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Audit Report Number	2012-LA-0002
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TO: Deborah Holston, Acting Deputy Assistant Secretary for Single Family Housing.
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Tanya E. Schulze

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: HUD's Statement of Work for Appraisal Field Review Services Did Not Always
Require Sufficient Confirmation of an Interior Review

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) field review appraisal process. This audit was conducted as part of the HUD Office of Inspector General's (OIG) fiscal year 2011 annual audit plan and was designed to follow up on selected findings in OIG's Audit Report 2008-LA-0003¹ on the appraiser review process. Our objective was to determine whether HUD (1) ensured that field review appraisers complied with the appraisal review process requirements and (2) paid contractors according to the scope of work performed.

¹ "Implementation Weaknesses Existed in All Major Phases of the FHA Appraiser Review Process," issued September 4, 2008

What We Found

HUD had ensured that the field review appraisers complied with the interior review inspection requirements and the contract field reviews appraisers were paid according to the scope of work performed. However, HUD's statement of work for appraisal field review services did not always require sufficient confirmation of an interior review.

What We Recommend

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing amend the statement of work for appraisal field review services to require that an interior photograph be taken in all instances in which an interior review is performed.

For each recommendation in the body of the report without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV 4. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided HUD a draft report on October 31, 2011, and held an exit conference on November 15, 2011. HUD provided written comments on November 30, 2011, and generally agreed with our report and recommendation. The complete text of the auditee's response can be found in appendix A of this report.

TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding: HUD’s Statement of Work for Appraisal Field Review Services Did Not Always Require Sufficient Confirmation of an Interior Review	6
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Auditee Comments	12

BACKGROUND AND OBJECTIVE

The Federal Housing Administration (FHA) was created by Congress in 1934 and is the largest insurer of mortgages in the world, having insured more than 34 million properties since its inception.

FHA provides mortgage insurance on loans made by FHA-approved lenders throughout the United States and its territories. FHA insurance reduces a lender's risk because FHA will pay a claim to the lender in the event of a homeowner's default. Loans must meet certain requirements established by FHA to qualify for insurance. One requirement is that lenders use appraisers on the FHA appraiser roster to perform the required appraisals on properties that will serve as security for FHA-insured single-family mortgages.

The appraisal and property condition assessment are used to determine the market value and acceptability of the property for FHA mortgage insurance purposes. The value serves as a basis for determining the maximum FHA insurable mortgage loan. The appraisal is performed for the use and benefit of the U.S. Department of Housing and Urban Development (HUD) and the lender involved in the FHA transaction. In addition to providing an estimate of value, the appraisal provides an examination of the property for any visible and obvious or apparent deficiencies that may affect the livability of that property in terms of basic needs and the health and safety of the property's occupants.

HUD's field review process begins with the desk reviewer. If the desk reviewer concludes that the appraisal report is inconsistent or unacceptable, an action or field review is recommended. The field review process consists of an interior and exterior review whenever possible. The goal is to ensure that the value on which an FHA loan is based does not place the insurance fund at risk.

In Office of Inspector General (OIG) Audit Report 2008-LA-0003, issued September 4, 2008, OIG reported that HUD did not have adequate controls over the appraiser review procedures conducted by the homeownership centers and HUD's oversight of the appraiser review process. The report identified problems with HUD's not enforcing the field review requirement for interior inspections and noted HUD staff concerns that contracted appraisers had claimed or billed for interior inspections that may not have been performed. In response to the audit report, HUD revised the appraiser review process. The Assistant Secretary for Housing – Federal Housing Commissioner implemented several new controls including (1) a written quality control plan for the appraiser review process that includes procedures to address the implementation weaknesses identified in the report, (2) a systematic process to evaluate the efficiency and effectiveness of the appraiser review process on a regular and recurring basis, (3) updating and consolidating the policies and procedures for the appraiser review process, (4) evaluating the appraiser review process data and reports on a regular and recurring basis, and (5) providing feedback to the homeownership centers regarding their implementation of the appraiser review process to promote consistency and best practices. Final action was completed in July 2010.

Objective

Our objective was to determine whether HUD (1) ensured that field review appraisers complied with the appraisal review process requirements and (2) paid contractors according to the scope of work performed.

RESULTS OF AUDIT

Finding: HUD's Statement of Work for Appraisal Field Review Services Did Not Always Require Sufficient Confirmation of an Interior Review

HUD had made substantial improvements to the FHA appraiser review process regarding field reviews in response to the recommendations of OIG Audit Report 2008-LA-0003. However, HUD's revised statement of work for appraisal field review services did not require an interior photograph if there was no finding. If HUD required an interior photograph in all instances, it would be able to more effectively monitor the field review process and ensure that the contractor was paid according to the scope of work performed.

HUD Implemented New Controls Over the Appraisal Review Process

HUD took steps to strengthen controls over the appraisal review process. For example, it developed and implemented the following:

- An FHA appraiser review process internal quality control plan,
- A revised statement of work for appraisal field review services,
- A desktop guide to the FHA appraiser review process,
- New reporting forms for the homeownership centers and headquarters, and
- Revised system functionality relative to the appraiser review process to permit more effective reporting and feedback to the homeownership centers.

The Revised Statement of Work for Appraisal Field Review Services Could Be Strengthened

The statement of work for appraisal field review services was revised as part of the improvements made to the appraisal review process. The revision no

longer required an interior photograph if there was no finding. HUD was implementing the statement of work as contracts were renewed.

A field review is recommended if an appraisal is inconsistent or unacceptable. According to the statement of work, all data reported by the original appraiser for the subject and comparables must be verified. The contractor must conduct an interior and exterior review whenever possible. Each interior and exterior review will determine the accuracy and quality of the appraisal by ensuring that the factual information included in the appraisal report is correctly reported and supported. This inspection must be completed in a way that allows the reporting of any readily observable defective conditions that do not meet HUD minimum property standards or minimum property requirements. When access to the property is denied, the contractor must fully document attempts made to obtain access to the property and complete an exterior review. For exterior reviews only, the contractor will receive 60 percent of the contract unit price.

For the audit, we tested 14 completed field reviews, 7 of which included an interior review. We found an instance in which there was no interior photograph submitted to confirm the interior review, although the contract with the appraiser required an interior photo. The homeownership center excused this omission by referencing the revised statement of work, which no longer required an interior photograph when there was no finding that needed to be substantiated.

Neither the homeownership center nor HUD headquarters management could explain why the statement of work was revised to not require an interior photograph if there was no finding. Without the confirmation of an interior review, there is an increased risk that noticeable interior property defects may not be detected or that appraisers may not be paid for the work performed. HUD should, therefore, revise the statement of work to require an interior photograph even if there is no finding. This measure would strengthen HUD's monitoring process because there would be documentation supporting the interior review. In addition, HUD would be able to ensure that there were no obvious and apparent deficiencies, and the appraiser would be paid for the scope of work performed.

Conclusion

HUD had taken significant steps to strengthen the appraisal review process by implementing new controls. However, the statement of work for appraisal field review services should be strengthened to increase monitoring efforts and ensure compliance with HUD policies and procedures.

In response to our inquires, HUD management agreed that it would again require the interior photograph and planned to revise the statement of work for appraisal field review services to require an interior photograph in all instances.

Recommendation

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing

- 1A. Amend the statement of work for appraisal field review services to require that an interior photograph be taken in all instances in which an interior review is performed.

SCOPE AND METHODOLOGY

We conducted the audit from July through October 2011 remotely from our offices using electronic records located in FHA Connection and requested documentation. Our audit covered the period July 1, 2009, through March 31, 2011.

To accomplish our audit objectives, we

- Interviewed both Atlanta and Denver Homeownership Center management and staff regarding the field review process and quality control;
- Reviewed instructions and policies developed by HUD;
- Reviewed applicable laws, regulations, guidance, and notices;
- Reviewed and evaluated the following documentation in FHA Connection²: 1) Field Review Submission Results, 2) Appraisal Review Report Results, 3) Appraiser Review Status Results and 4) exterior and interior pictures to determine whether the system was reliable and that it provided the homeownership centers with a complete, accurate, and transparent method of monitoring and documenting the field reviews;
- We tested the FHA electronic documentation against Field Review files maintained by the HOCs to determine the reliability of the information in FHA Connection; and
- Reviewed and evaluated the appraiser contracts and invoices to determine whether HUD paid contractors according to the scope of work performed.

A stratified systemic sample of 45 completed field reviews was pulled from a universe of 2,964 field reviews completed between July 2009 and March 31, 2011. The survey sample reviewed consisted of 14 of the 45 completed field reviews, 7 of which consisted of both interior and exterior review and the remaining 7 exterior only. One of the 14 field reviews was conducted by HUD staff.

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(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

² FHA Connection is an internet based system that allows FHA-approved lenders and business partners to have real-time access to several of FHA's systems over HUD's internet system for the purpose of originating and servicing loans. In addition, FHA Connection interactive application gives HUD's business partners interaction with HUD's mainframe system to do research and update files.

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 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:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that the program meets its objectives.
- Compliance with applicable laws and regulations - Compliance with applicable internal and regulatory requirements.

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.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- Controls over program operations were not sufficient to effectively monitor the field review process.

Appendix A

AUDITEE COMMENTS

Auditee Comments



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NOV 30 2011

MEMORANDUM FOR: Tanya E. Schulze, Regional Inspector General for Audit, Region IX,
9DGA
FROM: *Deborah C. Holston*
Deborah C. Holston, Acting Deputy Assistant Secretary for Single
Family Housing, HU
SUBJECT: Discussion Draft (Internal) – HUD’s Statement of Work for Appraiser
Field Review Services Did Not Always Require Sufficient Confirmation
of an Interior Review
OIG Audit Report No.: 12-LA-000x

The Office of Inspector General (OIG) performed an audit of the U.S. Department of Housing and Urban Development’s Statement of Work for Appraiser Field Review Services. HUD’s Office of Single Family Housing (Single Family) appreciates the opportunity to respond to the Discussion Draft report and comment as follows:

OIG’s Determination:

The report states HUD had ensured that the field review appraisers complied with the interior review inspection requirements and that the contract field review appraisers were paid according to the scope of work performed. However, the report further states that OIG determined HUD’s Statement of Work (SOW) for appraisal field review services did not always require sufficient confirmation of an interior review. To correct the deficiency, OIG recommended that the Acting Deputy Assistant Secretary for Single Family Housing amend the SOW for appraisal field review services to require that an interior photograph be taken in all instances in which an interior review is performed.

Single Family’s Response:

Single Family agrees with OIG’s determination and will implement the recommendation accordingly.

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