



Issue Date	February 1, 2006
Audit Report Number	2006-DE-1002

TO: Brian D. Montgomery, Assistant Secretary for Housing – Federal  
Housing Commissioner, H

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

SUBJECT: American Title Services, Greenwood Village, Colorado, Did Not Comply with  
Contract Terms When Closing Sales of HUD-Owned Properties

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited American Title Services (American Title), a contractor closing sales of U.S. Department of Housing and Urban Development (HUD) homes in Colorado. We performed the audit at the request of the director of the Denver Homeownership Center's Real Estate Owned Division. We wanted to determine whether American Title complied with contract terms for closing sales of HUD homes.

### **What We Found**

American Title did not comply with HUD contract terms for closing sales of HUD homes. It did not disburse funds on time or in correct amounts, improperly commingled HUD funds with retail funds, earned interest on closing funds, and did not reimburse HUD for bank charges. American Title was not prepared to perform its duties when it got the contract. Its poor handling of closing funds increased HUD's and homebuyers' risk of not meeting financial obligations and not receiving funds to which they were entitled. However, since HUD cut back its number of closings in August 2005, American Title's performance improved.

### **What We Recommend**

We recommend that HUD require that American Title correct the problems, improve controls, complete all disbursements, and pay HUD \$4,380 in interest.

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 draft audit report to American Title on January 9, 2006 and received their written response on January 30, 2006. American Title agreed with the finding and recommendations.

The complete text of American Title's response is in appendix B of this report.

## TABLE OF CONTENTS

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Background and Objectives	4
Results of Audit	
Finding 1: American Title Did Not Comply with the HUD Contract	5
Scope and Methodology	8
Internal Controls	9
Appendixes	
A. Schedule of Ineligible Costs	10
B. Auditee Comments	11

## **BACKGROUND AND OBJECTIVES**

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The Federal Housing Administration administers the single-family mortgage program. Upon default and foreclosure of an insured loan, the lender files a claim for insurance benefits. In exchange for payment of a claim, the lender conveys the foreclosed property to the U.S. Department of Housing and Urban Development (HUD). The HUD homes are termed real estate-owned properties. HUD, through a management and marketing contractor, manages and sells these single-family homes to promote home ownership and maximize return to the insurance fund. To sell the properties, HUD contracts with a closing agent to perform all necessary closing activities.

On February 11, 2005, HUD contracted with American Title Services (American Title) to close sales of HUD homes in the state of Colorado. American Title's office is located in Greenwood Village, Colorado.

From February 11 to August 15, 2005, American Title closed 1,102 sales of HUD homes. HUD received \$135,430,468 in net sales proceeds.

We wanted to determine whether American Title complied with HUD contract terms for closing HUD home sales.

## RESULTS OF AUDIT

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### Finding 1: American Title Did Not Comply with the HUD Contract

American Title did not comply with HUD contract terms for closing sales of HUD homes. It did not disburse funds on time or in correct amounts, improperly commingled HUD funds with retail funds, earned interest on closing funds, and did not reimburse HUD for bank charges. American Title was not prepared to perform its duties when it got the contract. Its poor handling of closing funds increased HUD's and homebuyers' risk of not meeting financial obligations and not receiving funds to which they were entitled. However, since HUD cut back its number of closings in August 2005, American Title's performance improved.

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#### Contract Violations

American Title did not disburse funds on time or in correct amounts. Our review of 29 case files identified numerous deficiencies including \$2,478 not disbursed correctly. The deficiencies included the following:

- In 17 cases, American Title did not pay the homebuyer or HUD refunds totaling \$1,912.
- In five cases, American Title did not have sufficient funds to pay all expenses. The shortages totaled \$319.
- In four cases, American Title overpaid itself \$247.
- In 22 cases, American Title disbursed funds after closing although the contract requires payment of any allowable expenses at closing. In 14 of the 22 cases, American Title issued the last check more than 30 days after closing and more than 60 days after closing in 12 of the 14 cases.

We discussed the deficiencies with American Title's president and he took prompt action to correct them.

Our review of the HUD trust account and the retail money market account showed that American Title commingled HUD funds with retail funds and improperly earned \$4,380 in interest on closing funds. In 36 cases, lenders incorrectly wired funds to American Title's retail money market account rather than to the HUD trust account. In 54 cases, American Title incorrectly deposited funds into the retail money market account. HUD funds deposited into the wrong account totaled \$6,486,553. These funds remained in the retail money market account earning interest up to 41 days before American Title transferred the funds to the HUD trust account.

In addition, American Title had not reimbursed the HUD trust account \$6,400 for bank charges through September 2005. The most recent reimbursement was on September 27, 2005, when American Title reimbursed the account \$4,220. This payment was not sufficient to cover bank charges through May 31, 2005. We discussed reimbursement of bank charges with American Title's president and he promptly reimbursed the HUD trust account the \$6,400 for bank charges.

### **American Title Not Prepared to Perform**

American Title was not prepared to close an estimated 200 sales per month. It did not have a quality control plan or written policies and procedures for closing sales of HUD homes. American Title did not implement a quality control plan until late August 2005, after HUD officials provided a cure notice for failure to perform. In addition, American Title had not trained employees on contract requirements, and its telephone system could not handle the high volume of calls.

American Title did not have adequate controls over HUD trust account wires, deposits, and checks. For example, closers did not check wire confirmations to ensure banks wired funds to the correct bank account, did not always use the correct deposit slips, incorrectly used money market checks to disburse funds, and did not ensure the numbers of issued checks matched the check numbers in the accounting system.

### **Increased Risk for HUD and Homebuyers**

American Title's poor handling of closing funds increased HUD's and homebuyers' risk of not meeting financial obligations and not receiving funds to which they were entitled. American Title did not always disburse funds at closing to pay expenses such as real estate taxes, utility bills, and homeowner association dues. HUD received numerous complaints from homebuyers concerning delayed closings, problems contacting American Title by telephone, and payment of expenses. American Title's delay in disbursing funds increased HUD's and the homebuyers' risk of not meeting their financial obligations, particularly if buyers wanted to resell their homes within a short time. In addition, American Title denied HUD and homebuyers funds to which they were entitled.

### **Improved Performance**

Since HUD cut back the number of closings in August 2005, American Title has increased its staff, provided staff training on contract requirements, and incorporated a new telephone system designed to handle all customer calls.

American Title was also in the process of reviewing closed case files to make all necessary disbursements and to reconcile the case files.

American Title also implemented steps to control deposit slips and checks. Now, only the president and the closing supervisor have access to the money market account deposit slips and checks. Each closer must sign out HUD trust account checks that the closing supervisor secures in a locked drawer.

In September 2005, American Title added an employee test to its quality control plan to make employees more aware of HUD contract terms. In addition, it upgraded its telephone system to handle 24 calls at a time to better serve its clients.

During the review, we expanded the audit period to October 15, 2005, to determine whether American Title had improved its performance. We reviewed 15 additional case files and found performance had improved. For the 15 case files, closers had disbursed all funds and reconciled all case files at closing. Each of the case files for closings after October 1, 2005, contained completed preclosing and postclosing checklists, ensuring that closers properly completed all documents and processes.

## **Conclusion**

While American Title has made progress in implementing management controls, HUD must continue monitoring to ensure it corrects all of the problems. As of October 2005, closers were not checking wire confirmations to ensure banks wired funds to the correct bank account. In addition, American Title has not completed review of all case files to make all necessary disbursements and to reconcile the case files.

## **Recommendations**

We recommend that the Assistant Secretary for Housing – Federal Housing Commissioner require American Title to

- 1A. Establish and implement management controls and a complete quality control plan to meet contract terms.
- 1B. Provide evidence that American Title has made all disbursements for previous closings (\$2,478) and properly reconciled all case files before renewing the contract.
- 1C. Pay \$4,380, the interest earned on closing funds improperly deposited into American Title's retail money market account.

## SCOPE AND METHODOLOGY

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Our review covered the period from February 11 to August 15, 2005. We extended the period to October 15, 2005, to meet our objective.

To accomplish our objective, we reviewed

- The contract between HUD and American Title and applicable HUD requirements,
- HUD reviews of American Title,
- American Title's quality control plan and closing process,
- Transactions in the HUD trust account and American Title's money market account, and
- Case files and related documentation.

In addition, we interviewed American Title's president and staff and HUD personnel.

We selected case files from the Closing Agent Performance Report from HUD's Single Family Acquired Asset Management System. We reviewed all 24 case files in which American Title wired sales proceeds to HUD more than nine days after the closing date. We also reviewed five case files HUD previously reviewed. We randomly selected 15 additional case files from American Title's closing calendars for various dates between August 19 and October 14, 2005, to evaluate how well American Title implemented its management controls. We did not rely on computerized data and traced all information to source documents.

We performed our audit work from September to November 2005. We conducted our fieldwork at American Title's office at 7935 East Prentice Avenue, Suite 101, Greenwood Village, Colorado.

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



# INTERNAL CONTROLS

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

- 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.

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## Relevant Internal Controls

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

- Policies and procedures to ensure the closing process complied with contract requirements.
- Controls to ensure closing funds were safeguarded and disbursed only for eligible expenses.

We assessed the relevant controls 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 Weaknesses

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

- American Title did not have management controls to ensure HUD contract compliance and to safeguard closing funds (finding 1).

## APPENDIXES

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### Appendix A

#### SCHEDULE OF INELIGIBLE COSTS

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Recommendation number	Ineligible 1/
1B	\$2,478
1C	\$4,380

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

## Appendix B

### AUDITEE COMMENTS

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#### AMERICAN TITLE SERVICES

January 27, 2006

Mr. Ronald J. Hosking  
Regional Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General  
Region 8 Office of Audit  
UMB Plaza Building  
1670 Broadway, 24<sup>th</sup> Floor  
Denver, CO 80202-4801

Re: American Title Services: Response to Inspector General Audit Report

Dear Mr. Hosking:

This is the response of American Title Services (ATS) to the January 26, 2006 draft of the Inspector General's report of the performance of ATS in the first half of our contract year with HUD. We agree with the auditor's general conclusions and findings, and we believe that it is a fair assessment of our performance. We have indicated the steps we took and processes put into place last year to correct our deficiencies, and we appreciate the acknowledgement by the Inspector General's auditor that in the last half of the year, our performance is greatly improved. We thank your auditor, Mr. Taylor, for his even-handed approach, and especially for the effort he put forth and help that he gave us during the audit.

The following sections of our response address your auditor's findings, the steps we have taken to date to answer these concerns, and include our comments to those findings. We note, for the record, that your report indicates that we closed 1,102 sales of HUD homes during this six month period, and that HUD was paid \$135,430,468 in net proceeds.

FINDING 1: American Title did not comply with the HUD Contract.

**A. Contract Violations:**

1. American Title did not disburse funds on time or in correct amounts. HUD looked at 29 accounts, and found that American Title did not disburse \$2,478.00. The report further evidences failure to pay Homebuyers in 17 cases, for \$1,912; insufficient funds in 5 cases, for \$319 in shortages; overpayments to American Title totaling \$247 in 4 cases; disbursement of funds after closing in 22 cases, and late issuance of checks in 14 of 22 files checked.

**PROCEDURES PUT IN PLACE TO CORRECT DEFICIENCIES**

1. 100% of all HUD files are now audited by Quality Control at least twice during the closing cycle: the first audit occurs as the loan docs are being prepared to be sent to the M&M; this audit covers over 50 separate check points; the second audit occurs within one business day of closing, and it covers 18 separate check points (e.g., that all funds are fully and accurately disbursed, and that the file has a "0" balance). Copies of our Pre and

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Post Closing Audit Check List forms are attached for your review.

#### RESPONSE OF AMERICAN TITLE:

The report is accurate. The deficiencies have all been corrected. From an historical perspective, the report covers a period of time during which American Title was just beginning to learn how to perform under our contract. During our forbearance period, we experienced, in a brief span of time, a disproportionate delivery of files from our M&M, which we believe contributed to some of our control deficiencies in the financial arena, and also led to contract compliance deficiencies. We believe, however, that we learned from this circumstance, and put into place, process and controls that led to dramatic improvements in the last quarter of 2005. For example, we established a Quality Control function, staffed with senior managers, and we implemented a regimen of tight tracking, and hands on review of all files; including QC audits of every file, pre-closing, before the file is sent to the M&M for review and approval; and then, a second, formal audit of every file, immediately after closing, to assure that checks were accurately prepared and disbursed; that the file balances; that all documents were sent for recording, and that the closing was conducted in a manner that comports with our contractual requirements. As a result of these efforts, 100% of the files that were review by the IG office in their expanded audit period to October 15, 2005 were in full compliance.

2. Our (i.e., HUD IG) review of the HUD trust account and the retail money market account showed that American Title commingled HUD funds with retail funds and improperly earned \$4,380 in interest on closing funds.

#### PROCEDURES PUT IN PLACE TO CORRECT DEFICIENCIES

- We opened a new bank account at a different bank.
- We provide written notification of wiring instructions on: our title commitments; our fax confirmations; and we send instructions with the HUD-1 to our lenders.
- Closers must place wire delivery receipts in the closing file.
- Our QC team reviews 100% of files for correct deposits.
- Our CPA conducts daily audits of the Trust Accounts verifying that deposits are in the correct account.
- The deposit slips for the Retail Trust Account are under the direct control of the President of American Title Services.
- HUD Checks and deposit slips are kept under lock and each closer must sign these out.
- A check log is now used to control and identify the person using each check.

RESPONSE OF AMERICAN TITLE: the audit report is accurate. HUD funds were intermixed into ATS' retail trust account; however, we want to emphasize that these funds were not placed in an ATS Operating Account. We acknowledge that there were occasions when HUD funds were actually deposited into ATS retail trust account by mistake, generally because of lender error, but oftentimes because of the clerical mistake of ATS' Closers, due to similarities in deposit slips leading to clerical errors. We recognize the need for tighter controls and we have implemented them; in addition, we have created a new Department of Financial Controls, guided by an experienced CPA to monitor and safeguard both HUD funds and ATS funds, to minimize the chance that we will ever again face the situations giving rise to these deficiencies. .

We would like to emphasize that a significant number of noted discrepancies resulted from lenders wiring their funds to the wrong Trust Account (i.e., into an ATS Trust Account for our retail business that these lenders (and their computer systems used to wire funds) were programmed to utilize the retail account). Despite written instructions given at least three different ways to these lenders to wire to our HUD Trust Account, mistakes were made and we were not equipped at the time to catch them as they occurred. That is all changed. The auditor further observes that American Title improperly earned interest (i.e., \$4,380.00) on closing funds. American Title has offered to pay HUD this modest amount. Since implementation of these procedures, 100% of the files that were reviewed by the IG office in their expanded audit period to October 15, 2005, were in full compliance.

3. The audit report initially points out that American Title has not reimbursed the HUD trust account for \$6400 for bank charges through September 2005. ATS has paid this amount in full.

#### PROCEDURES PUT IN PLACE TO CORRECT DEFICIENCIES

American Title has a CPA reviewing every bank statement and bank transaction. He performs daily audit reviews of the trust accounts to verify that deposits are made to the correct accounts. If by chance, a deposit is made to the incorrect account, a transfer is made to the correct account on the same day. Trust accounts are reconciled to the bank statement by the 15th day following month end. Finally, 100% of the closed files are audited by Quality Control the day after closing. The QC officer must verify that the funds have been received into the correct account and that all disbursements are made.

OUR RESPONSE: these unpaid bank charges have been reimbursed in full. We think it important to make the point that after months of HUD audits and reviews, including the Inspector General's audit, there is absolutely no evidence that American Title was engaged in practices designed to allow this firm to wrongly profit from the misuse of HUD funds. In fact, the preponderance of evidence suggests that HUD funds found their way into American Title's Retail Trust Account due to the honest mistake of lenders wiring funds to the wrong account, and because of mistakes by closers, who used the wrong deposit slips because they were almost identical visually to those for the HUD Trust Account. These deficiencies have been corrected by controls we put into place, by focusing attention on funds being wired to ATS and placing accountability for mistakes on our Closing Team Leaders, and by careful scrutiny of every significant wire by our new Department of Financial Control. We are confident that these positive steps have strengthened and solved our financial control problems.

Since implementation of these procedures, 100% of the files that were reviewed by the IG office in their expanded audit period to October 15, 2005, were in full compliance. Currently, as of month end December 2005, American Title Services has placed an extra \$1,000 in the HUD Trust account to offset bank charges.

#### B. American Title Not Prepared to Perform

1. The audit report also states that American Title was not prepared to close an estimated 200 sales per month. We agree, but we have corrected this problem. In the last quarter of 2005, we proved that we have been, and are ready to close, 200 files or more each month. We have demonstrated that we can close 200 or more files because we have a

trained core of key personnel (18 at this writing), who now have a full year of experience complying with our HUD contract, and who have closed 1,540 files last year.

#### PROCEDURES PUT IN PLACE TO CORRECT DEFICIENCIES

- At present, we have a mature, experienced staff of 18 FTE, virtually all with at least one full year of dealing with this Contract and closing HUD files.
- We have created a separate Quality Control Department
- We now have a separate Legal Department, focused on legal and contract compliance.
- We have developed a Compliance Handbook, detailing every single performance obligation we have under the contract.
- We have developed, in conjunction with our Quality Control Plan, new automated management reports, that allow us to track, for example, the timely entry of New Orders, the date Earnest Money is received; when Closings are Scheduled; when communications must be sent to buyers and brokers, and to the M&M, and when recordings are delivered to recording offices post-closing.
- We have instituted a Contract Compliance Training Program, with each member of the staff required to attend sessions covering every performance requirement of our Contract, from the content of the Sales Contract, through requirements to deliver docs to HUD post-close. It is working.

1. OUR RESPONSE: the report is accurate, and the evidence would suggest that we were not ready to process over 200 files per month during April, May and June. That is no longer true. While we believe it is fair to attribute some of our lack of preparedness on an uneven distribution of files, we also have to recognize that the M&M was under stress as well during this period. They were new, and learning the ropes. We believe that this combination of a new M&M, plus high volumes of property foreclosures and sales, contributed to our performance and control deficiencies. Nevertheless, we weathered this storm, invested heavily in technology, re-trained, then trained again, reorganized and changed key personnel (i.e., a new Contract Manager in August and new Alternate Contract Manager hired in June 2005), and just worked hard to turn things around. And we did it. Our performance in October, November and December 2005 evidence that turnaround. We wish to thank the Inspector General for the extra work in reviewing files closed during the last quarter, to give us input on our performance.

2. We further wish to point out that American Title has created a new department, devoted solely to Quality Control, Contract Compliance and Financial Controls. It consists of an Attorney, a CPA and an experienced senior QC specialist. We intend to hire one more senior person to staff this department, and our goal is to assure that every file we receive from HUD is closely monitored by our QC department, checked often and audited at least twice in its journey from New Order Entry to Post-Close. Quality Control Standards are in place. We continue to develop new reports and procedures to improve performance. We have implemented a new website that every American Title employee, QC officer, and outside, interested parties, including HUD, may access. It allows viewers to download actual documents and check to see that their file is moving steadily and predictably to closing.

#### C. Increased Risk for HUD and Homebuyers

1. American Title's poor handling of closing funds increased HUD's and homebuyer's risk of not meeting financial obligations and not receiving funds to which they were entitled.

#### PROCEDURES PUT IN PLACE TO CORRECT DEFICIENCIES

- Our QC function actually reviews 100% of all closed files within one business day of closing.
- QC reviews and audits 100% of files the day after closing, verifying among other things that the disbursement register is in the file, all checks are disbursed to the proper party and to the proper address, and that there is a zero balance.
- Our QC department also conducts a Pre-Closing audit of 100% of files to verify/require the presence in the file of an invoice for every disbursement.

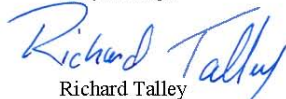
OUR RESPONSE: HUD's assessment is on-target, but we assert that not one single buyer has been financially put at risk by our performance; and we note that HUD has not been adversely impacted financially—or at worst, is awaiting our check for roughly \$2,478 of Buyer and HUD funds. We have reconciled and disbursed all of the funds identified in the 29 files audited by the IG. Many of the delays resulted from the lack of a proper invoice or address to send the checks. They would go out in the mail and be returned. We have rectified this problem by requiring complete and accurate invoices to be delivered for all disbursements prior to the delivery of a pre-closing package to the M&M. Quality Control audits this activity and will not issue a "Clear to Close" status on a file until all disbursements are reconciled against invoices. In any event, we assert that no homeowner was ever truly at risk and that HUD funds have been totally accounted for and held in trust, and virtually all disbursements made.

#### D. Conclusion

The audit report is accurate. It is important to observe that it is accurate for that period of time it purports to scrutinize: i.e., the first six months of our contract. We maintain that the deficiencies cited and controls criticized have been corrected and tightened. Your report bears that out, and we thank the Inspector General for pointing out our performance upturn. We are proud that we turned the situation around. HUD helped us do it—and hard work by our employees made it happen.

Thank you for giving us an opportunity to respond.

Respectfully,



Richard Talley  
President, American Title Services