HUD has a responsibility to determine the appropriate action to take.

## **Appendix F**

### **Sampling Methodology and Results**

#### Purpose of the Sampling

The objective of the audit was to determine whether HUD had controls in place to ensure paid claims were for loans meeting program requirements. In support of this objective, we employed an unrestricted variable sampling plan that allowed statistical projections of the dollar amount of the (i) insurance claims that were not supported by the documentation required by the contract of insurance and (ii) the dollar amount of HUD's net profit or loss after the insurance claim was paid for those claims that were not properly supported by required documentation.

#### Definition of the Audit Population and Tests Performed

Using data obtained from the Single Family Data Warehouse, we identified 80,352 claims valued at \$7,886,525,548 that went into final default within three years of endorsement during the period October 1, 2003 through June 3, 2005. A subpopulation of this universe included 59,975 claims that had completed the claim processing cycle, allowing HUD to determine the final loss for the claims totaled \$2,116,193,853.

For each transaction sampled, we obtained the HUD case binder for review. Based on the information included in the case binders, we assessed whether the program requirements for supporting documentation were met and showed the borrower (1) was able to make the required monthly payments, 2) made the minimum investment in the property, and 3) was creditworthy. For those claims for which the case binder did not show the borrower met all three specified requirements, we considered the claim and its associated dollar amount to have failed to meet program requirements for supporting documentation.

#### Sample Design

Using unrestricted variable sampling methodology, we determined that a sample size of 175 insurance claims was sufficient using a 95 percent confidence level and 50 percent estimated error rate. Accordingly, we randomly selected 175 insurance claims for a detailed review from the universe. Of the 175 insurance claims, 125 had progressed through the claim process and HUD established the final determination of profit or loss on the 125 insurance claims. Because the 125 insurance claims represented a subpopulation of the universe, we did not separately select another sample to review those insurance claims that had completed the claim process. Accordingly, we elected to accept whatever level of sampling precision that would be derived when the actual results and projections were computed for this subpopulation of the universe.



Statistical Projections of the Sample Data

Based on the results of the detailed tests performed on the sampled items, we are 97.5 percent confident that the minimum value of the universe of the 80,352 insurance claims that were properly supported was at least \$6,559,802,469. This means that HUD paid insurance claims totaling at least \$1,326,723,079 that were not adequately documented and properly supported.

The point estimate of the population of insurance claims was \$5,882,627,673, plus or minus \$677,174,796. In other words, we are 95 percent confident that the total value of the population of insurance claims that were sufficiently documented and adequately supported lies between \$5,205,452,877 and \$6,559,802,469. The average precision (sampling error) was 12 percent. Statistical projection details were:

<b>Information on the Universe and Sample size</b>			
Total Value of Claims In the Universe	\$7,886,525,548		
Total Number of Claims In the Universe	80,352		
Mean for Claims In the Universe	\$98,150		
Total Number of Claims In the Sample	175		
Mean for Claims In the Sample	\$96,713		
<b>Results for the Sample Evaluation</b>			
	Confidence Level	95%	
Precision For Estimated Value of Supported Claims	\$677,174,796	12%	
Estimated Value of Supported Claims (Point Estimate)	\$5,882,627,673		
Estimated Lower Limit of Supported Claims	\$5,205,452,877		
Estimated Upper Limit of Supported Claims	\$6,559,802,469		
<b>Determination of Estimated Value of Unsupported Claims</b>			
Total Value of Claims In the Universe	\$7,886,525,548		
Less Estimated Value of Supported Claims For Reporting (Upper Limit)	<u>\$6,559,802,469</u>		
Equals Estimated Value of Unsupported Claims For Reporting	<u>\$1,326,723,079</u>		

In addition, based on the results of the sample representing the subpopulation of insurance claims that were processed to the point of profit or loss determination, we are 95 percent confident that the minimum value of the universe of the 59,975 insurance claims that were properly supported was a loss of at least \$1,760,181,646. This means that HUD incurred losses totaling at least \$356,012,207 that were not adequately documented and properly supported. The point estimate of the subpopulation of insurance claims that were processed to the point of profit or loss determination was a

loss of \$1,560,768,315, plus or minus \$199,413,331. In other words, we are 90 percent confident that the total value of the loss for the subpopulation of insurance claims that were sufficiently documented and adequately supported lies between \$1,760,181,646 and \$1,361,354,984. The average precision (sampling error) was 13 percent. Statistical projection details were:

<b>Information on the Universe and Sample size</b>			
Total Loss on Claims In the Universe	\$2,116,193,853		
Total Number of Claims In the Universe	59,975		
Mean Loss for Claims In the Universe	\$35,285		
Total Number of Claims In the Sample	125		
Mean Loss for Claims In the Sample	\$36,942		
<b>Results for the Sample Evaluation</b>			
	Confidence Level	90%	
Precision For Estimated Loss on Supported Claims	\$199,413,331	13%	
Estimated Loss on Supported Claims (Point Estimate)	\$1,560,768,315		
Estimated Lower Limit of Loss on Supported Claims	\$1,760,181,646		
Estimated Upper Limit of Loss on Supported Claims	\$1,361,354,984		
<b>Determination of Estimated Value of Unsupported Claims</b>			
Total Loss on Claims In the Universe	\$2,116,193,853		
Less Estimated Value of Supported Loss on Claims For Reporting (Lower Limit)	<u>\$1,760,181,646</u>		
Equals Estimated Value of Unsupported Claims For Reporting	<u>\$356,012,207</u>		