



U.S. Department of Agriculture



Office of Inspector General  
Midwest Region

## **Audit Report**

### **Rural Development's Escrow Process for Single Family Housing Borrowers**

Report No. 04601-0008-Ch  
FEBRUARY 2004

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: February 2, 2004

REPLY TO  
ATTN OF: 04601-0008-Ch

SUBJECT: Rural Development's Escrow Process for Single Family Housing Borrowers

TO: Arthur A. Garcia  
Administrator  
Rural Housing Service

THROUGH: John M. Purcell  
Director  
Financial Management Division

We have completed our audit of Rural Development's escrow process for single-family housing borrowers. Our objective was to examine applicable internal controls and evaluate agency procedures to establish escrow accounts; apply payments to borrower escrow accounts; pay real estate taxes and insurance for homeowners; ensure the sufficiency of funds in escrow accounts; and distribute funds to borrowers when loans were paid off.

### **BACKGROUND**

The Rural Housing Service (RHS), an agency of Rural Development, provides financing to very low and low-income individuals to purchase single-family housing in rural areas. RHS' portfolio consists of over 400,000 single-family housing loans with an outstanding principle balance of \$15.1 billion. RHS services these loans through its Centralized Servicing Center (CSC) in St. Louis, Missouri. The CSC maintains escrow accounts and makes payments for insurance, taxes, and other assessments on homeowners' behalf.

### **SCOPE AND METHODOLOGY**

We performed work from September through November 2003 at RHS' National Office in Washington, D.C., and at the CSC in St. Louis, Missouri. The period of our review included fiscal years (FY) 2002 and 2003. We randomly selected 100 single-family housing loans, totaling \$7.4 million. We selected these loans from the 26,449 loans made during the period October 1, 2001, to August 31, 2003, totaling nearly \$2 billion. We also randomly selected another 50 loans from the 39,736 loans that had been paid off in FY 2003.

We identified, evaluated, and tested internal controls that we considered necessary to meet our objectives. We reviewed records and interviewed agency staff as needed to accomplish our objectives. We conducted this audit in accordance with Government Auditing Standards

### **SUMMARY OF WORK PERFORMED**

We verified that accounts had been established for 100 randomly selected loans made between October 1, 2002, and August 31, 2003. Our tests disclosed that escrow accounts had been established for 77 of the 100 loans. We also ensured that CSC timely received closing documents from field offices, accurately input tax and insurance information into its system, and collected sufficient funds for estimated payments. While the remaining 23 loans did not have escrow accounts, they met established, and acceptable, criteria for exclusion.

For the 77 loans with escrow accounts, we verified that borrowers' initial payments, and their monthly payments for the first year, were properly applied to escrow accounts. While examining the borrower payment process, we identified weaknesses in the procedures for handling incoming mail at CSC. We determined that inadequate controls existed to safeguard payments from theft or misuse that were being processed and disseminated from the mailroom. Specifically, there was no accountability for these payments, as two or more employees together did not log them in. Further, there were no reconciliations performed to ensure that logged payments reached desired destinations. We will provide more details regarding this issue in the near future in Audit Report No. 04601-9-Ch.

We reviewed borrower accounts for the 77 loans with escrow accounts and confirmed that CSC had timely and accurately made tax and insurance payments. CSC monitors the timeliness and accuracy of payments, as well as compliance with insurance requirements, through periodic reports prepared when payments are due. We reviewed the adequacy of these reports and verified that CSC staff was using them.

We verified that initial and monthly payments for the 77 loans with escrow accounts provided sufficient funds to pay taxes and insurance for the first year. We also evaluated CSC's annual analysis process and ensured that the 77 loans had sufficient funds to meet expected future payments for taxes and insurance. Our tests included procedures for ensuring that CSC properly analyzed accounts with surpluses and shortages during the annual review process.

Lastly, we reviewed applicable internal controls designed to ensure that CSC had properly distributed escrow account funds to borrowers when loans were paid off. We followed system postings and notes related to loan payoff for 14 accounts closed in FY 2003. We found that CSC had adequate controls in this area and had properly refunded the borrower's money for all 14 accounts.

**CONCLUSION**

Our examination did not identify any material internal control weaknesses in the escrow process. We concluded that CSC had properly established all escrow accounts in our sample; properly applied payments to the escrow accounts; accurately and timely paid real estate taxes and insurance; ensured that escrow accounts were adequately funded; and properly refunded escrow funds to borrowers when their loans were paid off.

We appreciate the assistance and cooperation of your staff. If you have any questions, please call me at (202) 720-6945, or have a member of your staff contact Philip T. Cole, Director, Rural Development and Natural Resources Division, at (202) 720-6805.

/s/

ROBERT W. YOUNG  
Assistant Inspector General  
for Audit