Federal Housing Finance Agency
Office of Inspector General

Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses

Evaluation Report • EVL-2013-012 • September 18, 2013

Synopsis

September 18, 2013

Evaluation of Fannie Mae's Servicer Reimbursement Operations for Delinquency Expenses

Why OIG Did This Report

The Federal National Mortgage Association (Fannie Mae) relies on mortgage servicers to make various payments on behalf of delinquent borrowers. Generally, these payments are for property maintenance, insurance, taxes, and loan liquidation costs. Ultimately, Fannie Mae reimburses the servicers for payments that comply with the *Fannie Mae Single Family Servicing Guide*. These servicer reimbursements are the subject of this evaluation.

To collect reimbursement, servicers submit a form electronically to Fannie Mae. Eighty percent of these forms require manual processing – a task that Fannie Mae outsources to Accenture LLP (Accenture). Accenture analysts review the submissions and decide to pay, curtail, or deny the reimbursements. Accenture relays these decisions to Fannie Mae, which reimburses servicers in the amount approved by the Accenture analysts.

In 2012, Fannie Mae reimbursed servicers $2.9 billion as a result of Accenture's manual processing decisions. Occasionally, however, Accenture analysts erroneously approve or deny servicer reimbursements. As a result of these errors, Fannie Mae overpays or underpays servicers. Thus, operational oversight is critical.

In 2010, Fannie Mae's Internal Audit Division began finding serious deficiencies in the controls and processes Fannie Mae used to ensure servicers were reimbursed in the correct amount. The Federal Housing Finance Agency (FHFA or Agency) Office of Inspector General (OIG) commenced this evaluation to assess FHFA's oversight of Fannie Mae's servicer reimbursement operations.

What OIG Found

Prior to 2013, FHFA conducted minimal oversight of Fannie Mae's servicer reimbursement operations. Recently, however, it has bolstered its monitoring and is currently conducting a targeted examination of the area.

Fannie Mae oversees Accenture principally by measuring its contractual performance. Although Fannie Mae collects useful data through sampling, it does not effectively utilize these data to minimize processing errors. For example, Fannie Mae does not aggregate the extent to which it overpays servicers as a result of Accenture's processing errors. Without attempting to quantify the problem, it may be difficult for Fannie Mae managers to make fully informed business decisions or measure their corrective actions.

Moreover, Fannie Mae has yet to implement a red flag system for servicer reimbursements, despite repeated urgings. In this context, a red flag system would identify reimbursement trends and data anomalies that adversely impact Fannie Mae financially.

Synopsis

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To quantify the effectiveness of Fannie Mae's controls, OIG analyzed Fannie Mae's sampling data. OIG estimates that Accenture analysts incorrectly approved 3.1% of servicer reimbursements in 2012. These processing errors prompted Fannie Mae to pay servicers $89 million (i.e., "overpayments").

What OIG Recommends

OIG recommends that FHFA:

1. Ensure Fannie Mae takes the actions necessary to reduce Accenture processing errors. These actions should include utilizing its process accuracy data in a more effective manner and implementing a red flag system.
2. Require Fannie Mae to:
    a. Quantify and aggregate its overpayments to servicers regularly;
    b. Implement a plan to reduce these overpayments by (i) identifying their root causes, (ii) creating reduction targets, and (iii) holding managers accountable; and
    c. Report its findings and progress to FHFA periodically.
3. Publish Fannie Mae's reduction targets and overpayment findings.

TABLE OF CONTENTS .....

ABBREVIATIONS 6

PREFACE 7

CONTEXT 8

Fannie Mae Loan Liquidation 8

Property Management During Delinquency and REO 8

Property Management During Delinquency 9

Property Management During REO 9

Fannie Mae's Servicer Reimbursement Operations 10

Form 571 10

Manual Processing 11

Fannie Mae Oversight of Accenture's Manual Processing 13

Internal Recognition of Deficiencies in Fannie Mae's Oversight 15

FINDINGS 17

1. Prior to 2013, FHFA Oversight of Fannie Mae's Servicer Reimbursement Operations Was Minimal; Recently, FHFA Has Bolstered Its Monitoring 17

FHFA Oversight Prior to 2013 17

FHFA Oversight in 2013 18

2. Fannie Mae's Oversight of Accenture's Claim Processing Focuses on Contractual Compliance Rather than Minimizing Overpayments to Servicers 18

Data Collection and Analysis 19

Red Flag System 19

3. Accenture Processing Errors Prompted Fannie Mae to Overpay Servicers $89 Million in 2012 20

CONCLUSIONS 22

RECOMMENDATIONS 23

FHFA Response to Recommendations 23

OBJECTIVE, SCOPE, AND METHODOLOGY 25
Estimation Methodology 25
Technical Errors 25
Claim Review Methodology 26
Improper Payment Analysis 28
Authority 29
APPENDIX A 30
FHFA's Comments on OIG's Findings and Recommendations 30
APPENDIX B 32
OIG's Response to FHFA's Comments 32
Methodology Concerns 32
OIG's Third Recommendation 33
ADDITIONAL INFORMATION AND COPIES 34

ABBREVIATIONS

Accenture	Accenture LLP
CPM-Ops	Credit Portfolio Management Operations
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Form 571	Expense Reimbursement Submission Request
Freddie Mac	Federal Home Loan Mortgage Corporation
HERA	Housing and Economic Recovery Act of 2008
IPERA	Improper Payments Elimination and Recovery Act of 2010
Navigant	Navigant Consulting, Inc.
OIG	Federal Housing Finance Agency Office of Inspector General
REO	Real Estate Owned
Servicing Guide	Fannie Mae Single Family Servicing Guide
SLAs	Service Level Agreements

PREFACE

FHFA was established by the Housing and Economic Recovery Act of 2008 (HERA),[1] which amended the Inspector General Act of 1978.[2] HERA requires FHFA to oversee the prudential operations of Fannie Mae and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively the Enterprises). Additionally, in September 2008, FHFA placed the Enterprises into conservatorships. The goals of the conservatorships are to preserve the Enterprises' assets and minimize taxpayer losses.

This report evaluates Fannie Mae's servicer reimbursement operations and FHFA's oversight of those operations. OIG appreciates the cooperation of all those who contributed to this evaluation, which was led by Bruce McWilliams, Senior Investigative Evaluator; Brian Harris, Investigative Counsel; Alexa Strear, Investigative Counsel; Omolola Anderson, Statistician; Christine Eldarrat, Senior Policy Advisor; and Desiree Yang, Financial Analyst. It has been distributed to Congress, the Office of Management and Budget, and others and will be posted on OIG's website, www.fhfaoig.gov.

George Grob
Deputy Inspector General for Evaluations

[1] Pub. L. No. 110-289.

[2] Pub. L. No. 95-452.

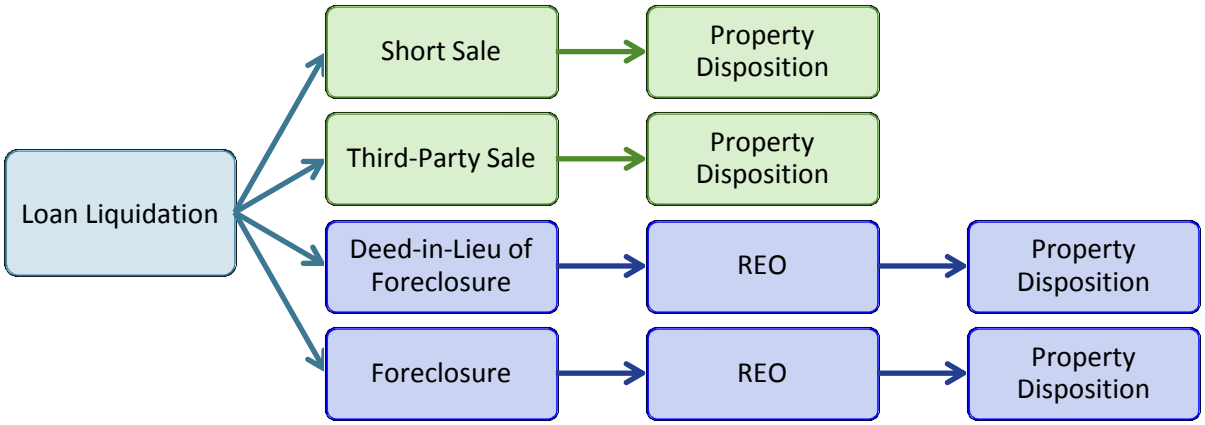
CONTEXT

Fannie Mae Loan Liquidation

When Fannie Mae purchases or guarantees a mortgage, it acquires a lien on the home that secures the mortgage. This lien enables Fannie Mae to liquidate the loan and sell the home if the borrower defaults. Accordingly, Fannie Mae has a financial interest in each of these homes.

The primary goal of loan liquidation is to sell the home to a third party. The loan can be liquidated in one of four ways: (1) short sale, (2) third-party sale, (3) deed-in-lieu of foreclosure, or (4) foreclosure. The former two liquidation options result in a direct sale of the home to a third party, thus ending Fannie Mae's affiliation with the property. In contrast, the latter two liquidation options result in Fannie Mae temporarily becoming the legal owner of the home. During this temporary ownership period, the property is classified as real estate owned (REO). Over time, REO properties are sold to third parties on the real estate market. Ultimately, loan liquidation and the subsequent sale of the home serve to mitigate the credit losses Fannie Mae incurs from a borrower default.

FIGURE 1. FANNIE MAE'S FOUR LOAN LIQUIDATION METHODS



Property Management During Delinquency and REO

Fannie Mae has measures in place to safeguard the value of its security interests when borrowers begin to miss payments. Depending on a loan's status, either the servicer or contractors working for Fannie Mae will manage the property and, if necessary, sell it.

Property Management During Delinquency

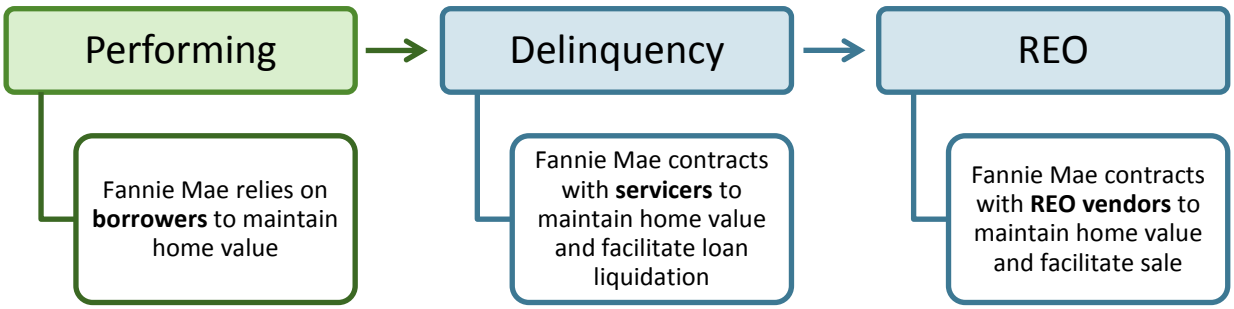
Delinquency begins when a borrower misses a mortgage payment and ends after (1) the borrower cures the delinquency or (2) one of the four loan liquidation events occurs. During this delinquency period, the loan's **servicer** is contractually obligated to protect Fannie Mae's beneficial interest in the home and, when appropriate, liquidate the loan. The former obligation entails making various payments on the borrower's behalf; generally, these payments are for property maintenance, insurance, taxes, and loan liquidation costs. Ultimately, Fannie Mae will reimburse servicers for all payments that comply with the *Fannie Mae Single Family Servicing Guide* (Servicing Guide). These servicer reimbursements are the subject of this evaluation.

Servicer: The entity responsible for collecting principal and interest payments from the borrower. The servicer may be the loan's originating bank.

Property Management During REO

When a home becomes REO (i.e., following foreclosure or deed-in-lieu of foreclosure), the servicer is relieved of its duty to protect Fannie Mae's beneficial interest in the property. To ensure home value and facilitate property disposition during this stage, Fannie Mae contracts with REO vendors. REO vendors are independent contractors that perform many of the same tasks that servicers perform during delinquency. Like servicers, Fannie Mae reimburses REO vendors for their expenses if they comply with Fannie Mae guidelines. REO vendor reimbursements are not the subject of this evaluation. However, this contextual information is critical to understanding OIG's findings.

FIGURE 2. MAINTENANCE OF FANNIE MAE'S SECURITY INTERESTS DURING DIFFERENT LOAN STAGES



Fannie Mae's Servicer Reimbursement Operations

Fannie Mae reimbursed servicers approximately $3.8 billion in 2012 for their delinquency expenses.[3] Generally, to obtain reimbursement for these expenses, servicers access Fannie Mae's Asset Management Network and electronically submit an Expense Reimbursement Submission Request (Form 571).

Form 571

Form 571 is comprised of 13 broad, billable categories. These categories are further refined into a total of 79 unique line items. Figure 3 provides various examples of these categories and the line items within them.

Each Form 571 submitted to Fannie Mae is referred to as a claim.[4] Claim complexity and submission timing vary. The average servicer claim contains approximately seven line items, but they can contain as few as one.[5] Generally, servicers submit their claims near the end of a borrower's delinquency period or immediately after loan liquidation. Thus, it is possible for servicers to make payments for years prior to requesting reimbursement from Fannie Mae.

FIGURE 3. EXAMPLES OF CATEGORIES AND LINE ITEMS ON FORM 571

Category	Line Item
Property Preservation Expenses	• Landscaping • Trash Removal • Locksmith
Insurance	• Hazard Premium • Mortgage Insurance Premium • Title Insurance
Taxes	• State Taxes • Property Taxes
Foreclosure Costs and Expenses	• Eviction Costs • Sherriff's Fees and Costs

Fannie Mae processes claims using three mutually exclusive methods:

1. *Scripted*. Scripted claims refer to those that require approval from an internal Fannie Mae business unit.

2. *Automatically*. If a claim's reimbursement request falls within specific, predetermined parameters, then Fannie Mae automatically reimburses the claim.

[3] This number has not been audited or validated by Fannie Mae for financial reporting purposes or compliance with the Sarbanes-Oxley Act of 2002.

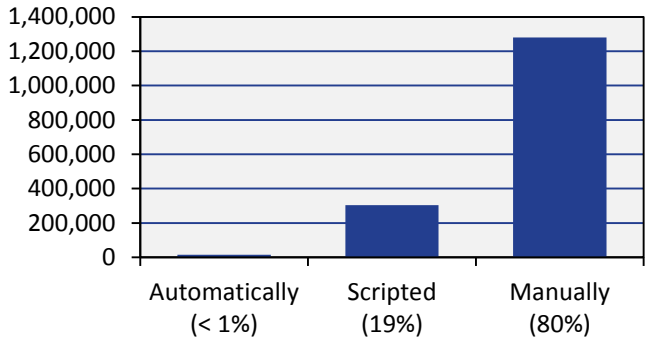
[4] Fannie Mae reimburses both servicers and REO vendors through the same means – Fannie Mae's Asset Management Network. When a distinction is necessary, this evaluation refers to servicer reimbursement submissions as "servicer claims" and REO vendor reimbursement submissions as "REO vendor claims."

[5] OIG calculated this average from Fannie Mae's process accuracy sample (discussed below). OIG found that 50% of the claims in the sample contain three or fewer line items.

3. *Manually*. If a claim does not fall within the parameters referenced above, then it is processed manually. This entails an analyst reviewing each line item on the claim for compliance with the Servicing Guide.

Figure 4 illustrates that a majority of servicer claims require manual processing. Accordingly, OIG's evaluation focuses on manual processing operations.

FIGURE 4. SERVICER CLAIM VOLUME BY PROCESSING METHOD IN 2012[6]



Manual Processing

Prior to 2011, Fannie Mae internally reviewed all claims that required manual processing in its Dallas, Texas, satellite office. In 2011, however, Fannie Mae decided to outsource this task to Accenture, a management consulting, technology, and outsourcing company. By July 2011, Accenture was processing all claims that required manual review – a practice that continues today. Accenture's claim processing staff consists of approximately 84 employees who work at an Accenture delivery center in San Antonio, Texas.

Curtail: Reimburse the servicer a lesser amount than requested.

Fannie Mae prescribes specific servicer claim review procedures that Accenture analysts are required to follow when reviewing each claim. These procedures are intended to ensure Fannie Mae only reimburses servicers for claims that comply with the Servicing Guide. After reviewing each line item on the claim, the analyst (1) approves reimbursement of the claim in full, (2) **curtails** the claim, or (3) rejects it.[7] This decision is relayed to Fannie Mae, which distributes the approved amount of money to the servicer. In 2012, Accenture manually processed approximately 1.3 million claims,[8] approving a total of $2.9 billion in servicer reimbursements.

[6] These numbers have not been audited or validated by Fannie Mae for financial reporting purposes or compliance with the Sarbanes-Oxley Act of 2002.

[7] If a servicer believes its claim was unjustly curtailed or denied, it can contact Fannie Mae for an explanation. Additionally, the servicer can repeatedly resubmit a curtailed or denied claim without penalty.

[8] This number has not been audited or validated by Fannie Mae for financial reporting purposes or compliance with the Sarbanes-Oxley Act of 2002.

FIGURE 5. CHRONOLOGY OF SERVICER REIMBURSEMENT PROCESS FOR MANUALLY PROCESSED CLAIMS

Ideally, Accenture analysts would only approve and deny claims in compliance with the Servicing Guide. However, errors do arise because of the (1) inconsistent application of guidelines by different reviewers, (2) limited resources devoted to avoiding such inconsistencies, (3) complex subject matter, and (4) large volume of servicer claims. When an Accenture analyst erroneously approves or denies a line item in a claim, it results in Fannie Mae making an overpayment or underpayment, respectively, to a servicer. Figure 6 provides four illustrative examples of errors that Accenture analysts are prone to make and their consequences.

FIGURE 6. EXAMPLES OF PROCESSING ERRORS THAT LEAD TO AN INCORRECT REIMBURSEMENT

Accenture Analyst Error	Consequence
An analyst reviews a servicer claim that contains a reimbursement request for hazard insurance. The hazard insurance request is for a period of time that exceeds the maximum allowed by the Servicing Guide. The analyst erroneously approves the amount requested.	Fannie Mae overpays the servicer.
An analyst reviews a duplicate servicer claim. The claim is for a service that was already processed and approved by another analyst. Unaware that it is a duplicate, the analyst erroneously approves the amount requested.	Fannie Mae overpays the servicer.
An analyst reviews a servicer claim that contains a reimbursement request for condominium fees. The servicer, however, did not provide the documentation required by the Servicing Guide. The analyst erroneously approves the amount requested.	Fannie Mae overpays the servicer.
An analyst reviews a servicer claim that contains a reimbursement request for attorney fees. The reimbursement request is within the Servicing Guide's acceptable boundaries. The analyst erroneously rejects the request as excessive.	Fannie Mae underpays the servicer.

Presently, neither Fannie Mae nor Accenture estimates how much money Fannie Mae overpays or underpays servicers. Further, operational factors tend to favor the correction of underpayments as opposed to overpayments. Notably, the burden falls on Fannie Mae to identify and recover its own overpayments. Currently however, Fannie Mae has no remedial measures to recover overpayments on 99% of claims because it only samples 1% of claims for accuracy (discussed below). Alternatively, when a servicer is underpaid, it often contacts Fannie Mae to discuss the underpayment and resubmits the claim at no additional cost. Because of this asymmetry, netting overpayments and underpayments does not accurately represent the financial loss that Fannie Mae incurs as a result of Accenture errors.

Fannie Mae Oversight of Accenture's Manual Processing

Fannie Mae conducts oversight of Accenture's manual processing operations though its Credit Portfolio Management Operations (CPM-Ops) business group.[9] CPM-Ops conducts oversight primarily by (1) quantifying a variety of claim processing metrics that are specified in the Fannie Mae-Accenture contract and (2) identifying data trends.

a. Quantifying Claim Processing Metrics

The Fannie Mae-Accenture contract specifies minimum claim processing standards known as service level agreements (SLAs). If Accenture fails to satisfy any of these SLAs, then the contract requires Accenture to remedy the failure operationally or by paying a penalty. The SLA most pertinent to this evaluation is the process accuracy rate.

The process accuracy rate measures the degree to which Accenture analysts correctly followed the claim review procedures when reviewing claims. To measure the process accuracy rate, Fannie Mae draws a weekly sample of about one percent of claims that have been manually processed by Accenture analysts. Then, a Fannie Mae reviewer examines each claim in the sample and answers the following five, weighted questions affirmatively or negatively:

1. Did the Accenture analyst make the correct reimbursement decision? **45 points**
2. If applicable, did the Accenture analyst obtain the necessary approvals? **20 points**
3. If applicable, did the Accenture analyst review proper documentation? **15 points**
4. If applicable, did the Accenture analyst properly address any payments that exceeded the reimbursement threshold for a specific line item? **15 points**

[9] The exact name and scope of the business unit that conducts Accenture oversight varies and has changed multiple times during this evaluation. In June 2013, these oversight duties were transferred to Credit Business Operation Solutions. For historical consistency, however, this report will refer to CPM-Ops as the business unit tasked with Accenture oversight.

5. Were the Accenture analyst's internal comments sufficient to support and explain the disposition of the claim? **5 points**

The reviewer records the answers electronically and makes an annotation in a comment box each time an Accenture analyst makes an error. If the Fannie Mae reviewer discovers an overpayment, the reviewer records the dollar amount and refers the claim to another business unit, which attempts to retrieve the overpayment. However, the primary goal of measuring the process accuracy rate is to grade Accenture's contractual performance, not to recapture overpayments to servicers. Additionally, Fannie Mae samples only about 1% of claims for process accuracy – it has no remedial means to recapture overpayments in the other 99% of claims.

After the reviewer answers the five process questions, Fannie Mae's software tracks the total process points awarded and the total process points possible for each claim. Then, on a monthly basis, Fannie Mae computes the process accuracy rate by dividing the sum of the total process points awarded on all reviewed claims in that month by the sum of the total process points possible in that month.

$$\text{Monthly Process Accuracy Rate} = \frac{\sum(\text{Process Points Awarded on All Claims})}{\sum(\text{Process Points Possible on All Claims})}$$

FIGURE 7. MEASURING THE PROCESS ACCURACY RATE

This contextual information is critical to OIG's second and third findings, below.

b. Identifying Data Trends

Additionally, CPM-Ops is responsible for designing and implementing a red flag system for servicer claims. Yet, no such system exists today.

In this context, red flags should identify reimbursement trends and data anomalies that adversely impact Fannie Mae financially. They signal that something unusual may need to be further investigated and can provide warning signs of fraud. They also can be indicative of an

unclear Fannie Mae procedure or a lack of training in a particular area. Figure 8 provides various examples that could raise red flags.

FIGURE 8. EXAMPLES OF TRENDS AND DATA ANOMALIES

Trend or Anomaly	Description
Duplicate Payment	Submission of more than one claim for the same service on the same loan
Odd Timing	Submission outside of expected service months or seasons (e.g., pool service in winter months in northern states)
Unusual Frequency	Excessive claim submission or claim submission occurring more than expected (i.e., more than one submission for a service that is generally performed once per the life of a loan)
Overpayment Request	Frequent claim submission for payment amounts above tolerances

Internal Recognition of Deficiencies in Fannie Mae's Oversight

Fannie Mae's Internal Audit Division (Internal Audit) evaluates the effectiveness of controls implemented by various internal business units. Over the past three years, Internal Audit has identified numerous deficiencies within Fannie Mae's servicer reimbursement operations. These deficiencies were documented in the three most recent audits of CPM-Ops.[10] The summaries of these audits below are not exhaustive; they are intended to illustrate the seriousness of Internal Audit's findings.

In 2010, Internal Audit rated the controls surrounding Fannie Mae's servicer reimbursement operations "unsatisfactory" – the lowest possible rating. At that time, Fannie Mae employees performed manual claim processing in-house. Notably, the audit found that Fannie Mae had no red flag system and lacked the controls necessary to prevent duplicate payments of the same claim.

The 2011 audit rated Fannie Mae's servicer reimbursement operations "needs improvement." The audit was performed while Fannie Mae was transitioning manual processing responsibilities to Accenture. The audit reported that, although Fannie Mae was aware of overpayments to servicers, it had performed no analysis to quantify their potential impact. Moreover, the audit noted that Accenture was not satisfying its contractual SLAs.

[10] The audits were conducted in October 2010, December 2011, and November 2012. The exact scope of these audits is broader than Fannie Mae's CPM-Ops business unit. For example, the scope of the 2012 audit included two operational groups – CPM-Ops and Single Family REO Accounting. However, a significant amount of each internal audit focuses on the deficiencies found within CPM-Ops processes and controls. Additionally, several of Internal Audit's findings were self-identified by Fannie Mae management.

In 2012, Internal Audit downgraded Fannie Mae's servicer reimbursement operations rating to "unsatisfactory." It reported that controls "related to processes performed by CPM-Ops are unsatisfactory and do not provide reasonable assurance that risks are being managed effectively." Similar to 2010, Internal Audit concluded that Fannie Mae had yet to establish a recurring and sustainable process to identify red flags, and there was no formal process to identify the source of duplicate payments. Additionally, the audit noted that the delegations of authority between Fannie Mae business units were insufficient.

FINDINGS .....

1. Prior to 2013, FHFA Oversight of Fannie Mae's Servicer Reimbursement Operations Was Minimal; Recently, FHFA Has Bolstered Its Monitoring

As Fannie Mae's regulator, FHFA is responsible for ensuring that it operates in a safe and sound manner. To ensure the safety and soundness of Fannie Mae's operations, FHFA monitors the quality of its risk management systems through three supervisory activities: (1) targeted examinations, (2) continuous supervision, and (3) supervisory analyses. A targeted examination is an in-depth evaluation of a specific risk or risk management system. It is FHFA's most thorough risk assessment product. After the completion of an exam, FHFA drafts a conclusion letter that communicates and supports the exam's findings. Continuous supervision encompasses various activities that are designed to monitor and analyze trends or emerging risks. Supervisory analyses involve research efforts to enhance FHFA's general understanding of a specific risk.

FHFA Oversight Prior to 2013

Prior to 2013, FHFA oversight of Fannie Mae's servicer reimbursement operations was limited. Despite Fannie Mae Internal Audit's findings, no targeted examinations were performed. There were only two instances in which FHFA independently analyzed the risks associated with Fannie Mae's claim reimbursement operations. First, FHFA engaged Navigant Consulting, Inc. (Navigant), an independent contractor, to perform an operational risk assessment of Fannie Mae's REO vendor reimbursement operations. Subsequent to the Navigant report, FHFA performed continuous supervision of both the servicer and REO vendor reimbursement operations.

a. Navigant Report

In January 2012, Navigant completed an analysis of the operational risk associated with Fannie Mae's REO vendor reimbursement operations. However, its scope did not include Fannie Mae's servicer reimbursement operations; thus, it does not constitute direct oversight of those operations.

Nevertheless, the report warrants consideration. It identified several key deficiencies in Fannie Mae's REO vendor reimbursement operations.[11] Therefore, at a minimum, FHFA

[11] The following were among Navigant's findings:

- System limitations constrain Fannie Mae's ability to provide adequate REO vendor oversight;
- Preventative fraud controls need improvement in order to fully mitigate the risk of erroneous or fraudulent payments; and

knew that Fannie Mae's REO vendor reimbursement operations – which are similar to its servicer reimbursement operations – contained deficiencies that exposed it to serious operational risk. Yet, at that time, FHFA did not engage a consultant nor did its examiners conduct a targeted examination of the servicer reimbursement operations. Rather, FHFA proceeded with limited continuous supervision.

b. FHFA's Continuous Supervision

According to FHFA's Division of Enterprise Regulation, FHFA examiners were performing continuous supervision of Fannie Mae's claim reimbursement operations in 2012. However, FHFA provided OIG with little evidence of this continuous supervision. The only document OIG received in connection with FHFA's oversight activities was a summary report of Fannie Mae internal documentation that was never finalized. It was drafted in May 2012 by two examiners who had visited Fannie Mae's claim reimbursement operations in Dallas, Texas. The draft's primary purpose was to further develop FHFA's understanding of Fannie Mae's claim reimbursement operations. The draft, however, contains minimal substantive information regarding servicer reimbursement operations; instead, it is a high-level, nine-page review of several topics and largely consists of charts summarizing Fannie Mae's internal statistics. OIG concludes that this draft is more akin to a supervisory analysis than continuous supervision. Regardless, these actions do not constitute rigorous oversight of a multi-billion dollar operation that consistently received poor ratings from Internal Audit and presents a risk of overpaying servicers tens of millions of dollars annually.

FHFA Oversight in 2013

Subsequent to the high-level review noted above, FHFA left Fannie Mae's servicer reimbursement operations largely unchecked until March 2013 – approximately ten months after OIG initiated this evaluation – when it assigned a recently hired examiner to Fannie Mae's claim reimbursement unit. On April 8, 2013, the examiner conducted an initial interview with the business unit and added it to the continuous supervision portfolio. In May 2013, FHFA initiated a targeted examination of Fannie Mae's claim processing operations, which remains open as of the date of this report.

2. Fannie Mae's Oversight of Accenture's Claim Processing Focuses on Contractual Compliance Rather than Minimizing Overpayments to Servicers

Fannie Mae can help reduce manual processing errors by utilizing the data it collects more effectively and implementing a red flag system.

- The lack of a centralized management system to monitor complaints against REO vendors inhibits Fannie Mae's ability to identify questionable business practices.

Data Collection and Analysis

As explained above, Fannie Mae reviewers sample Accenture's work to measure it against the contractual SLAs. When assessing the SLAs, the reviewers collect a wealth of information about Accenture's processing. For example, when computing the process accuracy rate, Fannie Mae reviewers record which of the five process elements an Accenture analyst failed (if any), annotate the reason why, and document overpayments and underpayments. However, Fannie Mae management does not effectively utilize these data to identify error trends. Rather, the data are used solely to grade Accenture's processing performance.

Moreover, Fannie Mae reviewers attempt to record every overpayment that they find within the sampled claims. Yet, Fannie Mae has no systematic method of aggregating these amounts or projecting them onto the entire claim population. Without quantifying the problem, Fannie Mae managers cannot make fully informed business decisions or measure their corrective actions.

Additionally, communication between Fannie Mae business units has been a consistent impediment to operational improvement. When a Fannie Mae reviewer records an overpayment, the claim is transferred to another business unit that attempts to recapture it. However, communication between the two business units is minimal. To date, Fannie Mae has not performed a cost-benefit analysis to determine whether investing additional money into or expanding its current overpayment recovery system would be beneficial. Indeed, such an analysis would be difficult to conduct without improved communications between the two units.

Red Flag System

Beginning in 2010, Internal Audit recommended that Fannie Mae implement a red flag system for servicer reimbursements. To date, Fannie Mae has not established a recurring and sustainable process to identify red flags for servicer claims. Thus, Fannie Mae is unable to identify reimbursement trends and data anomalies. This increases Fannie Mae's susceptibility to overpayments and potential servicer fraud.

For example, without a red flag system, Fannie Mae is susceptible to duplicate payments. A duplicate payment occurs when Accenture analysts approve more than one claim for the same service on the same loan. This results in the servicer being reimbursed twice for one service. Fannie Mae occasionally receives returned checks from servicers for duplicate payments that have gone unnoticed. Moreover, in 2012, Fannie Mae reported three operational incidents that resulted in a total of $20 million in duplicate payments. Although Fannie Mae eventually recovered the overpayments, these operational incidents highlight the importance of a red flag system that should, among other things, identify duplicate payments.

Notably, Fannie Mae has implemented a red flag system for REO vendor reimbursements. The REO vendor red flag system entails Fannie Mae reviewers examining a sample of claims. The reviewers either validate each claim or designate it as a finding. A finding indicates that at least a portion of the claim should not have been reimbursed. The system generates monthly reports that include the amount of findings, trends within the findings, and training opportunities. For example, the October 2012 red flag report observed that 70% of REO maintenance vendor claims erroneously included maintenance charges for the first month of services. These charges, which aggregate to $310,800, are non-reimbursable.

By searching for observable trends (such as the one above) within servicer reimbursements, Fannie Mae may be able to reduce overpayments. Fannie Mae, however, chose to focus its resources on REO vendors first because their claims are not as complicated as servicer claims. Presently, Fannie Mae states that it is actively researching and building an analogous red flag system for servicer reimbursements.

3. Accenture Processing Errors Prompted Fannie Mae to Overpay Servicers $89 Million in 2012

Currently, neither FHFA nor Fannie Mae quantifies the magnitude of overpayments or underpayments to servicers.[12] OIG estimated these numbers using Fannie Mae's 2012 process accuracy rate data.[13] This involved OIG (1) aggregating all overpayments and underpayments resulting from Accenture errors, (2) interpreting Fannie Mae reviewers' annotations, and (3) crosschecking the findings. A thorough description of the methodology can be found in the *Objective, Scope, and Methodology* section below.[14]

OIG estimates that Accenture analysts incorrectly approved 3.1% of servicer reimbursements in 2012, which prompted Fannie Mae to overpay servicers $89 million. Although these

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[12] As used in this report, an "overpayment" is any servicer reimbursement approved by an Accenture analyst for an ineligible service or fee, a duplicate payment, or services not performed. It also includes instances when the servicer did not submit proper documentation or correctly follow Fannie Mae procedures, but was reimbursed nonetheless. Conversely, an "underpayment" is any payment withheld by Fannie Mae that should have been approved at the time of processing. In either case, the actual amount of the servicer's claim that is classified as "over paid" or "under paid" is the portion of the line item that a Fannie Mae reviewer identified as an overpayment or underpayment. (In contrast to FHFA's characterization of OIG's methodology, OIG did not count "the whole amount" of any claim as an overpayment simply because one line item within the claim was reimbursed erroneously. See *Appendix A*.)

[13] As noted above, Fannie Mae collected these data solely to measure Accenture's processing performance. The data were not collected to estimate overpayments and underpayments. Further details regarding how OIG supplemented the process accuracy data to improve the accuracy of its estimation can be found in the *Objective, Scope, and Methodology* section below.

[14] Additionally, see *Objective, Scope, and Methodology* for an improper payment analysis that uses the Improper Payments Elimination and Recovery Act of 2010 for guidance.

overpayments may not equate directly to financial harm against Fannie Mae, they represent a fundamental problem that undermines the reliability and integrity of Fannie Mae's servicer reimbursement operations. Given the absence of available data, OIG has been unable to estimate the amount of financial harm caused by these overpayments (see *Appendix A* and *Appendix B* for a more in depth discussion of financial harm).[15]

Additionally, OIG estimates Accenture analysts incorrectly denied 0.9% of servicer reimbursements in 2012, which prompted Fannie Mae to withhold $27 million from servicers. Simply netting or aggregating overpayments and underpayments is not appropriate due to the different treatment accorded to each error. For example, when a servicer is underpaid, it can resubmit another claim to recover any suspected shortfalls. Fannie Mae, however, does not currently possess the means to discover or recapture overpayments for 99% of reimbursements that fall outside of its process accuracy sample.

[15] In FHFA's comments to this report, the Agency asserts that some overpayments may not cause Fannie Mae financial harm. Although there may be some merit to FHFA's assertion, the objective of OIG's evaluation was to determine whether Fannie Mae – under the conservatorship of FHFA – had a significant amount of erroneous servicer reimbursements and, if so, whether effective controls were in place to identify and mitigate such erroneous reimbursements. The objective was not to calculate the overall financial impact of all erroneous reimbursements (which neither the Agency nor OIG is in a position to do).

CONCLUSIONS

Prior to 2013, FHFA conducted limited oversight of Fannie Mae's servicer reimbursement operations. Recently, however, it has bolstered its monitoring, and is currently conducting an examination of the area.

Fannie Mae's oversight of Accenture's manual claim processing focuses on measuring Accenture's contractual performance rather than minimizing overpayments to servicers. Although Fannie Mae collects useful data in its sampling process, it does not utilize these data effectively to reduce payment errors. Additionally, Fannie Mae has yet to implement a red flag system for servicer reimbursements.

Neither FHFA nor Fannie Mae aggregates the amount of overpayments to servicers that result from Accenture processing errors. Without attempting to quantify the problem, it is difficult for Fannie Mae managers to make fully informed business decisions or measure their corrective actions. OIG estimates that Accenture processing errors prompted Fannie Mae to overpay servicers $89 million in 2012.

RECOMMENDATIONS

OIG recommends that FHFA:

1. Ensure Fannie Mae takes the actions necessary to reduce Accenture processing errors. These actions should include utilizing its process accuracy data in a more effective manner and implementing a red flag system.

2. Require Fannie Mae to:

    a. Quantify and aggregate its overpayments to servicers regularly;

    b. Implement a plan to reduce these overpayments by (i) identifying their root causes, (ii) creating reduction targets, and (iii) holding managers accountable; and

    c. Report its findings and progress to FHFA periodically.

3. Publish Fannie Mae's reduction targets and overpayment findings.

Based on its data analysis, OIG projects that Fannie Mae – if it continues to follow its current procedures without remediation – will overpay servicers $312 million between July 1, 2013, and December 31, 2016 – the date when Accenture's contract expires.[16] However, by following the above recommendations, FHFA and Fannie Mae can reduce overpayments to servicers and, thereby, reduce waste.

FHFA Response to Recommendations

After this evaluation was drafted, FHFA had the opportunity to review the report and its recommendations. FHFA's formal response can be found in *Appendix A*. The Agency agreed to implement the first two recommendations. OIG appreciates FHFA's support for these recommendations and its plans to implement them.

However, the Agency expressed concerns over OIG's methodology and disagreed with our third recommendation – the publication of reduction targets and overpayment findings.

[16] OIG calculated this figure by assuming $89 million in annual overpayments and multiplying it by three and one-half years (representing the time between July 1, 2013, to December 31, 2016). The figure does not account for other fluctuating variables (e.g., the housing market, volume of servicer claims, improved oversight, and improved manual processing procedures).

Prior to finalizing this report, OIG concluded that the methodology used in this evaluation – which is fully detailed below – is sound and objective.

Additionally, OIG's third recommendation is intended to improve transparency for U.S. taxpayers. Because Fannie Mae's quarterly net worth directly impacts Treasury, OIG believes that such transparency is appropriate.

For a more thorough response to FHFA's concerns, see *Appendix B*.

OBJECTIVE, SCOPE, AND METHODOLOGY .....

The objective of this report was to evaluate Fannie Mae's servicer reimbursement operations for delinquency expenses and FHFA's oversight of those operations. To achieve our objectives, OIG interviewed various Fannie Mae and Accenture personnel to gather information about the servicer reimbursement operations. OIG also interviewed FHFA personnel to assess the extent of its oversight. Additionally, OIG requested and reviewed numerous documents from Fannie Mae and FHFA.

When possible, OIG attempts to identify and estimate any "funds [that can be] put to better use."[17] This term includes any reduction in outlays that results from our recommendations. By following the recommendations outlined above, FHFA will ensure that Fannie Mae reduces the overpayments made to servicers as a result of Accenture errors.

Estimation Methodology

After conducting our field work, OIG developed the methodology below to estimate the figures in Finding Three. OIG confined its analysis to Accenture's manual processing operations; it did not assess claims that were processed by Fannie Mae's scripted or automatic methods. In addition, OIG did not count technical errors (discussed below) in calculating overpayments and underpayments.

Technical Errors

OIG recognized that an Accenture analyst can produce two distinct types of errors. The first occurs when an Accenture analyst approves or denies a claim in the wrong amount. OIG terms these types of errors *overpayments* and *underpayments*, and they are the type of errors reported in Finding Three. The second type of error occurs when an Accenture analyst approves or denies a claim in the correct amount, but fails to comply with Fannie Mae's claim review procedures. OIG terms these types of errors *technical overpayments* and *technical underpayments* because Fannie Mae reimbursed the servicer in the correct amount, but the Accenture analyst made a procedural mistake during the claim review. Such technical errors were not included in determining the $89 million in overpayments or the $29 million in underpayments discussed in Finding Three.

[17] Inspector General Act of 1978, 5 U.S.C. App. 3 § 5(a)(6).

FIGURE 9. EXAMPLE OF OVERPAYMENT VERSUS TECHNICAL OVERPAYMENT

Error Description	Reimbursement	Consequence
An analyst reviews a servicer claim that contains a reimbursement request for hazard insurance. The hazard insurance request is for an amount that exceeds the maximum allowed by the Servicing Guide. The analyst erroneously approves the request.	Accenture analyst approved the wrong reimbursement amount.	Overpayment
An Accenture analyst did not record internal comments that were sufficient to support and explain the disposition of the claim.	Accenture analyst made the correct reimbursement decision but failed to follow Fannie Mae's claim review procedures.	Technical Overpayment

Claim Review Methodology

OIG's claim review relied on the data Fannie Mae routinely collects to calculate Accenture's process accuracy rate. To collect this data, Fannie Mae selects and reviews a random sample of manually processed claims. Fannie Mae determines the necessary sample size to achieve a 99% statistical confidence level. Then, the Fannie Mae reviewer (1) answers the five process accuracy questions found on page 13, (2) records an error amount (if the reviewer found any), and (3) briefly explains the findings in a comment box. In 2012, Fannie Mae reviewed 13,917 servicer claims for process accuracy out of the 1.3 million that were processed.

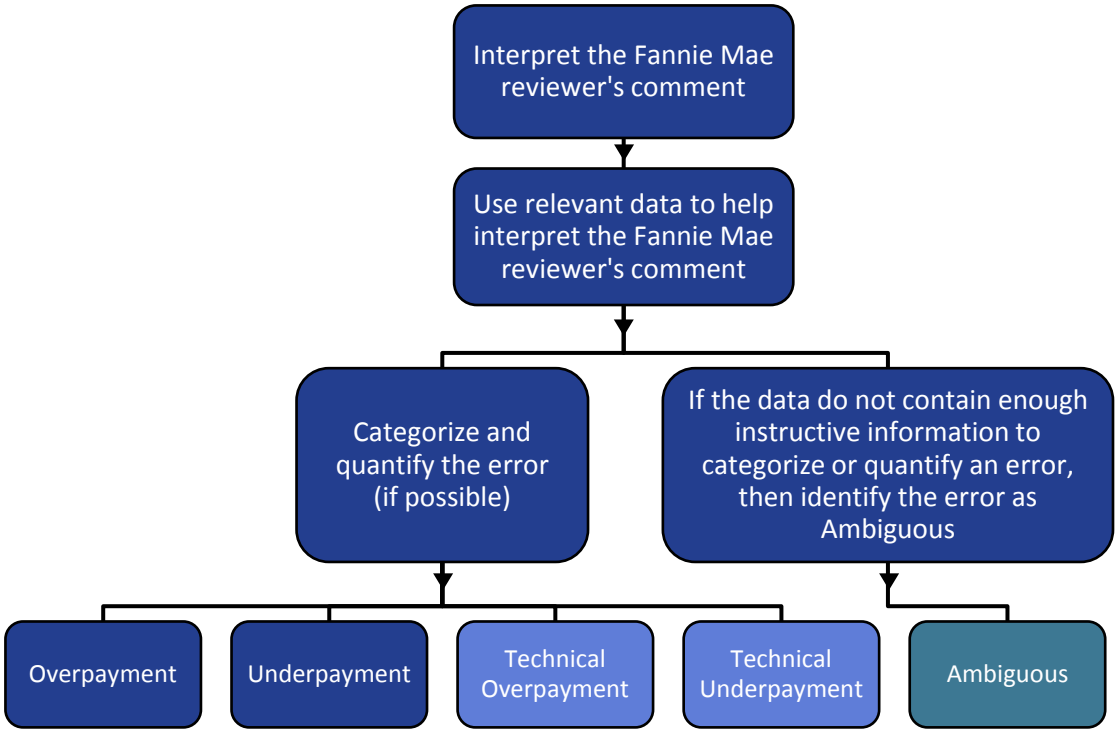
The process accuracy data, however, were not collected for the purpose of quantifying and aggregating how much Fannie Mae overpaid servicers as a result of manual processing errors. Consequently, an isolated examination of these data made estimation difficult, particularly because the data are maintained at the claim level. To supplement Fannie Mae's process accuracy data, OIG requested and received individual line item data from Fannie Mae that further detailed each claim within the sample.

Of the 13,917 servicer claims that were reviewed for process accuracy, Fannie Mae found that approximately ten percent – 1,331 – failed at least one of the five process accuracy questions. To obtain a more granular understanding of the data and exclude technical errors, OIG reviewed the 1,331 failed claims and their corresponding line item data. In doing so, the OIG reviewer primarily read and interpreted the Fannie Mae reviewer's comments. This is where the most instructive information was found. Then, the OIG reviewer examined various claim and line item data to help interpret the comments. For example, if the Fannie Mae reviewer enumerated an error amount, then the OIG reviewer used that number for guidance in identifying any errors.

To differentiate the errors that resulted in an incorrect reimbursement amount (overpayments and underpayments) from the technical errors (technical overpayments and technical underpayments), OIG used the Fannie Mae reviewer's answers to the five process accuracy questions. If the Fannie Mae reviewer determined that the Accenture analyst did not make the correct reimbursement decision (Question 1), then OIG presumed that the error was an overpayment or underpayment, unless the data indicated otherwise. If the Fannie Mae reviewer determined that the Accenture analyst made the correct reimbursement decision but failed one of the remaining four process questions, then OIG presumed that the error was a technical overpayment or technical underpayment.

After a full examination of the claim and line item data, the OIG reviewer attempted to categorize and quantify an Accenture error into one of four categories: (1) overpayment, (2) underpayment, (3) technical overpayment, and (4) technical underpayment. If the OIG reviewer determined there was not enough data to do so, then the claim was categorized as *ambiguous*. OIG did not include any errors categorized as ambiguous in its projections. The following flow chart demonstrates OIG's claim review process.

FIGURE 10. OIG CLAIM REVIEW FLOW CHART



After an OIG reviewer finished examining one month's data, a second OIG reviewer examined the first reviewer's decisions for accuracy. If there was a difference of opinion about how to categorize an error or the quantity of an error, the two reviewers discussed the issue and resolved the difference.

Finally, as discussed in Finding Three and illustrated in Figure 11, OIG projected its findings onto the 2012 claim population. In that year, Fannie Mae made a total of $2.9 billion in servicer reimbursements based on Accenture's manual processing. OIG determined that 3.1% of these reimbursements, $89 million, were overpayments and 0.9%, $27 million, were underpayments.

FIGURE 11. OIG PROJECTION OF OVERPAYMENTS AND UNDERPAYMENTS IN 2012

	Overpayments	Underpayments
Projection	$89 million	$27 million
Error Rate	3.1%	0.9%

Improper Payment Analysis

OIG also conducted an improper payment analysis using guidance from the Improper Payments Elimination and Recovery Act of 2010 (IPERA).[18] Although Fannie Mae is not obligated to comply with IPERA, OIG used the statute as a guide for best practices.

IPERA directs federal agencies within the executive branch to estimate the annual amount of gross improper payments for every program.[19] The Office of Management and Budget, the agency charged with issuing IPERA guidance, defines an improper payment as any payment that should not have been made or that was made in an incorrect amount under contractual requirements.[20] Incorrect amounts are overpayments or underpayments, including inappropriate approvals and denials – even if the amount reimbursed or withheld was correct. Thus, an improper payment includes technical overpayments and technical underpayments, which were not included in Finding Three.

Using the IPERA methodology, OIG estimates that Accenture processing errors produced $140 million in improper payments in 2012. This number is the sum of the projected

[18] Pub. L. No. 111-204.

[19] *See* Office of Management and Budget Memorandum M-11-16, *Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123*, at 5 (Apr. 14, 2011). A program includes any credit program. *Id.* at 4.

[20] Additionally, the Office of Management and Budget's guidance states that improper overpayments and improper underpayments should be summed in an agency's estimation of improper payments. A program's susceptibility is considered significant if its improper payments (1) exceed $10,000,000 and are disbursed at an improper payment rate greater than 1.5% or (2) exceed $100,000,000. If an agency estimates that a program's susceptibility to improper payments is significant, then the agency must (1) obtain a statistically valid projection of the program's improper payments and (2) implement a plan to reduce them.

overpayments ($89 million), underpayments ($27 million), technical overpayments ($10 million), and technical underpayments ($14 million) – the four categories noted in Figure 12; $140 million equates to an improper payment rate of 4.8% based on the $2.9 billion in manually processed servicer reimbursements in 2012.

FIGURE 12. OIG PROJECTION OF IMPROPER PAYMENTS IN 2012

	Overpayments	Underpayments	Technical Overpayments	Technical Underpayments	Total Improper Payments
Projection	$89 million	$27 million	$10 million	$14 million	$140 million
Error Rate	3.1%	0.9%	0.4%	0.5%	4.8%[21]

OIG concludes that IPERA would classify this level of susceptibility to improper payments as significant because Fannie Mae's gross improper payments for manually processed servicer reimbursements exceed $10 million and a rate of 1.5%.[22]

Authority

This evaluation was conducted under the authority of the Inspector General Act of 1978, as amended, and is in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which was promulgated by the Council of the Inspectors General on Integrity and Efficiency. These standards require OIG to plan and perform an evaluation that obtains evidence sufficient to provide reasonable bases to support the findings and recommendations made herein. OIG believes that the findings and recommendations discussed in this report meet these standards.

The performance period for this evaluation was from May 2012 to May 2013.

[21] Figures do not sum precisely due to rounding.

[22] Additionally, this level of improper payments qualifies as significant under IPERA's other criteria: a gross improper payment amount in excess of $100 million.

APPENDIX A .....

FHFA's Comments on OIG's Findings and Recommendations

Federal Housing Finance Agency

MEMORANDUM

TO: George Grob, Inspector General for Evaluations

FROM: Jon Greenlee, Deputy Director, Division of Enterprise Regulation

SUBJECT: Audit Report: An Evaluation of Fannie Mae's Reimbursements to Servicers for Delinquency Expenses (Assignment No. Eval-2012-013)

DATE: August 12, 2013

This memorandum transmits the Federal Housing Finance Agency's (FHFA) management responses to the recommendations in the report prepared by FHFA-OIG on Audit AUD-2012-014, *An Evaluation of Fannie Mae's Reimbursements to Servicers for Delinquency Expenses (Assignment No. EVAL-2012-013).* FHFA has been aware of the concerns regarding expense reimbursements to servicers since Fannie Mae internally identified this process as needing improvement. As your report notes, FHFA is currently conducting an onsite targeted examination. Although our findings are not yet finalized, we appreciate the opportunity to provide feedback on the FHFA-OIG findings.

While FHFA acknowledges that there are opportunities for Fannie Mae to strengthen processes and controls over its vendor, we have concerns with the FHFA-OIG's approach to estimating the error rates and financial impacts. In particular, the manner in which errors are measured and quantified in the FHFA-OIG analysis does not accurately reflect the actual financial impact of the payment processing errors. The analysis focuses on the gross payment amounts processed with some type of technical inaccuracy regardless if the claim was for a legitimate expense (e.g. local property taxes). In instances where Fannie Mae overpaid the vendor, FHFA-OIG counted the whole amount of the payment and not just the portion representing the overpayment. Preliminary analysis conducted by Fannie Mae on FHFA-OIG sampled transactions indicates that the actual financial impact from payment errors is substantially smaller than the estimated $89 million. As the report notes, the FHFA-OIG's methodology for calculating payment error rates is based on Improper Payments Elimination and Recovery Act (IPERA)[1], a law that does not apply to Fannie Mae, and is not used in commercial transactions. Rather, service level agreements in place between Fannie Mae and the vendor measure and track performance.

[1] IPERA was enacted in July 2010 and is intended to reduce wasteful, improper payments made by the United States Government.

FHFA-OIG recommends that FHFA:

1. Ensure Fannie Mae takes the actions necessary to reduce Accenture processing errors. These actions should include utilizing its process accuracy data in a more effective manner and implementing a red flag system.

Management Response: Agree. FHFA will continue its efforts to monitor Fannie Mae's ongoing remediation efforts and complete its examination to determine if additional steps are needed. FHFA will obtain an acceptable plan from Fannie Mae by January 31, 2014, once the examination is completed.

2. Require Fannie Mae to:
    a. Quantify and aggregate its overpayments to servicers regularly;
    b. Implement a plan to reduce these overpayments by (i) identifying their root causes, (ii) creating reduction targets, and (iii) holding managers accountable; and
    c. Report its findings and progress to FHFA periodically.

Management Response: Agree. FHFA will complete its examination and will evaluate Fannie Mae's remediation plan to determine if appropriate processes and controls are in place to track potential financial impact over time. Our examination and review of Fannie Mae's response will consider the need for additional steps to improve the overall process. FHFA will report and monitor Fannie Mae's implementation of their remediation plan through its ongoing monitoring supervisory efforts. This will be completed by June 30, 2014.

3. Publish Fannie Mae's reduction targets and overpayment findings.

Management Response: Disagree. Although FHFA will monitor the results of Fannie Mae's remediation efforts, we will not publish the results. While this is a requirement under IPERA for government agencies, Fannie Mae is not subject to this law and it would be inappropriate for FHFA to apply it in this instance. While this may be a best practice among government agencies, it is not used in commercial transactions such as Fannie Mae's contract with its current vendor. It would also result in an improper disclosure of Fannie Mae proprietary information obtained through our confidential supervisory process and potentially negatively impact future relationships with vendors.

cc: Richard Hornsby, Chief Operating Officer
Mark Kinsey, Chief Financial Officer
John Major, Internal Controls and Audit Follow-Up Manager

APPENDIX B.....

OIG's Response to FHFA's Comments

After this evaluation was drafted, FHFA had the opportunity to review the report and its recommendations. The Agency (1) expressed concerns over OIG's methodology and (2) disagreed with OIG's third recommendation.

Methodology Concerns

Although OIG appreciates FHFA's perspective and thoughtfulness, we stand behind this report's findings and recommendations.

In its official comments, the Agency stated that "FHFA-OIG counted the whole amount of the payment and not just the portion representing the overpayment." This statement is not accurate. As noted in the *Objective, Scope, and Methodology* section, OIG carefully conducted our analysis at the line item level. Furthermore, OIG only counted the dollar amount within each line item that the Fannie Mae reviewer identified as an overpayment. OIG did not count "the whole amount" of any claim as an overpayment simply because one line item within the claim was approved erroneously.

Additionally, FHFA commented that our "analysis focuses on the gross payment amounts processed with some type of *technical* [emphasis added] inaccuracy." The $89 million of overpayments noted in Finding Three, however, are not merely the result of a "technical" problem. They are the direct result of Accenture analysts erroneously approving servicer claims that are not in compliance with the Servicing Guide, many of which result in Fannie Mae paying for services that are non-reimbursable.

Finally, FHFA stated that Fannie Mae's actual financial harm is "substantially smaller" than $89 million. The following scenario illustrates this concept:

> A servicer submits a claim for reimbursement to Fannie Mae without the documentation required by the Servicing Guide. The Accenture analyst does not notice and erroneously approves the claim, which results in Fannie Mae reimbursing the servicer. Although the analyst approved a claim that was not in compliance with the Servicing Guide, it is conceivable that, if asked, the servicer *could* provide documentation for the claim. Thus, in this scenario, Fannie Mae would have suffered no actual financial harm even though the Accenture analyst erroneously approved the claim.

OIG acknowledges that there may be some merit to this viewpoint. However, OIG decided not to incorporate it for the following reasons.

First, Fannie Mae currently has no formal system to track which overpayments cause financial harm and which do not. Therefore, even if OIG agreed with this alternative viewpoint, we would have no reliable means of measuring which Accenture errors ultimately cause financial harm to Fannie Mae. This point further emphasizes the importance of OIG's first and second recommendations.[23]

More importantly, Accenture's inability to accurately process claims represents a serious problem that undermines the reliability and integrity of Fannie Mae's servicer reimbursement operations. In the hypothetical above, the Accenture analyst approved a claim that should have been denied at the time of processing.

Finally, OIG believes that FHFA's and Fannie Mae's remedial efforts should be focused on risk management processes that lead to an improvement in Accenture's front-end performance – before the Accenture analyst makes an error. This approach will improve Accenture's processing accuracy for the entire population of servicer claims. Conversely, FHFA's alternative perspective focuses on back-end corrections (i.e., performing additional analysis to determine the percentage of Accenture errors that theoretically would have no financial impact after a Fannie Mae overpayment). This approach centers on how much of an overpayment Fannie Mae should recover after an error occurs. As noted, however, any recovery of overpayments identified on the back-end would be limited to the 1% sample and have no effect on the 99% of claims not sampled.

OIG's Third Recommendation

FHFA disagreed with OIG's third recommendation: to publish Fannie Mae's reduction targets and overpayment findings. As noted above, OIG recognizes that FHFA has no legal obligation to publish the payment error rate or any action taken to reduce it. OIG made this recommendation to improve transparency for U.S. taxpayers as Fannie Mae continues to be in a conservatorship overseen by FHFA.

[23] FHFA agreed to OIG's first and second recommendations.

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