



**U.S. Department of Housing and Urban
Development, Washington, DC**

FHA Single Family Claims Branch



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

Issue Date: May 8, 2013

Audit Report Number: 2013-KC-0001

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

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: FHA Had Adequately Reduced Mortgage Insurance Claims for Funds Held by Lenders

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's Federal Housing Administration (FHA) Single Family Claims Branch.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8L, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



May 8, 2013

FHA Had Adequately Reduced Mortgage Insurance Claims for Funds Held by Lenders

Highlights

Audit Report 2013-KC-0001

What We Audited and Why

We selected the U.S. Department of Housing and Urban Development (HUD), Federal Housing Administration (FHA), Single Family Claims Branch, for audit based on an internal audit suggestion expressing concern that HUD may not have policies, procedures, or systems to identify and address funds held by lenders and submitted as part of a claim. Our audit objective was to determine whether FHA had adequately reduced mortgage insurance claims for funds held by lenders.

What We Recommend

This report contains no formal recommendations, and no further action is necessary.

What We Found

FHA had adequately reduced mortgage insurance claims for funds held by lenders. FHA's controls were adequate to ensure that escrow deduction amounts listed on the claim forms were correct. We found no discrepancies in the claims reviewed.

TABLE OF CONTENTS

Background and Objective	3
Results of Audit	
FHA Had Adequately Reduced Mortgage Insurance Claims for Funds Held by Lenders	4
Scope and Methodology	6
Internal Controls	7
Appendixes	
A. Auditee Comments	8
B. Criteria	9

BACKGROUND AND OBJECTIVE

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by approved lenders throughout the United States and its territories. FHA insures mortgages on single-family and multifamily homes, including manufactured homes and hospitals. It is the largest insurer of mortgages in the world, insuring more than 34 million mortgages. Congress created FHA in 1934, and it became part of the U.S. Department of Housing and Urban Development's (HUD) Office of Housing in 1965.

According to the FHA Annual Management Report, Fiscal Year 2011, FHA is focused on the following three priorities:

- Stabilizing the housing market and assisting homeowners at risk of foreclosure,
- Protecting FHA's fiscal health and strengthening risk management, and
- Ensuring responsible access to credit and liquidity to bring private capital back to the market and build a 21st century housing finance system.

The Monthly Report to the FHA Commissioner on FHA Business Activity, dated September 2012, reported HUD had 6,629,376 and 7,288,440 single-family FHA-insured mortgages at the beginning of fiscal years 2011 and 2012, respectively. By the end of fiscal year 2012, HUD had 7,711,684 single-family FHA-insured mortgages. There were 118,186 and 142,822 insurance claims recorded during fiscal years 2011 and 2012, respectively, resulting in a 1.76 percent annualized claim rate for fiscal year 2011 and 1.96 percent for fiscal year 2012.

HUD Handbook 4330.4, REV-1, CHG-1, chapter 1, states that the application for a mortgage insurance claim is form HUD-27011. The form is broken into five parts:

- Part A - Initial Application,
- Part B - Fiscal Data, and
- Parts C through E - Support Documentation.

Part B contains fiscal data consisting of allowable expenses and accrued interest. It provides summary information relating to receipts and disbursements by the lender, which affect the amount of the insurance claim. Line 109 of part B is the escrow amount held by the lender at the time of foreclosure. Line 109 reduces the amount of the claim paid by HUD.

Our audit objective was to determine whether FHA had adequately reduced mortgage insurance claims for funds held by lenders.

RESULTS OF AUDIT

Finding: FHA Had Adequately Reduced Mortgage Insurance Claims for Funds Held by Lenders

FHA had adequately reduced mortgage insurance claims for funds held by lenders. FHA's controls were adequate to ensure that escrow deduction amounts listed on the claim forms were correct. We found no discrepancies in the claims reviewed.

FHA Had Reduced Mortgage Insurance Claims

FHA had adequately reduced mortgage insurance claims for funds held by servicers. If an FHA loan defaults, FHA is required to reduce its insurance claim by the amount of funds the servicer is holding in an escrow account on behalf of the borrower for expenses such as mortgage insurance premiums, taxes, hazard insurance premiums, and interest buy-down funds. FHA reduces the claims by requiring the servicer to include this amount on the escrow deduction line (line 109) of the Single-Family Application for Insurance Benefits, form HUD-27011, which reduces the amount of the claim. We reviewed servicer-provided escrow ledgers to ensure that the balance in the ledger matched the amount reported on line 109 of form HUD-27011 and found no discrepancies.

Controls Were Adequate

HUD's controls were adequate for reviewing escrow deduction amounts listed on line 109 of form HUD-27011. According to the single-family claims process narrative in Office of Management and Budget (OMB) Circular A-123, data for all "forward mortgage" claims types are verified through automated data interchanges between the Single Family Insurance System (SFIS) and the Single Family Insurance Claims Subsystem (A43C). The A43C system performs edit checks on the claims data submitted by comparing the data to the information contained in SFIS. System edits are conducted within A43C to identify violations of monetary limits and various time constraints and to validate data such as FHA case number, endorsement date, unpaid principal balance, and holder or servicer number. The claims that fail to pass the system edits are automatically placed into suspension by A43C.

There are two types of edits that can occur, soft edit and hard edit. A hard edit (code K-3) will cause the system to stop processing the claim, placing it into

suspense if the escrow balance on line 109 of form HUD-27011 is greater than \$3,000. A soft edit identifies information that may be invalid or incomplete but is not crucial to processing the claim payment. Claims with soft edits and no hard edits are processed and paid without suspension.

Our review consisted of a non-statistical sample of 30 loans submitted for claim from November 2009 to October 2012. Of those 30 loans, 7 received the K-3 hard edit code. One of the seven loans fell outside the 3-year record retention requirement so documents to support the claim were not available. For the remaining six files, we reviewed the documents that HUD received to clear the edit code and found that they supported the escrow balance listed on line 109 of form HUD-27011.

We reviewed the other 23 files that did not receive the K-3 hard edit code because the escrow deduction amount was less than \$3,000. We reviewed servicer-provided escrow ledgers to ensure that the balance in the ledger matched the amount reported on line 109 of form HUD-27011. We found no discrepancies in the information reported to HUD.

Recommendations

This report contains no recommendations, and no further action is necessary.

SCOPE AND METHODOLOGY

Our audit generally covered the period January 2009 through September 2012. We performed our audit work between October 2012 and March 2013 and conducted audit fieldwork at HUD headquarters at 451 7th Street Southwest, Washington, DC.

To accomplish our objective, we

- Interviewed HUD staff;
- Reviewed applicable Federal regulations, HUD handbooks, and mortgagee letters;
- Selected and reviewed a nonstatistical sample of loan files submitted for insurance claim;
- Reviewed the Single-Family Application for Insurance Benefits, form HUD-27011, part B;
- Reviewed lenders' data to support the escrow deduction amount listed on the claim for insurance benefits; and
- Reviewed post claim reviews performed by HUD for claims that received the hard edit code K-3.

Our sample universe consisted of 303,047 loans submitted to HUD for mortgage insurance claims during our audit period. We used data analysis software to select a nonstatistical sample of 30 total loan files.

We selected two different samples for our review. Our first sample of 20 loan files represented four different subsets of data, including (1) the five largest unpaid principal amounts with an escrow amount, (2) the five largest unpaid principal amounts without an escrow amount, (3) the five largest unpaid principal amounts with a buy-down indicator, and (4) the five largest escrow amounts. Our second sample of 10 randomly selected loan files was not based on any attribute of the loan.

We relied, in part, on data maintained in the Single Family Data Warehouse. The Single Family Data Warehouse is an extensive collection of database tables to support the analysis, verification, and publication of Single Family Housing data. Specifically, we relied on the amounts listed as the escrow deduction and unpaid principal balance on the form HUD-27011. Although we did not perform a detailed assessment of the reliability of the data, we determined that the computer-processed data were sufficiently reliable to be used in meeting our objective because the data in the sampled items were corroborated by documentary evidence supplied by the sampled lenders.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls to ensure that HUD had reduced single-family mortgage insurance claims for funds held by lenders.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of FHA's internal control.

Appendix A

AUDITEE COMMENTS

Auditee Comments

The auditee elected not to provide written comments.

Appendix B

CRITERIA

HUD Handbook 4330.4, Chapter 1

1-1 Claim Types

All claims for single family mortgage insurance benefits must be submitted on Form HUD-27011, Single Family Application For Insurance Benefits.

OMB Circular A-123

Single Family Insurance Claims Subsystem (A43C) and SFIS Related Controls

Data for all “forward mortgage” claim types are verified through automated data interchanges between SFIS and A43C. Interface controls prevent errors from occurring when data are transferred between SFIS and A43C. The A43C system performs edit checks on the claims data submitted by comparing it to the information contained in the SFIS. Parameter verification is conducted within A43C to identify violations of monetary limits and the various time constraints, and to validate data such as FHA case number, endorsement date, unpaid principal balance, and holder/servicer number.

Electronic Data Interchange (EDI) Claim Submission

If a claim fails to pass any of the A43C “hard” or “fatal” edits, it will suspend until the lender either submits a corrected claim or the appropriate documentation validating the circumstances causing the suspension.