



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



DATE: May 28, 2010

REPLY TO
ATTN OF: 04703-2-KC (2)

TO: Dallas Tonsager
Under Secretary
Rural Development

FROM: Gil H. Harden
Assistant Inspector General /s/
for Audit

SUBJECT: Single-Family Housing Direct Loans Recovery Act Controls – Phase II

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. The Office of Management and Budget subsequently issued 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

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 that 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. As of May 18, 2010, RHS had obligated approximately \$883 million in direct loans to about 7,000 very-low and low income borrowers.

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 phase, we determined that Rural Development SFH Direct Loan Program controls could be improved to prevent weaknesses identified by State Internal Reviews (SIR) from recurring. This Fast report is the second in a series that will report on our oversight activities regarding SFH direct loans. Issues identified in these Fast reports will be compiled into a final report at the conclusion of our audit.

¹ The American Recovery and Reinvestment Act, Public Law 111-5, was signed into law on February 17, 2009. The program level increased to about \$1.56 billion due to changes in subsidy for fiscal year (FY) 2010.

² *Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, February 18, 2009, and *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*, April 3, 2009.

³ SFH Direct Loans are authorized by Title V of the Housing Act of 1949 under Section 502. 7 Code of Federal Regulations Part 3550 provides the policies for the SFH Direct Loan Program.

SIRs are comprehensive evaluation reviews, conducted by SIR teams comprised of State office personnel, of the delivery of programs and administrative functions in field offices and centralized program functions within the State.⁴ According to RD Instruction 2006-M, the SIR teams shall complete reviews of each field office and centralized program function at least once every 5 years.⁵ The purposes of SIRs include:⁶

- (1) Determining if policies and procedures for making and servicing loans/grants are being implemented according to Rural Development regulations, policies, and procedures;
- (2) Assessing the effectiveness of management controls to minimize the potential for waste, loss, unauthorized use, and misappropriation in field office operations; and
- (3) Identifying weaknesses in program and administrative operations with specific corrective actions for their elimination or reduction, including timeframes for completion.

The objective of our audit is to test the effectiveness of the key controls over the Recovery Act funded Section 502 SFH Direct Loan Program. To accomplish our objective, we tested the effectiveness of Rural Development's controls in addressing weaknesses identified during the SIRs. We obtained and reviewed the Nationwide SIR Summary Reports from fiscal years (FY) 2003-2008.⁷ From those reports, we compiled and analyzed the information for the SFH Direct Loan Program to identify trends. In addition, we interviewed officials at the Rural Development National Office and the Rural Development Financial Management Division (FMD) to discuss their roles in the SIR process.

Our audit identified trends in control weaknesses pertaining to the SFH Direct Loan Program. Program weaknesses continue to recur because the Rural Development National Office's management oversight process is not effective in correcting problems found during SIR reviews and preventing them from recurring. Specifically, neither Rural Development National Office nor FMD officials currently compile and analyze the Nationwide SIR Summary Reports to identify nationwide trends in control weaknesses from year to year, or to track the effectiveness of corrective actions. In addition, Rural Development National Office officials stated that nationwide training has not been directed to specifically target and correct SIR identified weaknesses. As a result, these weaknesses continue to recur in the SFH Direct Loan Program.

By December 31 of each year, each State Director is to submit a State SIR Summary Report of all SIRs conducted during the previous fiscal year to Rural Development FMD.⁸ A Nationwide SIR Summary Report of identified weaknesses is prepared annually by FMD and distributed to Rural Development National and State Office officials.⁹ When the Rural Development National Office officials receive the Nationwide SIR Summary Report, they utilize this information (1) to provide oversight and take corrective actions via the Management Control Review (MCR) process, (2) to provide National office training to the States, and (3) for onsite program visits to

⁴ RD Instruction 2006-M, 2006.601(e)(3) and 2006.603, dated May 19, 2004.

⁵ RD Instruction 2006-M, 2006.609(b)(1), dated May 19, 2004.

⁶ RD Instruction 2006-M, 2006.609(a), dated May 19, 2004.

⁷ The Nationwide SIR Summary Report for FY 2009 is scheduled to be released in July 2010.

⁸ RD Instruction 2006-M, 2006.609(h), dated May 19, 2004.

⁹ RD Instruction 2006-M, 2006.609(i), dated May 19, 2004.

individual States.¹⁰ However, neither Rural Development National Office nor FMD officials combine Nationwide SIR Summary Reports from multiple years and analyze those results to identify nationwide trends in control weaknesses over time or to track the effectiveness of corrective actions. Both Rural Development National Office and FMD officials stated that they had not considered using the Nationwide SIR Summary Reports for that purpose, but they agreed there was value in compiling that information over multiple years. FMD officials added that there is no requirement in RD Instruction 2006-M for that type of analysis to be conducted.

From our review of the Nationwide SIR Summary Reports from FY 2003-2008, we compiled and analyzed the information for the SFH Direct Loan Program to identify trends in the control weaknesses listed. The table below lists our analysis of recurring weaknesses in four key controls which were found during SIR reviews of Rural Development’s SFH Direct Loan Program from FY 2003-2008. The FY 2003-2005 Nationwide SIR Summary Reports did not document the specific number of States that had each problem (see “X” in the table). The

FY 2006-2008 reports did document the number of States that had each problem.¹¹

Weakness	2003	2004	2005	2006	2007	2008
Approved adverse credit exceptions/waivers not justified and/or documented	X	X	X	7	3	11
Annual, repayment, and/or adjusted incomes not verified, calculated, and/or documented properly	X	X	X	18	17	16
Eligibility Summary not always prepared properly, signed, and/or documented in files		X	X	7	10	11
Subsidy Repayment Agreement not always prepared properly and/or documented in files		X	X	9	9	10

FMD officials pointed out that while the overall weaknesses may recur in a subsequent year’s Nationwide SIR Summary Report, the weakness may be occurring in different States from year-to-year. Therefore, individual States may have taken corrective action to eliminate a SIR weakness; however, the weakness may have occurred in a different State in a subsequent year. For the four weaknesses identified above, we obtained a list of the States that had each weakness in 2007 and 2008. We found that the identified weaknesses did recur in a number of States. For example, 6 of the 16 States that identified annual, repayment, and/or adjusted incomes not verified, calculated, and/or documented properly in 2008 also reported the same weakness in 2007. However, we believe that if 10 new States are reporting that issue in 2008, it also represents a national concern.

¹⁰ The Nationwide SIR Summary Report is utilized by program officials in the MCR process for developing and updating review guide questions. The purposes of MCRs include determining if policies and procedures for making and servicing loans are being implemented as directed. MCRs are conducted on all assessable units within Rural Development on a 5-year cycle. The next review of field office operations for the Section 502 Direct Loan Program is scheduled for FY 2011.

¹¹ Rural Development has 47 State offices.

We discussed these issues with Rural Development National Office officials on January 27, 2010, and February 3, 2010, and with Rural Development FMD officials on February 4, 2010. According to FMD officials, the individual States and State Directors are primarily responsible for taking corrective actions on SIR identified weaknesses. They said that in accordance with RD Instruction 2006-M, officials in each State are to track and monitor their SIR weaknesses and take corrective actions to eliminate them. After seeing the table above on January 27, 2010, Rural Development National Office officials said they were concerned that the problems were not improving over time. When asked what led to the repetitive problems, Rural Development National Office officials stated that it is more than likely a training issue. They mentioned that Rural Development is dealing with limited training resources and said that training provided by the National office at the State and field office level has not been directed to specifically target and correct SIR identified weaknesses. They acknowledged that there is room for improvement with their training and the trend analysis and agreed trend analysis utilizing SIRs would be a good tool to track corrective actions to rectify weaknesses.

We recommend that the Rural Development National Office:

Develop and implement effective controls to ensure that actions taken correct weaknesses identified by SIRs and prevent issues from recurring. Revise RD Instruction 2006-M to require the analysis of Nationwide SIR Summary Reports over multiple years to identify trends. Utilize these analyses to direct training to State and field office staff.

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, Director, Rural Development and Natural Resources Division, at (202) 690-4483.

USDA'S

RURAL DEVELOPMENT'S

RESPONSE TO AUDIT REPORT



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

June 7, 2010

TO: Gil H. Harden
Assistant Inspector General for Audit

FROM: Dallas Tonsager /s/
Under Secretary

SUBJECT: Single Family Housing Direct Loans Recovery Act Controls –
Phase II 04703-2-KC (2)

This is in response to your memorandum dated May 28, 2010, in which you requested a response to a recommendation contained in the subject report. The recommendations resulted from your audit of the controls associated with Section 502, Single Family Housing (SFH) Direct Loan Program. The scope of your audit tested the effectiveness of Rural Development's controls in addressing weaknesses identified during State Internal Reviews (SIR) as reported in the Nationwide SIR Summary Report. In particular, your audit disclosed that corrective actions to eliminate SIR weaknesses were not always implemented effectively, and Rural Development did not currently compile and analyze SIR weakness trends from year-to-year.

The purpose of Rural Development's annual Nationwide SIR Summary Report is to identify SIR weaknesses occurring in multiple states. This report was designed to provide National Office Officials and State Directors with information regarding Nationwide weaknesses resulting from SIRs for the purpose of implementing corrective action, and to provide training to mitigate the weaknesses. While Rural Development has previously taken steps to establish controls and provide training, we acknowledge that instances of recurring weaknesses have occurred from year-to-year within the SFH Direct Loan Program.

Rural Development is in agreement with OIG that multiple-year analysis of SIR weaknesses may more clearly identify recurring weaknesses, and provide a mechanism for ensuring more effective implementation of corrective actions. The Financial Management Division (FMD) will perform this analysis on an annual basis, identify individual states with recurring weaknesses, and provide this information to the applicable Administrator and State Director for corrective action. FMD will also revise RD Instruction 2006-M, Management Control System, to require

1400 Independence Ave SW • Washington, DC 20250-0700
Web: <http://www.rurdev.usda.gov/>

Committed to the future of rural communities.

"USDA is an equal opportunity provider, employer and lender."
To file a complaint of discrimination write USDA, Director, Office of Civil Rights, 1400 Independence Avenue, S.W.,
Washington, DC 20250-9410 or call (800)795-3272 (voice) or (202) 720-6382 (TDD).

this annual multiple-year analysis of SIR weaknesses. The Single Family Housing Direct Loan Division will use the results of this analysis to work with the states to implement effective controls to eliminate recurring weaknesses, and provide necessary training, as appropriate.

If you have any questions regarding this memorandum, please contact the Single Family Housing Direct Loan Division at (202) 720-1474.