



# Office of Single Family Housing, Washington, DC

## HUD's Process for Making Changes to FHA Programs

**Office of Audit, Region 9  
Los Angeles, CA**

**Audit Report Number: 2017-LA-0002  
January 25, 2017**





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**From:** Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

**Subject:** HUD Failed To Follow Departmental Clearance Protocols for FHA Programs, Policies, and Operations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of HUD's process for making changes to Federal Housing Administration (FHA) programs and policies.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 213-534-2471.



**Audit Report Number: 2017-LA-0002**

**Date: January 25, 2017**

**HUD Failed To Follow Departmental Clearance Protocols for FHA Programs, Policies, and Operations**

## Highlights

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### What We Audited and Why

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We audited the U.S. Department of Housing and Urban Development (HUD), Federal Housing Administration's (FHA) process for making changes to its programs, policies, and operations based on an Office of Inspector General (OIG) preaudit analysis that noted potential violations of departmental clearance requirements for three documents. Our audit objective was to determine whether HUD followed the proper requirements and procedures when implementing changes to FHA single-family programs, policies, and operations.

### What We Found

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HUD failed to follow required departmental clearance procedures when implementing changes to FHA programs. Specifically, HUD's Office of Single Family Housing did not always pursue required departmental clearance and posted draft documents or directives in final form before departmental clearance. When departmental clearance was pursued, HUD did not always ensure that key officials reviewed the documents before issuance. This condition occurred because HUD did not have adequate controls over the directives process. Specifically, HUD did not implement clearly understood and updated guidance for directives and did not adequately monitor its clearance tracking system. As a result, significant policy information was distributed without proper review and clearance, which undermined the intent and integrity of the process. This action effectively bypassed the required review by other HUD offices, including OIG, which had questioned or opposed document policies in some cases. Additionally, the risk of issuing incorrect or inconsistent information was increased, potentially resulting in significant financial losses or other unintended consequences.

### What We Recommend

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We recommend that HUD (1) pursue departmental clearance for the 13 documents and policies identified that did not go through required departmental clearance and recall any documents that cannot be appropriately cleared, (2) update its clearance tracking system to include missing concurrence forms, (3) ensure that appropriate concurrence forms were obtained and documented for directives issued by other HUD program offices, (4) implement controls, update policies, and provide training to ensure that directives are reviewed and documented as required.

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# Background and Objective

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Directives are communications that relay important information or guidance about U.S. Department of Housing and Urban Development (HUD) programs, policies, or operations. Directives are primarily issued to external HUD constituents; however, internal communications may also be directives if they impact multiple HUD offices or outside interests. When making changes to its programs, policies, or operations using directives, HUD is required to comply with Federal statutory requirements for maintaining adequate records and ensuring information quality.

HUD issued a directives handbook (Handbook 000.2, REV-3, HUD Directives System), which describes the processes in place to comply with these requirements (see appendix B). This handbook states that all directives must go through departmental clearance. During departmental clearance, HUD offices with related policy or legal expertise review the document and provide input with the goal of ensuring that the information is accurate and does not conflict with other HUD policy.

Directives generally supplement or explain existing regulatory or statutory requirements that pertain to HUD programs or operations and include documents such as handbooks, mortgagee letters, notices, and other forms of communication (for example, email blasts) that provide information or guidance. In addition, departmental clearance must be completed for directives that are posted in draft for public comment before issuance in final form. Also, documents that impose new reporting and record-keeping require compliance with the Paperwork Reduction Act<sup>1</sup>, which also includes departmental clearance. However, documents that repeat information already cleared (with no further changes) are not considered directives.

Each HUD program office is responsible for designating a directives management officer and ensuring that directives originated by that office are cleared in accordance with the directives handbook. HUD's Office of Administration is responsible for monitoring HUD directives through a central tracking system and holds lead responsibility for ensuring compliance with the handbook. Directives must be cleared in accordance with the handbook unless a prior waiver is granted by the Office of Administration.

A June 2014 memorandum and related departmental clearance protocols, issued in September 2014, required all HUD offices to use HUD's Clearance Calendar tracking system for departmental clearance, with the exception of notices of funding availability. The Clearance Calendar site facilitates the review and approval process for HUD clearance documents. Each program office that initiates a directive is responsible for entering the subject document and form HUD-22 (Departmental Clearance and Approved Record), which authorizes the placement of directives into departmental clearance, into the Clearance Calendar and ensuring that all of the appropriate offices have an opportunity to respond. The directives management officer receives directives, puts them

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<sup>1</sup> The Paperwork Reduction Act of 1995 requires that agencies obtain Office of Management and Budget approval before requesting most types of information from the public. "Information collections" include forms, interviews, and recordkeeping requirements, to name a few categories.

into the Clearance Calendar, and monitors the responses from the reviewing offices. All directives must be cleared by six specified HUD offices. The reviewing offices document their response by signing the form HUD-22 and indicating a response of concurrence, nonconcurrence, or no position. If any required reviewing office nonconcur, the matter must be resolved. If the nonconcurrence cannot be resolved between the originating and reviewing office, it must be elevated to the Assistant Secretary or Deputy Assistant Secretary level.

During the audit scope of July 1, 2014, to December 31, 2015, the Office of Single Family Housing had 42 directives that were entered into the Clearance Calendar and went through departmental clearance.

Our objective was to determine whether HUD followed the proper requirements and procedures when implementing changes to FHA single-family programs, policies, and operations.

# Results of Audit

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## **Finding: HUD Failed To Follow Departmental Clearance Protocols for FHA Programs, Policies, and Operations**

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HUD failed to review, approve, and document FHA program directives as required when implementing changes to its programs, policies, and operations. Specifically, HUD's Office of Single Family Housing did not always pursue required departmental clearance and distributed at least 15 documents or directives and implemented policy without first completing departmental clearance. When clearance procedures were followed, HUD did not always ensure that key officials reviewed the documents before issuance. This condition occurred because HUD failed to implement adequate controls over the directives process. It did not implement clearly understood and updated guidance for directives and failed to adequately monitor its clearance tracking system. As a result, HUD distributed significant policy information without first completing departmental clearance, which undermined the intent and integrity of the process. This action effectively bypassed the required review by other HUD offices, including the Office of Inspector General (OIG), which had questioned or opposed document policies in some cases. Additionally, the risk of issuing incorrect or inconsistent information increased, potentially resulting in significant financial losses or other unintended consequences.

### **HUD Failed To Pursue Required Departmental Clearance**

HUD did not always pursue required departmental clearance when issuing directives or Paperwork Reduction Act documents. To identify potential directives that were not placed into clearance, we reviewed selected documents issued by HUD's Office of Single Family Housing during the audit period from July 2014 through December 2015. These documents included all mortgagee letters, housing notices, and Federal Register publications; documents posted on HUD's FHA Info<sup>2</sup> and Drafting Table<sup>3</sup> public Web sites; and two potential directives we became aware of during prior HUD OIG audits.<sup>4</sup> Based upon this limited testing, we determined that HUD distributed at least 15 documents and implemented significant policy without first completing departmental clearance (appendix C). The documents included three draft documents, seven final directives, and five Paperwork Reduction Act revision documents.<sup>5</sup> In 2

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<sup>2</sup> HUD's FHA Info Web site provides a Single Family housing industry subscription services that transmits email notification of important industry announcements such as new mortgagee letters, handbooks, policy notices, Federal Register notices, and events and training. The site provides a publically available archive of the email notifications.

<sup>3</sup> The Single Family Drafting Table Web site is used for posting drafts of upcoming proposed policies and handbook sections.

<sup>4</sup> Our audit testing was limited to the noted sources and was not designed to identify all potential directives. See the Scope and Methodology section for additional details.

<sup>5</sup> Three of these fifteen documents were identified in the preaudit analysis that prompted our audit. We determined that all three of these documents were posted in draft form before required departmental clearance (finding).

of the 15 cases, HUD completed departmental clearance after the document was published. The remaining 13 documents had not been cleared at the time of our audit.

#### HUD Posted Draft Documents Before Required Departmental Clearance

HUD's directives handbook requires that HUD complete departmental clearance before posting draft directive information for public comment. It states:

Posting in draft form for public comment will indicate to the public that, although in draft, the policy and legal positions in the draft form are accurate and reflect the direction that the Department is interested in pursuing. However, the public cannot be assured that draft directives will indeed be pursued, unless, the draft is approved through departmental clearance.

To solicit public comments, HUD posted at least three documents in draft form on its publically available Drafting Table Web site before required departmental clearance. These documents included the following.

1. **Loan Quality Assessment Methodology (Defect Taxonomy)** – This document discussed significant policy and procedural guidance related to HUD's FHA lender monitoring process and enforcement of FHA loan origination defects. HUD had published policy information regarding its monitoring processes in HUD handbooks and mortgagee letter directives. Because the draft Loan Quality Assessment Methodology presented information and guidance regarding proposed changes or additions to the existing guidance and would affect outside interests, HUD should have completed full departmental clearance before publically posting the document in draft form. However, HUD posted the draft document on FHA's Drafting Table Web site on September 16, 2014, without first completing the clearance process.

This document was significant because it discussed the "severity" of loan deficiencies. In this regard, we note that the National Mortgage News published an article on April 27, 2016 about the Loan Quality Assessment Methodology, saying that the mortgage industry "quickly came to support the project, recognizing its value in helping lenders avoid lawsuits from Justice for relatively minor underwriting mistakes."

2. **Addendum to Uniform Residential Loan Application (form HUD-92900-A)** – This document was used for establishing the eligibility of proposed mortgage transactions for FHA's insurance endorsement. It revised a previously cleared Paperwork Reduction Act document; therefore, departmental clearance was required. Further, clearance was also required because this document removed certification language that could potentially impact FHA's enforcement efforts. A memorandum issued from HUD's Principal Deputy Assistant Secretary for Housing, and a U.S. Department of Justice responsive press release highlighted the significance of the document changes.



Excerpt from FHA posting, March 15, 2016

In this final loan-level certification, FHA is clearly identifying what lenders will be held accountable for only those mistakes that would have altered the decision to approve the loan. This important move makes it very clear that minor mistakes that do not affect the decision to approve a loan are not the focus of our compliance efforts.

Excerpt from U.S. Department of Justice press release, March 15, 2016

The department will continue these enforcement efforts by using the False Claims Act, and will continue to be guided by the language of the act that prohibits the submission of knowing and material false claims. In the FHA context, this means that no lender will face False Claims Act enforcement based on an unknowing mistake or an immaterial requirement. But, at the same time, the department will not hesitate to bring an action where a lender – or any other individual or entity who would defraud the federal taxpayer – submits false statements and claims at the expense of the federal fisc.

HUD posted the document on its public Drafting Table Web site on May 1, 2015; however, it did not complete the departmental clearance process until August 11, 2015. In addition, the 60-day Federal Register notice relating to this document was improperly issued before it went through departmental clearance. The Federal Register notice was issued on May 15, 2015.

3. **Single Family Housing Policy Handbook 4000.1** – This document consolidated FHA single-family housing policy into a single source so lenders and other stakeholders could more easily find current policy information. HUD used its Drafting Table Web site to post sections of the Handbook in draft form to receive feedback from interested parties. Before posting this document publically, HUD's Office of Single Family Housing completed a waiver of a housing directive; however, only HUD's Offices of General Counsel and Housing signed the document. HUD did not provide documentation to show that the clearance process requirements were waived by the Office of Administration as required. Without an appropriately approved waiver, this document should have undergone full departmental clearance before it was posted publically in draft form. The following handbook sections were posted in draft form before clearance.

Single Family Housing Policy Handbook 4000.1 section	Date posted	Clearance start date
Origination through post-closing/endorsement	October 29, 2013	July 17, 2014
Doing business with FHA – FHA lenders and mortgagees	June 30, 2014	December 17, 2014
Quality control, oversight and compliance	June 30, 2014	February 11, 2015
203(k) rehabilitation mortgage insurance and 203(k) consultant	August 28, 2014	February 11, 2015
Servicing and loss mitigation	September 11, 2014	April 6, 2015
Doing business with FHA – Other participants	January 21, 2015	July 17, 2015
Claims and disposition	August 5, 2015	January 20, 2016

We note that one of these handbook sections, “Origination through post-closing/endorsement,” was processed through departmental clearance using an incomplete change log. The change log, provided to OIG as one of the six required reviewing offices, did not note the removal of language related to premium pricing within the prior handbook (Handbook 4155.1) or the definition of premium pricing that was not in the prior handbook. A change log is not a requirement of the directives handbook. However, because this change impacted a key program requirement, excluding this from the log was potentially misleading to reviewers who were not aware of HUD’s intention to provide a new interpretation or clarification regarding premium pricing or downpayment assistance. If a change log is provided to required reviewing offices, HUD should ensure that it is accurate and complete so that the scope of the guidance or policy changes is not misrepresented through omission of relevant information.

#### HUD Distributed Directives in Final Form Before Departmental Clearance

HUD distributed at least seven directives in final form without completing required departmental clearance. These documents included the following.

1. **Supplemental Performance Metric** – This document discussed significant policy and procedural guidance related to HUD’s enforcement of the FHA Credit Watch program. HUD implemented this program through regulations and mortgagee letters (directives) that set and adjusted thresholds for review of lenders and discussed factors evaluated for lenders with default and claim rates above specified termination thresholds. FHA stated the Supplemental Performance Metric is not a change in policy. However, we determined it is a change in policy for implementing the Credit Watch regulations. Specifically, it reinterprets the regulatory obligation of the HUD Secretary to consider whether excessive defaults are the result of lending in underserved areas with a new focus on borrower credit score. Because the Supplemental Performance Metric

implemented changes or additions to the existing policy guidance and would affect outside interests, departmental clearance was required. HUD first posted the Supplemental Performance Metric in draft form on FHA's Drafting Table Web site on May 13, 2014, to solicit comment from FHA lenders, and the policy was implemented on August 17, 2015. HUD did not complete departmental clearance for this document.

2. **Appraisal Report and Data Delivery Guide** – This document provides guidance to appraisers for preparing residential appraisal reports. As stated on HUD's FHA Info Web site, the guide is not technically part of the Single Family Policy Handbook, but it is used in concert with certain sections of the Handbook. The Single Family Policy Handbook states that the appraiser must certify that it will comply with the Guide. The Appraisal Report and Data Delivery Guide included specific instructions and guidance that were not stated in a current directive and, therefore, should have undergone full departmental clearance as part of the Handbook clearance or a separate clearance before it was issued to the public.
3. **Waiver of FHA Requirement for Form 26-8937** – This document waived an FHA requirement for lenders to obtain U.S. Department of Veterans Affairs (VA) form 26-8937 (Verification of VA Benefits) when documenting FHA borrower disability benefits. Because this waiver changed existing policy guidance and affected outside interests, departmental clearance as a directive was required. However, HUD did not complete departmental clearance and instead inappropriately published a waiver form on its FHA Info Web site. Because HUD documented this change in FHA requirements only as a waiver within the HUD Client Information and Policy System (HUDClips)<sup>6</sup> policy repository, the information was not appropriately categorized and, therefore, may not have been readily accessible by parties that could be affected, such as HUD employees, FHA borrowers, and lenders.
4. **Interpretation of FHA's Loss Mitigation Policy Letter**<sup>7</sup> – This document was issued to FHA lenders using a group email list maintained by HUD's National Servicing Center. It provided a significant policy interpretation related to FHA claim eligibility under HUD's FHA-Home Affordable Modification Program. It also waived HUD enforcement for certain prior excessive or ineligible FHA insurance claims for lenders that misinterpreted the existing requirements. This document should have been considered a directive and placed into departmental clearance because it would affect outside interests (such as FHA borrowers and lenders), could impact other HUD offices with enforcement responsibilities, and included policy guidance specifying which of the possible interpretations of FHA requirements was required. The document was distributed only as part of an

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<sup>6</sup> HUDClips is a searchable online repository of directives and forms available to HUD staff, stakeholders, and the public.

<sup>7</sup> This document was identified for review through OIG audit report 2015-LA-0003, issued September 18, 2015.

email to specific recipients and was not documented with the HUDClips policy repository. Therefore, the information was not appropriately accessible by parties that could be impacted, such as HUD employees, FHA borrowers, and lenders.

5. **Standard Operation Procedures (SOP) Extension and Variance Automated Requests System (EVARS)<sup>8</sup>** – This internal document provided HUD’s policy and procedures for approving or disapproving loss mitigation claim variance/exception requests submitted by lenders.<sup>9</sup> Internal documents are not considered directives if they do not affect HUD-wide operations or impact outside interests. In this case, the EVARS SOP policy did impact outside interests (such as FHA borrowers and lenders) and also changed certain requirements in existing directives. For example, Mortgagee Letter 2008-43 stated that partial claims must be deducted when calculating the required minimum net sales proceeds for a preforeclosure claim; however, the EVARS SOP effectively eliminated this policy by stating that partial claim amounts do not need to be deducted if excluding the partial claim would otherwise result in approval. Because a substantial number of FHA claims are approved based on HUD variance approvals, the policies within the document could have a significant impact on FHA borrowers and the FHA insurance fund.
6. **Mortgagee Letter 2015-01** – This document implemented a 50-basis-point reduction in the FHA annual mortgage insurance premium rates. Because the document is an FHA mortgagee letter that would affect outside interests and changed an existing HUD directive policy regarding insurance premium rates, it should have undergone departmental clearance before issuance to the public.
7. **Legal Interpretation Letter (Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs)** – This document was posted on HUD’s Office of General Counsel public Web site and stated an interpretation of the statutory minimum investment requirements for FHA loan borrowers. Although the directives handbook states that legal opinions are a type of nondirective communication that does not require clearance, in this case, the document fit the definition of a directive and, therefore, should have been placed into departmental clearance. The handbook states that the content of a document, rather than the title, determines whether it constitutes a directive. It also states that public communications constitute directives when they relay guidance for the first time, beyond merely explaining provisions of existing policy or requirements. Existing statutory requirements in paragraph 203(b)(9)(c) of the National Housing Act prohibit gifts (to meet FHA’s minimum required investment) that involve direct or indirect reimbursement from an entity that financially benefits from the transaction. HUD’s legal interpretation letter, on the

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<sup>8</sup> This document was identified for review through OIG audit report 2013-LA-0002, issued September 5, 2013.

<sup>9</sup> A variance is a formal request that requires the HUD National Servicing Center’s approval to allow a servicer to vary from HUD’s guidelines.

contrary, indicates a policy that would allow prearranged transactions, which include reimbursements to gift donors by involved financial institutions that benefit from the transaction.<sup>10</sup>

The legal interpretation letter was further reinforced by a memorandum publicly issued by HUD's Principal Deputy Assistant Secretary for Housing in July 2015. While referencing an OIG audit report<sup>11</sup> finding that premium interest rates were inappropriately used to fund borrower downpayments, the memorandum indicated FHA support for such programs and noted that FHA "allows" housing finance agencies to fund their programs "appropriately."

Excerpt from FHA posting, July 20, 2015

The intent of our rules regarding down payment assistance is clear and allows HFAs the discretion necessary to fund these programs appropriately. HUD is taking active steps to completely resolve the issues raised in the audit and to provide proper clarity and guidance to the market.

This letter, along with the legal opinion letter, created an impression that the information represented HUD policy. Because HUD's legal interpretation letter indicated a new policy, was plainly inconsistent with the existing statutory requirements, and was available to the public on HUD's Web site, HUD should have placed this document into departmental clearance as a directive. The potential effect of these types of noncleared postings by FHA or its leadership is that those who read the statements can perceive the statements as official FHA policy. Without departmental clearance in this case, there were no checks and balances in place to ensure that legal, regulatory, or policy concerns with the statements were addressed internally. Further, because OIG, a required reviewing office for departmental clearance, indicated disagreement with the subject policy, HUD should have pursued required resolution procedures for reviewing office nonconcurrence outlined in HUD's directives handbook before issuing this document.

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<sup>10</sup> The Deputy Secretary issued a decision on May 25, 2016, on housing finance agency borrower-financed downpayment assistance programs in which the funds are indirectly derived through higher mortgage interest rates. HUD's position is that these programs are permissible because housing finance agencies provide the downpayment assistance and they are not a source prohibited by the statute, regardless of how the agency acquires the funds to provide the downpayment. OIG strongly disagrees with that decision. Further, underscoring the significance of this issue, we note that a 2015 actuarial review of FHA's insurance fund found that previous loans with similar downpayment arrangements involving interested parties (sellers) ultimately cost FHA almost \$16 billion in added losses.

<sup>11</sup> OIG audit report 2015-LA-1005, issued July 9, 2015

### HUD Distributed Paperwork Reduction Act Documents Before Departmental Clearance

HUD did not use the directive process for five completed Paperwork Reduction Act notices. The directives handbook states that when forms are being substantially revised, the program office should use the directive process to announce substantive changes to the form. The five notices listed in appendix C revised previously approved forms, yet HUD did not complete departmental clearance.

### HUD Failed To Implement Adequate Controls Over the Departmental Clearance Process

HUD issued documents without following required clearance procedures because it failed to implement clearly understood and updated guidance for the directives process. HUD had not updated the directives handbook since 2012, and the handbook did not reflect current office organization and procedures. For example, the handbook did not reference the Clearance Calendar tracking system, the Drafting Table Web site, or the transfer of directives oversight responsibilities from the Office of the Chief Human Capital Officer (OCHCO) to the Office of Administration. Further, the handbook did not provide clearly understood guidance defining which documents required clearance. HUD officials indicated they were not always sure which documents required departmental clearance and had differing opinions regarding whether specific documents would require clearance. At least one official was not aware that draft documents would require clearance, and another was not aware that internal documents affecting multiple offices required full departmental clearance. One key HUD program official stated that the official only recently became aware of the directives handbook, and several HUD officials stated that they were not aware of the departmental clearance protocols document issued in 2014, which discussed additional departmental clearance requirements. Most of the officials interviewed stated that it would be helpful to update the directives handbook and provide training regarding the directives process. A June 2014 letter issued to principal staff acknowledged the need for changes to the departmental clearance process and discussed planned improvements. This letter stated that HUD would establish a standing working group to develop recommendations related to departmental clearance, assist the Office of Administration in overseeing compliance, and work with all offices to improve the clearance process. However, at the time of our audit in 2016, HUD officials acknowledged that the standing working group was never formed and, therefore, had not met to further address clearance process improvements or oversight.

### **HUD Failed To Ensure That Key Officials Reviewed Directives Before Issuance**

HUD's Clearance Calendar tracking system was incomplete and did not support that the required program offices reviewed and approved directives as required. HUD offices were required to use HUD's automated Clearance Calendar, which facilitates the review and approval process for HUD clearance documents. The directives handbook requires that all directives be cleared by at least the following six HUD offices:

- Office of the Chief Information Officer,
- Office of the Chief Financial Officer,
- Office of Inspector General,
- Office of General Counsel,
- Office of Policy Development and Research, and

- Office of Administration.<sup>12</sup>

The reviewing offices document their response by signing form HUD-22 and indicating concurrence, nonconcurrence, or no position. If any required reviewing office nonconcur, the matter must be resolved or elevated to the Assistant Secretary or Deputy Assistant Secretary level. We reviewed all 42 documents initiated by HUD’s Office of Single Family Housing and posted to the Clearance Calendar from July 2014 through December 2015. All 42 (100 percent) of the directives were missing required form HUD-22 concurrence forms or other evidence of review and concurrence from at least one of the six required reviewing offices. HUD manually searched hardcopy and email records and located documentation for 29 of these 42 directives to support that required offices reviewed the directive. For the remaining 13 (31 percent) directives, HUD was unable to locate documents showing that the required offices reviewed the directives.

HUD clearance ID	Missing office responses
436	2
452	1
453	1
459	2
511	1
527	1
626	1
627	1
658	1
693	2
743	2
767	1
768	1
<b>Total</b>	<b>17</b>

Even when responses were received and entered into the Clearance Calendar, the system did not correctly track these responses. It is the responsibility of the reviewing offices to enter the form HUD-22 concurrence form and document their response in the Clearance Calendar. HUD program offices failed to correctly report their responses for 17 of the 42 (40 percent) directives reviewed. For example, in some cases, the attached form HUD-22 completed by reviewing offices indicated “concurrence,” yet the Clearance Calendar system showed that no response was submitted. One HUD employee, responsible for documenting a reviewing office’s response in the Clearance Calendar, stated that to avoid the appearance of a late response, she was instructed to enter a “concur” response into the Clearance Calendar before key officials reviewed the document. In this case, the involved office apparently intentionally manipulated the

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<sup>12</sup> The directives handbook states that OCHCO is one of the required reviewing offices; however, according to HUD officials, the Office of Administration should replace OCHCO in the handbook. The Office of Administration was an office within OCHCO but became a separate office in 2014.

departmental clearance system and did not properly review the associated policies or guidance as required.

For 2 of the 42 directives reviewed, the Clearance Calendar tracking system did not document that HUD properly resolved reviewing office “nonconcurrency” responses as required. HUD’s directives handbook states that nonconcurrency responses should be resolved by appropriate staff if possible and elevated to the Assistant Secretary level and then to HUD’s Deputy Secretary if needed. HUD failed to provide documentation to support that the reviewing office had lifted the nonconcurrency or that the issue had been elevated for resolution as required.

The missing and inaccurate information in the Clearance Calendar system continued, indicating that appropriate HUD officials did not adequately monitor the Clearance Calendar to ensure its accuracy and completeness. After the clearance process is completed, the program office that originated the directive sends the document to the Office of Administration to post to the HUDClips Web site. Before posting the directive to HUDClips, the Office of Administration is responsible for ensuring that the clearance process was completed in accordance with the directives handbook. However, Office of Administration employees acknowledged that they did not consistently review the Clearance Calendar to ensure that all required officials had reviewed HUD’s directives.

## **Conclusion**

Because HUD failed to follow departmental clearance requirements, HUD and its stakeholders lacked appropriate assurance that guidance and policies were reviewed, approved, and documented in accordance with the directives handbook and associated legal authorities. Failing to follow the departmental clearance process undermines the intent and integrity of the process. Additionally, documents that were not issued and documented as official directives may not be appropriately accessible for entities impacted by the guidance, including HUD staff, stakeholders, and the general public. Changes to FHA programs, policies, and operations can have wide-ranging impacts affecting not only FHA borrowers and lenders, but also the U.S. housing market and economy. In 2015, FHA insured \$233 billion in new single-family housing mortgages and paid insurance claims totaling \$14.5 billion. While information on potential financial impact specific to each item identified in this report could not readily be estimated, issuance of unclear, inaccurate, or contradictory information resulting from uncleared directives within FHA programs could potentially cause significant financial losses or other unintended consequences.



## **Recommendations**

We recommend that the Acting Deputy Assistant Secretary for Single Family Housing

- 1A. Pursue departmental clearance for the 13 documents and policies identified that did not go through required departmental clearance. For any items that cannot be appropriately cleared, HUD should take appropriate action to recall the document or policy.
- 1B. Obtain missing HUD-22 concurrence forms for the 13 identified directives and update the Clearance Calendar tracking system to properly document clearance of the 42 directives with incomplete Clearance Calendar documentation. For any items that cannot be appropriately cleared, HUD should take appropriate action to recall the document or policy.

In addition, we recommend the Chief Administrative Officer for the Office of Administration

- 1C. Review the Clearance Calendar and ensure that appropriate form HUD-22 concurrence forms were obtained and documented for directives issued by other HUD offices.
- 1D. Implement controls to ensure that future directives are reviewed and documented in the Clearance Calendar tracking system as required.
- 1E. Update policies and procedures for the directives process, including responsibilities for process oversight and clear guidance defining when clearance is required.
- 1F. Develop and provide training to appropriate staff and required reviewing offices regarding the departmental clearance process requirements.

# Scope and Methodology

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We performed our audit fieldwork from November 2015 to June 2016. Our audit period covered directives that were issued or cleared from July 2014 to December 2015 but was expanded to include two potential directives we became aware of during prior HUD OIG audits.

To accomplish our objective, we

- Reviewed applicable HUD requirements and guidelines,
- Interviewed appropriate HUD personnel from the Office of Housing and Office of Administration,
- Reviewed documentation for 42 clearance items from HUD's Clearance Calendar Web site,
- Reviewed additional sources and HUD public Web sites to identify directives that may not have been entered into the Clearance Calendar and gone through the clearance process (such as HUDClips, FHA Info, Drafting Table, and Federal Register publications issued by HUD), and
- Reviewed two potential directives we became aware of during prior HUD OIG audits.

We used data maintained by HUD in its Clearance Calendar tracking system to identify all directives entered into the clearance process for the Office of Single Family Housing. There were some concerns related to the completeness of the data so we reviewed the following sources to assess the reliability of the data and identify directives that were not entered into the Clearance Calendar: (1) HUDClips Web site, (2) FHA Info Web site, (3) Single Family Drafting Table Web site, (4) Federal Register publications issued by HUD, and (5) the Office of General Counsel's Web site of published legal opinions. As stated in the findings section of the audit report, we identified directives that HUD did not enter into the Clearance Calendar and did not go through departmental clearance. In addition, we identified two potential directives from prior OIG audits:

- 2015-LA-0003, issued September 18, 2015. The audit included a review of HUD's Home Affordable Modification Program.
- 2013-LA-0002, issued September 5, 2013. The audit included a review of the Standard Operation Procedures Extension and Variance Automated Requests System.

Our audit testing was limited to the noted sources and was not designed to identify all potential directives. Additional documents posted on HUD Web pages or distributed internally at HUD or

letters and emails sent to third parties were not tested. Therefore, HUD may have distributed additional directives that were not identified by our audit testing.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

# Internal Controls

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

## **Relevant Internal Controls**

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

- Controls to ensure that HUD reviewed, approved, and documented FHA single-family documents as required when implementing changes to its programs, policies, and operations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## **Significant Deficiency**

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

- HUD did not have adequate controls to ensure that directives were reviewed, approved, and documented as required when implementing changes to FHA single-family programs, policies, and operations (finding).


# Appendixes

## Appendix A

### Auditee Comments and OIG's Evaluation

#### Ref to OIG Evaluation

#### Auditee Comments



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

NOV 15 2016

MEMORANDUM FOR: Tanya E. Schulze, Regional Inspector General for Audit, 9DGA

FROM: Robert E. Mulderig, Acting Deputy Assistant Secretary for Single Family Housing, HU  
*R. E. Mulderig*

SUBJECT: Auditee Response  
HUD Failed to Follow Departmental Clearance Protocols for FHA Programs, Policies, and Operations.  
OIG Draft Audit Report Number: 2017-LA-00XX  
Issue Date: October 13, 2016

Thank you for providing the Office of Housing (Housing) the opportunity to comment on the draft audit report of the Office of Inspector General (OIG) regarding concerns that HUD Failed to Follow Departmental Clearance Protocols for FHA Programs, Policies, and Operations (2017-LA-00XX). The audit review was performed due to OIG's assertion that there were potential violations of Departmental clearance requirements for multiple deliverables issued by the Office of Single Family Housing.

Housing takes very seriously the need for proper vetting of documents in accordance with the Directives Handbook. Housing believes that, in its consideration of the documents that the OIG contends were not properly cleared, OIG may have overlooked evidence of the clearance activity that did occur for some of these documents, as well as the circumstances surrounding the remaining deliverables that rendered those documents outside the requirement for a formal clearance process, according to the Directives Handbook. In particular, Housing notes the Directives Handbook's citation that "HUD directives primarily supplement statutes, regulations, and HUD or Administration policies to provide practical guidance on how to comply with these legal authorities and policies." Either at the time these documents were delivered to HUD constituents, or in response to the OIG draft audit report, Housing consulted with the Office of Administration and Office of General Counsel (OGC) on the relevance of procedures described in the Directives Handbook.

Regarding the 13 subject documents, Housing respectfully requests that the OIG consider the following information, which may have been overlooked in the development of the draft audit report:

[www.hud.gov](http://www.hud.gov) [espanol.hud.gov](http://espanol.hud.gov)

Comment 1

Comment 2

Comment 3

Comment 4

Comment 2

Comment 4

**Ref to OIG  
Evaluation**

Comment 5

Comment 6

Comment 7

Comment 8

Comment 9

Comment 10

Comment 11

1. **Loan Quality Assessment Methodology (Defect Taxonomy).** The Loan Quality Assessment Methodology was first published on FHA's Drafting Table for purposes of soliciting industry feedback. The final Loan Quality Assessment Methodology was put through departmental clearance prior to its publication on June 18, 2015. Please see the attached copy of the clearance record for this item (Attachment A).  
  
The Methodology was issued to the FHA lender industry as information about FHA's forthcoming approach to assessing loan defects; it was not a statement of policy. As was indicated in the press release accompanying the publication, the "Taxonomy is not a comprehensive statement on all compliance monitoring or enforcement efforts by FHA... and does not establish standards for administrative or civil enforcement action...Nor does it address FHA's response to patterns and practice of loan-level defects, or FHA's plans to address fraud or misrepresentation in connection with any FHA-insured loan." Thus, Housing contends that release of the Methodology on the FHA Drafting Table was not an activity for which Departmental clearance was required, under the guidance of the Directives Handbook.
2. **Supplemental Performance Metric (SPM).** Housing believes that the press release concerning the roll-out of the Supplemental Performance Metric in the Neighborhood Watch Early Warning System was not required to be vetted through Departmental clearance in accordance with the Directives Handbook. The release of the Supplemental Performance Metric did not provide guidance to lenders on how to comply with legal authorities or policies. It was provided for informational purposes only in order to better communicate an additional compensating factor that FHA may use as a part of its Credit Watch and Lender Insurance termination initiatives.
3. **Appraisal Report and Data Delivery Guide.** Housing consulted with the Office of General Counsel on this item, whose staff opined that the Appraisal Report and Data Delivery Guide did not require clearance because it reflected previously cleared policy and only contained instructions on how to complete a form.
4. **Waiver of FHA Requirement for Form 26-8937.** The content of this waiver affected all persons equally; and therefore, under Section E: Waiver of Directives Handbook 000.2 REV-3, did not require Departmental Clearance.
5. **Interpretation of FHA's Loss Mitigation Policy Letter.** The subject document was issued merely as a clarification of existing policy. This was necessary once FHA learned from a trusted national advocacy group that the industry was misinterpreting its loss mitigation policy and, as a result, adversely impacting a small segment of FHA borrowers. Section B of the Administrative Handbook does not require that such clearance take place for documents of this sort.
6. **Standard Operating Procedures (SOP) Extension and Variance Automated Request System (EVARS).** This document consists of FHA's internal SOPs, used to accept or reject requests from lenders via EVARS. Section B of the Administrative Handbook does not require that such clearance take place for documents of this sort.

**Ref to OIG  
Evaluation**

Comment 12

Comment 13

Comment 14

Comment 15

Comment 16

**7. Mortgagee Letter 2015-01.** This Mortgagee Letter was properly cleared. Due to the impact to the financial markets, this directive was hand-carried through clearance and not placed on the clearance calendar. Please see Attachment B.

**8. Legal Interpretation Letter (Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs).** The General Counsel's legal opinion was prepared for, addressed to, and provided to Edward Golding, Principal Deputy Assistant Secretary. The General Counsel's subsequent posting of the legal opinion on OGC's public website does not change the nature of the document. Handbook 000.2 Rev-3 B-3 specifically states that, among other things, legal opinions are not directives and therefore do not go through clearance. The General Counsel's legal opinion was based on existing policy and issued to provide the Principal Deputy Assistant Secretary with an understanding of the existing policy of FHA at that time.

**9. 60-Day Notice of Proposed Information Collection: Builder's Certification of Plans, Specifications, and site.**

**10. 60-Day Notice of Proposed Information Collection: Request for Acceptance of Changes in Approved Drawings and Specifications.**

**11. 60-Day Notice of Proposed Information Collection: FHA Insured Mortgage Loan Servicing Involving the Loss Mitigation Program.**

**12. 203(k) Consultant Roster Certification Form.**

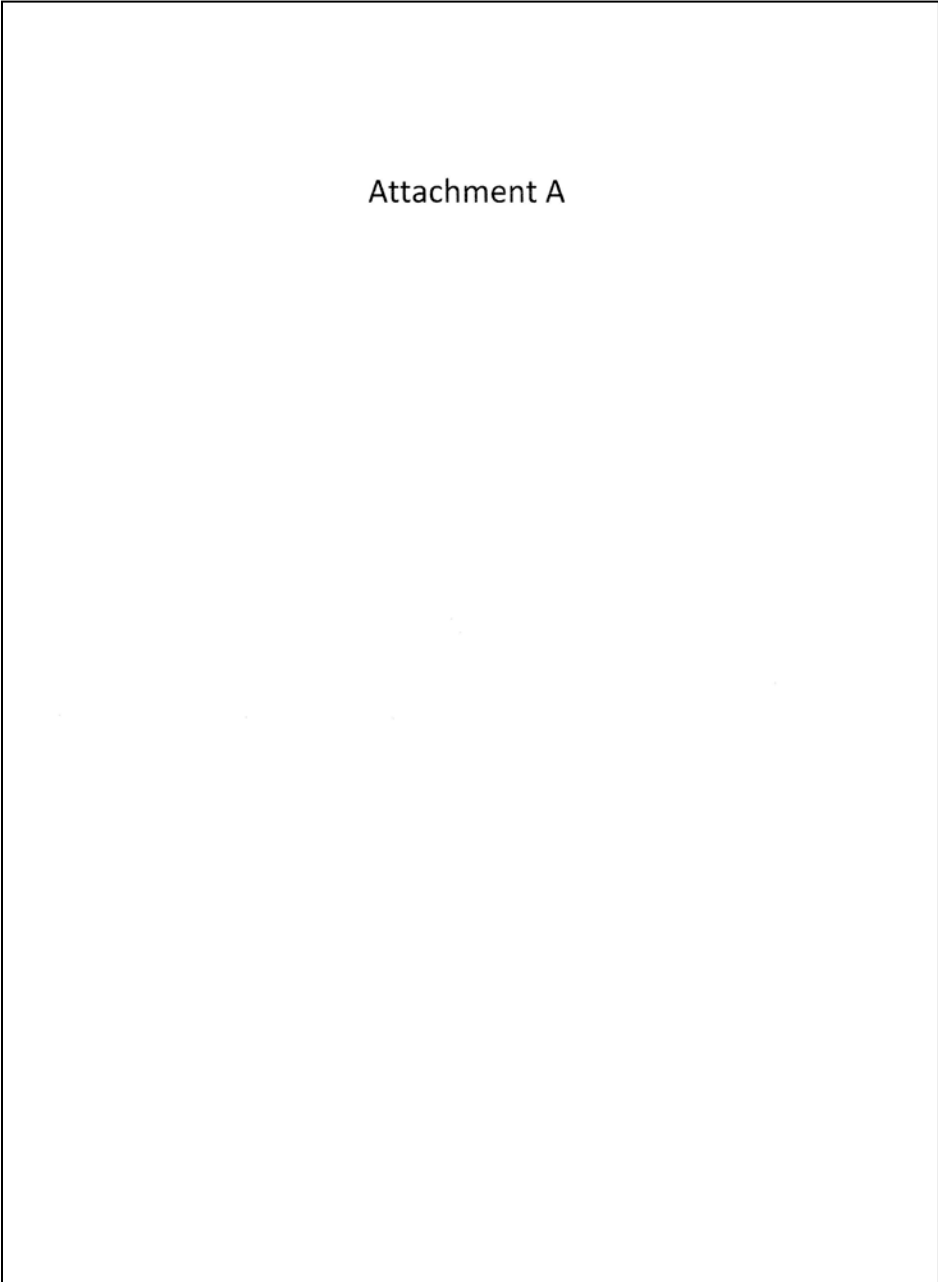
These *Federal Register* notices (Items 9-12) for what were, in each case, current OMB-approved PRA collections did not require Departmental clearance as per directives management. Per HUD Handbook No. 000.2 REV-3, "HUD directives are different than Federal Register (FR) publications... clearing Federal Register publications is managed by ... OGC" (introduction, pg. ii).

**13. Revisions to FHA Lender Annual Recertification Statements.** This *Federal Register* notice revising an existing OMB-approved PRA collections did not require departmental clearance as per directives management, for reasons cited above for Items 9-12. However, the proposed revisions were in fact put through a Departmental clearance process. Please see the attached memorandum (Attachment C).

The Office of Administration notes that it is updating the directives program, including the Directives Handbook, to provide more awareness of and clarity on the process for clearing the types of items covered in this memorandum.

We hope these comments are helpful as you prepare your final report. Housing looks forward to working with the OIG to address any remaining concerns with Housing activities relative to Departmental clearance protocols. Thank you very much for the opportunity to comment on your draft audit report.

**Ref to OIG  
Evaluation**



Attachment A



Ref to OIG  
Evaluation

**Departmental Clearance & Approval Record** U.S. Department of Housing and Urban Development

**Note to Clearing Offices:** If your response has not been received by the Deadline Date, the Originating Office may proceed without it.

1. Job Control Number(s) 2. Classification Number 3. Type of Action  Clearance  Final Clearance  Redeclearance  Approval 4. Deadline Date **April 6, 2015**

5. Complete Title  
Single Family Quality Assurance Defect Taxonomy Framework

6. Principal Audience or User  HUD Staff  Program Participants 6a. Proposed Distribution (spell-out, do not use codes)

7. Person most familiar with the Document 7a. Organization Code / Office **HSG/SF Housing** 7b. Telephone Number **x6318** 7c. Room Number **9282**

8. Type of Document  
 New Handbook  Handbook Revision  New Form  Federal Register Notice  Regulation  Other (specify)  
 Handbook Change  Notice  Form Revision  Publication  Special Directive

9. Mark the boxes for the organization(s) reviewing this document. (specify under "other" the HQ/Field staff components within the reviewing offices, e.g., admin officers)

<input type="checkbox"/> OCHCO	<input type="checkbox"/> GNMA	<input checked="" type="checkbox"/> PIH	<input type="checkbox"/> CPO	<input type="checkbox"/> EEO	<input type="checkbox"/> CIR	<input type="checkbox"/> Public Affairs	<input type="checkbox"/> Other
<input type="checkbox"/> CPD	<input type="checkbox"/> HSG	<input checked="" type="checkbox"/> OGC	<input checked="" type="checkbox"/> CFO	<input type="checkbox"/> ODOC	<input type="checkbox"/> OSDBU	<input checked="" type="checkbox"/> CIO	
<input type="checkbox"/> FPM	<input checked="" type="checkbox"/> OIG	<input checked="" type="checkbox"/> PD&R	<input type="checkbox"/> FHEO	<input checked="" type="checkbox"/> Lead Hazard Control	<input type="checkbox"/> REAC	<input type="checkbox"/> DEC	

10. Front-End Risk Analysis  Completed  In Process  Not Needed

11. Information Collection Requirements (Paperwork Reduction Act)  Completed  In Process  Not Needed

12. Impact on Small Entities (Regulatory Flexibility Act)  Completed  In Process  Not Needed

13. Finding of No Significant Impact (FONSI) / Environmental Impact Statement (EIS) (National Environmental Policy Act)  EIS Required  FONSI Required  FONSI Not Needed

14. Organization	Signature & Title of Clearing/Approving Official	Date	Concur (no comments)	Concur (comments attached)	Non-Concur (comments attached)	No Position (NP)	No Need to Review (NR)
Housing	[Redacted] AS / s/						
PD&R	[Redacted] AS						
CFO	[Redacted] CFO						
OGC	[Redacted] GC						
OIG	[Redacted] Director				X		
	For [Redacted]						
	TOP Director						

15. List HQ/Field components involved in developing the document (drafts, discussions, etc.)

16. Comments  
See attachment for OIG's comments.

17. Return this record to [Redacted] 17a. Telephone Number **x2103** 17b. Room Number **9116**

ref. Handbook 000.2 form HUD-22 (5/2012)

Comment 5

\* Names redacted for privacy reasons.

## Ref to OIG Evaluation

### Comment 5

#### Single Family Taxonomy

OIG is lifting its previous non-concurrence and providing the following comments.

##### OIG's Comments

- What is the Quality Assurance Defect Taxonomy – The document is not consistent in whether the quality assurance reviews are on the loans or of the lender's overall loan performance. For example, slide 2, the Department states the taxonomy plans to identify and capture information about defects and severities on individual loan level reviews. However, slide 3, under the Taxonomy column, the last point states the sources and causes will be captured and analyzed at the aggregate level. It's not clear if the aggregate level includes analysis on the lender level. Clarification is needed. Will FHA address this in the monitoring section in Handbook 4000.1?
- Suggest the taxonomy include language that clarifies this methodology is prospective looking and does not apply retrospectively.
- Slide 5- The general references to "qualitative issues of eligibility" under causes are insufficiently clear to identify significant issues affecting eligibility of the loan.
- Slide 6 – Defects with examples of source and causes – OIG suggests adding a general defect regarding a failure to ensure all conditions of the AUS certificate were met. Similarly, for a manual loan, the draft should include a general defect regarding a failure to ensure all closing conditions were met.
- Slide 7 – Recording outcomes – This methodology may only be intended to show what occurs between HUD and lenders. Will the monitoring section of 4000.1 include outcomes such as referral of cases to OPE/MRB for possible administrative actions/sanctions or OIG for possible civil/criminal investigation
- Slide 7, Footnote 1- Thresholds– what are these thresholds and do they effectively modify current handbook requirements for DTI and LTV?
- Slides 7 & 8– Tier 1 and 2 defects will be rated 'unacceptable' and loans rated with Tier 3 and 4 defects will be rated 'deficient.' The Department needs to define these ratings and what outcomes are associated with them. Also, the Department needs to clarify if indemnification is an option for loans with tier 3 or 4 defects. If not, are there other remedies such as "no HUD action, but may include referral for other actions, etc.?" Overall, it would be helpful to see a matrix of how the Department plans to apply remedies to outcomes.
- Slide 8- Recording Outcomes: If final outcomes include referral for penalties or other sanctions against the lender, this should be referenced.
- Sampling – The taxonomy does not state how the loans will be selected for review. The original taxonomy proposal included the selection of a statistically valid group of loans and upfront payments for portfolio rates. Without a valid sample, FHA cannot analyze the reasons for the defects at the aggregate level as noted on slide 3. OIG recommends that the Department include language that this taxonomy does not address sampling. OIG is concerned with how FHA plans to analyze the reasons for the defects at the aggregate level as noted on Slide 3. Clarification is

## Ref to OIG Evaluation

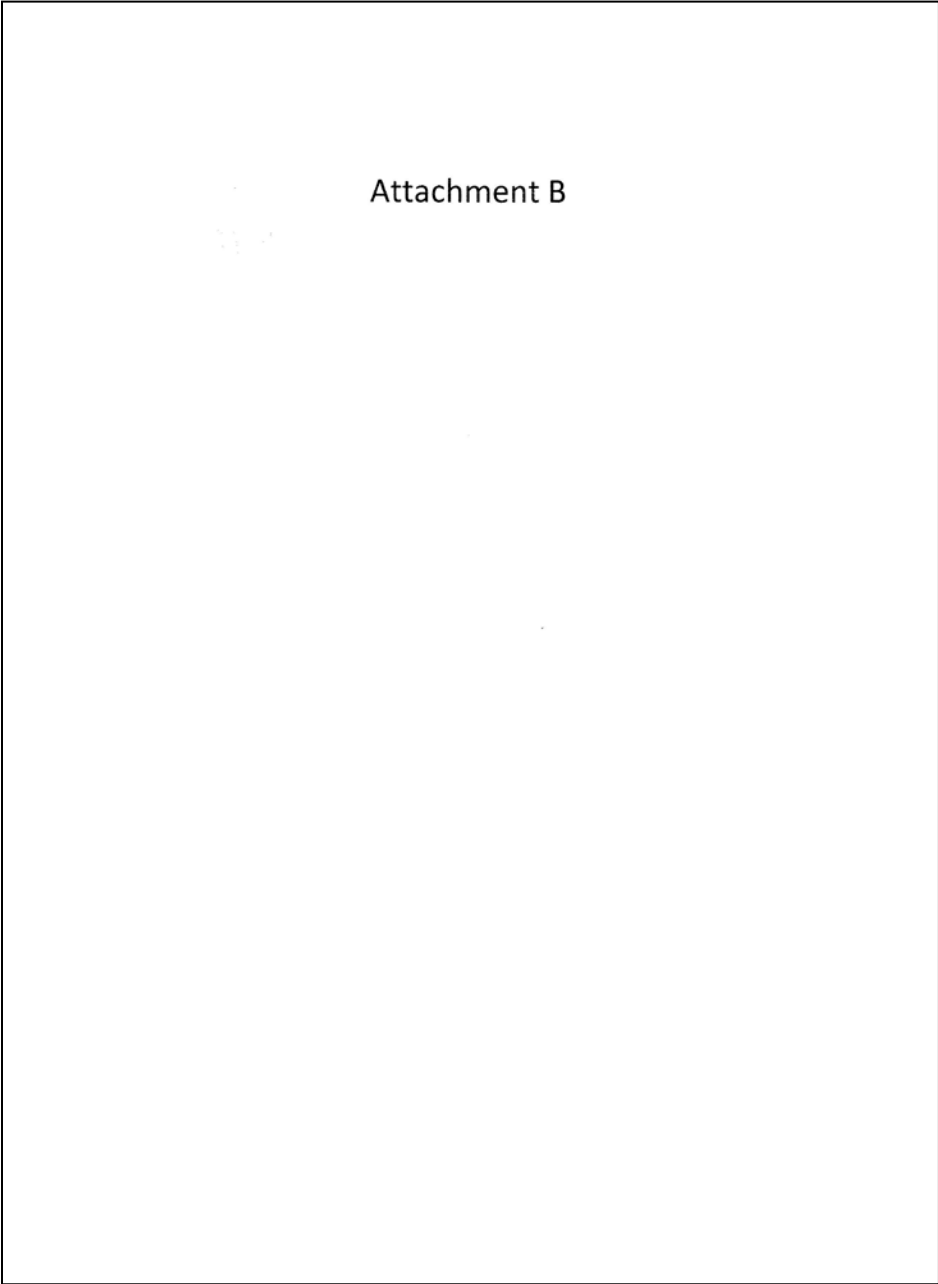
needed. Will FHA address the selection of loans and overall implementation in the monitoring section in Handbook 4000.1?

- Misrepresentation vs. fraud. The document needs to use these terms consistently. In some areas throughout the document, it says 'misrepresented' and speaks to the lender knowing or should have known. For example, (1) Slide 8 –the third bullet under Lender Mitigation Cause of defect says "All findings of fraud or misrepresentation..." (Implying a difference between the two), and (2) Slide 6, Causes of defect examples, it says "misrepresentation/fraud (implying similarities between the two, or they mean the same thing.)
- Slide 7 – Footnote 1 – Tolerance Threshold – if this is not referring to the thresholds in ML 2014-02, the Department needs to clarify, establish and publish another set of thresholds.
- Slide 11 – Tiers 2 and 3 - The tier criteria provides what tiers the loans would fall into for qualifying ratios exceeding ratios by more than and less than 3 percentage points. However, there is no discussion on how to rate the loans where the ratios exceed limits by exactly 3 percentage points. There should be criteria to address this.
- Slide 11 – Borrower Income – Tier 2- for AUS Loans, it says when errors in sources and calculations of income change the TOTAL decision to 'refer' and no acceptable compensating factors for ratios exceeding qualifying ratios by more than 3 percent. Generally, there are more errors in the file than the single error with income, so is FHA considering correcting changes in TOTAL for just income or for all errors in the file when implying this resubmission in AUS? Our understanding is that AUS considers several factors in the approval process together so lenders could manipulate the AUS by playing with income/debts/liabilities and assets.
- Slide 17 – Borrower Assets – It's not clear how the Department chosen the threshold to be either too high or too low by \$500.
- Layering of Risk - This methodology seems to eliminate the idea of 'layering of risk.' If the loan didn't have a critical fail item, but there were several items of concern about the eligibility of the borrower or the borrower's ability to repay the loan, FHA would support the idea of the layering of risk being too high for the loan to be eligible/insured. That seems to be eliminated in the more defined defect approach, but that doesn't seem to be a good elimination. This is echoed on page 26, as it says that: "The defect code with the highest tier severity will determine the overall loan rating." This too seems to imply that several tier 2s cannot make a loan an overall tier 1 and receive tier 1 treatment, etc.
- Borrower Credit/Liabilities- Slide 12- For source of defect #3 – OIG suggests that the following be added to the example - debt of a non-purchasing spouse living in a community property state is not included."
- Property Eligibility- Slide 19, there are examples and tier criteria provided for Tiers 1, 2 and 4. However, for Tier 3, there is nothing noted, except for "N/A." It's not clear why there would be no applicable comments given for Tier 3.

## Ref to OIG Evaluation

- Property Appraisal
  - Slide 21, there are examples and tier criteria provided for Tiers 1, 2 and 4. However, for Tier 3, there is nothing noted, except for "N/A." It's not clear why there would be no applicable comments given for Tier 3
- Lender Operations –
  - Lender Operations is one of the proposed 9 defect categories. However, the methodology focuses on reviews of individual loans. OIG's reviews and civil cases consistently identified that the lender's own quality assurance reviews identified the poor underwriting of individual loans. The proposed driver of severity does not include reviewing the lenders' quality control reviews and actions taken to reduce poor underwriting.
  - FHA should include "Certifications not signed appropriately," and "Certifications missing," as sources of defect, unless this is included as part of "other." HUD relies on the certifications and if it is incorrect or missing, it should be an un-insurable loan.
- Typo – Slide #13 – Tier 2 First line has a potential typo – instead of 'credit/**debit** history,' do you mean 'credit/**debt** history?'

**Ref to OIG  
Evaluation**



Ref to OIG  
Evaluation

Comment 12

**Departmental Clearance & Approval Record**      U.S. Department of Housing and Urban Development  
Office of Administration

**Note to Clearing Offices:** If your response has not been received by the Deadline Date, the Originating Office may proceed without it.

1. Job Control Number(s)      2. Classification Number      3. Type of Action      4. Deadline Date

Clearance       Final Clearance  
 Reclearance       Approval

5. Complete Title  
**Reduction of FHA Annual MIP Rates and Temporary Case Cancellation Authority**

6. Principal Audience or User      6a. Proposed Distribution (spell-out, do not use codes)

HUD Staff       Other  
 Program Participants       Other

7. Person most familiar with the Document      7a. Organization Code / Office      7b. Telephone Number      7c. Room Number

██████████      HUPH, SF Housing      X4317      9266

8. Type of Document

New Handbook       Handbook Revision       New Form       Federal Register Notice       Regulation       Other (specify)  
 Handbook Change       Notice       Form Revision       Publication       Special Directive

9. Mark the boxes for the organization(s) reviewing this document, (specify under "other" the HQ/field staff components within the reviewing offices, e.g., admin officers)

ADMIN       GNMA       PIH       CFO       EEO       CIR       CIO  
 CPD       HSG       OGC       CFO       Lead Hazard Control       OSDBU       DEC  
 FPM       OIG       PD&R       FHEO       Public Affairs       REAC       Other

10. Front-End Risk Analysis      11. Information Collection Requirements (Paperwork Reduction Act)      12. Impact on Small Entities (Regulatory Flexibility Act)      13. Finding of No Significant Impact (FONSI) / Environmental Impact Statement (EIS) (National Environmental Policy Act)

Completed       Completed       Completed       EIS Required  
 In Process       In Process       In Process       FONSI Required  
 Not Needed       Not Needed       Not Needed       FONSI Not Needed

14.

Organization	Signature & Title of Clearing/Reviewing Official	Date	Concur (no comments)	Concur (comments attached)	Non-Concur (comments attached)	No Position (N/A)	No Need to Review (N/A)
Housing	██████████ Acting AS	1/7/15	✓				
General Counsel	██████████ GC	4/7/15					
GNMA	██████████ President	1/7/15					
Inspector General	██████████ IG	1/7/15					

15. List HQ/field components involved in developing the document (drafts, discussions, etc.)

16. Comments:

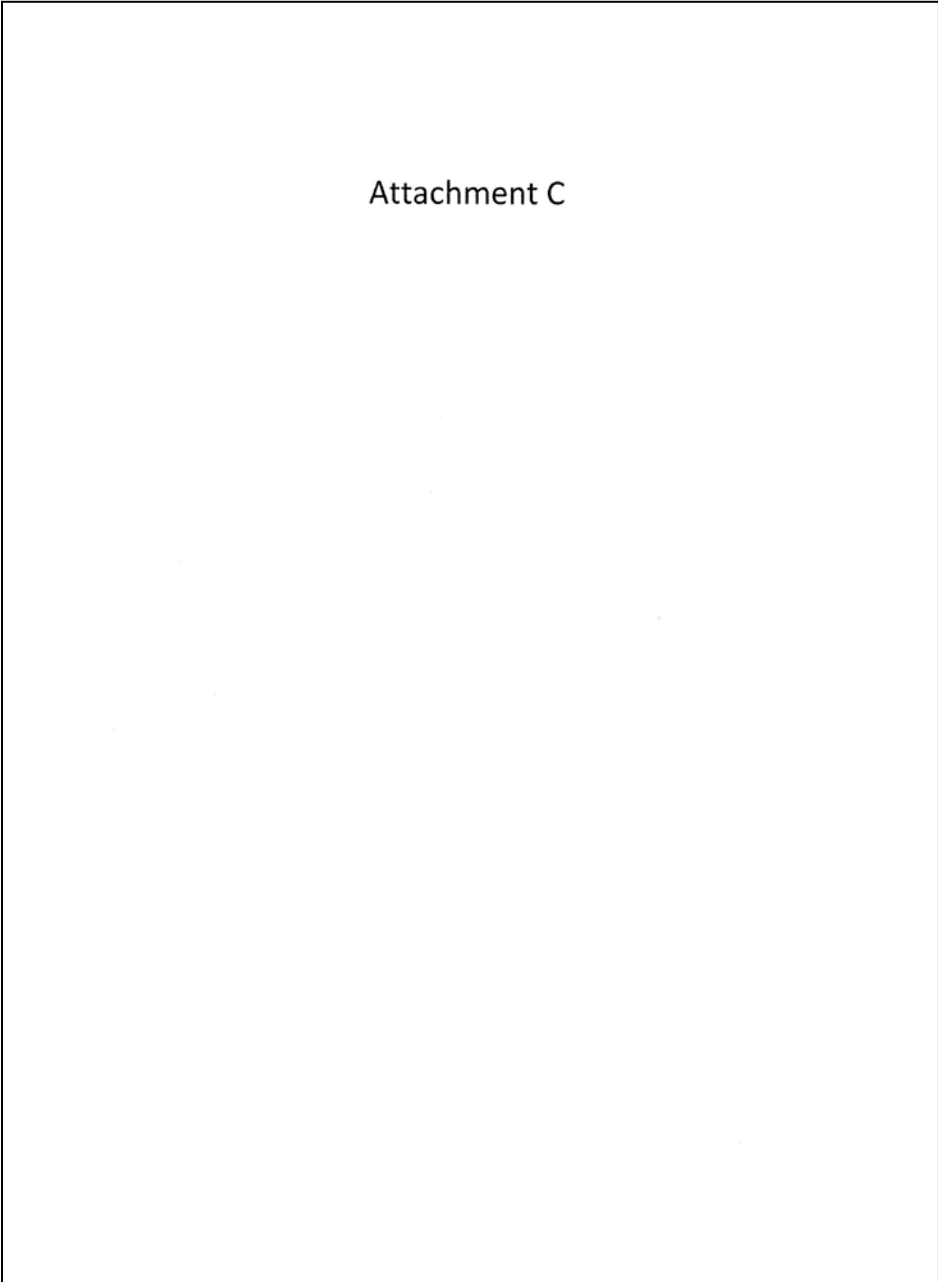
17. Return this record to      17a. Telephone Number      17b. Room Number

██████████      X2689      9106

ref. Handbook 000.2      form HUD-22 (5/2012)

\* Names redacted for privacy reasons.


**Ref to OIG  
Evaluation**



Attachment C

Ref to OIG  
Evaluation

Comment 15

  
OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

JUN 03 2016

MEMORANDUM FOR: Edward L. Golding, Principal Deputy Assistant Secretary for Housing, H

THROUGH: Robert E. Mulderig, Acting Deputy Assistant Secretary for  
Single Family Housing, HU *RE Mulderig*

FROM: *Jr. Nadle*  
Joy L. Hadley, Director, Office of Lender Activities and Program  
Compliance, HUL

SUBJECT: Departmental Clearance for Lender-Level Certification Revisions  
Submitted through the OMB Paperwork Reduction Act Process

The attached documents describe proposed revisions to FHA's lender-level certifications, which are subject to the Paperwork Reduction Act (PRA) approval process under OMB control number 2502-0005. The Office of Lender Activities and Program Compliance is submitting these documents for departmental clearance through the process typically used for policy directives. While PRA approvals, renewals and revisions are not, as a rule, subject to the departmental clearance process for policy directives, such clearance is being used in this specific case due to the high level of interest around the proposed revisions. This approach is consistent with the clearance approach used when Housing published the proposed lender-level certification revisions for a 60-day public comment period (September 2015) and a 30-day public comment period (March 2016).

The lender-level certifications, like other electronic collections and forms, are not truly policy directives, but are rather tools that facilitate enforcement of specific, existing HUD regulations, policies and requirements. This clearance process takes into account the particular sensitivity surrounding these certifications and is not intended to establish a precedent for future revisions under OMB control number 2502-0005.

Attachments

[www.hud.gov](http://www.hud.gov) [espanol.hud.gov](http://espanol.hud.gov)



## OIG Evaluation of Auditee Comments

- Comment 1 We appreciate that the Office of Single Family Housing (Housing) recognizes the need for proper vetting of documents in accordance with the directives handbook. The following comments detail our consideration of the information provided by Housing regarding the 13 subject documents.
- Comment 2 HUD disagreed with a portion of the audit report by stating that 12 specific documents cited in the report did not require clearance and that one document underwent clearance. However, HUD's response did not address two documents cited in the report that HUD inappropriately published in draft form before completing departmental clearance.<sup>13</sup> The response also did not address HUD's failure to ensure that key officials reviewed directives during departmental clearance. For example, HUD did not provide a response for the following problems related to its departmental clearance process:
- All 42 (100 percent) of the directives reviewed in HUD's Clearance Calendar tracking system were missing evidence of review and concurrence from at least one of the six required reviewing offices.
  - HUD program offices failed to correctly report their responses for 17 of the 42 (40 percent) directives reviewed, and, therefore, the Clearance Calendar did not correctly track the reviewing office responses.
  - For 2 of the 42 directives reviewed, the Clearance Calendar did not document that HUD properly resolved reviewing office nonconcurrence responses as required.
  - One reviewing office apparently intentionally manipulated the departmental clearance system and did not properly review the associated policies or guidance as required.
- Comment 3 We disagree with HUD's statement that evidence of clearance activity for some documents may have been overlooked during the audit. The audit considered clearance activity for the subject documents by reviewing HUD's Clearance Calendar tracking system and related documents provided by HUD officials. This review determined that HUD did not complete departmental clearance for these

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<sup>13</sup> Documents not addressed in HUD's response include the Addendum to Uniform Residential Loan Application (form HUD-92900-A) and Single Family Housing Policy Handbook 4000.1, sections of which were published on separate dates. Although these documents were ultimately cleared, draft versions were inappropriately published before departmental clearance.

items. As discussed below, this fact is further confirmed by the additional documentation provided as attachments to HUD's response to the audit report.<sup>14</sup>

Comment 4 Regarding the 12 documents that HUD asserts did not require departmental clearance, HUD stated that we may have overlooked the circumstances that rendered those documents outside the requirement for a formal clearance process according to HUD Handbook 000.2, REV-3 (Directives Handbook). HUD noted a directives handbook sentence, which reads, "HUD directives primarily supplement statutes, regulations, and HUD or Administration policies to provide practical guidance on how to comply with these legal authorities and policies."

We note that the cited sentence from the directives handbook, along with the other relevant provisions not mentioned in HUD's response, were considered during the audit to determine whether clearance was required. For example, other provisions considered from the directives handbook included the following:

- "Directives are communications relaying important information or guidance about HUD programs, policy, or operations."
- "Directives generally supplement or elaborate upon existing regulatory or statutory requirements that pertain to HUD programs or operations."
- "Directives generally guide the reader toward enhanced understanding of and compliance with the subject matter of the guidance."
- "Directives include documents such as handbooks, mortgagee letters, and notices, but may also be other forms of communications (for example, email blasts) that provide information or guidance."
- "These are communications that are for the first time relaying guidance to program participants or regulated parties beyond merely explaining provisions of existing HUD policy or requirements in statutes and regulations."
- "Where forms are being substantially revised, but not necessarily relate to a directive, the program office should use the directive process to announce substantive changes to forms."
- "A handbook that pertains to operations internal to a particular HUD office may require clearance, if such operations impact another HUD office or its programs."
- "...Guidance on processing notices of funding availability (NOFA) requires clearance because these directions impact outside interests seeking federal financial assistance."
- "Frequently asked questions (FAQs) and their corresponding answers that convey legal or policy interpretations for the first time require clearance."

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<sup>14</sup> Incomplete clearance records were provided by HUD for two documents cited in the audit report. See comment number 5 (Loan Quality Assessment Methodology) and comment number 12 (Mortgagee Letter 2015-01).

- “Notices are used to give instructions or guidance about aspects of HUD programs that generally supplement statutes or regulations.”
- “Protocols are internal directions or instructions to HUD employees regarding how to implement certain activities.”

Also, we note that HUD’s Information Quality Guidelines<sup>15</sup> referred to in the directives handbook require that “at a minimum, all handbooks, supplements, notices, special directives, and letters clarifying or elaborating on existing procedures or policy and used to issue guidance, are subject to the procedures in the Directives Handbook.”

Although these provisions state that directives can guide readers toward enhanced understanding or clarify policies with the intent of assisting those parties with policy compliance, presentation of new binding requirements for compliance by outside parties is not a condition for a document’s classification as a directive. Directives generally do not implement new binding requirements, which must be implemented through HUD’s rulemaking process, unless there is an underlying statutory or regulatory authority as the basis for a directive containing such requirements.

As detailed in the following comments, each of the documents cited in the audit report should have been placed into departmental clearance in accordance with the above requirements. All of the documents included new information related to HUD’s policies and procedures that internal HUD staff or external interests were expected to comply with. HUD’s response and its failure to acknowledge the need for required clearance, even for certain substantial policy documents noted in the audit report, such as the publically issued downpayment assistance policy interpretation letter and loss mitigation program variance policy,<sup>16</sup> both of which involved billions of dollars in FHA loans, raises concerns about HUD’s commitment to maintaining appropriate transparency and compliance with applicable record-keeping, information quality, and internal control standards.<sup>17</sup> In this regard, we note that objectives of the departmental clearance process include ensuring coordination of new information with existing policy<sup>18</sup> and

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<sup>15</sup> HUD’s Information Quality Guidelines were published on November 18, 2002, at 67 Federal Register 69641 under Section 515 of the Treasury and General Government Appropriations Act of 2001 (Public Law 106-554) and related Office of Management and Budget (OMB) guidelines. HUD’s Information Quality Guidelines require departmental clearance of directives.

<sup>16</sup> Standard Operation Procedures (SOP) Extension and Variance Automated Requests System (EVARS)

<sup>17</sup> OMB Circular A-123, Management’s Responsibility for Internal Control, states that Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. HUD’s directives clearance system is one of HUD’s internal control processes.

<sup>18</sup> HUD Handbook 000.2, REV-3, Section D, Clearance, states, “Departmental clearance is necessary and important to ensure requisite agreement by applicable HUD leadership on the subject matter and content of the directive; review by HUD offices with expertise, policy or legal, with the subject matter of the directive; and no conflict with other HUD policy or Administration policy.”

providing transparency regarding HUD's policies and transactions.<sup>19</sup> HUD's apparent interpretation of the departmental clearance requirements does not account for the range of potential directive documents discussed in the directives handbook and highlights the lack of clarity surrounding HUD's directives system and the associated need for additional clarification and training as recommended in the audit report.

- Comment 5 HUD incorrectly asserts that the Loan Quality Assessment Methodology - Defect Taxonomy was put through clearance before its publication on June 18, 2015. To support this assertion, HUD provided a form HUD-22 clearance record, dated April 6, 2015 (attachment A of Housing's response). As stated in the audit report, HUD posted the subject document in draft form for public comment on September 16, 2014, before completing required departmental clearance. This is a violation of the following directives handbook requirement that HUD complete departmental clearance before publically posting directives in draft form.

*Departmental clearance also must be undertaken for directives that are intended to be issued or posted in draft for public comment before issuance in final form. Posting in draft form for public comment will indicate to the public that, although in draft, the policy and legal positions in the draft form are accurate and reflect the direction that the Department is interested in pursuing. However, the public cannot be assured that draft directives will indeed be pursued, unless, the draft is approved through departmental clearance.*

Further, as confirmed by the incomplete clearance record attached to HUD's response, not all of the six required reviewing offices reviewed the subject document before it was published for a second time on June 18, 2015. Additionally, the document was not entered into HUD's Clearance Calendar tracking system as required.

- Comment 6 HUD asserts that the Loan Quality Assessment Methodology - Defect Taxonomy did not require departmental clearance because it was "not a statement of policy" and points out that a related HUD press release stated that the subject document was not a comprehensive statement of all FHA compliance monitoring or enforcement efforts.

We agree that the subject document did not discuss every aspect of HUD monitoring, such as fraud enforcement; however, it did include significant new guidance and information regarding HUD's policy for routine monitoring and enforcement of regulatory and program requirements. It supplemented and

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<sup>19</sup> Chapter 29 of 44 U.S.C. (United States Code), a statute upon which HUD's directives handbook was based, states that an objective of adequate records management procedures is to ensure accurate and complete documentation of the policies and transactions of the Federal Government.

elaborated on existing requirements by providing guidance about how HUD would interpret and assign relative severity to these requirements during its lender compliance reviews.

During our audit, a key official from Housing stated that the subject document was still in draft form and agreed that it would require clearance before issuance in final form. Although HUD's response now asserts that the document was not considered policy, the related press release (referred to in HUD's response to the audit report) conflicts with this assessment by stating that the document would provide "increased clarity" related to FHA standards. It stated "By enhancing the way FHA provides policy direction and monitors lender compliance and performance, the FHA insurance fund, borrowers, lenders and taxpayers will be better protected." HUD's press release also confirms that the subject guidance was not solely related to internal HUD procedures and practices but, rather, was intended to have an impact on lenders' existing origination and underwriting processes and cause an increase in loan volume for a subset of potential borrowers. It states that the taxonomy is part of FHA's effort to ... "encourage lending to qualified borrowers across the credit spectrum." Further highlighting the instructional nature of this document and its impact on lender compliance efforts, the press release statement acknowledges that lenders may need time to make changes and align their existing quality control processes with the newly established violation categories and thresholds presented in the document. By assigning relative weight to existing program regulations and requirements, the policy effectively provided instruction to lenders regarding how to design and focus their procedures to control compliance risk. In addition to providing generally applicable guidance to lenders as a public document, the defect taxonomy was also instructive for HUD employees responsible for compliance with the new monitoring methodology established by the document.

Because the draft Loan Quality Assessment Methodology presented new information and guidance regarding proposed changes and additions to HUD's existing policies and because these changes would impact outside interests, HUD should have completed departmental clearance before publically posting the document. Historically, HUD used handbooks and mortgagee letters when issuing guidance related to its monitoring process. These types of documents are classified as directives and would be required to go through departmental clearance. Despite this, in this case HUD posted the document publically without pursuing required clearance.

Comment 7 We disagree with HUD's statement that the Supplemental Performance Metric was not required to be vetted through clearance because it did not provide guidance to lenders on how to comply with legal authorities or policies and was provided for informational purposes only.

As noted in the audit report, this document provided significant new guidance related to HUD's enforcement of the FHA Credit Watch program, which was the subject of existing regulatory requirements. The document effectively served as a statement about new HUD policy because it interpreted and elaborated on the existing regulations. The document presented a new practical standard that could impact lenders' continued eligibility for FHA approval if they failed to meet the newly implemented threshold. Further, this document and the associated press release confirmed that the new policy was not only informative, but also was designed to impact lenders' existing loan origination and underwriting processes to increase FHA loan approvals for a subset of potential FHA borrowers. It stated that the new metric would "encourage lenders to serve creditworthy underserved borrowers."

Although HUD's directives handbook excludes some informative documents from directive requirements, the subject document clearly did not fit into this exception because it included a change to HUD's existing methodology for terminating lenders under its Credit Watch program. The handbook states:

*Information issued by HUD offices to program constituents that merely present information about access to HUD systems, identify HUD points of contact, or repeat information already cleared (with no further changes) are not subject to the HUD directives management system.*

Comment 8 We disagree with HUD's statement that the Appraisal Report and Data Delivery Guide did not require clearance because it reflected previously cleared policy and only contained instructions on how to complete a form. Because the subject document contained specific instructions and guidance that were not stated in a current directive, clearance was required in accordance with the directives handbook.

We agree that HUD previously cleared policy information contained in the subject document. However, the previously cleared document had been superseded by HUD Handbook 4000.1 (Single Family Policy Handbook) and was no longer in effect. Therefore, the subject document contained directive content yet had not been cleared as part of a current directive and was not vetted in the context of the current program requirements.

The directives handbook states, "Forms often contain substantive instructions to program participants or contain policy guidance and, therefore, they should undergo the vetting process applicable to directives." We agree that the subject document included form instructions; however, it also specified required procedures appraisers must follow to comply with HUD's policies for conducting the property valuation analysis. For example, the Guide included

- Required procedures appraisers must use to establish the number of rooms in a home (it instructed appraisers to insert a hypothetical wall and evaluate whether a single room should be counted as two rooms),
- Instructions to appraisers regarding how to calculate the number of driveway spaces for purposes of the valuation,
- Maximum adjustment percentage limits that appraisers should use when evaluating comparable properties, and
- Instructions that require appraisers to take action and contact the lender if the transaction potentially violated HUD’s property flipping requirements.

These are items that could impact the property valuation and, thus, could impact eligibility for FHA insurance. Highlighting the significance of the document’s substance and content, the Single Family Policy Handbook states that appraisers must certify that they complied with the Guide.

Comment 9 HUD concluded that the waiver of the FHA requirement for U.S. Department of Veterans Affairs (VA) form 26-8937 did not require clearance because the waiver provisions in the directives handbook did not apply to documents that affect all persons equally.

We agree with HUD’s assessment that the handbook section addressing waivers did not apply to the subject document. However, because the waiver provisions<sup>20</sup> did not apply, HUD should not have used a waiver to implement the subject policy. In this case, because HUD changed the requirement to obtain the VA form 26-8937 for all individuals, HUD should have issued this change as a directive and completed departmental clearance before issuing the document. The directives handbook does not exempt policy changes with general applicability from departmental clearance requirements. Rather, it specifically requires clearance for documents that impact existing requirements. For example, it defines public communication directives as “communications that are for the first time relaying guidance to program participants or regulated parties beyond merely explaining provisions of existing HUD policy or requirements in statutes and regulations.”

Comment 10 HUD states that the Interpretation of FHA’s Loss Mitigation Policy Letter was only a “clarification” of existing policy and that section B of the directives handbook does not require clearance for such documents. HUD further states that the industry’s misinterpretation of existing policies that prompted the subject document impacted only a “small segment of FHA borrowers.” We disagree that

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<sup>20</sup> HUD’s requirements related to waivers stated in Federal Register Notice 73 FR 76674 (Waiver of regulations issued by HUD of restatement policy) also specify that the waiver provisions apply only to actions impacting specific individuals or entities outside the Department and not to actions applicable to all individuals or entities that are in similar circumstances.

this document did not require clearance and find that HUD’s response inaccurately characterizes its content and significance.

We agree that the subject document clarified or interpreted an existing policy; however, we point out that by definition, such policy interpretations (a form of directive) always relate to existing policies and, therefore, this fact would not preclude the document’s classification as a directive. As stated previously, HUD’s Information Quality Guidelines require, “At a minimum, all handbooks, supplements, notices, special directives, and letters clarifying or elaborating on existing procedures or policy and used to issue guidance, are subject to the procedures in the Directives Handbook.” Additionally, section B-1 (Public Communications) of the directives handbook states that documents presenting legal or policy interpretations for the first time require clearance.

The subject line of this document was “Interpretation of FHA’s Loss Mitigation Policy.” It clearly contained a new policy interpretation and instructed lenders on how to comply with the existing program requirements, which were found to be unclear. Specifically, lenders had been miscalculating eligible partial claim amounts by including unpaid mortgage payment arrears and fees in partial claims without first appropriately capitalizing these costs into a loan modification. The subject document interpreted the existing policy and provided practical guidance regarding which of the possible claim amount calculations was required.

Although HUD’s response seems to minimize the significance of this document by indicating that it impacted only a small segment of FHA borrowers, we note that the misinterpretation resulted in a substantial number of ineligible partial claims being paid through the FHA insurance fund. During a prior OIG audit,<sup>21</sup> we found that 32 of 135 (23.7 percent) of the FHA claims reviewed as part of a statistical sample contained ineligible amounts due to the policy addressed by the subject document. Further demonstrating the significance of this document, it also waived HUD’s rights to enforcement for the associated ineligible FHA insurance claims. This portion of the interpretation itself would require clearance because it stated a generally applicable HUD policy regarding its future monitoring and enforcement (or lack thereof) for a significant segment of FHA loans and could impact other HUD offices with enforcement responsibilities. This waiver of enforcement for the mortgage industry was done without approval through departmental clearance, which should have included concurrence by offices with enforcement-related jurisdiction, including OIG. Further, not only was this document not made available for clearance review before issuance, it also was distributed to lenders via email only and was not properly documented in HUD’s policy repository. Therefore, it was not appropriately transparent and accessible to internal HUD offices, the lending industry, or the public.

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<sup>21</sup> HUD OIG Audit report number 2015-LA-0003, Federal Housing Administration, Home Affordable Modification Program, Partial Claim Option



HUD's failure to acknowledge the importance of clearance for this type of document with significant legal and policy implications reinforces the overall audit report conclusion that HUD's procedures undermined the intent and integrity of the departmental clearance process.

Comment 11 HUD stated that the "Standard Operation Procedures (SOP) Extension and Variance Automated Requests System" was used to accept or reject requests from lenders and that section B of the directives handbook does not require clearance for "documents of this sort."

HUD's general statement that documents "of this sort" do not require clearance is not supported by the directives handbook or HUD's Information Quality Guidelines. For example, section B-2 of the directives handbook, which discusses internal communications, indicates that clearance is required for HUD's internal guidance documents that impact outside interests. As noted in the audit report, the subject document did impact outside interests (such as FHA borrowers and lenders) because it set thresholds used by HUD staff to approve or deny claim eligibility for lenders and FHA borrowers seeking assistance through the FHA program's loss mitigation process. HUD's Information Quality Guidelines stated, "HUD Directives advise staff and/or program participants about how to carry out their respective responsibilities under HUD programs." The subject document falls within this definition because it provided practical guidance to HUD staff regarding how to comply with HUD's policy for approving and denying variance requests. The audit report noted that the subject document also implemented new policy by effectively eliminating a previously issued directive requirement. One objective of the clearance process is to address such apparent inconsistencies with existing policy. Documents of this type that set policy with general applicability, impact outside interests, and advise staff about how to carry out their respective responsibilities under HUD programs fall within the applicable classification parameters for directives.

As stated in the audit report, a substantial number of FHA claims are approved based on HUD's variance process, and, therefore, the policies in the subject document could potentially have a significant impact on FHA borrowers and the FHA insurance fund. A prior HUD OIG audit<sup>22</sup> found that more than 60 percent of FHA preforeclosure insurance claims had been paid based on an approval under HUD's variance policy at the time. Again, we note that HUD's failure to acknowledge the importance of clearance for this type of document with

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<sup>22</sup> HUD OIG Audit report number 2013-LA-0002, FHA Preforeclosure Sales Program, found that one or more variance requests were approved for 27,455 (60.5 percent) of the 45,378 preforeclosure claims paid during the period September 1, 2011, through November 30, 2012. Preforeclosure claim amounts paid during this period totaled more than \$4 billion, indicating that claims associated with HUD's variance policy likely exceeded \$2 billion.

significant implications for HUD programs and stakeholders reinforces the overall audit report conclusion that HUD's current procedures undermine the intent and integrity of the departmental clearance process.

Comment 12 HUD states that the subject document (Mortgagee Letter 2015-01) was properly cleared and provided as attachment B to its response, a form HUD-22 clearance record documenting which offices reviewed the document.

As confirmed by the form HUD-22 attached to HUD's response, HUD did not complete departmental clearance for this document as only two of the six required reviewing offices concurred on the document (Office of General Counsel (OGC) and OIG). The directives handbook states, "Minimum clearance requires concurrence by the Office of General Counsel (OGC), the Office of the Chief Financial Officer (OCFO), the Office of the Chief Information Officer (OCIO), the Office of Inspector General (OIG), the Office of Policy Development and Research (PD&R), the Office of the Chief Human Capital Officer (OCHCO), and additional HUD offices based on the subject matter of the directive."

Comment 13 We disagree with HUD's statement that the "Legal Interpretation Letter - Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs" was prepared for an internal HUD official and that the posting of this document on its public Web site "does not change the nature of the document." HUD stated that the directives handbook exempts legal opinions from classification as directives and that the subject legal opinion was based on existing policy.

It is concerning that HUD has found it acceptable to bypass departmental clearance for a publically issued policy statement with general applicability to all lenders by characterizing the document as an "internal" advisory opinion. It is especially concerning, since the practice considered allowable in the document was initially referred to OIG by HUD's own Quality Assurance Division for investigation (questioning the legality of the practice in question) and had been contested by OIG at the time it was issued. Underscoring the significance of this document, we note that recent OIG audit analysis found that the policy stated in this document could impact an estimated \$12.9 billion in FHA loans, which were potentially ineligible but for the subject document issued publically by HUD.

According to HUD's directives handbook, "...what constitutes a directive is not necessarily the title of a specific type of communication, but the content." Accordingly, although the formatting of this document was as a legal interpretation addressed to an internal HUD official, once it was publically posted with intended precedential effect with general applicability for all lenders, it did indeed change the nature of this document from an internal advisory document to a public communication.

We disagree that the document was simply repeating existing HUD policy. As noted in the audit report, the policy stated in the document was plainly inconsistent with the existing statutory requirements in paragraph 203(b)(9)(c) of the National Housing Act. Again, we note that one objective of the clearance process is to identify and address such potential conflicts with existing policy. The directives handbook states that new legal or policy interpretations require clearance. When discussing public communications it states, “Frequently asked questions (FAQs) and their corresponding answers that convey legal or policy interpretations for the first time require clearance.” Also, regarding HUD requirements for departmental clearance, we note that HUD’s Information Quality Guidelines require, “At a minimum, all handbooks, supplements, notices, special directives, and letters clarifying or elaborating on existing procedures or policy and used to issue guidance, are subject to the procedures in the Directives Handbook.”

Comment 14 HUD stated that current Office of Management and Budget (OMB) approved Paperwork Reduction Act collections did not require departmental clearance and noted that the directives handbook states that HUD directives are different from Federal Register publications and that clearance of Federal Register-related documents is managed by HUD OGC.

We agree that HUD OGC may be involved in the departmental clearance process for documents that HUD intends to publish in the Federal Register. However, we find that this fact does not conflict with the audit report conclusion that the subject documents required departmental clearance. HUD’s directives handbook specifically requires that substantive form changes undergo the process applicable to directives, which included departmental clearance. It states:

*“Where forms are being substantially revised, but not necessarily relate to a directive, the program office should use the directive process to announce substantive changes to forms. Forms often contain substantive instructions to program participants or contain policy guidance and, therefore, they should undergo the vetting process applicable to directives.”*

As stated in the audit report, the five subject notices (listed in appendix C of the audit report) revised previously approved forms. HUD’s failure to complete departmental clearance for these documents represents a violation of the directives handbook requirements.

Comment 15 HUD stated that the proposed revisions to the FHA Lender Annual Recertification Statements were put through a departmental clearance process. HUD provided an attached letter, dated June 3, 2016, stating that the form revision was not truly a policy directive, yet HUD would place the document into departmental clearance due to a high level of interest around the proposed revisions.

HUD appears to be referring to a different document instead of the Revisions to FHA Lender Annual Recertification Statements referred to in the audit report.<sup>23</sup> HUD did not complete departmental clearance for the document cited in the audit report. Clearance was required for this document in accordance with the directives handbook, which states that substantive form changes should undergo the same vetting process applicable to directives.

Comment 16 HUD stated that the Office of Administration is updating the directives program to provide more awareness of and clarity on the process for clearing the types of items covered in this memorandum. We agree that changes to HUD's directives process are needed and note that the audit report includes six recommendations to address the existing deficiencies.

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<sup>23</sup> HUD's response refers to an attached document that cites FHA register publications from September 2015 and March 2016, which is after the effective date of the subject document. According to HUD's FHA Info Web site, the subject document became effective January 1, 2015.

## Appendix B

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### Criteria

**HUD's Departmental Clearance Protocols** (dated September 29, 2014) state that the SharePoint Clearance Calendar must be used for all departmental clearances. The protocol notes that all HUD employees have access to the Clearance Calendar and use of this system brings transparency to the clearance process.

**HUD Handbook 000.2, REV-3, HUD Directives System**, defines HUDs process for issuing directives. The handbook states that it is imperative to clear directives within HUD to ensure coordination with existing policy, compliance with other HUD or Federal actions, and consistency with Administration positions. The directives handbook states:

- Minimum required reviewing offices for departmental clearance include Office of General Counsel (OGC), Office of Chief Financial Officer (OCFO), Office of Chief Information Officer (OCIO), Office of Inspector General (OIG), Policy Development & Research (PD&R), Office of Chief Human Capital Officer (OCHCO), and additional HUD offices based on the subject matter of the directive.
- OCHCO (or Office of Administration as a designee) holds lead responsibility for oversight of the HUD directives management system, including compliance with the handbook and exceptions thereto.
- Provisions of the handbook (including departmental clearance) must be addressed unless a prior waiver is granted by OCHCO (or Office of Administration as a designee).
- An originating office does not assume an official response by a reviewing office lacking an executed HUD-22.
- Departmental clearance must be undertaken for directives that are intended to be issued or posted in draft for public comment before issuance in final form.
- What constitutes a directive is not necessarily the title of a specific type of communication, but the content.
- Clearance is required for documents that must be approved under the Paperwork Reduction Act.
- Directives can include:
  - Public communications (including announcements, restatements or interpretations) that, for the first time, relay guidance to program participants or regulated parties beyond merely explaining provisions of existing HUD policy or requirements in statutes and regulations.
  - Frequently asked questions (FAQs) and their corresponding answers that convey legal or policy interpretations for the first time.
  - Notices that give instructions or guidance about aspects of HUD programs that generally supplement statutes or regulations (without imposing new, binding requirements, unless authorized by statute or regulation).
  - Internal communications that impact another HUD office or its programs.

- Internal guidance that impacts outside interests.
  - Internal directions or instructions to HUD employees (protocols) regarding how to implement certain activities.
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- When forms are being substantially revised, but not necessarily relate to a directive, the program office should use the directive process to announce substantive changes to forms.
  - Federal agencies are required to adequately document, in appropriate directives, their policies and procedures, and for such directives to be maintained by the appropriate agency directives management officers.

## Appendix C

### Schedule of Documents Issued Before Clearance

	Document	Draft directive posted before clearance	Final directive posted before clearance	Paperwork Reduction Act document posted before clearance
1	Loan Quality Assessment Methodology (Defect Taxonomy)	X		
2	Addendum to Uniform Residential Loan Application (form HUD-92900-A) <sup>24</sup>	X		
3	Single Family Housing Policy Handbook 4000.1	X		
4	Supplemental Performance Metric		X	
5	Appraisal Report and Data Delivery Guide		X	
6	Waiver of FHA Requirement for Form 26-8937		X	
7	Interpretation of FHA's Loss Mitigation Policy Letter		X	
8	Standard Operation Procedures (SOP) Extension and Variance Automated Requests System (EVARS)		X	
9	Mortgagee Letter 2015-01		X	
10	Legal Interpretation Letter (Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs)		X	
11	60-Day Notice of Proposed Information Collection: Builder's Certification of Plans, Specifications, and Site			X
12	60-Day Notice of Proposed Information Collection: Request for Acceptance of Changes in Approved Drawings and Specifications			X
13	60-Day Notice of Proposed Information Collection: FHA Insured Mortgage Loan Servicing Involving the Loss Mitigation Program			X
14	203(k) Consultant Roster Certification Form			X
15	Revisions to FHA Lender Annual Recertification Statements			X

<sup>24</sup> HUD completed departmental clearance after this document was published.