

**SYSTEMIC IMPLICATIONS
REPORT**

**U. S. Department of Housing
and Urban Development
Office of Inspector General
Office of Investigation**

AGENT: (b) (7)(C)	
DISTRICT/OFFICE: Special Investigations Division (GfO)	DATE: January 17, 2013
A. Description of Systemic Deficiency:	
On November 3, 2011, case number (b) (7)(C) was initiated by the United States Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), Special Investigations Division (SID). The case was initiated after HUD, OIG, SID (b) (5), (b) (7)(C)	
(b) (7)(C)(b) (7)(C)(b) (7)(C)	
HUD when, at the time of (b) (7)(C) a Federal indictment had been filed against (b) (7)(C) wherein it was alleged (b) (7)(C) had been involved in a mortgage fraud scheme.	
HUD, (b) (7)(C)(b) (7)(C)(b) (7)(C)(b) (7)(C)(b) (7)(C)	
(b) (7)(C), (b) (5)	
(b) (7)(C), (b) (5)	
(b) (7)(C)(b) (7)(C)(b) (7)(C)(b) (7)(C)(b) (7)(C)(b) (7)(C) specifically, the review found that the (b) (7)(C) lacks basic internal policies, management and oversight, to ensure a sound and effective personnel security program. The following systemic weaknesses were identified as major barriers to a sound and effective personnel security program:	
1. (b) (7)(C) does not have written policies, procedures and/or regulations to direct personnel security specialists in the administration of the personnel security program.	
2. (b) (7)(C) does not have an effective case management system for the timely review and evaluation of the character, background, and history, of candidates for employment before they are selected and enter on duty with HUD. The lack of an effective system has resulted in HUD's inability to timely identify candidates for	

employment who have a criminal record, or a pending criminal charge, in order to properly evaluate a candidates suitability for employment before they enter on duty with HUD.

3. (b) (7)(C) lacks an effective case management system to ensure the timely review and adjudication of personnel security background investigations, and re-investigations. The lack of an effective system has resulted in HUD's inability to take timely and appropriate personnel action relative to employees who pose a personnel security risk based on suitability issues identified and reported to HUD in background investigations, and re-investigations.

B. Suggestions to Correct Deficiency:

The following recommendations are made to address the major barriers identified:

1. (b) (7)(C) should immediately develop and implement personnel security program policies, procedures and regulations for the administration of HUD's personnel security program in accordance with Title 5, Code of Federal Regulations, part 731, and U.S. Office of Personnel Management, Federal Investigative Standards.
2. (b) (7)(C) should immediately develop and implement an effective and timely case management process for reviewing and evaluating the character, background, and history, of candidates for employment before they are selected and enter on duty with HUD in accordance with Title 5, Code of Federal Regulations, Part 731, and Office of Personnel Management, Federal Investigative Standards requirements.
3. (b) (7)(C) should immediately develop and implement an effective case management system to ensure the timely review and adjudication of personnel security background investigations, and re-investigations, in accordance with Title 5, Code of Federal Regulations, Part 731, and U.S. Office of Personnel Management, Federal Investigative Standards requirements.

C. Investigative Techniques:

The suggestions presented within this Systemic Implications Report are a result of a review of the facts and circumstances related (b) (7)(C)(b) (7)(C)(b) (7)(C) HUD, and are supported by information and documentation obtained (b) (7)(C)(b) (7)(C)(b) (7)(C) (b) (7)(C)

Distribution: 1 Case File 2 AIGI 3 OMAP 4 Other:__ __

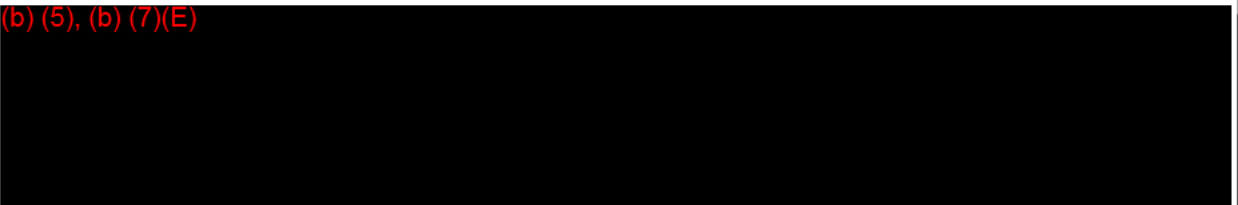
SYSTEMIC IMPLICATIONS REPORT

U. S. Department of Housing
and Urban Development
Office of Inspector General
Office of Investigation

DISTRICT / OFFICE: Region 2 / 2AGI		DATE : March 15, 2013
A. Description of Systemic Deficiency: <p>A recent investigation into Single Family Origination (SFO) Fraud conducted by this office has revealed a potential weakness in the underwriting of FHA-insured loans under the Section 203 programs. A Cooperating Defendant (CD) revealed that he preferred to report self-employment for the straw buyers he utilized because fictitious Income Tax Returns can easily be filed and then amended after the lender obtains an Income Tax Transcript. This allowed the CD to utilize straw buyers who otherwise would not have qualified for mortgages because they were unemployed, or their employment earnings were insufficient for mortgage qualification.</p> <p>FHA underwriting guidelines require that self-employed borrowers provide Income Tax Returns for the prior 2 years as one form of income verification. The borrower is also required to sign an Internal Revenue Service (IRS) form 4506-T, Request for Tax Transcript. However, the Tax Transcripts are frequently not received by the lender until after the mortgage closing, and an IRS form 1040X can easily be filed to change the reported income.</p> <p>In multiple instances, the CD prepared IRS forms 1040 for the prior year reporting that the straw buyers were self-employed and earned income of over \$100,000 per year. The CD would file the returns with the IRS within one month of closing (in one instance the 1040 was filed on the day of closing). The CD could file the return but not pay any tax to the IRS, leaving a report of income earned and an amount of tax owed. The CD would wait 2 to 3 months for the lender to obtain Income Tax Transcripts, and then the CD would file an amended Income Tax Return (1040X) for the straw buyer, reducing the amount of income from over \$100,000 to less than \$15,000. The amended filing also eliminated any tax owed to the IRS.</p>		
B. Suggestions to Correct Deficiency: <p>FHA underwriting guidelines state that a borrower is not eligible for participation in the program if they have "Delinquent Federal Debt." Delinquent Federal Debt includes delinquent Federal taxes, but tax delinquency is generally restricted to a tax lien. FHA underwriting guidelines also state, "Tax liens may remain unpaid, provided the lien holder subordinates the tax lien to the FHA mortgage." A review should be conducted to determine if continued tax delinquency should be identified as a credit risk and affect eligibility.</p> <p>The FHA should consider steps to tighten the underwriting of loans to self-employed borrowers. Additional steps may include requiring the lender to obtain Income Tax Return</p>		

Transcripts and reconciliation of those transcripts with borrower-supplied information prior to the loan closing. Tax Return Transcripts clearly show the tax liability of a taxpayer as well as the outstanding balance of any taxes owed, and any unpaid tax balances should be adequately explained, justified and documented.

(b) (5), (b) (7)(E)



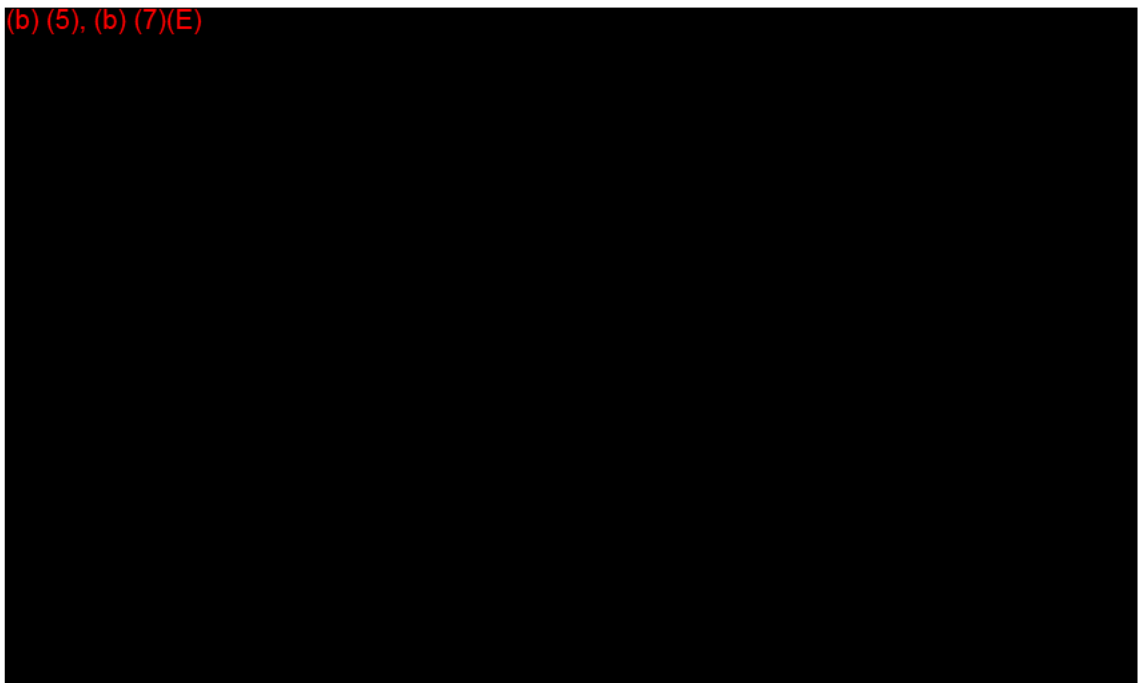
receives a tax transcript. If the borrower has a tax delinquency, the borrower should be required to show support of payment to the IRS.

Finally, the FHA should initiate Quality Assurance reviews of loans to self employed borrowers. In the case referenced above, the CD was able to manipulate the most recent year's tax filings for the straw buyers, but was unable and/or reluctant to manipulate prior year's filings because the straw buyers had already filed returns for those years. When the lender obtained the previous two years' Income Tax Transcripts, the most recent year matched the Uniform Residential Loan Application (URLA) and IRS form 1040 figures, but the prior year didn't match. The discrepancies in the prior years were overlooked by the Direct Endorsement (DE) Underwriter(s) and the loans were subsequently insured by FHA.

C. Investigative Techniques:

The following investigative techniques may be used in the investigation and detection of SFO fraud:

(b) (5), (b) (7)(E)



borrower and compare with known information (borrower's previous

(b) (5), (b) (7)(E)

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