



U.S. Department of Agriculture



Office of Inspector General  
Midwest Region

# **Audit Report**

## **Accuracy of Single Family Housing Borrower Accounts**

Report No. 04601-0009-Ch  
JUNE 2004

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: 6/30/04

REPLY TO  
ATTN OF: 04601-0009-CH

SUBJECT: Accuracy of Single Family Housing Borrower Accounts

TO: James C. Alsop  
Acting Administrator  
Rural Housing Service

THROUGH: John Purcell  
Director  
Financial Management Division

We evaluated the loan payment process for single-family housing borrower accounts. Our review consisted of examining and testing the procedures used to ensure that loan payments received by contractor banks and the Centralized Servicing Center (CSC) were applied to the proper borrower accounts. The process used by the CSC to apply payments to single-family housing borrower accounts is generally working well. However, in testing the procedures for processing loan payments, we found two areas in need of improvement. These two weaknesses left borrower payments vulnerable to theft or loss. First, the CSC did not establish accountability of loan payments and other funds before being processed by mailroom employees. Second, the CSC did not adequately oversee the physical security of funds in the mailroom.

To identify systemic weaknesses in the loan payment process, we traced 110 payments made to the contractor banks and the CSC to borrower accounts. We also examined borrower complaints made to our hotline desk alleging the misapplication of payments. We found no discrepancies with the 110 payments in our review. Further, we determined that agency officials had properly resolved the borrower complaints made to our hotline desk and that none of the complainants included in our sample were adversely impacted by agency actions.

We have incorporated the agency's written comments into the appropriate sections of this report, and have included your response in its entirety as exhibit A. We accept your management decision for both recommendations in the report. Thus, no further action with us is necessary. Please follow your agency's internal procedures in forwarding final action to the Office of the Chief Financial Officer.

## **BACKGROUND**

The Rural Housing Service (RHS), an agency within the Rural Development mission area, is responsible for over 400,000 single-family housing loans with an outstanding principle balance of \$15.1 billion. Those borrowers make loan payments each month to banks under contract with RHS (located in Pittsburgh, PA, and St. Louis, MO), or to RHS' CSC in St. Louis, MO. The majority of payments, approximately \$1 billion in fiscal year 2003, are made to the banks, which transfer the funds to RHS' account at the U.S. Treasury. The CSC received about \$130 million in payments from loan payoffs, credit fees, and insurance proceeds in fiscal year 2003, but it does not maintain records on the amount of loan payments it receives. Instead, loan payments are opened at the CSC and then transferred to a bank in St. Louis, MO, for deposit in the U.S. Treasury. Annually, the Treasury Department reviews, or contracts to review, the banks' payment processing functions. These reviews did not identify weaknesses in the areas of our audit coverage. The CSC's payment process is monitored on a continuous basis by internal staff, as well as every five years through the agency's management control review process. The last management control review of the CSC was performed in fiscal year 2002, and it did not identify weaknesses in the areas of our audit coverage.

## **OBJECTIVE**

Our objective was to evaluate procedures for ensuring the accuracy of loan payments made to single-family housing accounts and related internal controls. To accomplish our objective, we performed tests to determine if the CSC had: 1) Posted borrower loan payments accurately, 2) established sufficient controls for resolving payment-related complaints, 3) used borrower complaints to identify systemic weaknesses in the payment process, and 4) investigated borrower complaints related to the misapplication of borrower payments.

## **SCOPE AND METHODOLOGY**

We performed work from September to December 2003, at RHS' National Office in Washington, D.C., and at the CSC in St. Louis, MO. The period of our review included fiscal years 1998 through 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.

As of September 9, 2003, the Office of Inspector General's hotline desk had received 12 borrower complaints concerning the misapplication of payments by the CSC for the period of our review. We reviewed the case files for these complaints and judgmentally selected five for a comprehensive examination. We also judgmentally selected 10 of the 114 payments made to the CSC on September 22 and 23, 2003 and 100 of the 31,840 loan payments made to the contractor banks on December 13, 1999, April 17, 2000, August 27, 2001, and October 28, 2002, to ensure they were properly applied to borrower accounts. The sampled payments totaled \$34,167 of the \$8.7 million submitted by borrowers on those dates.

## **AUDIT RESULTS**

### **Accountability for and Security of Loan Funds Needs Improvement**

Due to gaps in its policies and procedures, the CSC had not established accountability for loan-related payments, and had not properly secured those funds while they were being processed in the mailroom. Thus, funds mailed by borrowers directly to the CSC were vulnerable to theft and loss. Since the facility processed more than \$130 million in loan-related funds alone in fiscal year 2003, excluding loan payments, the CSC needs to correct these weaknesses to ensure that it safeguards all payments on borrower accounts.

The CSC receives funds in the form of borrower loan payments, loan payoffs, credit fees for new loans, insurance proceeds, and other payments. We observed that, when mail arrived at the CSC, the mailroom supervisor distributed unopened envelopes containing checks, money orders, and cash to mail processors who took the envelopes to the privacy of their desks to be opened, sorted, and distributed to the appropriate department. In order to ensure accountability of funds, the CSC needs procedures for handling incoming loan payments and other receipts—for example, requiring one individual to open the envelopes while another individual logs the contents. CSC could also implement other procedures that would ensure accountability of funds.

We also observed that mail processors had not adequately safeguarded loan funds while they were being processed in the mailroom. We noticed mail processors had left checks on their desks while taking breaks. The funds were clearly visible and could have easily been stolen by other mailroom employees or even employees from other departments, as access to the mailroom was unrestricted. In other instances, mail processors placed checks in an unlocked safe that was accessible to all employees. Although the CSC's desk procedures do require that all unprocessed funds be maintained in the safe, they do not require that the safe be locked or that access to the mailroom be restricted to authorized employees.

#### **Recommendations No. 1:**

Strengthen procedures to ensure accountability of loan payments and other loan-related proceeds received by CSC.

#### **Agency Response:**

The agency agreed and has established procedures requiring two or more processors working together at a central table in the mailroom to filter all mail and establish accountability for negotiable instruments.

#### **OIG Position:**

We accept the agency's management decision for this recommendation.

**Recommendations No. 2:**

Strengthen procedures to ensure that all funds are properly safeguarded while in the custody of the mailroom.

**Agency Response:**

The agency agreed and has either reinforced or added the following controls to ensure expected levels of safeguards are in place:

- The fireproof safe located in the mailroom has been secured by physically moving the safe into the supervisor's office and changing the access code. The supervisor locks the safe and takes the key whenever his office is unattended.
- Only processors involved in the central screening process have access to cash and/or negotiable instruments (checks, money orders, etc.). Under no circumstances are checks left on the screening table unattended.
- The entrance to the mail room facility has been restricted to "AUTHORIZED PERSONNEL ONLY" and there is a reception door that must be cleared prior to entry into the mailroom. The other doors leading to the mailroom have been locked.

In addition to the corrective actions outlined above, CSC has purchased a drop safe for the Cash Management Section, to accommodate check delivery outside the normal drop times. CSC is also studying internal processes and customer letters that require payments to be delivered to the CSC rather than a lockbox-processing center. CSC hopes to reduce the number of payments received by establishing new lockbox procedures and directing all payments to lockbox facilities.

**OIG Position:**

We accept the agency's management decision for this recommendation.

We appreciate the assistance and cooperation of your staff during the audit.

/S/

ROBERT W. YOUNG  
Assistant Inspector General  
for Audit



United States  
Department of  
Agriculture

Rural Development

Operations and  
Management

Washington, DC  
20250

APR 28 2004

SUBJECT: Accuracy of Single Family Housing Borrower  
Accounts  
(Audit No. 04601-009-CH)

TO: Robert W. Young  
Assistant Inspector General  
for Audit  
Office of Inspector General

Attached for your review is the Rural Housing Service's response to the official draft for subject audit.

This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendations.

If you have any questions, you may contact Steven Maged of my staff at 202-692-0330.

A handwritten signature in cursive script that reads "John M. Purcell".

JOHN M. PURCELL  
Director  
Financial Management Division

Attachment





United States Department of Agriculture  
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service  
Washington, DC 20250

APR 22 2004

TO: John M. Purcell  
Director  
Financial Management Division

FROM: Patricia G. Fiala  
Director  
Centralized Servicing Center

THROUGH: David J. Villano  
Deputy Administrator  
Single Family Housing

For Arthur A. Garcia  
Administrator  
Rural Housing Service

SUBJECT: Office of Inspector General OGC Report 04601-0009-Ch  
Accuracy of Single Family Housing Borrower Accounts

We appreciate the opportunity to review the subject draft report. We submit the following in response to the draft recommendations. In addition, the Centralized Servicing Center (CSC) has already taken several corrective actions, as outlined below:

**OIG RECOMMENDATION 1:** Strengthen procedures to ensure accountability of loan payments and other loan related proceeds received by CSC.

**AGENCY RESPONSE:** The Centralized Servicing Center (CSC) agrees and has taken the following corrective actions:

- Two or more processors working together at a central table in the mailroom now filter all mail. The processors open all mail to find and establish accountability for negotiable instruments. Negotiable instruments, such as checks, are immediately logged and separated from the remaining mail for delivery to Cash Management. Cleared mail is distributed to mail clerks for normal processing.

**OIG RECOMMENDATION:** Strengthen procedures to ensure that all funds are properly safeguarded while in the custody of the mailroom.

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**AGENCY RESPONSE:** CSC agrees and has either reinforced or added the following controls to ensure expected levels of safeguards are in place:

- The fireproof safe located in the mailroom has been secured by physically moving the safe into the supervisor’s office and changing the access code. The supervisor locks the safe and takes the key whenever his office is unattended.
- Only processors involved in the central screening process have access to cash and/or negotiable instruments (checks, money orders, etc.). Under no circumstances are checks left on the screening table unattended.
- The entrance to the mail room facility has been restricted to “AUTHORIZED PERSONNEL ONLY” and there is a reception door that must be cleared prior to entry into the mailroom. The other doors leading to the mailroom have been locked.

In addition to the corrective actions outlined above, CSC has purchased a drop safe for the Cash Management Section, to accommodate check delivery outside the normal drop times. CSC is also studying internal processes and customer letters that require payments to be delivered to the CSC rather than a lockbox-processing center. We hope to reduce the number of payments received by establishing new lockbox procedures and directing all payments to lockbox facilities.

We have taken immediate and significant steps to address payment accountability and security. CSC will continue to monitor and strengthen the process as outlined. Should you have any questions for CSC, please call at (314) 206-2818 or you may call Mr. Villano at (202) 720-5177.

cc: Sheri Bickmeyer, Deputy Director, CSC  
Toni L. Carter, Compliance Officer, CSC



Informational copies of this report have been distributed to:

Agency Liaison Officer, RHS	(4)
Office of the Chief Financial Officer	
Director, Planning and Accountability Division	(1)
General Accounting Office	(1)