VA Office of Inspector General

OFFICE OF AUDITS AND EVALUATIONS

Veterans Benefits Administration

Audit of Foreclosed Property Management Contractor Oversight

August 27, 2013
12-01899-238

ACRONYMS AND ABBREVIATIONS

LGY	Loan Guaranty Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
PMOU	Property Management Oversight Unit
VBA	Veterans Benefits Administration

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Report Highlights: Audit of VBA's Foreclosed Property Management Contractor Oversight

Why We Did This Audit

We conducted this audit to determine if the Veterans Benefits Administration (VBA) Loan Guaranty Service (LGY) approved payments for allowable expenses submitted by VA's foreclosed property management contractor. In addition, the audit determined whether LGY ensured properties met safety, preservation, and maintenance requirements.

What We Found

LGY made payments for 528 of 890 individual expense items not supported by vendor invoices. This occurred because LGY did not ensure the contractor complied with the contractual requirement to provide the documentation necessary to demonstrate the appropriateness and legitimacy of expenses claimed for reimbursement. As a result, we found LGY made approximately $64,400 in payments from October 2010 through March 2012 for expense reimbursements submitted by the contractor without adequate supporting documentation.

In addition, LGY did not timely notify the contractor of property maintenance exceptions that posed safety hazards or risk of immediate deterioration or ensure correction of these issues. This occurred because LGY policies did not require LGY staff to report maintenance exceptions and ensure correction. Foreclosed properties with uncorrected maintenance exceptions may increase VA's potential liability, take longer to sell, and reduce the value of these properties.

What We Recommended

We recommended the Under Secretary for Benefits ensure VBA's contractor provides vendor invoices to substantiate claimed expenses prior to reimbursement by LGY and determine whether it is cost effective to initiate recovery of improper payments. Additionally, we recommended the Under Secretary develop policies that ensure LGY staff report maintenance exceptions and ensure contractor correction.

Agency Comments

The Under Secretary concurred with Recommendations 1 and 3 but did not concur with Recommendation 2. We revised Recommendation 2 to recognize that LGY can decide if recouping these improper payments from the prior property management contractor is cost effective.

However, we reiterated that VBA paid some expenses not supported by evidence. Without adequate documentation to support expenses claimed, LGY cannot reasonably ensure the prudent use of taxpayer funds in compensating the contractor for expenses incurred for managing VA-owned foreclosed properties.

Linda A. Halliday

LINDA A. HALLIDAY
Assistant Inspector General
for Audits and Evaluations

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INTRODUCTION

Objective

We conducted this audit to determine if the Veterans Benefits Administration (VBA) Loan Guaranty Service (LGY) approved payments for allowable expenses submitted by VA's foreclosed property management contractor. In addition, the audit determined whether LGY ensured properties met safety, preservation, and maintenance requirements. We conducted this audit, in part, as a response to allegations made through the VA Office of Inspector General (OIG) Hotline in March 2012. The complainant alleged that the Property Management Oversight Unit (PMOU) was directed to reimburse the contractor without original invoices.

VA Home Loan Program

The VA Home Loan Program assists eligible veterans, active duty personnel, and other qualified individuals to finance home purchases, construction, improvement, or refinancing with favorable terms. In October 2012, VA reported they had approved 20 million home loans since VA established the program in 1944 and had 1.7 million active VA guaranteed loans with a total value of approximately $284 billion. VA guaranteed approximately 540,000 loans in FY 2012, which includes refinanced loans.

Property Foreclosure Management

LGY provides oversight and monitors the performance of the property management contractor through the Property Management Central Office in Washington, DC, and PMOU in Nashville, TN. The loan servicer, such as a bank, may initiate foreclosure or termination proceedings when veterans cannot meet their loan obligations. The servicer may acquire the property, and has the option of conveying the property to VA. Once conveyed, VA assigns the property to a contractor for management and sale. According to VBA in FY 2012, VA paid Bank of America approximately $83 million for managing VA-owned foreclosed properties. VA had an inventory of approximately 9,500 foreclosed properties valued at about $953 million at the beginning of FY 2013.

Contractor Responsibilities

The contractor is responsible for securing foreclosed properties, maintaining properties in a clean, safe, and sanitary condition, maximizing the properties' sales return, and minimizing the properties' time on the market. VBA pays the contractor a monthly management fee for each property in the inventory and generally reimburses the contractor for allowable expenses after the sale of the property.

Other Information

The following appendixes provide additional information.

- Appendix A provides additional background information.
- Appendix B provides audit scope and methodology.
- Appendix C provides contractor performance information.

RESULTS AND RECOMMENDATIONS

Finding 1 Property Management Expense Reimbursements Approved, But Lacked Adequate Documentation

LGY made payments for 528 (59 percent) of 890 sampled expenses not supported by vendor invoices. This occurred because LGY did not ensure the contractor complied with the contractual requirement to provide the documentation necessary to demonstrate the appropriateness and legitimacy of expenses claimed for reimbursement. LGY management accepted the contractor's summaries of expenses rather than vendor invoices to verify work completed on properties and other expenses incurred, such as utility costs. As a result, we found LGY made approximately $64,400 in payments from October 2010 through March 2012 for contractor-submitted expense reimbursements that lacked adequate supporting documentation.

Payments Made Without Adequate Support

LGY paid the contractor for expense reimbursements associated with the preservation and maintenance of foreclosed properties that lacked adequate supporting documentation. Specifically, LGY made payments for 528 of 890 claimed expenses that were unsupported by detailed vendor invoices. Unsupported LGY payments averaged approximately $122 and were as high as $2,450 for a single expense. As shown in Table 1, property maintenance expenses were the most common expense lacking support by vendor invoices, totaling approximately $41,500. Other expenses included utilities and administrative expenses, which include eviction expenses and fees, homeowner's association/condominium fees, marketing appraisal fees, and title research fees.

Table 1

Expenses With Insufficient Documentation		
Expense Type	**Number of Expenses**	**Dollar Amount**
Property Maintenance	235	$41,500
Utilities	229	12,400
Administrative	64	10,600
Total	**528**	**$64,400**

Source: VA OIG analysis of reimbursed expenses lacking adequate support
Note: Expenses do not total $64,400 due to rounding.

Criteria

PMOU procedures require staff to review expense claims submitted by the foreclosed property management contractor to ensure the appropriateness of property maintenance, utility, and repair expenditures prior to reimbursement. In addition, VA's contract with Bank of America required all expenses submitted for reimbursement be substantiated by complete imaged (electronic) documentation, such as bids, work orders, and invoices, in support of allowable expenses. The contractor was required to make this documentation available concurrently with the electronic invoice presented to VA for payment. Office of Management and Budget (OMB) Memorandum M-11-16, Issuance of Revised Parts I and II to Appendix C, Circular A-123 states when an agency is unable to discern whether a payment was proper due to a lack of or insufficient documentation, the payment is considered an improper payment.

Expense 'Summaries' Submitted

LGY made payments to reimburse contractor expenses and did not ensure the contractor complied with the contractual requirement to provide the documentation necessary to demonstrate the appropriateness and legitimacy of claimed expenses. Instead, LGY management accepted summaries of expenses generated from the contractor's invoice management system in support of just over 500 claimed expenses.

Expense summaries submitted by the contractor to LGY did not include a detailed breakdown of charges accounting for the total dollar amount of the line item expense(s) requested for reimbursement. Instead, the summaries included only the total cost for line item expenses, expense type, and dollar amount claimed for reimbursement. We determined these expense summaries lacked sufficient evidence to verify if the expenses claimed were accurate, allowable, and legitimate.

As a result, we found LGY made approximately $64,400 in payments from October 2010 through March 2012 for contractor-submitted expense reimbursements that lacked adequate supporting documentation.

LGY needs to ensure its foreclosed property management contractor complies with contract requirements by providing vendor invoices to substantiate claimed expenses prior to reimbursement. Without adequate documentation to support expenses claimed, LGY cannot reasonably ensure the prudent use of taxpayer funds in compensating the contractor for expenses incurred for managing VA-owned foreclosed properties.

Recommendations

1. We recommended the Under Secretary for Benefits ensure the Veterans Benefits Administration's foreclosed property management contractor provides vendor invoices to substantiate expenses claimed by the contractor prior to reimbursement by Loan Guaranty Service.

2. We recommended the Under Secretary for Benefits determine whether it is cost effective to initiate recovery of improper payments identified in our audit.

Management Comments

The Under Secretary for Benefits concurred with Recommendation 1 and requested closure based on the new contractual terms with the current contractor. Although the Under Secretary concurred with this recommendation, the Under Secretary disagreed with our assertion that the contract payments we reviewed were improper and not supported by sufficient documentation. The Under Secretary for Benefits did not concur with Recommendation 2 and stated the OMB circular referenced does not provide measures to determine whether documentation is sufficient and disagreed with our interpretation of what OMB considers sufficient documentation. In addition, VBA stated the contractor's processes and internal controls, the validity of the expense summaries, and PMOU's standard operating procedures and expertise in handling invoices ensured payments made were proper. As a result, VBA believes that payments made were proper and does not concur with determining the cost effectiveness of initiating recovery of these payments.

OIG Responses

We reiterated that VBA approved and reimbursed some expense, claimed by its foreclosed property management contractor, not supported by sufficient documentation.

VBA's assertions and OIG comments follow.

- **VBA Position:** The OIG reviewed only a particular step in LGY's process and overlooked other key steps, such as its oversight process of their property management contractor. Additionally, VBA thoroughly reviewed the contractor's invoice processes, procedures, internal controls, and related systems; thus, VBA had assurance that the contractor's handling of sub-contractor expenses was proper.

  OIG Response: We thoroughly reviewed LGY's oversight processes and procedures with LGY staff and management officials, to include LGY's verification of the contractor's invoice management system. VBA was unable to provide documented evidence of an LGY review of the invoice management system, which would support their reliance on the contractor's automated and manual controls, processes, and procedures. Without such a review of the system, LGY has no assurance that their handling of sub-contractor invoices was sound. In addition, LGY's review procedures did not comply with contractual requirements and lacked reasonable assurance expenses claimed for reimbursement were appropriate.

- **VBA Position:** VBA chose to use expense summaries as sufficient supporting documentation for expenses due to the fact the summaries provided multiple details about the expense and work performed.

  OIG Response: The LGY contractor-provided expense summaries, also referred to by VBA as "proof of payment" screens, did not provide sufficient documentation to substantiate reimbursements. Without detailed vendor invoices supporting contractor claimed expenses, we were not able to, nor can VBA, determine if expenses claimed included non-reimbursable fees and expenses. Further, VBA cannot verify actual dates to ensure expenses were not incurred outside the period for which

VA was responsible for the property and determine whether the expense was actually incurred and accurate. We maintain that LGY's decision to accept summaries lacking necessary detail to substantiate expense reimbursements resulted in a lack of assurance that expenses paid were appropriate.

- **VBA Position:** Well-trained, closely monitored staff review expenses prior to reimbursement through a thorough, two-step review process.

  OIG Response: Despite staff training or monitoring, LGY management's decision to accept the expense summaries/proof of payment screens as sufficient evidence of claimed expenses limited the effectiveness of these reviews for reasons stated above. The contractor did not provide staff performing invoice reviews with sufficient documentation in the majority of sampled invoices to make a determination that a claimed expense was accurate or allowable prior to reimbursement.

- **VBA Position:** OIG's own contracted financial statement auditors had no objections to the appropriateness of supporting documentation provided by the contractor.

- **OIG Response:** The purpose of the financial statement audit is to express an opinion on whether VA's financial statements are free of material misstatements and conform to generally accepted accounting principles in accordance with the Chief Financial Officers Act of 1990. The auditors conduct their testing only to render an opinion on VA's financial statements taken as a whole, not to provide assurance on the accuracy of the foreclosed property management contractor's invoices or VBA-related payment controls. Therefore, LGY should not rely on financial statement audit results to assert they have adequate internal controls because this was not a specific objective of the financial statement contractor's work.

  OIG testing during this audit of the specific controls used by LGY provides a better assessment regarding how well LGY performs invoice reviews and assures compliance with the specific control requirements established by VBA. Additionally, it provides an assessment of how well VBA designed the controls and to what extent they were working as intended. Based on this testing, we determined that controls in place did not provide LGY with reasonable assurance of the prudent use of taxpayer funds in compensating the contractor for expenses incurred for managing VA-owned foreclosed properties.

- **VBA Position:** The referenced OMB circular does not specifically state what type and level of documentation is considered sufficient.

- **OIG Response:** We disagree. Office of Management and Budget Memorandum M-11-16, Issuance of Revised Parts I and II to Appendix C, Circular A-123 states that when an agency's review is unable to discern whether a payment was proper because of insufficient or lack of documentation, this payment must be considered an improper payment. For each expense we identified as lacking sufficient documentation, VBA's LGY staff agreed they were unable to determine whether the expense was appropriate and allowable based upon the information submitted by the contractor. Without vendor invoices substantiating reimbursement claims by the contractor, VBA does not have reasonable assurance that payments made were proper and cannot further substantiate the appropriateness of payments made.

In regards to the Under Secretary's response to Recommendation 1, LGY is now providing the current contractor with a flat fee for property preservation activities. Therefore, we consider this recommendation closed.

We disagree with the Under Secretary's comments for Recommendation 2. The payments we found in error meet the definition of "improper payments" as defined by OMB. However, we have revised this recommendation, to recognize that LGY needs to decide if recouping these improper payments from the previous foreclosed property management contractor is cost effective. See Appendix E for the Under Secretary's full response.

Finding 2 Timely Notification of Property Maintenance Exceptions Not Provided, Nor Corrections Ensured to be Taken

LGY was not timely about notifying the contractor of property maintenance exceptions identified during field inspections that posed safety hazards or placed the properties at risk of immediate deterioration. Also, LGY did not consistently ensure correction of these issues by the contractor. This occurred because LGY policies did not require LGY staff to report maintenance exceptions to the contractor when identified and ensure the contractor corrected these issues. Yet, VA's potential liability increases if LGY does not timely report maintenance exceptions and ensures correction. Additionally, maintenance exceptions that place foreclosed properties at unnecessary risk of deterioration can reduce property values and make it more difficult to maximize the return on properties sold.

Maintenance Issues Identified by LGY Staff

In FY 2011, LGY staff inspected approximately 3,400 foreclosed properties as part of its oversight responsibilities. When LGY staff inspect foreclosed properties, property issues identified are classified in two categories.

- **Maintenance Exceptions**—Safety hazards, such as an unsecured pool or holes in the floor, and those that place the property at risk of immediate deterioration, such as failure to winterize the property or active water damage
- **Other Maintenance Issues**—Issues identified during an inspection, such as overgrown lawns and shrubs or broken windows

The foreclosed property management contract requires LGY staff to report maintenance exceptions identified during field inspections to the contractor via quarterly reports. In addition, while not part of the contractor's performance measures, LGY reports other issues identified to the contractor quarterly to document these issues discovered during field inspections.

Maintenance Exceptions Not Reported

LGY was not timely about reporting maintenance exceptions to the contractor for correction. LGY did not report 26 of 35 sampled maintenance exceptions to the contractor when identified. The 26 maintenance exceptions consisted of 25 that placed the properties at risk of immediate deterioration and 1 safety hazard. The majority of these maintenance exceptions were failure to winterize properties. VA generally requires the winterization of all VA-owned foreclosed properties, which includes procedures such as completely draining all plumbing systems and disconnecting water service. Properties not winterized are at an increased risk of flooding or water damage.

LGY reported these 26 maintenance exceptions to the property management contractor in quarterly reports. As a result, the number of days before LGY notified the contractor ranged from 43–118 days, with an average of 79 days.

Table 2 shows the number of days from the date of the inspection to the date LGY sent the quarterly report to the contractor.

Table 2

Number of Days From Identification to Notification	
Number of Days	**Number of Maintenance Exceptions**
Less than 45 days	2
45–90 days	17
Greater than 90 days	7
Total	**26**

Source: VA OIG analysis

Policies Needed

LGY needs to develop policies to ensure staff report maintenance exceptions when identified. The foreclosed property management contract requires property issues identified during field inspections be reported to the contractor quarterly. By not requiring staff to timely report maintenance exceptions, LGY creates unnecessary delays that potentially increase the risk of more costly property repairs and situations where the contractor may not have the opportunity to correct maintenance exceptions prior to sale. For example, 13 of the 26 properties were sold prior to LGY notifying the contractor of these maintenance exceptions by quarterly reports. As a result, exceptions can go uncorrected, increasing VA's potential liability for unsafe and poorly maintained properties and possibly reduce the value of these properties prior to sale.

Follow-Up Lacking

LGY did not consistently ensure its foreclosed property management contractor corrected reported maintenance exceptions. For 26 of the 35 maintenance exceptions in our sample, we found no evidence LGY followed up to ensure the contractor corrected these issues. LGY staff was unable to provide evidence of follow-up with the contractor, such as contractor-provided written confirmation or vendor invoices to ensure the contractor corrected these issues. According to PMOU management, LGY does not perform follow-up field inspections targeting properties with previously reported maintenance exceptions. PMOU management stated this was because of LGY's limited resources to cover the geographical dispersion of all its foreclosed properties.

LGY did not consistently ensure correction of maintenance exceptions because LGY policies did not require LGY staff to follow up with the contractor to ensure the correction of maintenance exceptions. If staff do not follow up with VBA's foreclosed property management contractor to verify property maintenance exceptions are expeditiously addressed and corrected, VA properties may take longer to sell, and it may be more difficult to maximize return on sale of the properties.

LGY can improve its oversight of its foreclosed property inventory by developing policies to ensure staff report maintenance exceptions when identified and follow up with the contractor to obtain evidence that the contractor has corrected maintenance exceptions. LGY cannot reasonably ensure foreclosed properties do not unnecessarily deteriorate or pose potential safety and other liability issues until it improves its policies.

Recommendation

3. We recommended the Under Secretary for Benefits develop policies that require Loan Guaranty Service to report maintenance exceptions to its foreclosed property management contractor when identified and follow up to ensure correction.

Management Comments

The Under Secretary for Benefits concurred and stated that VBA is in the process of implementing policies that require LGY to report maintenance exceptions to its foreclosed property management contractor when identified and follow up to ensure correction. VBA expects implementation by the end of August 2013. The Under Secretary contends that the majority of the properties identified in this report did not necessitate immediate notification, thus OIG overstated the potential liability associated with this finding.

OIG Response

In regards to the Under Secretary's response to our recommendation, we consider the planned action acceptable, and we will follow up on its implementation. We disagree with the Under Secretary's contention that the majority of the properties were inappropriately included. In its response, VBA stated that for immediate notification to be warranted, the issue must present an immediate safety hazard or threat of deterioration. However, VBA's contention reflects an inconsistency with the definition of a maintenance exception according to its contract with the property management contractor.

The contract defined maintenance exceptions as safety hazards or risks of immediate deterioration. All properties sampled for this finding included one or more maintenance exceptions as identified by VBA staff. Therefore, by contract definition, all properties included in this finding had a safety hazard or risk of immediate deterioration. During our work at the PMOU, we verified each error with appropriate staff.

Appendix A Background

VA Home Loan Program

Since the inception of the VA Home Loan Program in 1944, an important objective has been to assist eligible veterans to transition from military to civilian life. The program makes home ownership more affordable for veterans, service members, and some surviving spouses. In addition, the program protects lenders from loss if the borrower fails to repay the loan.

VA guarantees loans to buy, build, improve, or refinance a home. Specific benefits generally include negotiable interest rates, exemption from the funding fees (due to receipt of disability compensation), lower closing costs, no mortgage insurance premiums, no down payments, and assistance to borrowers in default due to temporary financial difficulty. According to VA, 71 percent more homes were purchased with VA guaranteed loans in FY 2012 than in FY 2007. VA guaranteed approximately 540,000 mortgages in FY 2012 and reported 1.7 million active VA guaranteed home loans, including refinanced loans, with a total value of approximately $284 billion in October 2012.

Foreclosed Property Management

The loan servicer may initiate termination proceedings when veterans cannot meet their mortgage obligations on VA guaranteed home loans. The loan servicer may acquire the property and has the option of conveying the property to VA. Once conveyed, VA assigns the property to a contractor for management and sale.

Prior to 2003, LGY staff directly managed VA-acquired foreclosed properties. Since 2003, LGY has contracted with three companies to manage its foreclosed property inventory—Ocwen from 2003 to 2008 and Countrywide Home Loans (who changed their name to Bank of America Home Loan Servicing) from 2008 until September 2012. Vendor Resource Management fully assumed management of VA's foreclosed property inventory in September 2012.

The contractor's responsibilities include securing foreclosed properties; maintaining properties in a clean, sound, and sanitary condition; and ensuring the return on sale is maximized while minimizing time on the market. VA pays a monthly management fee, ranging from $20 to $200, to the contractor for each property in the inventory. According to VBA, in FY 2012, Bank of America received approximately $83 million in fees and reimbursements for managing VA-owned foreclosed properties. VA reimburses the contractor for allowable expenses after sale of the property.

According to VBA, VA acquired approximately 13,500 properties for about $1.4 billion and sold approximately 10,400 properties for about $1.1 billion in FY 2012. VA began FY 2013 with an inventory of approximately 9,500 properties, valued at about $953 million.

Organizational Structure

VBA's LGY administers the VA Home Loan Program. LGY provides oversight of the property management contractor from the following two locations.

- **Property Management Central Office in Washington, DC—**Provides overall contract management and policy dissemination.
- **Property Management Oversight Unit in Nashville, TN—**Assesses contractor compliance with contract provisions and reviews and certifies payments made to the foreclosed property management contractor. The PMOU has two primary functions.
  - **Invoice Reviews—**Reviews the contractor's expense claims associated with foreclosed property management after the sale of a foreclosed property to ensure the appropriateness of property maintenance and repair expenditures claimed by the contractor for reimbursement.
  - **Field Inspections—**Ensures sampled foreclosed properties managed by the contractor are secured, maintained, and free from safety hazards.

Prior Audits and Reviews

In 2012, the VA OIG issued the *Audit of Liquidation Appraisal Oversight Cleveland and Phoenix Regional Loan Centers* (Report No. 10-04045-124, October 4, 2012), which concluded LGY needed to strengthen oversight of liquidation appraisals to help ensure VA pays fair and reasonable prices when acquiring real estate properties. Additionally, the OIG concluded LGY Service must take further actions to strengthen risk management.

In 2009, the VA OIG issued the *Audit of Veterans Benefits Administration's Loan Guaranty Program Risk Management* (Report No. 08-01987-118, April 28, 2009), which concluded VBA lacked reasonable assurance LGY appropriately managed risks. Additionally, the OIG concluded LGY was not monitoring and adjusting a control implemented to mitigate the risk of losses on the sale of foreclosed properties.

In 2007, the Government Accountability Office issued *Actions Needed to Strengthen VA's Foreclosed Property Management Contract Oversight* (GAO-08-60, November 15, 2007), which concluded 32–46 percent of properties inspected did not meet overall inspection standards. They further concluded VBA's supporting systems did not include real-time property maintenance and repair information, including expense data.

Appendix B Scope and Methodology

We conducted our audit work from August 2012 through May 2013. The audit focused on VBA's oversight of contractor responsibilities for managing VA-acquired foreclosed properties. Specifically, we reviewed VBA controls over maintenance exceptions identified during field inspections, reimbursement of contractor expenses, and management fees claimed for properties assigned to the PMOU from October 1, 2010, through March 31, 2012.

To assess VBA's oversight of contractor responsibilities for managing VA-acquired foreclosed properties, we reviewed laws, regulations, and policies pertaining to the acquisition and management of VA-acquired foreclosed properties. In addition, we reviewed VA's contract during our review period for the acquisition and management of VA-acquired foreclosed properties. We also conducted site visits and interviewed management and staff at VBA's Property Management Central Office and PMOU.

We used property records established in the Centralized Property Tracking System and the contractor's property management system to review information associated with a sample of properties. We selected 132 unique properties for review from a population of 19,095 properties assigned to the PMOU from October 1, 2010, through March 31, 2012. We examined 890 claimed expenses LGY approved for payment related to 93 property invoices.

Fraud Detection

In order to obtain reasonable assurance of detecting fraud that may have occurred within the context of our objectives, we considered fraud risk factors such as management controls, the nature of operations, and a VA OIG Hotline complaint when developing our audit steps. We interviewed LGY management concerning LGY procedures to identify and report fraudulent activity. We also interviewed VA OIG Office of Investigations staff to determine if criminal investigations related to the management of VA foreclosed properties had been recently undertaken. In addition, we reviewed a sample of expense reimbursements processed by LGY to determine the effectiveness of controls to identify potentially fraudulent reimbursements made by LGY.

Data Reliability

We used computer-generated data from VBA's Centralized Property Tracking System and Oracle Discoverer for the period of October 1, 2010, through March 31, 2012, to support the scope of our audit. To test the reliability of data, we compared key elements from our sample selection (such as amount claimed for payment) with Centralized Property Tracking System information and summary expense information in the contractor's information system. We did not identify any inconsistencies. We determined the computer-generated data to be sufficiently reliable to meet the audit objectives and support our recommendations.

Government Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. These 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. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Appendix C Contractor Performance

According to VBA data, as shown in Table 3, the foreclosed property management contractor's performance was between the performance bonus and penalty range during the period of our audit scope.

Table 3

Bank of America Quarterly Performance (October 1, 2010–March 31, 2012)			
Performance Metric	**Contractual Performance Incentive (Bonus Paid)**	**Contractual Performance Disincentive (Penalty Charged)**	**Actual Average Quarterly Performance**
Return on Sale	88% (or higher)	72% (or lower)	80.6%
Maintenance	95% (or higher)	80% (or lower)	86.7%
Aged Inventory	7.4% (or lower)	21% (or higher)	12.3%
Property Access	95% (or higher)	80% (or lower)	87.0%
Average Days in Inventory	106 days (or less)	175 days (or more)	141 days

Source: VA OIG analysis using data provided by LGY

A description of Bank of America's five quarterly performance metrics follows.

- **Return on Sale**—Average net sales proceeds for all properties sold in a quarter divided by average initial listing price set by the property management contractor averaged over all properties sold in the quarter
- **Maintenance**—Number of properties with no maintenance exceptions (safety hazards or risk of immediate deterioration of property) divided by number of properties field inspected
- **Aged Inventory**—Percentage of properties at the end of the quarter which have been in inventory for nine or more months from the date of assignment to the contractor
- **Property Access**—Percentage of properties VA gains access to using the lock box code provided by the contractor
- **Average Days in Inventory**—Total number of days each property was in inventory through the end of a quarter divided by total number of properties in inventory

Appendix D Statistical Sampling Methodology

To evaluate VBA's oversight over its foreclosed property management contractor, we selected a statistical sample of properties assigned to the PMOU from October 1, 2010, through March 31, 2012. We excluded properties without at least one processed invoice, one field inspection maintenance exception (safety hazards and risks of immediate deterioration), or one monthly management fee from our sample.

Population

The population consisted of 19,095 properties assigned to the PMOU from October 1, 2010, through March 31, 2012. The population included 11,235 properties with invoices processed, 536 properties with maintenance exceptions, and 19,081 properties with monthly management fees.

Sampling Design

We used a stratified sample to select properties to review. We segregated our population into 7 mutually exclusive strata and selected 132 unique properties for review from the 5 strata containing 1 or more properties. We chose this approach to allow us to make objective inferences about the whole population. Table 4 shows the population and sample size for each stratum.

Table 4

Population and Sample Size of Foreclosed Properties by Stratum

Stratum	Population	Sample Size
Properties with processed expense invoices, field inspection maintenance exceptions, and monthly management fees	350	30
Properties with processed expense invoices and field inspection maintenance exceptions but no monthly management fees	0	0
Properties with field inspection maintenance exceptions and monthly management fees but no processed expense invoices	186	30
Properties with field inspection maintenance exceptions but no processed expense invoices or monthly management fees	0	0
Properties with processed expense invoices and monthly management fees but no field inspection maintenance exceptions	10,871	31
Properties with processed expense invoices but no field inspection maintenance exceptions or monthly management fees	14	10
Properties with monthly management fees but no processed expense invoices or field inspection maintenance exceptions	7,674	31
Total	**19,095**	**132**

Source: VA OIG sample selection performed in consultation with the Office of Audits and Evaluations statistician

Of the 132 unique properties, we reviewed 71 properties with processed invoices. For these 71 properties, we reviewed 93 expense reimbursement claims comprised of 890 individual expenses. We also reviewed 33 properties with maintenance exceptions and 122 properties with monthly management fees. Properties reviewed included one or more of the following:

- Field inspections with one or more maintenance exception
- Processed expense invoices
- Paid monthly management fees

Appendix E Under Secretary for Benefits Comments

Department of Veterans Affairs

Memorandum

Date: August 7, 2013

From: Under Secretary for Benefits (20)

Subj: OIG Final Report—Audit of Foreclosed Property Management Contractor Oversight [Project No. 2012-01899-R9-0117]—VAIQ 7362467

To: Assistant Inspector General for Audits and Evaluations (52)

1. Attached is VBA's revised response to the OIG's final report: Audit of Foreclosed Property Management Contractor Oversight. Based on the information in the final report, VBA continues to have several significant concerns with the report as written, and does not agree with two of the conclusions reached by OIG:

   - VBA disagrees with OIG's assertion that the contract payments reviewed were unsupported and therefore, improper.
   - Secondly, VBA does not agree with the number of maintenance exceptions OIG identified as requiring immediate reporting to the property management contractor.

   We have held a number of meetings aimed at resolving areas of disagreement, but have been unable to reach a consensus.

2. VBA disagrees with OIG's contention on page 2, under Finding 1 of the Results and Recommendations section: "Loan Guaranty Service (LGY) made improper payments for 528 (59 percent) of 890 sampled expenses not supported by vendor invoices." VBA contends that the payments were proper and supported by sufficient documentation. Please refer to the "Improper Payments" section in the attached technical comments for VBA's rationale.

3. VBA has an additional concern with OIG's assertion on page 5, under Finding 2 of the Maintenance Exceptions Not Reported When Identified section. OIG states, "Twenty-six of 35 maintenance exceptions reviewed were not reported to the contractor when identified by LGY." VBA agrees with OIG's recommendation to develop policies that require immediate reporting of maintenance exceptions when they pose safety hazards or place the properties at risk of immediate deterioration. However, VBA does not agree with the number noted in the report as requiring immediate reporting because they did not pose a safety hazard or risk of property deterioration. Only four of the twenty six maintenance exceptions cited in the report required immediate notification to the property management contractor. Please refer to the "Maintenance Exceptions" section in the attached technical comments for VBA's rationale.

4. As such, VBA can only concur in part with OIG's draft report. We concur with recommendation 1, to ensure that the property management contractor provides vendor invoices to substantiate expenses prior to reimbursement, and with recommendation 3, to develop policies that require reporting of maintenance exceptions to the property management contractor when identified and follow up to ensure correction. However, we do not concur with recommendation 2, which states that VBA should determine the cost effectiveness of initiating recovery of improper payments identified in the report.

5. Questions may be referred to Lori Washington, Program Analyst, at 461-1445.

for Allison A. Hickey

Attachment

Veterans Benefits Administration (VBA)
Comments on OIG Draft Report
Audit of Foreclosed Property Management Contractor Oversight

The Veterans Benefits Administration provides the following technical comments:

VBA disagrees with two of the conclusions related to improper payments and maintenance exceptions asserted by OIG in this report.

Improper Payments

The following comments pertain to the property management contract in place during the time period reviewed by OIG for this report, from October 2010 to March 2012. A new Real Estate Owned and Portfolio Servicing Contract (RPSC) was awarded in April 2012, which contains a flat fee for property preservation and no longer requires invoices for these activities. Additionally, for reimbursable expenses, the current RPSC service provider obtains vendor invoices from the entities described in the contract. As a result, VBA contends not only that the prior contract payments reviewed by OIG were proper, but that the contention of improper payments in their report does not apply to the current RPSC.

Payments for property management contractor expenses involved multiple transaction steps before funds were reimbursed to the property management contractor. However, OIG focused on one particular step in this process and overlooked other key steps (and related oversight processes and procedures) during this audit, resulting in an inaccurate representation of VBA's oversight of the property management contractor.

VBA's property management contractor (PMC) required all sub-contractors to provide invoices, cancelled checks, and W-9s for any assigned property preservation activities. These documents were uploaded into the PMC's invoice management system, which was a third-party system utilized widely by the Real Estate Owned (REO) industry to process invoice payments. The invoice management system employed front-end controls to ensure invoice charges were pre-analyzed for automated business rule and financial guideline compliance. The system's automated controls included screening of all line item invoice expenses against VBA allowable expenses and dollar threshold limits. Invoice expenses also required review by a PMC technician prior to payment. If an invoice failed any of the business rules, it was automatically forwarded for review by the PMC's management, and additional supporting documentation was required prior to approval. VBA's understanding is that OIG did not review the PMC's oversight processes, procedures, and invoice management system during this audit.

However, VBA did not have full access to the PMC's invoice management system, because partitioning VBA's invoices out from all of their other client's invoices would have come with significant cost and possible contract modifications, as well as potential workload issues in the timely processing of REO invoices. It was not possible for the PMC to limit what accounts users had access to, and allowing VBA carte-blanche access to all system invoices would have created a security issue for both VBA and the contractor. Since VBA had thoroughly reviewed the PMC's invoice processes, procedures, internal controls, and related systems, VBA had assurance that their handling of sub-contractor invoices was sound. The 'proof of payment' screen included amounts paid to sub-contractors, the types of work that were completed, payment certification reviews listed by person, and the dates the payments were certified. If any additional management review of an invoice was required, it also listed the person that performed the review and the date the review was completed. Therefore, VBA chose to use the 'proof of payment' screen from the PMC's invoice management system as sufficient supporting documentation for reimbursable REO expenses.

The contract stated that all required expenses submitted for reimbursement be substantiated by complete imaged (electronic) documentation, such as bids, work orders, and invoices, in support of allowable expenses. The PMC submitted their expenses to VBA for reimbursement and substantiated them with additional supporting documentation, which included the 'proof of payment' screen from their invoice management system. The 'proof of payment' screen is what OIG terms "expense summaries" in the report. Although OIG asserts the 'proof of payment' screens were insufficient evidence to verify that the expenses claimed were accurate, allowable, and legitimate, there is no indication in the report that the OIG performed a review of the PMC's invoice management system and the related processes that provide information to those screens.

Once the PMC submitted their expenses to VBA, Property Management Oversight Unit (PMOU) staff reviewed them prior to reimbursement. New PMOU staff undergo extensive on-the-job training and shadowing of other experienced PMOU staff. Upon being considered fully trained in the handling of REO invoices, PMOU staff work is closely monitored to ensure adherence to PMOU standard operating procedures. When PMOU staff completed a review of submitted expenses by the PMC, they had a peer perform a secondary review prior to reimbursement. During these reviews, contractor systems were checked for supporting documentation such as 'proof of payment' screens, pictures of properties, appraisals, and HUD-1 documents. If a line item on an invoice was not allowable, did not have the required supporting documentation, or was not considered reasonable or customary, that line item was rejected and required additional supporting documentation prior to reimbursement. For example, if an invoice was submitted for grass cutting in Arizona, PMOU staff would check the appropriate system to view pictures of the property. If upon review of the pictures, it was determined that the property had a gravel lawn, then the grass cutting expenses would have been rejected and would not have been reimbursed to the property management contractor.

It is important to note that since 2008, OIG's own contracted financial statement auditors (Deloitte & Touche before 2010 and Clifton Gunderson after 2010) had no objections with the level of supporting documentation described above. The auditors were provided a detailed walk-through of all PMC and PMOU invoice processes and associated systems, including acceptance of the 'proof of payment' screen from the PMC's invoice management system. Additionally, Deloitte and Touche verified the accuracy of the submitted invoice information listed in the 'proof of payment' screen by sending confirmation letters to the PMC's sub-contractors, and VBA received no findings regarding insufficient documentation to process REO invoices.

OIG cites OMB circular A-123 that states, "when an agency is unable to discern whether a payment was proper due to a lack of or insufficient documentation, the payment is considered an improper payment." OIG's report goes on to state that the expense summaries (i.e., 'proof of payment' screens) did not provide sufficient evidence to verify the expenses claimed were proper. The referenced OMB circular does not specify which specific, or what level/degree of documentation is considered sufficient. OIG provides no support for their independent redefinition of OMB's guidance, and VBA contends that this is not appropriate. VBA disagrees with OIG's interpretation of what documentation OMB considers sufficient. VBA contends that the PMC's processes and internal controls regarding their sub-contracted activities, the validity of the 'proof of payment' screens, and PMOU's standard operating procedures and subject matter expertise in handling REO invoices, all ensured payments made were proper. VBA again notes that in past OIG financial statement audits, no findings related to the sufficiency of the PMC invoices were rendered.

Maintenance Exceptions

With regard to PMC notification of maintenance exceptions and maintenance issues on REO properties, VBA makes the distinction between critical issues and those which require correction, but do not necessitate immediate notification to the PMC. For immediate notification to be warranted, the maintenance exception or maintenance issue must present an immediate safety hazard or threat of deterioration or damage to the structure or adjoining properties. If a maintenance exception or maintenance issue does not meet this threshold, VBA considers it a contract compliance issue, and it is reported quarterly to the contractor as part of the performance report. OIG noted that 26 of 35 reviewed maintenance exceptions were not reported to the PMC immediately upon identification. VBA contends that the majority of the identified properties with maintenance exceptions and issues did not necessitate immediate notification to the PMC. VBA believes the figures cited by OIG in the report provide an inaccurate impression of the number of maintenance exceptions and maintenance issues that warranted immediate notification, and thus OIG overstates the potential liability involved with this finding.

The following list explains the rationale as to why 22 of the 26 maintenance exceptions and maintenance issues noted by OIG did not warrant immediate notification to the PMC:

- 9 properties were under contract and it is typical REO practice to have homes de-winterized for a brief period of time in order to allow the purchaser to have mechanical systems inspected;
- 5 properties that were inspected during the summer months and were located in the southern section of the United States, which the urgency to report findings due to likelihood of freeze damage was not warranted;
- 3 properties were in eviction status, i.e., the contractor did not have full custody of the property at the time of inspection and could not winterize properties until eviction was complete;
- 2 properties had electricity on with heat at the time of inspection, which means the likelihood of pipes freezing is minimal and therefore did not require immediate notification;
- 1 property had been winterized the day of the inspection;
- 1 property had an unsecured swimming pool, which the PMC was aware of since bids to secure the pool were being processed at time of the property inspection; and
- 1 property had a roof leak, which the PMC was aware of since bids for repairs had been issued and the property subsequently went under contract with no repairs.

The following comments are submitted in response to the recommendations in the OIG draft report:

Recommendation 1: We recommended the Under Secretary for Benefits ensure the Veterans Benefits Administration's foreclosed property management contractor provides vendor invoices to substantiate expenses claimed by the contractor prior to reimbursement by Loan Guaranty Service.

VBA Response: Concur. The current Real Estate Owned and Portfolio Servicing Contract (RPSC), which started in April 2012, contains a flat fee for property preservation, no longer requiring invoices for these activities. Additionally, for reimbursable expenses, the current RPSC service provider obtains vendor invoices from the entities described in the contract. VBA requests closure of this recommendation.

Recommendation 2: We recommended the Under Secretary for Benefits determine whether it is cost effective to initiate recovery of improper payments identified in our audit.

VBA Response: Non-concur. Office of Management and Budget Memorandum M-11-16, Issuance of Revised Parts I and II to Appendix C, Circular A-123, states that when an agency is unable to discern whether a payment was proper due to a lack of or insufficient documentation, the payment is considered an improper payment. The referenced OMB circular does not specify what specific or level/degree of documentation is considered sufficient. OIG provides no support for its independent redefinition of OMB's guidance, and VBA contends that this is not appropriate. VBA disagrees with OIG's interpretation of what documentation OMB considers sufficient. Additionally, VBA contends that the PMC's processes and internal controls in regard to its sub-contracted activities, the validity of the 'proof of payment' screens, and PMOU's standard operating procedures and subject matter expertise in handling REO invoices all ensured payments made were proper. VBA also notes that on a past OIG financial statement audit, the sufficiency of the PMC invoices was tested and no findings related to their adequacy were rendered. As a result, VBA stands by its determination that payments made were proper and does not concur with determining the cost effectiveness of initiating recovery of these payments.

Recommendation 3: We recommended the Under Secretary for Benefits develop policies that require Loan Guaranty Service to report maintenance exceptions to its foreclosed property management contractor when identified and follow up to ensure correction.

VBA Response: Concur. VBA is in the process of implementing policies that require LGY to report maintenance exceptions to its foreclosed property management contractor when identified and follow up to ensure correction. VBA expects this will be fully implemented by the end of August 2013.

Target Completion Date: August 31, 2013

Appendix F Office of Inspector General Contact and Staff Acknowledgments

OIG Contact	For more information about this report, please contact the Office of Inspector General at (202) 461-4720.
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