



Issue Date	May 4, 2005
Audit Report Number	2005-DE-1003

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

//signed//

FROM: Ronald J. Hosking, Regional Inspector General for Audit, 8AGA

SUBJECT: Citywide Home Loans in Salt Lake City, UT, Did Not Comply with Federal Housing Administration Loan Origination and Quality Control Requirements

**HIGHLIGHTS**

**What We Audited and Why**

We audited Citywide Home Loans (Citywide) in Salt Lake City, UT. We determined an audit was warranted based on loan origination and quality control deficiencies identified in a prior audit.

Our audit objectives were to determine whether Citywide complied with U.S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions in the origination of insured loans selected for review and to determine whether Citywide’s quality control plan, as implemented, met HUD’s requirements.

**What We Found**

Citywide did not comply with HUD regulations, procedures, and instructions in the origination of 20 of the 23 loans selected for review. Citywide used independent loan officers to originate insured loans. HUD prohibits this practice because it represents an increased risk to the insurance fund.

Citywide’s quality control reviews were not performed in a timely manner, and corrective actions taken for deficiencies identified were not documented.

Citywide used a contractor to implement its quality control plan. However, the contractor completed only 42 percent of the required quality control reviews of the loan files within the 90 days timeframe requirements.

### **What We Recommend**

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner take appropriate action as recommended in the two findings of this audit report. This action should include requiring Citywide to bring its policies and procedures for the origination of insured loans into full compliance with HUD regulations and to fully implement its quality control process.

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**

We provided the discussion draft of the audit report to Citywide on March 25, 2005, and requested its comments by April 18, 2005. Citywide provided its written response on April 14, 2005. Citywide generally disagreed with finding 1 and generally agreed with finding 2. The complete text of Citywide's response, along with our evaluation of that response, can be found in appendix A of this report. Along with its comments, Citywide provided an updated quality control plan. However, we did not include the updated quality control plan in the report.

# TABLE OF CONTENTS

---

Background and Objectives	4
Results of Audit	
Finding 1: Citywide Allowed Independent Contractors To Originate Federal Housing Administration-Insured Loans	5
Finding 2: Citywide’s Quality Control Process Is Deficient	7
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Auditee Comments and OIG’s Evaluation	11

## **BACKGROUND AND OBJECTIVES**

---

In December 1998, Citywide Home Loans (Citywide) was incorporated in Utah as a for-profit corporation. Citywide originates Federal Housing Administration, Veterans Affairs, and conventional mortgage loans. Citywide received approval from the U.S. Department of Housing and Urban Development (HUD) as a Title II nonsupervised loan correspondent on April 20, 2000. We reviewed Citywide's loan origination and quality control activities at its main office located at 4001 South 700 East, Suite 250, Salt Lake City, UT 84107.

Citywide originated 1,156 Federal Housing Administration-insured loans, with a beginning amortization date between April 1, 2001, and August 31, 2004, for properties located in Utah. The total mortgage amount for these loans was \$146,036,270. As of August 31, 2004, insurance claims had been paid on 38 loans, 82 loans had defaulted, and 26 loans were still in default. As of December 30, 2004, HUD had paid insurance claims on 11 of the 23 loans that we reviewed, with losses on the sale of six of the 11 loans totaling \$287,115.

Between January 2003 and September 2004, Citywide had 67 independent contract loan officers originating insured loans.

The objectives of our review were to determine whether Citywide complied with HUD's regulations, procedures, and instructions in the origination of insured loans selected for review and to determine whether Citywide's quality control plan, as implemented, met HUD's requirements.

## RESULTS OF AUDIT

---

### Finding 1: Citywide Allowed Independent Contractors To Originate Federal Housing Administration-Insured Loans

Citywide allowed independent contractors, self-employed individuals as defined by Internal Revenue Service Form 1099, to originate Federal Housing Administration-insured loans. HUD prohibits using contract loan officers because it represents an increased risk to the insurance fund. Citywide told us it was acting upon verbal comments made by HUD staff that its loan origination procedures were in compliance with HUD requirements. However, these procedures did not fully comply with HUD's written requirements.

---

#### Use of Independent Contract Loan Officers

For 20 of 23 loans reviewed, Citywide permitted independent contract loan officers, who did not receive on-going supervision, to originate HUD-insured single family mortgage loans.<sup>1</sup> Citywide entered into written agreements with the independent loan officers that defined their business relationship as a contracted service, rather than an employer-employee relationship. Citywide compensated the loan officer contractors for each insured loan closed by paying commissions. The commissions were based on the size of the loans, less administrative and processing fees and a charge for office space. The agreements also contained provisions indemnifying Citywide from any risk associated with the loan officers' contracted responsibilities.

Citywide management informed the OIG that they were acting upon verbal confirmation received from HUD program staff that its operations complied with HUD requirements. Citywide management also stated that they were following what they believed to be the industry norms within the state of Utah for the origination of government insured loans.

However, HUD Handbook 4060.1, REV-1<sup>2</sup>, and Mortgagee Letter 95-36 prohibits lenders from using these business relationships to originate insured loans. HUD requires that lenders originate insured loans only with their own employees and supervise their loan production.

Citywide has since revised its business relationship with its loan officers by eliminating the indemnification provision in the contracts and references to

---

<sup>1</sup> Mortgagee Letter 95-36.

<sup>2</sup> Handbook 4060.1, REV-1 was subsequently revised during our audit period. The revision is Handbook 4060.1, REV-1, CHG-1.

“independent contractor.” However, we believe these steps are insufficient for full compliance with HUD requirements.

Over the course our audit, we have seen evidence of Citywide's attempts to come into compliance with HUD's requirements. As mentioned above, Citywide has re-written their contract to eliminate the indemnification provision. The majority of Citywide's loan officers now work in Citywide's office, which allows Citywide to provide the loan officers with increased supervision. We believe that Citywide is continuing to work towards full compliance with HUD requirements.

## **Conclusion**

Citywide did not fully comply with HUD's written requirements. According to Citywide's owner, he believed that the company operated in compliance with HUD requirements. Citywide's owner believed he was in compliance because HUD staff provided him with verbal clarification that the practice of using Internal Revenue Service Form 1099 was OK. However, the verbal clarification did not support HUD's written requirements. It is Citywide's responsibility to obtain written approval from HUD program staff for any deviations from HUD's written requirements. Citywide's owner also stated that paying the contract loan officers as self-employed entities, instead of company employees, was simply a business decision that increased their commission income.

HUD prohibits using contract loan officers because it represents an increased risk to the insurance fund. We believe that Citywide did not exercise the required level of supervision over these loan officers and their loan origination activities.

## **Recommendations**

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner

- 1A Ensure Citywide has changed its policies and procedures for the origination of Federal Housing Administration-insured loans to fully comply with all HUD directives and regulations.

## Finding 2: Citywide's Quality Control Process Is Deficient

Citywide's quality control plan does not contain all of the elements required by HUD. The quality control reviews were not performed in a timely manner, and corrective actions taken for the noted deficiencies were not documented. Further, Citywide did not report withdrawn and denied loans in accordance with the Home Mortgage Disclosure Act. The deficiencies associated with Citywide's quality control process are due to Citywide not fully complying with HUD's and its own requirements. Because its quality control processes are deficient, Citywide is unable to ensure the accuracy, validity, and completeness of its loan origination operations.

---

### **Plan Does Not Contain All Required Elements**

Our review disclosed that Citywide's quality control plan does not contain all of HUD's required elements. For example, the plan does not require the assurance of loans being processed by employees or authorized agents of Citywide, nor does the plan require the analysis of all loans that default within the first 6 months. Citywide was not aware that this was a requirement. Further, the plan has not been updated to incorporate changes as a result of the revised chapter 6 of HUD Handbook 4060.1-REV-1, CHG-1. Citywide explained that it did implement the changes, but it had not updated the plan to reflect those changes.

### **Reviews Performed Late**

Citywide did not adequately monitor the performance of its quality control contractor. Citywide used a third party contractor to perform its quality control reviews. However, the reviews were not performed in a timely manner. Additionally, the corrective actions taken for deficiencies were not documented. We found that 58 percent of the quality control reviews of loans selected for review were performed more than 90 days after the loans were closed. According to Citywide management, Citywide submitted reports to its third party contractor for selection of loans for review on time. However, the third party contractor was late in performing the quality control reviews. Citywide was unaware that the reviews were being performed late until it was identified by the OIG.

Following our onsite review in September 2004, Citywide sent a letter to its third party contractor requesting that the quality control reviews be performed within the 90-day requirement.

### **Reporting Requirements Not Met**

Citywide did not meet HUD's requirements for reporting withdrawn or denied applications based on credit decisions in accordance with the Home Mortgage Disclosure Act. Citywide did not comply with the Home Mortgage Disclosure

Act for the years 2001 and 2002 because at the time it did not realize that it was a requirement. For 2003, Citywide mistakenly sent the Home Mortgage Disclosure Act report to the Federal Reserve Board instead of HUD.

### **Incomplete Case Files**

Citywide was not maintaining the entire case file as required. Citywide was able to provide us with a loan file for 17 of the 23 loans we reviewed. Six of the 23 loan files selected for review could not be located by Citywide, and 3 of those 6 files were within the required 2-year retention period.<sup>3</sup> We reviewed the 17 loan files for completeness. In all seventeen cases, copies of documents used during the loan origination process were missing, incomplete, and/or unsigned. Citywide explained that it did try to obtain all of the required documents; however, it was difficult to obtain the documents from the sponsors, and/or title companies.

The absence of documentation in the case files prevented Citywide from ensuring that the loan origination process was properly documented. In addition, missing and/or incomplete documentation may impede the performance of quality control reviews.

### **Conclusion**

We concluded that the deficiencies associated with Citywide's quality control process are due to Citywide not fully complying with HUD's and its own requirements.<sup>4</sup> Without proper establishment of a quality control process, Citywide is unable to ensure the accuracy, validity, and completeness of its loan origination operations. Potential deficiencies may not be identified and corrected in a timely manner, resulting in an increased risk to HUD's insurance fund.

### **Recommendations**

We recommend that the Assistant Secretary for Housing-Federal Housing Commissioner

- 2A. Require Citywide to fully establish and implement its quality control process in accordance with HUD's requirements.
- 2B. Review Citywide's implementation of 2A and ensure Citywide's quality control process is fully implemented in conformity with HUD's requirements.

---

<sup>3</sup> HUD Handbook 4000.2, REV-2, 5-10.

<sup>4</sup> HUD Handbook 4060.1, REV-1, 2-13, and Handbook 4060.1, REV-1, CHG-1



## SCOPE AND METHODOLOGY

---

Our audit generally covered the period of April 1, 2001, through August 31, 2004. When applicable, we expanded the audit period to include current data. We conducted our preliminary survey fieldwork in June 2003 and our subsequent audit fieldwork was conducted from September 2004 thru February 2005.

Our audit approach was to identify and evaluate the internal controls in place over the key areas of Citywide's Federal Housing Administration-insured loan origination activities. Our review methodology entailed the review of 23 insured loans from the universe of 1,156 such loans originated by Citywide with a beginning amortization date between April 1, 2001, and August 31, 2004, for properties located in Utah.

We selected a number of insured loans based on certain characteristics identified that pertained to the audit. We chose not to use 100 percent selection as the sheer number of auditable transactions precludes examining each unit in the universe. The results of our testing apply only to the 23 loans reviewed and cannot be projected to the universe of 1,156 loans.

In addition, 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 these systems.

To accomplish the audit objectives, we

- Interviewed HUD's management and staff to obtain background information on Citywide.
- Reviewed applicable Federal and HUD regulations and other applicable reference materials related to single-family requirements.
- Reviewed the Federal Housing Administration case binders and Citywide's scanned loan case files.
- Obtained information from current and past employers for the borrower(s) and/or coborrower(s) identified in the case files mentioned in the previous bullet.
- Interviewed Citywide officials, staff, and independent loan officers to obtain information regarding its policies and procedures.
- Reviewed Citywide's quality control plan and available quality control reviews.
- Reviewed the independent auditor's reports for fiscal years 2001, 2002, and 2003.
- Reviewed the general ledger entries for the checking account for the period January 2003 through August 2004.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

---

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

- Effectiveness and efficiency of operations,
- 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 Controls

We determined the following internal controls were relevant to our audit objectives:

- Loan Origination Process – Policies and procedures established by management to ensure Federal Housing Administration-insured loans are originated in accordance with HUD requirements and
- Quality Control Process – Policies and procedures established by management to ensure the quality control plan has been implemented and related reviews are performed in accordance with HUD requirements.

We assessed the relevant controls identified above.

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

## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Citywide does not have an adequate loan origination process to ensure compliance with HUD requirements (finding 1), and
- Citywide does not have an adequate quality control process to ensure compliance with HUD requirements (finding 2).

# APPENDIX

## Appendix A

### AUDITEE COMMENTS AND OIG'S EVALUATION

#### Ref to OIG Evaluation

#### Auditee Comments

Comment 1

Comment 2



April 11, 2005

HUD OIGA,  
UMB Plaza Building  
1670 Broadway, 24th Floor  
Denver, CO 80202-4801

Re: Citywide Home Loans, a Utah corporation  
Audit Report

To Whom It May Concern:

Citywide Home Loans makes the following comments to the Audit Report from your office.

**Response to Finding 1**  
Citywide Allowed Independent Contractors To Originate Federal House Administration-Insured Loans.

Citywide has both spoken to and received emails from the Denver Office stating that there was nothing that required Citywide to W2 Loan Officers vs. 1099 them.

From our first visit with AIG HUD Auditors, they noticed that our Loan Officers were indemnifying Citywide of some risk. Under the Auditors advice, we changed the indemnifying clause(s) so that Citywide would assume all risk. The Auditors reviewed and agreed that Citywide now is taking all the risk for its Loan Officers.

**Response to Finding 2**  
Citywide's Quality Control Process Is Deficient

AIG HUD Auditors noted that we had not revised our written Quality Control System to coincide with revised chapter 6 of HUD Handbook 4060.1. Citywide

1670 Broadway, Suite 2400 Denver, CO 80202-4801 • 303.747.0200 Fax: 303.747.0201 • 1-800-368.4321 • [www.citywide.com](http://www.citywide.com)

Home Loans had adopted and made internal changes without updating its own policy until now.

Citywide understands that we had some failing with the 90-day time restraint with past audits. Upon discovery Citywide has been in compliance since September 2004.

Citywide has contracted with Leslie Peterson with Mortgage Educators. She is assisting Citywide to update, train processors, loan officers and management in all aspects of its Quality Control System and HUD requirements. Please see the updated Quality Control System that has gone into effect April 11, 2005.

Comments ended.

Please feel free to contact my staff or myself if you need any clarification.

Respectfully submitted,



STEVE GOORMAN  
President

C: File  
Enclosures

## **OIG Evaluation of Auditee Comments**

- Comment 1** Citywide states that it has both spoken to and received emails from the HUD program staff. However, Citywide was not able to provide written verification of the guidance provided by HUD regarding the use of the Internal Revenue Service Form 1099.
- Comment 2** Citywide states that the auditors reviewed and agreed that Citywide is taking all the risk for its Loan Officers. We agree that the new contract no longer contains the indemnification clause. However, the scope of our audit included loans that were originated by loan officers who were under a contract that held them responsible for indemnification.