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UNITED STATES GENERAL ACCOUNTING OFFICE
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STATEMENT OF
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DIRECTOR, FINANCIAL AND GENERAL
MANAGEMENT STUDIES DIVISION
BEFORE THE
SUBCOMMITTEE ON HUD AND INDEPENDENT AGENCIES
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE
ON
HUD'S ACCOUNTING SYSTEM FOR
SECRETARY-HELD MULTIFAMILY MORTGAGES

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Mr. Chairman and Members of the Subcommittee:

We are here today at your request to discuss our review of the Department of Housing and Urban Development's (HUD's) accounting system for Secretary-held multifamily mortgages. With me today are Mr. John Cronin, Senior Group Director of our Financial and General Management Studies Division, Mr. James Curry of his staff, Mr. Sam Piscitell of our New York Regional Office, and Mr. Keith Fultz of our Community and Economic Development Division.

Over the years, we have reported and testified on many deficiencies in HUD's accounting systems. We first reported on accounting weaknesses in 1975 when we examined HUD's system for the payment of taxes on HUD-owned property. At that time, HUD informed us of its plans to institute a highly automated system, termed "HUDMAP," which was to be the solution to most of its system problems. Since then, HUD has continued to cite

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the still forthcoming HUDMAP system as the answer to many problems identified in our reviews and currently plans to have the multifamily phase of HUDMAP operational by October 1981. The new system should address itself to many of the current system problems. We believe, however, that since the planned implementation of the multifamily HUDMAP phase is still almost 2 years away, interim changes must be made to the current system to correct some of the problems we will be discussing today.

Before discussing the results of our current review I would like Mr. John Cronin to present an overview of the accounting and servicing systems for Secretary-held multifamily mortgages.

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We acknowledge that HUD's management and servicing of assigned multifamily mortgages is a difficult and formidable task. When assigned, the projects already have a history of financial and/or management problems. However, while we recognize these difficulties, our analysis of the current inventory indicates that HUD can improve the management of its multifamily inventory.

As of September 30, 1979, HUD held 2,034 project mortgages valued at approximately $3.7 billion. About 71 percent, or 1,442, of these projects were delinquent in their mortgage payments. The total amount of those delinquencies, according to records in HUD's Office of Finance and Accounting, was about $500 million, of which about $325 million was owed for accrued interest delinquencies. The 1,442 delinquent mortgages were classified as follows:

No current workout agreement	696
Under current workout agreement	382
In foreclosure process	364

As shown above, 696 of the financially troubled projects did not have current workout agreements and were not in foreclosure. We found no evidence that many of those mortgages had ever been placed under a workout agreement. Others had been under workout agreements which expired many years ago.

During the period owners are delinquent in their mortgage payments and while foreclosure on mortgages is in process, Internal Revenue Service (IRS) officials said the project owners can claim income tax deductions for accrual of unpaid interest and depreciation expenses. Justice, HUD, and IRS officials acknowledged that owners often contest foreclosure actions to extend the period of time in which they can benefit from accrued interest and depreciation deductions on their Federal income tax returns.

As of September 30, 1979, the total accrued interest delinquency on HUD-held multifamily mortgages was about $325 million. Since about three-fourths of these projects are owned by profit-motivated mortgagors, substantial income tax revenues could be lost to the Federal Government because deductions are allowed for expenses which are not actually paid. That part of the accrued interest delinquencies, which may eventually be paid by project owners, will not result in lost tax revenues. However, for many mortgages which are seriously delinquent and those in foreclosure, the likelihood of accrued interest ever being paid to HUD is small. These and other matters are discussed in a CED report issued to the Chairman, January 16, 1980. (CED 80-43)

CURRENT SYSTEM PROVIDES INADEQUATE COLLECTION INFORMATION TO SERVICERS IN THE FIELD OFFICES

HUD's accounting system for Secretary-held project mortgages, which provides monthly payment and billing data to the mortgagors and the HUD field offices, does not provide servicing personnel with sufficient information to aggressively service their workload. More specifically, we noted that:

--The monthly bills were based on the payment terms of the original mortgages and did not reflect the status of the accounts under workout agreements, which provide for reduced payments.

--The monthly bills were generally received by the loan servicers in the area offices after the due date of the monthly payment shown on the bill, thus making aggressive servicing of troubled projects difficult.

--Interim billing procedures did not exist for newly assigned mortgages, resulting in delayed initial billing.

--The lack of inventory controls caused some bills to go to the wrong field offices.

--Adequate incentives did not exist to encourage mortgagors to make payments by the due date.

--The accounting system did not provide annual account statements or produce sufficient delinquency data.

--The system had no effective mechanism to reconcile the tax status of the properties with the records of the local taxing authorities.

ACCOUNTING SYSTEM DOES NOT TRACK PAYMENT STATUS UNDER TERMS OF WORKOUT AGREEMENTS

Once a defaulted mortgage is assigned, the HUD field office should determine if the mortgage can be brought current or if it should be foreclosed. If reinstatement is possible, a new payment agreement, called a workout agreement, should be negotiated. After entering into a workout agreement, the HUD servicer must know if the mortgagor meets the workout agreement's terms. Under HUD's current system, the bills continue to be based on the terms of the original mortgage and do not reflect the payment status under the workout agreement, a copy of which is on file at headquarters. As such, performance under the workout agreement cannot be easily determined.

Even though the payment status under the workout agreement can be determined with this system, the time required is not a good use of resources. Only by reviewing each bill in detail, or by maintaining a local payment history and then comparing that history to the terms of the workout agreement, could a servicer determine the payment status. Several servicers in HUD's New York field office stated they did not know the payment status of the cases they serviced or gave us incorrect information when we asked for the payment status.

In San Francisco we found that the HUD field office, contrary to the HUD procedures for centralized payment, was receiving payments locally for most of its inventory of Secretary-held multifamily mortgages. This practice enabled the field office to develop its own payment histories and aggressively service its inventory.

We believe that the Department should provide servicing personnel with information that reports mortgagors' payment status under the terms of the workout agreements. This information would simplify the servicing efforts of the field office personnel. However, to determine the payment status of the mortgages under the workout agreements, all workout agreements should specify a minimum payment amount due. We found in the past that not all workout agreements specified a payment amount. Some New York workout agreements called only for cash remaining after the payment of reasonable and necessary operating expenses.

Therefore, mortgagors submitting no payments could be current under their workout agreements.

MONTHLY BILLS RECEIVED IN HUD FIELD OFFICES LATE

In both field offices we visited, personnel complained that the monthly bills sent from the Department's Office of Finance and Accounting in Washington, were generally received late and were of limited use in servicing the projects. During our review, we noticed the following examples:

--The June 1979 monthly bills for the New York field office, which showed both the amount due June 1, 1979, and the payments received in May 1979, were received by the servicers in the New York field office on July 2, 1979, over a month late.

--The September 1979 monthly bills for the San Francisco field office, which reflected both the amounts due September 1, 1979, and the amounts paid in August 1979, were received in HUD's San Francisco field office on September 17, 1979, at least 17 days late.

--Some monthly bills were sent to the wrong field offices. For example, in May 1979 the New York field office received bills for six projects not serviced by it.

Aggressive servicing is not possible when field offices do not get timely payment data. We believe the monthly bills should be in the hands of the servicers by the due date of the payments. In addition, collection data should be transmitted to field offices shortly after payments are received.

LATE FIRST BILLS ON NEWLY ASSIGNED SECRETARY-HELD MORTGAGES

HUD is responsible for aggressively servicing newly assigned mortgages and impressing upon mortgagors their obligation to make full mortgage payments to HUD. However, we found that delays were occurring in billing newly assigned mortgagors.

We selected 26 of the 126 New York projects and 12 of the 49 San Francisco projects for further review. Our review revealed that for the New York projects, the Office of Finance and Accounting took an average of 4.6 months from the date of assignment to the first bill. The range was from 1 to 16 months. The average for the San Francisco projects was 2.8 months, with a range of 1.5 to 5 months.

After assigning a defaulted mortgage to HUD, the original lender has 45 days to file for payment of the insurance claim. The Office of Finance and Accounting was not preparing the first bill until the necessary documents wete received. Since some claims are not filed on time, or are filed with incomplete information, the Office of Finance and Accounting often took many months to prepare the first bill. Therefore, the servicer did not know the status of the account. We believe interim billing procedures should be implemented to ensure that once the notice of assignment is received, the mortgagor is immediately billed for the normal payment due under the mortgage.

SYSTEM DOES NOT PROVIDE ADEQUATE PENALTIES FOR LATE PAYMENTS

HUD does not provide adequate incentives to mortgagors to make their payments by the due date. At the time of our review, late penalties were only assessed on mortgagors who were current under their mortgage terms and who made a late payment. Since the majority of the Secretary-held mortgages are delinquent under the mortgage terms, few late penalties are actually assessed. Late charges could not be assessed on delinquent mortgagors because the accounting system did not track compliance with the payment terms of workout agreements.

We believe that late penalties should be assessed either on the minimum payment specified in the workout agreements, or when workout agreements are not in effect, on the payment due under the mortgage. HUD officials informed us that they are considering revising their late-charge policy.

BETTER CONTROLS NEEDED TO RECONCILE RECORDS OF TAXING AUTHORITIES WITH HUD RECORDS

Taxes on Secretary-held multifamily mortgages are paid centrally from HUD's Office of Finance and Accounting in Washington. In the past, we have reported on a number of problems with centralized tax payment systems. Subsequent to our 1975 report to the Congress entitled "Action Being

Taken to Correct Weaknesses in the System of Paying Taxes on Acquired Residential Properties," HUD assigned the responsibility for the tax payment function for acquired single-family property to the field offices.

In addition to that decentralization, HUD recently changed its procedures for tax payments on Secretary-held, single-family mortgages by requiring field offices to obtain all tax bills, post them to local records, and forward the bills to Washington for payment. However, the tax payments for the multifamily projects remained centralized.

To determine the tax status of the New York Secretary-held project mortgages, we reviewed 26 selected projects at the taxing authorities in the cities of New York and Yonkers. Numerous under- and overpayments were reflected on the records of the taxing authorities:

--Eight of the 26 projects owed delinquent real estate taxes totaling $39,883.

--$111,427 was owed to the projects or HUD for overpayments of real estate taxes on nine projects.

--Nine projects owed delinquent water and sewer charges of $41,003.

--$16,983 was owed to the projects or HUD for overpayments of water and sewer charges on nine projects.

--$33,182 had been paid on 14 projects for interest and penalties on delinquent taxes.

We found one project which HUD listed as exempt from taxes, but according to taxing authority records it was exempt only from real estate taxes and not water and sewer charges. Because the water and sewer charges on this project had not been paid for 4 years, the city of New York had started action to take over the property for nonpayment.

New York City taxing authorities said that overpayments of taxes are not netted against underpayments, and overpayments are refunded only if the overpaying party submits a claim for refund and proves the overpayment was made. Furthermore, there is a 6-year statute of limitations on refunding overpayments. Therefore, if the refund is not applied for within 6 years of the overpayment, the city of New York retains the funds. These problems point out a need for HUD and taxing authority records to be reconciled periodically. We believe these reconciliations can best be performed from the HUD field offices where a fewer number of different taxing authorities need to be dealt with and where visits to the taxing authorities to periodically reconcile records are feasible.

To correct the problems noted, we recommend the Department

--provide servicing personnel with information that reports mortgagors' payment status under the terms of workout agreements.

--establish an interim billing system for newly assigned mortgages,

--assess late charges on payments due under the mortgages or the workout agreements,

--require periodic inventory reconciliations,

--decentralize to field offices the responsibility to obtain tax bills, and

--require periodic reconciliations between the records of HUD and the taxing authorities.

MAJOR IMPROVEMENTS NEEDED IN SERVICING AT HUD'S NEW YORK FIELD OFFICE

We selected at random 26 of the 126 multifamily projects for detailed analysis at HUD's New York field office. On May 1, 1979, the 26 projects were in the following status:

--Five projects had never been under a workout agreement since assignment even though they were assigned as far back as 1975.

--Nine projects had expired workout agreements but were still delinquent.

--Two projects were serviced under an informal agreement (no written agreement existed).

--Ten projects were either under a permanent modification agreement, a current workout agreement, or had been recommended for foreclosure.

We determined the change in delinquency status under the mortgages for the 26 projects from the date of assignment to May 1, 1979. Of the 26 projects:

--Four, or 15 percent, showed some decrease in the number of months delinquent.

--Twenty-two, or 85 percent, showed an increase in delinquency since assignment. Seven of the 22 were recommended for foreclosure, however, of the remaining 15, nine increased the amount of their delinquency under the mortgages by 12 or more mortgage payments and four increased their delinquency rate under the mortgages by over 3 years.

SOME DELINQUENT MORTGAGORS HAVE NEVER HAD A WORKOUT AGREEMENT

Five of the 26 New York projects we reviewed had never been under any workout agreements even though two of the five had been assigned as far back as February 1975. As of May 1979, these two projects were delinquent $840,505 and $909,347, and both had increased their delinquencies by 49 months since assignment. We were recently informed that these two projects have been recommended for foreclosure.

FINANCIAL ANALYSIS IS LIMITED AND REQUIRES IMPROVEMENT

HUD requires that annual financial reports for each project be prepared in accordance with the requirements of the Secretary. These statements are due within 60 days after the end of each fiscal year and are certified to be accurate by both an independent public accountant and an officer of the mortgagor. Upon receipt of financial statements from mortgagors, HUD requires a timely review and evaluation of the statements to determine their completeness and accuracy.

HUD's audit guide sets forth standards to be followed by independent public accountants in conducting audits of multifamily mortgagors whose mortgages are or have been insured by HUD. The audit guide must be followed by independent public accountants in performing audits of projects with a fiscal year ending on or after December 31, 1978.

The audit guide also requires that the independent public accountants conducting the audits will have to judge the propriety of project disbursements. Their judgment is important because HUD has no precise definition of expenses reasonable and necessary to the operation and maintanence of the projects.

As provided for in HUD regulations, delinquent mortgagors are required to submit monthly accountings showing cash receipts and disbursements. HUD considers those monthly reports to be essential to monitoring multifamily projects at such critical times as when a project is in default. These reports provide basic data and, since they show all cash receipts and disbursements during the previous month and cash on hand at the end of the month, they should be carefully reviewed shortly after receipt.

A followup system is required to assure that the monthly reports are received promptly. Reports are due by the 10th of the month. Failure to submit the required accountings is contrary to the regulatory agreement. If the mortgage is under an approved workout agreement, failure to submit the reports is not in compliance with the terms of this agreement.

Review of specific items in the monthly and annual financial statements

The required reviews of monthly and annual financial statements must be made promptly, and questionable items must be investigated. However, we found that these reviews were not always being made.

Our analysis of 11 financial statements for New York projects, which reported on periods covered by the audit guide, revealed that none of the 11 statements fully complied with the requirements in the guide. All 11 statements were missing one or more of the statements or the supporting data required by HUD. In addition, eight of these projects did not submit their statements within the required 60 days and in no cases did the independent public accountants question any expenses of the projects as unreasonable and/or unnecessary.

A review of the files of these 11 projects revealed only two instances where the mortgagor was requested to submit revised financial statements to conform to the new audit guide requirements. We found that the revised statements for one of the two projects were still incomplete at the time of our review and had not been reviewed by the responsible servicers. The other project had not submitted revised statements.

Our review of the monthly accountings submitted for the 26 New York projects for January through June 1979 revealed

--no evidence that eight of the 26 projects had their monthly statements reviewed,

--failures to submit reports and HUD's failure to request such delinquent reports.

--various expenditures which needed further clarification,

--unsigned reports, and

--late receipt of reports.

In discussing our findings with field office officials, they admitted that their analysis of financial information did not conform to HUD requirements. They stated that servicing personnel do not have the financial background to adequately review financial information.

We feel this failure to receive and/or review required financial information is a serious breakdown in HUD's internal control system and creates a situation where project receipts can be easily diverted.

Similar problems previously reported

In the past, both the GAO and the HUD Inspector General have reported on problems similar to those we found in New York. In a March 1979 report prepared by the HUD New York Regional Inspector General for Audit, New York's servicing of HUD-insured and HUD-held mortgages was found to be inadequate. According to the report, because financial statements and monthly accounting reports are not reviewed, the branch failed to detect

--possible diversions of project funds,

--excessive management fees and improper Section 8 application fees,

--questionable withdrawals of project funds while the mortgage was in default, and

--improperly executed workout agreements not in accordance with HUD regulations.

In addition, in a December 11, 1979, summary audit report to the Assistant Secretary for Housing, the Inspector General summarized the audit findings of 82 audit reports covering 93 insured and HUD-held projects for the 12 months ending June 30, 1979. The report identified a total of about $12.3 million of project funds questioned or disallowed in these 82 audit reports. Of the $12.3 million, $7.8 million was attributed to the improper or questionable use of operating revenues by 72 of the 93 projects reviewed.

Also, in a November 20, 1979, report to the Chairman, Senate Committee on Appropriations, the Committee's investigative staff identified problems with loan servicing. This review was performed at HUD's field offices in Washington, Boston, Chicago, Detroit, and Los Angeles.

As mentioned earlier, our analysis of monthly and annual financial statements raised a number of questions on the appropriateness of expenditures and on whether all receipts are properly accounted for. In cases where all receipts are not credited to HUD projects or where improper expenditures are charged to projects, funds that could have been used to make payments to HUD can be diverted to the owners and/or managing agents.

Let me give you some facts about two of the cases we examined.

In the first case, the independent public accountant's reports on the projects showed that between 1974 and 1978, the mortgagor had distributed $1.6 million to its partners and had loaned another company $1.1 million. This was done despite section 1715Z-4 of title 12, United States Code, which prohibits the use of project funds for other than necessary operating expenses. Because HUD's New York field office did not adequately review the financial statements for 1974 through 1978 until 1979, these problems were not discovered for almost 5 years. Our own review work showed expenses charged to the projects which we believe should have been charged to the management fee paid the mortgagor's managing agent. These included annual charges of approximately $3,000 for Christmas parties and $9,300 for the salary of a rental agent. We understand negotiations are in process to both enter into a workout agreement and obtain the return of the $2.7 million.

At the other managing agent, we identified charges to projects which also appeared should have been charged to the managing agent's fees. These charges included telephone expenses (for one project such expenses were $5,000 in 1 year), association dues, and other administrative expenses.

Our work was greatly hampered by the fact that neither of these two mortgagors had complied with HUD regulations which specify separate cash accounts for each project. Instead, the managing agents have commingled HUD project funds with other funds which makes auditing difficult and makes it difficult to tell whether funds have been used in unauthorized ways.

These problems are not new. In a March 1974 GAO report to the House Committee on Government Operations we identified many of the same problems we are discussing here today. The recommendation for increased monitoring by HUD we are making today was also made in the 1974 report. The recommendation is being repeated because adequate corrective action was not taken by HUD in response to our 1974 report, and testimony before the House Committee on Government Operations where HUD officials cited corrective actions in process.

To improve HUD's mortgage servicing efforts, we are recommending that the Department:

--Establish workout agreements within 90 days after assignment that provide for a specific payment amount.

--Require field offices to follow up and obtain adequate financial statements when statements are not submitted promptly or fail to meet HUD regulations.

--Provide for additional training of servicers in financial statement analysis.

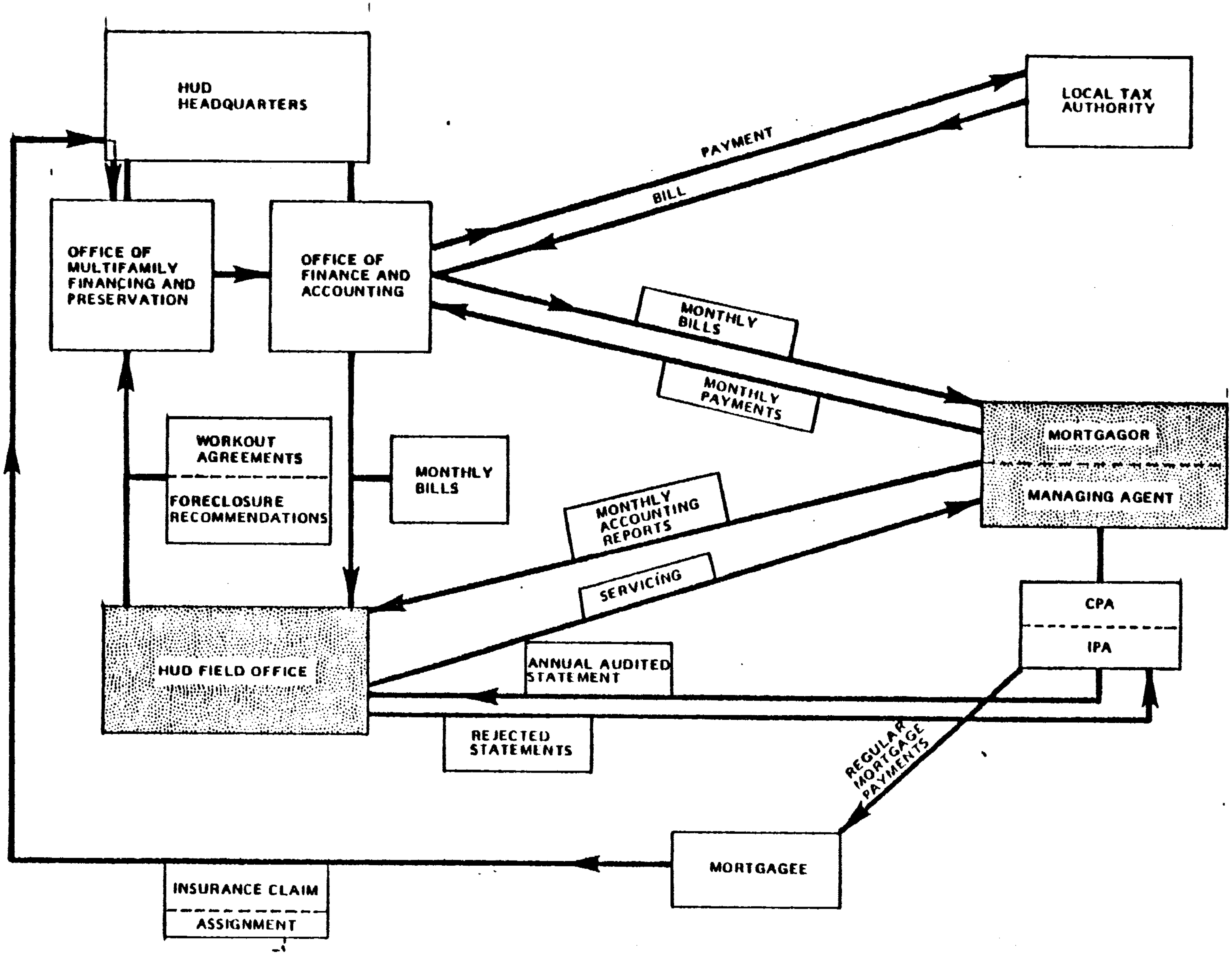
--Require aggressive action to obtain repayment of project funds that have been diverted.

CONCLUSION

Considering the disclosures that we have made here today, and disclosures in the recent Inspector General summary audit report which reported on what appeared to be sizable diversions of project funds, as well as the recent report of the Appropriations Committee's investigative staff which reported similar problems, we believe that the problems with HUD's multifamily Secretary-held program are serious and widespread.

We have discussed our findings with HUD officials and they have advised us of a number of actions they are taking or plan to take. These actions, as explained to us, appear to be responsive to the recommendations we have made in this statement. However, many of these deficiencies have been reported before, in some cases several years ago, and the actions taken then did not solve the problems. Consequently, the Subcommittee may wish to ask HUD to periodically report on the status of corrective actions and their effectiveness in correcting these problems.

This concludes my statement, Mr. Chairman. We would be pleased to answer any questions you or other Members of the Subcommittee may have.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