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TO: John C. Weicher, Assistant Secretary for Housing, H
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FROM: Daniel G. Temme, Regional Inspector General for Audit, Mid-Atlantic, 3AGA

SUBJECT: Procedures for Filing Uniform Commercial Code Continuation Statements

INTRODUCTION

We audited HUD's procedures for filing of Uniform Commercial Code Continuation Statements. Our audit objective was to determine whether HUD's existing procedures for filing of Uniform Commercial Code Continuation Statements were effective.

To accomplish our audit objective we:

- Interviewed responsible officials from: HUD's Offices of Multifamily Asset Management, Chief Financial Officer Accounting Center, and General Counsel; HUD's West Virginia Field Office, the Assistant U.S. Attorney, and the U.S. Bankruptcy Trustee.
- Reviewed HUD's project files, the Regulatory Agreement, the last audited financial statement, and Shawnee Hills, Incorporated's bank statements for the period ending May 2002.
- Visited the primary location where Shawnee Hills, Incorporated's applicable financial records were stored.

We performed our audit at various times from May 2003 through October 2003. The audit complied with generally accepted government auditing standards.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, 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 considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact John Buck, Assistant Regional Inspector General for Audit, at (215) 656-3401, extension 3486.

SUMMARY

During our limited review of Shawnee Hills, Incorporated¹, a not-for-profit company that managed several HUD assisted Section 202/811 properties², we found HUD did not file Continuation Statements as required under the Uniform Commercial Code to protect all of HUD's financial interests. Under the Uniform Commercial Code, HUD must file a report periodically (every 5 years or as state law requires) to assure that a lien on chattels remains in effect until the mortgaged property is paid in full or foreclosed. A chattel is any article of tangible property other than land, and buildings such as office furnishings, furniture, or capital equipment.

HUD's West Virginia Field Office was not aware of the process for filing Continuation Statements for Section 202/811 capital advances and direct loans. In part, we attribute this to the fact the applicable HUD Handbooks and related Directive that provide HUD staff with the policies and procedures to follow for filing Continuation Statements are outdated, and need to be appropriately revised and re-issued to provide proper guidance to program staff. More specifically, under an internal HUD Agency reorganization in 1998, HUD's Regional Accounting Divisions were eliminated, and its function of maintaining a tickler system to advise the Loan Management Branch of the date when Continuation Statements need to be filed was not assumed by or transferred to another HUD division. As a result, HUD's financial interests in chattels are not fully protected and this problem is not limited to the West Virginia Field Office.

BACKGROUND

We performed a limited review of Shawnee Hills, Incorporated in response to a complaint. The results of that review can be found in Audit Memorandum Number 2003-PH-1802. While performing that review, we identified a related problem regarding HUD's existing procedures for filing Continuation Statements required under the Uniform Commercial Code. The Uniform Commercial Code requires the filing of a Continuation Statement during the six months immediately before the five-year expiration date of the existing Financing Statement. Timely filing of the Continuation Statement will assure that a lien on chattels remains in effect until the mortgaged property is paid in full or foreclosed.

¹ HUD OIG Audit Memorandum 2003-PH-1802, issued September 4, 2003.

² Housing for the Elderly or Handicapped (Nonprofit) – Section 202 of the Housing Act of 1959 or Section 811 of the National Affordable Housing Act.

Responsible officials from HUD's West Virginia Field Office informed us they were unaware of the process for filing the statements and they relied on the Pittsburgh Office of General Counsel to handle legal matters. The responsible attorney from the Pittsburgh Office of General Counsel told us HUD's Pittsburgh Field Office maintained a tickler file for the projects it serviced to alert them when Continuation Statements needed to be filed. However, he did not know the process the West Virginia Field Office used for projects it serviced.

Based on the problems noted during our review of Shawnee Hills, Incorporated, we initiated this audit of HUD Handbooks and other available guidance covering HUD's procedures for filing Uniform Commercial Code Continuation Statements.

FINDING 1

HUD Does Not Have Effective Procedures for Filing Uniform Commercial Code Continuation Statements

HUD's existing policies and procedures that provide HUD staff guidance on filing Uniform Commercial Code Continuation Statements are substantially out-of-date and ineffective. We found three HUD Handbooks and a HUD Memorandum providing guidance on filing of Continuation Statements needed updating. This occurred primarily because the Regional Accounting Divisions were eliminated under an internal HUD Agency reorganization, and its function of maintaining a tickler system to advise the Loan Management Branch of the date when Continuation Statements needed to be filed was not assumed by or transferred to another HUD division. As a result, procedures and policy needed updating and HUD's financial interests in chattels were not always protected. A chattel is any article of tangible property other than land, and buildings such as office furnishings, furniture, or capital equipment.

Existing Procedures Outdated

We found the following active HUD Handbooks and Memorandum providing overall procedures on the filing of the Continuation Statements were outdated and ineffective:

- HUD Handbook 4571.4, Supportive Housing for Persons with Disabilities, Conditional Commitment – Final Closing, dated June 7, 1994.
- HUD Handbook 4571.1 REV-2, Direct Loan Program for Housing for the Elderly or Handicapped, dated March 1983.
- HUD Handbook 4350.1, Multifamily Asset Management and Project Servicing, dated January 23, 1996.

- HUD Memorandum dated February 22, 1990, entitled “Establishment of a Tickler System for Uniform Commercial Code Continuation Statements for Section 202 Projects and Preparation and Filing Procedures”.

These three handbooks and the HUD Memorandum provide general guidance on requirements to file Continuation Statements and state that procedures relating to Continuation Statements are set forth in the HUD-held Servicing Handbook 4360.1, Chapter 7, Section 2. They also state that upon receipt of the executed Continuation Statement from the borrower, the Loan Management staff must forward a copy to the Regional Accounting Division. The Regional Accounting Division was then required to maintain a tickler system in order to advise the Loan Management Branch at least six months in advance of the date when the Continuation Statement was to be filed.

However, we noted HUD-held Servicing Handbook 4360.1 was dated September 1970 and had been rescinded. Also, when the Regional Accounting Division was eliminated under an internal HUD Agency reorganization, its function of maintaining a tickler system to advise the Loan Management Branch of the date when Continuation Statements needed to be filed was not assumed by or transferred to another HUD division.

Accounting Center Does Not Maintain Tickler System

We contacted the responsible official in HUD’s Chief Financial Officer Accounting Center to determine if the Accounting Center maintained the tickler system. He told us that in 1998, HUD’s ten Regional Accounting Divisions were eliminated and all Section 202/811 capital advance and direct loan files were sent to the Fort Worth, Texas Accounting Center. While the Accounting Center is now responsible for managing the Section 202/811 files, it does not have responsibility for maintaining a tickler system. He also informed us that Field Counsel would have knowledge of the date when Financing Statements provided at loan closing needed to be renewed by the filing of Continuation Statements.

In summary, HUD’s existing policies and procedures that provide HUD staff guidance on filing Uniform Commercial Code Continuation Statements are outdated and need to be updated to ensure HUD’s interests are protected.

AUDITEE COMMENTS

We discussed the draft finding with responsible officials from HUD’s Office of Housing and Office of Chief Financial Officer during the audit. On November 17, 2003, we provided a discussion draft of the audit report to HUD’s Assistant Secretary for Housing and HUD’s Deputy Chief Financial Officer. Responsible officials from HUD’s Office of Housing and Office of Chief Financial Officer informed us they agreed with the findings and recommendations in this report. On November 24, 2003, responsible officials further informed us they did not wish to provide formal written comments or conduct a formal exit conference on this audit.

RECOMMENDATIONS

We recommend that HUD's Assistant Secretary For Housing and HUD's Deputy Chief Financial Officer:

- 1A. Coordinate efforts and take appropriate action to ensure existing policies and procedures for preparing and filing Uniform Commercial Code Continuation Statements are updated and/or consolidated.
- 1B. Ensure updated procedures for preparing and filing Uniform Commercial Code Continuation Statements are appropriately distributed to responsible field office staff for immediate implementation.

MANAGEMENT CONTROLS

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined the following management controls were relevant to our objective:

- Updating and/or consolidating HUD's procedures for preparing and filing Uniform Commercial Code Continuation Statements.
- Distributing HUD's procedures for preparing and filing Uniform Commercial Code Continuation Statements to responsible field office staff.