OFFICE of INSPECTOR GENERAL
UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Flat Branch Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans

Audit Report Number: 2025-NY-1003

June 20, 2025

Office of Audit | Office of Inspector General
U.S. Department of Housing and Urban Development

To: Matthew Jones
Deputy Assistant Secretary for Single Family Housing, HU

//signed//

From: Kilah S. White
Assistant Inspector General for Audit, Office of Inspector General, GA

Subject: Flat Branch Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans, Columbia, MO

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our audit of Flat Branch Mortgage Inc.'s quality control program for originating and underwriting Federal Housing Administration (FHA)-insured loans.

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, as amended, requires that OIG post its reports on the OIG website. Accordingly, this report will be posted at https://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call Kimberly S. Dahl, Audit Director, at (202) 617-6886.

Highlights

Flat Branch Mortgage, Inc., Did Not Have a Sufficient Quality Control Program for FHA-Insured Loans | 2025-NY-1003

What We Audited and Why

We audited Flat Branch Mortgage, Inc., to evaluate its quality control (QC) program for originating and underwriting Single Family FHA-insured loans. Our audit covered the period October 2020 through September 2022. We selected Flat Branch for review based on its loan volume and delinquency rate and because its rate of self-reporting loans to HUD when it identified fraud, material misrepresentations, and other material findings that it could not mitigate was below average for more than a 5-year period.

What We Found

Flat Branch's QC program for originating and underwriting FHA-insured loans was not sufficient. Specifically, Flat Branch (1) did not select the proper number of loans for review and maintain complete and accurate data to document its loan selection process; (2) did not complete all loan reviews in a timely manner; (3) did not always complete key review steps and sometimes missed material deficiencies; and (4) did not adequately assess, mitigate, and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because Flat Branch had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. As a result, HUD did not have assurance that Flat Branch's QC program fully achieved its intended purposes, which include, among other things, protecting the FHA insurance fund and lender from unacceptable risk, guarding against fraud, and ensuring timely and appropriate corrective action.

What We Recommend

We recommend that HUD require Flat Branch to (1) update its QC plan and related procedures to align with HUD requirements; (2) provide training to staff and management on HUD requirements for lender QC programs; (3) review the loans that it had not selected and take appropriate actions when applicable; (4) obtain credit reports and reverifications of borrower information for QC reviews in which it did not complete these steps and evaluate the risk of findings identified for these loans; and (5) evaluate its QC files for the loans in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that it did not acceptably mitigate.

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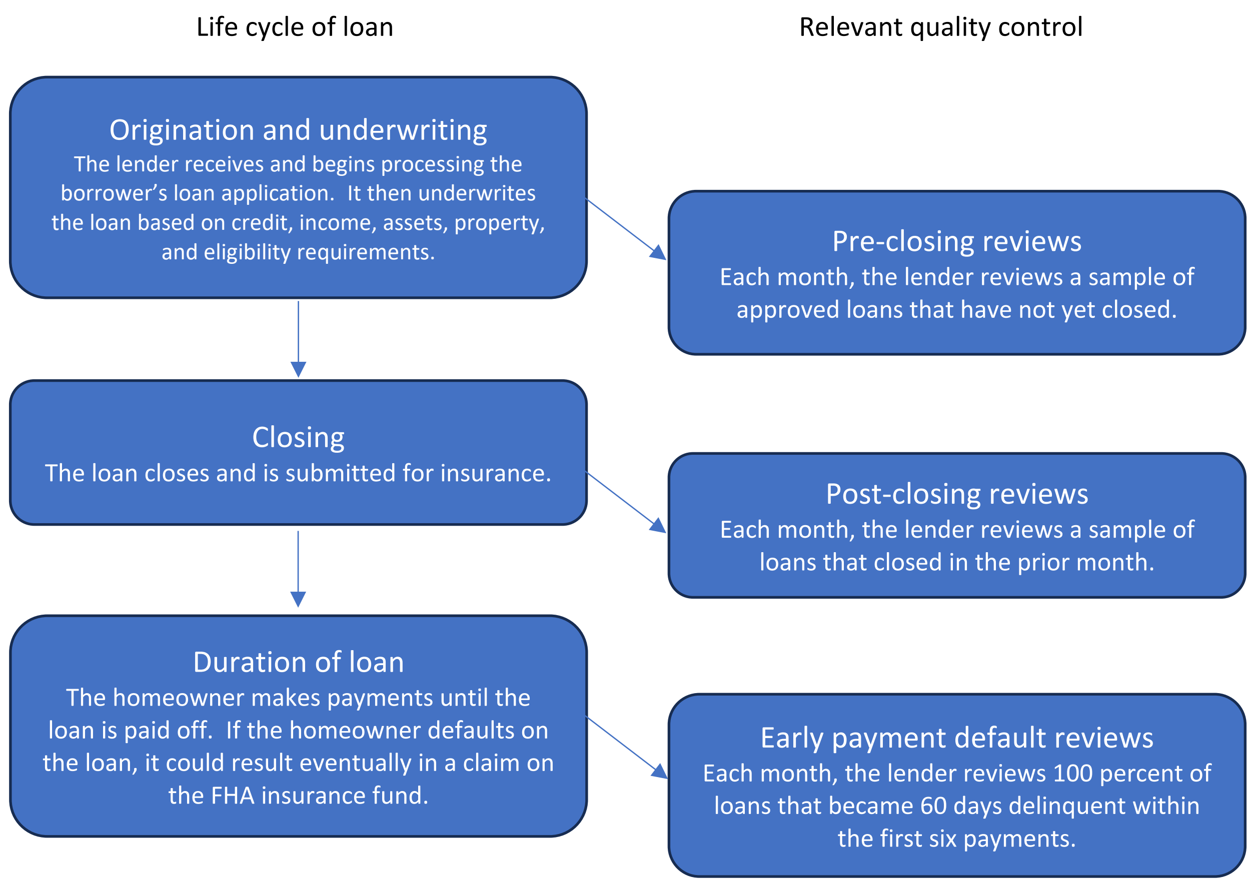
Background and Objective

FHA, a part of HUD, provides mortgage insurance on single family loans made by FHA-approved lenders throughout the United States and its territories. This insurance protects lenders against losses as a result of homeowners' defaulting on their mortgage loans. The lenders bear less risk because HUD will pay a claim to the lender in the event of a homeowner's default.

HUD monitors a number of lenders each year and performs random and targeted reviews of loans throughout the year. Further, HUD requires each lender to implement a quality control (QC) program to (1) ensure compliance with policy and guidelines; (2) protect FHA and the lender from unacceptable risk; (3) guard against errors, omissions, negligence, and fraud; (4) determine the root cause of any deficiencies and identify potential internal and external control weaknesses; (5) alert lender management to patterns of deficiencies; (6) ensure timely and appropriate corrective action; (7) ensure the existence of required documentation that is the basis of underwriting decisions; (8) ensure that loans are secured by properties with values sufficient to support the loan; and (9) ensure compliance with fair lending laws.

Lender QC programs must cover the life cycle of an FHA-insured loan for any functions that the lender performs. As shown below, lenders who originate and underwrite loans must review samples of loans before closing, after closing, and if they default early in the life of the loan.



To help ensure that lender QC programs meet their intended purposes, Section V of HUD's FHA Single Family Policy Handbook requires lenders to have written QC plans setting forth the procedures they will use. It also sets parameters for how many loans lenders must review each month and requires them to document the results of each loan review performed, including any corrective actions taken. Lenders must review all loan files selected for compliance with the handbook's requirements related to debts, employment, income, sources of funds, the property, how documents were handled, underwriting accuracy and completeness, etc. Further, they must do additional analysis when conducting post-closing and early payment default (EPD) reviews by obtaining new credit reports, reverifications of borrower information, and appraisal field reviews if relevant based on the type of loan.

As shown below, lenders must also meet key requirements when their reviews identify findings.

Requirement	Description
Loan sample risk assessment	Loans must be evaluated based on the severity of the violations found using prescribed risk categories, and lenders must use this information to conduct trend analyses over time.
Reporting to lender management	Initial findings and final reports must be shared with senior lender management. The lender must respond to each instance of fraud, material misrepresentation, or other material finding.
Reporting to HUD	Lender management must self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.

Flat Branch Mortgage, Inc., is a nonsupervised lender based in Columbia, MO, with offices in 11 States.[1] It is a nonbank entity and has been approved to conduct business with FHA since 2007. Over the past 5 years, Flat Branch has originated or underwritten more than 16,000 FHA-insured loans. It conducts pre-closing and EPD reviews in-house. Post-closing reviews are conducted by a QC contractor.

Our objective was to evaluate Flat Branch's QC program for originating and underwriting FHA-insured loans.

[1] Nonsupervised lenders are lending institution that have as their principal activity the lending or investing of funds in real estate mortgages, consumer installment notes, similar advances of credit, or the purchase of consumer installment contracts. In contrast, supervised lenders are banks, savings banks, or credit unions that are members of the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), or the National Credit Union Administration (NCUA). Nonsupervised lenders do not fall under the supervision of the FDIC, OCC, or NCUA.

Results of Audit

Flat Branch's Quality Control Program Did Not Fully Achieve Its Purpose

Flat Branch's QC program for originating and underwriting Single Family FHA-insured loans was not sufficient. Specifically, Flat Branch (1) did not select the proper number of loans for review and maintain complete and accurate data to document its loan selection process; (2) did not complete all loan reviews in a timely manner; (3) did not always complete key review steps and sometimes missed material deficiencies; and (4) did not adequately assess, mitigate, and report loan review findings, which included self-reporting loans to HUD when required. These issues occurred because Flat Branch had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. As a result, HUD did not have assurance that Flat Branch's QC program sufficiently protected the FHA insurance fund and lender from unacceptable risk, guarded against fraud, and facilitated timely and appropriate corrective action.

Flat Branch's Loan Selection Process Was Insufficient

While Flat Branch selected a sufficient number of loans for pre-closing and post-closing reviews, it did not always select and review all EPD loans. Further, it did not maintain complete and accurate data to document its loan selection process.

EPD Loans Were Not Always Selected for Review

HUD requires lenders to review 100 percent of EPD loans when they become 60 days delinquent within the first six payments.[2] These reviews are important because they can provide valuable insight into what caused the borrowers to default on their loans and identify underwriting weaknesses. From October 2020 through September 2022, Flat Branch reviewed 234 of the 298 loans in which borrowers went into early payment default.[3] Flat Branch did not perform approximately 21 percent of the required EPD reviews because it had insufficient staff to meet the extraordinarily high volume of EPD loans during the COVID-19 pandemic and because it was not using data from its servicing system to help identify EPD loans for review. As a result, Flat Branch was unable to develop relevant and timely insights on 64 loans with original mortgage amounts totaling more than $11 million that could have been used to mitigate risks and strengthen its operations over time. Although Flat Branch later provided QC reports for 57 of the 64 loans, it was unable to show when the loans were selected and when the EPD reviews were completed due to a system issue. Flat Branch explained that a system issue may have caused the dates on QC reports to be changed when they were printed. Further, it was unable to identify another method to show when the loans were selected and when the EPD reviews were completed.

2 HUD Handbook 4000.1, section V.A.3.a.iv.(B)

3 Flat Branch reviewed an additional 41 loans during this period that had gone into default but did not meet HUD's definition for EPD. While lenders may choose to conduct reviews on additional loans that do not meet HUD's definition and could count such loans as part of their discretionary sample, these would not satisfy its responsibility to review all EPD loans. Further, during this period, Flat Branch reviewed an additional 7 loans that met the definition, which we did not count in the 234 or 298 figures because the loans should have been selected for review before our audit period based on when they became EPDs.

Selection Data Accuracy Could Be Improved

Flat Branch did not maintain complete and accurate data to document its pre-closing, post-closing, and EPD loans selection process as required by HUD.[4] For example, the sample universe data it provided contained missing, incorrect, improperly formatted, and duplicative FHA case numbers, as well as non-FHA loans in its selection. This condition occurred because Flat Branch did not have a system in place that was capable of generating quality data and reports specific to the FHA program. Instead, Flat Branch's staff created the reports manually, resulting in human error. Therefore, it was initially difficult to reconcile Flat Branch's data and ensure that it had adequate coverage. While we were able to confirm the information through communication with the lender, the absence of quality data could compromise the integrity of its QC program by making it difficult to confirm compliance and adequate coverage.

Flat Branch's Loan Reviews Were Sometimes Delayed

While Flat Branch generally completed pre-closing reviews within established timeframes, it completed 335 of its 1,011 post-closing reviews between 1 and 45 days late (averaging around 22 days) and at least 58 of its 339 EPD reviews between 20 and 139 days late (averaging around 76 days).[5]

Number of days late	Number of post-closing reviews	Number of EPD reviews
1-14 days	102	
15-45 days	233	9
More than 45 days		49
Total	335	58

HUD requires post-closing reviews to be completed within 60 days from the end of the prior 1-month period of the loans' selection and EPD reviews to be completed within 60 days from the end of the month in which the loans were selected.[6] The untimely EPD reviews could generally be attributed to Flat Branch's starting EPD reviews covering October through December 2020 late because it misinterpreted a waiver and initially believed the reviews were not required. Flat Branch attributed its other untimely reviews to an increase in loan volume combined with staffing constraints, which impacted both Flat Branch and its contractor for post-closing reviews, resulting in backlogs. As a result of the issues described above, Flat Branch was unable to quickly identify deficiencies and take appropriate corrective actions to prevent similar issues.

Flat Branch's Loan Reviews Were Inadequate

Flat Branch's loan-level reviews were not always of sufficient quality. Lenders must review selected loans for compliance with requirements, such as those related to debts, employment, income, sources of funds, the property, how documents were handled, and underwriting accuracy and completeness.

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4 HUD Handbook 4000.1, section V.A.4.a

5 We were unable to determine whether an additional 57 of the 339 EPD reviews were completed in a timely manner because Flat Branch could not show when the loans were selected for review and a system issue may have caused some of the QC report dates to be changed when they were printed to pdf.

6 HUD Handbook 4000.1, section V.A.3.a.i.(B) and (C)

Further, for post-closing and EPD reviews, HUD requires lenders to conduct a deeper analysis using new credit reports, reverifications of borrower information, and appraisal field reviews when relevant based on the loan type. Flat Branch's loan reviews sometimes missed these key steps or failed to identify material deficiencies that would have affected loan approval and insurance eligibility.

Flat Branch Did Not Consistently Conduct Key Steps

For post-closing and EPD reviews, HUD requires lenders to conduct a deeper analysis by obtaining new credit reports, reverifications of borrower information, and appraisal field reviews when relevant based on the loan type.[7] For example, lenders are required to obtain new credit reports for credit-qualifying loans, and to reverify employment, income, assets, gift funds, source of funds, and mortgage or rental payment history. These key steps help ensure that the original documents lenders obtained to qualify borrowers for FHA-insured loans are valid and sufficient. Flat Branch did not always conduct these steps when required.

New Credit Reports and Reverifications Were Not Obtained During EPD Reviews

While Flat Branch reverified borrower information for all its post-closing reviews, it did not obtain new credit reports or reverify employment, income, assets, gift funds, source of funds, or mortgage or rental payment history for any of the 339 EPD reviews it performed.[8] This deficiency means that Flat Branch missed opportunities to confirm that the documentation used to approve the loans was valid and sufficient and to evaluate any discrepancies between the original and new documents. Flat Branch acknowledged this systemic issue and explained that it had believed that EPD reviews needed to focus only on the contents of the loan file and identify any red flags that were not addressed during processing that may have led to the default. As a result, Flat Branch QC reviews did not adequately evaluate the risk associated with 339 loans with original mortgage amounts totaling more than $54.3 million.

Appraisal Field Reviews Were Obtained for Only 82 Percent of Loans that Were Required

While Flat Branch obtained appraisal field reviews or allowable substitutions for 82 percent of 222 post-closing and EPD reviews performed for our audit period that required appraisal field reviews,[9] it failed to obtain them for an additional 40 loans. Appraisal field reviews are in-person reviews of both the interior and exterior of a property to verify an appraiser's conclusions. While HUD requires lenders to obtain appraisal field reviews for at least 10 percent of the relevant loans selected for post-closing and EPD reviews,[10] Flat Branch did not meet appraisal field requirements for 17 of the 24 months during our audit period. These issues occurred because Flat Branch misinterpreted temporary waivers related to field appraisal reviews and did not have adequate controls to ensure that it selected the proper number of loans for appraisal field reviews. As a result, Flat Branch could not thoroughly evaluate the value of 40 properties and their eligibility for FHA insurance. Although Flat Branch later caught its error related to

7 HUD Handbook 4000.1, section V.A.3.c.ii

8 The 339 EPD reviews cited includes the 234 EPD reviews Flat Branch performed on EPD loans during our audit period, the 57 additional EPD reviews provided during the audit, and the 48 additional EPD reviews discussed in footnote 3 that were for loans it should have selected before our audit period or that it chose to complete.

9 Appraisal field reviews are not required for streamline refinance loans that do not require an appraisal.

10 For the first 9 months of our audit period (through June 2021), HUD generally required lenders to obtain appraisal field reviews or to use an alternative third-party valuation tool for 10 percent of post-closing reviews and all EPD reviews.

interpreting waivers and provided employee training, it should improve its appraisal field review sample selection process to ensure ongoing compliance with HUD requirements.

Material Deficiencies Were Missed

Flat Branch did not always detect origination and underwriting deficiencies that would have affected loan approval and insurance eligibility during its QC reviews. Although its QC reviews identified findings in 15 of the 20 loans sampled, Flat Branch missed material deficiencies in at least 2 loans, or 10 percent of the loans sampled.[11] In one instance, Flat Branch did not verify and manually underwrite a loan when considering the borrower's more than $26,000 in serious credit delinquencies, such as disputed student loans and a collection account.[12] In the other instance, Flat Branch omitted a debt when the cumulative payments were nearly 19 percent of the borrower's gross monthly income, exceeding HUD's 5 percent threshold.[13] In addition, a comparison of Flat Branch's QC data with data from HUD's quality assurance reviews found six loans in which HUD identified material deficiencies that resulted in indemnification agreements, but Flat Branch's reviews had failed to detect the deficiencies.[14] These issues occurred because Flat Branch did not adequately review some files for compliance with requirements. As a result, HUD did not have assurance that Flat Branch's loan reviews sufficiently supported compliance with underwriting requirements and protected the FHA insurance fund and lender from unacceptable risk.

Flat Branch's Assessment, Mitigation, and Reporting of Review Findings Were Inadequate

While Flat Branch used a risk assessment methodology for QC reviews conducted by a contractor, it did not adequately document and assess the risk of all findings identified during in-house QC reviews, and did not mitigate or report findings to HUD when necessary. Further, it lacked evidence showing when initial loan-level findings were shared with management and its final reporting was inadequate.

Findings Were Not Adequately Documented and Assessed

HUD requires lenders to document all QC review results, including findings, and to establish a risk assessment methodology to evaluate violations found during QC reviews.[15] At a minimum, lenders must include low, moderate, and material risk categories in their risk assessment methodology and use that information to conduct trend analyses. Flat Branch used minor, important, and serious risk categories for

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[11] Although we identified material deficiencies that Flat Branch missed in 2 of the 20 loans sampled, it is important to note that the QC reviews for 9 of the 20 loans were missing required verification steps. Therefore, the number of loans in which Flat Branch missed material deficiencies could be understated.

[12] HUD Handbook 4000.1, section II.A.4.b.iii.(B) requires lenders to manually underwrite loans (not use an automated underwriting system) when the credit report indicates that a borrower has $1,000 or more in disputed derogatory credit accounts or serious credit delinquencies of 30 days or more.

[13] HUD Handbook 4000.1, section II.A.4.b.iv.(A)

[14] Indemnification agreements protect HUD against loss associated with a loan should it result in a claim against the FHA insurance fund. We identified 80 loans that had both a QC review by Flat Branch and a HUD quality assurance review. HUD identified material deficiencies that resulted in indemnification agreements for 6 of the 80 loans. However, as noted above, Flat Branch did not detect these material deficiencies during its QC reviews.

[15] HUD Handbook 4000.1, sections V.A.1.d and V.A.3.b

the post-closing QC reviews conducted by a contractor.[16] However, for pre-closing and EPD QC reviews conducted in-house, Flat Branch did not clearly document its findings and assess the associated risk. Flat Branch's pre-closing QC reports identified only significant findings, and its EPD QC reports did not identify or assess any findings. These issues occurred because Flat Branch's in-house QC review process was informal and did not require it to clearly document findings identified during pre-closing and EPD reviews, including their severity levels. As a result, HUD did not have assurance that Flat Branch's QC reviews alerted the lender to patterns of deficiencies and protected the FHA insurance fund and lender from unacceptable risk. In total, Flat Branch did not have data documenting violations and their associated risk and related trend analyses for 1,327 pre-closing reviews and 339 EPD reviews on loans with original mortgage amounts totaling more than $272 million.[17]

Internal Reporting of Findings Was Inadequate

HUD requires all QC review findings to be reported to lender senior management, including sharing initial findings with senior management within 30 days of the initial finding report, followed by providing final findings reports within 60 days. Further, the lender's final report must identify the corrective actions being taken, the timetable for completion, and any planned follow-up activities. While Flat Branch documented that it provided final findings reports to senior management, it did not provide sufficient data or reports showing that it provided initial finding reports to senior management. Further, its final reports did not include corrective action plans, the timetables for completion, and any planned follow-up activities. Last, the final reports for post-closing QC reviews conducted by a contractor were undated.

Material Findings Were Not Adequately Mitigated or Reported to HUD

HUD requires lenders to self-report to HUD all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.[18] Findings are considered material if disclosure of them would have altered the lender's decision to approve the loan or seek FHA endorsement for it.[19] Material findings are considered mitigated only if the deficiencies have been remedied so that the loan approval and insurance endorsement decisions are considered acceptable.[20] Further, HUD requires lenders to retain all QC results and documentation, including actions taken to mitigate findings.[21] Flat Branch did not adequately mitigate findings or report them to HUD when necessary.

While Flat Branch identified material findings in 8 of the 20 loans we sampled, it only complied with HUD's requirement to mitigate or self-report the findings for 3 of these 8 loans, or approximately 38 percent.[22] For each of the 3 loans, it complied with the requirement by documenting mitigation of the material findings. For the remaining five of eight sampled loans with material findings, Flat Branch's records did not show that it acceptably mitigated the findings or self-reported the loans to HUD. For

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[16] This aligns with the Federal National Mortgage Association's risk assessment categories, which are similar but not identical to the risk assessment categories required by HUD for QC reviews of FHA-insured loans.

[17] Flat Branch conducted both pre-closing and EPD reviews on 41 loans. Therefore, the $272 million represent the original mortgage amounts of 1,625 loans with pre-closing and EPD reviews.

[18] HUD Handbook 4000.1, section V.A.2.d.iv

[19] HUD Handbook 4000.1, section V.A.2.d.i.(B)

[20] HUD Handbook 4000.1, section V.A.2.d.i.(C)

[21] HUD Handbook 4000.1, section V.A.2.d.v

[22] We considered loans that Flat Branch's pre-closing QC reports classified as significant and that its post-closing QC reports classified as serious to have material findings.

example, for two loans, its pre-closing QC reviews discovered that the loan files did not contain evidence that Flat Branch checked a participant eligibility list and re-disclosed a change in the loan amount. Further, for three loans, its post-closing QC reviews discovered that the loan files did not contain evidence that it had checked participant eligibility lists or contain the correct addendum to the application and the appraisal report addendum.

These issues occurred because Flat Branch did not follow its QC plan requirements for resolving pre-closing QC review findings before closing and did not ensure that its QC plan aligned with HUD requirements for mitigation and self-reporting. Flat Branch acknowledged the self-reporting issue and stated that the root cause appeared to have been inadequate training regarding when self-reporting was required. As a result, HUD did not have assurance that Flat Branch's QC program guarded against fraud, ensured appropriate corrective action, and protected the FHA insurance fund and lender from unacceptable risk, including for the five loans with original mortgage balances totaling more than $851,000. In addition, we identified 29 other loans with original mortgage amounts totaling $4.1 million that were reviewed by Flat Branch and contained material findings that may not have been adequately mitigated or self-reported to HUD.[23]

Conclusion

Flat Branch's QC program did not fully achieve its intended purposes, which include, among other things, protecting HUD and itself from unacceptable risk, guarding against fraud, identifying patterns of deficiencies, and facilitating timely and appropriate corrective action. These issues occurred because Flat Branch had insufficient controls over its QC program, was not always familiar with HUD requirements, and experienced staffing constraints. If Flat Branch updates its QC plan and related procedures, and provides training to its staff and management, it will help ensure that its QC program complies with requirements and better achieves its intended purposes going forward.

Recommendations

We recommend that the Deputy Assistant Secretary for Single Family Housing require Flat Branch to

1A. Update its QC plan and related processes and procedures to align with requirements for loan selection, including maintaining data and documenting how sample sizes and loan selections were determined.

1B. Update its QC plan and related processes and procedures to align with requirements for (1) loan file reviews, including requirements to obtain new credit reports, reverify borrower information, and obtain appraisal field reviews; (2) documenting review results, including maintaining data on findings; (3) assessment of findings; (4) mitigation of findings; (5) reporting findings internally to lender management; and (6) reporting findings to HUD when required.

1C. Provide annual training to its staff and management on HUD requirements for lender QC programs and provide proof of training to HUD.

23 Because Flat Branch maintained findings data only for post-closing reviews, this figure reflects only loans with post-closing reviews that it classified as having serious findings.

1D. Review the six EPD loans not previously selected for review and submit the results to HUD, including all findings of fraud or material misrepresentation, along with any other material findings that it is unable to mitigate.[24] If required, Flat Branch should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1E. Obtain credit reports and reverify borrower information for up to 279 EPD reviews performed and evaluate the risk of both new findings identified and existing findings contained in its QC files to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its records did not show have been acceptably mitigated.[25] If required, Flat Branch should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1F. Evaluate its QC files for the 29 post-closing QC reviews in which it identified material findings to confirm whether it self-reported to HUD all findings of fraud or material misrepresentation, along with any other material findings that its records did not show have been acceptably mitigated.[26] If required, Flat Branch should execute indemnification agreements or reimburse claims paid to help protect the FHA insurance fund from unacceptable risk.

1G. Provide indemnification agreements or documentation to support the two loans in which it missed material deficiencies and the three loans in which it identified material findings that it did not acceptably mitigate or self-report to HUD. Implementation of this recommendation will protect the FHA insurance fund from an estimated loss of $228,793.[27]

Management Response

Management agreed to take action on six of the recommendations. It asked that we reconsider recommendation 1E because the loans have aged and authorizations to reverify borrower information may not be honored.

Management disagreed that its QC program did not achieve its intended purpose and stated that many of the findings were corrected before or during the audit. Further, Management stressed that the audit's scope was during the Covid-19 Pandemic, which presented challenges for the mortgage industry.

[24] While we identified 64 EPD loans that Flat Branch did not review during our audit period as required, we reduced this figure to 6 loans to account for 57 reviews that Flat Branch later provided and 1 loan that had a post-closing review during our audit period.

[25] While we identified 339 EPD reviews for which Flat Branch did not obtain relevant credit reports and reverifications and had not documented or assessed the risk of findings identified, we reduced this figure to 279 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

[26] While we identified 35 post-closing reviews in which Flat Branch had identified material findings and might need to self-report them, we reduced this figure to 29 to account for those loans that were terminated without a claim, such as when a loan is paid in full.

[27] This amount was based on the unpaid balances of five loans, which totaled $672,921, and FHA's average loss experience of about 34 percent. Two loans were terminated without claims.

Management disagreed that its loan selection process was insufficient and that it failed to maintain complete and accurate data to support its selection process. Management stated that during the audit, it provided evidence that more EPD reviews were performed but it acknowledged that it could not show when these reviews were completed due to an automation issue. Management acknowledged that manual reporting has a higher risk of human error but stated that the handbook does not prohibit manual processing of data, provided that the lender reviews the data for completeness and accuracy, which it did. Further, Management noted that it has begun using automation to ensure data integrity and replaced its QC vendor for more comprehensive reporting.

Management agreed that loan reviews were sometimes delayed during the audit period and noted that it had self-identified and corrected the issue before our audit.

Management indicated that the loan review inadequacies identified related to credit reports and reverifications were limited to EPD reviews and noted that it now sends all EPD loans to its QC vendor to conduct required reverifications.

Management disagreed that material deficiencies were missed that required self-reporting. However, it acknowledged that evidence of its clearance of findings related to exclusionary lists for two loans and support for its decision to not self-report these loans was not included in its loan files at the time of the audit, though it was subsequently provided. Regarding the third loan cited by OIG, Management stated that significant appraiser notes on market conditions and marketability made the absence of a market conditions form immaterial, which meant that it was not required to mitigate or self-report the loan.

Management's full comments are in Appendix B.

OIG Evaluation of Management Response

Management's response generally addressed our recommendations. Although we did not make significant changes to our report, we added language clarifying that the issue related to new credit reports and reverifications was limited to EPD reviews. For recommendation 1E, HUD will work with Flat Branch and OIG during the audit resolution process to come up with a reasonable resolution.

While we acknowledge that Flat Branch designed its QC program to meet its intended purpose, the issues cited in this report explain the instances in which it fell short during the audit period covering October 2020 through September 2022.

The audit report acknowledged that Flat Branch later provided reviews for 57 of the 64 EPD loans cited, but that it could not show when the loans were selected or the reviews completed, which Management did not dispute.

We acknowledge Management's efforts to ensure data integrity and provide more comprehensive reporting going forward, and to use a vendor to conduct all required reverifications during EPD reviews. These efforts are responsive to our finding and will facilitate future audits and monitoring reviews.

Management acknowledged that at the time of the audit, its loan files did not include support for its decision to not self-report. During the audit resolution process, HUD will determine whether the support provides sufficient evidence to close the recommendation.

Scope and Methodology

We performed our audit work between February 2023 and April 2024. We conducted our field work offsite for this audit. Our audit covered the period October 2020 through September 2022 and was expanded to include loan statuses as of January 2025 and additional documentation Flat Branch provided in response to our observations, such as QC reports for 57 EPD reviews, which were dated between October 2022 and April 2024.

To accomplish our objective, we

- reviewed relevant requirements, including handbooks, and mortgagee letters;
- reviewed the lender's QC plan and related policies, procedures, and other relevant documentation to obtain sufficient background information on the program and lender;
- reviewed monthly QC summary reports from both the lender and the third-party contractor covering the 2-year audit period;
- reviewed the lender's QC data for pre-closing, post-closing, and EPD reviews;
- compared the lender's QC data and data from HUD's Single Family Data Warehouse (SFDW) to determine whether the lender reviewed the correct quantity of loans; whether the reviews were performed in a timely manner; and whether the lender obtained new credit reports, reverifications, and appraisal field reviews for the correct quantity of loans each month;
- compared the lender's QC data and data from HUD's Loan Review System (LRS) to identify loans in which the lender could have missed material deficiencies during its QC reviews, failed to properly categorize or correct deficiencies identified, or failed to self-report the loans to HUD;
- reviewed loan data from Neighborhood Watch;
- reviewed training records, including a spreadsheet listing training received by staff;
- interviewed key lender officials to obtain an understanding of its operations, data, and documentation and to discuss potential issues identified during the audit; and
- reviewed Flat Branch's contract with its QC contractor.

For the period October 2020 through September 2022, Flat Branch performed QC reviews on 2,411 loans.[28] We selected a targeted sample of 20 loans based on various factors, such as whether the loans were currently or previously in default, especially those 6 months or more delinquent or in foreclosure; the default reason listed in HUD's SFDW system; when the loans closed; and the highest lender finding level. For each of the 20 loans, we reviewed the lender's QC and loan files to determine whether Flat Branch looked at all required QC elements, missed any significant deficiencies, reasonably categorized deficiencies identified, mitigated deficiencies, took appropriate corrective action, self-reported the loan to HUD if required, and completed its review and follow-up in a timely manner. When considering whether deficiencies identified or missed by Flat Branch would have affected loan approval and insurance eligibility, we considered information in FHA's Defect Taxonomy. Our results were limited to the loans in our sample and cannot be projected to the universe.

Of the 2,411 loans that Flat Branch originated or underwrote and for which it conducted QC reviews, HUD had reviewed 80 loans as of May 2023. We identified six loans in which HUD found indemnifiable deficiencies despite the lender's not having self-reported the loans. We performed limited scope reviews

[28] This figure is based on the information available at the time we selected a sample and does not include all additional EPD reviews later provided.

of the six loans to confirm whether the lender found the deficiencies identified by HUD, how it categorized and corrected the findings, and whether it self-reported the loans to HUD.

We relied on computer-processed data provided by Flat Branch as well as data contained in HUD's Neighborhood Watch system, SFDW, and LRS. We assessed the reliability of the computer-processed data and determined that the data were sufficiently reliable to achieve our audit objective. We also assessed the relevant internal controls to the extent necessary to determine whether they were logical, reasonably complete, and likely to deter or detect any potential problems or indicators.

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.

Appendixes

Appendix A – Schedule of Funds To Be Put to Better Use

Recommendation number	Funds to be put to better use 1/
1G	$228,793

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified. In this case, if HUD implements our recommendation, it could avoid potential losses for two loans in which Flat Branch missed material deficiencies and three loans in which it identified material findings that it did not acceptably mitigate or self-report to HUD. The amount above reflects that upon paying a claim on defaulted loans, FHA's average loss experience is about 34 percent based on statistics provided by HUD.

Appendix B – Management Response

Flat Branch HOME LOANS

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To: Kilah S. White
Assistant Inspector General for Audit
Office of Inspector General
451 7th street, SW
Washington, D.C. 20410

Via Email to: kwhite@hudoig.gov

Re: Flat Branch's Response to HUD OIG's Draft Audit Report of Company's Quality Control Program for FHA-Insured Loans from October 2020-September 2022

Dear Ms. White,

Flat Branch appreciates this opportunity to respond to the findings set forth in HUD OIG's Audit Report of Company's Quality Control Program for FHA-Insured Loans from October 2020-September 2022 ("Report"). Flat Branch respectfully disagrees with OIG's conclusion that Flat Branch's Quality Control Program failed to achieve its intended purpose. The purpose of a Quality Control Program is to uphold compliance with FHA policies while safeguarding the parties from unacceptable risk. Consistent with this purpose, Flat Branch's Quality Control program is designed to help prevent errors, omissions, negligence, and fraud, while ensuring appropriate underwriting decisions, identifying and controlling weaknesses, informing management, and facilitating timely corrective actions. In its Report, OIG characterizes findings, many of which were self-identified and corrected either prior to or during the audit period, as a failure of intended purpose. The Covid-19 Pandemic presented various challenges to the mortgage industry as a whole, serving as an involuntary stress test on the ability of originators to meet their obligations. It is relevant that the scope of this audit was during the pandemic, and that Flat Branch responded to these challenges by increasing staff, adding leadership in key compliance roles, and outsourcing functions to improve its efficiency and reporting capability. These measures were taken both during and after the audit period in an effort to fortify Flat Branch's quality control program and better protect FHA from unacceptable risk. For the reasons that follow, Flat Branch disagrees that its QC program failed to achieve the purposes stated by HUD Handbook 4000.1 (the "Handbook").

I. Flat Branch disagrees with OIG's finding that Flat Branch's loan selection process was insufficient, and that Flat Branch failed to maintain complete and accurate data in support of its selection process.

Specifically, OIG found that Flat Branch failed to review 21 percent of the EPD loans it was required to review. Flat Branch disagrees with this finding. While it agrees that the extraordinary volume experienced across the industry during the Pandemic taxed its staff and its third-party QC vendor, it disagrees that 21 percent of the required EPD reviews were not completed. During the audit process,

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Flat Branch provided evidence that 97.65 percent of the required EPD reviews were completed; however, due to an automation issue, Flat Branch was not able to demonstrate the dates for all of these reviews. While this issue prevented Flat Branch from demonstrating the reviews were completed timely, OIG's conclusion that the reviews were not completed at all is inaccurate.

OIG also contends that Flat Branch did not maintain complete and accurate data to document its pre-closing, post-closing, and EPD selection process because it leveraged manual processes that made reporting susceptible to human error. For this finding, OIG cites HUD Handbook 4000.1, section V.A.4.a., which requires mortgagees to review the completeness and accuracy of information used to make their sample selections. Flat Branch's reporting included duplicative and improperly formatted case numbers, which Flat Branch manually corrected as part of its selection process. In its report, OIG does not claim the data used by Flat Branch was inaccurate or incomplete and further states that it was able to confirm the accuracy of the information through communication with Flat Branch. While Flat Branch agrees that manual reporting is more susceptible to human error than automated reporting; the Handbook does not prohibit the use of a manual process, provided the mortgagee reviews the data for completeness and accuracy, which Flat Branch did, and OIG confirmed. Flat Branch has since corrected the formatting issue that included reporting on duplicative case numbers, deployed automation to ensure the integrity of data used to make loan selections, and has replaced its QC vendor in favor of a vendor with more comprehensive reporting capability.

I. Flat Branch agrees with OIG's finding that Flat Branch's loan reviews were sometimes delayed.

Flat Branch agrees that its loan reviews were sometimes delayed during the period in scope for this audit, which coincides with a period of unprecedented volume, staffing constraints, and vendor backlogs that impacted much of the industry during the COVID-19 Pandemic. Staffing constraints further resulted in the misinterpretation of guidance that caused the start date for 58 EPD reviews to be late. Flat Branch self-identified and corrected this issue prior to the audit.

II. Flat Branch disagrees with OIG's finding that Flat Branch's Loan reviews were inadequate.

Flat Branch disagrees with the finding that its loan reviews were inadequate to the extent that it characterizes the inadequacy in a manner that is overly broad and suggests that certain key steps were missed on all post-closing reviews, when in fact, the deficiencies identified were limited to EPD reviews only. Flat Branch's EPD reviews included a thorough review of the loan file and supporting documents, including the escalation of red flags to its BSA Officer and Senior Management for further scrutiny and evaluation. Reverifications were not conducted in the absence of a red flag. Flat Branch further evaluated the EPD reviews conducted and determined there were no red flags in the supporting documents, and therefore, the files reviewed did not include the necessary reverifications. The root cause of this deficiency was identified as an employee training issue, which was corrected during the audit. Flat Branch sends all EPD loans to its QC vendor, which conducts all required reverifications as part of its review.

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III. Flat Branch disagrees with OIG's finding that Flat Branch missed material deficiencies that required self-reporting.

Flat Branch disagrees with OIG's finding that material deficiencies were missed that required self-reporting. The Handbook requires a mortgagee to self-report all material findings it is unable to mitigate. A finding is material if disclosure of the finding would have altered the mortgagee's decision to approve the mortgage or to seek endorsement from FHA for insurance of the mortgage. Upon review of the Draft Report, Flat Branch requested identification of the material deficiencies it purportedly missed and failed to self-report. OIG provided Flat Branch with findings on three loans. Two of the three loans included findings related to SAM (System for Award Management) checks for both LDP (Limited Denial of Participation) and GSA (General Services Administration) exclusions. In both instances, the deficiencies were not missed. Flat Branch's QC vendor identified parties to the transaction who were not checked against the required exclusionary lists, and Flat Branch cleared the findings as part of its QC process. For one of the loans, there were two parties who were associated with the QC findings. One of the findings was cleared with evidence that the party was checked against the relevant exclusionary lists before closing. The other party was cleared post-closing, and although evidence of this was uploaded to Flat Branch's system in response to the QC finding, it was not included in the file submission provided to OIG. Flat Branch has since provided documentation showing the dates these checks were uploaded to its system. In the second instance, the QC finding was related specifically to the failure to run the LDP check. For QC purposes, Flat Branch cleared this finding by confirming the SAM check, which was run pre-closing, was inclusive of the LDP list. In follow up to OIG's request, the separate LDP check was added to the file; however, that did not negate the fact that the LDP check had already been run as part of the Sam check. Because these findings would not have altered Flat Branch's decision to approve either mortgage, nor seek endorsement from FHA, it respectfully disagrees these deficiencies required self-reporting. OIG noted that evidence of these checks was provided in response to their inquiry rather than in response to the QC findings. Flat Branch agrees the checks were not in either loan file at the time of this audit; however, evidence these checks were run as part of the QC process, at the time of the QC findings, and in support of its decision not to self-report has been provided. Because it concluded these findings were not material, Flat Branch was not required to mitigate or self-report these loans to FHA.

For the third loan, the post-closing QC auditor determined the market conditions report was missing from the file. This was not required to be self-reported. The process for self-reporting loans at the time of review was to escalate to Senior Management, who would then make a final decision on whether a self-report was required. In this case, the QC vendor found the form was missing; however, the appraiser included significant notes regarding market conditions and marketability in the appraisal report. Senior Management concluded that the mere absence of the form was not material to the decision to approve the loan where the substance to be included in the form was included in the appraisal, reviewed by the underwriter, and relied upon for loan approval. Because it concluded the finding was not material, Flat Branch was not required to mitigate or self-report the loan to FHA.

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IV. Recommendations

OIG has made the following recommendations, many of which have already been or are in the process of being implemented by Flat Branch:

1A. Flat Branch will update its QC Plan to ensure alignment with all HUD requirements for loan selection, including regarding the maintenance and documentation of accurate data.

1B. Flat Branch will update its QC Plan to ensure alignment with all HUD requirements for (1) loan file reviews, including requirements to obtain new credit reports, reverify borrower information, and obtain appraisal field reviews; (2) documenting review results, including maintaining data on findings; (3) assessment of findings; (4) mitigation of findings; (5) reporting findings internally to lender management; and (6) reporting findings to HUD when required.

1C. Flat Branch will provide annual training to its staff and management on HUD requirements for lender QC programs and provide evidence of training to HUD.

1D. Flat Branch has sent these six loans to its QC vendor for review and will submit the results to HUD. If required, Flat Branch will comply with any requests from HUD for reimbursement or indemnification agreements.

1E. Flat Branch requests reconsideration of this recommendation on the basis the loans are aged, and the authorizations to reverify are not likely to be honored by third parties.

1F. Flat Branch has evaluated its QC files for these 29 loans and confirmed there were no findings that required self-reporting.

1G. Flat Branch will indemnify the two loans for which material deficiencies were not mitigated.

Respectfully submitted,

Flat Branch Home Loans
Kristi A. Estrada, Chief Legal and Compliance Officer

Appendix C – Summary of Significant Issues Identified

The table below summarizes the significant issues identified in key areas of Flat Branch's QC program.

Key area		Issue identified
Loan selection	Pre-closing reviews	
	Post-closing reviews	
	EPD reviews	X
	Selection data	X
Loan reviews	Timeliness of reviews	X
	Document review and reverification	X
	Identification of material deficiencies	X
Loan review findings	Assessment of risk	X
	Mitigation and reporting of findings	X