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Office of Inspector General
Great Plains Region
Audit Report

Rural Housing Service
Rural Rental Housing Program
Servicing of Insurance Expenses – Phase III
Washington, D.C.

OFFICE OF INSPECTOR GENERAL • USDA •

Report No.
04601-5-KC
August 2002

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington D.C. 20250

DATE: September 8, 2002

REPLY TO
ATTN OF: 04601-5-KC

SUBJECT: Rural Housing Service, Rural Rental Housing Program Servicing of Insurance Expenses – Phase III

TO: Arthur A. Garcia
Administrator
Rural Housing Service

THROUGH: Sherie Hinton Henry
Director
Financial Management Division

This report presents the results of the subject audit. The written response, dated July 18, 2002, to the draft report has been incorporated into the Findings and Recommendations section of the report where appropriate. The text of the response is attached as exhibit C. The reply generally expressed agreement with the recommendations. We were able to accept the management decisions for Recommendations Nos. 2 and 6. The Findings and Recommendations section of the report explains those actions necessary for us to consider management decisions on Recommendations Nos. 1, 3, 4, and 5. In general, we will need to be provided copies of billings and advised of the specific actions completed or planned along with acceptable dates for completing the proposed actions.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing corrective actions taken or planned and the timeframes for accomplishing final action for those recommendations where management decision has not been reached. Please note that the regulation requires management decisions to be reached on all findings and recommendations within 6 months from the date of report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

/s/

RICHARD D. LONG
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

RURAL HOUSING SERVICE
RURAL RENTAL HOUSING PROGRAM
SERVICING OF INSURANCE EXPENSES – PHASE III
WASHINGTON, D.C.

REPORT NO. 04601-5-KC

RESULTS IN BRIEF

We initiated this audit as a third phase of our review of insurance expenses of the Rural Rental Housing (RRH) Program. During our first phase, we evaluated the Rural Housing Service (RHS) controls for ensuring that (1) insurance costs charged to RRH projects were appropriate and (2) identity of interest entities were properly disclosed.[1] During the second phase, we determined whether selected management companies had accurately reported insurance costs to the RHS and complied with RHS regulations covering insurance.[2] During this third phase, we used information from one large insurance agent/broker (Broker A) to determine if its insured management companies had complied with RHS regulations designed to protect the Government's interests including coverages, deductibles, and mortgagee endorsements. We further determined whether six judgmentally selected management companies (not insured through Broker A)[3] had accurately reported insurance costs to the RHS and complied with RHS regulations covering insurance. The results of these three reviews will be summarized into an overall report addressing areas where RHS needs to strengthen controls and oversight over insurance operations and expenses.

As part of this review, we obtained data from Broker A, an insurance agent/broker serving over 900 RRH projects in 23 States and the Virgin Islands. This data showed the insurance policies purchased from Broker A underinsured 728 RRH projects by about $15.5 million in property insurance coverage because policy deductibles exceeded the maximum limit provided in regulations. The Government, as mortgagee, was at increased risk because these excessive deductibles exposed the collateral to uninsured losses. In addition, the policies did not identify

[1] Audit Report No. 04801-6-KC, Rural Rental Housing Program Insurance Expenses, dated December 18, 2000.
[2] Audit Report No. 04601-4-KC, Rural Rental Housing Program Insurance Expenses - Phase II, dated September 28, 2001.
[3] One management company had a limited number of projects insured through Broker A, but those projects were not reviewed.

Rural Development as the mortgagee for 33 projects listed in the Multi-Family Information System (MFIS) database.[4]

In response to our management alert reporting the underinsured projects, RHS officials advised they had started corrective action. Their response noted RHS planned to provide instructions to servicing officials to correct the conditions we reported.

In addition, four of the six management companies reviewed overcharged projects for insurance and employer taxes by charging the projects rates higher than the actual costs or incurred duplicating insurance coverages.

- Two of the four management companies used estimated rates that were greater than the actual costs incurred for workers' compensation insurance. As a result, one management company overcharged its RRH projects more than $181,000 for workers' compensation in 2000, and the second management company overcharged the two projects we reviewed $553 for workers' compensation in calendar years 1999 and 2000. (The overcharges could exceed $14,000 for 1999 and 2000 for all Minnesota projects managed by the second company.)

- The two other management companies improperly charged projects for the management companies' fidelity coverage. In addition, 11 Louisiana projects paid for dual fidelity coverage on project site employees and paid duplicated general liability insurance costs. As a result, the two management companies overbilled the projects at least $1,828.

- One of the above management companies also overbilled 43 Louisiana projects $9,920 because payroll taxes were charged at a higher rate than the management company's actual costs. A management company official provided a written response noting an error occurred because the fees charged to the properties were not properly adjusted.

All six management companies we reviewed did not properly handle and account for insurance claims. For example, indemnity checks were not issued jointly payable to Rural Development and the borrowers and were not timely deposited into project accounts. In general, these conditions occurred because management companies did not keep servicing officials informed of insurance matters and did not properly control indemnity funds owed to projects. Although our tests did not identify any improper use of indemnity funds, the reduced RHS oversight over these funds resulting from these conditions could allow their use for unauthorized purposes.

[4] These conditions were reported in our Management Alert, dated September 19, 2001.

Exhibit A presents a summary of the monetary results for this audit.

KEY RECOMMENDATIONS

We recommended RHS instruct servicing officials to review deductibles and initiate servicing actions to ensure any excessive deductibles are reduced to the required levels. RHS should also determine if the 33 projects found in MFIS without Rural Development listed as the mortgagee on projects' insurance policies are properly insured including taking appropriate actions to ensure Rural Development is properly listed as mortgagee on these insurance policies. RHS should instruct servicing officials to require the cited management companies to limit insurance charges to only those that are allowed under terms of instructions and management agreements and properly account for insurance claims. In addition, servicing officials should ensure the cited unallowable charges are properly refunded to the projects, and procedures are established to prevent similar overcharges in the future.

AGENCY RESPONSE

RHS officials provided written comments, dated July 18, 2002, to the draft report expressing general concurrence with the facts presented therein. These comments have been attached as exhibit C except we did not attach the draft procedures provided with the written comments. The response showed that in January 2002, the Agency sent servicing officials a memorandum requesting information on the cited projects' insurance policies (where we questioned the large deductibles). The response stated the Agency plans to issue an Administrative Notice to address the issue of deductibles. Also, the Agency completed followup on 33 cases which we questioned as not having Rural Development as mortgagee. The Agency further agreed to send memorandums by July 30, 2002, to the management companies addressing the issues raised in the report.

OIG POSITION

The information provided indicates RHS has taken positive actions to service the conditions and questioned costs noted in our report. In order to achieve management decisions for Recommendations Nos. 1, 3, 4, and 5 where management decisions have not been accepted, we need specific determinations and corrective actions to be taken along with proposed dates for beginning and completing the proposed corrective actions. In addition, we need copies of billings, where appropriate, for the questioned costs in exhibit A.

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INTRODUCTION

BACKGROUND

The Rural Rental Housing (RRH) Program was established to provide affordable housing to low and moderate income persons in rural areas. As of September 30, 2001, the Multi-Family Housing Program had a loan portfolio of $11.8 billion. There were 458,440 units of which 256,363 were assisted with Rural Housing Service (RHS) rental assistance. RHS administers its programs through Rural Development's network of offices. This network consists of a National office located in Washington, D.C., 47 Rural Development State offices, and 654 USDA Service Centers.

The Housing Act of 1949, as amended, authorizes the RRH Program. Instruction 1930-C was published in the Federal Register in 1980 to direct servicing of RRH projects. Borrowers must submit yearend financial reports, audits, and statements of budget and cash flow. Loan agreements provide basic requirements for maintaining the physical condition of projects. As agents for borrowers, management companies assume responsibility for meeting loan objectives and complying with all applicable laws, regulations, and loan covenants. Management agreements specify allowable compensation for management companies. Instruction 426.1 provides insurance requirements for real property used as security for RHS loans. Instructions[5] provide that initial insurance policies will be provided to RHS at loan closing, evidence of paid premium in subsequent years will not be required, and changes of insurance provider or level of coverage will be reported on Form 1930-7 (Multiple Family Housing Project Budget).

The RRH Program now has the second generation of the Multi-Family Information System (MFIS). It is designed to assist servicing office personnel in monitoring the management of the RRH Program through project supervision, the scheduling and tracking of supervisory and servicing activities, and analysis of project budgets and special accounts. MFIS has been enhanced to function in combination with the Multiple-Housing Tenant File System and the Automated Multi-Housing Accounting System (AMAS) eliminating the duplication of data input and providing a much larger database to track, monitor, and analyze RRH activities. Budgeted and actual expenses are input by RHS servicing personnel for each project and stored in MFIS.

[5] Instruction 1930-C, exhibit B, XV B 1.

Broker A, a large insurance agent/broker that provides insurance for RRH projects, is the sixth largest insurance broker in the United States.

OBJECTIVES

The objective was to determine if selected management companies: 1) had accurately reported insurance costs to RHS, 2) complied with RHS insurance regulations, and 3) purchasing insurance through a large broker had complied with RHS regulations designed to protect the Government's interests including coverages, deductibles, and mortgagee endorsements based on information provided by the broker.

SCOPE

Because of Broker A's extensive involvement providing insurance for RRH project owners and management companies, we requested Broker A to provide selected information from its files. We received the names, locations, number of units, insurable values, deductibles, named insureds, and mortgagee clauses for RRH projects insured through Broker A. We entered the data into spreadsheets for analysis and comparison to insurance regulations and MFIS. According to the data provided, Broker A insured 933 RRH projects managed by 33 management companies with 31,959 units and an insurable value of over $1 billion in 23 States and the Virgin Islands. (Note: We were unable to verify that every project Broker A listed as an RRH project was indeed an RRH project. Not every project (57 of 933) that Broker A listed as RRH was in the MFIS database.)

We worked with the Rural Development Information Resources Management Division to obtain insurance cost information from the MFIS database. We obtained the nationwide database on March 1, 2001, which contained fiscal year 1999 actual yearend income and expenses by project. We analyzed insurance costs per State, costs per management company, costs per project, management companies with large numbers of units managed and high costs; and summarized the information provided using database and spreadsheet applications. While the MFIS database contained errors, we considered it satisfactory for our purposes because we were able to identify management companies with unusually high or low average insurance costs per unit.

After analysis and review of insurance expense data, we judgmentally selected and visited the following management companies:

- River City Management, Inc. (RCMI), located in Breaux Bridge, Louisiana, which managed 43 RRH projects in Louisiana and 9 RRH projects in Mississippi;

- Livingston Management, Inc. (Livingston), located in Baton Rouge, Louisiana, which managed 53 RRH projects in Louisiana;

- Security Management & Realty (SMR), located in North Mankato, Minnesota, which managed 75 RRH projects in 3 States, including 69 in Minnesota, 5 in Iowa, and 1 in South Dakota;

- Life Style, Inc. (LS), located in Owatonna, Minnesota, which managed 61 RRH projects in Minnesota and 1 RRH project in South Dakota;

- Boyd Management (Boyd), located in Columbia, South Carolina, which managed 308 RRH projects in 5 States, including Florida, Georgia, North Carolina, South Carolina, and Virginia; and

- United Management (United), located in Fayetteville, North Carolina, which managed 27 RRH projects in North Carolina and 10 RRH projects in South Carolina.

We selected:

- RCMI and Livingston for review because their average insurance costs were among the top 10 in the nation for management companies with greater than 500 units;

- SMR for review since it is a large management company with higher than average insurance costs in Minnesota and Iowa. According to MFIS, one SMR managed project had the eighth highest workers' compensation expense in the United States;

- LS for review because it is a large management company with identity of interest[6] insurance;

- Boyd for review because, according to MFIS, it is the largest management company managing RRH projects in the nation; and

- United for review because its projects had higher than average insurance costs in North and South Carolina.

(See exhibit B for a list of management companies and other sites visited.)

We reviewed the management companies' insurance activities for 1999 and 2000 and we expanded our coverage to other periods, as appropriate. We judgmentally selected the management companies, projects, and transactions reviewed in order to review recent, unusual, and large-dollar transactions. When we identified potentially adverse conditions, we

[6] The management company reported to RHS that a management official was a relative of an employee of the insurance agency.

reviewed additional transactions and periods to ascertain the impact. We conducted our fieldwork between May 2001 and December 2001.

We conducted this audit in accordance with Government Auditing Standards.

METHODOLOGY

We interviewed Rural Development servicing officials and State insurance officials to obtain background information, policies, and procedures regarding project insurance expenses. We obtained and analyzed data from a large insurance broker (Broker A) and interviewed officials to obtain an understanding of the information provided and procedures followed by the broker.

We also reviewed the MFIS database in order to identify insurance issues and unusually high costs. At the selected management companies, we interviewed management company officials and representatives of their insurance agencies. We reviewed insurance documents, including policies and invoices, and other management company records. We compared insurance premiums per the policies to invoices, general ledgers, audited financial statements, and project budgets. We compared project insurance expenses, coverages, deductibles, and practices to what was allowed by management agreements, Rural Development regulations, and insurance regulations. In addition, we judgmentally selected and reviewed insurance claims to test compliance with RHS regulations. We selected claims based on size and date of loss.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	BROKER A'S INSURANCE POLICIES DID NOT PROPERLY PROTECT THE GOVERNMENT'S INTEREST

FINDING NO. 1

RRH borrowers obtained insurance policies from Broker A that underinsured 728[7] projects by about $15.5 million in property insurance coverage due to deductibles in excess of what RHS regulations allow. Even though Broker A's executive vice president was aware that RRH deductibles generally should not exceed $5,000, these borrowers purchased insufficient coverage from this broker/agent on their projects. This occurred, in part, because the various RHS servicing officials had not identified and/or taken action on the excessive deductibles, and the files did not contain sufficient documentation justifying the excessive deductibles. For example, one Rural Development area office we visited did not take action because they were unaware of the regulations limiting insurance deductibles. As a result, the Government, as mortgagee, was at increased risk because the excessive deductibles exposed the collateral to uninsured losses. In addition, the policies did not list Rural Development as the mortgagee for 33 projects listed in the MFIS database. Allowing borrowers or management companies to purchase policies not in compliance with the regulations from one insurance agent or broker could result in a competitive advantage over other insurance providers that encourage their insureds to limit deductibles to the amounts specified in the regulations.

RHS instructions provide that policy restrictions and loss deductible clauses must meet specific RHS requirements or be eliminated or modified to afford the required protection.[8] Failure to provide and maintain required property insurance is a nonmonetary default and servicing officials are to refer cases where borrowers cannot or will not arrange adequate property protection to the State Director.[9] Instructions generally provide that project insurance deductibles may be up to one-fourth of 1 percent of the insurable value with a maximum deductible of $5,000.[10] However, management companies were obtaining insurance policies

[7] This represented 78 percent of the 933 RRH projects insured through Broker A.
[8] Instruction 426.1 II I.
[9] Instruction 426.1 V A 2 and VI.
[10] Instruction 426.1 II I 1 c (2) (i).

through Broker A with wind and hail deductibles of 2 percent of the insurable value with a minimum deductible of $25,000 (see below). When specifically authorized by RHS, funds may be escrowed in the replacement reserve account to offset the increased deductible.[11] Besides escrowing funds in the replacement reserve account, regulations[12] offer another exception limited to wind and hail deductibles only in hurricane areas. In such areas, servicing officials may accept higher deductibles if windstorm and hail insurance that meets all Rural Development requirements is not available. Rural Development may accept the windstorm and hail insurance policy that most nearly conforms to Rural Development requirements. If such an exception is made, the situation should be fully documented in the borrower's case file.

Examples of some of the high deductible cases follow:

a. We reported that Choctaw Mounds, a Mississippi project managed by Southeastern Management Company, Inc. (Southeastern), incurred additional uninsured damages of $21,500 during the 1999 policy year because its deductible ($25,000) exceeded regulations.[13] Southeastern's projects are insured through Broker A. During the current audit, we found that Southeastern's wind and hail deductible was reduced from $25,000 to $5,000 on its 2000 insurance policy, and the associated premium increased almost 7 percent for each of Southeastern's RRH projects. Conversely, we found for this management company's projects for the 2001 insurance period that the wind and hail deductible increased from $5,000 to at least $25,000, and the average premium also increased about 25 percent.

b. Washington Manor, a 12-unit project in Michigan managed by W.S. Smith Company, had an insurable building value of $400,000. (Note: We considered the building values in the insurance policies to be the insurable or replacement values for all projects.) The maximum deductible allowed by regulations in this case was $1,000 ($400,000 multiplied by 0.0025). Washington Manor was covered under a policy with a $5,000 deductible. Thus, the actual deductible exceeded the maximum allowable deductible by $4,000 ($5,000 - $1,000).

c. Crestwood Villa, a 72-unit project in Ohio managed by Provident Management, had an insurable building value of $2,690,000. The maximum deductible allowed by regulations in this case was $5,000.[14] Crestwood Villa was covered under a policy with a 2 percent ($25,000 minimum) wind and hail deductible. Thus, the actual wind and hail

[11] Instruction 426.1 II I 1 c (2) (iii).
[12] 7 CFR 1806.3 c viii and Instruction 426.1 III C 3.
[13] Audit Report 04801-6-KC, Rural Rental Housing Program Insurance Expenses, dated December 18, 2000.
[14] Per regulations, the deductible was computed as $2,690,000 multiplied by 0.0025 with the deductible not to exceed $5,000.

policy deductible was $53,800,[15] which exceeded the maximum allowable deductible by $48,800 ($53,800 - $5,000).

The Government was at increased risk because the excessive deductibles for the 728 projects exposed the collateral to uninsured losses. For example, if Washington Manor had a $6,000 fire loss, the project would be financially responsible for the $4,000 difference between the actual and authorized deductibles ($5,000 - $1,000). Further, if Crestwood Villa had a wind and hail loss of $50,000, the project would be financially responsible for the entire $50,000 loss because the deductible ($53,800) would exceed the claimed loss ($50,000).

Our review disclosed that justifications for excessive deductibles were not documented in the borrowers' case files nor were additional funds escrowed in the replacement reserve account to offset the increased deductibles.[16] One State official said they were not aware of the excessive deductibles until we issued the management alert. In fact, the official said two management companies were not aware they had the 2 percent wind and hail deductible clause in their policies until we started our review. Those two management companies have since changed insurance providers. For another management company, Broker A eliminated the excessive wind and hail deductible on projects not in Florida or located on the coast. Based on our conversations with industry and servicing officials, we were told that insurance practices in the "hurricane States" were undergoing dramatic changes and coverage was becoming more expensive.

In addition, the insurance policies issued by Broker A did not list Rural Development as the mortgagee for 33 projects that were listed in MFIS. If Rural Development is not listed as the mortgagee, indemnity checks may not be made jointly payable to Rural Development as required. (Note: Since the MFIS data is from 1999 and some insurance policies were from 2001, we were unable to verify that all 33 projects were currently in the RRH Program.[17] Also, property coverage may be through a different agent with Broker A providing only "property/crime-bond coverage.")

Rural Development and all other mortgagees whose interests are insured by the policy are to be shown either in the mortgage clause or in the "Declaration Page" in the order of priority of their mortgages.[18] Servicing officials are to collect the amount of the loss and loss proceeds are to be made payable jointly to Rural Development and the borrower.[19]

[15] Per the policy, the wind and hail deductible was actually $53,800 ($2,690,000 multiplied by 0.02).
[16] 7 CFR 1806.3 c viii and Instruction 426.1 III C 3 and II I 1 c (2) (iii).
[17] We found 20 of the 33 projects in RHS Automated Multi-Family Accounting System. A detailed listing was provided to RHS.
[18] Instruction 426.1, II G 4.
[19] Instruction 426.1, V B 1 and 2.

We issued a management alert[20] to the RHS national office advising that projects were potentially underinsured due to excessive deductibles and some policies did not list Rural Development as the mortgagee. We recommended that servicing officials be instructed to review the cited projects' insurance policies and take appropriate action to reduce improper deductibles to required levels and ensure Rural Development is properly listed as mortgagee on the cited insurance policies. RHS provided a September 27, 2001, response to our management alert advising RHS planned to provide instructions to servicing officials to correct the conditions we reported. During the audit, the agency provided documentation that servicing officials had reviewed the 33 projects without Rural Development listed as the mortgagee and that the agency was now properly listed on the policy.

RECOMMENDATION NO. 1

Instruct servicing officials to review the cited projects' insurance policies to determine if deductibles are excessive. Take appropriate servicing action to ensure any excessive deductibles are reduced to the required levels and instruct servicing officials to fully document the decisions.

RHS Response

The Agency's July 18, 2002, written response to the draft report (see exhibit C) advised that in January 2002, the Agency sent servicing officials a memorandum requesting information on the cited projects' insurance policies. The Agency plans to issue an Administrative Notice to address the issue of deductibles.

OIG Position

We can consider the management decision when we are advised of the final action date for completing a review of the questioned deductibles and issuing instructions to the management companies/borrowers to take corrective action. We also need the estimated date when the proposed Administrative Notice will be issued.

For final action, the Agency needs to issue the proposed Administrative Notice and complete the review to assure the deductibles are currently in accord with Agency requirements. This includes completing the necessary servicing actions to achieve compliance for those management companies/borrowers still having excessive deductibles.

[20] Management Alert No. 04601-5-KC, dated September 19, 2001.

RECOMMENDATION NO. 2

Instruct servicing officials to determine if the 33 projects found in MFIS without Rural Development listed as the mortgagee in the projects' insurance policies are properly insured including taking appropriate actions to ensure Rural Development is properly listed as mortgagee on these insurance policies.

RHS Response

RHS officials advised that the Agency has provided us with a copy of 33 projects without Rural Development listed as mortgagee. It should be noted that the Agency did not receive a copy of the insurance policy in question, so the current binders were provided.

OIG Position

We accept the management decision. In each of the 33 questioned cases, the Agency provided copies of insurance documents showing that the current coverage properly listed the Government as mortgagee. Therefore, we consider the action taken to constitute final action.

CHAPTER 2	MANAGEMENT COMPANY PRACTICES UNNECESSARILY INCREASED PROJECT INSURANCE COSTS AND PAYROLL TAXES

We found four of six management companies: (1) charged projects for workers' compensation and payroll taxes using estimated rates that were higher than the actual costs without reconciling the project charges to the actual costs incurred, (2) duplicated insurance coverages and expenses, and (3) did not take effective steps to reduce costs such as obtaining workers' compensation insurance policies that classified site managers at the most advantageous rate. In general, this occurred because RHS servicing officials were not aware of the existence of the overcharges because they had relied on the reports submitted by the management companies and required independent audits that did not expose the overcharges. These practices unnecessarily increased project expenses and in some cases, improperly increased management company revenue.

Loan resolutions and instructions require project funds to be used for purposes that will promote the loan purposes without jeopardizing loan collection or impairing the adequacy of the security.[21] Instructions require management agents to meet the needs of tenants, maintain the project, and provide sound and economical project operation.[22] State Directors are authorized to require borrowers to carry insurance of types and amounts necessary on real estate and property mortgaged to RHS.[23]

We identified questioned costs and opportunities for savings as follows.

	Improper Workers' Compensation Reimbursement	Unallowable or Duplicated Coverage	Excessive Payroll Tax	Total
Boyd	$181,398			$181,398
River City (RCMI) 1/		$1,828	$9,920	$11,748
Livingston (LV) 1/				
Life Style (LS)	**2/** $553			$553
Total				$193,699

1/ Information available at the management company was insufficient to allow us to determine the excessive costs resulting from charging coverage of management company staff because these costs were not itemized in the insurance policy.

2/ The questioned costs shown relate only to the two sample projects we tested. Since LS' projects were insured on the same workers' compensation policy, a similar condition existed for the management company's remaining 59 Minnesota RRH projects.

[21] Instruction 1930-C, exhibit B, XIII B 2 c (5).
[22] Instruction 1930.102.
[23] Instruction 1965.55.

FINDING NO. 2

WORKERS' COMPENSATION CHARGES WERE EXCESSIVE

Boyd and LS management companies charged projects for workers' compensation at rates higher than the actual cost and did not reconcile the amounts paid by the projects for workers' compensation with the actual cost of the workers' compensation insurance policy. This occurred because the management companies did not use the actual workers' compensation rates as provided in their insurance policies. As a result, Boyd overcharged its 308 RRH projects $181,398 for workers' compensation in 2000, and LS overcharged the 2 projects reviewed[24] $553 for workers' compensation in 1999 and 2000. Similar conditions existed for LS' other RRH projects, resulting in potential overcharges in excess of $14,000 for these 2 years based on their office procedures.

Instructions state when a project site employee is covered under the "umbrella" of the agent's insurance, the portion of (workers' compensation) premium attributable to a project site employee may be a project expense.[25] Instructions state "project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under agency regulations."[26] Workers' compensation policies include rates for each type of payroll classification based on the level of workers' compensation risk. For example, the maintenance classification is charged at a much higher rate than the clerical classification. Insurers review (audit) their workers' compensation policies after each policy year to determine the actual salary for each payroll classification experienced by their insureds. The "audit" does not result in changes to the policy rates but determines the amount of salary attributable to each classification.

a. Boyd overcharged projects for workers' compensation insurance by charging the projects for workers' compensation at rates higher than the actual cost for payroll of site management and maintenance employees. The projects also reimbursed Boyd at rates higher than the actual cost for any subcontractors' workers' compensation (in which the subcontractor did not have their own workers' compensation insurance).

   A Boyd official said they charge a flat 5 percent rate for workers' compensation for all employees, including resident manager, maintenance, custodial, etc., and they do not differentiate whether they are doing cleaning, maintenance, grounds, or office work. The official acknowledged workers' compensation should be charged at different rates, but contended that historically it has averaged out to be 5 percent.

[24] The sample projects were judgmentally selected based on location.
[25] Instruction 1930-C, exhibit B, XV B 2.
[26] Instruction 1930-C, 1930.106.

Boyd's projects have two workers' compensation general ledger accounts (workers' compensation expense and workers' compensation liability). Workers' compensation expense is an additional charge based on the payroll for site management and maintenance employees, like any other payroll tax. Workers' compensation liability tracks the amount of workers' compensation Boyd withholds from subcontractors who do not have their own workers' compensation insurance.

The yearend workers' compensation "audit" shows the 2000 premium was $205,573. A representative from Boyd confirmed all people, including subcontractors, site managers, maintenance, etc., were included on the 2000 workers' compensation policy. However, Boyd projects were charged about $415,427. This resulted in an overcharge to projects of $209,854 ($415,427 - $205,573).

To determine the portion of the overcharge attributable to the RRH projects (Boyd also managed non-RRH projects), we added the workers' compensation expense and liability accounts for the RRH projects and divided the sum by the total amount of workers' compensation paid by all projects. The percentage of workers' compensation attributable to the RRH projects was 86.44 percent. As a result, Boyd overcharged their RRH projects about $181,398 (86.44 percent times $209,854) for workers' compensation insurance in 2000.

The following table presents the workers' compensation expense and workers' compensation liability portion for RRH projects and non-RRH projects.

	RRH Projects	Non-RRH Projects	Total
WC Expense	$237,384.05	$38,596.40	$275,980.45
WC Liability	$121,717.98	$17,728.45	$139,446.43
Total	$359,102.03	$56,324.85	$415,426.88
Percent of Total	86.44	13.56	100.00

A Boyd official said Boyd charged the projects too much for workers' compensation in 2000 and concurred the overcharge was about $200,000. He said Boyd might have overcharged the projects for workers' compensation in 2001, but that information would not be available until the 2001 workers' compensation "audit" was completed. The official said Boyd had no formal or written procedures to reconcile workers' compensation.

b. LS' projects reimbursed the management company for site manager and caretaker workers' compensation. LS officials said they estimated the workers' compensation rate based on the workers' compensation "audit." LS charged projects in 1999 and 2000 based on the rate on the last workers' compensation "audit" (1998). An LS official said LS did not have written procedures reconciling project workers' compensation charges to the actual costs incurred.

We found that the workers' compensation rates charged by the insurer on the 1999 and 2000 policies were less than the 1998 rate. LS' owner said if the workers' compensation rate per the "audit" is less than the rate charged to the projects, the management company should refund the money back to the projects. As stated above, the workers' compensation "audit" does not change the rate, so LS was billing the projects at a higher than actual rate.

Along with not using the correct rate, LS did not take into account discounts that further reduced the workers' compensation rate. The 1999 and 2000 workers' compensation policies included various discounts and extra charges. When taking into account both the discounts and extra charges, there were net discounts of over 30 percent for both years, which were not passed on to the RRH projects.

We recomputed workers' compensation using the correct rates and discounts and determined the two projects[27] reviewed were overcharged a total of $553 for workers' compensation in 1999 and 2000. Based on our reviews, we believe similar conditions existed for each of LS' remaining 59 Minnesota RRH projects.

In addition, LS' site managers were not classified at the most advantageous rate to the projects. LS' site managers were classified as "9015", which was the same rate for performing maintenance and repair work. This rate did not reflect less risky site management duties including leasing and collecting rents. In comparison, we noted that other management companies classified their site managers as "9012", which was the same rate for leasing agents. For other management companies, we found the "9012" rate was seven times less than the "9015" rate. In addition, another rate (8742) which could be used includes collectors who are employees engaged in such duties away from the employer's premises. The "8742" rate was also about seven times less than the "9015" rate. The workers' compensation regulations essentially state:

> *If original payroll records do not disclose the actual payroll applicable to each classification, the entire payroll of the*

[27] Linder-Willson Villa and Cedardale South Apartments.

individual employee shall be assigned to the highest rated classification that represents any part of his or her work.

However, there is a Minnesota statute that states:

An insurer shall permit an employer to divide payroll among the rating classifications most closely fitting the work actually performed by each employee in a 4-hour block or more for purposes of premium calculation when the employer's records provided adequate support for a division. An insurer is not required to divide an employer's payroll unless the employer requests or demands that it do so and notifies the insurer of its election or desire to have its payroll divided.

A representative from the Minnesota Workers' Compensation Insurers' Association said insurance companies sometimes disregard the Minnesota statute due to the excessive time and paperwork it may require. The representative said payroll could be split between the workers' compensation classes if it was clear the management company kept track of it on the books. LS may meet this requirement because its accounting system already allocates payroll costs between site manager and cleaning, grounds, maintenance, and repair payrolls.

When we asked LS officials about the classification of site managers, officials said they classified site managers as "9015" because that was their interpretation of the workers' compensation insurance regulations. LS officials believed that since site managers also perform some maintenance duties, all their salary had to be classified as "9015." The officials said they contacted their insurance agent/company about splitting site managers between the different classification codes, but the request was denied.

We believe these cited management companies should develop written procedures to assure that estimated figures are reconciled to actual costs to ensure their projects are not overcharged in the future. In addition, since management companies are responsible for assuring costs are reasonable and necessary, LS should fully explore other opportunities to reduce rates charged to the projects for site managers.

RECOMMENDATION NO. 3

Instruct the responsible servicing officials to require the cited management companies to fully account for and recover the improper workers' compensation charges (including potential overcharges for 2001) for all their RRH projects and to establish written procedures to prevent similar overcharges in the future. Instruct the responsible servicing officials to have LS work with the current insurer or explore obtaining workers' compensation insurance from another company in order to minimize project costs for coverage of site managers.

RHS Response

The agency advised that a memorandum to the cited management companies addressing the issues raised would be sent by July 30, 2002.

OIG Position

We can consider the management decision after we receive evidence that the agency has billed the management companies for the unallowable costs. In addition, we need to be advised of the specific servicing actions to be taken along with timeframes for the management companies to complete the corrective actions. This includes working with the cited management company to obtain insurance as economically as possible. Where applicable, we need to be advised of actions taken or planned by management companies to prevent the noted conditions from recurring.

For final action, the Agency needs to issue the corrective instructions to the management company and obtain assurance the management companies have taken appropriate action. For the questioned monetary amounts, the Agency must complete actions on the disallowed costs.

FINDING NO. 3

PROJECTS IMPROPERLY PAID FOR INSURANCE COSTS RELATED TO THEIR PACKAGE INSURANCE POLICIES

RCMI and Livingston projects improperly paid for their management companies' fidelity insurance coverage because it was included in the projects' package insurance policies.[28] In addition, 11 Louisiana RCMI projects paid for duplicate fidelity coverage on project site employees because the projects purchased a separate fidelity bond in addition to the package fidelity coverage. Moreover, these RCMI projects paid duplicated general liability insurance costs because they were already included in the projects' package insurance policies. We attribute these conditions to the management companies not being aware that their insurance coverages overlapped and costs were duplicated. As a result, RCMI overcharged the 11 projects about $1,253 in 1999 and 2000 for general liability insurance and $575 in duplicated fidelity charges on project site employees in 2000. (There were insufficient records available at the management offices for us to determine the overcharges related to projects paying for fidelity coverage for management company staff because these costs were not itemized in the insurance policy.)

Instructions state "project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose

[28] Fidelity insurance coverage is designed to protect an employer against dishonest or fraudulent acts of employees, such as embezzlement, fraud, or theft of money.

authorized under agency regulations."[29] Instructions state the premium for a borrower's fidelity coverage on project site employees is a project expense.[30] The premium of a management agent's fidelity coverage for the agent's principals and employees will be the management agent's business expense.[31] In addition, management agreements for both management companies state the management agent agrees to furnish, at its own expense, fidelity coverage to the owner. (Note: Some Livingston project management agreements were missing the "at its own expense" phrase.)

a. Projects Paid Expense of Management Company - All Livingston projects and 11 RCMI projects paid for the management companies' fidelity coverage because it was included in the projects' package insurance policies. The projects paid the entire package premium. The actual amount of the improper project charges for this coverage was indeterminable, as the fidelity coverage premium was consolidated with other coverages.

   The Livingston president said he checked with the insurance agent about whether the fidelity coverage was on the management agent and/or project site employees. The insurance agent said the coverages were combined as part of the package policy. The president said in the past he had asked the insurance agent if any premium needed to be broken out of the package policy and paid by the management company, and the agent said no. The president said he planned to call his agent and see if an amount for the management company's fidelity coverage could be broken out for the policies.

b. Dual Fidelity Coverage - Eleven Louisiana RCMI projects paid for dual fidelity coverage on project employees because the projects purchased a separate fidelity bond in addition to their package fidelity coverage. All 52 RCMI projects maintained fidelity bond coverage through one insurance company. However, 11 projects insured through another insurance company had fidelity coverage included in their package policies. As a result, those 11 projects paid $575 in excess for duplicated fidelity coverage on project site employees in 2000.

   After confirming the duplicated coverage with the insurance agent, an RCMI management company official said he would look into removing the fidelity portion from the second insurance company's policies.

c. Duplicated Charges for General Liability – RCMI's Louisiana projects reimbursed the management company monthly for site manager workers' compensation.[32] During 1999 and 2000, the Louisiana

[29] Instruction 1930-C, 1930.106.
[30] Instruction 1930-C, exhibit B, XV A 12.
[31] Instruction 1930-C, exhibit B, XV A 13.
[32] RCMI bears the costs of workers' compensation for its Mississippi projects (per a Mississippi State Administrative Notice).

projects reimbursed RCMI for workers' compensation at a higher rate than the actual cost. An RCMI official explained both workers' compensation and general liability insurance were included in the increased rate in order for projects to reimburse RCMI for the general liability insurance it had paid for.

However, 11 projects had already paid for general liability insurance because it was included in the projects' package insurance policies. As a result, RCMI overcharged those 11 projects about $1,253 in 1999 and 2000 for coverage already provided under its general liability insurance policy.

RECOMMENDATION NO. 4

Instruct servicing officials to require the cited management companies to review their insurance coverages and eliminate any duplicated costs. Remind management companies to limit insurance charges to projects to only those amounts that are allowed under terms of the management agreement and instructions. Ensure the unallowable charges for insurance are properly refunded to the cited projects.

RHS Response

The agency advised that a memorandum to the cited management companies addressing the issues raised would be sent by July 30, 2002.

OIG Position

We can consider the management decision after we receive evidence that the agency has billed the management companies for the unallowable costs. In addition, we need to be advised of the specific servicing actions to be taken along with timeframes for the management companies to complete the corrective actions.

For final action, the Agency needs to issue the corrective instructions to the management companies and obtain assurance the management companies have taken appropriate action. In addition, the Agency must complete actions on the disallowed costs.

FINDING NO. 4

PROJECTS WERE OVERCHARGED FOR PAYROLL TAXES

RCMI charged 43 Louisiana projects for payroll taxes at a higher rate than its actual cost. According to an RCMI official, this occurred because they failed to properly adjust the fees charged to the properties. As a result, RCMI overbilled the projects about $9,920 for payroll taxes in 1999 and 2000.

Instructions state "project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under agency regulations."[33] The RCMI management plans generally stated that the agent will bill the project for gross payroll for the preceding month and for applicable payroll taxes, workers' compensation, general liability insurance, and any other related expenses/costs.

The Louisiana projects reimbursed RCMI monthly for site manager workers' compensation.[34] The Louisiana projects also reimbursed RCMI for manager salary and manager payroll taxes on the same invoices as workers' compensation.[35]

An RCMI official said payroll taxes were about 9.5 percent[36]; however, RCMI actually charged its projects 10 and 11 percent of manager salary in 1999 and 2000, respectively for payroll taxes. When we asked RCMI for support of the 10 and 11 percent markups of salary expenses actually charged, an RCMI official wrote in part, that:

> *In reference to managers' salary, the payroll tax rate is based on the current rate for Medicare, Social Security, and Federal and State unemployment taxes, with State unemployment taxes changing more frequently. It is apparent that the fees charged the properties were not properly adjusted for the changes that occurred at the beginning of this year. These rates are adjusted during the budget process, which we have just begun. We are usually finished with the budgets when we learn of any changes in our unemployment rate, which causes us to use estimates. We will address the fees charged and adjust them accordingly.*

RECOMMENDATION NO. 5

Instruct servicing officials to remind the cited management company to limit charges to projects to only those that are proper, provide a full reconciliation of State

33 Instruction 1930-C, 1930.106.
34 RCMI bears the cost of workers' compensation for Mississippi projects per a Mississippi Administrative Notice dealing with management fees.
35 Since payroll taxes are on the same invoices as workers' compensation, we also checked the payroll tax rates.
36 The payroll tax percentages actually incurred by RCMI for Louisiana projects for selected periods are shown below.

	2/1999 Percentage	12/1999 Percentage	12/2000 Percentage	2/2001 Percentage
Social Security	6.20	6.20	6.20	6.20
Medicare	1.45	1.45	1.45	1.45
Federal Unemployment Tax (FUTA)	.80	.80	.80	.80
State Unemployment (SUI)	.73	.73	.91	.43
Total	9.18	9.18	9.36	8.88

In performing our calculations, we used the yearend managers' salaries and payroll taxes as reported by the management company. We estimated the payroll taxes for each project using rates of 9.20 and 9.40 percent for 1999 and 2000, respectively and considered the difference to be questioned costs. (Since we did not attempt to identify every rate in effect for the period, we used the 9.20 and 9.40 rates to arrive at a conservative estimate of the overcharge.)

unemployment taxes charged projects compared to expenses actually incurred, develop written procedures to prevent future overcharges, and return the improper charges to the projects.

RHS Response

The agency advised that a memorandum to the cited management companies addressing the issues raised would be sent by July 30, 2002.

OIG Position

We can consider the management decision after we receive evidence that the agency has billed the management company for the unallowable costs. In addition, we need to be advised of the specific servicing actions to be taken along with timeframes for the management company to complete the corrective actions.

For final action, the Agency needs to issue the corrective instructions to the management company and obtain assurance the management company has taken appropriate action. In addition, the Agency must complete action on the disallowed costs.

CHAPTER 3	INSURANCE CLAIM PROCESS DID NOT FOLLOW REGULATIONS

FINDING NO. 5

All six management companies we reviewed did not properly account for insurance claims according to instructions. For example, indemnity checks were not jointly payable to Rural Development and not timely deposited into project accounts. In general, these conditions occurred because Rural Development servicing officials were not aware of the claims or did not stress that management companies were to keep them informed of insurance matters. As a result, RRH projects were subjected to increased risk of not being properly indemnified for insured losses. All of the indemnity funds that we selected for verification had been ultimately deposited into project bank accounts or used to repair the project.

Instructions require borrowers to immediately notify servicing officials of any loss or damage to insured property.[37] Servicing officials are to collect the amount of the loss, and loss proceeds are to be made payable jointly to Rural Development and the borrower.[38] Indemnity checks are to be deposited in a supervised bank account to be used in repairing or replacing the damaged building.[39] Loss payments are to be deposited in a supervised bank account so that all repairs and replacements done by or under direction of the borrower, or by contract, will be planned, performed, inspected, and paid for in the same manner as improvements financed with loan funds.[40]

From our review of project insurance policies, we found the mortgage clauses readily identified Rural Development as the mortgagee for the six management companies. However, the manner in which the insurance claims and/or indemnities were handled by the management companies did not follow instructions as the management companies did not keep servicing officials informed of insurance matters. Details are:

a. River City Management did not notify Rural Development servicing officials of the $46,910 fire loss at Bayou Teche Apartments. Servicing officials first learned of the loss when the management company wanted to withdraw funds from the reserve account to pay for the completed repairs. In addition, servicing officials did not have the opportunity to countersign the $46,910 indemnity check because the check was not issued jointly payable to Rural Development by the

[37] Instruction 426.1, V A.
[38] Instruction 426.1, V B 1 and 2.
[39] Instruction 426.1, V B 3.
[40] Instruction 426.1, V B 6.

insurance company. From our review of RCMI's claims, we found seven indemnity checks totaling $60,676 (including the Bayou Teche check) from four different insurance companies were not jointly payable to Rural Development.

b. Livingston did not notify Rural Development servicing officials of the $41,432 fire loss at Park Place Apartments. Servicing officials first learned of the loss "by accident during a casual drive by." In addition, servicing officials did not have the opportunity to countersign the two indemnity checks totaling $41,432, as the checks were not issued jointly payable to Rural Development by the insurance company. On December 10, 1998, Rural Development informed Livingston officials that it had found it was not shown jointly payable on indemnity checks, as it should have been since Rural Development was the mortgagee. Livingston provided records showing the funds had been used to repair the projects.

   Management company officials said they generally notify Rural Development of insurance claims, except for an instance or two where they may not have.

   We noted there were delays (from 2 to 8 months) in the deposit of five indemnity checks. Management company officials said they sometimes waited until the damage was repaired before cashing the indemnity check.

c. SMR and LS officials said they did not always inform Rural Development officials of insured losses. SMR sometimes waited until repairs were completed before sending indemnity checks to Rural Development for countersignature to be deposited into project accounts. Two SMR indemnity checks totaling $27,558 and two LS indemnity checks totaling $2,707 were not jointly payable to Rural Development, but the checks were deposited into project accounts. Four indemnity checks from another insurance company to LS' Countryside Estates totaling $6,152 were made payable to the project owner and Rural Development. However, only the owner endorsed and deposited the checks. The owner subsequently wrote another check to the project for $6,152, which was deposited into a project account.

d. Two Boyd indemnity checks totaling $9,546 and two United indemnity checks totaling $9,580 were not made jointly payable to Rural Development but were deposited into project accounts. This occurred because United's insurance agent said it was company policy not to list Rural Development on small indemnity checks even though it was shown in the mortgagee clause of the policy. As a result, RRH projects were subjected to increased risk of not being properly indemnified for insured losses.

We believe these instances of non-compliance with the instructions covering the handling of insurance proceeds result in reduced RHS oversight over funds belonging to projects and could allow the funds to be used for unauthorized purposes.

RECOMMENDATION NO. 6

Require servicing officials to remind the cited management companies to (1) promptly report all insurance losses in order to allow servicing officials to review loss adjustments and indemnities, (2) ensure indemnity checks are made jointly payable to Rural Development, and (3) promptly deposit loss payments immediately in projects' supervised accounts.

RHS Response

The agency advised that a memorandum to the cited management companies addressing the issue raised would be sent by July 30, 2002. The response cited an agency regulation and noted that RHS was only required to deposit funds in a supervised bank account for amounts of $1,000 or more.

OIG Position

We accept the management decision.

For final action, the Agency should provide its instructions to the cited management companies and follow its internal procedures for reporting final action.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Finding No.	Description	Amount	Reference
1	Excessive Deductibles Did Not Protect Government's interests	$15,500,000	1/
2	Projects Overcharged For Workers' Compensation	$181,951	2/
3	Projects Improperly Charged Insurance Expenses	$1,828	2/
4	Projects Overcharged For Payroll Taxes	$9,920	2/

1/ Funds to be put to Better Use – Management or Operating Improvements/Savings.

2/ Questioned Costs, Recovery Recommended.

EXHIBIT B – SITES VISITED AND CONTACTS MADE

SITES VISITED

Rural Development State Office	- Raleigh, NC
Rural Development Area Office	- Florence, SC
Rural Development Area Office	- Lafayette, LA
Rural Development Area Office	- Faribault, MN
Boyd Management	- Columbia, SC
United Management	- Fayetteville, NC
River City Management, Inc.	- Breaux Bridge, LA
William C. Smith Insurance Agency	- Baton Rouge, LA
Livingston Management, Inc.	- Baton Rouge, LA
Security Management & Realty	- North Mankato, MN
Life Style, Inc.	- Owatonna, MN

CONTACTS

Rural Development State Office	- Columbia, SC
Rural Development State Office	- Alexandria, LA
Rural Development State Office	- St. Paul, MN
Broker A	
Kiser Commercial Agency	- Riviera Beach, MD
American Rural Housing Insurance Agency	- Winter Park, FL
Employee Benefits & Insurance Services	- Mankato, MN
Louisiana Department of Labor	- Baton Rouge, LA
MN Workers Compensation Insurers' Association	- Edina, MN

EXHIBIT C – RHS RESPONSE TO THE DRAFT

USDA

JUL 1 8 2002

United States
Department of
Agriculture

Rural Development

Operations and
Management

Washington, DC
20250

SUBJECT: Official Draft - Rural Housing Service, Rural Rental Housing Program Servicing of Insurance Expenses - Phase III (04601-005-KC)

TO: Richard D. Long
Assistant Inspector General
for Audit
Office of Inspector General, USDA

Attached is a memorandum dated July 5, 2002, along with a copy of a draft Administrative Notice (to address the issue of deductibles), from the Deputy Administrator, Multi-Family Housing, concerning recommendations 1, 2, 3, 4, 5, and 6 in the above subject audit.

This response is being submitted for your consideration to reach management decision.

If you have any questions, please contact Rochelle Diamond of my staff on 692-0077.

SHERIE HINTON HENRY
Director
Financial Management Division

Attachment

USDA

United States Department of Agriculture
Rural Development

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

JUL - 5 2002

TO: Leroy Jones
Acting Director
Financial Management Division

FROM: Obediah G. Baker, Jr.
Deputy Administrator
Multi-Family Housing

SUBJECT: Audit Report 04601-5-KC
Rural Rental Housing Program Insurance Expenses – Phase III

This memorandum is submitted to reach management decision on the recommendations of Audit 04601-5-KC.

RECOMMENDATION NO. 1
OIG POSITION:

Instruct servicing officials to review the cited projects' insurance policies to determine if deductibles are excessive. Take appropriate servicing action to ensure any excessive deductibles are reduced to the required levels and instruct servicing officials to fully document the decisions.

AGENCY RESPONSE:

On January 7, 2002, the Agency sent to the servicing officials a memo requesting information regarding the cited projects' insurance policies. Under separate cover, the documentation was submitted to OIG.

The Agency, also, plans to issue an Administrative Notice (AN) to address the issue of deductibles. Attached is a draft copy.

RECOMMENDATION NO. 2
OIG POSITION

Instruct servicing officials to determine if the 33 projects found in MFIS without Rural Development listed as the mortgagee in the projects' insurance policies are properly insured including taking appropriate actions to ensure Rural Development is properly listed as mortgagee on these insurance policies.

AGENCY RESPONSE:

Under separate cover, the Agency has provided OIG with a copy of 33 projects found in MFIS without Rural Development listed as mortgagee. It should be noted that the Agency did not receive a copy of the insurance policy in question, so the current policy binders were provided.

RECOMMENDATION NO. 3
OIG POSITION

Instruct the responsible servicing officials to require the cited management companies to fully account for and recover the improper workers' compensation charges (including potential overcharges for 2001) for all their RRH projects and to establish written procedures to prevent similar overcharges in the future. Instruct the responsible servicing officials to have LS work with the current insurer or explore obtaining workers' compensation insurance from another company in order to minimize project costs for coverage of site managers.

AGENCY RESPONSE:

A memorandum to the cited management companies addressing the issues raised will be sent by July 30, 2002.

RECOMMENDATION NO. 4
OIG POSITION

Instruct servicing officials to required the cited management companies to review their insurance coverages and eliminate any duplicated costs. Remind management companies to limit insurance charges to projects to only those amounts that are allowed under terms of the management agreement and instructions. Ensure the unallowable charges for insurance are properly refunded to the cited projects.

AGENCY RESPONSE:

A memorandum to the cited management companies addressing the issues raised will be sent by July 30, 2002.

RECOMMENDATION NO. 5
OIG POSITION

Instruct servicing officials to remind the cited management company to limit charges to projects to only those that are proper, provide a full reconciliation of State unemployment taxes charged projects compared to expenses actually incurred, develop written procedures to prevent future overcharges and return the improper charges to the projects.

AGENCY RESPONSE:

A memorandum to the cited management companies addressing the issues raised will be sent by July 30, 2002.

RECOMMENDATION NO. 6
OIG POSITION

Require servicing officials to remind the cited management companies to (1) promptly report all insurance losses in order to allow servicing officials to review loss adjustments and idemnities, (2) ensure idemnity checks are made jointly payable to Rural Development, and (3) promptly deposit loss payments immediately in projects' supervised accounts.

AGENCY RESPONSE:

A memorandum to the cited management companies addressing the issue raised will be sent by July 30, 2002. It should be noted that RD Instruction 426.1 V B 3 a, states:

a A loss draft which in the opinion of the County Supervisor represents a satisfactory adjustment of the loss will be endorsed immediately without recourse (see RD Instruction 1951-B) and deposited in a supervised bank account to be used in repairing or replacing the damaged building, except:

> *(1) When the amount of the loss is $1,000 or less and the borrower will use the funds for repairing or replacing an essential building, the loss draft may be endorsed without recourse and given to the borrower upon satisfactory proof that the repairs or replacements have been made, or upon satisfactory assurance that the work will be performed.*

Therefore, we are only required to deposit funds into a supervised bank account for amount of $1,000 or more.

If you have any questions or concerns, please contact Janet Stouder, Deputy Director, Multi-Family Housing Portfolio Management Division at 720-9728.

ABBREVIATIONS