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Audit Report Number	2005-FW-1009

TO: Frank L. Davis
General Deputy Assistant Secretary for Housing, H

FROM: Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: Allied's Quality Control Process Did Not Comply with HUD Requirements

HIGHLIGHTS

What We Audited and Why

As part of the U.S. Department of Housing and Urban Development/Office of Inspector General's (HUD/OIG) strategic plan, we audited Allied Home Mortgage Capital Corporation (Allied), a nonsupervised loan correspondent. We chose Allied for audit because of its high loan default rate. Our audit objectives were to determine whether Allied: (1) implemented a quality control plan according to HUD requirements and (2) complied with HUD regulations, procedures, and instructions in the origination of Federal Housing Administration insured single family mortgages.

What We Found

Allied had a quality control plan that complied with HUD requirements. However, it did not fully implement the plan. Allied did not always review early payment defaults, perform reviews of its offices, or complete its monthly quality control reviews in a timely manner. In addition, Allied's monthly quality reviews were vague and failed to adequately address corrective actions. This occurred because Allied did not dedicate the resources necessary to operate an effective quality control program. As a result, Allied was unable to ensure the accuracy, validity, and completeness of its loan origination process.

Allied did not follow HUD requirements when originating 20 Federal Housing Administration mortgages reviewed. Because Allied's Federal Housing Administration sponsors are ultimately responsible to HUD for these deficiencies, we will address them to the appropriate sponsors in separate reports.

What We Recommend

We recommend that HUD's general deputy assistant secretary for housing:

- Ensure that Allied fully implements its quality control program.
- Take appropriate administrative actions to include civil money penalties.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

Allied disagreed with the report but acknowledged some deficiencies in its quality control procedures. The complete text of the auditee's response, along with our evaluation of that response, can be found in Appendix A of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding Allied Did Not Fully Implement Its Quality Control Plan	5
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Auditee Comments and OIG's Evaluation	11

BACKGROUND AND OBJECTIVES

Section 203(b)(1) of the National Housing Act, as amended, authorizes the U.S. Department of Housing and Urban Development (HUD) to provide mortgage insurance for single family homes. HUD must formally approve a lender that originates, purchases, holds, or sells Federal Housing Administration-insured loans. Lenders must follow the statutory and regulatory requirements of the National Housing Act and HUD's instructions, guidelines, and regulations when originating insured loans. Lenders that do not follow these requirements are subject to administrative actions.

On September 26, 1991, HUD approved Allied Home Mortgage Capital Corporation (Allied) as a nonsupervised loan correspondent lender to originate Federal Housing Administration loans. As a condition for its approval, HUD required Allied to establish and maintain a quality control plan for the origination of insured loans. The quality control plan must be a prescribed function of Allied's operations and assure that it maintains compliance with HUD's requirements and its own policies and procedures.

As a loan correspondent, Allied must send the Federal Housing Administration loans it originates to a HUD-approved direct endorsement sponsor for underwriting approval before loan closing and submission to HUD for insurance endorsement. The loan origination process includes taking initial loan applications, initiating the appraisal assignment, obtaining the credit report, and procuring verifications of deposit and employment. Based on the information gathered by the loan correspondent, the sponsor lender underwrites the loan and decides whether the borrower represents an acceptable credit risk for HUD.

We selected Allied for audit because of its high loan default rate within the state of Texas. From July 1, 2002, to June 30, 2004, Allied originated 4,779 loans and experienced a default rate of 6.51 percent for loans defaulting in the first two years. The default rate for the state of Texas was only 4.31 percent. We limited our file reviews to the Hurst branch because it had the greatest number of early defaults of all of Allied's HUD-approved branches in Texas. Allied voluntarily terminated the Hurst branch on March 23, 2004.¹ Our audit objectives were to determine whether Allied: (1) implemented a quality control plan according to HUD requirements and (2) complied with HUD regulations, procedures, and instructions in the origination of the Federal Housing Administration insured single family mortgages.

¹ Although we selected the Hurst branch for review, none of the loans in our sample was actually originated by the Hurst branch. Instead, seven different satellite offices using the Hurst branch's identification number originated the loans. Six of these satellite offices are still originating Federal Housing Administration loans for Allied using the branch identification numbers of other HUD-approved branches.

RESULTS OF AUDIT

Finding: Allied Did Not Fully Implement Its Quality Control Plan

Allied had a quality control plan that complied with HUD requirements. However, it did not fully implement the plan. Allied did not always review early payment defaults, perform reviews of its offices, or complete its monthly quality control reviews in a timely manner. In addition, Allied's monthly quality reviews were vague and failed to adequately address corrective actions. This occurred because Allied did not dedicate the resources necessary to operate an effective quality control program. As a result, Allied was unable to ensure the accuracy, validity, and completeness of its loan origination process. This contributed to an increased risk of loss to HUD's insurance fund.

Allied Is Behind in Performing Early Payment Default Reviews

Allied is at least a year behind in performing early payment default reviews. Allied said it was not aware it had to perform early payment default reviews until a HUD monitoring review in January 2003. However, we noted its quality control plan, dated September 2000, included provisions to review early payment defaults. HUD did not issue its written monitoring findings until June 29, 2004. Afterwards, Allied began performing early payment default reviews starting with the oldest loans still shown in default. In October 2004, Allied issued its first report. Allied officials acknowledge they are at least a year behind in performing early payment default reviews. HUD Handbook 4060.1, REV-1, CHG-1, "Mortgagee Approval Handbook," requires lenders to review all loans going into default within the first six payments.

Allied Office Reviews Were Not Conducted in a Timely Manner

Allied did not review all of its branch offices in 2004. Allied had 607 branches but only performed quality control reviews of 331 branches. HUD Handbook 4060.1, REV-1, CHG-1, requires lenders to conduct audits of their branch offices annually or provide written criteria supporting less frequent reviews. Allied's quality control plan states the operations department will conduct regular onsite audits of new branches within 90 days of opening and perform yearly audits of existing branches as part of its ongoing commitment to quality control.

On January 21, 2005, we requested that Allied provide the most recent reviews for the branch offices in our sample. As can be seen from the table below, the

reviews were not performed until after our request and were more than six months late.

Branch office	Date of most recent review	Prior review	Months late
Hurst 669 Airport Freeway	01/25/2005	06/24/2003	7
Dallas 3140 Coit Road	Closed	04/25/2001	N/A
Richardson 1202 Richardson Drive	01/24/2005	06/25/2003	7
Arlington 1006 N. Bowen Road	01/25/2005	06/27/2003	7
Arlington 3100 W. Arkansas	01/25/2005	06/26/2003	7
Dallas 14001 Goldmark Drive	01/24/2005	06/25/2003	7
Brownwood 807 B Center Street	01/26/2005	05/07/2003	9
Allen 303 S. Jupiter Road	01/24/2005	06/25/2003	7

Allied explained that it has experienced a lot of staff turnover within the operations department responsible for the reviews. The operations manager and several employees resigned in April, May, and June 2004. In September and October 2004, Allied only had two employees on staff. As of March 14, 2005, Allied had five employees in the operations department including the operations manager. Allied considers the department fully staffed. We question whether a staff of four is sufficient to review 607 branches annually.

Allied's Monthly Monitoring Reviews Were Not Always Completed in a Timely Manner

Allied did not review loans within 90 days of closing. HUD requires lenders to review 10 percent of their loans within 90 days after the loan is closed. In March 2005, we requested that Allied provide support for its monitoring reviews for loans closed in September 2004. We requested copies of Allied's reverifications of credit, employment, deposits, and appraisals for the 53 loans in its sample. We found Allied did not begin reverifications for half of the loans until more than 150 days after the loans closed. Further, Allied did not verify employment for 15 of the loans and did not provide evidence that it conducted desk reviews of the property appraisals.

Allied's Monthly Monitoring Review Reports Were Vague

Allied used vague language in its reports to describe the reverification of employment and deposits and field reviews of appraisals. The reports did not identify the reverifications Allied requested, the reverifications received, or any outstanding reverifications. They only stated, "Re-verifications of Employment, Previous Employment and Deposits are being completed on 100 percent of the audit sample for the current reporting period. There have been no discrepancies noted between the original documentation and the re-verifications that were received." For the field reviews of appraisals, the reports stated review appraisals were ordered and completed for 10 percent of the audit sample. However, the report did not detail which appraisals were requested or provide the results of each new appraisal. The lack of specificity limits the usefulness of the reports and calls into question the quality of the reviews.

Allied's Monthly Monitoring Review Reports Did Not Identify Effective Corrective Actions

Allied's monthly quality control reports did not adequately address corrective actions. While all of the 2004 reports identified deficiencies, Allied proposed general corrective actions that did not address the specific deficiencies identified. For example, the August report rated two loan files as serious due to a missing credit report and appraisal. Although the report noted that Allied instructed the branch managers to provide missing documentation, it did not state why the deficiencies occurred. Further, Allied limited the report recommendations to a discussion of regional training sessions and improvements in the quality control review process. HUD Handbook 4060.1, REV-1, CHG-1, requires quality control reports to identify planned corrective actions, the timetable for their completion, and any planned follow-up actions. Allied needs to improve its quality control reviews by developing and reporting corrective actions aimed at preventing the specific deficiencies identified.

Prior HUD Review Questioned Allied's Quality Control Procedures

HUD questioned Allied's implementation of its quality control plan during a January 2003 review of its Albertville, Alabama branch. In its June 2004 monitoring letter, HUD requested that Allied submit documentation supporting its quality control review efforts for the prior six months for all branches using the

Albertville, Alabama branch identification number. In reviewing the documentation submitted by Allied, HUD concluded that Allied's early payment default loan summary was "very general" and failed to include specifics such as the results or reverifications performed. HUD also found that Allied had not performed early payment default reviews for all loans defaulting in six or fewer payments. In addition, HUD questioned the effectiveness of management's corrective actions as Allied had not reduced or eliminated problems such as missing documentation, unallowable fees, or overcharges for credit reports over the six-month period. Since Allied has yet to fully implement its quality control plan, we recommend HUD take appropriate administrative actions to reduce the risk to HUD's insurance fund.

Recommendations

We recommend that the general deputy assistant secretary for housing:

- 1A. Ensure Allied brings its quality control process into full compliance with Federal Housing Administration rules.
- 1B. Take appropriate administrative actions to include civil money penalties.

SCOPE AND METHODOLOGY

We conducted the audit at Allied's main office in Houston, Texas. We conducted our audit from August 2004 through March 2005. To accomplish our objectives, we:

- Reviewed applicable HUD handbooks and mortgagee letters.
- Interviewed HUD staff, Allied management, and loan borrowers.
- Reviewed Allied's quality control plan and quality control reviews.
- Performed site visits to 17 homes in our sample.
- Mailed postal tracers to borrowers.
- Performed Lexis/Nexis searches on borrowers.
- Reviewed 20 Federal Housing Administration-insured loans.

We reviewed 20 of the Federal Housing Administration-insured loans originated under the Hurst branch identification number between July 2002 and June 2004. The nonrepresentative selection of 20 loans was from a universe of 4,779 loans originated by Allied within the state of Texas. All of the borrowers in our sample defaulted on their loans after making two payments or fewer. The results of our detailed testing apply only to the 20 loans selected and cannot be projected to the universe of 4,779 loans.

We relied, in part, on data maintained by HUD in the Single Family Data Warehouse and Neighborhood Watch systems. We did not perform a detailed analysis of the reliability of HUD's Single Family Data Warehouse or Neighborhood Watch data.

The audit covered the period from July 2002 through June 2004. The period was adjusted as necessary. We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operation;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Control

We determined the following internal control was relevant to our audit objectives:

- Controls over origination of Federal Housing Administration loans.

We assessed the relevant control identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our audit, we believe the following item is a significant weakness:

- Allied did not fully implement its quality control plan consistent with HUD requirements.

APPENDIXES


Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1



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BY OVERNIGHT MAIL

Mr. Frank E. Baca
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Region VI, Office of Inspector General
819 Taylor Street, Room 13A09
Fort Worth, Texas 76102

Re: Allied Home Mortgage Capital Corporation
 April 2005 Draft Audit Report

Dear Mr. Baca:

This is in reply to your letter of April 14, 2005, to Allied Home Mortgage Capital Corporation (“AHMCC” or the “Company”) forwarding a copy of a draft audit report (the “Draft Audit Report”) prepared by your office regarding the Company. The Draft Audit Report reviews the practices of AHMCC in implementing its quality control plan and the origination of HUD-FHA insured mortgages. The audit covered the period of January 2002 to June 2004. This letter provides the formal comments of the Company on the Draft Audit Report.

The Company appreciates the opportunity to comment on the Draft Audit Report. Respectfully, however, AHMCC differs in important ways with certain key findings and recommendations in the Draft Audit Report, as discussed below.

We address below each of the findings in the Draft Audit Report.

FINDING: ALLIED DID NOT FULLY IMPLEMENT ITS QUALITY CONTROL PLAN

Allied is Behind in Performing Early Payment Defaults:

Allied Home Mortgage Capital Corporation (“AHMCC”) has always been fully

committed to strict compliance with HUD requirements regarding quality control reviews in accordance with HUD Handbook 4060.1 REV-1, CHG-1, Paragraph 6-6 (D), with respect to performing quality control reviews of early payment defaults. To insure that reviews are completed timely, AHMCC has added additional staff to its Quality Control Department. The additional staff is presently devoting the majority of their time and effort to early payment default reviews. AHMCC believes that this will help to ensure that quality control reviews of early payment defaults are completed timely.

AHMCC for the most part previously relied on its sponsors to perform quality control reviews of early payment defaults since AHMCC's sponsors performed the underwriting function. When the findings of the HUD monitoring review of AHMCC performed in January 2003 were received from HUD by AHMCC on June 29, 2004, AHMCC diligently began performing early payment default reviews on the oldest loans still shown in default. AHMCC's first report with respect to these reviews was issued in October 2004. Respectfully, the Draft Audit Report is incorrect in stating that AHMCC began performing such reviews in October 2004.

The OIG indicates in this finding that HUD Handbook 4060.1 Rev-1 CHG-1 (the "Handbook") requires lenders to review all loans going into default within the first six payments.

It is significant to note that the Handbook states further:

"... as defined here, early payment defaults are loans that become 60 days past due."

AHMCC respectfully submits that HUD's requirements regarding the timelines of quality control reviews are inconsistent and provide conflicting instructions. AHMCC, as a HUD-FHA approved loan correspondent, is placed in a difficult position regarding compliance with these requirements.

Comment 2

The Handbook requires a lender to perform quality control reviews of loans within 90 days of closing. However, a default may occur outside the 90-day timeframe established by HUD. Therefore, in many instances it would not be possible to comply with this requirement. Respectfully, this 90-day requirement cannot be applied to early payment defaults.

Importantly, HUD does not address this issue or provide guidance to the lender in any written instruction regarding the timelines for performing quality control reviews of early payment defaults.

It would be unfair for the OIG to allege that AHMCC did not timely perform quality control review of early payment defaults, when in fact, HUD has no guidelines for the timeframe with respect to completing such reviews.

Further, and importantly, AHMCC's sponsoring lenders do not always report early payment defaults immediately nor can AHMCC track these loans by endorsement date through Neighborhood Watch for targeting such loans for quality control reviews. Specifically, if a loan is originated in January 2004 and endorsed immediately and the first payment date is March 2004 with a late payment occurring during the last possible reporting date to HUD in September 2004, that payment would be reported as late by the sponsoring lender, for default purposes which would have been due for the November or December 2005 payment.

Accordingly, AHMCC would not have access to the default information through Neighborhood Watch data until January or February 2005. This is 12 months from the closing date. Under these circumstances, AHMCC is unable to be timely informed that a loan is an early payment default and should be targeted for a quality control review.

The HUD Handbook requires lenders to review all early payment defaults that become 60 days past due. Correspondent lenders are instructed by HUD to use Neighborhood Watch to monitor defaults for early payment default reviews. However, in Mortgagee Letter ML 00-20

Comment 3

Comment 4

Neighborhood Watch is described as a tool which identifies lenders, loan types, and locations by zip code that have a high incidence of single-family insured mortgages going into default (90 days delinquent) within the first or second year from loan origination. AHMCC respectfully submits that HUD's instructions are inconsistent with the Handbook requirements since Neighborhood Watch identifies only those loans that are in default 90 days or more.

Since HUD's Neighborhood Watch data displays loans that are 90 days or more in default, this data does not provide the necessary information regarding early payment defaults 60 days past due that a lender needs to meet HUD's requirements as stated in the Handbook.

It is further important to recognize that AHMCC is a loan correspondent and thus, does not service the loans that it originates. AHMCC relies primarily on information in HUD's Neighborhood Watch system to monitor early payment defaults.

Comment 5

Further, sponsoring lenders generally will not furnish AHMCC with payment histories or other pertinent information regarding early payment defaults for monitoring and quality control review purposes because of privacy policies of the sponsoring lender. Without this information, AHMCC is unable to identify all of the early payment defaults that need to have a quality control review performed.

AHMCC respectfully submits that HUD's requirements for quality control reviews of loans going into default within the first six payments were developed for lenders other than a loan correspondent, with the assumption that such lenders have data readily available regarding all early payment defaults. This is simply not applicable to a loan correspondent that must rely upon HUD's data in the Neighborhood Watch system and its sponsors to identify early payment defaults and provide this information to the loan correspondent in order to perform quality control reviews. Respectfully, this places an unfair burden on the loan correspondent that other types of HUD-FHA approved lenders are not faced with.

AHMCC is diligently monitoring the data in Neighborhood Watch to identify and target early payment defaults for quality control reviews. Further, AHMCC has hired additional staff to focus primarily on performing quality control reviews of early payment defaults and believes that any shortcomings that may have existed have been corrected. AHMCC will continue also to work diligently with its sponsoring lenders to obtain information regarding early payment defaults to target for its quality control reviews all such defaults that are not shown in the Neighborhood Watch system.

AHMCC respectfully submits that no administrative action or civil money penalties against AHMCC are warranted based on this finding.

Allied Office Reviews Were Not Conducted in a Timely Manner:

It is AHMCC's policy to comply fully with HUD requirements for timely performing reviews of AHMCC's branch offices. AHMCC recognizes that there were some shortcomings in our performance in 2004. Respectfully, however, the reason that all of our branch offices did not receive an annual review was due to staff turnover within the operations department which is responsible for performing the annual reviews. In the second quarter of 2004, AHMCC's operations manager left along with several employees that worked in the department. As a result, the timeliness of branch reviews was affected.

Further, in this finding, the OIG notes that AHMCC had 607 branches but only performed quality control reviews of 331 branches.

AHMCC respectfully submits that the OIG is incorrect. Specifically, at the end of 2004, AHMCC:

- Had 607 branch offices.
- Added 136 branch offices during 2004 that were not due for a review until 2005.

Comment 6

Comment 7

- Of the 136 new branch offices, AHMCC completed reviews of 48 of these offices.
- Reviewed 283 existing branch offices.
- Completed 24 remote branch reviews in accordance with HUD Handbook 4060.1 Rev-1, CHG-1, Paragraph 6-3(F).

Accordingly, there were 164 branch offices that did not receive a review in 2004 as a result of staff turnover.

Importantly, AHMCC now has five full time auditors and a departmental manager. The department is fully staffed and trained. Significantly, 305 onsite branch office audits have been completed year to date by AHMCC including 27 remote audits. The problem with staffing that occurred previously has been corrected and reviews are being performed timely.

AHMCC respectfully submits that no administrative action or civil money penalties against AHMCC are warranted based on this finding.

Allied's Monthly Monitoring Reviews Were Not Always Completed in a Timely Manner:

Comment 8

The OIG's findings regarding reverifications and desk reviews of appraisals and timeliness of reviews relate to AHMCC's monitoring reviews for loans that were closed in September 2004. As stated elsewhere in this response, AHMCC's reverifications were previously logged on a separate form and were not available on the loan summary reports. With respect to the 21 loans for which the OIG indicates that reverifications of employment were not ordered, 6 of these were non-credit qualifying streamline refinances that did not require reverifications, and for others, the employers failed to respond to AHMCC's requests for reverification of the information sought.

Comment 9

Comment 10

Further, desk reviews of appraisals were performed by AHMCC but previously not reflected on the loan summary reports. Copies of each review appraisal performed were retained in AHMCC's loan files.

AHMCC has changed the procedures that it uses in its reverification process of credit, employment, deposits, and appraisals. The information for all reverifications including credit, employment, deposits, desk and field appraisal reviews is now documented directly on the individual loan summary reports that print out of the quality control software system that AHMCC utilizes. Whatever shortcomings may have existed have been corrected.

AHMCC recognizes that there were some shortcomings in timely completing quality control reviews and obtaining reverifications in the latter part of 2004. As stated previously, this problem occurred as a result of the turnover of staff in AHMCC's operations department. This has been corrected. The department is fully staffed and trained. Quality control reviews are now performed timely including the reverification process.

AHMCC respectfully submits that no administrative action or civil money penalties against AHMCC are warranted based on this finding.

Allied's Monthly Monitoring Review Reports Were Vague:

In September 2004, AHMCC updated its software system with respect to its quality control program. AHMCC further received from the manufacturer of the quality control system software comprehensive on-site training for AHMCC's quality control staff.

It is important to note that previously when reverifications were ordered and received by AHMCC, they were logged on a separate form and were not available for downloading on to the individual loan summary reports that print out of the software system. Significantly, however,

the reverifications were always retained by AHMCC and served as a record for all reverifications.

The update to AHMCC's quality control system now enables the reverification information to be printed on the individual loan summary reports, and importantly, on the monthly management reports. Further, this update also enables AHMCC to provide a more comprehensive monthly report as it accumulates and displays historical data and current audit findings in order to track and trend analysis.

Further, the update to AHMCC's quality control system indicates which appraisals were requested and provides the results of each new appraisal.

AHMCC respectfully submits that no administrative action or civil money penalties are warranted based on this finding.

Allied's Monthly Monitoring Review Reports Did Not Identify Effective Corrective Actions:

Allied respectfully disagrees with the OIG's conclusions regarding this finding.

The OIG cites AHMCC's August 2004 monthly monitoring report which indicates a problem with missing documentation in connection with two loans.

AHMCC strives diligently to take corrective action, as appropriate, and to maintain complete loan origination files. However, AHMCC's sponsoring lenders and title companies do not routinely provide AHMCC with copies of all HUD loan file documentation. This includes the signed MCAW, and the automated-underwriting findings that typically include credit reports and loan conditions that are obtained directly by the sponsoring lender. Therefore, AHMCC must continually follow up with the sponsoring lender and title companies to obtain these

documents. To address this issue, AHMCC has developed and implemented forms that are now sent to the title companies and sponsoring lenders to assist in obtaining missing documentation along with aggressive follow up action by AHMCC.

With respect to the two loans that were specifically cited by the OIG, AHMCC's August 2004 quality control report clearly states that one of the loans was missing a credit report that had been obtained through the sponsoring lenders' automated underwriting system. A copy of the credit report has been obtained by AHMCC and is now in the hardcopy of the file. The other loan had an electronic appraisal that the branch failed to copy and retain in the hard copy of the loan file. AHMCC respectfully notes that the August 2004 monthly report specifically addresses these issues.

Importantly, AHMCC has been working diligently for an extended period of time to correct any shortcomings. Regional training sessions are being conducted as noted in AHMCC's August 2004 report and several other quality control reports. These regional training sessions and onsite monitoring and training conducted by AHMCC are an important part of the continuing effort by AHMCC as part of its quality control process to train branch personnel with respect to quality control issues. As stated in AHMCC's August 2004 quality control report, these training sessions have resulted in significant improved audit results. AHMCC's August 2004 report further explains that the QC staff has implemented a more rigorous and inclusive follow up program, which has also improved audit results. Respectfully, AHMCC submits that its monthly review reports do, in fact, identify effective corrective actions taken by AHMCC

Further, AHMCC's Management is in the process of making significant changes to its quality control procedures regarding findings noted during reviews. These changes will further insure that reports more clearly define and identify planned corrective action, timetables for their completion and any planned follow-up actions. These changes include aggressive follow up with sponsoring lenders to obtain missing documentation at the regional and corporate level. AHMCC has also established specific time frames for responses from branches with respect to

Comment 11

quality control reviews that include providing missing documents and correction of deficiencies. Branch offices that do not comply with maintaining complete and accurate loan origination files will incur a fine for noncompliance and will be subject to additional onsite operational audits and training.

AHMCC respectfully disagrees with OIG's conclusions that AHMCC's monthly monitoring review reports did not provide effective corrective actions.

Prior HUD Review Questioned Allied's Quality Control Procedures:

Allied respectfully disagrees with OIG's conclusions regarding this finding. It should be noted that HUD's January 2003 review of the Albertville, Alabama branch findings were not issued until June 2004 (a year and a half later). In the June 2004 report HUD alleged that AHMCC had not provided previous QC reviews or reports to management indicating that a review of the Albertville branch was performed. This allegation was disputed in the response from AHMCC to HUD dated August 30, 2004. In fact, the reports were provided to the HUD staff member during the January 2003 review. Further, HUD responded to AHMCC on September 23, 2004 and did not include this finding in HUD's final report. Respectfully, this confirms that the finding from the 2003 HUD review, which is the basis for the OIG finding, is incorrect.

AHMCC has fully responded in finding number one of this document regarding early payment defaults and the management report issues cited by the OIG in findings four and five.

AHMCC also respectfully disagrees with HUD's conclusion that AHMCC management's corrective actions have not reduced or eliminated problems such as missing documentation, unallowable fees, or overcharges for credit reports over the six-month period. Specifically, the six-month period is defined in HUD's response to AHMCC dated September 23, 2004 as the

Comment 12

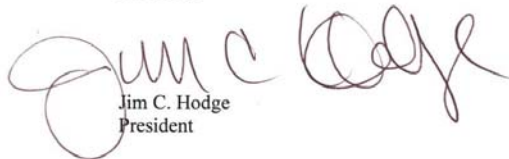
period from November 2003 to April 2004. It is significant to note that in November 2003, 39 loans had missing documents, December 2003 had 41, January 2004 had 15, February 2004 had 9, March 2004 had 12, and April 2004 had 15. This clearly demonstrates that corrective actions implemented by AHMCC have reduced and are eliminating the problem of missing documentation. In May 2004 there were not any overcharges of credit report fees or unallowable fees noted as compared to the period of November 2003 to April 2004. The improvement of documents and charges of fees that were missing or incorrect were the areas that AHMCC concentrated on during the regional trainings of its branch office personnel.

AHMCC respectfully submits that no administrative action or civil money penalties against AHMCC are warranted based on this finding.

Conclusion

Again, AHMCC appreciates this opportunity to respond to the Draft Audit Report. Respectfully, however, we note that a number of the alleged findings are not supported or represent a misunderstanding of the facts and we disagree with the Office of Inspector General's conclusions. Where there were some shortcomings in our performance, they have been corrected. AHMCC has always been committed fully to strict compliance with HUD-FHA requirements. AHMCC respectfully submits that no administrative action or civil money penalties against the Company are warranted, and that the audit report findings should be resolved with the Quality Assurance Division for the HUD Denver Homeownership Center.

Sincerely,



Jim C. Hodge
President

Comment 13

OIG Evaluation of Auditee Comments

- Comment 1** The scope of our review was July 2002 through June 2004. However, we extended our review of Allied's quality control program through December 2004 due to the problems we found.
- Comment 2** We revised the draft to indicate that Allied issued its first report on early payment default reviews in October 2004.
- Comment 3** Allied officials do not believe it is fair for the OIG to state that Allied did not perform timely early payment default reviews since HUD does not provide a specific time frame for completing the reviews. We disagree. In order for the reviews to be useful to management, they must be completed in a timely manner. At the time of our review, Allied officials acknowledged being at least a year behind in performing early payment default reviews.
- Comment 4** We limited our review to loans identified by Neighborhood Watch as early payment defaults.
- Comment 5** Allied provides a number of explanations as to why it would have difficulty identifying early payment defaults beyond those identified by Neighborhood Watch. However, Allied does not offer an explanation as to why it did not timely review the early payment defaults identified by Neighborhood Watch. Allied's quality control plan requires early payment default reviews and limits the reviews to loans that go 90 days without payment.
- Comment 6** Allied's quality control plan requires on-site reviews of all new branches within 90 days of branch opening. Accordingly, only those branches opened in the last quarter of 2004 would be exempt from on-site monitoring.
- Comment 7** We did not consider Allied's remote branch reviews because Allied was unable to provide written criteria supporting its decision not to review the branches on-site. HUD requires lenders to conduct annual, on-site branch reviews or establish written criteria for less frequent monitoring.
- Comment 8** We did not base our report conclusions solely upon the content of the loan summary reports. We requested Allied provide copies of the reverifications it performed for its September 2004 monthly monitoring review. We based our findings upon an analysis of the documentation provided by Allied.
- Comment 9** We revised the report to state that Allied did not verify employment for 15 of the loans.
- Comment 10** Allied was unable to produce copies of desk reviews of appraisals for loans included in its September 2004 monthly monitoring review.

Comment 11 Allied believes its monthly review reports identified effective corrective actions. We disagree. As noted in the report, Allied provided general corrective actions that did not address the specific deficiencies identified.

Comment 12 We revised the report to exclude information HUD reported in their June 2004 monitoring letter.

Comment 13 We believe our report accurately identifies a number of deficiencies in Allied's quality control procedures. We commend Allied on its efforts to improve its quality control process and hope it will continue to make the improvements necessary to come into full compliance with HUD requirements. We also appreciate the professionalism and courtesy extended to audit staff.