



Audit Report

District Inspector General for Audit Capital District

Report: 98-AO-123-0001

Issued: January 30, 1998

TO: Emelda Johnson, Deputy Assistant Secretary for Single Family Housing, HS

FROM: Austin B. Groom, Jr., District Inspector General for Audit, Capital District, 3GGA

SUBJECT: Audit of the Single Family Real Estate Owned Pilot Contracts

We have completed our audit of the Single Family Real Estate Owned (SFREO) pilot contracts. Our objectives were to (1) identify areas in the pilot contracts where HUD is vulnerable to waste, fraud, and abuse of Federal assets and (2) recommend ways to improve your proposed approach to issue a national single family property disposition contract. In addition, we developed two areas that impact on the REO process as a whole and are not limited to the SFREO pilot contracts.

This report addresses program improvements that HUD should implement now as well as revised contract language designed to improve the consistency and effectiveness of any future contracts dealing with single family property disposition. We also provided suggestions for improving the controls in the areas of custodial properties and the Single Family Acquired Asset Management System.

Within 60 days please give us, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

We appreciate the cooperation of HUD's headquarters and field staff during this audit. Should you or your staff have any questions concerning the audit or the report process, please contact Donald W. Cairns, Assistant District Inspector General for Audit, on (202) 708-0351.

Executive Summary

The Capital District was requested by the HUD Single Family Division to review the Single Family Real Estate Owned (SFREO) pilot contracts to identify areas where HUD is vulnerable to fraud, waste, and abuse of Federal assets. We were also requested to recommend ways to improve their proposed approach to issue a national single family property disposition contract. During our exit conference, we were informed that HUD is no longer actively pursuing the national contract concept but is considering the use of similar contracts at the individual HUD Single Family Home Ownership Centers. Based on our audit of the three pilot contracts, we identified program improvements that HUD should implement now as well as revised contract language that will improve the efficiency and effectiveness of the pilot contracts. If HUD reconsiders pursuing the national contract or similar pilot contracts, HUD should revise the contracts to include our recommended improvements.

Consistency and Effectiveness of Contract Requirements

The pilot contracts need improvement to maintain consistency and effectiveness in performance. Specifically, the contracts do not require the contractor to comply with current changes in HUD legislation, regulations, or other HUD policy and procedural documents; contract terminology is vague and nonspecific; and restrictions are not placed on the use of identity-of-interest companies. In addition, the pilot contracts do not require the contractor to maintain a written policies and procedures manual for its property disposition operations. In a related matter, we believe HUD could reduce its cost of repairs reimbursed under the pilot contract by modifying the contracts to require the use of preferred vendor lists and unit pricing matrices instead of soliciting bids for repairs over \$1,000. We recommend that HUD address the cited contract improvements in pilot contracts now or in the national contracts if HUD proceeds with the concept.

Management of Custodial Properties

Custodial properties are a continuing problem. Properties remain classified as custodial for years because HUD does not aggressively follow up on title transfers. As a result, HUD incurs increased and unnecessary holding costs to maintain them. For example, we estimated that for the last 3 years, holding costs of \$31.8 million were paid for 1,013 custodial properties that have been in the inventory for 3 years or more. We recommend that HUD improve its management of custodial properties with unresolved title problems prior to assigning them to the contractor.

**Integrity and Accuracy
of Data in SAMS**

The Single Family Acquired Asset Management System (SAMS) is unreliable to serve as the key management information system used by HUD and the contractor to make decisions concerning the disposal of HUD-owned properties. We found that it contains duplicate or nonexistent properties as well as properties that do not belong to HUD. Further, background clearance was not obtained for contractor staff who access and update SAMS. We recommend that HUD evaluate SAMS and take any steps necessary to insure the integrity and accuracy of the database. In addition, we recommend that HUD obtain background clearances for the contractor staff who access SAMS.

The Deputy Assistant Secretary for Single Family Housing generally agreed with our recommendations in her December 30, 1998 response to our draft report. That response is included in its entirety as Appendix 1 to this report. Summarized comments to our recommendations and our evaluation of those comments are included at the end of each finding.

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Abbreviations:

FY - Fiscal Year
HUD - U.S. Department of Housing and Urban Development
OIG - Office of Inspector General
SAMS - Single Family Acquired Asset Management System
SFREO - Single Family Real Estate Owned

Introduction

Background

In line with the current HUD Administration's reinvention efforts, HUD management is constantly reviewing Departmental structure, operations, practices, and procedures. For the Single Family Division, the objectives are to effectively manage, evaluate, and market HUD-owned properties in a manner which produces the highest possible return to the Department's mortgage insurance funds. In its approach to property disposition, HUD wants to reduce the average loss on sales and the average time properties remain in inventory.

The objectives are to be accomplished while projecting a positive image for HUD's properties and minimizing complaints. HUD Single Family Division management determined that the best way to accomplish those objectives was to contract out the management and marketing of the Department's acquired single family properties on a national basis. In September 1996, HUD entered into three pilot contracts with Golden Feather Realty Services, Inc. to test that approach. Golden Feather was incorporated in December 1991 and specializes in the management and disposition of single family properties. The corporate office is located at 13409 NW Military Highway, San Antonio, Texas. Branch offices are located in Dallas, Texas; Phoenix, Arizona; Baltimore, Maryland; Metairie, Louisiana; and Sacramento, California.

In addition to the three pilot contracts, Golden Feather provides single family property disposition services for HUD's Texas State Office located in Fort Worth, Texas. Under the name Real Estate Asset Management, Inc., Golden Feather also provides the same services to HUD's Arizona State Office located in Phoenix, Arizona and to the San Antonio, Texas Area Office.

Under the contracts, those management and marketing functions formerly performed by local HUD office staff would be performed by Golden Feather for 1 year plus up to 4 optional years. The pilot contracts covered acquired single family property inventories for HUD's Maryland and Louisiana State Offices and Sacramento Area Office jurisdictions. The contracts were indefinite quantity/fixed unit price contracts. The contract awards were:

HUD Office	Original Award	Modified Increase	Total
Maryland	\$1,680,257	\$2,000,000	\$3,680,257
Louisiana	1,079,620	1,000,000	2,079,620
Sacramento	974,912	1,425,088	2,400,000
Totals	\$3,734,789	\$4,425,088	\$8,159,877

The pilot contracts require Golden Feather to provide facilities, materials, supplies, equipment, labor, services, and working capital required to successfully manage

single family properties owned by or in the custody of HUD. Computer equipment needed by the contractor to access SAMS was provided by HUD. In addition, the contracts required Golden Feather to market the single family properties, oversee the sales closing activity, and protect and preserve those single family properties in the custody of HUD.

During the exit conference with Single Family Division staff, we were informed that HUD was no longer actively pursuing the national contract concept. Rather, HUD was in the process of determining how they were going to dispose of its single family acquired properties including the use of similar contracts at the Single Family Homeownership Centers. This change in direction required us to restructure our report to discuss ways to improve HUD SFREO operations and the pilot contracts. If HUD reconsiders pursuing the national contract concept, or similar pilot contracts, HUD should revise the contracts to include our recommended improvements.

Audit Objectives, Scope, and Methodology

Our objectives were to (1) identify areas in the pilot contracts where HUD is vulnerable to fraud, waste, and abuse of Federal assets and (2) recommend ways to improve the proposed approach to issue national single family property disposition contracts.

Our audit was performed in accordance with generally accepted government auditing standards. In addition, the audit was conducted between March 1997 and July 1997 and covered the period October 1, 1996 through June 30, 1997. We performed the field work at HUD Headquarters located at 451 Seventh Street, S.W., Washington, DC; HUD's Maryland State Office in Baltimore, MD; HUD's Louisiana State Office in New Orleans, LA; and at Golden Feather's offices located in Baltimore, MD; Metairie, LA; and San Antonio, TX. We decided not to include the Sacramento Office in our testing because our work in Baltimore and New Orleans was sufficient to document our observations and Sacramento did not have a significant problem with custodial properties.

Management controls for the pilot contracts were reviewed to identify and determine deficiencies and to recommend ways to strengthen property management contract performance for the national contract concept. We also determined the extent Golden Feather was required to comply with applicable laws, regulations, directives, notices, and other HUD requirements.

We reviewed and analyzed pertinent records maintained by HUD and Golden Feather. The HUD records reviewed included copies of the pilot contracts, contract modifications and supporting documentation, and automated reports from the Single Family Acquired Asset Management System (SAMS). At Golden Feather's offices, we reviewed their automated system reports, property files, subcontractor files, financial records, and monitoring files. We also performed

physical inspections of the HUD properties managed by Golden Feather. Appropriate HUD and Golden Feather staff were interviewed as necessary.

At HUD's offices, we obtained and reviewed copies of the pilot contracts, contract modifications and supporting documentation, SAMS reports relating to the inventory assigned to Golden Feather for servicing, monitoring reports prepared by the HUD Offices while evaluating Golden Feather's performance, and other documents relating to Golden Feather.

At Golden Feather's offices, we obtained and reviewed draft copies of Golden Feather's practices and procedures. In addition, we determined and documented Golden Feather's process used to manage properties, the payment process, including requests for payment from HUD and payments to subcontractors for work on HUD properties. We also examined documentation supporting contract modifications, automated reports relating to the inventory of HUD properties, property files, subcontractor files, and financial records.

At Golden Feather's Baltimore office, we selected a random sample of 68 properties from the current and closed property inventory as of April 4, 1997 for file review. In addition, we randomly selected 15 of those properties for site reviews where we visually determined the condition of each selected property.

At Golden Feather's Metairie office, we only performed file reviews for the seven properties which we physically inspected. File reviews of the current and closed property inventory were not performed because our work at Baltimore did not disclose significant deficiencies in the property files. Our sample of seven properties was selected using the same method as that used in our Baltimore office review.

Findings

Finding 1

Contract Requirements Need Improvement To Strengthen Consistency And Effectiveness

The Single Family Housing Real Estate Owned (SFREO) pilot contracts' requirements need improvement to maintain consistency and effectiveness in performance. Specifically, we noted the contracts do not require the contractor to comply with current changes in HUD legislation, regulations, or other HUD policy and procedural documents; contract terminology is vague and nonspecific; and no restrictions are placed on the use of identity-of-interest companies. We also noted that the pilot contracts do not require the SFREO contractor to maintain a written policies and procedures manual for its property disposition operations. Additionally, we believe HUD could reduce its contract costs by modifying the contract terms to require the use of preferred vendor lists and unit pricing matrices instead of soliciting bids for repairs over \$1,000.

We believe that if HUD implements the cited contract improvements, HUD will be able to achieve the highest possible return on sales of single family acquired properties. Further, if HUD should pursue either a national contract or similar pilot contracts, it will have a greater assurance that each HUD office or each SFREO contractor will follow the contract requirements in a consistent manner.

Compliance with HUD's Laws and Regulations

The SFREO contractor's duties and responsibilities are regulated by the pilot contracts, contract modifications, and documents incorporated into the contracts or modifications by reference. The SFREO contractor must comply with HUD legislation, regulations, etc. that were specified in the contract when it was signed.

We noted the SFREO contractor was not required to comply with current changes in HUD's legislation, regulations, or other HUD policy and procedural documents. For example, we found that after the pilot contracts were awarded, the regulations governing the lead based paint program were changed. The pilot contracts did not recognize those changes and, thus, the SFREO contractor was not in compliance with them. Subsequently, the pilot contracts were modified to incorporate the new lead based paint requirements.

We also found that because the contract had to be modified to require compliance with the change, the implementation of the revised HUD lead based paint program requirements were delayed. We believe the SFREO contractor should be required to comply with current changes in the law, regulations, etc. by modifying the contract terms to require compliance to new or revised regulations on an ongoing basis.

Nonspecific Contract Terminology

We noted that the pilot contracts are worded in general terms and those terms are not defined; e.g., timely, reasonable, and adequate. Such terms are vague and could have different meanings to different contractors as well as HUD staff. The terms are defined in HUD's regulations and handbooks. We believe the pilot contracts should be modified to define those terms.

We also noted the contract requirements do not define the difference between a repair covered by the SFREO contractor's fees and a maintenance item reimbursed under the contract. We found that the difference in terminology is specifically defined in the HUD Real Estate Asset Manager (REAM) contract requirements. However, the definitions were not included in the pilot contracts.

Written Policies and Procedures

During our audit, the SFREO contractor did not have formal written policies and procedures for its property disposition operations. The SFREO contractor's staff indicated they used the pilot contract requirements to provide guidance for accomplishing performance for property disposition. In addition, the SFREO contractor stated they are in the process of developing a policies and procedures manual for its current operations and provided us a copy of their draft document. However, we believe HUD needs to specify a contract requirement that a written policies and procedures manual be maintained by the contractor so that HUD can review and evaluate the contractor's operations and determine whether their policies, practices, and procedures are consistent with those exercised by HUD.

Use of Identity-of-Interest Companies

We noted that the pilot contract requirements do not limit or place restrictions on the use of identity-of-interest companies. An identity-of-interest company is an entity wherein the owners or managers have a relationship (partnerships, family members, etc.) with the contractor. This relationship results in a liability to HUD because contractors frequently use such firms to obtain excess profits from government contracts by overcharging costs or fees for goods and services provided to the contractor under the contract.

We found that the SFREO contractor did not use any identify-of-interest companies. However, we believe the pilot contracts should be proactive and limit the use of identity-of-interest companies.

**Preferred Vendor Lists
and Unit Pricing Matrices**

We noted that the SFREO contractor developed and used a unit pricing matrix and preferred vendor lists for unreimbursable repairs paid out of their fees. This helped in minimizing the SFREO contractor's costs under the contract. In contrast, the SFREO contractor did not develop similar lists and matrices for reimbursable repairs under the pilot contracts because the contract required the SFREO contractor to solicit oral quotes from three or more subcontractors for repairs of \$1,001 to \$2,000 and to solicit written quotes for repairs over \$2,000. No solicitations are required for repairs under \$1,000.

We believe HUD could reduce the cost of repairs reimbursed under the pilot contracts by modifying the contracts to require the development of a preferred vendors list and unit pricing matrices. To qualify for the preferred vendor list, subcontractors would have to compete and agree to perform repairs and provide services or goods at a preset unit price. The SFREO contractor could then request subcontractors on the list to perform repairs without having to solicit quotes. If a vendor does not perform as expected, then the vendor is removed from the list.

Auditee Comments

In their response, the HUD Single Family Housing staff agreed with each of our suggested improvements to the pilot contracts except for requiring the contractor to develop a written policies and procedures manual for property disposition. Housing said that the suggested improvements have been added to the updated contract format sent to the Home Ownership Centers for future use or are the subject of ongoing discussions and will be added to the contract format as soon as acceptable language can be developed.

Regarding the recommendation requiring contractors to develop a policies and procedures manual, Housing said that while it may be desirable for contractor employees, it should not be a mandatory requirement in the contract. Housing added that its reviews of contractor operations are based on how the contractor is performing under the contract terms not on a manual developed by the contractor.

OIG Evaluation of Auditee Comments

We concur in Housing plans to implement our recommendations. However, in order to enter management decisions into the Departmental Audits Management System, Housing staff need to provide us with a copy of the revised contract format and target dates for developing the language relating to repairs versus maintenance costs and the preferred providers lists and unit price matrices.

In regards to our recommendation on a written procedures manual, we believe a written policies and procedures manual is an integral part of an effective internal

controls system and is the first document examined by anyone reviewing or inspecting a contractor's operations. Also, the strength or weakness of an internal controls system is generally used to determine the scope of a review. Management is responsible for establishing internal controls and the lack of an effective internal controls system generally leads to inconsistency in management operations. Consequently, we are leaving this recommendation open for further discussion.

Recommendations

- 1A. We recommend that Single Family Housing incorporate the below listed provisions into the current and future SFREO contracts
 - Contract language requiring the contractor to comply with any changes in HUD legislation, regulations, or other HUD policy and procedural documents on an ongoing basis.
 - Contract language defining terminology such as timely, reasonable, and adequate as defined in HUD's regulations and handbooks.
 - Contract language defining the difference between a repair and a maintenance item so that the contractor will know which costs are reimbursable under the contract and those costs that should be absorbed as part of the contractor's maintenance fees.
 - Contract language limiting or placing restrictions on the contractor's use of identity-of-interest firms.
 - Contract language requiring the contractor to develop and maintain a written policies and procedures manual for its property disposition operations.
- 1B. We recommend that HUD revise the contract requirements to improve reimbursable repair costs by developing and using preferred vendor lists along with unit pricing matrices.

Finding 2

MANAGEMENT OF CUSTODIAL PROPERTIES NEED IMPROVEMENT

Custodial properties are a continuing problem. Properties remain classified as custodial for years because HUD has not resolved title problems. As a result, HUD incurs increased and unnecessary holding costs to maintain them.

Custodial Properties

Custodial properties are single family unoccupied properties that have defaulted loans assigned to HUD under the former assignment program. These properties are either awaiting a loan sale or titles to the properties have not been obtained through a foreclosure by HUD. Holding costs are incurred daily for single family properties. The costs include property taxes, property maintenance and operating expenses. The costs also include HUD's lost opportunity costs such as interest income on real estate investment because the property is not sold on a timely basis and headquarters and field office staff costs used in managing the properties.

We found that title problems with the custodial properties have remained unresolved for an extended period, resulting in excessive holding costs to HUD. We believe there is inadequate HUD follow up when title transfer is delayed or held up by the courts or when HUD has not initiated timely foreclosure actions.

\$31.8 Million in Holding Costs

To illustrate the significance and magnitude of HUD's holding costs for the custodial properties, we noted that as of April 1997, HUD's single family nationwide property inventory included 1,013 properties classified as custodial for 3 years or more. The holding costs for just the last three years would be in excess of \$31.8 million. We also found during our audit that HUD's Baltimore and New Orleans offices had 34 and 28 properties, respectively, in their inventories for 3 or more years.

We believe HUD's holding costs were unnecessarily increased because there was no aggressive follow up to acquire title to the custodial properties on a timely basis. We further noted properties that could be sold are not marketed and remain dormant for years. Thus, HUD's holding costs grow greater each day resulting in reduced returns realized from the sale of the property, if and when the properties are sold.

Continuing Problem

We previously reported similar concerns regarding custodial properties in our April 2, 1996 review of selected aspects of the Single Family Housing Assignment Program. For a more

detailed discussion of the report, see the "Follow Up On Prior Audits" section of this report.

Auditee Comments

In responding to the draft report, HUD Office of Single Family Housing staff agreed with the report recommendations and implemented corrective action. Specifically, the Denver Home Ownership Center and the Oklahoma Single Family Servicing Division staff have been assigned the task of addressing the custodial property issues. HUD anticipates that this effort will be completed by September 30, 1998.

OIG Evaluation of Auditee Comments

We concur with HUD's corrective actions and have entered management decisions in the Departmental Audits Management System for the following report recommendations.

Recommendations

- 2A. We recommended that HUD research and resolve titles to custodial properties before assigning them to the contractor.

- 2B. We recommended that HUD improve the management of custodial properties by actively pursuing follow up on properties that have been in the inventory for extended periods.

Finding 3

IMPROVEMENT NEEDED TO INCREASE THE INTEGRITY AND ACCURACY OF DATA IN THE SINGLE FAMILY ACQUIRED ASSET MANAGEMENT SYSTEM

The data maintained in the Single Family Acquired Asset Management System (SAMS) is unreliable for making decisions relating to single family property disposition. Specifically, SAMS data includes duplicate properties as well as properties in which HUD no longer holds any ownership interest. In addition, we noted that SAMS does not show custodial properties that should be identified as available for sale. We also found that background clearances were not obtained for contractor staff who access and update SAMS. We believe the lack of data accuracy and absence of background clearances for the contractor's staff could leave HUD vulnerable to fraud, waste, and abuse of Federal assets.

<p>Data Integrity and Reliability</p>
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SAMS is HUD's management system for maintaining all accounting data associated with single family properties and for tracking the movement of single family properties from acquisition to final sales closing. As such, it is the primary source of information HUD management uses to make decisions affecting the single family property disposition program. In addition, contractors prepare their bids based on the estimated current inventory and anticipated turnover in the inventory recorded in SAMS.

As part of our audit, we assessed the integrity and reliability of data in SAMS. We found that SAMS contains duplicate properties as well as properties for which HUD is no longer responsible; e.g., they were sold, lost due to nonpayment of taxes, etc. In addition, foreclosed custodial properties were never listed in SAMS as available for sale.

Our review of SAMS data for HUD's Baltimore and New Orleans offices current inventories assigned to the SFREO contractor for management disclosed that the inventory included 36 duplicate properties. We also noted the inventories included 10 properties that were sold and should have been deleted from SAMS. These 10 properties were turned over to Golden Feather for preservation, protection, and maintenance as required by the pilot contract. HUD paid \$4,100 in custodial fees for maintaining the 10 properties after they were sold. No fees were paid for the duplicate properties.

We also noted that SAMS was not always updated to reflect the current status of properties. For example, HUD foreclosed on one property in October 1996 and another four properties in November 1996. The change in the properties' status was not entered into SAMS and the SFREO contractor was not made aware of them until April 1997. Consequently, the properties remained in limbo; were not preserved, protected, or maintained; and were not made available for sale.

HUD is taking corrective action on the problems noted in SAMS for the Baltimore and New Orleans inventory. However, we believe similar problems with SAMS exist with the single family property inventory in other HUD offices. HUD needs to initiate a nationwide effort to review the SAMS database to correct the problems we noted in our audit.

Background Clearances

We noted background security clearances were not obtained for the SFREO contractor staff who access and update SAMS. The pilot contract specifies that all contractor staff requiring access to SAMS submit a completed Standard Form 85P (SF85P), Questionnaire for Public Trust Positions, as a condition for obtaining access to SAMS. The SF85P provides information used in conducting background checks to the extent required by the Federal Automated Data Processing Regulations. We noted that Golden Feather staff access SAMS daily. However, we found no completed SF85Ps for Golden Feather's staff. In addition, we found no evidence that HUD requested the SF85Ps from Golden Feather.

Auditee Comments

In responding to the draft report, HUD Office of Single Family Housing staff agreed with our report recommendations and implemented corrective action. Specifically, Housing agreed that data integrity issues existed with SAMS and the response to the draft report included a corrective action plan designed to address those issues.

OIG Evaluation of Auditee Comments

We evaluated the plan and believe it will address the issues raised in our draft report. Therefore, we have updated the Departmental Audits Management System to reflect management decisions on the draft recommendations. The target date is September 30, 1998.

Recommendations

- 3A. We recommend that HUD evaluate the SAMS database, purge the system of duplicate or nonexistent properties and properties for which HUD is no longer responsible. In addition, HUD-owned properties not listed should be added.

- 3B. We recommend that HUD ensure compliance with the pilot contract requirements that all contractor staff requiring access to SAMS submit a completed SF85P, Questionnaire for Public Trust Positions.

Management Controls

In planning and performing our audit, we considered HUD's and the contractor's management controls to determine our audit procedures and not to provide assurance on those controls. Management is responsible for establishing effective management controls.

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Controls Assessed

We determined that the controls most relevant to our audit objectives pertained to the following:

- Practices and procedures used to manage single family property disposition.
- Assuring the integrity and reliability of computer processed data.
- Managing and maintaining custodial properties.

We assessed the controls in place. We obtained an understanding of HUD's and the contractor's practices and procedures, assessed the control risk, and performed various tests of the controls.

Results

A significant weakness exists if controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse of Federal assets; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our audit, we believe that significant weaknesses exist in assuring the reliability and integrity of computer data and managing custodial properties. The specific weaknesses are discussed in the findings.

Follow-up on Prior Audits

This is the first OIG audit of the Single Family Real Estate Owned Pilot Contracts. However, we previously reported on problems with custodial properties in our report entitled "Review of Selected Aspects of the Single Family Housing Assignment Program" dated April 2, 1996. In the report, we noted delays of up to six months before the Real Estate Owned Branch was notified that custodial properties were available for disposition. We also noted that some properties listed in the custodial inventory had already been sold at a note sale. For those properties, HUD paid excess holding costs and/or maintenance fees.

Appendices

Appendix 1

Auditee Comments

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U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

DEC 30 1997

MEMORANDUM FOR: Austin B. Groom, District Inspector General
for Audit, 3GGA

FROM:  Emelda Johnson, Deputy Assistant Secretary
for Single Family Housing, HS

SUBJECT: Draft Audit Report - Single Family Real Estate Owned
Pilot Contracts

This is in response to the subject report that was issued by your office on October 31, 1997, regarding the current management and marketing contracts with Golden Feather Realty Services, Inc. in the Maryland State, Louisiana State and Sacramento Area Offices.

The report has been reviewed and we offer the following comments with respect to each of the findings identified:

FINDING 1: Contract Requirements Need Improvement to Strengthen Consistency and Effectiveness

We agree that the current contract does not require the contractor to comply with any changes in HUD legislation, regulations or other HUD policy and procedural documents on an ongoing basis. Additionally, the terminology used in the contract is vague and was identified as having different meanings to the contractor and HUD staff. Both issues were previously identified by Headquarters' staff and the three Government Technical Representatives (GTRs). Discussions have been held with the appropriate contract support staff to ensure that the contracts are modified to incorporate these shortcomings. These issues have been applied to the updated contract format sent to the Home Ownership Centers (HOCs) for future use.

With regard to the differences between repair and maintenance items, Headquarters, the GTRs and the contractor have had numerous discussions on this issue and it is one that cannot easily be resolved. Because this was a pilot contract, we attempted to allow the contractor some flexibility in the type of

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repairs that were done to the properties to make them more attractive to purchase. The repairs did not always reflect those to meet the intent of the Minimum Property Standards (MPS) as discussed in the REAM contract. The GTRs and the contractor have reached agreement, in most cases, on the repair items which will be reimbursed to them and continue to discuss issues as they arise. The GTRs and contract support staff are working to develop definitions for repair and maintenance. As soon as acceptable definitions are established, these contracts and any future contracts of this type will contain the appropriate definitions.

Your recommendation to require the contractor to develop and maintain a written policies and procedures manual for property disposition was noted. Although we agree this might be desirable for the contractor's employees, we do not believe that such a requirement should be mandatory in the contract. HUD's review of the contractor's operation is based on the contract and how the contractor is performing the requirements, not on a manual that is developed by them. If the contractor wants to develop such a manual for their employees to use, that is a business decision that the contractor must make.

The report indicates that the pilot contracts should limit the use of identity-of-interest companies. While the report indicates that the contractor did not use any identity-of-interest companies, this issue had previously been raised with contract support staff. They were in agreement that this limitation should be added to the pilot contracts and steps will be taken to do so. This limitation has been applied to the updated contract format sent to the HOCs for future use.

Housing will discuss the concept of Preferred Provider lists and unit price matrices with contract support staff to ensure that a procedure is implemented which is proper under the procurement regulations governing this contract. Although we agree that better pricing is needed for the items HUD reimburses, we are not sure that we can meet this objective in this manner. The results of this discussion will also be applied to the updated contract format sent to the HOCs for future use.

FINDING 2: MANAGEMENT OF CUSTODIAL PROPERTIES NEED IMPROVEMENT

We agree with recommendations 2a and 2b that title problems and other issues related to custodial properties should be researched and resolved more aggressively, both prior to and after assignment. With the conclusion of the notes sales programs, FHA is in a better position to assign loan management

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staff to this function. The management of the Denver Home Ownership Center (HOC) has been tasked with addressing these servicing issues for the residual component of the inventory. The Oklahoma Single Family Servicing Division and Denver HOC Directors are currently allocating staff resources to address this concern. We anticipate that these activities will be completed by September 30, 1998.

FINDING 3: IMPROVEMENT NEEDED TO INCREASE THE INTEGRITY AND ACCURACY OF DATA IN THE SINGLE FAMILY ACQUIRED ASSET MANAGEMENT SYSTEM

We have completed our review of the 36 duplicate properties and the 10 properties noted by the IG in the audit. Thirty-five of the 36 cases and all of the 10 sold properties have already been removed from SAMS. We have asked the Office of the FHA Comptroller to review the other case to see if it should also be terminated.

Despite the correction of almost all of these individual cases, Housing agrees that there are data integrity issues with SAMS as there are with most of the Department's computer systems. The major sources of erroneous or duplicate cases in SAMS are the following:

- It is possible for the Field staff to enter data into SAMS incorrectly since the edit fields on various input screens were deactivated so that SAMS could process cases. Also, there have been instances where an erroneous case entry into SAMS has not been corrected despite the system edit feature which checks a case number against the insurance in force.
- Cases received from the former HUD assignment program (custodial cases). There have been instances where loan management may not have correctly identified the case numbers and the Field staff merely entered that case number into SAMS.

Housing Plan of Correction Action

Over the last several months, Housing has instituted an aggressive strategy to address these problems in a cost effective manner and consistent with the Department's 2020 plan. The following actions have been completed or will be completed in the next 6 months:

I. Eliminating Duplicate Cases From The Current SAMS Inventory

For internal control purposes, HUD Field staff do not have the authority to remove duplicate cases from SAMS once any

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accounting transactions have been made. Therefore, duplicate cases have been carried on the inventory while Field staff pursue the disposition of the properties under the "correct" case number.

This problem can be substantially reduced by researching and deleting incorrect numbers before any accounting transactions have posted. Housing will provide some additional instructions to the Field staff to minimize the number of duplicate cases.

Furthermore, the Office of Single Family Housing will ask the Field staff to submit a listing of duplicate or erroneous cases that may still remain in SAMS. The Office of the FHA Comptroller regularly terminates duplicate cases in SAMS. However, the Office of the FHA Comptroller staff have indicated that software changes to SAMS that would facilitate this effort will not be completed until 9/30/98.

II. Cross-checking Of Custodial Properties In SAMS vs. Homes Sold In HUD Asset Sale No. 5

Housing has undertaken a special project to verify that all homes sold as part of Asset Sale No. 5 are eliminated from SAMS to avoid the payment of maintenance costs for these properties. The closing data for the sale occurred in mid-November. By December 1997, a computer matching program will be written to determine which cases should be deleted from SAMS.

An individual list of these cases will then be sent to each Field office. The Field office will have to assign a generic NAID to the case so that the Office of the FHA Comptroller can eliminate the case from the active database.

III. Instituting Controls To Mitigate Data Quality Problems In The Future

During the last six months, we have undertaken several initiatives which should help curb this problem in the future. We have determined the critical SAMS data screens needing correction and these screens and reports are being modified in SAMS Releases 3.7-4.0. The estimated completion date for these projects is 6/30/98.

Furthermore, we are investigating the possibility of moving to an electronic transmission of information from the insurance claim system (A-43C) to SAMS rather than having the Field office manually enter the information from the HUD Claim Form 27011. IT has been asked to provide additional information; the analysis of the system changes to A-43C and SAMS needed to move to a more automated process should be completed by 3/31/98.

Appendix 1

Auditee Comments

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IV. Final Sweep of Possible Erroneous Cases In SAMS

After completion of the process noted in Section II above, we are considering generating a computer matching of possible custodial cases that may still be in the inventory. This computer program will compare the number of cases in SAMS against other estimates of total inventory. Housing personnel will instruct system programmers on the business rules to apply for the correction of any erroneous cases that might be discovered through this method.

V. QUESTIONNAIRE FOR PUBLIC TRUST POSITION, 85P SHOULD BE COMPLETED BY ALL CONTRACTOR STAFF

Housing agrees that the contractor staff should have completed the 85P forms. The contractor has been provided with forms and instructions that the forms must be completed and submitted within 60 days for any employee with access to SAMS. Also, a memorandum will be sent to the Field staff to remind them that all contractors must complete the 85P forms.

If you have any questions about this response, please contact Kitty Woodley, Director of the Single Family Property Disposition Division at 708-0740.

Appendix 2

Distribution

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