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Resources, Community, and  
Economic Development Division

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September 30, 1992

The Honorable Marge Roukema  
Ranking Minority Member  
Subcommittee on Housing and Community  
Development  
Committee on Banking, Finance and  
Urban Affairs  
House of Representatives

Dear Mrs. Roukema:

In response to your October 9, 1991, request and subsequent discussions with your office, we reviewed two internal control reports issued by Price Waterhouse in 1991 on single- and multifamily housing programs administered by the Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA). As you know, FHA does not make loans or build housing; rather, it operates insurance programs. FHA's primary objective is to provide insurance for private lenders against loss on mortgages financing homes and multifamily (apartment) projects. The latest available information shows that FHA had an outstanding insurance-in-force balance of about \$373 billion at the close of fiscal year 1991 (\$329.1 billion for the single-family program and \$43.9 billion for the multifamily program), and FHA lost \$2.5 billion in that fiscal year.

As agreed with your office, this letter provides information on the number and nature of financial and management internal control weaknesses that were reported for the first time in the Price Waterhouse reports and highlights those newly reported control weaknesses that the independent accounting firm believes pose the greatest risk to the financial and management integrity of the programs. It also includes the views of FHA, HUD's Office of Inspector General (OIG), and our Office on the problems identified by the reports.

In 1990 FHA management recognized that to efficiently and effectively address long-standing internal control weaknesses affecting the financial and management integrity

GAO/RCED-92-227R, FHA Internal Controls

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of the agency's single- and multifamily programs, they needed to obtain a more comprehensive understanding of the programs' internal controls. FHA's Comptroller said that because FHA lacked risk-based internal controls needed for its management to systematically address internal control issues, it contracted with Price Waterhouse to comprehensively review its mortgage programs.

In 1991 the independent accounting firm issued detailed internal control reports that identified previously reported and newly reported unresolved control weaknesses in each mortgage program's activity areas. Price Waterhouse identified nine program activities for FHA's single-family program and seven program activities for the agency's multifamily program. It also provided FHA with detailed reports that identified key program activities and related risks for each mortgage program, as well as self-assessment guides for use by FHA management to conduct ongoing evaluations to ensure that internal controls are efficiently and effectively meeting program control objectives.

In summary, Price Waterhouse's reports identified 206 financial and management internal control weaknesses in FHA's single- and multifamily housing programs, of which 59, or 29 percent, were newly reported.<sup>1</sup> The remaining 147 problems had been previously reported. The reports concluded that significant control weaknesses exist in both FHA programs that could negatively impact their integrity and hinder attempts by FHA to accomplish its mission of helping expand homeownership and affordable housing opportunities. Price Waterhouse's reports pointed out that weaknesses in financial and management controls involve all program activities, such as approving and monitoring mortgage lenders, originating and servicing mortgage loans, and disposing of foreclosed properties. Overall, 11 of the 147 internal control weaknesses previously reported were considered by Price Waterhouse to be of material significance, posing the greatest risk to the programs' integrity. Using the Office of Management and Budget's Circular A-123, Internal Control Systems, Price Waterhouse defined "material" weaknesses as those control weaknesses that can significantly impair the fulfillment of an agency's

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<sup>1</sup>Control weaknesses were identified by Price Waterhouse as newly reported if the problems were not cited in the Secretary's Financial Management Report on Material Weaknesses and reports issued by HUD's Inspector General, financial auditors, and contractors during the 2 years before its internal control reviews.

mission, deprive the public of needed services, and/or violate statutory or regulatory requirements. In addition, 8 of the 59 newly reported weaknesses were considered of material significance.

FHA's Comptroller stated that FHA management generally agrees with the findings contained in the two Price Waterhouse reports. She provided information indicating that the agency has taken steps designed to correct all of the previously and newly reported material weaknesses. HUD's Assistant Inspector General for Audit believes that FHA is firmly committed to strengthening its single- and multifamily mortgage programs, although it is too soon to determine whether actions taken by FHA have actually corrected long-standing problems. He also pointed out that the management of internal controls is an ever-evolving process. In fact, since the issuance of the Price Waterhouse reports, the independent accounting firm has issued financial audits of FHA for fiscal years 1990 and 1991 that further address internal control problems. We believe that a direct correlation exists between the effectiveness of internal controls, the accuracy and timeliness of financial information, and the magnitude of losses incurred by FHA. These problems underscore the importance for the Congress, HUD's OIG, and our Office to continue to actively oversee the agency's efforts to resolve these problems.

INTERNAL CONTROL WEAKNESSES  
REPORTED FOR THE FIRST TIME

Price Waterhouse's 1991 reports on FHA's single- and multifamily programs concluded that significant control weaknesses exist in both programs that could negatively impact the programs' integrity and undermine FHA's overall mission. Because of FHA's commitment--\$373 billion insurance-in-force outstanding as of September 30, 1991 (\$329.1 billion for its single-family program plus \$43.9 billion for its multifamily program)--the federal government's exposure to financial risk is considerable. This level of commitment, coupled with FHA's losses--\$2.5 billion in fiscal year 1991--underscores the importance of implementing effective program controls to minimize abuse and mismanagement.

Of the 206 financial and management internal control weaknesses reported by Price Waterhouse, 133 pertained to FHA's single-family program. The accounting firm's report of April 1991 disclosed that 99 of the 133 weaknesses were reported in prior audits and studies and 34 (about

26 percent) were being reported for the first time. In examining the program's nine identified activity areas, Price Waterhouse concluded that the greatest number of weaknesses involved mortgage premium processing (42), insurance claims processing (23), mortgage note servicing (20), and property disposition (15). Enclosure I contains a summary by program activity area of these previously reported and newly reported internal control weaknesses.

In terms of significance, 11 of the 133 reported internal control weaknesses in the single-family program were material, in Price Waterhouse's judgment. Eight of the 11 material weaknesses were previously reported and involved 3 program activities--property disposition (4), insurance claims processing (3), and assignment processing (1). Of the 34 newly reported internal control weaknesses, Price Waterhouse considered 3 to be material.

- Mortgage premium processing. FHA had not established adequate controls to (1) determine the amount of premiums required to be remitted by mortgage lenders to FHA and (2) ensure that premiums were collected.
- Management of insurance data base. Updated information on mortgages was not always contained in FHA's Insurance-in-Force System data base, and FHA was not investigating or resolving problems with data base entry in a timely manner.
- Property disposition. FHA was not properly monitoring the activities of contractors responsible for performing vital services on HUD-owned properties available for sale, including managing computerized systems and making financial disbursements.

Enclosure II contains a detailed description of these newly reported material weaknesses.

Of the 206 financial and management internal control weaknesses reported by Price Waterhouse, 73 pertained to FHA's multifamily program. The independent accounting firm's report of March 1991 disclosed that 48 of the 73 weaknesses were reported in prior audits and studies, and 25 (34 percent) were being reported for the first time. In examining the program's seven identified activity areas, Price Waterhouse concluded that the greatest number of weaknesses involved property disposition (27), mortgage premium processing and distribution (12), mortgage note servicing (12), and project monitoring (10). Enclosure III contains a summary by program activity area of these

previously reported and newly reported internal control weaknesses.

In terms of the significance, 8 of the 73 reported internal control weaknesses in the multifamily program were material in Price Waterhouse's judgment. Three of the eight weaknesses were previously reported and involved claims processing, project monitoring, and property disposition. Of the 25 newly reported internal control weaknesses, Price Waterhouse considered 5 to be material.

- Lender approval and monitoring. FHA's procedures for monitoring the activities of FHA-approved mortgage lenders were informal and ineffective.
- Project monitoring. FHA's analyses of financial data it receives from borrowers on multifamily projects it insured were submitted late and were inadequate. Also, FHA did not consistently monitor projects to ensure that required corrective actions were taken.
- Mortgage note servicing. HUD lacked adequate controls over the financial disbursements made by a major contractor handling administrative functions for multifamily projects whose mortgages were held by HUD.
- Mortgage note servicing. HUD did not adequately pursue delinquent mortgage payments due on multifamily project mortgage notes held by HUD.
- Property disposition. HUD did not adequately monitor multifamily properties it owns to ensure that property managers acting on behalf of HUD are, as required, obtaining optimum rental revenues for those properties.

Enclosure IV contains a detailed description of these newly reported material weaknesses.

OBSERVATIONS OF FHA, OIG, AND GAO  
ON PRICE WATERHOUSE'S REPORTS

According to FHA's Comptroller, FHA management believes that the two Price Waterhouse reports are comprehensive and of great benefit in managing the single- and multifamily programs. The Comptroller also stated that FHA management generally agrees with the findings contained in the reports and that they believe that notable progress is being made to correct the long-standing financial and management internal control weaknesses that have been identified. She provided us with information that shows that the agency has taken

steps designed to correct all of the previously and newly reported material internal control weaknesses that were identified by Price Waterhouse in its reports on the single- and multifamily programs.

According to the FHA Comptroller, a major objective of management was to use the reports prepared by Price Waterhouse to implement systematic risk-based internal control systems that would result in better management of the single- and multifamily programs and thus help ensure that FHA's assets are fully protected and that program resources are expended appropriately. She told us that since receiving the Price Waterhouse reports in early 1991, the agency has been developing a comprehensive risk-based internal controls system to correct identified program weaknesses. She told us that actions have included setting risk-based priorities for first tackling those material weaknesses that crosscut both mortgage programs, such as monitoring. The Comptroller also explained that as part of this planning effort, FHA has been developing a formal procedure to track the resolution status of the 206 financial and management control weaknesses identified in the 1991 Price Waterhouse reports. FHA is planning to use its annual internal control review process to evaluate the efficacy of implemented changes once sufficient time has passed to warrant an evaluation.

HUD's OIG agrees with FHA's viewpoint that the availability of the Price Waterhouse reports on internal control weaknesses in FHA's single- and multifamily programs will likely be a major benefit to agency management. The Assistant Inspector General for Audit pointed out, however, that an agency's internal controls environment is a moving target because over time, changes occur in policies, procedures, systems, staffing, and organizational structure and that such changes underscore the importance of having mechanisms in place to facilitate the monitoring of program control activities.

In fact, since the issuance of Price Waterhouse's internal control reports, the independent accounting firm has issued financial audits of FHA for fiscal years 1990 and 1991 that further address internal control problems. For example, in its March 1992 report on FHA's 1991 financial statements, Price Waterhouse stated that it was unable to express an opinion on FHA's 1991 financial statements. This was due, in part, to the identification of material internal control weaknesses in FHA's single- and multifamily programs that could cause material errors in FHA's financial statements.

Nonetheless, the Assistant Inspector General for Audit believes that FHA is firmly committed to strengthening its single- and multifamily mortgage programs, although rectifying some long-standing problems will be difficult, especially in view of FHA's staff constraints and deficiencies in FHA's management information systems. These constraints and deficiencies have an impact on the agency's ability to act on identified weaknesses. The Assistant Inspector General for Audit said that, for the most part, it remains largely unknown whether actions taken by FHA have actually resolved many long-standing problems. The reasons are twofold: (1) not enough time has passed to undertake a comprehensive assessment of FHA's progress and (2) the only reviews of unresolved material weaknesses completed to date are the few that have been done by the OIG on behalf of the Department's Chief Financial Officer, who is responsible for conducting such reviews.

Like Price Waterhouse, we also have identified weaknesses in FHA's systems of internal controls. In a January 1992 report, we summarized the results of our prior work on those weaknesses.<sup>2</sup> We concluded that FHA's systems of internal controls did not adequately protect against fraud, waste, and mismanagement and that these weaknesses had serious repercussions for FHA. Moreover, we reported that a direct correlation exists between the effectiveness of internal controls, the accuracy and timeliness of financial information, and the magnitude of losses incurred by FHA as well as by other HUD programs. As we pointed out in testimony on that report,<sup>3</sup> FHA's long-standing internal control problems, as well as problems experienced in other HUD activities, underscore the importance of the Congress, HUD's OIG, and our Office in continuing to actively oversee the agency's efforts to resolve these problems.

#### VIEWS OF AGENCY OFFICIALS

We discussed the facts in this correspondence with FHA's Comptroller and with HUD's Assistant Inspector General for Audit. They generally agreed with the facts as presented. Changes have been made, where appropriate, on the basis of these discussions to further clarify the information

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<sup>2</sup>HUD Reforms: Progress Made Since the HUD Scandals, but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992.)

<sup>3</sup>HUD Reforms: Limited Progress Made Since the HUD Scandals (GAO/T-RCED-91-62, June 12, 1991).

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presented. As requested by your office, we did not obtain written agency comments on a draft of this correspondence.

SCOPE AND METHODOLOGY

In performing our work, we reviewed the 1991 Price Waterhouse reports on FHA's single- and multifamily housing programs, our reports addressing FHA internal controls, and the HUD OIG's semiannual audit reports for March 1989 to March 1992. We supplemented these efforts with discussions with FHA to determine the impetus for the Price Waterhouse studies and FHA's plans for addressing the problems identified in the reports. In addition, we spoke with HUD's OIG to obtain its views on the purpose and likely benefits of the reports' findings. Our work was conducted between February and August 1992.

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As agreed with your office, unless you publicly announce the contents of this correspondence earlier, we plan no further distribution of it until 10 days from the date of this letter. At that time, we will send copies to the Secretary of Housing and Urban Development, the Director of the Office of Management and Budget, and to other interested parties. We will also make copies available to others upon request.

As agreed with your office, the submission of this information completes our work in response to your October 1991 request. If we can be of further assistance, please contact me at (202) 275-5525.

Sincerely yours,



Judy A. England-Joseph  
Director, Housing and  
Community Development Issues

Enclosures



SUMMARY OF INTERNAL CONTROL WEAKNESSES REPORTED IN APRIL 1991  
BY PRICE WATERHOUSE ON FHA'S SINGLE-FAMILY HOUSING PROGRAM

<u>Activity area of weakness</u>	<u>Number of weaknesses</u>		
	<u>Previously reported</u>	<u>Newly reported</u>	<u>Total reported</u>
Lender approval	0	4	4
Lender monitoring	1	4	5
Insurance application process	8	4	12
Mortgage premium processing	37	5	42
Mortgage note servicing	16	4	20
Insurance claims processing	17	6	23
Mortgage assignment processing	6	0	6
Property disposition	13	2	15
Management of insurance data base	<u>1</u>	<u>1</u>	<u>56</u>
Total	<u>99</u>	<u>34</u>	<u>133</u>

DESCRIPTION OF MATERIAL INTERNAL CONTROL WEAKNESSES  
NEWLY REPORTED IN PRICE WATERHOUSE'S REPORT ON  
FHA'S SINGLE-FAMILY HOUSING PROGRAM

Under the Federal Housing Administration's (FHA) Single-Family Mortgage Insurance Program, the Department of Housing and Urban Development (HUD) helps to qualify borrowers--first-time buyers and others who might not qualify for conventional loans--for mortgage financing by guaranteeing the mortgage lender that FHA will repay the outstanding loan if the borrower does not meet repayment terms. The mortgage insurance is provided through the Mutual Mortgage Insurance Fund, the largest of four funds managed by FHA. This fund covers potential losses for insured loans that default and undergo foreclosure. When borrowers default on their loans, their lender usually forecloses and files an insurance claim with HUD. HUD pays the claim and becomes the owner of the property. HUD's field offices then contract with private management brokers, who manage the property.

The fund is intended to be self-sustaining by charging home buyers a premium on the mortgage. In addition, the fund must be actuarially sound so that premiums are sufficient to pay claims due to defaults and other expenses. The latest available information shows that, as of September 30, 1991, the outstanding balance of FHA's single-family mortgages was about \$329.1 billion.

Given the level of FHA's commitment, the financial risk to the federal government is considerable, requiring effective program controls to minimize abuse and mismanagement. Price Waterhouse's April 1991 report on FHA's single-family program disclosed, however, 133 unresolved internal control weaknesses in the program as of the end of fiscal year 1990, 34 of which were being reported for the first time. Three of the newly reported weaknesses were considered by the independent accounting firm to be material because they posed a major risk to the program's financial and operational integrity. These three weaknesses are described below.

CONTROLS OVER PREMIUM COLLECTIONS ARE INADEQUATE

Under FHA's Direct Endorsement Program, lenders are authorized to directly underwrite single-family mortgage loans and to approve the mortgages for FHA insurance. The lending institutions are responsible for collecting mortgage premium payments from borrowers and remitting the payments to FHA. FHA identifies variances between expected and actual premium collections through its Periodic Premium Collection System.

In reviewing the collection process, Price Waterhouse found that some variances were not investigated or resolved. Because of the volume of lender remittances each month, FHA's five collection specialists have been instructed to not investigate the nonpayment of premiums by lenders with 500 or fewer mortgages in their portfolios. Of the 6,000 lenders FHA had expected to remit premiums in June 1990, 3,662 did not do so, and only 79 of these 3,662 cases were subsequently investigated. As a result, a variance of \$1 million remained that FHA had not investigated at the time of Price Waterhouse's review.

Another 2,239 lenders remitted premiums for amounts that differed from what FHA expected to receive. Price Waterhouse determined that \$227,000 less in actual premiums than expected were collected. FHA had not reconciled the reasons for the differences. According to Price Waterhouse, reconciling the differences would be difficult for FHA because key information needed for reconciliation in the agency's Insurance-in-Force System had not been updated.

#### INSURANCE DATA BASE IS NOT UPDATED IN A TIMELY MANNER

Information is periodically received from mortgage lenders and borrowers that must be incorporated into FHA's Insurance-in-Force System--the program's primary information system. However, Price Waterhouse found that about 260,000 information updates had not been fully processed as of October 1990. Consequently, borrower and lender records in the system did not contain corrected or updated information involving many single-family mortgages. In addition, Price Waterhouse reported that, of the 260,000 updates, 50,000 record updates involving its Computerized Home Underwriting Management System had been suspended (placed aside to be researched) by FHA. This system contains information on mortgage endorsements. The length of time items had been suspended could not be determined because FHA did not maintain the information needed to make such determinations.

According to Price Waterhouse, FHA believes that the underlying cause of these problems is inadequate resources to handle a growing volume of information. Price Waterhouse's report also attributes the problems to (1) design flaws in the Insurance-in-Force System that prevent the processing of certain information, (2) management's failure to assign responsibility for resolving problems with each type of transaction, and (3) lack of management review and control of the information not incorporated into the data base.

The integrity of the data in the Insurance-in-Force System--the centerpiece of FHA's mortgage insurance operations--is essential. Incomplete or untimely processing of information can adversely affect such program operations as mortgage endorsements, assumptions, and premium collections. Besides increasing data-processing costs, claims not processed because of processing errors can result in delays in processing and payment of insurance benefits. Because the interest due mortgage lenders who have filed claims continues to accrue until claims are paid, FHA's costs are further increased.

#### CONTRACTOR MONITORING IS INADEQUATE

Price Waterhouse reported that, while FHA had engaged contractors to perform various functions on its behalf, program managers did not adequately monitor the activities of contractors performing key property disposition functions involving HUD-owned properties. Such activities included entering payment voucher information into the Single Family Accounting and Management System<sup>1</sup> and preparing financial disbursement documentation that is sent to the Treasury Department for payment.

Although the failure of contractors to abide by their contractual obligations can expose FHA to additional risk, the agency had not in more than 2 years audited a key contractor responsible for maintaining the aforementioned data base system, according to Price Waterhouse. The independent accounting firm also determined that FHA was reimbursing foreclosure agents for sizable amounts of claimed expenses--mostly related to hiring attorneys to process foreclosures--without reviewing the accuracy or validity of the payment amounts.

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<sup>1</sup>A new FHA data base system being implemented is designed to track single-family properties from the time HUD assumes the title until it sells the properties.

SUMMARY OF INTERNAL CONTROL WEAKNESSES REPORTED IN MARCH 1991  
BY PRICE WATERHOUSE ON FHA'S MULTIFAMILY HOUSING PROGRAM

<u>Activity area of weakness</u>	<u>Number of weaknesses</u>		
	<u>Previously reported</u>	<u>Newly reported</u>	<u>Total reported</u>
Lender approval and monitoring	0	1	1
Mortgage application processing and construction	0	4	4
Mortgage premium processing and distribution	7	5	12
Project monitoring	4	6	10
Insurance claims processing	6	1	7
Mortgage note servicing	8	4	12
Property disposition	<u>23</u>	<u>4</u>	<u>27</u>
Total	<u>48</u>	<u>25</u>	<u>73</u>

DESCRIPTION OF MATERIAL INTERNAL CONTROL WEAKNESSES  
NEWLY REPORTED IN PRICE WATERHOUSE'S REPORT ON  
FHA'S MULTIFAMILY HOUSING PROGRAM

Under FHA's multifamily housing program, FHA delegates technical processing functions, such as mortgage credit analysis, to lenders but retains the responsibility for approving firm commitments to insure mortgages against borrower default on loans. Since their inception, FHA's multifamily programs have helped create more than 3.4 million affordable rental housing units in thousands of properties nationwide.

While adequate internal controls are needed to help minimize program abuse and mismanagement, Price Waterhouse's March 1991 report on FHA's multifamily program reported a total of 73 weaknesses in the program's system of internal controls. Of that number, 25 were reported for the first time. The following describes the five newly reported weaknesses that Price Waterhouse considered material, posing a major risk to the program's financial and operational integrity.

INEFFECTIVE PROCEDURES FOR OVERSEEING LENDERS

In overseeing lenders' activities, HUD is responsible for ensuring that lenders that have made loans to construct, rehabilitate, and/or purchase multifamily properties effectively service the mortgages in their FHA-insured portfolio. Servicing requirements include reviewing the financial statements of properties and conducting on-site property reviews.

However, according to the Price Waterhouse report, HUD had not formulated certain procedures for FHA to help ensure that lenders were prudently servicing their mortgages to prevent or minimize borrower defaults. Also, the report noted that HUD did not have adequate financial information from lenders that would facilitate necessary analyses to determine, for example, whether lenders were properly controlling the release of various account funds used by borrowers. The independent accounting firm also pointed out that additional information from lenders could help HUD formulate an effective strategy to decrease the risk of defaults and subsequent financial losses to FHA. In addition, Price Waterhouse reported that FHA (1) lacked measures to help detect when lenders have sold FHA-insured mortgages to non-FHA-approved lenders and (2) lacked measures to help identify those FHA-insured mortgages that were sold inappropriately to lenders who had been sanctioned by FHA for regulatory noncompliance.

With respect to lender monitoring, Price Waterhouse also reported that FHA lacked control procedures to track lenders' historical default rates and to help identify those lenders not complying with FHA requirements. It also noted that additional financial information would help FHA formulate an effective strategy to minimize the risk of borrower defaults. The independent accounting firm also pointed out that the rate of multifamily claims and subsequent losses to FHA can increase unnecessarily if lenders do not follow HUD's required loan management and default prevention procedures. However, the lack of effective monitoring by the agency did not, according to Price Waterhouse, provide private lenders with an incentive to properly perform their loan-servicing functions.

#### INADEQUATE MONITORING OF MULTIFAMILY PROJECTS

Loan Management Specialists in HUD field offices are responsible for reviewing information submitted by borrowers on HUD-insured multifamily projects. In reviewing the financial data received from borrowers, field staff are to focus their analyses on potential problems in such areas as rental income, project expenses, and liquidity. The objectives of such analyses are to efficiently and effectively identify problems so that corrective actions can be taken before borrowers default on their mortgages.

Price Waterhouse identified several problems that had prevented HUD from efficiently and effectively performing necessary financial analyses. First, field staff often did not receive required financial statements or received them after the stipulated reporting deadline, which is no later than 60 days after the end of each fiscal year. When financial statements were received, the field staff at times did not perform timely reviews of the financial statements. At one field office, for example, Price Waterhouse had found a 4-month backlog in the review of statements and in entering key financial data into the Multifamily Information Processing System. According to Price Waterhouse, such problems can create major impediments for the financial review process because data from the financial documents are needed to generate key tracking reports for program managers.

The Price Waterhouse report also questioned the extent and quality of HUD's financial analyses. The independent accounting firm stated that it had examined financial statements of projects that were identified as having been reviewed by the loan management specialists and that it had found growing negative financial trends in several areas, including the accounts payable

and rents receivable categories. Despite the possible problems such trends could suggest for the future viability of projects, HUD field staff had not identified the potential problems, and thus borrowers were not asked to explain them; nor had the FHA field staff flagged the questionable items for follow-up.

In other instances, Loan Management Specialists failed to designate problem loans as "troubled." FHA officials told Price Waterhouse that there was a reluctance to classify projects as troubled. The designation places an additional burden on field offices because financial reports of such projects must be analyzed monthly and on-site inspections performed annually. Even when potential problems were identified, staff did not always ensure that corrective actions were implemented. For example, Price Waterhouse identified a multifamily project--the note for which had been assigned to HUD--that had been generating income for the last 2 years.<sup>1</sup> Despite these profits, the project's mortgage was delinquent because the profits had not been submitted to HUD. Although the borrower was told of the problem, no attempts were made to ensure that the monies--almost \$1 million--were repaid to HUD.

According to Price Waterhouse, these control weaknesses were due to (1) the limited level of training and experience of some FHA loan management specialists, (2) the fact that some staff had been assigned more multifamily projects than they could effectively monitor, (3) the lack of automated tracking of the status of follow-up actions that Price Waterhouse had examined, and (4) computer system programming errors that prevented the entry of financial data on projects already in the system. Nonetheless, Price Waterhouse noted that financial analyses of projects are necessary so that problems and abuses can be identified and management can take timely action to minimize defaults and losses to FHA.

#### INADEQUATE CONTROLS OVER MORTGAGE NOTE SERVICING

HUD's Multifamily Notes Servicing Branch is responsible for authorizing contractors' disbursements for activities related to

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<sup>1</sup>When borrowers default on FHA-insured loans, lenders file insurance claims with HUD. In settling claims HUD sometimes agrees to accept the assignment of a mortgage's note rather than foreclose and take over the actual property. HUD will accept mortgage notes if it appears that a borrower has a good chance of bringing the mortgage current and keeping possession of the property.



multifamily properties whose mortgages are held by HUD. This branch is responsible for sending information to a contractor concerning authorized disbursements. In turn, the contractor is required to incorporate the disbursement information into the Multifamily Accounting, Reporting, and Servicing System and prepare a disbursement computer tape for payment by the Treasury Department.

Price Waterhouse found several control weaknesses when it tested the adequacy of controls used to oversee the financial disbursement activities of a HUD contractor. For example, FHA was sending disbursement requests to the contractor without reviewing them. Also, on-site reviews of the contractor's operations had not been conducted to ensure that disbursements were correct and valid. Moreover, HUD had not audited the contractor in over 2 years.

Price Waterhouse noted that poor monitoring results from the lack of control policies and procedures over contractors performing administrative functions that were previously performed by HUD. As a result, the potential existed for errors and irregularities to go undetected by HUD. Such problems could ultimately increase the losses to FHA.

#### INEFFECTIVE MORTGAGE PAYMENT COLLECTION ACTIVITIES

HUD owned 1,998 multifamily assigned notes with a total unpaid principal balance of \$5 billion as of September 30, 1990. According to Price Waterhouse's report, about half the mortgage notes had delinquent payments due at that time, with the amount in arrears totaling \$750 million.

HUD field offices are responsible for following up on delinquent accounts and, if necessary, initiating foreclosure actions. However, Price Waterhouse found variances among field offices in collection rates and collection practices. One office, while taking action to collect on delinquent notes, still had one-quarter of its portfolio in default. Another office was not taking any collection action on delinquent accounts even though about three-quarters of its portfolio was in default, according to Price Waterhouse.

While variances in collection rates are due, in part, to differing local economic conditions, the accounting firm also believed that some of the disparity was attributable to the lack of aggressive monitoring activities by some HUD field offices. In its report, Price Waterhouse noted that because HUD did not pursue the collection of monies due the Department, significant

amounts of revenues are foregone and, with the passage of time, FHA's recovery of monies on delinquent accounts becomes less likely.

INADEQUATE MONITORING OF HUD-OWNED PROPERTIES

Price Waterhouse found that HUD personnel were not consistently performing the required quarterly project monitoring reviews of HUD-owned properties. During a visit to a HUD field office, Price Waterhouse found, for example, that on-site reviews were not conducted in a timely manner. As a result, HUD could not ensure that rents were properly collected or apartment vacancies were effectively reduced. In one instance, the Property Disposition Branch was unaware that HUD had taken control of a property. As a result, no property manager had been appointed to handle the project's financial and managerial responsibilities--including rent collection--for 1-1/2 months.

Price Waterhouse also noted that field offices were not consistently reviewing project documentation on rental rates and expenses. Consequently, project managers' decisions about the appropriateness of rental rates and project expenses were not being reviewed.

Several adverse effects were associated with these control weaknesses, according to Price Waterhouse. Without HUD oversight, the potential for obtaining maximum rental rates, occupancy rates, and collections on delinquent notes might not be fully realized. Additionally, HUD could not be assured that all project rents collected by project managers were, in fact, being remitted to HUD.

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