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**Protecting Your Business by Managing FHA, VA and OIG
Audits**

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Topic Summary

❖ **Managing OIG Audits**

- **General Overview**

- **The OIG Audit Process**

- **What To Do**

Managing OIG Audits

General Overview

- ❖ **FHA and VA have been important in assisting families, including first time homebuyers and low-to-moderate income families to obtain affordable housing:**
 - **FHA should continue to be a viable source of less costly financing for lower-income homebuyers.**
 - **Without FHA many families would not own a home.**

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General Overview (cont.)

- ❖ **Over the past several years, there has been a significant decline in FHA's market share:**
 - **This can be attributed to burdensome program policies and requirements.**
 - **This can be attributed also to overly aggressive enforcement policies such as:**
 - ❑ **Demands for indemnification for “technical” violations of FHA guidelines where there is no cause and effect between the violation and FHA's claim loss.**

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General Overview (cont.)

- Treble damages for failure to engage in loss mitigation.**
- Lender accountability for appraisals.**
- **Such an enforcement approach is unrealistic and counter productive to FHA's goal of increasing homeownership opportunities.**
- **FHA is attempting to regain market share and has implemented a number of program changes such as:**

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General Overview (cont.)

- Hybrid adjustable rate (ARM) mortgages.**
- Revised borrower closing costs permitting lenders to charge reasonable and customary closing costs.**
- Expanded lending areas that reduces from 25 to 13 the number of branch offices that a lender needs for nationwide lending.**
- Direct Nationwide Lending Authority for Internet and/or call center loan origination**

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The OIG Audit Process:

- ❖ **In order for government housing programs to become viable again OIG audits become a factor.**
- ❖ **The HUD office of OIG has two principal organizational elements:**
 - **An office of audit that performs audits of HUD program participants including mortgage lenders.**
 - **An office of investigation that performs investigations (including lenders) involving program fraud and makes referrals to the Department of Justice for prosecution.**

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The OIG Audit Process (cont.)

- ❖ **OIG “triggers” for selecting lenders for audit include:**
 - **Large volume of loan originations.**
 - **Early defaults.**
 - **Higher than average claim and default rates.**
 - **Complaints from borrowers, lenders, investors.**
 - **Referrals from HUD program offices.**

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- ❖ The OIG Audit includes the following steps:
 - **Opening conference with lender's staff.**
 - **Review of loan files, interviews with lender's staff and other parties to the transactions such as borrowers, real estate agents, and appraisers.**
 - **Exit conference with lender's staff.**
 - **Post audit issuance of a draft and final audit report.**

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❖ What To Do:

Preparing for the OIG Audit

- **Have all loan files and other information requested by the OIG ready.**
- **Take a professional, positive, and cooperative approach with any reasonable request (e.g. workspace, telephone access, copying machine, etc).**
- **Appoint an experienced senior manager to act as the contact person/coordinator through which all information is provided to OIG staff.**

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Preparing for the OIG Audit (cont.)

- To also handle requests for explanation of lender's policies, practices and procedures.**
- All of the lender's employees should be instructed to route requests for information to the contact person/coordinator.**
- **Cooperate with OIG staff but do not volunteer any information beyond what the staff requests.**
- **Provide all information requested promptly.**

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Preparing for the OIG Audit (cont.)

- **If specific files have been requested in advance, review the files to determine if any patterns or problems are present that involve the same “players” (e.g. loan officer, underwriter, processor, real estate broker, title company, etc.).**
- **Make sure the files contain the required documentation and be prepared to explain missing documentation.**

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Preparing for the OIG Audit (cont.)

- **Analyze the files to determine if the documentation supports the underwriting decision.**
 - ❑ **Make sure that any document, handwritten note or record of any telephone confirmation of the borrower's information has been placed in the file.**
 - ❑ **This will help to avoid incorrect findings by the OIG staff and potential demands by HUD for indemnification.**

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Opening Conference

- ❖ **OIG staff will discuss the scope of the audit work with the lender's staff:**
 - **Provide information requested by OIG as promptly as possible.**
 - **Offer to follow-up in writing if information is not on hand or will take time to compile.**
 - **Stress to OIG staff that they will be given full cooperation during the audit.**

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Opening Conference (cont.)

- **Stress to OIG staff that they should ask for information if they have questions or concerns regarding any loan file, or aspect of the lender's policies or operating procedures.**
 - ❑ **This will help to avoid incorrect findings as the OIG staff may not be experienced in FHA requirements.**

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Opening Conference (cont.)

- This will also help to avoid the OIG staff applying the wrong FHA guidelines during the audit.**
- This will help to prevent unwarranted indemnification requests by HUD.**

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The Audit

- ❖ **Steps that the lender should take during the audit:**
 - **Do not volunteer any information.**
 - **All questions that the OIG staff have regarding a loan file, lender policy, or operating procedure should, to the extent possible, be resolved during the audit.**
 - ❑ **This will help to avoid incorrect audit findings and requests for indemnification.**

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The Audit (cont.)

- This will also help to avoid a potential referral to HUD's Mortgagee Review Board for administrative sanctions and civil money penalties.**
- **The designated contact person/coordinator should periodically "look-in" on the OIG staff to see that they have needed information and to offer any needed explanation or clarification.**

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Exit Conference

- ❖ **At the conclusion of the audit the OIG staff conducts an exit conference with the lender:**
 - **OIG staff generally informs the lender of OIG's audit findings.**
 - **OIG staff generally offers the lender an opportunity to submit additional follow-up information in writing.**

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Exit Conference (cont.)

- **The lender should stress to OIG staff that it will promptly clarify all questions and concerns that the OIG may have.**
 - **This should be done to attempt to resolve any audit findings before the OIG issues its draft audit report.**

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Post Audit

- ❖ **The OIG may perform additional work after the audit (e.g. interviews with borrowers and other parties with knowledge of the transactions) particularly where serious violations are identified.**
- ❖ **After completion of the audit a draft audit report is issued to the lender and the lender is provided an opportunity to submit a written response to the audit findings:**
 - **If serious violations are alleged the lender would be well served to obtain legal counsel to assist in preparing the audit response to protect its interest.**

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Post Audit (cont.)

- **The response must be comprehensive and address each finding and provide supporting documentation for the lender's arguments.**
 - ❑ **Carefully review the finding to make sure that the OIG has not incorrectly cited a violation of an FHA requirement (or the requirement is broader than interpreted by OIG staff).**

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Post Audit (cont.)

- ❑ Submit copies of all available supporting documentation including any handwritten notes, and records of telephone calls (e.g. reconfirmation of borrowers income and employment prior to loan approval).**
- ❑ The key point is to demonstrate that the lender properly originated the loan and the underwriting decision to approve the loan was reasonable, consistent with FHA guidelines, and based on supporting documentation.**

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Post Audit (cont.)

- Identify the loans that were underwritten using an automated underwriting system (AUS) and FHA's Total Mortgage Scorecard and show that the AUS documentation requirements were complied with.**
- Re-underwrite the loans and identify any compensating factors that were used for loans with ratios exceeding FHA guidelines.**

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Post Audit (cont.)

- Where the audit findings allege that false information or documents were submitted the burden of proof is on the OIG to demonstrate that the lender knew or should have know of this.**
- If the lender believes that it was a victim of fraudulent acts on the part of other parties this should be fully explained.**

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Post Audit (cont.)

- If any of the alleged violations were previously reported to HUD prior to the audit this should be explained.**
- If the audit findings allege that the lender's employees participated in or were aware of the alleged violations, interview those employees to determine if the findings are correct, and if not correct obtain written statements from the employees and submit them with the response.**

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Post Audit (cont.)

- Explain the corrective measures that have been implemented either prior to or after the audit to preclude a recurrence of any valid shortcomings cited by the audit.**
- ❖ **After reviewing the lender's response to the draft audit report the OIG issues a final audit report:**
 - **The lender's response is made part of the final audit report as an attachment.**

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Post Audit (cont.)

- **The final audit report contains the OIG's recommendations to HUD (these can include indemnification, administrative sanctions, and civil money penalties.**
- **The final audit report is issued to either the FHA Commissioner or HUD's Mortgagee Review Board for resolution.**
 - ❑ **A copy of the audit report is provided to the lender.**

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Post Audit (cont.)

- **The FHA Commissioner or Mortgagee Review Board informs the lender of the proposed action to be taken on the OIG's audit recommendations.**
 - ☐ **The proposed action may include a demand for indemnification.**

Managing OIG Audits

Post Audit (cont.)

- **The Mortgagee Review Board has authority to impose administrative sanctions (including withdrawal of FHA approval) and civil money penalties.**
- **The Mortgagee Review Board can impose civil money penalties of \$7,500 per violation up to \$1.375 million for all violations during any one year.**