



**U.S. Department of Agriculture**

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**Office of Inspector General  
Southeast Region**

**Audit Report**  
**Guaranteed Rural Housing Loan Program**  
**Followup**

**Report No. 04601-3-AT**  
**September 2006**

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



September 29, 2006

REPLY TO

ATTN OF: 04601-3-At

TO: Russell T. Davis  
Administrator  
Rural Housing Service

THROUGH: John Dunsmuir  
Acting Director  
Financial Management Division

FROM: Robert W. Young /s/ Tracy LaPoint (for)  
Assistant Inspector General  
for Audit

SUBJECT: Guaranteed Rural Housing Loan Program Followup

This report presents the results of the subject audit. Your response to the official draft report, dated September 21, 2006, is included as exhibit B, with excerpts and the Office of Inspector General's (OIG) position incorporated into the Findings and Recommendations section of the report.

Based on your response, we reached management decisions on all audit recommendations. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

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

# Executive Summary

## Guaranteed Rural Housing Loan Program Followup (Audit Report No. 04601-3-AT)

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### Results in Brief

In March 1999, the Office of Inspector General (OIG) issued an audit report of the Rural Housing Service's (RHS) Guaranteed Rural Housing Loan Program (GLP).<sup>1</sup> GLP helps low-income rural families purchase homes by guaranteeing loans for individuals who may not ordinarily qualify for a loan. The 1999 audit found several problems with how RHS administered these loans. We recommended that the agency improve how it monitors lenders, defines eligible rural areas, and collects losses from borrowers who default on their loans. We conducted this followup review to determine if RHS had addressed these conditions, as agreed in its response to the prior report.

We found that RHS has not taken corrective actions in accordance with agreed to actions for 6 of the 13 audit recommendations made in the March 1999 audit report (see exhibit A).

- We found that lenders approved applications for GLP loans for borrowers whose eligibility was questionable. Although RHS agreed to advise lenders regarding eligibility requirements by means of a permanent directive, the agency instead used administrative notices (AN). These ANs expire 1 year after issuance, and we found that RHS did not reissue them on a timely basis.
- We found that RHS paid 15 loss claims that included \$73,175 in questionable or unsupported costs. Although RHS agreed to issue lenders a directive instructing them to identify excessive loss claims and take appropriate action, it did not send this directive to all lenders nor did it make this directive permanent.
- We found that RHS was not reviewing its maps to ensure that guaranteed loans were made only in eligible rural areas. Although RHS agreed to implement controls for reviewing its maps regularly, it has not done so.
- We found that RHS did not track foreclosed properties so that it would receive its share of any proceeds from their liquidation. Although RHS did issue an AN requiring lenders to share with the agency any proceeds from the liquidation of foreclosed properties, it did not make that notice permanent.

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<sup>1</sup> Audit Report No. 04601-2-At.

- We found that RHS had made no effort to recover losses totaling \$1.4 million. Although the agency did take significant steps towards identifying delinquent accounts receivable against borrowers in default, it had not, as of June 2005, actually established any accounts receivables.
- We found that RHS needed to improve how it obtained appraisals for guaranteed loans to ensure appraisers' independence. Although the agency did make some changes in response to this recommendation, those changes were neither permanent nor adequate to correct the identified problem.

RHS stated that they believed they had taken steps to fully address these six recommendations, in part by the fact that final action has been granted by the Office of the Chief Financial Officer (OCFO) for the three of the six of recommendations. Our review found that RHS did take some steps towards addressing the concerns raised by all of the six recommendations; however, the changes they implemented were either not permanent or did not always adequately address the recommendation. Until the agency has established the necessary internal controls to permanently and adequately resolve these conditions, the problems identified will likely continue.

In addition, we found that RHS did not implement or report corrective actions within prescribed timeframes (i.e. one year after management decision has been reached), taking as long as an additional 983 to 1965 days after the 1-year period, or required final action date, to implement or report to the OCFO the status of audit recommendations for 12 of the 13 recommendations included in the 1999 GLP report. For six of the recommendations, RHS had taken corrective action within 1 year but had not reported these actions to the OCFO. However, for the six other recommendations, RHS had not fully implemented corrective actions within 1 year. For most recommendations, RHS had established completion dates that were within the required 1 year time frame; however, they lacked the resources to fully implement some of the recommendations. We also found that there was a general lack of understanding of the audit followup process and that RHS had not reported final actions in a timely manner because it was unfamiliar with the requirement to forward evidence of corrective action taken to the audit liaison. Although RHS has procedures in place specifying management's responsibilities when responding to audit recommendations, those procedures should be made more detailed.

We concluded that RHS needs to take steps to resolve, as expeditiously as possible, the six remaining recommendations from the 1999 audit. Furthermore, the agency should also improve its general procedures for addressing audit recommendations.

**Recommendations  
in Brief**

We recommend that RHS implement the agreed-upon corrective actions for the six open recommendations from the 1999 audit report, including the issuance of permanent directives.

We also recommend that RHS develop and implement detailed procedures for agency officials to follow in achieving and reporting management decisions and final actions on audit recommendations.

**Agency Position**

In its September 21, 2006, written response to the draft report, RHS officials generally agreed with the recommendations in the report. We have incorporated applicable portions of RHS' response, along with our position, in the Findings and Recommendations section of the report. RHS' responses to the draft report are included in their entirety as exhibit B of the audit report.

**OIG Position**

Based on RHS' responses, we have reached management decisions on all the audit recommendations.

### ***Abbreviations Used in this Report***

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AN	Administrative Notice
DCIA	Debt Collection Improvement Act of 1996
DR	Departmental Regulation
FMD	Financial Management Division
FY	Fiscal Year
GLP	Guaranteed Rural Housing Loan Program
GLS	Guaranteed Loan System
IRS	Internal Revenue Service
LMH	Lender Monitoring Handbook
MCR	Management Control Review
NIR	National Internal Review
OCFO	Office of the Chief Financial Officer
OGC	Office of General Counsel
OIG	Office of Inspector General
RD	Rural Development
RHS	Rural Housing Service
SFH	Single-Family Housing
SIR	State Internal Review
TM	Technical Manual

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# Background and Objectives

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## Background

In 1991, the Guaranteed Rural Housing Loan Program (GLP) was authorized to help low-income individuals or households purchase homes in rural areas.<sup>2</sup> In the first year of the program, Rural Housing Service (RHS) issued a total of 662 guaranteed loans valued at \$38.4 million; by the end of fiscal year (FY) 2004, RHS had issued 34,817 loans valued at \$3.2 billion.

RHS administers GLP through Rural Development (RD) State Offices and determines the eligibility of multistate or national lenders. RD State Directors are responsible for determining the eligibility of lenders who operate only within their State.

In March 1999, we issued an audit report on GLP.<sup>3</sup> The objectives of the prior audit were to (1) evaluate RHS' compliance with policies and procedures regarding borrower eligibility for guaranteed loans, (2) evaluate lenders' processing of loan applications and servicing of active loans, (3) determine whether loss claim payments on liquidated loans were proper and justified, and (4) determine whether loans were being made only to applicants in rural areas.

Our prior review found that (a) RHS approved loans for individuals whose eligibility was questionable because lenders had improperly approved the application; (b) RHS needed to implement a more aggressive outreach program to ensure that GLP was achieving its objective of providing home ownership opportunities to low- and moderate-income rural residents; (c) RHS did not require that lenders incur a proportionate share of losses on defaulted loans; (d) RHS' guarantee fees were not sufficient to offset program losses; (e) RHS did not properly evaluate, review, or update maps used in defining rural areas; (f) RHS approved loss claims that included questionable or unsupported costs; (g) RHS did not properly monitor lenders; (h) RHS did not ensure that proceeds from the sale of foreclosed properties were shared by the lender and RHS; (i) RHS did not attempt to collect from borrowers who defaulted on their loans; and (j) RHS' appraisal system for loan approval and liquidation needed improvement.

We made 13 recommendations to address these findings.<sup>4</sup> According to Departmental Regulations (DR), the agency and the Office of Inspector General (OIG) must reach management decision and agree to a corrective action plan for each recommendation.<sup>5</sup> Management decisions must include

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<sup>2</sup> The program was established by Public Law 101-625 §706.

<sup>3</sup> Audit No. 04601-2-At.

<sup>4</sup> See exhibit A for the 13 recommendations and the agreed-upon corrective actions.

<sup>5</sup> Per DR 1720.001, management decision is an agreement between agency management and the OIG on the action(s) taken or to be taken to address a finding and recommendation cited in an audit report. The management decision must include the agreed upon dollar amount affecting the recommendation and an estimated completion date unless all corrective action is completed by the time agreement is reached.

both a plan of action and an estimated completion date for the action plan. By May 2001, RHS and OIG had agreed to management decision on all 13 recommendations.

After both parties agree to management decision, the agency has 365 days to implement final corrective action. The agency is responsible for reporting all final actions to the Office of the Chief Financial Officer (OCFO).

**Objectives**

The objectives of the current audit were to evaluate whether corrective actions had been implemented and were effective in addressing the conditions cited in the prior audit report.

# Findings and Recommendations

## Section 1. *RHS' Corrective Actions Did Not Ensure That Program Deficiencies Were Adequately and Timely Addressed*

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RHS has not accomplished final corrective action for 6 of the prior audit's 13 recommendations. Although agency officials did take some steps towards addressing the concerns raised by these recommendations, the changes they implemented were not permanent and did not always adequately address the recommendation.

Even when RHS did implement the agreed-upon changes, the agency was not timely in fulfilling the Department's reporting requirements for 12 of the 13 prior audit's recommendations. For 6 of the 13 recommendations, RHS did not fully implement corrective actions. For the six other recommendations for which we agreed with the corrective action taken, RHS did not report the corrective actions to the OCFO within the 365 days prescribed by regulations, taking instead as long as 1965 days.

Generally, we found that RHS' procedures for achieving final action on audit recommendations could be improved, as RHS officials were often unaware of their specific responsibilities when responding to these recommendations.

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### Finding 1

#### **RHS Did Not Implement Agreed-Upon Corrective Actions**

For 6 of the prior audit's 13 recommendations, RHS did not take corrective actions in accordance with agreed-upon management decisions.<sup>6</sup> Although RHS officials stated that they believed the agency had taken steps to fully address these recommendations, our review found that they had not. Until RHS has taken final corrective action to respond to these audit recommendations, the agency cannot be certain that the problems identified by the 1999 report have been addressed.

Departmental regulations state that agencies will ensure that final action is achieved as agreed upon in the management decision unless a request for a change in management decision has been forwarded to OCFO and approved by OIG.<sup>7</sup>

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<sup>6</sup> Including three recommendations for which OCFO had agreed with corrective actions taken and closed the recommendations (recommendations 1b, 5b, and 6b).

<sup>7</sup> DR 1720-001.

We found RHS had either not responded to or fully implemented audit recommendations intended to ensure that:

- lenders complied with all eligibility requirements when approving loan applications;
- lenders were submitting loss claims only for eligible and supported costs;
- eligibility maps were current and only buyers in eligible rural areas were allowed to participate;
- lenders were sharing proceeds from the liquidation of foreclosed properties with RHS;
- accounts receivable were established and collection efforts pursued for paid loss claims; and
- appraisers were monitored to ensure that they estimated the value of guaranteed properties fairly.

See exhibit A for a detailed description of each of the 1999 audit report's recommendations, RHS' response, and our current assessment of the agency's corrective actions.

#### RHS Has Not Ensured that Lenders Do Not Issue Loans to Ineligible Applicants

In our prior audit, we found that lenders approved loans for individuals whose eligibility to receive GLP loans was questionable. To ensure that loans were only made to borrowers whose incomes did not exceed the prescribed levels, and who possessed suitable repayment ability and acceptable credit history, we recommended<sup>8</sup> that RHS inform lenders that all loan eligibility criteria must be met before making a loan.

To reach management decision for this recommendation, RHS agreed to issue a directive advising lenders of the requirements for underwriting loans and the need to adhere to agency regulations. The directive would identify the loan eligibility criteria which must be met, and would caution lenders to carefully scrutinize each eligibility criterion before making a loan. RHS stated that they would send the directive to all approved lenders by April 30, 1999. On the basis of RHS' corrective action plan, we reached management decision for this recommendation on March 25, 1999.

However, our current audit disclosed that RHS' corrective actions were not those agreed upon, and may not have been adequate to address the conditions we noted. Although the guidance and policies issued by RHS to correct the problems with ineligible applicants was sufficient, it was lacking in two areas. First, instead of issuing a permanent directive to its handbook, RHS issued ANs which remain in effect for only 1 year and lapse if not renewed.

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<sup>8</sup> Recommendation 1b of Audit Report No. 04601-2-At dated March 1999

When we discussed this with RHS officials, they stated that they believed the agency had adequately responded to the recommendation. They stated that they, as well as other agencies, use ANs for these purposes. While agreeing that these notices expire, they stated that they re-issue them within a few days or a week of expiration.

We found that 10 of the initial ANs issued to address Recommendation 1b had expired before being replaced, and the average replacement time was 139 days after the expiration date. In two cases, the ANs had not been replaced for periods in excess of 700 days. We performed a similar analysis of 18 ANs that were subsequently issued, or replaced the initial ANs for Recommendation 1b and found that 14 had been allowed to expire before the issuance of their replacements. Although 4 of the 18 had been replaced in a timely manner, the average replacement time for the other 14 ANs was 91 days after the expiration date, and 2 of the 14 ANs were not replaced for periods in excess of 300 days. During these periods, the lenders were not bound by the requirements of the expired ANs. It is clear, therefore, that ANs are not always being timely replaced when they expire. As a result, we do not consider the ANs to be an adequate alternative to a permanent directive.

Second, we found that the ANs were all addressed to “national lenders” and to RD State offices. RHS officials stated that lenders are responsible for following all regulations and guidelines, and that lenders should either access RHS’ website or the ALL-REGS subscription service (a database of RHS regulations) to keep abreast of current rules and regulations. While we concur that all lenders would have the same access to ALL-REGS through the means described by RHS officials, the fact that the notices were addressed to national lenders only could potentially cause other lenders (those who operate only on a Statewide or local level) to interpret the ANs as not being applicable to them. To avoid any possible confusion, we believe that directives need to be addressed to all lenders.

We concluded that the ANs that RHS issued were not adequate to address our recommendation since they were not permanent, and most had been allowed to expire for varying periods before being reissued. In addition, some lenders may have regarded ANs addressed to “national lenders” as not intended for them. Although RHS officials stated that they plan to incorporate these ANs into the handbooks in the form of permanent directives, the actions taken to date do not provide sufficient assurance that all lenders are complying with agency instructions.

#### RHS Has Not Ensured that Lenders Submit Loss Claims only for Eligible and Supported Costs

In our prior audit, we found that RHS paid 15 loss claims that included \$73,175 in questionable or unsupported costs, such as excess interest and

unsupported liquidation expenses. We recommended<sup>9</sup> that RHS caution lenders that loss claims should include only eligible and supportable costs.

To reach management decision for this recommendation, RHS agreed to issue a directive instructing all lenders to identify excessive claims and take appropriate action when processing loss claims. In addition, RHS stated that it was automating its loss claim process and that this new system would standardize loss claim calculations and would establish uniform loss claim reimbursement categories. This system would help ensure that loss claims are processed consistently and fairly nationwide. On the basis of RHS' corrective action plan, management decision for this recommendation was reached on March 15, 2001.

However, as in their corrective action for Recommendation 1b, RHS officials drafted ANs instead of a permanent directive to the applicable handbook. For example, AN 3544 was issue on May 10, 2000 to address Recommendations 1b and 6b. It expired on May 31, 2001 and was reissued as AN 3861 on May 13, 2003, more than 700 days after it expired. Also, the ANs were addressed only to "national lenders," which again could lead lenders who operate on only a Statewide or local basis to believe that the ANs do not apply to them.

Again, we believe that to be effective, RHS needs to issue a permanent directive to address this recommendation, and ensure that it is made clearly applicable to all lenders.

#### RHS Has Not Ensured That Only Applicants in Eligible Rural Areas Are Allowed to Participate

In our prior audit, we found that RHS needed to update its maps to ensure that loans were only issued to applicants in eligible rural areas. We recommended<sup>10</sup> that RHS include as part of its national internal reviews and State internal reviews a check to verify that States had updated their maps to account for growth.

To reach management decision for this recommendation RHS agreed to revise, by August 25, 1999, the management control review guide it uses for conducting national internal reviews to include a check for updates to rural area eligibility maps. In addition, RHS stated that it would add this requirement to its guide for State internal reviews. On the basis of RHS' corrective action plan, management decision for this recommendation was reached on March 25, 1999.

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<sup>9</sup> Recommendation 6b.

<sup>10</sup> Recommendation 5b.

However, our current audit disclosed that the actions RHS took to respond to this management decision were not adequate. RHS added to its management control review guide for conducting national internal reviews, the question, "Are current county maps showing ineligible areas available in RHS field offices?" To its guide for State internal reviews, RHS added the question, "Is the local office rural area map (with current State director approval) displayed?" These questions address whether a map is available, not whether the map has been updated to account for changes in eligible areas.

We also noted that RHS officials had stated that they would ensure that eligible areas are updated as required by performing national and State internal reviews. However, RHS has performed only one national internal review since we issued our 1999 report. As a result, RHS officials could not determine whether changes to the national and State review guides were adequate to resolve this recommendation.

#### RHS Has Not Ensured that Lenders Share Recoveries

In our prior audit, we found that RHS did not track lenders' liquidation of foreclosed properties to ensure that proceeds were properly shared with RHS. To ensure that lenders share these proceeds, we recommended<sup>11</sup> that the agency require lenders to submit annual status reports showing the disposition and sale proceeds of inventory properties held at the time loss claims were paid.

To reach management decision for this recommendation, RHS agreed to include in its *Lender Monitoring Handbook* a checklist covering how proceeds from the sale of foreclosed properties should be divided between RHS and the lender. On the basis of RHS' corrective action plan, we reached management decision for this recommendation on September 28, 2000.

However, our current audit disclosed that the actions RHS took to respond to this management decision were not adequate. Instead of revising the handbook, RHS issued an AN.

For reasons noted earlier, we do not consider this an adequate corrective action. We believe that RHS needs to issue a permanent directive as part of its handbook.

#### RHS Has Not Established Accounts Receivable to Recover Paid Loss Claims

In our prior audit, we found that that RHS had made no effort to recover losses totaling \$1,439,844 sustained on loans associated with 72 loss claims. We recommended<sup>12</sup> that RHS establish accounts receivables against

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<sup>11</sup> Recommendation 8.

<sup>12</sup> Recommendation 9.

borrowers to recover losses on defaulted loans. In addition, we recommended that RHS not release borrowers from liability until all available means of recovering losses have been explored.<sup>13</sup>

To reach management decision for this recommendation, RHS agreed to amend GLP regulations to require future loss claim payments for guaranteed loans as debts owed to the Federal Government and establish procedures for referring such accounts to the U.S. Department of the Treasury for collection under the Debt Collection Improvement Act of 1996 (DCIA). In addition to these regulatory changes, RHS stated that it would work to develop and implement a computer system to electronically refer loss claim data to the U.S. Department of the Treasury. On the basis of RHS' corrective action plan, we reached management decision for this recommendation on May 22, 2001.

On March 25, 2005, RHS submitted a request for change in management decision to OCFO. The agency stated that, according to an Office of General Counsel opinion, it did not need a regulatory change in order to collect from borrowers under DCIA. Instead, RHS needed only to clearly establish a direct relationship between the borrowers and the agency. Consequently, RHS amended Form RD 1980-21, "Request for Single-Family Housing Loan Guarantee," to include language which allowed the agency to establish a receivable against the borrower to recover any losses paid on a defaulted loan. In April 2003, RHS established an automated system to identify losses paid on defaulted loans and to hold borrowers responsible for those losses.

Although these significant measures had been accomplished by April 2003, our current review disclosed that RHS' subsequent actions were not adequate to respond to this recommendation. As of June 2005, RHS had not established any accounts receivables under this process because its automated system had not been fully implemented to allow automatic referral to the U.S. Department of Treasury.

When we discussed this issue with RHS officials, they stated that when RHS began the process of designing this automated system, they believed that there would not be enough receivables accrued before the automated system was in place to necessitate a manual interim solution. RHS had not attempted to collect any of these loans as of June 2005, but in June 2005, RHS reported to us that due to the significant number of eligible accounts, the Deputy Chief Financial Officer began establishing procedures to manually refer accounts to the U.S. Department of Treasury. Subsequent to our fieldwork, RHS reviewed their data and stated that as of June 2006, 768 accounts were eligible for collection under DCIA (i.e., loan originating and having loss

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<sup>13</sup> Available means include deficiency judgments, IRS tax offsets, and Federal salary offsets.

claims paid after April 2003), and they had established receivables totaling \$16,312,773 for 608 of these accounts<sup>14</sup>.

Subsequent to the completion of our fieldwork, RHS initiated a process to address this recommendation, however, the actions agreed to in the management decision remained incomplete more than 4 years after management decision was reached.

### RHS Has Not Monitored Appraisers to Ensure the Independence of Their Appraisals

In our prior audit, we found that RHS needed to develop a system for ensuring the independence of appraisers who determine the value of properties pledged as security for loans. Since lenders select and pay these appraisers, it is possible that appraisers might assign properties unrealistic values in order to satisfy their employers. We recommended<sup>15</sup> that RHS establish a rotating list of RHS-approved appraisers in each State, and assign appraisers from the list to perform appraisals for lenders seeking a guaranteed rural housing loan. We also recommended that this list be used when appraisals are necessary for a loan in default.

To reach a management decision for this recommendation, RHS agreed to include in its *Lender Monitoring Handbook* a process for reviewing appraisers and property appraisals. On the basis of RHS' corrective action plan, we reached management decision for this recommendation on September 28, 2000.

On March 25, 2005, RHS submitted to OCFO a request for a change in management decision stating that each and every appraisal submitted by lenders is reviewed by loan approval officials who record their analysis on Form RD 1922-15, "Residential Appraisal Review for Single Family Housing (SFH)." RHS also stated that it would test appraisal validity when conducting lender compliance reviews. Additionally, RHS issued guidance for appraisals in the form of ANs regarding acceptable appraisal forms, existing dwelling inspection requirements, and appraisals in remote rural areas and on tribal lands. Finally, we noted that RHS had issued lender review guides in 1999 and 2001 addressing performance of administrative appraisal reviews.

However, RHS' actions have not been adequate to respond to this recommendation because they did not address the essence of the recommendation. First, Form RD 1922-15 was required during the previous audit and was not identified as an adequate control to ensure appraisers'

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<sup>14</sup> RHS stated that the remaining 160 accounts were not referred for collection under the DCIA because the losses were attributable to the death of the borrower, bankruptcy, or other mitigating factors.

<sup>15</sup> Recommendation 10.

independence. Secondly, as noted earlier, ANs cannot replace formal directives on a permanent basis. Finally, the revisions to the lender compliance review guides do not address the issue of appraiser independence. The lender compliance review guides ask the reviewer to “test whether the appraisal is signed and dated,” and “test whether the appraisal supports the value of the loan.” The guide also asks the reviewer to determine, “Was the appraiser licensed or certified?” None of these compliance review revisions adequately address the issue of appraisers’ independence.

For these six recommendations discussed, we found that in most cases RHS had taken some corrective actions. However, the actions were insufficient because they were generally implemented by ANs that were not always timely replaced upon expiration. In addition, those involving actions that needed to be taken by lenders were addressed only to national lenders rather than all lenders who might be affected by them. Finally, in some case the actions themselves were not those agreed to in the management decisions and were not adequate to address the conditions found in our report.

Overall, we concluded that RHS needs to take steps to resolve, as expeditiously as possible, all six remaining recommendations from the 1999 audit report.

## Recommendation 1

Require that all lenders receive permanent notification of policy, procedural, and informative documents so that corrective actions are in accordance with the management decision (Recommendation 1b and 6b).

**Agency Response.** In its September 21, 2006, response, the agency stated that by August 2007:

\* \* \* \* \*

[R]ural Development proposes to amend its current regulation, RD Instruction 1980-D, by means of Procedure Notices. The Procedure Notice will become a permanent part of RD Instruction 1980-D, or any replacement regulation. The regulation will be amended to advise lenders about the need to underwrite loans according to Agency regulations. The regulatory change will require lenders to process and approve loans in accordance with program instructions, that loan applications be reviewed for accuracy and completeness, that the income limits must not be exceeded, and that borrowers must have adequate loan repayment ability and acceptable credit histories.

The regulatory changes will also advise lenders that loss claims include only supportable costs and any excess costs will be denied.

To address the matter of lenders receiving notification of future regulatory changes or policy directives \* \* \*. The regulation will be supplemented to include a stipulation that lenders regularly check Rural Development's website for new issuances related to program requirements.

**OIG Position.** We concur with management decision for this recommendation.

## Recommendation 2

Require that State internal review and management control review guides include a check to determine whether States have updated their rural area eligibility maps as agreed in the management decision (Recommendation 5b).

**Agency Response.** In its September 21, 2006, response, the agency stated that:

\* \* \* \* \*

The next [Management Control Review] MCR to be conducted for the [Single Family Housing Guaranteed Loan Program] SFHGLP will include testing to determine that the required eligible area reviews are taking place.

[A] \* \* \* more specific question regarding the conducting of the reviews has been added to the 2007 SIR guide, question #23 for the guaranteed guide \* \* \* as follows: Has the field office conducted the required periodic rural area review and updated the electronic mapping system on the Agency's eligibility website?  
\* \* \*

\* \* \* \* \*

**OIG Position.** We concur with management decision for this recommendation.

### Recommendation 3

Include in the *Lender Monitoring Handbook* a section covering proceeds from the sale of foreclosed property (Recommendation 8).

**Agency Response.** In its September 21, 2006, response, the agency stated that:

\* \* \* A permanent change to the regulation was made by Procedure Notice. Based on this permanent change to our regulation, the OCFO accepted final action for Recommendation 8 on March 17, 2006.

[RD] has made a permanent change to our regulation RD Instruction 1980-D. The changes to our regulation covering [RD] and lender the proceeds from the sale of foreclosed property, was added by Procedure Notice as a new section to the regulation, section 1980.377.

\* \* \* \* \*

**OIG Position.** We concur with management decision for this recommendation.

### Recommendation 4

Obtain necessary regulatory changes and establish accounts receivable for those loans that had a loss claim paid subsequent to April 2003 (Recommendation 9).

**Agency Response.** In its September 21, 2006, response, the agency stated that:

\* \* \* [RD] has made the changes necessary to establish accounts receivables for loans that were originated subsequent to April 2003. \* \* \* The OCFO was provided with evidence of the accounts receivable in October 2005, and they accepted final action for the [R]ecommendation 9 on March 17, 2006. The accounts receivable are now reported in [RD's] financial statements.

\* \* \* \* \*

**OIG Position.** We concur with management decision for this recommendation.

## Recommendation 5

Include in the *Lender Monitoring Handbook* a process for reviewing appraisers and property appraisals to ensure their independence (Recommendation 10).

**Agency Response.** In its September 21, 2006, response, the agency stated that:

\* \* \* Based on this permanent change to our regulation, the OCFO accepted final action for Recommendation 10 of Audit No. 04601-002-AT on August 1, 2006.

[RD] has made a permanent change to our regulation, RD Instruction 1980.D. \* \* \* The change to the regulation was made by Procedure Notice as an amendment to the regulation section 1980.344. \* \* \*

**OIG Position.** We concur with management decision for this recommendation.

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**Finding 2****RHS Needs Improved Procedures to Ensure Corrective Actions Are Taken and Reported to OCFO in a Timely Manner**

We found that RHS either did not implement or report corrective actions within prescribed timeframes, taking between 983 to 1,965 days after the required final action date to implement or report 12 of the 13 recommendations. RHS officials stated that this occurred because they lacked the staff to fully implement some of the recommendations. We also found, however, that RHS officials had not reported completed actions in a timely manner because they were unfamiliar with the requirement to forward evidence of corrective actions to the audit liaison. Although RHS did have procedures in place to specify how management should respond to audit recommendations, RD Instruction 2012-A, "Audits and Investigations", those procedures could be made more specific. As a result, of these problems, RHS required much longer to close these recommendations.

For each audit where final action has not been completed within 365 days from management decision, Departmental regulations state that agencies must report the reason final action is not complete and also provide a revised completion date, as well as semiannual time-phased implementation plans for each audit recommendation.<sup>16</sup> These plans should include major corrective action milestones and estimated completion dates for each open recommendation. Additionally, RD regulations establish and provide the policies, procedures, and responsibilities for achieving management decisions and taking final actions on recommendations resulting from audit reports.<sup>17</sup>

We assessed how RHS addressed the prior audit's 13 recommendations and found that RHS had not implemented or reported corrective actions within 365 days of management decision for 12 of the 13 recommendations despite the fact that RHS had established realistic completion dates which generally fell inside the 365 day timeframe. For 6 of these recommendations, as discussed in Finding 1, RHS had not fully implemented corrective actions. For the other 6 recommendations, RHS did not report the corrective actions to OCFO within the prescribed timeframe, although they had in fact implemented measures to address the recommendations within 365 days of reaching management decision.<sup>18</sup>

Our review of RHS' actions indicated that management did not always understand the audit followup process. To fulfill the requirements for reaching management decision for Recommendation 1a, for instance, RHS agreed on March 25, 1999, to develop a standardized and comprehensive checklist to aid loan approval officials in ensuring that loan applicants meet

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<sup>16</sup> DR 1720.1.

<sup>17</sup> RD Instruction 2012-A, "Audits and Investigations."

<sup>18</sup> Recommendations 1a, 2, 4a, 5a, 6a, and 7.

all eligibility requirements. In 2000, RHS instead implemented a series of edit checks and other application controls within its Guaranteed Loan System (GLS) database, but did not request a change in management decision until March 25, 2005, after we made inquiries concerning this recommendation and subsequently encouraged RHS officials to submit their revised corrective action plan. This recommendation was thus left open for almost 1,965 days after corrective action had been taken.

When we discussed this problem with RHS officials, they told us that they had not submitted documentation to the agency audit liaison because they were not aware they were responsible for providing evidence of final corrective action unless the audit liaison explicitly requested them to do so. However, an official from the RD audit liaison's office provided us with documentation indicating that the liaison contacted program officials on a quarterly basis to remind them of open recommendations.

To illustrate the significant delays in achieving final action, table 1 shows the required final action dates and the dates final action was actually achieved for each recommendation.

Table 1

Days Exceeding Final Action Due Dates					
Rec. No. <sup>19</sup>	Management Decision Date	Required Final Action Date	Date Corrective Action Implemented by Agency	Date Final Action Achieved	Days Final Action Exceeded Required Date <sup>20</sup>
1a	25-Mar-1999	25-Mar-2000	1-Jan-2000	10-Aug-2005	1,965
1b	25-Mar-1999	25-Mar-2000	N/A	31-Aug-2004	1,621
2	26-Jun-2000	26-Jun-2001	26-Jun-2000	5-Mar-2004	983
3 <sup>21</sup>	29-Aug-2002	29-Aug-2003	29-Aug-2002	29-Aug-2003	0
4	3-Dec-1999	3-Dec-2000	6-Jun-2000	5-Mar-2004	1,189
5a	3-Dec-1999	3-Dec-2000	3-Dec-1999	5-Mar-2004	1,189
5b	25-Mar-1999	25-Mar-2000	N/A	5-Mar-2004	1,442
6a	15-Mar-2001	15-Mar-2002	8-Feb-2001	25-Mar-2005	1106
6b	25-Mar-1999	25-Mar-2000	N/A	31-Aug-2004	1,621
7	28-Sep-2000	28-Sep-2001	13-Sep-1999	10-Aug-2005	1,412
8	28-Sep-2000	28-Sep-2001	N/A		1,463
9	22-May-2001	22-May-2002	N/A		1,227
10	28-Sep-2000	28-Sep-2001	N/A		1,463
<b>Note: Although OCFO granted final action for Recommendations 1b, 5b, and 6b, we took exception to this determination in Finding 1. For the purpose of this report, we consider these recommendations open.</b>					

Given RHS' problems achieving final action in a timely manner, we reviewed RD's directive regarding the audit followup process. RD's directive<sup>22</sup> does describe the basic elements of the followup process, but the directive does not detail agency management's responsibilities when responding to audit recommendations, nor does it include timeframes for completing final action.

We concluded that RHS should develop procedures to better set forth management's responsibilities when responding to audit recommendations.

<sup>19</sup> Recommendation numbers correlate with the recommendation numbers assigned in Audit No. 04601-2-At, and with exhibit A.

<sup>20</sup> Where final action has not been reached, the "days final action exceeds required date" is calculated as of September 30, 2005.

<sup>21</sup> Recommendation 3 resulted in no action being required by RHS. In the report, OIG recommended that RHS limit loss payments to lenders to 90 percent of the loss, not to exceed 90 percent of the loan amount. This recommendation was not acceptable to RHS and was elevated to the Under Secretary of RD for further consideration. On August 29, 2002, we agreed to a post-audit justification requiring RHS to take no further action.

<sup>22</sup> RD 2012-A, "Audits and Investigations."

## Recommendation 6

Develop a procedural manual that clarifies RD Instruction 2012-A, "Audits and Investigations" to clearly identify the responsibilities of agency management and establish procedures for responding to audit recommendations. These procedures should include timeframes for completing final corrective action.

**Agency Response.** In its September 21, 2006, response, the agency stated that:

\* \* \* A procedural manual for internal use and reference has been developed that reiterates the responsibilities of management. These procedures include timeframes for completing final corrective action.

Estimated Completion Date: February 2007

**OIG Position.** We concur with management decision for this recommendation.

# **Scope and Methodology**

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This audit was a followup to a prior OIG audit that made 13 recommendations for RHS' GLP.<sup>23</sup> During the current review, we examined and assessed how RHS implemented and reported its final corrective actions for these recommendations.

To accomplish our objective, we examined evidence provided by RHS to assess whether the agency had taken corrective action in accordance with the agreed-upon management decisions. We also assessed whether the corrective actions were implemented within 365 days of reaching management decision. If actions taken by RHS were not timely reported or did not agree with the proposed corrective action plan, we evaluated the issue and assessed its effect on the guaranteed loan program. We also interviewed RHS officials, OCFO officials, and RD-Financial Management Division (FMD) officials to clarify agency actions. We performed our work from February through July 2005 at RHS' National Office, OCFO, and RD-FMD offices in Washington, D.C.

Initially, our objective and scope included an assessment of the effectiveness of implemented corrective actions; however, due to other OIG audit priorities, we decided to assess the effectiveness of the corrective actions as part of a separate audit.

Our review was performed in accordance with generally accepted government auditing standards.

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<sup>23</sup> Audit No 04601-2-At, "RHS—GLP," dated March 25, 1999.

# Exhibit A – Status of the 13 Recommendations From the Prior Audit Report

Exhibit A – Page 1 of 5

Audit Report No. 04601-2-At Recommendation	Management Decision	Final Action	OIG Assessment of Final Action
<p><b>1a:</b> Develop a comprehensive standardized checklist to be used by RHS loan approval officials to ensure that guaranteed rural housing loan applicants meet all eligibility requirements.</p>	<p>A checklist will be issued with the new handbooks that are scheduled to be published in December 1999.</p> <p>In March 2005, RHS submitted a request for a change in management decision to seek approval of an automated comprehensive standardized application (within GLS) to replace the checklist.</p> <p><i>Management Decision date: 3/25/99</i></p>	<p>OIG granted a change in management decision and allowed the automated application, which included edit checks, to serve as a replacement for the checklist.</p> <p><i>Final Action granted: 8/10/05</i></p>	<p>RHS' actions were appropriate to reach final action with a request for change in management decision.</p> <p>However, RHS did not timely report final action to OCFO. The corrective action was completed in January 2000 but RHS did not contact OCFO until March 2005, when the agency requested a change in management decision.</p>
<p><b>1b:</b> Provide lenders with information regarding the basis for ineligible loans identified in this report, and caution them that more care must be taken in reviewing future applications to ensure that all loan eligibility criteria is in compliance.</p>	<p>The agency will advise lenders regarding agency requirements for underwriting loans and the need to adhere to agency regulations. This directive will identify the loan eligibility parameters which must be examined, and will caution lenders to carefully scrutinize each aspect of loan eligibility. The directive will be sent to all approved lenders by April 30, 1999.</p> <p><i>Management Decision date: 3/25/99</i></p>	<p>RHS provided a number of published ANs concerning loan eligibility criteria.</p> <p><i>Final Action granted: 8/31/04</i></p>	<p>RHS' actions were not sufficient to meet intent of management decision because actions taken did not provide assurance that all lenders received ANs. These documents were addressed only to national lenders and the State office. The ANs were available to lenders using the RD website and ALL REGULATIONS, an online regulations subscription service. Further ANs are not permanent corrective actions because they expire. As such, they are unacceptable forms of instruction to serve as final action.</p> <p>RHS did not timely report final action. Corrective actions were first implemented in October 1999 with additional ANs being issued in subsequent years.</p>
<p><b>2:</b> Require State directors to implement a more aggressive outreach program to ensure that the objective of providing home ownership opportunities to low- and moderate-income residents of rural areas is achieved.</p>	<p>The FY 2000 GLP special outreach area goal was established in RD Instruction 1940-L, exhibit A, attachment 2, part II, subpart C. FY 2000 funding has been allocated to States in two funding streams. Seventy percent of GRH funds may be used in any eligible area. Thirty percent are to be used for special outreach areas. Those States not meeting the goal will be required to implement procedures to ensure that utilization in special outreach areas is increased.</p> <p><i>Management Decision date: 6/26/00</i></p>	<p>RHS provided RD Instruction 1940-L, exhibit A, attachment 2, part II, subpart C, which established funding allocations to States in two streams.</p> <p><i>Final Action granted: 3/5/04</i></p>	<p>RHS' actions were appropriate to reach final action.</p> <p>Corrective actions were timely implemented in June 2002.</p> <p>RHS did not timely report final action.</p>

# Exhibit A – Status of the 13 Recommendations From the Prior Audit Report

Exhibit A – Page 2 of 5

Audit Report No. 04601-2-At Recommendation	Management Decision	Final Action	OIG Assessment of Final Action
<p><b>3:</b> Limit loss payments to lenders to 90 percent of the loss not to exceed 90 percent of the loan amount.</p>	<p>Our review found no violation of statutory provisions. No further action is required of the agency.</p> <p><i>Management Decision date:</i> 8/29/02</p>	<p>No action necessary.</p> <p><i>Final Action granted:</i> 8/29/02 (recorded as 12/6/03)</p>	<p>RHS' actions were appropriate to reach final action. However, final action was not timely recorded in the tracking system.</p>
<p><b>4:</b> Increase guarantee fees to a level that will provide sufficient funds to pay loan losses and eliminate the need for appropriate funds to subsidize the program. As applicable, RHS should seek legislation to revise Pubic Law 101-625 to authorize an appropriated increase in the guarantee fee.</p>	<p>The agency has developed proposed legislation to increase the guarantee fee from 1 percent to 2 percent. The increase in the guarantee fee may eliminate the need for appropriated funds to subsidize the program. The fee increase, if approved and cleared by the Department and the Office of Management and Budget and passed by Congress, would become effective in FY 2001.</p> <p><i>Management Decision date:</i> 12/3/99</p>	<p>Section 739 of Public Law 106-387 provided the Secretary of Agriculture the authority to set the guarantee fee up to 2 percent.</p> <p><i>Final Action granted:</i> 3/5/04</p>	<p>RHS' actions were appropriate to reach final action.</p> <p>Corrective actions were timely implemented.</p> <p>RHS did not timely report final action.</p>
<p><b>5a:</b> Require State offices to establish a tracking system to ensure that loan approval officials perform reviews and updated county maps in a timely manner so that guaranteed rural housing loans are limited to eligible areas.</p>	<p>The instruction for reviewing rural area designations, from the Section 502 <i>Direct Field Office Handbook</i>, was provided. The same instruction which apply to the direct program applies to the GLP. Also attached is a copy of the Administrator's directive issued on 12/18/98.</p> <p><i>Management Decision date:</i> 12/3/99</p>	<p>AN 3679 required that State directors re-designate communities based upon data from the 2000 census following paragraph 5.3 of Handbook-1-3550.</p> <p><i>Final Action granted:</i> 3/5/04</p>	<p>RHS' actions were appropriate to reach final action.</p> <p>Corrective actions were timely implemented.</p> <p>RHS did not timely report final action.</p>
<p><b>5b:</b> Include as part of National Internal Reviews (NIR) and State Internal Reviews (SIR) an evaluation of update revisions to eligibility maps to ensure that guaranteed rural housing loans are limited to eligible areas.</p>	<p>The agency is in the process of updating its Management Control Review (MCR) guide and will ensure this element is added. In addition, the agency will ensure that this element is added to the SIR guide. Both will be accomplished in the next 90 days (from May 25, 1999).</p> <p><i>Management Decision date:</i> 3/25/99</p>	<p>The question, "Is the local office rural area map (with the current State director approval) displayed?" was included in the SIR.</p> <p>The question, "Are current county maps showing ineligible areas available in RHS field offices?" was included in the MCR in 2003.</p> <p><i>Final Action granted:</i> 3/5/04</p>	<p>RHS' actions were not sufficient to achieve final action.</p> <p>We do not believe that these questions address the concerns identified by OIG in the previous audit. These questions address whether a map is available. While SIR does allude to the current State director's signature, it in no way provides assurance that eligibility reviews and map updates were performed.</p> <p>RHS did not timely report final action.</p>

# Exhibit A – Status of the 13 Recommendations From the Prior Audit Report

Audit Report No. 04601-2-At Recommendation	Management Decision	Final Action	OIG Assessment of Final Action
<p><b>6a:</b> Recover \$73,715 in questioned or unsupported payments made to lenders on 15 claims and pay \$5,342 in accrued interest due the 6 lenders identified in the audit.</p>	<p>RHS agreed to request repayment of \$4,069 from one lender based on OIG's calculation of overpayment.</p> <p><i>Management Decision date: 3/15/01</i></p>	<p>In March 2004, RHS submitted a request for final action. OCFO denied the request because it showed that only one collection notice was sent in 1999. In March 2004, OCFO requested proof of additional collection efforts. In July 2004, RHS responded that they believed the debt to be uncollectible due to its age. OCFO requested an OGC opinion supporting this statement. In November 2004 RHS requested an opinion from the Texas OGC. In December 2004, Texas OGC provided an opinion stating that RD could not successfully enforce the collection because the claim was time barred. RHS reported this to OCFO in February 2005.</p> <p><i>Final Action granted: 3/25/05.</i></p>	<p>RHS' actions were sufficient to reach final action.</p> <p>The delay in requesting final action the first time contributed to the debt becoming uncollectible. Had the request for final action been timely, additional collection efforts could have been pursued before the debt became time barred. However, OCFO correctly granted final action in light of circumstances (time-barred collection).</p> <p>RHS did not timely report final action.</p>
<p><b>6b:</b> Caution lenders about the need to ensure that loss claims included only supportable costs and any excess costs will be denied.</p>	<p>The agency will issue a directive to all lenders participating in GLP to ensure the expeditious handling of loss claims and to identify excessive claims for appropriate action.</p> <p>In addition, the agency is currently automating its loss claim processes. Automation will standardize loss claim calculations such as interest accrual and will establish uniform loss claim reimbursement categories. The goal of these efforts is to insure that loss claims are processed consistently and fairly nationwide.</p> <p><i>Management Decision date: 3/25/99</i></p>	<p>Several ANs were published to caution lenders and field staff about the need to ensure loss claims includes only supportable costs and that excess costs will be denied. RHS cited the following ANs: RD AN 3941, "Acceptable Liquidation Fees and Costs"; RD AN 3939, "Occupied Real Estate Owned Inspection, Valuation and Loss Claim"; RD AN 3935, "Acceptable Foreclosure time Frames"; RD AN 3885, "Foreclosure Sales Bids"; RD AN 3877, "Loss Mitigation – Comprehensive Clarification of Policy"; RD AN 3865, "Future Recovery of Real Estate Owned Sale Proceeds"; RD AN 3861, "Lender Real Estate Owned Property Disposition Plans."</p> <p>The agency has automated the loss claims process, process was implemented in early 2003.</p> <p><i>Final Action granted: 8/31/04</i></p>	<p>RHS' actions were not sufficient to achieve final action.</p> <p>RHS did not provide assurance that lenders received the notice concerning proper handling of loss claims. The directives, which were temporary in nature, were not addressed to all lenders, but to the State office and the national lenders. RHS delegated the responsibility to the State to ensure compliance by non-national lenders, but provided no assurance that the State had fulfilled its duty.</p> <p>RHS did not timely report final action.</p>

# Exhibit A – Status of the 13 Recommendations From the Prior Audit Report

Audit Report No. 04601-2-At Recommendation	Management Decision	Final Action	OIG Assessment of Final Action
<p><b>7:</b> Develop a lender review guide that incorporates results obtained from this audit and CPA reviews to be used by loan approval officials in performing lender reviews.</p>	<p>The LMH and <i>Technical Manual</i> (TM) will incorporate the results obtained from this audit and CPA reviews.</p> <p>As stated in previous responses, both the LMH and TM will not be finalized until the new regulation governing GLP has been published. We anticipate publication on October 1, 2001.</p> <p><i>Management Decision date:</i> 9/28/00</p>	<p>In March 2005, RHS submitted a request for a change in management decision stating that LMH is no longer in production. Instead, two lender monitoring guides had been published in their place, along with applicable ANs. RHS provided copies of the two lender monitoring guides that incorporated the results from the audit and are now used by loan approval officials when performing lender reviews. RHS also provided copies of the compliance review workpapers that are used to guide lender compliance reviews.</p> <p><i>Final Action granted:</i> 8/10/05</p>	<p>RHS' actions were appropriate to reach final action with a request for change in management decision.</p> <p>Corrective actions were timely implemented.</p> <p>RHS did not timely report final action.</p>
<p><b>8:</b> Require lenders to submit annual status reports that show the disposition and sale proceeds of inventory properties held at the time loss claims were paid and ensure that any gains are properly shared with RHS.</p>	<p>The LMH will include a section in the checklist covering gains on the sale of foreclosed property in inventory. The LMH will not be finalized until the new regulation governing the GLP has been published. We anticipate publication on October 1, 2001.</p> <p><i>Management Decision date:</i> 9/28/00</p>	<p>In March 2005, RHS submitted a request for a change in management decision stating that ANs (AN 4019), "Loss Claims and Future Recovery Processing," and predecessors includes a <i>Loss Claim and Future Recovery Guide</i> as an exhibit. It also includes a future recovery calculator to be used by lenders and agency staff to calculate future recovery owed by the agency. By comparing AN 4019 with its predecessors, the instruction on loss claims and future recovery processing has evolved and improved over time. (The term "future recovery" is a regulatory and industry expression which is defined as the Government's share of gains on the sale of foreclosed property in a lender's inventory.)</p> <p><i>Final Action granted:</i> N/A</p>	<p>RHS' actions were not sufficient to achieve final action.</p> <p>ANs are not permanent corrective actions and thus are not acceptable for final action.</p> <p>Final action was not implemented in a timely manner.</p> <p><i>Final Action has not been achieved</i></p>

# Exhibit A – Status of the 13 Recommendations From the Prior Audit Report

Audit Report No. 04601-2-At Recommendation	Management Decision	Final Action	OIG Assessment of Final Action
<p><b>9:</b> Establish accounts receivable against borrowers to recover losses on defaulted loans. Also, do not release borrowers who default on guaranteed rural housing loans from liability until all available means including deficiency judgments, Internal Revenue Service (IRS) tax offsets, and/or Federal salary offsets have been explored to recover losses sustained on defaulted loans.</p>	<p>Within the next 6 months, RHS agrees to develop a Regulatory Work Plan for review and approval by the Under Secretary for Rural Development to amend GLP regulations to establish future loss claim payments for SFH guaranteed loans as debts owed to the Federal Government and establish procedures for referral of such accounts to the U.S. Department of the Treasury for collection under DCIA.</p> <p>In addition to regulatory changes, computer system enhancements are needed to electronically refer loss claim data to the Department of the Treasury. These enhancements will have to be developed, tested, and implemented. RHS will attempt to prioritize the system enhancements, but it should be recognized that securing the necessary funding and human resources for a project of this scope will be an issue that will affect the implementation timeframe.</p> <p><i>Management Decision date: 5/22/01</i></p>	<p>In March 2005, RHS submitted a request for a change in management decision stating that a regulatory work plan was not necessary because in accordance with OGC opinion, the Agency did not need a regulatory change in order to collect against borrowers under DCIA. Instead, RHS needed only to clearly establish privity or a direct relationship between borrowers and the agency. Thus, In January 2003, Form RD 1980-21 was re-drafted to require borrowers to acknowledge that they will be subject to DCIA.</p> <p><i>Final Action: N/A</i></p>	<p>RHS' actions were not sufficient to achieve final action.</p> <p>RHS did not establish any accounts receivable for those loans which defaulted after April 2003, the date at which RHS stated they would begin enforcing the policy of establishing a federal receivable against defaulted borrowers. At this date, RHS was able to identify any account subject to collection, but had not implemented procedures to pursue collection or establish the accounts receivable.</p> <p>Final action was not implemented in a timely manner.</p> <p><i>Final Action has not been achieved.</i></p>
<p><b>10:</b> Establish a rotation list of RHS approved appraisers in each State, and assign appraisers from the list to perform appraisals for lenders whose applicants are seeking a guaranteed rural housing loan. Also, RHS should use the rotation list to select appraisers for defaulted loans.</p>	<p>The LMH will include a process for reviewing appraisers and property appraisals. The LMH will not be finalized until the new regulation governing the GLP has been published. We anticipate publication on October 1, 2001.</p> <p><i>Management Decision date: 9/28/00</i></p>	<p>In March 2005, RHS submitted a request for a change in management decision stating that each and every appraisal submitted by lenders is reviewed in detail by loan approval officials who are required to record their analysis on Form RD 1922-15, "Residential Appraisal Review for SFH." The agency tests appraisal validity when conducting lender compliance reviews.</p> <p><i>Final Action: N/A</i></p>	<p>RHS' actions were not sufficient to achieve final action.</p> <p>Form RD 1922-15 was required during the previous audit and was not identified as a sufficient control</p> <p>The questions in the lender compliance review guides do not address the qualitative aspects of an appraisal that would be necessary to ensure that an accurate valuation was presented.</p> <p>Final action was not implemented in a timely manner.</p> <p><i>Final Action has not been achieved.</i></p>

# Exhibit B – Agency Response

Exhibit B – Page 1 of 7



United States Department of Agriculture  
Rural Development

SEP 21 2006

SUBJECT: Housing and Community Facilities Programs  
Guaranteed Rural Housing Loan Program  
Follow-up (Audit No. 04601-003-AT)

TO: Robert Young  
Assistant Inspector General  
for Audit

Attached for your review is the Single-Family Housing response to the official draft for the subject audit.

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

If you have any questions, please contact Arlene Pitter of my staff at (202) 692-0083

A handwritten signature in cursive script that reads "Walter Wright for".

JOHN DUNSMUIR  
Acting Director  
Financial Management Division

Attachment

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

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# Exhibit B – Agency Response

Exhibit B – Page 2 of 7



United States Department of Agriculture  
Rural Development

TO: John Dunsmuir  
Acting Director  
Financial Management Division

ATTENTION: Arlene Pitter  
Financial Analyst  
Financial Management Division

SEP 19 2006

FROM: David J. Villano  
Deputy Administrator  
Single Family Housing

*for*

A handwritten signature in black ink, appearing to read "David J. Villano".

SUBJECT: Guaranteed Rural Housing Loan Program  
Audit No. 04601-003-AT

We are in receipt of your letter dated August 31, 2006, concerning the subject Office of Inspector General (OIG) audit. Please find our responses below.

#### OIG Recommendation 1

*Require that all lenders receive permanent notification of policy, procedural, and informative documents so that corrective actions are in accordance with the management decision (Recommendation 1b and 6b).*

#### Rural Development Response:

In achieving final action with the Office of the Chief Financial Officer (OCFO) for recommendations 1b and 6b, Rural Development issued a series of directives, starting in 1999, by means of Administrative Notice, which unquestionably had a direct impact on the lending community. On August 31, 2004, the Office of the Chief Financial Officer (OCFO) granted final action for recommendations 1b and 6b of Audit No. 04601-002-AT. Both Rural Development and the OCFO were in agreement that the corrective actions were in accordance with the prior management decisions for recommendations 1b and 6b.

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1400 Independence Avenue, S.W., Washington, DC 20250-9410 or call (800) 795-3272 (Voice) or (202) 720-6382 (TDD).

In the current audit, OIG states that final actions implemented for 1b and 6b were not sufficient.

Rural Development believes it is essential that lenders ensure that all loan and loss claim eligibility requirements are met.

Administrative Notices and other policies used to reach final action have effectively accomplished notification to lenders of policy and procedure directives. Aside from publication on the Rural Development website, the Administrative Notices have been mailed to lenders, are republished by the Mortgage Bankers Association of America and by a service known as ALLREGS. ALLREGS publishes all the regulations, mortgagee letters, handbooks, and administrative notices issued by the Housing and Urban Development (HUD), the Federal Housing Administration (FHA), Veteran's Affairs, Fannie Mae, Freddie Mac, and Rural Development. Rural Development also distributes its Administrative Notices and other guidance electronically through an e-mail distribution process called *ListServ*.

Rural Development regulations places the burden of staying informed on program regulations and guidelines, including all amendments and revisions of program requirements and polices, on approved lenders (see RD Instruction 1980-D, Section 1980.309(b)(2)(i)). Approved lenders agree and take the responsibility for staying informed on program requirements. Rural Development believes its website, and industry information forums like ALLREGS, in addition to mailing and e-mailing the Administrative Notices to lenders, provided broad access to the information used to implement the management decisions.

To reach management decision, Rural Development proposes to amend its current regulation, RD Instruction 1980-D, by means of Procedure Notices. The Procedure Notice will become a permanent part of the RD Instruction 1980-D, or any replacement regulation. The regulation will be amended to advise lenders about the need to underwrite loans according to Agency regulations. The regulatory change will require lenders to process and approve loans in accordance with program instructions, that loan applications be reviewed for accuracy and completeness, that the income limits must not be exceeded, and that borrowers must have adequate loan repayment ability and acceptable credit histories.

The regulatory changes will also advise lenders that loss claims include only supportable costs and any excess costs will be denied.

To address the matter of lenders receiving notification of future regulatory changes or policy directives, Rural Development will supplement its current instruction that contains the general requirement that approved lenders must stay informed on program regulations and guidelines, including all amendments and revisions of program requirements and policies. The regulation will be supplemented to include a stipulation that lenders regularly check Rural Development's website for new issuances related to program requirements.

Estimated Completion Date: August 2007

OIG Recommendation 2:

*Require that State internal review and management control review guides include a check to determine whether States have updated their rural area eligibility maps as agreed in management decision (Recommendation 5b).*

Rural Development Response:

OCFO accepted final action for this recommendation March 5, 2004 by allowing a question added to the State Internal Review (SIR) and the last conducted Management Control Review (MCR) guide of 2003 regarding currently approved maps displaying ineligible areas.

Rural area designations are applicable to both the 502 direct and guaranteed loan programs. The Fiscal Year 2006 Management Control Reviews of the Section 502 Direct Loan Program – Field Office Operations included an examination of the periodic rural area eligibility reviews conducted by the Field Offices as well as the necessary notifications provided by the State Offices. The MCR revealed that the required reviews and notifications were taking place.

The next MCR to be conducted for the SFHGLP will include testing to determine that the required eligible area reviews are taking place.

An additional and more specific question regarding the conducting of the reviews has been added to the 2007 SIR guide, question #23 for the guaranteed guide and question #76 for the direct guide, as follows:

*Has the field office conducted the required periodic rural area review and updated the electronic mapping system on the Agency's eligibility website? [1980-D, §1980.312, 7 CFR 3550.56, HB-1-3550, 5.3(C)]*

OIG Recommendation 3:

*Include in the Lender Monitoring Handbook a section covering proceeds from the sale of foreclosed property (Recommendation 8 of Audit No. 04601-002-AT).*

Rural Development Response:

Between the time OIG completed its field work for this audit in June 2005 and the issuance of its official draft audit report on August 21, 2006, a permanent change to the regulation was made by Procedure Notice. Based on this permanent change to our regulation, the OCFO accepted final action for recommendation 8 on March 17, 2006.

Rural Development has made a permanent change to our regulation, RD Instruction 1980-D. The change to our regulation, covering Rural Development and lender the proceeds from the sale of foreclosed property, was added by Procedure Notice as a new section to the regulation, section 1980.377.

Additionally, for all loss claims paid since Feb. 7, 2006, Rural Development has have instituted a firm control that provides for Agency follow-up for all claims that are paid based on an appraised value of the loan collateral. This process is handled from one location at our Centralized Servicing Center in St. Louis, Missouri for all loans, nationwide.

If the required information is not submitted from a lender on a potential future recover case, Rural Development will track and follow-up on each case to collect the actual collateral sale information.

OIG Recommendation 4:

*Obtain necessary regulatory changes and establish accounts receivable for those loans that had a loss claim paid subsequent to April 2003 (Recommendation 9 of Audit No. 04601-002-AT).*

## Rural Development Response:

Between the time OIG completed its field work for this audit in June 2005 and the issuance of its official draft audit report on August 21, 2006, Rural Development has made the changes necessary to establish accounts receivables for loans that were originated subsequent to April, 2003. We note that loans originated prior to that date are not subject to the DCIA even if they have a loss claim paid subsequent to April, 2003. The OCFO was provided with evidence of the accounts receivables in October, 2005, and they accepted final action for recommendation 9 on March 17, 2006. The accounts receivables are now reported in Rural Development's financial statements.

Form RD 1980-21 "Request for Single Family Housing Loan Guarantee" was revised in April 2003, to establish that borrowers are subject to the DCIA. All loans originated, obligated and closed since the form was revised are subject to DCIA if their loan defaults and a claim is paid. Borrowers who sign the revised forms, and for whom loss claims are paid, are subject to the DCIA and accounts receivables are established for them. Rural Development began establishing accounts receivables for all DCIA eligible borrowers in July, 2005.

## OIG Recommendation 5:

*Include in the Lender Monitoring Handbook a process for reviewing appraisers and property appraisals to ensure their independence (Recommendation 10 of Audit No. 04601-002-AT).*

## Rural Development Response:

Between the time OIG completed its field work for this audit in June 2005 and the issuance of its official draft audit report on August 21, 2006, a permanent change to the regulation was made by Procedure Notice. Based on this permanent change to our regulation, the OCFO accepted final action for recommendation 10 of Audit No. 04601-002-AT on August 1, 2006.

Rural Development has made a permanent change to our regulation, RD Instruction 1980-D. The regulation currently serves as our lender monitoring guidance. The change to our regulation provides a process for reviewing appraisers and property appraisals. The change to the regulation was made by Procedure Notice as an amendment to the regulation section 1980.344. This permanent change to the regulation was made by Procedure Notice specifically because of the recent concerns by OIG over the permanency of Administrative Notices.

# Exhibit B – Agency Response

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OIG Recommendation 6:

*Develop a procedural manual that clarifies RD Instruction 2012-A, "Audits and Investigations" to clearly identify the responsibilities of agency management and establish procedures for responding to audit recommendations. These procedures should include timeframes for completing final corrective action.*

Rural Development Response:

Single Family Housing believes RD Instruction 2012-A is clearly written, and will follow the instruction. Nevertheless, a procedure manual for internal use and reference has been developed that reiterates the responsibilities of management. These procedures include timeframes for completing final corrective action.

Estimated Completion Date: February 2007

Informational copies of this report have been distributed to:

Administrator, RHS

THRU: Agency Liaison Officer (4)

Government Accountability Office (1)

Office of the Chief Financial Officer (1)

Director, Planning and Accountability Division

Office of Management and Budget (1)