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Office of Inspector General

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

Audit Report 04703-2-KC
September 2010

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

DATE: September 24, 2010

REPLY TO
ATTN OF: 04703-2-KC

TO: Dallas Tonsager
Under Secretary
Rural Development

Tammye Trevino
Administrator
Rural Housing Service

THROUGH: John Purcell
Director
Financial Management Division

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

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

This report presents the results of the subject review. The report compiles the results of our work that we reported to you in four Fast Reports during the period May 28, 2010, to July 7, 2010. Excerpts of your responses, along with the Office of Inspector General's position, are incorporated into the report.

Based on your responses, we were able to reach management decision for all recommendations in the report. Please follow your agency's internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer. In accordance with Departmental Regulation 1720-1, all final actions need to be completed within 1 year of each management decision.

We appreciate the courtesies and cooperation extended to us by members of your staff during this audit.

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Executive Summary

The American Recovery and Reinvestment Act of 2009 (Recovery Act) was signed into law on February 17, 2009.[1] The purposes of the Recovery Act include preserving and creating jobs, promoting economic recovery, and assisting those most impacted by the recession. The Recovery Act included $1 billion for the Rural Housing Service (RHS) to provide single-family housing (SFH) direct loans to borrowers for fiscal years (FY) 2009 and 2010.[2] These loans are directly funded by the Government and are available for very-low and low income households that cannot qualify for other credit to obtain homeownership.[3] These loans are commonly referred to as Section 502 direct loans.

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.[4] According to guidance issued by the Secretary of Agriculture, agencies shall develop transparent, merit-based criteria that will guide their discretion in committing, obligating, or expending funds under the Recovery Act.

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. We are using a multi-phase approach in performing our review of the Recovery Act-funded Section 502 SFH Direct Loan Program. The objective of this first segment of our Phase II audit was to test the effectiveness of key controls over the Recovery Act-funded Section 502 SFH Direct Loan Program that we identified in Phase I of this audit.[5] We identified specific weaknesses in the key controls we tested over (1) detecting, reducing, and preventing improper payments; (2) preventing previously identified weaknesses from recurring; and (3) segregating key duties.

Based on those tests, we concluded that controls need to be strengthened to improve documentation supporting eligibility determinations and secondary reviews before loan approval in order to detect, reduce, and prevent improper loan payments to SFH direct loan applicants. We determined that Rural Development field personnel were not consistently documenting their final computations supporting borrowers' eligibility with current, updated information and were not required to document the scope and timing of their second party reviews in the loan files. As a result, Rural Development found that 9 of the 75 (12 percent) Recovery Act borrowers reviewed as part of their Improper Payments Information Act of 2002 (IPIA) Risk Assessment

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[1] Public Law 111-5.

[2] The program level increased to about $1.56 billion due to changes in subsidy rates for fiscal year 2010.

[3] Very-low income is defined as below 50 percent of the area median income (AMI), and low income is between 50 and 80 percent of AMI.

[4] *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.

[5] The objective of the second segment of Phase II will be to determine if Rural Development field staff complied with the agency's established internal control procedures at loan origination and closing to ensure program participants who received Recovery Act funds met eligibility guidelines. As part of the second segment of Phase II, we will be reviewing a statistical sample of Recovery Act loan files.

received improper payments. However, based on our assessment of the results of these reviews, we concluded that they could not be relied on for the purposes of this audit due to differences between the intended purposes of our review and Rural Development's IPIA Risk Assessment.

We also determined that Rural Development's SFH Direct Loan Program information technology system needed enhancements for Rural Development personnel to be able to detect, reduce, and prevent improper payments. We found data input errors and missing data in critical fields that prevented the effective use of data for compliance purposes. Needed enhancements include establishing system parameters/edit checks for data fields and capturing additional data in the system.

In addition, Rural Development needs to strengthen controls to prevent weaknesses identified by State Internal Reviews (SIR) from recurring. Program weaknesses continue to recur because the Rural Development National Office's management oversight process is not effective in correcting problems found during SIRs and preventing them from recurring. Specifically, neither Rural Development National Office nor Financial Management Division 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. As a result, these weaknesses continue to recur in the SFH Direct Loan Program.

Finally, we determined that Rural Development needs to monitor employee application access where duties cannot be effectively separated to decrease the risk of improper activity. We found weaknesses in controls involving authorizations to initiate, approve, obligate, and disburse loans that could allow possible improper activity in the Section 502 Direct Loan Program. We identified 149 Rural Development personnel that were given multiple access authorities in its mortgage servicing system who also had access to the loan origination system. This significantly increased the risk that improper activities and errors may go undetected in the SFH Direct Loan Program.

We issued four Fast Reports, two dated May 28, one dated June 15, and one dated July 7, 2010, to the Under Secretary for Rural Development. Rural Development responded in writing to the Fast Reports and generally agreed with the findings and conclusions.

Recommendation Summary

Rural Development needs to (1) strengthen controls to ensure borrower eligibility is updated and re-verified as part of loan closing based on the current information available and revise procedures to require Loan Approval Officials to document the scope and timing of their second party review of eligibility determinations, (2) develop and implement a plan to correct the data integrity and system design issues and develop and implement an automated review process to identify any SFH Direct Loan Program data irregularities for follow up, (3) develop and implement effective controls to ensure that actions taken correct weaknesses identified by SIRs and prevent issues from recurring, and (4) develop procedures and controls, utilizing existing capabilities, to monitor loan approval, obligation, and disbursement activities of users with multiple access authorities.

Agency Response

Agency national officials generally agreed with our findings and recommendations. The agency responses are posted on our website with the applicable Fast Report. The responses can be found at http://www.usda.gov/oig/recovery/recovery_reports.htm.

OIG Position

We agreed with the agency's proposed corrective actions and reached management decision on all recommendations in the report.

Background & Objectives

Background

The Rural Housing Service (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. These loans are directly funded by the Government and 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. Mortgage payments are based on the household's adjusted income.[6] These loans are commonly referred to as Section 502 direct loans.[7]

Rural Development's mission is to increase economic opportunity and improve the quality of life for all rural Americans. Rural Development has an $86 billion portfolio of loans and administers nearly $16 billion in program loans, loan guarantees, and grants through its programs each year. The Rural Development mission area administers the Section 502 SFH Direct Loan Program through the RHS National Office in Washington D.C., and its network of State, area, and local offices. RHS helps rural communities and individuals by providing loans and grants for housing and community facilities such as fire and police stations, hospitals, libraries, and schools. As of May 2010, the Section 502 SFH Direct Loan Program portfolio consisted of almost 332,000 loans with an unpaid balance of about $14.9 billion.

The RHS National Office is responsible for establishing policy, procedures, and internal controls for the program.[8] In the field, RHS operations are carried out through 47 State and 481 area and local Rural Development offices, which are responsible for issuing direct loans to borrowers. The Rural Development Centralized Servicing Center (CSC), located in St. Louis, Missouri, services or provides support to local servicing efforts for all RHS SFH loans.[9]

Section 502 direct loan applicants must have very-low or low incomes. Very-low income is defined as below 50 percent of the area median income (AMI), and low income is between 50 and 80 percent of AMI.[10] Families must be without adequate housing, but be able to afford the mortgage payments, including taxes and insurance, which are typically 24 percent of an applicant's adjusted income. Applicants must be unable to obtain credit elsewhere, yet have reasonable credit histories.

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[6] Adjusted income is used to determine whether a household is income eligible for payment assistance. It is based on annual income and provides for deductions to account for varying household circumstances and expenses such as child care expenses.

[7] Section 502 direct loans are authorized by Title V of the Housing Act of 1949 under Section 502.

[8] 7 Code of Federal Regulations Part 3550 provides the policies for the Section 502 SFH Direct Loan Program. *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 describe loan processing policies and establish procedures for originating Section 502 direct loans.

[9] CSC performs limited servicing for loans originated in Western Pacific territories.

[10] AMI is established by the United States Department of Housing and Urban Development. For example, if the AMI of a county was $36,600 for a family to two, then the upper limit is $18,300 to be considered very-low income.

Section 502 direct loans are financed for up to 33 years (38 for those with incomes below 60 percent of AMI and who cannot afford 33-year terms). RHS sets the promissory note interest rate based on the Government's cost of money. However, that interest rate is modified by payment assistance subsidies. Under this program, housing must be modest in size, design, and cost. Modest housing is property that is considered modest for the area, does not have market value in excess of the applicable area loan limit, and does not have certain prohibited features (e.g. in-ground swimming pools).

The Recovery Act included $1 billion for RHS to provide SFH direct loans to borrowers for FYs 2009 and 2010. The program level has since increased to about $1.56 billion due to changes in subsidy rates for FY 2010. As of August 18, 2010, RHS had obligated almost $1.17 billion in Recovery Act direct loans to about 9,200 very-low and low income borrowers.

Objectives

The objective of the first segment of our Phase II audit was to test the effectiveness of the key controls over the Recovery Act-funded Section 502 SFH Direct Loan Program. This report addresses the weaknesses we identified in the key controls over (1) detecting, reducing, and preventing improper payments; (2) preventing previously identified weaknesses from recurring; and (3) segregating key duties.

Section 1: Improper Payments

Finding 1: Rural Development Needs to Strengthen Controls to Detect, Reduce, and Prevent Improper Payments

From our review of Rural Development's Improper Payments Information Act of 2002 (IPIA) Risk Assessment review conducted in October 2009 and the corresponding loan files, we found that loan underwriting decisions were not based upon updated documentation in the loan files. Rural Development found that 9 of the 75 (12 percent) Recovery Act borrowers reviewed as part of their IPIA Risk Assessment received improper payments, and incomplete documentation was cited as a problem in 7 of the 9 cases.[11] Specifically, Rural Development field personnel were not consistently documenting their final computations supporting borrowers' eligibility with current, updated information. We also found that Rural Development Loan Approval Officials were not required to document the scope and timing of their second party reviews in the loan files. Second party reviews should have caught these improper eligibility determinations and prevented the loans from closing until the Loan Originator worked with the applicant to rectify the problems. As a result, we concluded that controls need to be strengthened to improve documentation supporting eligibility determinations and secondary reviews before loan approval in order to detect, reduce, and prevent improper loan payments to SFH direct loan applicants.

Borrower Eligibility Information Not Updated Prior to Loan Closing

Both the Office of Inspector General (OIG) and Rural Development found that loan underwriting decisions were not based upon updated documentation in the loan file. This included documentation supporting the borrower's income and debt or the property's tax and insurance amounts at the time of loan closing. These are the key items Rural Development field personnel use for determining if an applicant has adequate repayment ability.

According to Rural Development's Field Office Handbook for processing SFH direct loans, the primary consideration in determining whether an applicant can afford to purchase a home is the applicant's repayment income.[12] The Agency bases underwriting decisions on an analysis of the percentage of income the applicant would be required to spend on housing costs and the applicant's total debt if the loan is approved. The principal, interest, taxes, and insurance (PITI) ratio compares the amount the applicant must spend on these housing costs to the applicant's repayment income.[13] The total debt (TD) ratio compares applicant debt to repayment income.[14] Borrowers must meet the Agency's standards for both ratios, and these ratios are calculated on the Eligibility Summary document.

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[11] Based on our review of Rural Development's IPIA Risk Assessment, we determined the IPIA results would not be useful to estimate an error rate for our Phase II sample loan file reviews. Because of differences in the intended purposes of the reviews, we reached a different conclusion on 4 of the first 16 sampled IPIA Risk Assessment loan files. Therefore, we are not using the IPIA Risk Assessment error rate for our review.

[12] *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.

[13] Very low income applicants are considered to have repayment ability if they do not have to pay more than 29 percent of repayment income for PITI expenses. Applicants with incomes above the very low-income limit are considered to have repayment ability if they do not have to pay more than 33 percent of repayment income for PITI expenses.

[14] Applicants, regardless of income, are considered to have repayment ability when they do not have to spend more than 41 percent of repayment income on total debt.

OIG and Rural Development found that the loan files did not always contain a final Eligibility Summary and/or the corresponding Payment Assistance Method Calculation Spreadsheet with the correct income, debt, taxes, and/or insurance at loan closing.[15] The loan files contained those documents when the loan was approved/obligated, but those documents were not updated before loan closing. According to Rural Development's Field Office Handbook, the applicant's circumstances may have changed since loan approval/obligation and must be reviewed as part of closing preparations. After all reverifications have been completed, the Loan Originator will print out and sign a new Eligibility Summary and place it in the applicant case file.

Rural Development requires a checklist to be included in the loan file as a processing aid for field staff.[16] However, that checklist has been ineffective in ensuring that key information is updated, recalculated, and reviewed prior to loan closing. The checklist does not have a place for the Loan Originator to document that this information has been updated and reviewed at closing or for the Loan Approval Official to verify it has been done by the Loan Originator. We believe Rural Development should enhance the current checklist to include re-computing eligibility at/or near closing based on the current information available.

Scope and Timing of Second Party Reviews Not Documented

In our review of the loan files, we noted that the files did not always contain documentation of the scope and timing of second party reviews during the approval process. According to HB-1-3550, the Loan Approval Official should review all of the documents contained in the case file to ensure that they are completed properly and confirm that the Loan Originator's underwriting decision is sound. However, Rural Development's Field Office Handbook does not specify how the Loan Approval Official should document the scope and timing of that review and confirmation in the loan file.[17] Several States have developed forms and certifications for the review; however, there is no national procedure.

We believe the second party loan file review and approval process needs to be consistently documented in the loan file (1) as verification that the file contained all the current, updated information to justify the final eligibility computations and initial approval, and (2) as evidence the Loan Approval Official reviewed and verified that information when approving the loan. We believe Rural Development should develop and implement an approval checklist that includes space to re-compute eligibility, identify who updated key documents and when, along with space to identify who reviewed those documents and when.

In conclusion, we believe that strengthening these controls will help Rural Development detect, reduce, and prevent improper payments. We discussed these issues with Rural Development National Office officials on January 27 and February 3, 2010. They agreed with these issues and confirmed that there is no established procedure as to how Loan Approval Officials should

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[15] The Payment Assistance Method Calculation Spreadsheet is used to determine if a borrower is eligible for payment assistance. Payment assistance is an available subsidy that could reduce the monthly installment on the note to an amount equal to what it would be if the note were amortized to as low as 1 percent, depending on the loan amount and the size and income of the family.

[16] *Rural Development Handbook HB-1-3550*, Attachment 3-G, 502 Single Family Housing Checklist.

[17] Form RD 3550-25, Loan Closing Instructions and Loan Closing Statement, does have a place to indicate which Rural Development official verified the borrower's income and credit, but it does not indicate which documents that official reviewed, and when, to verify income and credit.

document the scope and timing of their second party reviews. They mentioned that they were in the process of developing an underwriting compliance tool to improve documentation and gain consistency in the underwriting process. According to Rural Development National Office officials, this tool will guide Loan Approval Officials to ask the right questions while reviewing a loan and to make sure all documents are in the file and are updated and signed before closing.

In its July 8, 2010, response to the Fast Report, Rural Development officials wrote that they generally agreed with the findings and conclusions on this issue, and they have begun working on an underwriting tool to address the concerns raised in this report.

Recommendation 1

Strengthen controls to ensure borrower eligibility is updated and re-verified as part of closing based on the current information available, as required by Field Office Handbook procedures. This could be accomplished by enhancing the loan file checklist to document who updated and reverified the information and when.

Agency Response

On July 8, 2010, Rural Development responded to our Fast Report stating that it is working on an underwriting compliance tool to improve documentation and gain consistency in the underwriting process. The tool will guide Loan Approval Officials to ask the right questions while reviewing a loan and assure that documents in the file are appropriately authenticated and current. Implementation of this tool will address the concerns raised in the subject report.

On August 23, 2010, Rural Development informed us that it will revise the 502 SFH Checklist to instruct field staff to re-verify an applicant’s eligibility using updated documentation. The checklist will include a mechanism to record the age of supporting documentation at both loan approval and before loan closing, as well as document who updated and reverified the information and when that was accomplished. The 502 SFH Checklist, and any other conforming change as a result of the checklist revision, will be completed by September 30, 2010.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Revise procedures to require Loan Approval Officials to document the scope and timing of their second party review of eligibility determinations. This could include a standard calculation form or checklist in the loan file with space to re-compute eligibility, identify who updated key documents and when, and identify who reviewed those documents and when.

Agency Response

On July 8, 2010, Rural Development responded to our Fast Report stating that it is working on an underwriting compliance tool to improve documentation and gain consistency in the underwriting process. The tool will guide Loan Approval Officials to ask the right questions while reviewing a loan and assure that documents in the file are appropriately authenticated and current. Implementation of this tool will address the concerns raised in the subject report.

On August 23, 2010, Rural Development confirmed that it will develop an underwriting compliance tool for Loan Approval Officials. The underwriting compliance tool will guide Loan Approval Officials through a series of questions to assist them in evaluating credit risk factors and assessing the applicant's eligibility using updated information, document who updated and reverified the information, and document when that was done. This tool will also help Loan Approval Officials identify potential risk layering in a mortgage application. The underwriting compliance tool, and any other conforming change as a result of the implementation of this new document, will be completed by December 31, 2010.

OIG Position

We accept management decision for this recommendation.

Finding 2: Rural Development's Information Technology System Needs Enhancements to be Used to Prevent or Reduce Improper Payments

We determined that Rural Development could reduce the risk of improper payments by improving the integrity of SFH Direct Loan Program data in its automated information technology system, the Dedicated Loan Origination and Servicing System (DLOS). Rural Development National Office oversight is based on a sample of loan file reviews performed by national and State office officials after loan closing to identify and measure the risk of improper loan payments - its annual IPIA Risk Assessment review (see Finding 1). We found, and Rural Development National Office officials agreed, that data captured in DLOS could be used to identify potentially ineligible applicants before loans are closed, thereby preventing or reducing improper payments. However, the Rural Development National Office staff is not using DLOS data for these purposes because of data integrity and system design issues.

In our review, we found data input errors and missing data in critical fields that prevented the effective use of DLOS data for compliance purposes. Rural Development National Office officials said that input errors occur because data fields do not have established parameters or edit checks. Rural Development officials agreed that this has been a long-standing problem with the SFH Direct Loan Program data in DLOS. They attributed these conditions to the information technology software being off-the-shelf software that includes industry standard checks and balances, which can be costly to modify to meet SFH program requirements. Rural Development National Office officials agreed that system enhancements are needed and overdue, and Rural Development has not made these enhancements a top priority. We believe overcoming these data integrity and system design issues would help Rural Development detect, prevent, and ultimately reduce the occurrence of improper direct SFH program loan payments.

The National Institute of Standards and Technology (NIST) is responsible for developing minimum requirements for Federal information systems. NIST recommends that Federal information systems check information for accuracy, completeness, validity, and authenticity in reviews accomplished as close to the point of origin as possible.[18] These actions are commonly referred to as edit checks. Rules for checking the valid syntax of information system inputs (e.g., character set, length, numerical range, acceptable values) should be in place to verify that inputs match specified definitions for format and content. These actions are commonly referred to as parameter checks.

From our review of the SFH Direct Loan Program Recovery Act data, we noted the following data integrity and system design challenges:

Establishing System Parameters/Edit Checks to Prevent Data Input Errors

Rural Development needs to establish system parameters/edit checks for data fields in DLOS. We obtained and analyzed Rural Development's database of SFH Direct Recovery Act loans obligated as of the end of FY 2009. As of September 30, 2009, Rural Development approved

[18] NIST's Special Publication 800-53, *Recommended Security Controls for Federal Information Systems*, Revision 2, SI-10, Information Accuracy, Completeness, Validity, and Authenticity, December 2007.

and obligated 2,030 SFH Program Direct Recovery Act loans for about $267 million. Rural Development's SFH Direct Loan Program is designed for individuals who are unable to obtain credit elsewhere, mainly due to limited income and/or assets, but who meet the agency's requirements for repayment ability. In addition, according to *Rural Development Handbook HB-1-3550*, unless an exception is granted, the amount of the loan may not exceed the area loan limit.[19] Our analysis of data uploaded from DLOS to the Data Warehouse identified 28 loans where the borrower's eligibility should have been questioned. We found:

- Nine borrowers with net assets (assets minus liabilities) of over $100,000, which indicates that the borrowers should be able to obtain credit elsewhere and should not have been approved for a SFH loan. Five of these borrowers had net assets that exceeded $250,000, including two with net assets over $500,000. For example, one borrower received a $193,500 loan with $618,903 in total assets and $19,999 in total liabilities.

- Five borrowers with net liabilities (liabilities minus assets) of over $100,000, which indicates that the borrowers do not have repayment ability and should not have been approved for a SFH loan. For example, one borrower received a $182,500 loan with $1.52 in total assets, $178,325 in total liabilities, and an annual income of $44,520.

- Fourteen loans exceeded the area loan limit by more than $3,600 (the highest margin was $22,000 on a $272,000 loan). (Note: Requests for exceptions may be approved by the State Director if the cost of the property will not exceed $3,600. Anything above $3,600 would need Rural Development National Office approval.)

Rural Development reviewed the 28 cases we identified above and found that 1 of the 28 borrowers would have been ineligible for the amount of the loan obtained. The borrower received a $164,540 loan, which exceeded the $160,000 area loan limit. The Rural Development field office did not properly account for the area loan limit when approving the loan. In the remaining cases, Rural Development found data entry errors occurred, loan limit approvals were obtained, or Rural Development was able to satisfactorily justify the borrower's eligibility. In the case of the borrower with $618,903 in assets detailed above, Rural Development entered the borrower's bank cash account balance in the system as $593,885, instead of $593.88. In the case of the borrower with $178,325 in total liabilities, Rural Development included the liability from a prior mortgage, but did not include the house as an offsetting asset in the system.

Rural Development National Office officials agreed that establishing system parameters and edit checks at the point of data entry would help ensure that ineligible applicants are not obtaining loans.

Capturing Critical Data to Determine Repayment Ability

Rural Development needs to (1) ensure data are entered into critical fields and captured in DLOS and (2) modify DLOS to include additional data fields needed to determine borrowers'

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[19] *Rural Development Handbook HB-1-3550*, Direct Single Family Housing Loans and Grants, Field Office Handbook, issued January 23, 2003, and associated Special Procedural Notices. It defines the area loan limit as the maximum market value of a property to be considered modest for the area.

repayment ability before loan closing. A key element in determining eligibility is the borrowers' ability to repay the loan. According to *Rural Development Handbook HB-1-3550,* the agency bases underwriting decisions on (1) an analysis of the percentage of income the applicant would be required to spend on housing costs and (2) the applicant's total debt if the loan is approved. However, this information is not required to be entered in its loan origination system (LOS).[20] The PITI ratio compares the amount the applicant must spend on these housing costs to the applicant's repayment income.[21] The TD ratio compares applicant debt to repayment income.[22] Borrowers must meet the agency's prescribed limits for both ratios to ensure repayment ability.

Our review of the Rural Development database, as of September 30, 2009, revealed that the PITI and TD ratio fields were blank for 1,221 of 2,030 (60 percent) approved borrowers because these ratios are not required to be entered in the LOS. We found that 4 out of the remaining 809 (2,030 – 1,221) approved borrowers had PITI and/or TD ratios outside Rural Development's prescribed limits.[23] The credit score field, another indicator of repayment ability, was also blank for 1,875 of the 2,030 (92 percent) approved loans because the information technology system does not automatically populate that data field from the LOS.

In addition, important information for calculating the total housing costs is not currently included in Rural Development's information technology system, such as insurance and real estate taxes. Rural Development National Office officials agreed that insurance and real estate tax information are important, since both are components of the repayment ratios, and have initiated actions to modify DLOS to add the insurance and tax fields. Once added to the system, Rural Development needs to ensure that information in the insurance and tax fields is updated at loan closing, as those figures are revised from estimates to actuals as part of closing preparations.

Rural Development National Office officials agreed that it is important (1) to ensure information is entered into critical fields and captured in DLOS, (2) to include additional data fields in DLOS needed to compute repayment ratios, and (3) that data in DLOS needs to be updated before loan approval and closing to reflect the actual information that field personnel used to make eligibility determinations.

We also believe that Rural Development should augment its oversight policies and procedures to target and review loans before loan closing to ensure that Recovery Act loans are only being approved for eligible applicants. Currently, the Rural Development National Office focuses its oversight primarily on manual loan file reviews, which include IPIA Risk Assessments and State Internal Reviews. However, the loan file review process is a time-consuming, labor-intensive process that focuses on closed loans. Rural Development National Office officials agreed that

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[20] LOS, which is part of DLOS, is an information technology application located in each Rural Development field office that is used by loan originators. LOS retains applicant information, calculates maximum loan amounts, and generates loan approval and closing forms.

[21] Repayment income is based only on the income attributable to parties to the note and is used to determine whether an applicant has the ability to make monthly loan payments. Very low income applicants are considered to have repayment ability if they do not have to pay more than 29 percent of repayment income for PITI expenses. Applicants with incomes above the very low-income limit are considered to have repayment ability if they do not have to pay more than 33 percent of repayment income for PITI expenses.

[22] Applicants, regardless of income, are considered to have repayment ability when they do not have to spend more than 41 percent of their repayment income on total debt.

[23] Rural Development examined the four cases and found that data input errors occurred in two instances, and Rural Development granted waivers in the other two instances.

improving the information technology system data would allow them to automate the review process to better target and review loan files to detect, reduce, and prevent improper payments before loan closing.

We discussed the issues identified in this report with Rural Development National Office officials on January 27 and February 3, 2010. On April 7, 2010, Rural Development provided us with supplemental information for the loans where we questioned the borrower's eligibility for the program. During these and other follow-up discussions, Rural Development officials generally agreed with our findings to correct data integrity and design issues and have already initiated actions to add some key fields to DLOS. They also agreed that identifying data irregularities could help identify ineligible applicants before loan closing to ensure that direct SFH program funds are expended only on those individuals intended to benefit from the Recovery Act.

In their June 23, 2010, response to the Fast Report, Rural Development officials wrote that they generally agreed with the findings and conclusions. They agreed that there is a need for well placed edits in DLOS and that improvements to the Data Warehouse would help Rural Development to develop and implement better oversight reviews.

Recommendation 3

Develop and implement a plan to correct the data integrity and system design issues involving DLOS. These issues include identifying and establishing critical system parameters and edit checks at the point data are entered or updated; ensuring information is entered into critical data fields and captured in DLOS; modifying DLOS to include additional data fields needed to determine borrower repayment ability; and ensuring that the data in DLOS are always updated with the most current figures before loans can be approved and closed.

Agency Response

On June 23, 2010, Rural Development responded to our Fast Report stating that it agreed that there is a need for well placed edits in DLOS.

On August 23, 2010, Rural Development provided an update on the actions taken to date. Rural Development implemented several system changes to correct data integrity issues involving DLOS. These included (1) ensuring the PITI ratio was recalculated and not lost when updates were made to the approved loan terms screen, (2) adding a warning message on several screens to inform the user when the TD ratio exceeded 41 percent, and (3) creating a new table to enable entry of the dollar limit on assets, as the system now requires assets above the limitation to be used towards the down payment.

On August 23, 2010, Rural Development also described additional actions planned for the future. Rural Development plans to further enhance data integrity in DLOS by adding edits to produce error messages when (1) either the net assets or net liabilities for an applicant are greater than $100,000, (2) certain applicant information is not completed if the Application Completed Date is entered, and (3) specific property information is not completed if the Loan Approval Date is entered. This project will also implement a provision to track exceptions when the proposed loan amount exceeds the area loan limit. Any increase in the loan amount would be tracked as an exception noting the reason for approval and who approved the exception. These enhancements will be presented to the Business System Council by December 31, 2010, for approval and funding. By March 31, 2011, Rural Development will update its automated information technology system to populate the credit score field for loans when a credit report is obtained, ensuring more accurate data on reports.

OIG Position

We accept management decision for this recommendation.

Recommendation 4

Develop and implement an automated review process at the National, State, and/or area offices to identify any SFH Direct Loan Program data irregularities for follow up and to target and review loan files before closing to ensure Recovery Act SFH direct loans are only being approved for eligible applicants.

Agency Response

On June 23, 2010, Rural Development responded to our Fast Report stating that it agreed that improvements to the Data Warehouse would help Rural Development to develop and implement better oversight reviews.

On August 23, 2010, Rural Development informed us that it will enhance the Data Check Query Tool, update the field office handbook to integrate the Data Check Query Tool as part of loan processing, and develop State and national office review processes to monitor compliance. The query tool provides users with an automated method to ensure critical application data have been entered in DLOS and are within acceptable values. Enhancements will include an expansion to the number of data fields reviewed and the scope of edits. Handbook changes will require field office staff to validate accounts using the query tool prior to loan obligation. The Data Check Query Tool upgrade will be completed for testing and the handbook changes and review process will be drafted by October 30, 2010. These actions will be fully implemented by December 31, 2010.

OIG Position

We accept management decision for this recommendation.

Section 2: State Internal Reviews (SIR)

Finding 3: Rural Development Needs to Strengthen Controls to Prevent Weaknesses Identified by SIRs from Recurring

We 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 SIRs and preventing them from recurring. Specifically, neither Rural Development National Office nor Financial Management Division (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.[24] A Nationwide SIR Summary Report of identified weaknesses is prepared annually by FMD and distributed to Rural Development National and State Office officials.[25] 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 individual States.[26] 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.[27]

[24] RD Instruction 2006-M, 2006.609(h), dated May 19, 2004.

[25] RD Instruction 2006-M, 2006.609(i), dated May 19, 2004.

[26] The Nationwide SIR Summary Report is utilized by program officials in the MCR process for developing and updating review guide questions. One purpose of MCRs includes 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.

[27] Rural Development has 47 State offices.

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.

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 agreed that trend analysis utilizing SIRs would be a good tool to track corrective actions to rectify weaknesses.

In their June 7, 2010, response to the Fast Report, Rural Development officials wrote that they are in agreement 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. They plan to take steps to address the weaknesses we identified.

Recommendation 5

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.

Agency Response

On June 7, 2010, Rural Development responded to our Fast Report stating that it agreed 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 reviews. FMD will perform this analysis on an annual basis, identify 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 this annual multiple-year analysis of SIR weaknesses. The SFH 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.

On August 23, 2010, Rural Development provided an update on the actions taken to date. FMD performed a multiple-year analysis of SIR weaknesses and issued the analysis to Rural Development National Office officials and State Directors in a June 21, 2010, memorandum. In addition, on August 12, 2010, FMD provided each Rural Development Administrator with an e-mail detailing the SIR weaknesses for their program, which identified the specific State(s) where the recurring weaknesses were reported. The specific States were identified so that the Administrator can work to implement effective controls to eliminate recurring weaknesses, and provide necessary training, as appropriate. FMD will revise RD Instruction 2006-M, to require multiple-year analysis of SIR weaknesses, by September 30, 2010.

OIG Position

We accept management decision for this recommendation.

Section 3: Separation of Duties

Finding 4: Rural Development Needs to Monitor Employee Access Authorities to Decrease the Risk of Improper Activity

We found weaknesses in controls involving authorizations to initiate, approve, obligate, and disburse loans that could allow possible improper activity in the Section 502 Direct Loan Program. We identified 149 Rural Development personnel that were given multiple access authorities in its mortgage servicing system (MSS)[28] who also had access to the loan origination system (LOS).[29] According to Rural Development's Information Technology Internal Control Office (IT-ICO) officials, nothing in either system prevents individuals, given both access to LOS and the authority in MSS to obligate and disburse, from solely processing an entire loan from application to disbursement. This significantly increased the risk that improper activities and errors may go undetected in the SFH Direct Loan Program.

We reviewed information obtained from Rural Development's IT-ICO listing all LOS and MSS users, including their MSS Profile IDs.[30] We analyzed these data listings to identify Rural Development personnel assigned special MSS Profile IDs. We then cross-referenced these IDs to determine their access authorities in LOS. We also obtained and reviewed the unnumbered letters dated July 2, 2008, and September 18, 2008, issued by Rural Development's national office to States.[31] These letters outlined the justifications needed for making special Profile IDs available to MSS users.

Based on our review, we identified 149 Rural Development personnel that were given multiple access authorities. Specifically, we found 88 Rural Development personnel with an MSS Profile ID (Profile ID A) in 38 States, which identifies employees with loan approval authority that are also authorized to obligate and disburse Section 502 Direct SFH loans.[32] Of these 88 employees, we identified 70 that also have access to LOS, which allows them to initiate the loan making process. In addition, we identified 108 Rural Development personnel with an MSS Profile ID (Profile ID B), which gives these employees multiple authorities to obligate and disburse Section 502 Direct SFH loans in 42 States, but who do not have loan approval authority.[33] We found 79 of these users also have access to LOS. Although personnel with MSS Profile ID B are not

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[28] The mainframe-based computer application that is used by Rural Development field offices to electronically communicate with, and transmit information to CSC, and by CSC to service and track borrowers' loans. MSS is also part of DLOS.

[29] An internet-based application used by loan originators in each Rural Development field office. LOS retains application information, calculates maximum loan amounts, and generates loan approval and closing forms. It is part of Rural Development's Dedicated Loan Origination System (DLOS).

[30] The MSS ID defines the "level of authority" a user has in DLOS to approve, obligate, and/or disburse a loan.

[31] Unnumbered Letter, dated September 18, 2008, described the authorities associated with a new MSS Profile ID. These were Rural Housing and Community Development Service (RHCDS)/Check Request or Cancel and RHCDS/Obligation Request Validation. This unnumbered letter also provided guidelines concerning the assignment of this Profile ID. This Profile ID was developed to identify MSS users that also have been granted loan approval authority by their respective State offices. Unnumbered Letter, dated July 2, 2008, describes the authorities associated with another new MSS Profile ID. These were also RHCDS/Check Request or Cancel and RHCDS/Obligation Request Validation, but identified users without loan approval authority.

[32] The analysis identified a total of 95 users with MSS Profile ID A. Of these 95, we identified 7 duplicate users, based on name, resulting in the 88 individuals.

[33] Our analysis identified a total of 120 users with MSS Profile ID B. Of these 120, we identified 12 duplicate users, based on name, resulting in the 108 individuals.

delegated loan approval authority, like Profile ID A, according to Rural Development's IT-ICO officials, nothing in either system prevents individuals, given both access to LOS and the authority in MSS to obligate and disburse, from solely processing an entire loan from application to disbursement.

Our analysis of the user information provided by the IT-ICO identified 17 State offices where there were a high number of users (4 or more) with MSS Profile IDs A and B distributed between the State and Area Office employees (see table below). The high number of users with these elevated authorities presents a risk for potential improper activities. Broad access to initiate, approve, obligate, and disburse loans creates potential for misdirecting loans or funds for personal use, to personal friends or family members, or to particular realtors and/or contractors, among many other possibilities.

NIST provides that an organization separate duties of individuals as necessary to prevent malevolent activity without collusion through assigned information system access authorizations.[34] NIST also provides that an organization employ the concept of least privilege, allowing only authorized access privileges for users which are necessary to accomplish assigned tasks in accordance with organizational missions and business functions.[35] When access authorizations do not adequately separate assigned duties, we believe other compensating controls should be implemented to monitor the activity of the users with multiple access privileges to ensure authorities are not abused and no improper activity has occurred.

Rural Development officials acknowledged the increased risk of improper activities and errors that may go undetected with the use of these special MSS Profile IDs. However, they justified giving these MSS Profile IDs in some States because, in many field offices, there may be only one or two employees who work on SFH direct program loans. If one person is on leave or sick, the loan processing, closing, or disbursement of loan funds could be unreasonably delayed or halted.

The Table that follows lists the 17 State offices with a high number of users with MSS Profile ID A or Profile ID B that also have access to LOS.

No.	State Office	ID A SO Users with LOS Access	ID A AO Users with LOS Access	ID B SO Users with LOS Access	ID B AO Users with LOS Access	Total MSS Users with LOS Access
1	GA	0	0	3	1	4
2	HI/GU/WP	1	1	1	1	4
3	ID	2	5	1	1	9
4	IL	0	0	5	0	5
5	IN	1	1	0	3	5
6	LA	0	0	3	1	4
7	MO	2	5	1	0	8

[34] NIST Special Publication 800-53, Revision 3, Information Security, Access Control-5 (AC-5).

[35] NIST Special Publication 800-53, Revisions 3, AC-6, Least Privilege.

No.	State Office	ID A SO Users with LOS Access	ID A AO Users with LOS Access	ID B SO Users with LOS Access	ID B AO Users with LOS Access	Total MSS Users with LOS Access
8	MT	2	0	2	0	4
9	NV	2	0	1	2	5
10	NJ	2	1	0	2	5
11	NY	2	2	1	0	5
12	NC	0	0	2	2	4
13	OR	2	0	2	0	4
14	PA	2	0	1	2	5
15	UT	2	2	0	0	4
16	VT/NH	1	0	3	2	6
17	WY	1	3	1	0	5

Effective controls to mitigate the risk for the authorities granted in MSS Profile IDs like Profile ID A and Profile ID B generally require, at a minimum, automated logging of the on-line activities of employees with these IDs, particularly of loan obligations and check requests. Additionally, the log(s) of these employees' activities should be independently reviewed and monitored on a frequent basis to ensure the authorities are not abused and no improper activity has occurred.

We met with the IT-ICO staff to discuss automated or manual controls implemented to monitor usage of authorities granted by Profile IDs A and B. Our review disclosed that there were no automated controls in place in LOS or MSS that would identify instances where users with these authorities exercised initiation, approval, and/or disbursement authorities on the same loan. Rural Development officials stated they did not generate any specific reports or logs or perform any other special procedures to monitor activity by users with these profile IDs. When we asked if the system had the capabilities to generate logs or other reports that could be used to monitor the activity of staff with multiple authorities, Rural Development officials stated that they could generate such reports if requested. However, they said that the only control currently implemented was that the security officer who assigned these profile IDs was to make sure that State or national office officials requesting these authorities provided justification for initializing the access privileges.

In more recent discussions, we learned that Rural Development first became aware during its FY 2007 annual OMB Circular No. A-123, Appendix A, tests that the threat of not logging the employees' activities for the MSS created vulnerability, that suspicious activity was not being reviewed, and that the opportunity for detection was lost. As part of the process to complete the auditing and monitoring milestones identified in the Agency's plan of action, a cost-benefit and risk mitigation analysis was conducted on the MSS application. The cost-benefit analysis described manual and automated compensating controls that the Agency maintains reduced the risk of program dollars lost (or risk value) to a level less than the cost of implementing the automated logging controls.[36] Consequently, Rural Development's Chief Information Officer signed a document forgoing the implementation of these automated logging controls.

We agree that it is senior management's responsibility to implement the most appropriate controls to decrease risk to an acceptable level at the least cost. Although we did not audit all the controls listed in Rural Development's cost-benefit analysis in this review, we found one of the compensating controls listed that would be effective to address multiple access authorizations was only partially in place, and Rural Development relied on this control in the cost-benefit analysis to significantly reduce the risk value. The control requires the national office to monitor the activity of all employees who approve loans and concurrently access the system to obligate loans and/or disburse checks. Rural Development implemented a control to ensure that any such access must be approved by national office program staff before granting the authorities. We agree with this control, but believe the activities of these employees must also be monitored periodically, either manually or automatically, to significantly reduce the risk of improper activity in the SFH Direct Loan Program. This additional control, however, is not being performed at the national office level.

In a subsequent discussion with Rural Development National Office officials on March 26, 2010, we were told that the responsibility for monitoring separation of duties for the authorities granted by these profile IDs was delegated to the States. They further stated that no monitoring procedures or guidance had been issued to the States, outside of the unnumbered letters. They did state, however, that on Form RD 3550-25, Loan Closing Instructions and Loan Closing Statement, there is a separation of duties certification where the Loan Approving Official enters the names of staff members who verified the borrower's income and credit, obligated the funds in MSS, and activated the loan in MSS. However, procedures do not require an independent verification as to the accuracy and completeness of this information or to determine that the same official did not perform all actions on the same loan. Rural Development officials added that this certification is routinely reviewed during their State Internal Reviews (SIR). However, from our analysis of the SIRs, we found these reviews are only performed once every 5 years at field offices in each State and only require looking at whether the Separation of Duties certification on Form RD 3550-25 was completed.

In our follow-up discussion with Rural Development officials on March 26, 2010, they agreed with our concern with the broad authorities granted by the MSS Profile IDs. They commented that in the case of field offices with few staff who work on SFH direct loans, it is difficult, and in some cases, not possible to attain true separation of duties. They reemphasized that controls monitoring usage of the MSS Profile IDs should be at the State office level and automated logging controls would be costly to implement. Further conversations confirmed that there is no formal guidance requiring monitoring of the usage of these MSS Profile IDs. Follow up with State office officials in Missouri and Kansas confirmed that there was no monitoring requirement; therefore, no control is currently in place.

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[36] Rural Development's Risk Mitigation Analysis described the compensating controls as: (1) Physical Security, (2) Firewalls, (3) Local Area Network Access to Network Activity Directory, (4) LOGBOOK Controls for Elevated Access, (5) Limited State Access, (6) Separation of Duties within MSS, (7) National Monitoring of Loan Approval Authority, (8) Transaction Level Thresholds, (9) MSS Access Limited to Roles Established, and (10) Deputy Chief Financial Officer/Treasury Controls.

In their July 15, 2010, response to the Fast Report, Rural Development officials wrote that they agreed that additional monitoring would further strengthen internal controls. They plan to develop procedures and implement additional monitoring requirements at the State offices.

Recommendation 6

Develop procedures and controls, utilizing existing capabilities, to monitor loan approval, obligation, and disbursement activities of users with MSS Profile IDs A or B. These monitoring activities should be documented and readily identify when a user exercises multiple authorities on the same loan. The monitoring process should be reviewed frequently by Rural Development officials at an appropriate level to investigate the circumstances surrounding the suspicious use of these authorities and determine whether concurrent use of these authorities on a single loan was justified.

Agency Response

On July 15, 2010, Rural Development responded to our Fast Report stating that it agreed that additional monitoring would further strengthen internal controls. Rural Development will develop and implement a manual process to require State office monitoring of loan approval, obligation, and disbursement activities for users with MSS Profile IDs A and B within 90 days. Rural Development will also continue to explore automated alternatives should a viable option be identified.

On August 23, 2010, Rural Development informed us that an automated solution will be developed to extract MSS activity logs on a routine basis and transfer them to the SFH Direct Data Warehouse for loan making activities. An exception report will be developed utilizing data available from the MSS history logs and other existing SFH Direct data fields to identify field office staff that performed multiple loan making activities (loan approval, obligation, and disbursement) on the same loan. The Rural Development National Office will establish procedures for the State Office Program Director to review the accounts identified on the exception report and provide an explanation regarding the use of these authorities. Rural Development plans to implement these actions on or before March 31, 2011.

OIG Position

We accept management decision for this recommendation.

Recommendation 7

Require each State to reevaluate the current authorizations to determine whether the individuals assigned these multiple authorities have an absolute need for them, based on the concept of least privilege. Also, determine whether LOS access is necessary for those staff members granted these multiple authorizations.

Agency Response

On July 15, 2010, Rural Development responded to our Fast Report stating that it will require each State to reevaluate the current authorizations for those with multiple authorities on an annual basis to assure there is an absolute need for these authorities, including access to the LOS.

According to Rural Development on August 23, 2010, Rural Development currently has a Quarterly User ID Access Review Process in place that requires States to validate and re-certify all system access IDs and the roles assigned. The Information Systems Security Staff distributes these verification reports to points of contact with instructions for validation of access and completion of the Verification Report Checklist that itemizes any necessary changes. The process is to be reviewed and approved by each user's immediate supervisor or assigned State official that understands each user's system needs. MSS is included in the quarterly verification reporting process.

In detail, these instructions direct the points of contact to review and certify all access listed on the reports. These instructions provide explanations of the access, requires the points of contact/supervisor to ensure that all their users are listed on the report and that each user's access is commensurate with their assigned duties. The points of contact are required to open Logbook tickets to facilitate any access changes, which would adhere to the strict guidance established for MSS profiles.

To enhance this process, Rural Development will add guidance to HB-1-3550 by December 31, 2010. This guidance will assure that the State Program Director is involved in the review of persons with multiple authorities in MSS and those with access to LOS have a continued need for such access in accordance with the concept of least privilege.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We conducted our audit of the Section 502 SFH Direct Loan Program at the Rural Development (1) National Office located in Washington, D.C.; (2) Financial Management Division (FMD) Office located in Washington, D.C.; and (3) Information Technology Internal Control Office (IT-ICO) located in St. Louis, Missouri.

The period of our audit coverage was Section 502 SFH Direct Loan Program loans funded by the Recovery Act in FYs 2009 and 2010. On March 20, 2009, Rural Development was authorized to begin distributing Recovery Act funds. As of August 18, 2010, Rural Development had obligated almost $1.17 billion in Recovery Act direct loans to about 9,200 very-low and low income borrowers.

To accomplish our overall objectives, we tested the effectiveness of the key controls over the Recovery Act-funded Section 502 SFH Direct Loan Program. During this phase, we examined the results of Rural Development's Improper Payments Information Act of 2002 (IPIA) Risk Assessment review conducted in October 2009. This review serves as one of Rural Development's primary controls to detect, reduce, and prevent improper payments made by field office staff and to assess the effectiveness of internal management policies and compliance with operating procedures. As part of our examination, we reviewed a statistically selected sample of the Recovery Act loan files that Rural Development evaluated as part of the IPIA Risk Assessment. In addition, we interviewed Rural Development National Office officials to discuss Rural Development's controls for detecting, reducing, and preventing improper payments.

We also tested the effectiveness of Rural Development's use of its automated Dedicated Loan Origination and Servicing (DLOS) system to detect, reduce, and prevent improper payments. For this test, we obtained and analyzed Rural Development's database of SFH Direct Recovery Act loans, obligated as of the end of FY 2009. As of September 30, 2009, Rural Development obligated 2,030 SFH Direct Program Recovery Act loans, totaling about $267 million. In addition, we interviewed Rural Development national office officials to discuss Rural Development's SFH Direct Loan Program information technology system and its limitations.

In order to test the effectiveness of Rural Development's controls in addressing weaknesses identified during the SIRs, we obtained and reviewed the Nationwide SIR Summary Reports from FYs 2003-2008. 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 FMD to discuss their roles in the SIR process.

We also tested the effectiveness of Rural Development's controls over employee access authorities to initiate, approve, obligate, and disburse loans in its loan origination system (LOS)[37] and its mortgage servicing system (MSS).[38] We did not review, analyze, or verify information in LOS and MSS, and make no representation of the adequacy of the systems or the information

[37] An internet-based application used by loan originators in each Rural Development field office. LOS retains application information, calculates maximum loan amounts, and generates loan approval and closing forms. LOS is part of DLOS.

[38] The mainframe-based computer application that is used by Rural Development field offices to electronically communicate with CSC, and transmit information for CSC to service and track borrowers' loans. MSS is also part of DLOS.

generated from them. However, we did review information obtained from the IT-ICO, listing all LOS and MSS users, including their MSS Profile IDs.[39] We analyzed these data listings to identify Rural Development personnel assigned special MSS Profile IDs. We then cross-referenced these IDs to determine their access authorities in LOS. We also obtained and reviewed the unnumbered letters dated July 2, 2008, and September 18, 2008, issued by Rural Development's national office to States.[40] These letters outlined justifications needed for making special Profile IDs available to MSS users. Additionally, we interviewed officials in Rural Development's CSC, Missouri and Kansas State offices, and Rural Development's National Office and the IT-ICO to discuss the number of Rural Development staff approved for the special Profile IDs. We discussed how Rural Development monitors individual usage of the authorizations provided by the special MSS Profile IDs to ensure they are not being abused.

To accomplish our audit objectives, we also:

- Identified and reviewed Rural Development published guidance, instructions, handbooks, and regulations that detail the controls and procedures over the Section 502 SFH Direct Loan Program;
- Reviewed Rural Development's Recovery Act Plan for its SFH Direct Loan Program; and
- Obtained and reviewed documents, such as OMB guidance, to gain an understanding of the provisions and requirements related to Rural Development's Section 502 SFH Direct Loan Program.

We performed our audit fieldwork from November 2009 through July 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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[39] The MSS ID defines the "level of authority" a user has in the DLOS to approve, obligate, and/or disburse a loan.

[40] Unnumbered Letter, dated September 18, 2008, described the authorities associated with a new MSS Profile ID. These were RHCDS/Check Request or Cancel and RHCDS/Obligation Request Validation. This unnumbered letter also provided guidelines concerning the assignment of this Profile ID. This Profile ID was developed to identify MSS users that also have been granted loan approval authority by their respective State offices. Unnumbered Letter, dated July 2, 2008, describes the authorities associated with another new MSS Profile ID. These were also RHCDS/Check Request or Cancel and RHCDS/Obligation Request Validation, but identified users without loan approval authority.

Abbreviations

AMI .... Area Median Income
CSC .... Centralized Servicing Center
DLOS .... Dedicated Loan Origination and Servicing System
FMD............................ Financial Management Division
FY .... Fiscal Year
IPIA............................. Improper Payments Information Act of 2002
IT-ICO......................... Information Technology Internal Control Office
LOS .... Loan Origination System
MCR............................ Management Control Review
MSS............................. Mortgage Servicing System
NIST............................ National Institute of Standards and Technology
OIG .... Office of Inspector General
OMB .... Office of Management and Budget
PITI .... Principal, Interest, Taxes, and Insurance
RHCDS .... Rural Housing and Community Development Service
RHS............................. Rural Housing Service
SFH .... Single-Family Housing
SIR .... State Internal Review
TD .... Total Debt