



Issue Date	February 17, 1999
Audit Case Number	99-NY-221-1004

TO: Morris E. Carter, Director, Home Ownership Center
Philadelphia, Pennsylvania

FROM: Alexander C. Malloy, District Inspector General for Audit,
New York/New Jersey

SUBJECT: Homestead Financial Services, Inc.
Non-Supervised Mortgagee
Syracuse, New York

We completed an audit of the books and records of Homestead Financial Services, Inc., (Homestead) a non-supervised mortgagee. The objective of the audit was to determine whether Homestead originated loans in accordance with the requirements of the U.S. Department Housing and Urban Development/Federal Housing Administration (HUD/FHA) which requires adherence to prudent lending practices. The review covered the period between June 1, 1996 and June 30, 1998.

Our review disclosed that contrary to HUD/FHA requirements, Homestead split the attorney fees with the various attorneys that participated in the HUD/FHA loan closings. In addition, we found that Homestead did not always comply with HUD/FHA's requirements regarding the Section 203(k) rehabilitation loan program. Also, Homestead's Quality Control Plan was not complete and in some instances Homestead personnel did not adhere to the requirements identified in its Quality Control Plan.

Within 60 days, please provide us a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is not considered necessary. Also, please furnish us copies of any correspondence or directives issued related to this audit.

If you or your staff have questions, please contact William H. Rooney, Assistant District Inspector General for Audit, on (212) 264-8000, extension 3976.

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Executive Summary

We completed an audit of the books and records of Homestead Financial Services, Inc., a non-supervised mortgagee. The objective of the audit was to determine whether Homestead originated loans in accordance with the requirements of the U.S. Department of Housing and Urban Development/Federal Housing Administration (HUD/FHA) which requires adherence to prudent lending practices. We found that Homestead was not always in compliance with HUD/FHA requirements as explained below.

Fee splitting prohibited

Our review disclosed that Homestead was not complying with all of the provisions of the Real Estate Settlement Procedures Act (RESPA). Specifically, Section 3500.14 (b) of RESPA prohibits individuals from splitting fees unless work was actually done. Also, HUD/FHA instructions to mortgagees prohibits Homestead from charging borrowers for settlement services. We found that contrary to the above requirements, Homestead split the attorney fees with the various attorneys that participated in the HUD/FHA loan closings.

Homestead's President believed that fee splitting is an acceptable practice because the closing attorney fees are within the acceptable guidelines. However, we believe that this practice is prohibited for the following reasons. The attorneys hired to perform loan closings forwarded monies (fee splitting) to Ward Financial Group, Inc., for loan settlement processing services who in turn forwarded monies to Homestead. However, Ward Financial Group, Inc., did not perform any work and it only has one employee, the President of Homestead. The loan settlement processing services were actually performed by Homestead employees. It is our opinion that the fee splitting with Ward Financial Group, Inc., circumvents the HUD/FHA requirement that Homestead is not allowed to charge for settlement services.

To determine the magnitude of the fee splitting, we expanded our initial sample universe and determined that during the period January 1, 1997 to June 30, 1998, Homestead processed over 1,000 HUD/FHA loans and charged unallowable loan settlement costs to HUD/FHA borrowers amounting to over \$242,000.

Our review also identified two other findings that warrant attention: one pertains to the Section 203(k) rehabilitation loan program and the other pertains to Homestead's Quality Control Plan.

Problems with Section 203(k) Program

Homestead did not properly administer Section 203(k) rehabilitation loan funds and did not always comply with HUD/FHA requirements. Specifically, Homestead, did not (a) determine whether rehabilitation work was to be completed by either a contractor or a borrower, (b) have adequate management controls to ensure that rehabilitation repairs were completed and (c) assure that costs were eligible and supported before releasing rehabilitation funds to the borrower. We attribute these deficiencies to the lack of knowledge on the part of Homestead's staff regarding Section 203(k) program requirements and Homestead not implementing adequate management controls. As a result, HUD/FHA's risk of potential losses are greater because Homestead is not following the Section 203(k) program requirements.

Quality Control Plan

Weaknesses exist in Homestead's Quality Control. Specifically, Homestead's Quality Control Plan was not complete and in some instances Homestead did not adhere to all the requirements identified in its Quality Control Plan. The deficiencies occurred because Homestead's management did not always assure that the Quality Control Plan was complete and personnel complied with the Plan. As a result, mortgages may have been approved for unqualified borrowers causing HUD/FHA to have assumed an unnecessary risk to the insurance fund.

Recommendations

Our report contains three findings. Regarding the first finding (fee splitting) we recommend that you refer the conditions cited in the this finding to Mortgagee Review Board for appropriate action. Regarding the second and third findings, we made specific recommendations for your action.

Exit Conference

The results of the audit were discussed with representatives of Homestead during the course of the audit and at an exit conference held on November 30, 1998, attended by:

Homestead

Summary

Timothy Ward, President
Lee E. Woodward, Attorney

Office of Inspector General

William H. Rooney, Assistant District Inspector
General for Audit
Garry Clugston Senior Auditor
Patrick Anthony, Auditor

At the exit conference Homestead's President told us that he agreed with the second and third findings and will take corrective action. Regarding the fee splitting issue (Finding 1) Homestead's President believes that the fee splitting is allowable. Homestead's comments regarding fee splitting are summarized at the end of Finding 1 and included in its entirety in Appendix A to this report.

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Table of Contents

Management Memorandum	i
-----------------------	---

Executive Summary	iii
-------------------	-----

Introduction	1
--------------	---

Findings

1	Borrowers Charged Unallowable Loan Settlement Costs	3
---	---	---

2	Homestead Did Not Properly Administer Section 203(k) Rehabilitation Loan Funds	7
---	--	---

3	Weaknesses in Homestead's Quality Control	13
---	---	----

Management Controls	17
---------------------	----

Follow Up On Prior Audits	19
---------------------------	----

Appendices

A	Auditee Comments	21
---	------------------	----

B	Distribution	25
---	--------------	----

Abbreviations

FHA	Federal Housing Administration
HUD	U.S. Department of Housing and Urban Development
OIG	Office of Inspector General

Introduction

Homestead Financial Services, Inc. (Homestead) is a non-supervised mortgagee located in Syracuse, New York with a Branch Office in Buffalo, New York. All underwriting is done in the Syracuse Office which is located at 5795 Widewaters Parkway, Syracuse, New York.

During the period between June 1, 1996 and May 31, 1998 Homestead originated 1261 HUD/FHA loans under the Direct Endorsement Program. As of April 16, 1998, there were 34 mortgages in default status. Homestead originates HUD/FHA insured loans, Veterans Administration insured loans and conventional loans.

Audit Objective

Our audit objective was to determine whether Homestead originated HUD/FHA mortgages in accordance with HUD/FHA requirements and prudent lending practices. Initially we selected a two year audit period ranging from June 1, 1996 to May 31, 1998. When we became aware of the issue identified in Finding 1, we extended our audit period to end June 30, 1998; therefore, our audit period became June 1, 1996 to June 30, 1998.

Audit Scope and Methodology

To accomplish our objective, we performed an examination of 25 loans. Included in the 25 loans were 15 loans of the 34 mortgages that were in default status as of April 16, 1998. Most of these loans went into default within one year after origination. The remaining 10 loans in our sample of 25 were Section 203(k) rehabilitation loans that were judgmentally selected.

Our examinations were intended to confirm the accuracy of all material information used as a basis for originating and closing the loans. Our audit procedures included: (a) a reconfirmation of the borrowers' income assets and employment; (b) a verification of selected data on the settlement statements; (c) inspections of selected homes and; (d) interviews with borrowers, HUD/FHA and Homestead staff.

Our audit procedures regarding the settlement fees included scheduling payments and tracing payments from the attorneys hired to perform loan closing to Ward Financial Group, Inc., and payments from Ward Financial Group Inc., to Homestead. Also we reviewed the accounting records, bank statements and tax returns of Ward Financial

Group Inc., and we interviewed its owner, Timothy Ward who is also the President of Homestead.

The audit work was performed at Homestead's Syracuse and Buffalo Offices. We performed the audit field work from June, 1998 through October, 1998 in accordance with generally accepted governmental auditing standards.

A copy of this report was provided to Homestead.

Borrowers Charged Unallowable Loan Settlement Costs

The Real Estate Settlement Procedures Act (RESPA) prohibits individuals from splitting fees unless the work was actually done. Also, HUD/FHA prohibits mortgagees such as Homestead from charging borrowers for loan settlement services. Our review disclosed that contrary to the above mentioned requirements, Homestead split the attorney fees with the various attorneys that participated in the HUD/FHA loan closing. Specifically, the attorneys hired to perform loan closing, forwarded monies to Ward Financial Group, Inc., for loan settlement processing services. However, Ward Financial Group, Inc., did not perform any work and it only has one employee, the President of Homestead. The loan settlement processing services were performed by Homestead's employees.

Homestead's President believed that this was an acceptable practice. However, we believe that it is fee splitting which is prohibited by RESPA. Also, payments to Ward Financial Group, Inc., circumvents the HUD/FHA requiremen whereby Homestead is not allowed to charge for loan settlement services. As a result, HUD/FHA borrowers have been charged over \$242,000 of unallowable loan settlement costs.

Criteria

Concerning fee splitting, Section 3500.14 (b) of the Real Estate Settlement Procedures Act (RESPA) provides that no person shall give and no person shall accept any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federal mortgage loan other than for services actually performed.

Mortgagee letter 94-7 item IV regarding fees charged by mortgagees provides that loan settlement fees may only be charged to the borrower on a HUD/FHA insured mortgage, if the service was provided by some entity other than the mortgagee. If, however, the business entity providing the service is controlled, owned, or otherwise has an identity of interest with the lending institution, then the fee may be charged only if the provider is an entity actively engaged in soliciting and providing such services to other mortgagees. Obviously, a company created solely to provide this service for the mortgagee would not be permitted to charge settlement preparation fees to borrowers on HUD/FHA insured mortgages. As always, the fees collected by the

mortgagee may never be in excess of that actually charged by the service provider.

In addition, Chapter 5, section 5-3 of HUD Handbook 4000.2, Mortgagees Handbook Application through Insurance, provides that customary and reasonable fees and charges that may be collected from the borrower by the mortgagee at loan closing include attorney fees only if the attorneys are not employees of the mortgagee.

Significant portion of attorney fees passed through to Homestead.

A review of Homestead's HUD-1 Settlement Statements disclosed a charge to the borrowers for closing attorney fees. The charge generally was the lesser of \$500 or one percent of the mortgage amount and a check was made out to the attorney of record mentioned on the HUD-1 Settlement Statement. When the attorney of record was at the closing, the attorney of record kept \$200 of the amount received and forwarded the balance to Ward Financial Group, Inc. In some instances, the attorney of record was not the attorney at the closing. We were told that in these situations, the attorney of record, kept \$50, paid \$150 to the attorney who attended the closing and forwarded the remainder to Ward Financial Group, Inc., for loan settlement processing services.

Ward Financial Group, Inc., received loan settlement processing fees

During the period January 1, 1997 to June 30, 1998, Ward Financial Group, Inc., received fees totally \$455,234 from the attorneys hired to close loans. These fees were for loan settlement processing services, such as preparing the HUD-1 Settlement Statement. Further review disclosed that during this period 53 percent of these fees, \$242,292 came from closings involving over 1,000 HUD/FHA insured loans.

Once, Ward Financial Group, Inc., received the fees, it made payments to Homestead's President or to other miscellaneous vendors, such as, automobile dealers. The following table shows a breakdown of payments made by

Ward Financial Group, Inc., during the period January 1, 1997 through June 30, 1998.

Period	Homestead	Payments to President/ Owner	Other	Totals
1/1/97 to 6/30/98	\$242,869	\$164,500	\$26,321	\$433,690 ¹

Our review disclosed that Ward Financial Group, Inc., did not have any employees other than the President of Homestead. The loan settlement processing work, such as, preparing the HUD-1 Settlement Statement was performed by Homestead's employees. In addition, we did not find any evidence to indicate that Ward Financial Group, Inc., provided loan settlement services to any other entity. Furthermore, our review noted that the \$242,869 paid by Ward Financial Group, Inc., to Homestead was not supported by documentation, such as, bills or invoices. Likewise, we did not find any documentation to support the \$164,500 payments to the President of Homestead. Homestead's President stated that since he owned both entities he did not require that bills or invoices be prepared. The President said that he simply periodically wrote checks to either Homestead or to himself. Regarding payments to himself, we observed a copy of Ward Financial Group, Inc., 1997 tax return and it indicated that payments to the President of Homestead were for commissions.

March 8, 1993 HUD denies Homestead's request to charge fees

In a letter dated February 23, 1993, to the HUD Albany Area Office, Homestead requested permission to perform loan settlement services and charge the borrowers a \$100 fee. The HUD Albany Area Office responded on March 8, 1993, saying that the proposal to perform loan settlement services and charge the borrowers separately for such services was unacceptable to HUD.

Also, our review disclosed that in accordance with Section 3500.7(e) of RESPA when a mortgagee requires that a

¹ Difference from \$455,234 in fees received is due to deposits in transit, interest and bank charges.

Finding 1

particular provider (such as a law firm) provides legal services, the mortgagee is required to include as part of the good faith estimate, a statement as to whether or not the provider has a business relationship with the mortgagee. During our review, we did not find any evidence to indicate that Homestead included a statement as part of the good faith estimates to identify that a business relationship existed between the closing attorneys and Ward Financial Group, Inc.

In summary, in accordance with HUD/FHA Mortgagee Letter 94-7 and the above mentioned HUD Albany Area Office Letter, Homestead may not charge borrowers a fee for loan settlement processing services. The President of Homestead believed that the payments by the closing agents to Ward Financial Group, Inc., was an acceptable practice. However, we believe that payments by the closing agents to Ward Financial Group, Inc., who in turn remitted funds to either Homestead or its President circumvents the HUD/FHA requirement that Homestead is not allowed to charge for settlement services.

Auditee Comments

Homestead's President believes that Homestead is in compliance with the requirements because the attorney fee charged to the borrower is within the guidelines for the attorney's fees.

OIG Evaluation of Auditee Comments

As explained in the Finding we believe that the Homestead's fee splitting practice is prohibited because Homestead's practice of splitting fees circumvents HUD/FHA requirement regarding payments to mortgagees for settlement processing services.

Recommendation

We recommend that you:

- 1A. Refer the conditions cited in the Finding to the Mortgagee Review Board to take appropriate action.

Homestead Did Not Properly Administer Section 203(k) Rehabilitation Loan Funds

Homestead did not properly administer Section 203(k) rehabilitation loan funds and did not comply with program requirements. Specifically, our review disclosed that Homestead did not: (a) determine whether rehabilitation work was to be completed by either a contractor or the borrower; (b) have adequate management controls to ensure that rehabilitation repairs were complete; and (c) ensure that costs were eligible and supported before releasing rehabilitation funds to the borrower. We attribute these deficiencies to the lack of knowledge on the part of Homestead's staff regarding the Section 203(k) program regulations and Homestead not implementing adequate management controls. As a result, HUD's risk of potential losses are greater because Homestead is not following the Section 203(k) program requirements.

Criteria

HUD's requirements regarding the administration of Section 203(k) rehabilitation loans are included in HUD Handbook 4240.4 REV-2, Rehabilitation Home Mortgage Insurance, and various Mortgagee Letters issued by HUD including 94-11 and 98-11. Also, Section 1-19 (D) of HUD Handbook 4240.4 REV-2 provides that the mortgagee will be fully responsible for processing 203(k) applications, including the authority to release funds from the rehabilitation escrow account.

Homestead did not determine whether rehabilitation work would be completed by a contractor or the borrower

Our review of 10 loans disclosed that the files contained both the self help agreements and homeowner/contractor agreements; however, the homeowner/contractor agreements were not completed. Generally, we would expect to observe either a self help agreement or a homeowner/contractor agreement because the homeowners (borrowers) would either perform the work themselves (self help) or hire a contractor to perform the work. In certain situations, both agreements could exist; however, if a homeowner/contractor agreement exists, we would expect to observe the amount that the homeowner (borrower) agreed to pay the contractor and the contractor's signature accepting the agreed upon amount. However, our review disclosed that when a homeowner/contractor agreement

existed the amount to be paid to the contractor and contractor's signature were left blank. When we inquired about this, we were told that Homestead's staff routinely had all the borrowers sign both agreements at the same time. Using both agreements on a routine basis raises the question as to who is performing the work. If the borrower does the work, the borrower is only entitled to be reimbursed for material costs and any labor performed by the borrower is considered sweat equity and is not to be reimbursed by Homestead. Also, if the borrower performs the work, Homestead should ensure that the borrower has the time and expertise to complete the rehabilitation work. Our review indicated that Homestead's staff was unable to determine if the rehabilitation work was performed by either the borrower or the contractor. Homestead's Underwriter explained that he was unaware of this requirement when Homestead processed the 10 loans included in our sample.

Homestead Needs to Strengthen Control Over Rehabilitation Repairs

We performed physical inspections on five properties with Section 203(k) loans. Our inspections disclosed two properties in which Homestead disbursed loan funds for items that were not completed.

At the one property, we found that the rehabilitation escrow funds had been disbursed for work items that had not been completed; yet, Homestead certified that the rehabilitation work was in fact done. Specifically, Homestead made payments to the borrower for items that were included on the work write-up, but not completed, such as, the repair of 16 existing windows, the replacement of an existing tub and shower, the installation of a hood fan and the installation of four electrical outlets. The borrower stated the payments for the uncompleted items were used to pay for other items not included in the work write-up, such as, a hot water tank, and a storm door.

During our inspection at a second property, the borrower indicated that work was performed by both the borrower and contractor. The rehabilitation work was to be completed by June 30, 1998, and it was extended to August 30, 1998. At the time of our inspection, Homestead approved a \$3,940 disbursement for painting. However,

our inspection indicated that only scrapping and priming had been completed. Whereas the painting was not completed, our inspection indicated that other work was done that was not in the work write up. For example, two skylights were installed, yet these items were not in the work write up.

As a result of our inspections, we believe there is a need for Homestead to ensure that the inspectors hired to verify completion of work are held accountable to ensure that rehabilitation funds are used for the agreed upon work items.

Inadequate Control Over Payments

Homestead needs to improve control over funds disbursed. Our review of the 10 Section 203(k) loans originated by Homestead found that all 10 loans had at least one or more of the following deficiencies.

- In five cases all checks were issued solely to the borrower and not the contractor as the co-payee (Draw Request form HUD-9746-A).
- For seven cases, Homestead did not obtain the general contractor's signature and certification on at least one of the draw down requests (Draw Request form HUD-9746-A).
- Section 17 of Mortgagee Letter 94-11 provides that for self help work the borrower can only be reimbursed for the actual costs of materials and cannot receive any cash for labor performed. Also, the Mortgagee Letter provides that work estimates must include the cost of labor. Labor is included in the estimate because if the work can not be completed by the borrower there should be sufficient money in the escrow account to obtain a contractor to perform the work. In three cases, it appears that the borrowers did the work themselves; thus, Homestead should have assured that the borrower had receipts or other documentation to support the actual costs of the work. The files did not contain supporting documentation to justify the borrowers request for the escrow draw down.

- For six cases, Homestead did not implement adequate control over change orders. None of the Request for Acceptance of Changes in Approved Drawings and Specifications form HUD-92577 were signed by the contractor.
- For four loans, Homestead approved the release of contingency funds for the completion of additional non health and non safety construction items when the mortgages were in excess of 95 percent of the appraised value. Section 16 of Mortgagee Letter 94-11 provides that the contingency reserve account can be used by the borrower to make additional improvements to the dwelling when the mortgagee determines the following. First, it is unlikely that any deficiency which may affect the health and safety of the property will be discovered. Second, that the mortgage will not exceed 95 percent of the appraised value of the property. If the mortgage exceeds 95 percent of the appraised value the contingency reserve must be use to pay down on the mortgage principal. For four loans Homestead did not comply with this requirement. Homestead's Underwriter claimed that he was unaware of this program requirement.

Because of the deficiencies mentioned above, we believe that Homestead has not maintained effective controls regarding the disbursement of Section 203 (k) rehabilitation funds. When we discussed these issues with Homestead's staff, we were told that the staff was unaware of many of the program requirements.

In summary, we believe that Homestead did not properly administer the Section 203 (k) program and did not comply with all the program requirements. We believe that there is a need for Homestead to review its Quality Control Plan (Finding 3) and ensure that the deficiencies mentioned in this finding are included in the plan.

Auditee Comments

Homestead's President agreed to take corrective action.

Recommendations

We recommend that you require Homestead to:

- 2A. Ensure that its staff are properly trained and thoroughly familiar with the Section 203(k) rehabilitation loan program requirements.
- 2B. Ensure that its staff determines whether the borrower or the contractor will perform the rehabilitation work. Also, if the borrower performs the work, Homestead staff must assure that the borrowers have the expertise to complete the work in a timely workmanlike manner.
- 2C. Implement the following controls regarding the disbursement of rehabilitation funds:
 - When applicable, checks are issued to both the contractor and the borrower.
 - When applicable, the draw down request should include the signature of the contractor.
 - Work that is completed by the borrower must be supported by actual costs.
 - Changes to work item specification must be signed off by contractors.
 - Establish procedures that will ensure that the release of contingency funds to the borrower occurs only if the situation meets the Section 203 (k) program requirements.

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Weaknesses in Homestead's Quality Control

Our review disclosed weaknesses in Homestead's Quality Control of loan origination. Specifically, Homestead's Quality Control Plan was not complete and in some instances Homestead did not adhere to all the requirements identified in its Quality Control Plan. The deficiencies occurred because Homestead's management did not always assure that the Quality Control Plan was complete and personnel complied with the Plan. As a result, mortgages may have been approved for unqualified borrowers causing HUD/FHA to have assumed an unnecessary risk to the insurance fund.

Quality Control Plan

Criteria

Section 6-1 of HUD Handbook 4060.1 REV-1 Mortgagee Approval Handbook provides that mortgagees must maintain a Quality Control Plan for the origination and servicing of insured mortgages. The Quality Control Plan must be sufficient in scope to enable the mortgagee to evaluate the accuracy, validity and completeness of its loan origination and servicing operations.

Quality Control Plan did not include all the required elements

Section 6-2 of HUD Handbook 4060.1 REV-1 lists the required elements of a mortgagee's Quality Control Plan. Our review disclosed that Homestead's Plan did not include provisions that provide for assurance that: (1) the termination of HUD/FHA mortgage insurance was properly reported to HUD on Form HUD 27050-A; (2) escrow funds received from borrowers were not excessive and were not used for any purpose other than that for which they were received; (3) reviews were made of escrow accounts including Section 203 (k) escrow accounts and (4) mortgage insurance premiums have been paid on loans when servicing has been transferred.

Reviews were not performed in a timely manner

Our review disclosed that Homestead's 1996 quality control reviews were not performed in a timely manner.

Specifically, Section 6-1 (C) of HUD Handbook 4060.1 REV-1 provides that the mortgagee may choose to review the lesser of 10 percent of all loans closed on a monthly basis or a random sample. Further, Section 6-3 provides that quality control reviews must be performed within 90 days of the closing of the loan. We observed that Homestead included these requirements in its Quality Control Plan; however, our review disclosed that Homestead did not perform the reviews in a timely manner. The quality control reviews of its 1996 loans were not performed until January 1998. Also, as of September 1998, Homestead had not completed its reviews of the 1997 loans and 1998 loans.

Quarterly reports not prepared

Section 6-1(G) of HUD Handbook 4060.1 REV-1 requires written notification to the mortgagee's senior management, at least quarterly of the deficiencies cited as a result of its reviews. Homestead's Quality Control Plan includes this requirement. However, our review disclosed that Homestead did not issue a report for its review of the 1996 loans until January 1998. Also, as of September, 1998, there were no quarterly reports issued regarding loans processed in 1997 and 1998.

Corrective actions not documented

Section 6-1(G) of HUD handbook 4060.1 REV-1 provides that senior management must promptly initiate actions to correct all deficiencies. The action taken must be formally documented by citing each deficiency, identify the cause of the deficiency and provide management's response or actions taken. This requirement is included in Homestead's Quality Control Plan. Our review disclosed that Homestead reviewed its 1996 loans and identified 15 findings. However, we found no evidence to indicate that senior management took corrective action to resolve the findings.

In summary, we believe that Homestead's Quality Control Plan was not complete. Because Homestead personnel did not always comply with its Quality Control Plan, Homestead can not be assured that its loan origination processing is in compliance with HUD/FHA requirements. During our review of Homestead's origination process, we

found some deficiencies that may have been identified and corrected by Homestead, if Homestead had an adequate Quality Control Processes.

Auditee Comments

Homestead's President agreed to take corrective action.

Recommendations

We recommend that you require Homestead to:

3A. Develop a Quality Control Plan that meets all HUD/FHA requirements.

3B. Periodically certify to you that Homestead is following its Quality Control Plan.

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Management Controls

In planning and performing our audit, we considered the management controls of Homestead in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that goals are met. Management controls include the process for planning, organizing, directing and controlling program operations. Also, they included the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

We determined that management controls in the following areas were relevant to our audit objective:

- Controls to assure that settlement fees were allowable and properly shown on the HUD-1 settlement statement.
- Procedures for origination and administration of Section 203(k) rehabilitation loans.
- Quality Control Reviews.

Assessment Results

We assessed all of the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe that significant weaknesses exist in all the management control areas disclosed above. These weaknesses are described in the finding sections of this report.

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Follow Up On Prior Audits

This was the first Office of Inspector General (OIG) audit of Homestead Financial Services , Inc. Homestead's last independent audit report for the year ended December 31, 1997 contained seven findings. Homestead provided a corrective action plan for the seven findings.

One of the findings was that Homestead had not performed quality control reviews for 1997. Homestead response was that the 1997 files were presently being reviewed and will be completed shortly. As noted in our report, the quality control reviews have not been completed.

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Auditee Comments

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Distribution

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