U.S. Department of Agriculture
Office of Inspector General
Washington, D.C. 20250

DATE: July 2, 2009

REPLY TO
ATTN OF: 04703-1-KC

TO: Dallas Tonsager
Under Secretary
Rural Development

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Single-Family Housing Direct Loans Recovery Act Controls (3)

The American Recovery and Reinvestment Act of 2009 (Recovery Act) included $1 billion for the Rural Housing Service (RHS) to provide single-family housing direct loans to borrowers.[1] Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of funds. Further, on February 18, 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.[2] As of June 23, 2009, Rural Development had obligated approximately $156 million in direct loans to 1,209 very-low and low income borrowers.

RHS, an agency within the Rural Development mission area, is responsible for distributing Recovery Act funds through the Section 502 Single-Family Housing (SFH) Direct Loan Program.[3] These loans are available for very-low and low income households who cannot qualify for other credit to obtain homeownership. Applicants may obtain 100 percent financing to purchase an existing dwelling, purchase a site and construct a dwelling, or purchase newly constructed dwellings located in rural areas.

Our role, as mandated by the Recovery Act, is to oversee agency activities and to ensure agencies expend funds in a manner that minimizes the risk of improper use. During this initial phase, we reviewed management controls that ensure Rural Development field offices have sufficient and competent staff to timely and properly process the increase of Section 502 direct loans due to the additional funding provided by the Recovery Act. We determined that State offices are not fully utilizing funds for administrative costs provided by the Recovery Act to mitigate staff shortages. We also found areas where Rural Development could better optimize

[1] The American Recovery and Reinvestment Act, H.R. 1, was signed into law by President Obama on February 17, 2009.
[2] *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, April 3, 2009.
[3] Section 502 direct loans are authorized by title V of the Housing Act of 1949 under Section 502. 7 CFR Part 3550 provides the policies for the SFH Direct Loan Program.

the use of current field office staff. This memorandum is one in a series that will report on our oversight activities regarding SFH direct loans. Issues identified in these memoranda will be compiled into a final report at the conclusion of our audit.

To accomplish our overall objectives, we assessed the program's policies and procedures, as well as its internal controls.[4] Agency officials followed this guidance to process Section 502 direct loans obligated under the Recovery Act. To meet this specific objective, we interviewed Rural Development National Office officials, program directors, housing specialists, and housing technicians in the Missouri and Kansas State offices to obtain their comments on the current resources available to handle the additional funds for Section 502 direct loans. We accompanied a State SFH Program Director as he performed his scheduled State Internal Review (SIR) in two sub-area offices.[5] We also discussed Rural Development's use and oversight of the funding for administrative costs provided by the Recovery Act. In addition, we reviewed Rural Development's American Recovery and Reinvestment Act Implementation Plan (Recovery Act Plan) for its SFH Direct Loan Program.

Rural Development's SFH Direct Loan Program has almost doubled due to the $1 billion in funds it received from the Recovery Act for fiscal years 2009 and 2010. In its Recovery Act Plan, Rural Development reported that the number of field staff administering the SFH Direct Loan Program has declined making timely delivery of the additional funds a challenge for area offices. Missouri State Office officials told us they lost 7 of 65 SFH staff positions since October 2006; officials from Kansas said they lost 13 of 37 similar positions in the same timeframe. According to the State Office officials, this was due to overall budget reductions and greater emphasis placed on the delivery of business and community loans, and guaranteed loans over recent years.

In the Missouri and Kansas State offices, officials we interviewed also foresee difficulties in processing the direct loans funded by the Recovery Act due to the shortage of qualified, experienced staff. They are concerned about the potential for backlogs of loans waiting to be processed, the loss of customers due to untimely delivery of services, employee burn-out from working too many hours, and the overall quality of loan-making decisions. Rural Development's Recovery Act Plan further stresses that the lack of personnel could threaten effective disbursement of the Recovery Act funds.

We discussed potential remedies to staff shortages with Rural Development officials in the Missouri and Kansas State offices. We found that (1) neither State has implemented an effective plan to use the available administrative funding provided by the Recovery Act to mitigate staffing concerns, and (2) duties assigned to field office personnel could be redirected to optimize the use of current staff resources. Addressing these issues could assist Rural Development in timely processing Section 502 direct loan applications to effectively deliver the Recovery Act funds.

[4] Rural Development Handbook HB-1-3550, Direct Single Family Housing Loans and Grants, Field Office Handbook, dated January 23, 2003, and associated Special Procedural Notices.
[5] According to Section 2006.609 of RD Instruction 2006-M, dated May 19, 2004, SIRs are comprehensive evaluation reviews of the delivery of program and administrative functions in field offices and centralized program functions within a State. The SIR occurs at each field office at least once every 5 years.

Use of Funding for Administrative Costs

One potential remedy to staff shortages is the effective use of Recovery Act funds allocated for administrative expenses. The Recovery Act authorized Rural Development to utilize up to 3 percent, or approximately $130.8 million of its total $21 billion in program funds, to cover related administrative expenses. This funding can be used to contract for services, travel, and purchase computer or communications equipment. It can also be used to hire additional personnel to administer the SFH Direct Loan Program. As of June 11, 2009, however, Rural Development had only allocated to State offices and agency administrators about $15.5 million (less than 12 percent) of the approximately $130.8 million authorized for administrative costs. National office officials told us they were holding the remaining $116.5 million (about 88 percent) in reserve for future requests.[6]

The Kansas State office received $212,000 and the Missouri State office received $430,000 for administrative costs associated with distributing Recovery Act loans. As of June 24, 2009, Missouri had spent only $14,000, or about 3 percent (mostly on overtime and travel expenses), and Kansas had not spent any of its allocation. This was primarily because neither State office had been required to develop or implement a plan for utilizing these funds that would mitigate staffing concerns and ensure Recovery Act direct loans would be timely and properly processed. Officials in both State offices told us that the real demand is for more experienced and skilled field staff to originate and process loans. Although National Office officials budgeted almost half (46 percent) of the total administrative costs for hiring temporary Federal employees and other contractor services, such as loan packaging, Missouri and Kansas officials do not believe these are viable options.

State officials told us that hiring and training new staff is not a good option because of the time needed to announce the jobs, interview candidates, process the job offers, do background checks, and train new staff. Coordinating this lengthy process would also take valuable time away from experienced staff desperately needed in the field. Further, they worry that newly trained staff would not be experienced enough to make quick decisions on loan eligibility. Missouri and Kansas officials also contend that contracting for services is not optimal. They explained that by the time a contract is let, security procedures are met, and the staffs are trained, especially in all the facets of loan packaging, the Recovery Act monies would already be spent. As noted above, as of June 25, 2009, we were told that the Kansas State office had not spent any of the administrative funds. The Missouri State Office was in the process of hiring one temporary administrative staff at about $25,000 and working on hiring one retired annuitant. Neither State was satisfied that they had an effective plan to mitigate the staff shortages, and neither had received any guidance from the National Office on a viable solution.

We discussed the States' use of the 3 percent allocation with Rural Development National Office officials on June 11, 2009. National Office officials provided us with copies of the guidance they issued to States and agency administrators to track and reconcile the Recovery Act administrative funds. State directors and agency administrators are instructed to monitor obligations and ensure the funds are being effectively utilized within the limits provided by the Recovery Act. National Office officials stated that the program is in its infancy and very little of the 3 percent administrative cost allocation has been expended to date, although a process is in

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[6] In a memo from the Acting Undersecretary dated April 20, 2009, Rural Development allocated a total of $2 million to agency administrators and a total of $13.15 million to the States, leaving a balance of $116.5 million in reserve.

place for requesting additional funds. However, each State director and agency administrator assumes full control and responsibility for timely and effectively utilizing these funds.

In our follow-up discussion on June 26, 2009, with Rural Development, National Office officials recognized that effectively using the available administrative funds to mitigate staff shortages is critical. They added that the guidance they had provided to States in the past had only focused on the restrictions for using the administrative funds and tracking the expenditures in the financial systems. They agreed that Rural Development should get more involved in reviewing how the States plan on using the administrative funds and potentially provide additional guidance to State Offices. The National Office officials also emphasized that this issue raises a concern that relates to all Rural Development programs that received Recovery Act funding, and States should provide a comprehensive plan for using their administrative funds. Although we are only addressing the Section 502 Direct Loan Program in this memorandum, we agree this is a cross-cutting issue. Since it may affect several Rural Development programs, we also agree the appropriate resolution may be addressed on a more comprehensive basis.

Efficient Use of Field Office Staff Resources

A second remedy to mitigate staff shortages is to optimize the use of current field office staff by reviewing and redirecting the workflow. For example, Rural Development officials in both Missouri and Kansas told us that experienced field staff spend a great deal of time on general tasks such as scanning and shredding guaranteed loan files, when their time could be better spent on processing new Section 502 direct loans under the Recovery Act. State officials explained that guaranteed loan files are scanned in order for Rural Development's Centralized Servicing Center (CSC) to have immediate access to the pertinent information needed to process loss claim requests from the lenders. After the files are scanned and sent to CSC, field office personnel must shred and dispose of any supporting paper files due to the personal information they contain and because space in the field offices is limited.

Specifically in Missouri, one area program coordinator (APC) along with the program technicians in four other area offices are responsible for scanning and shredding the guaranteed loan files for all 6 area and 22 sub-area offices. With the increase in the number of direct and guaranteed loans to be processed due to Recovery Act funding, only the APC is currently scanning guaranteed loan files and a backlog is growing. In Kansas, there are 10 program technicians in 5 area offices whose duties include scanning and shredding guaranteed loan files. According to Kansas and Missouri State Office officials, the scanning and shredding takes valuable time away that the program technicians would normally spend on preparing the paperwork needed for the loan specialists to review and approve direct loans.

Even before the Recovery Act funding, these field office personnel were unable to keep up with the mounting number of guaranteed loan files to be scanned. During site visits to two field offices in Missouri, we noticed large backlogs of guaranteed loan files that needed to be scanned and sent to CSC, and other large piles of previously scanned guaranteed loan files that still needed to be shredded. Kansas State office officials also told us that statewide there is a backlog of thousands of guaranteed loan files to be scanned and shredded from prior fiscal years. With the Recovery Act providing an additional $10.5 billion in funding for Section 502 guaranteed loans, this problem will only be exacerbated.

According to Missouri and Kansas State Office officials, scanning a file can take about 15 to 20 minutes at a field office, but CSC can use high speed scanners to scan two files per minute.

Rural Development officials in both Missouri and Kansas agreed that sending the guaranteed loan files to CSC for scanning and shredding would free up considerable time in the field that could be devoted to the delivery of new Section 502 direct loans.

When we discussed this issue with Rural Development National Office officials on June 4, 2009, the officials agreed that the shredding and scanning of SFH loan files is a problem that needs to be resolved. Some initial discussions had taken place in the past year; however, no formal corrective actions have been put into place to address the situation. In our follow-up meeting on June 26, 2009, National Office officials agreed that the scanning and shredding of guaranteed loans in State area and sub-area offices would be reviewed and addressed. The Rural Development officials also agreed to review and consider other creative approaches to optimize the use of current staff resources and provide guidance to State and field offices.

With its current staffing, Rural Development's Section 502 Direct Loan Program is challenged to meet increased loan processing needs created by the Recovery Act. Without action, the current Rural Development field office staffs may be unable to timely and accurately process these loans, which could lead to incorrect loan approvals, incorrect loan rejections, employee burnout, and untimely service to borrowers. It also threatens effective implementation and possible loss of Recovery Act funds.

We therefore recommend that the Undersecretary of Rural Development:

> Require State offices to develop and implement an effective plan to use the available administrative funding that ensures Recovery Act Section 502 direct loans will be timely and properly processed.
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> Monitor and ensure State offices utilize the administrative funds in accordance with their State plan to mitigate staff shortages and timely and properly deliver Section 502 direct loans.
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> Consider additional ways to optimize the use of current staff resources and provide guidance to State offices.

Please provide a written response within 5 days outlining your proposed corrective action for this issue. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Steve Rickrode, Audit Director, Rural Development and Natural Resources Division, at (202) 690-4483.

United States Department of Agriculture
Rural Development
Office of the Under Secretary

July 10, 2009

TO: Robert W. Young
Assistant Inspector General
for Audit

ATTN: 04703-1-KC

FROM: Dallas Tonsager /S/ Timothy McNeilly (for)
Under Secretary
Rural Development

SUBJECT: Single-Family Housing Direct Loans Recovery Act Controls (3)

This is in response to your audit memorandum of July 2, 2009, regarding recommendations associated with the American Recovery and Reinvestment Act of 2009, P.L. 111-5 (the Recovery Act) activities (Document 04703-1-KC). In particular, your memorandum addresses the Single-Family Housing (SFH) Direct Loan Recovery Act program, and includes recommendations that impact Rural Development beyond just the SFH program. I appreciate your observations and recommendations, as RD is committed to assisting rural Americans in quickly reviving our economy. Our efforts are aimed at providing benefits to our clients in an expeditious while transparent manner, as required by the Recovery Act.

As indicated in your memorandum, Rural Development has issued initial guidance on the appropriate use of Recovery Act administrative funds to the National Office and states. In addition, Rural Development has also established processes that permit National Office and states to request additional administrative funds based upon detailed written justifications that comply with the requirements of the Recovery Act. Those materials have previously been provided to the Office of the Inspector General (OIG).

On April 21, 2009, Rural Development provided $21.15 million in start-up funds to the National Office and states for immediate investments related to administrative recovery activities. Each state was provided with an initial allocation based upon staffing levels, and each National Office Program Area was allocated $2 million in initial operating funds for critical implementation activities. These amounts have been provided to the various operating units for immediate implementation of the most critical Recovery Act needs.

Rural Development leadership remains actively involved in ensuring that Recovery Act program funds are obligated and expended in an appropriate and timely manner. This includes effectively using the three percent administrative set-aside in the Recovery Act appropriations language to facilitate the mission areas' in delivering program funds to rural Americans. That set-aside is only a modest portion of administrative funds that are being invested in delivering related program dollars. Recovery Act costs related to permanent staffs are not being charged against recovery activities, as regular full-time activities are funded under the Omnibus Appropriations Act, 2009 P.L. 111-8 passed March 11, 2009.

In your memorandum of July 2, 2009, OIG included the following recommendations for Rural Development:

1. Require State Offices to develop and implement an effective plan to use the available administrative funding that ensures Recovery Act Section 502 direct loans will be timely and properly processed.

2. Monitor and ensure State Offices utilize the administrative funds in accordance with their State Plan to mitigate staff shortages and timely and properly deliver Section 502 direct loans.

3. Consider additional ways to optimize the use of current staff resources and provide guidance to State Offices.

Rural Development leadership is implementing the following initiatives relative to Recovery Act programs:

1. State Offices will be directed to develop internal spending plans regarding the initial allocation of Recovery Act administrative funds. In general, those initial allocations are intended to cover over-time and other initial costs. Implementation of those plans will be the responsibility of the State Directors. However, Rural Development will ensure that Recovery Act administrative funds are properly managed and documented, in accordance with the Recovery Act. Any requests for additional funding related to Recovery requirements will need to be justified in writing though the existing request process.

2. Rural Development will provide additional guidance to the National Office and states in August 2009, related to procurement, hiring, and information technology activities for Recovery Act activities.

3. State Offices will be contacted regarding the need to strategically deploy existing and temporary employees to maximize effective delivery of Rural Development programs. To the maximum extent possible, state personnel will focus on program delivery while temporary employees will provide support functions.

Again, I want to thank you and the OIG staff for your recommendations regarding Recovery Act funding. We look forward to working closely with OIG to ensure that Recovery Act program dollars are deployed in an efficient and effective manner.

If you have any questions regarding this memorandum, please contact Lorenzo Rasetti, Director, Budget Division, at (202) 692-0122.