United States Department of Agriculture

Office of Inspector General

Rural Development: Single Family Housing Direct Loan Servicing and Payment Subsidy Recapture

04601-0001-31

July 2014

Rural Development: Single Family Housing Direct Loan Servicing and Payment Subsidy Recapture

Audit Report 04601-0001-31

What Were OIG's Objectives

OIG reviewed how RHS services SFH direct loans to determine if CSC performs yearly reviews of borrower income, if the borrower is eligible for payment subsidy, and if payment subsidy is accurately calculated and repaid.

What OIG Reviewed

From 111,197 borrower accounts, representing $432 million in payment subsidy over the term of the agreement, we statistically selected 100 accounts receiving payment subsidy in fiscal years (FY) 2011 and 2012. Our audit also covered borrower accounts where payment subsidy recapture was established or repaid during FYs 2008 through 2012. From 62,331 accounts with an estimated $514 million in outstanding recapture receivables, we statistically selected 100 borrower accounts subject to recapture of payment subsidy.

What OIG Recommends

CSC should strengthen its oversight controls and correct subsidies as well as recover over-payments to borrowers.

OIG reviewed how Rural Housing Service Single Family Housing administers direct loan payment subsidies.

What OIG Found

The Office of Inspector General (OIG) determined that the Centralized Servicing Center (CSC) performed reviews of borrower income and generally made accurate payment subsidy eligibility and recapture determinations. However, we noted the following exceptions. We identified issues with how CSC was servicing these accounts, especially as it relates to recapture of payment subsidy. We found that CSC processors inaccurately calculated the final recapture receivables for 13 of the 100 borrower accounts in our recapture sample. Based on statistical projections, we estimate that 8,103 borrower recapture receivable accounts may not have been accurately established, with a total value of $33 million. In addition, we found that CSC lacked formal procedures to actively monitor borrower occupancy and did not always establish final payment subsidy recapture receivables in a timely manner.

Additionally, our review of the payment subsidy renewal process found that for 7 of the 100 borrower accounts, CSC inaccurately calculated the borrowers' payment subsidy. We estimate that the payment subsidy for 7,784 borrower accounts, with a projected total value of $4.9 million over the term of the payment subsidy agreement, may also be inaccurately calculated. Also, we found evidence that unreported household members may have been residing in the Rural Development-financed properties. The agency generally concurred with our recommendations and we accept management decision for all recommendations.

United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250

DATE: July 18, 2014

AUDIT NUMBER: 04601-0001-31

TO: Tony Hernandez
Administrator
Rural Housing Service
Housing and Community Facilities

ATTN: John Dunsmuir
Acting Director
Financial Management Division

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Rural Development: Single Family Housing Direct Loan Servicing and Payment Subsidy Recapture

Attached is a copy of the final report on the subject audit. Your written response to the official draft, dated May 27, 2014, is attached, with excerpts from your response and the Office of Inspector General's position incorporated into the relevant Finding and Recommendation sections of the report.

Based on your response to our official draft report, we accept management decision for all audit recommendations in the report. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer. In accordance with Departmental Regulation 1720-1, final action should be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publically available information and will be posted in its entirety to our website (http://www.usda.gov/oig) in the near future.

Table of Contents

Background & Objectives 1

Section 1: Payment Subsidy Recapture 4

Finding 1: CSC Did Not Timely Complete Final Payment Subsidy Recapture Calculations 4

- **Recommendation 1** 7
- **Recommendation 2** 7

Finding 2: CSC Did Not Always Calculate Final Payment Subsidy Recapture Accurately 9

- **Recommendation 3** 12
- **Recommendation 4** 12
- **Recommendation 5** 13
- **Recommendation 6** 13
- **Recommendation 7** 14

Finding 3: CSC Needs to Implement a Process for Determining if Borrowers Still Occupy the Property 15

- **Recommendation 8** 18
- **Recommendation 9** 19
- **Recommendation 10** 19

Recommendation 11 20

- **Recommendation 12** 20

Section 2: Payment Subsidy Renewals 21

Finding 4: CSC Needs to Ensure that All Household Incomes are Reported 21

- **Recommendation 13** 23

Finding 5: CSC Did Not Always Calculate Borrower Payment Subsidy Accurately 25

- **Recommendation 14** 28
- **Recommendation 15** 28

Scope and Methodology 30

Abbreviations 32
Exhibit A: Summary of Monetary Results 33
Exhibit B: Statistical Exhibit 34
Exhibit C: Monetary Results Detail 41
Agency's Response 43

Background & Objectives

Background

The Rural Housing Service (RHS), an agency within the Rural Development mission area of the U.S. Department of Agriculture (USDA), provides funding for the Single Family Housing (SFH) Direct Loan Program.[1] The RHS national office in Washington, D.C., administers the program through 47 State offices and a network of field offices nationwide. The Rural Development Centralized Servicing Center (CSC), located in St. Louis, Missouri, services and provides support to local servicing efforts for all RHS SFH direct loans.

SFH direct loans are funded by the Government and are available for very-low and low income households who cannot qualify for other credit to obtain home ownership. Applicants may obtain 100 percent financing to purchase an existing dwelling, a site for constructing a dwelling, or a newly constructed dwelling located in a rural area. Payment subsidies enhance a borrower's repayment ability for SFH direct loans. Mortgage payments are based on a household's adjusted income and size. Borrowers pay the greater of either a loan payment amortized at an equivalent interest rate as low as 1 percent or a payment calculated at between 20 and 26 percent of the borrower's adjusted income.[2]

To be eligible for payment subsidy,[3] at the time of origination, a borrower must be income-eligible for a SFH direct loan—i.e., the borrower must have adjusted income that does not exceed the applicable low-income limit at the time of loan approval and the applicable moderate-income limit at the time of loan closing.[4] To be eligible for payment subsidy during the term of the loan, a borrower not already on payment subsidy must have adjusted income at or below the applicable low-income limit. Once a borrower begins to receive a payment subsidy, the borrower may continue to do so until their income calculated into the applicable formula no longer allows a payment subsidy. A borrower who is receiving payment subsidy must personally occupy the dwelling during the term of the loan; the borrower may be temporarily absent from the property for a period of 6 months with a reason acceptable to RHS, such as seasonal or migratory employment, military deployment, or hospitalization.

SFH direct loans are serviced by CSC, and field offices assist in certain circumstances. CSC obtains payments from the borrower, maintains escrow accounts for real estate taxes and homeowner's insurance, and provides counseling to past-due borrowers. CSC also performs annual reviews to determine whether the borrower is eligible for continued payment

[1] SFH direct loans are authorized by Title V of the Housing Act of 1949.
[2] Adjusted income is based on annual income and provides for deductions to account for varying household circumstances and expenses.
[3] According to regulations, payment subsidy is a general term for subsidies which reduce the borrower's scheduled payment.
[4] 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. Moderate income is greater than the low-income limit, but does not exceed the low-income limit by more than $5,500. All three income limits are established by the U.S. Department of Housing and Urban Development.

subsidy.[5] The borrower must notify RHS whenever an adult member of the household changes or obtains employment; there is a change in household composition; or current household income increases by at least 10 percent, so that RHS can determine whether a review of the borrower's circumstances is required.

CSC services a portfolio of over 325,000 direct housing loans, with an outstanding principal balance exceeding $16 billion. Specifically for our audit work, we identified a universe of 111,197 borrower accounts that were receiving payment subsidy, totaling $432 million over the term of the agreement, and were subject to payment subsidy renewal during fiscal years 2011 and 2012. SFH Direct Loan Program borrowers receive payment subsidy and will continue to receive it as long as they qualify. Regulations require repayment of a pro-rated portion or the entire payment subsidy, referred to as recapture. Our audit work also covered 62,331 borrower accounts where payment subsidy recapture was billed and/or collected during fiscal years 2008 through 2012, with an estimated $514 million[6] in recapture receivables.

CSC is required to calculate the amount of payment subsidy to be recaptured when a borrower refinances or otherwise pays the mortgage loan in full.[7] The calculation to determine the amount of payment subsidy recapture is based on the principal reduction attributed to subsidy (PRAS) and equals PRAS plus the lesser of the amount of payment subsidy received or up to 50 percent of the adjusted value appreciation of the property.[8] Initially, when loans are paid off through the scheduled course of loan payments, a maximum payment subsidy recapture receivable is posted to the account to ensure that the mortgage lien is not released prior to the repayment of payment subsidy recapture.[9] The maximum payment subsidy recapture receivable is different from the final payment subsidy recapture receivable. In order to calculate a final payment subsidy recapture amount, CSC requests that the Rural Development field office obtain the market value of the property at the time the loan is paid in full. The market value will be determined by an

[5] While the regulatory citation calls them annual reviews, the reviews are conducted at various timeframes depending on the type of income earned by the borrower. A borrower earning Social Security Administration benefits or with stable wage income renews his/her payment subsidy status every 24 months. A self-employed borrower and those with wages that vary renews his/her payment subsidy status every 12 months. Temporarily unemployed borrowers renew their payment subsidy status every 9 months.

[6] We are 95 percent confident that the billed payment subsidy recapture amount for our audit universe was between $368,801,698 and $660,870,581. During fieldwork, CSC officials were unable to provide us with the total payment subsidy recapture billed for the borrowers in the audit universe and requested that we statistically estimate the total recapture billed for the audit universe.

[7] Title 7, *Code of Federal Regulations* (CFR), 3550.162.

[8] Principal reduction attributable to subsidy (PRAS) accrued on all SFH direct loans that were subject to recapture and received payment subsidy (interest credit) between October 1, 1979, and December 31, 1989. During this period, payment subsidy was applied by reducing the effective interest rate. Because payments were applied at an interest rate below the note rate, principal pay down was accelerated. PRAS is the difference between the current principal balance and what the principal would have been had all payments been applied at the note rate. The mortgage servicing system automatically begins to reduce the amount of PRAS after the loan is 15 years old. Loans made since January 1, 1990, do not have PRAS because the agency changed the method of applying payment subsidy to loans.

[9] The maximum payment subsidy recapture receivable is a total of all subsidies received during the life of the loan. Once the current market value of the property is received from the field office, CSC calculates and posts the final payment subsidy recapture receivable (prorated amount based on the value of the property at the time of payoff) to the borrower's account.

appraisal, arm's length sales contract, assessed value, tax records, or other reliable evidence.[10] The field office is required to submit the market valuation to CSC within 60 days of the request.[11]

When appraisals are used to determine the market value of the property, Rural Development utilizes a quality review process whereby the field officials are required to perform administrative reviews of all appraisals. Field and State office staff review the appraisals and CSC accepts their value determinations.[12] Additionally, the State appraisers perform technical desk reviews on appraisals submitted within the States under plans established by the applicable State Director to ensure that appraisals are accurate, reasonable, and conform to Uniform Standards of Professional Appraisal Practice.[13]

Borrowers who repay a loan are permitted to defer payment of the payment subsidy recapture amount as long as they continue to occupy the property and retain title. Payment subsidy subject to recapture must be repaid whenever the borrower ceases to occupy the property or transfers title. All payments for payment subsidy recapture amounts are returned to the Department of the Treasury.

Objectives

The objective of this audit is to review how RHS services SFH direct loans to determine if CSC performs yearly reviews of borrower income and whether borrowers remain eligible for payment subsidy and, if so, if the borrowers are receiving the correct payment subsidy. Also, we determined if CSC correctly computes the amount of payment subsidy recapture in cases where recapture is triggered and the extent of collections of identified payment subsidy recapture amounts.

[10] Handbook (HB)-2-3550.2.24(B).
[11] HB-2-3550.2.24(B)(2).
[12] HB-2-3550.2.24(B)(1).
[13] The *Uniform Standards of Professional Appraisal Practice* (USPAP) are the generally accepted standards for practice in North America. USPAP contains standards for all types of appraisal services. Standards are included for real estate, personal property, business, and mass appraisal.

Section 1: Payment Subsidy Recapture

Finding 1: CSC Did Not Timely Complete Final Payment Subsidy Recapture Calculations

Of the 100 borrower accounts in our sample, we found that Rural Development's CSC did not timely establish final payment subsidy recapture receivables for 18 borrower accounts.[14] Timeframes to establish the final payment subsidy recapture receivable ranged from 75 to 2,919 days (about 8 years). Delaying the final payment subsidy recapture calculation may increase or decrease the amount of payment subsidy the borrower is required to repay the agency, depending on the market valuation of the property at that time. In 2 of the 18 accounts, we determined the delays could have resulted in overbilling the borrowers for a total of $2,043 in final payment subsidy recapture. This occurred because CSC did not have a system to track outstanding requests to field offices for property market valuations or an alert that flags overdue requests. Based on our audit sample results, we estimate that 11,220 recapture receivables (almost 18 percent of the portfolio), with a projected total billed amount of approximately $160 million, may not have been established in a timely manner due to lack of market valuations needed for the calculation of the receivables, creating the potential for similar over- or underpayments to borrowers. [15, 16] Delays such as these could cause inconsistent treatment of borrowers who paid off their loan during the same time period, as well as the potential for lost revenues from payment subsidy recapture receivables owed the Government.

According to regulations, CSC is required to calculate the amount of payment subsidy to be recaptured when a borrower refinances or otherwise pays the mortgage loan in full without transfer of title and continues to occupy the property. CSC will request assistance from the field office to obtain the market value, which will be determined by an appraisal, arm's length sales contract,[17] assessed value, tax records, or other reliable evidence.[18] Agency guidance requires that the field office provide the property valuation to CSC within 60 days.[19] Additionally, as part of the appraisal process, Rural Development's handbook states that field or State officials will review the appraisals and CSC will accept their value determinations.[20] Rural Development State appraisers perform technical desk reviews of appraisals submitted within each State under

[14] At the time of our audit fieldwork, the total billed amount of payment subsidy recapture was $256,701 for these accounts.

[15] We did not project the $2,043 in potential overpayments to the total billed amount for the 11,220 borrower accounts because we were unable to estimate the potential over- or underpayments in the other 16 accounts in our sample due to lack of market valuations needed for the calculation of receivables. Since we only found two exceptions, our confidence interval at the 95 percent confidence level is too wide to report a viable estimate for this issue.

[16] We are 95 percent confident that between 6,448 (about 10 percent) and 15,991 (about 26 percent) recapture receivables of our total universe of 62,331 accounts subject to payment subsidy recapture may also be calculated in an untimely manner. The total payment subsidy recapture billed for these borrower accounts is between $70.0 million and $249.9 million based on a projected estimate of recapture receivables for our universe totaling $514.8 million. See Exhibit B for the statistical sample design.

[17] "Arm's length" is defined as the condition or fact that the parties to a transaction are independent and on an equal footing.

[18] HB-2-3550.2.24(B).

[19] HB-2-3550.2.24(B)(2).

[20] HB-2-3550.2.24(B)(1).

plans established by the applicable State Director to ensure that appraisals are accurate, reasonable, and conform to Uniform Standards of Professional Appraisal Practice.[21] Amounts to be recaptured are due and payable when the borrower transfers title or ceases to occupy the property. Payment of recapture may be deferred, interest free, until the property is sold or vacated.[22]

During our audit of borrower accounts for fiscal years 2008 through 2012, we found that 18 of 100 borrower accounts in our sample did not have final payment subsidy recapture receivables calculated in a timely manner. In one case, the request for market valuation was about 8 years overdue. In addition, the scope of our audit work revolved around a very turbulent real estate market, which saw sharp inclines and declines in property values. Ultimately, delaying the final recapture calculation may increase or decrease the amount of payment subsidy the borrower is required to repay the agency, depending on the real estate market at that time.

When a borrower pays off a loan, CSC submits a request to the Rural Development field office to obtain the current market value of the subject property. According to agency guidance, the field office has 60 days to provide the market valuation to CSC, including conducting an administrative review of the appraisal.[23] However, field officials did not respond to these requests in a timely manner. For example, one of our sample accounts was paid in full in 2003, but CSC was not provided a tax assessment until 2011 (about 8 years later). This tax assessment included historical values of the subject property for the past 10 years. We noted that the tax value of the property in 2003 was almost 20 percent less than the tax value in 2011. Therefore, we substituted a market value, minus 20 percent, in the final payment subsidy calculation and found that the borrower would owe approximately $1,760 less in final payment subsidy recapture had the market valuation been completed timely. While CSC officials agreed that this receivable was not established in a timely manner, they disagreed with the dollar errors, since the field officials did not verify the property condition back in 2003.

In another case, the borrower's account was paid in full in 2002. CSC officials inadvertently requested a market valuation for the property, even though a current appraisal had been provided 1 month prior to the loan payoff. The field office did not respond to CSC's request until 2009 (about 7 years later). CSC used the 2009 market valuation of $35,000 to calculate a final payment subsidy recapture amount of $6,330. We found that had the 2002 market valuation of $29,500 been used, the borrower would owe approximately $283 less in payment subsidy recapture. CSC agreed with this amount and adjusted the borrower's deferred final recapture balance.

The untimely final recapture calculations occurred because the agency did not have a system to track or alert officials that there were overdue requests for market valuations. CSC officials acknowledged this internal control deficiency and stated that a special project was started in December 2007 which identified 8,097 borrower accounts with overdue final recapture

[21] HB-1-3550.5.21(B).
[22] 7 CFR 3550.162(c).
[23] HB-2-3550.2.24(B).

calculations.[24] The agency worked from 2007 until 2012 to obtain market valuations and establish final recapture calculations. However, the project was suspended during June 2012, due to staff availability, even though 1,498 accounts with overdue calculations remained. Therefore, in order to ensure that all of the overdue recapture receivable calculations are addressed, we are recommending that CSC take the necessary steps to ensure that market values are received from the field offices and final payment subsidy recapture is calculated and established as receivables for the remaining 1,498 special project borrower accounts, as well as any other outstanding accounts.

CSC officials agreed that the 18 final recapture calculations we identified were not completed timely and that the delays in obtaining market valuations would impact the total amount of final recapture billed to the borrowers. As a result of their special project work, they recognized a need to change their procedures for obtaining market values. Rural Development officials determined that they could centralize the appraisal process to eliminate the need for field offices to obtain market values. However, at the time of our discussions, the new process to centralize appraisals had not yet received administrative approval. Also, CSC officials were concerned that funding may not be available to implement a service procurement contract. Therefore, we are recommending that CSC establish internal controls to ensure that final recapture amounts are timely and accurately calculated. If a centralized appraisal process should be approved in the future, we want to stress the importance of developing internal controls equivalent to the administrative and technical reviews performed on appraisals in the field and State offices to ensure that appraisals are accurate, reasonable, and conform to Uniform Standards of Professional Appraisal Practice.

Based on the results of our audit work, CSC immediately contacted the respective field offices to obtain the market values for six sample accounts that still required calculation of final recapture receivables.[25] Of the six requests that CSC sent out, three went unanswered multiple times. We contacted two of the field offices to determine why they had not responded. One field official stated that he was new to the position and was unaware that his staff had not responded to the tasks until we brought it to his attention. This field official plans to counsel the staff on the importance of timely completion of CSC requests. Another field official stated that she was not trained on the processing of CSC requests and accidentally deleted the requests prior to completion. She further stated that upon deletion of the tasks, the information necessary to complete the process was irretrievable. CSC subsequently obtained the necessary market value information to resolve five of the six outstanding accounts. One of the six remained unresolved at the time of this report.

OIG maintains that these are examples of the management challenges that Rural Development is facing as an agency. CSC officials stated that CSC is currently operating at about 20 percent

[24] The timeframe of CSC's special project fell within the scope of our audit work (fiscal years 2008 through 2012). However, we only have testimonial evidence from CSC that accounts identified during their special project were included in our total universe of 62,331 borrower accounts that were subject to recapture. We did not specifically review the supporting documentation for this work nor did we evaluate the effectiveness or accuracy of the special project. There may have been accounts within our sample that were a part of this special project.

[25] CSC received market values and calculated final recapture for the other 12 borrower accounts prior to our audit work but still in an untimely manner.

below its authorized staff levels.[26] We are not recommending training for the field office staff on completion of CSC tasks because the agency may be implementing new processes. However, in the interim, we recommend that CSC develop and implement a tracking system or edit check to alert CSC and field staff of overdue requests for market valuations and ensure that final recapture amounts are timely and accurately calculated.

Recommendation 1

Develop and implement a tracking system or edit check to alert the Centralized Servicing Center (CSC) and field office staff of overdue requests for market valuations and establish internal controls to ensure that final recapture amounts are timely and accurately calculated.

Agency Response

Rural Development's May 27, 2014, response stated that the Rural Housing Service will develop a database to track and age tasks sent to the field office requesting market valuations until a nationwide contract is created to eliminate the need for field offices to individually obtain market valuations. The agency will develop procedures to track the receipt of market valuation appraisals and to follow-up on delinquent (more than 75 days old) tasks to ensure all market valuation appraisals are received. The existing desk procedures will be updated to implement additional controls and procedures to ensure the final recapture amount is computed timely and accurately. Rural Development stated that the estimated completion date for the corrective action is March 31, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Ensure that the necessary steps are taken to calculate and establish the receivables for the remaining identified 1,498 borrower accounts from the special project and any other outstanding accounts with overdue recapture receivable calculations.

Agency Response

Rural Development stated that the Rural Housing Service will resume the special project to review the remaining 1,498 accounts with maximum recapture receivable balances to determine the correct recapture amount. In addition, the agency will identify all accounts with overdue recapture calculations not included in the special project and compute the recapture amount using current market valuations as provided by the field offices. To allow field office staff sufficient time to obtain the market values, the agency will review 250 accounts per month. A tracking database will be developed to monitor and ensure all 1,498 borrower accounts and

[26] CSC officials stated that they have a staff ceiling of 617 employees. During fieldwork, CSC officials stated that they were operating with 495 full time equivalent employees.

additional accounts identified are completed. This database will ensure that requests for market valuations are received, final recapture calculations are created and the completion status is documented. Rural Development stated that the estimated completion date for the corrective action is May 30, 2015.

OIG Position

We accept management decision for this recommendation.

Finding 2: CSC Did Not Always Calculate Final Payment Subsidy Recapture Accurately

We found that overall CSC processors correctly calculated final payment subsidy recapture amounts for the program borrowers. However, of the 100 borrower accounts in our sample, we found that CSC processors inaccurately calculated the final recapture receivable for 13 borrower accounts, errors that totaled $53,093.[27] These errors were caused by processor oversight; additionally, the agency did not have in place a comprehensive secondary review to detect such errors before the final payment subsidy recapture was posted. Recapture receivables due were over- or under-billed depending on the type of error made at the time of calculation. Based on our audit sample results, we estimate that 8,103 borrower accounts (almost 13 percent of the portfolio) may not have been accurately established, with a projected total value of $33 million.[28, 29] Due to these errors, low-income borrowers may suffer undue financial hardships as a result of overbillings, and the Federal Government may miss opportunities to collect on debts owed.

Borrowers that meet income guidelines may receive payment subsidies and are required to repay all or a portion of the payment subsidy they receive over the life of the loan when they no longer occupy the property or transfer title.[30] The amount of payment subsidy to be repaid is calculated with a specific formula that includes the current market value of the property, borrower's mortgage debt, borrower's original equity, closing costs, capital improvements, and other factors.[31] At the time of loan payoff, borrowers can either pay the payment subsidy recapture due or elect to defer repayment of the recapture amount, interest free, providing they do not transfer title to the property and continue to occupy the property.[32] However, for a borrower to receive credit for capital improvements, a current property appraisal and an addendum for any capital improvements must be obtained.[33]

Final payment subsidy recapture amounts were inaccurately calculated for 13 of 100 borrower accounts in our sample, resulting in errors totaling $53,093. Rural Development's mortgage servicing system computes the final payment subsidy recapture once a CSC processor establishes and inputs the original owner's equity; closing costs, if applicable; and market value of the home accounting for eligible capital improvements.

---

[27] This amount equals $32,404 in under-billings and $20,689 in over-billings. See Exhibit A for the summary of monetary results.

[28] We are 95 percent confident that between 3,926 (about 6 percent) and 12,280 (about 20 percent) of our total universe of 62,331 borrower accounts subject to recapture may also be inaccurately calculated. These loans have a projected total recapture billed between $2.6 million and $63.5 million. See Exhibit A for the summary of monetary results and Exhibit B for the statistical sample design.

[29] Since the focus of our sample review was to test Rural Development's controls over recapture calculations and not intended to be an improper payments review, our projections are based on the number of borrower accounts where we questioned the calculation of recapture instead of incremental improper payment amounts for each borrower account. If actual recapture error amounts were used to project an improper payment error rate, this amount would potentially result in a lower total projection than the 13 percent error rate.

[30] 7 CFR 3550.68(a).

[31] HB-2-3550.2.23(C).

[32] 7 CFR 3550.162(c).

[33] 7 CFR 3550.162(b)(1).

We found that the payment subsidy recapture amounts for the 13 borrower accounts were not always calculated accurately by CSC for a range of reasons, including (1) incorrect appraised values and closing costs were used; (2) original owner's equity totaled more than 100 percent or was over-stated; (3) ineligible capital improvements were allowed; (4) prior loan balances were not accounted for accurately; and (5) unsupported values were used. The following are examples for each instance we found.

- **Incorrect Appraised Values and Closing Costs Used:** We found seven borrower accounts with this issue. In one borrower account, the loan was paid off on August 7, 2009 and an appraisal was received on August 28, 2009. We determined that the appraised market value for the property had not been used, which resulted in the borrower receiving a final recapture statement for the full amount of payment subsidy received, totaling $60,207. CSC officials agreed that this was a processor error and plan to adjust the borrower's account by the over-billed amount of $15,897.

- **Owner's Equity Over-stated:** We found two borrower accounts with this issue. For example, a processor did not verify that the equity amounts in the system were correct when a borrower paid off two loans at the same time. The processor entered equity amounts that were greater than 100 percent, which caused the payment subsidy recapture due to be calculated at zero. Since there were two separate loan accounts, the system does not have an edit check that would prevent this type of issue from occurring. We determined the payment subsidy recapture due should have been $17,496 and CSC officials agreed. However, Rural Development released the lien on the property at loan payoff; therefore, they told us they would need to discuss recovery options with the Office of the General Counsel (OGC).

- **Ineligible Capital Improvements Used:** We found one borrower account with this issue. According to agency procedures, borrowers may only receive credit for in-ground swimming pools. Yet, in one of our borrower accounts, a processor allowed a $2,500 credit for an above-ground swimming pool. CSC officials agreed that final recapture was incorrectly calculated and under-billed by $169.

- **Inaccurate Prior Loan Balances:** We found one instance of this issue in which an additional active loan balance was not included when the processor calculated the final recapture due. CSC officials agreed that this was an error and that payment subsidy recapture was over-billed by $521.

- **Unsupported Values Used:** We found two borrower accounts with this issue. For example, one borrower account included an appraisal with a market value of $75,000; however, the processor used a market value of $52,000. Neither CSC nor OIG were able to locate documentation within the account file to support the $52,000 market value. Additionally, closing costs were inaccurately doubled. CSC agreed with these errors and noted that payment subsidy recapture was under-billed by $1,560. However, this is another example where the mortgage lien was released.

CSC agreed that these errors occurred due to processor oversight and did not detect these errors because it lacked a comprehensive secondary review process. While CSC officials previously acknowledged this internal control deficiency and implemented a secondary review process in July 2012, this secondary review is only performed on final recapture amounts that are deferred.[34] Currently, no secondary reviews are conducted on accounts where payment subsidy recapture is billed and paid at the time of loan payoff. We believe this is the most critical time when a review should be conducted as the agency is preparing to release the lien. CSC officials stated that 6 of the 13 processor errors we found during our audit work would not have been caught by CSC's secondary review process since they only review deferred recapture calculations. Therefore, we concluded that the agency needs to include all final recapture calculations in their current secondary reviews to ensure that the amounts are correct before it releases the lien.

The agency generally agreed with our conclusions. We determined that CSC over-billed five borrowers for $20,689 and recommend that the agency reimburse or adjust the accounts of those borrowers for the amounts in question.[35] CSC already provided written notification to the five sample borrowers where they over-billed the final recapture payable amounts. We also determined that CSC under-billed eight borrowers for $32,404.[36] We discussed these instances with CSC officials, who stated that for all eight borrowers who were under-billed, the agency released the lien on the mortgage and may no longer have the legal capacity to collect on the debts owed. Therefore, we recommend that CSC evaluate its recovery options for the eight borrowers where payment subsidy recapture amounts were under-billed.

In addition to the errors discussed above, we found one instance where a processor calculated that no repayment of payment subsidy recapture was required, since there was no increase in the subject property value. While we agree that the subject property did not increase in value, we found that $1,934 of payment subsidy recapture is due because the payment subsidy reduced the mortgage principal.[37] Essentially, the borrowers still owe $1,934 in mortgage principal. According to CSC's informal policy, no payment subsidy recapture is due when there is no value appreciation of the property, including principal that was reduced by payment subsidy at an accelerated rate. We determined that the regulations specifically require that principal reduced by payment subsidy at an accelerated rate should be collected.[38] CSC officials stated they believe they are correctly interpreting the regulation and may need to obtain an OGC opinion. Therefore, we are recommending that CSC obtain a formal OGC opinion regarding the

[34] According to 7 CFR 3550.162(c), as long as the borrower continues to occupy the property and does not transfer title, payment subsidy recapture may be deferred.
[35] See Exhibit C for the monetary results detail.
[36] See Exhibit C for the monetary results detail.
[37] Principal reduction attributable to subsidy (PRAS) accrued on all SFH direct loans that were subject to recapture and received payment subsidy (interest credit) between October 1, 1979, and December 31, 1989. During this period, payment subsidy was applied by reducing the effective interest rate. Because payments were applied at an interest rate below the note rate, principal pay down was accelerated. PRAS is the difference between the current principal balance and what the principal would have been had all payments been applied at the note rate. The mortgage servicing system automatically begins to reduce the amount of PRAS after the loan is 15 years old. Loans made since January 1, 1990, do not have PRAS because the agency changed the method of applying payment subsidy to loans.
[38] According to 7 CFR 3550.162(b)(1), the amount to be recaptured is PRAS plus the lesser of: (1) the amount of payment subsidy received or (2) the portion of value appreciation in the subject property.

regulatory requirements for collecting principal reduction attributable to subsidy. Depending on the outcome of this opinion, CSC needs to update the specific guidance and instructions to reflect this policy and evaluate the recovery options for the $1,934 in payment subsidy recapture amount payable from the sample borrower where the agency under-billed the borrower. Since we only found one borrower account with this issue, we are not projecting this exception and its estimated dollar impact across the universe.[39] However, there is concern that this issue could be systemic and Rural Development may be foregoing recovery of actual debts owed by borrowers as a result of its interpretation of the regulations.

Recommendation 3

Evaluate recovery options for $32,404 in payment subsidy recapture amounts payable from the eight sample borrowers where the agency under-billed the borrowers.

Agency Response

Rural Development stated that the Rural Housing Service will review each of the eight accounts and pursue recovery of funds from each borrower if the under-billed amount is enforceable and collectable. For those borrowers whose under-billed amount is enforceable and collectable: (1) the recapture account will be re-established, (2) a receivable for the under-billed amount will be created on the account, and (3) a demand letter for payment and appeal rights will be provided to each borrower. Rural Development stated that the estimated completion date for the corrective action is November 30, 2014.

OIG Position

We accept management decision for this recommendation.

Recommendation 4

Refund or adjust the five borrowers' accounts by $20,689 in over-billed final payment subsidy.

Agency Response

Rural Development stated that the Rural Housing Service will recalculate the recapture amount for the five borrowers who were over-billed. Borrowers who have paid their recapture balance in full will receive a refund check for the amount of the over payment and a letter of explanation will be provided. For borrowers whose account was not paid in full, the recapture receivable amount will be reduced by the over-billed amount and a letter will be sent explaining the reduction in the recapture receivable. Rural Development stated that the estimated completion date for the corrective action is August 30, 2014.

[39] Since we only found one exception, our confidence interval at the 95 percent confidence level is too wide to report a viable estimate for this issue.

OIG Position

We accept management decision for this recommendation.

Recommendation 5

Expand the current secondary review process to include all final recapture calculations prior to release of the lien documents to reduce the potential of the questioned $33 million in inaccurate recapture calculations.

Agency Response

Rural Development stated that the Rural Housing Service will expand its current secondary review process to include all final recapture calculations prior to releasing the lien documents and modify existing desk procedures and internal control processes to implement and document the expanded secondary review process to include all final subsidy recapture calculations. Rural Development stated that the estimated completion date for the corrective action is December 31, 2014.

OIG Position

We accept management decision for this recommendation.

Recommendation 6

Obtain a formal OGC opinion on the regulatory requirements for collecting principal reduction attributable to subsidy. Depending on the outcome of this opinion, update guidance and instructions to reflect this policy and evaluate the recovery options for the $1,934 in payment subsidy recapture amount payable from the sample borrower where the agency under-billed the borrower.

Agency Response

Rural Development stated that the Rural Housing Service will consult and obtain legal written opinion(s) from Rural Development's OGC on the regulatory requirements for collecting PRAS and whether the current method of calculating subsidy recapture is in accordance with the regulations. If the OGC opinion is that the current method of calculating subsidy recapture is not in accordance with the regulations, the agency will modify the recapture calculation based on the legal opinion, update HB-2-3550 and the desk procedures to reflect the change in calculation.

In addition, the agency will consult with OGC and obtain legal written opinion(s) as to whether the under-billed amount of $1,934 can be collected from the borrower in question. If the under-billed amount on the sample account can be collected, the agency will establish a receivable for the under-billed amount and issue a demand letter for payment to the borrower along with appeal

rights. Rural Development stated that the estimated completion date for the corrective action is May 30, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 7

If the OGC opinion confirms OIG's interpretation, apply the effect of the opinion to the entire portfolio of SFH direct loans by performing a portfolio-wide review and corrections, including recovery of under-billed payment subsidy recapture where warranted.

Agency Response

Rural Development stated that if the OGC opinion received under Recommendation 6 determines that the current method of calculating subsidy recapture related to PRAS is not in accordance with the regulations, the Rural Housing Service will identify all open recapture receivable accounts established by CSC whose loans received payment subsidy (interest credit) between October 1, 1979, and December 31, 1989. On the identified accounts, the agency will re-compute the recapture amount and compare it to the original recapture amount, adjust all recapture accounts where the amount is different, and send the borrowers a letter explaining the change in the recapture amount. In addition, the agency agrees to update existing desk procedures to reflect the change in recapture calculation. Rural Development stated that the estimated completion date for the corrective action is May 30, 2015.

OIG Position

We accept management decision for this recommendation.

Finding 3: CSC Needs to Implement a Process for Determining if Borrowers Still Occupy the Property

According to regulations, once a borrower no longer occupies the subject property or transfers title, CSC must recapture the payment subsidy. We found, however, that in 5 of the 100 borrower accounts reviewed, the borrowers no longer occupied the property or had transferred title. This occurred primarily because CSC lacked formal procedures to actively monitor occupancy after the loan is paid in full. In addition, CSC lacked a formal process to take action after notification that a borrower is no longer occupying a property. Without such processes and procedures, Rural Development has limited assurance that CSC will collect the $74,819 in payment subsidy recapture receivables it should have collected from these 5 accounts in a timely manner. Based on our sample results, we estimate that 3,117 borrowers (about 5 percent of the universe) may no longer occupy their homes and would immediately be required to repay payment subsidy recapture receivables to the Federal Government.[40]

Rural Development regulations state that borrowers are required to repay payment subsidy amounts. Borrowers can elect to defer repayment of the payment subsidy recapture amount, interest free. However, the amounts to be recaptured are due and payable when the borrower transfers title or ceases to occupy the property.[41] This may or may not coincide with final payment of the outstanding loan.[42]

Of our 100 sample accounts, we found evidence that 5 borrowers no longer occupied the subject properties, and did not repay the payment subsidy recapture due in a timely manner when they ceased to occupy the properties. To verify whether the borrowers still occupied their properties, we used various processes:

- First, we utilized a tool called "skiptrace" and determined three sample borrowers may have ceased to occupy their homes. Skiptracing is a term used to describe the process of locating a person's whereabouts for any number of purposes.[43]

- Also, we compared our sample borrowers to the Social Security Administration's death database and determined that two sample borrowers were deceased, but CSC officials either were not aware or had not followed up when they were informed of the borrowers' deaths.

---

[40] We are 95 percent confident that between 410 (about 1 percent) and 5,823 (about 9 percent) borrowers also may no longer occupy their homes and would immediately be required to repay the payment subsidy owed the Federal Government. We are not reporting a monetary projection for this finding due to the extremely large precision value we obtained for that estimate (over 100 percent). See Exhibit B for the statistical sample design.
[41] 7 CFR 3550.162(a) and (c).
[42] HB-2-3550.2.22.
[43] At our request, the CSC Unauthorized Assistance Unit ran skiptrace reports on all of our sample borrower accounts so that we could look for indicators of whether or not the borrowers continued to occupy the properties. CSC obtains skiptrace reports from a commercial vendor to confirm the current and past addresses of borrowers and the occupants of loan properties. CSC officials normally obtain skiptrace reports during quality control and special reviews to determine if borrowers obtained unauthorized assistance.

We found that CSC did not collect payment subsidy recapture, totaling $74,819 for these five borrowers, in a timely manner.

Borrowers Who Cease to Occupy Properties When Payment Subsidy Recapture is Deferred

The skiptrace reports provided evidence that three sample borrowers may have ceased to occupy the sample properties. CSC officials agreed that these three sample borrowers had fully repaid all Rural Development loans and deferred the payment subsidy recapture due, but had ceased to occupy the subject properties. For two of these cases, CSC officials concurred with our findings and referred the borrowers for foreclosure action in order to collect $39,393 in recapture receivable amounts. According to regulations, once a borrower vacates the property, CSC should attempt to collect on the debts owed, even if through the foreclosure process.[44] The third sample borrower vacated the subject property when the Rural Development loan principal was paid in full. Since CSC was unaware of this, collection of the recapture receivable totaling $3,654 was delayed for 2 years at which time the borrower actually paid the payment subsidy recapture. CSC officials stated that if they had been aware of the situation at the time, they would have collected the payment subsidy recapture due.

CSC officials agreed they were not always aware if borrowers continued to occupy the property because they lacked a formal procedure to actively monitor the borrowers after loans are paid in full, but payment subsidy recapture is deferred. Once a loan is paid in full and payment subsidy recapture is deferred, communication with the borrower is limited to mailing the annual recapture receivable statement.[45] Current procedures do not require routine use of tools such as skiptrace unless the borrower is included in a quality control or special review performed by the CSC Unauthorized Assistance Unit. CSC officials stated they will consider using skiptrace for all borrowers subject to payment subsidy recapture on a regular basis. On occasion, a third party or the borrower may inform the agency that they no longer occupy the property. However, there currently is no procedure to be followed when borrowers notify the agency that they have moved. In order to resolve these deficiencies, we believe CSC needs to develop and implement tools and procedures to actively monitor borrower occupancy after the loan is paid in full, and develop and implement a procedure to be followed when CSC is notified that a borrower is no longer occupying the property.

[44] HB-2-3550.2.22.

[45] CSC provides an annual statement to every borrower with outstanding payment subsidy recapture amounts indicating the unpaid recapture amount payable.

Deceased Borrowers

In order to obtain sufficient evidence to support occupancy, we compared our sample borrower accounts with the Social Security Administration's death database. The results of this match confirmed that two of our sample borrowers were deceased. When we discussed these cases with CSC, they were unaware of the circumstances. For one case, CSC officials determined that there were no heirs occupying the property and referred the case for foreclosure. An heir subsequently repaid the payment subsidy recapture of $12,521 prior to any foreclosure actions. We asked CSC officials if they had access to the Social Security Administration's death database and they said they were in the process of gaining access to the data. They relied on heirs to inform them of the death of borrowers and agreed they would benefit from obtaining access to and using the Social Security Administration's death match database in order to promptly identify deceased borrowers. Since CSC is already in the process of obtaining access to this data, we are recommending that it develop and implement procedures to fully utilize the death match database on a monthly or at least quarterly basis to determine if and when borrowers have passed away.

In addition, we found a case where a borrower died in September 2003. CSC was informed of the borrower's death in April 2004, but CSC did not follow up to determine if an heir occupied the property. Nor did CSC obtain written confirmation of the borrower's death from the heirs until January 2009. An heir of the deceased borrower ensured that the mortgage payments were made for the sample loan but never occupied the property, which is a regulatory requirement.[46] However, the payment subsidy recapture was not billed or collected until the sample loan was refinanced in July 2009 by the heir. During the refinancing process, CSC collected $19,250 in payment subsidy recapture. In this instance, CSC was provided with information, but failed to take the necessary actions. CSC officials acknowledged this occurred because they did not have formal procedures to be followed when they are informed that a borrower is deceased or no longer occupying a property. Therefore, we are recommending that CSC develop and implement procedures to follow when it is notified that a borrower is deceased or no longer occupies the property.

We discussed all five of the sample accounts with CSC officials and they agreed that the borrowers no longer occupied the properties. Additionally, they agreed that procedures need to be implemented to actively monitor borrower occupancy after the loan is paid in full and take action upon notification that a borrower is no longer occupying a property.

We discussed another potential case of a borrower not occupying the subject property with CSC. CSC officials disagreed in this instance, based on an informal policy that payment subsidy recapture is not due on an active loan. In this case, the borrower informed the agency that she was renting out the property during 2009. However, the calculation of the final recapture receivable amount was delayed until 2011, when the property was sold. At the time of sale, payment subsidy recapture totaling $21,230 was paid in full. CSC officials stated they did not believe their regulation, regarding the borrower ceasing to occupy the property, was applicable since this sample borrower continued to make her mortgage payments on her active loans. They believe the intent of the regulation was to require payment subsidy recapture to be due and

[46] 7 CFR 3550.163(c).

payable only if all Rural Development loans were fully repaid. We disagree because the regulation is specific in that it requires payment subsidy recapture to be paid once the borrower ceases to occupy the property.[47] We concluded that "occupancy" means that the borrower is living in the property. Additionally, the Housing Act states that, "the Secretary shall provide for the recapture of all or a portion of such assistance rendered upon the disposition or non-occupancy of the property by the borrower."[48]

As a result of our discussion on the topic of occupancy, CSC officials conferred with OGC, who also instructed the agency to follow its regulations and Rural Development handbook in making determinations about borrower occupancy. However, it is our understanding that this was not a formal opinion. Therefore, we are recommending that CSC obtain formal opinions from OGC on the statutory and regulatory requirement for occupancy specifically as it relates to payment subsidy recapture collection with deferred recapture and with an active loan, to ensure that the agency's regulations and operating procedures are consistent with the statute.

Recommendation 8

Develop and implement tools and procedures to actively monitor borrower occupancy after the loan is paid in full and recapture is deferred, in order to determine whether a borrower ceases to occupy the property to ensure that recapture receivables become due and payable at the time the borrower vacates the property.

Agency Response

Rural Development stated that the Rural Housing Service will amend the language on the annual recapture receivable statement to include language stating that the borrower must occupy the property and not transfer title in order to defer the recapture due. Additionally, the agency will develop and implement a follow-up system to investigate borrowers whose annual receivable statements are returned by the United States Postal Service as undeliverable. All returned annual receivable statements will be researched thoroughly to determine if the former borrower no longer resides in the property. Borrowers who are determined to be no longer residing in the property will be accelerated to recover the amount of the recapture receivable. Existing desk procedures will be modified to reflect the new follow-up process. Rural Development stated that the estimated completion date for the corrective action is March 31, 2015.

OIG Position

We accept management decision for this recommendation.

[47] 7 CFR 3550.162(c).
[48] Title 42, United States Code (U.S.C.), section 1490a(a)(1)(D)(i).

Recommendation 9

Develop and implement a procedure to be followed when CSC is notified that a borrower is deceased or no longer occupying a property to ensure that recapture receivables become due and payable at the time the borrower vacates the property.

Agency Response

Rural Development stated that the Rural Housing Service will utilize the Do Not Pay process being developed under Recommendation 10 to identify deceased borrowers. In addition, the agency will modify its current methodologies and practices when notified in writing or verbally that a borrower is deceased or no longer occupying a property. This change will include notification to the Payoff Research Section who will refer the account for acceleration upon verification of non-occupancy or death. Existing desk procedures will be modified to reflect the change. Rural Development stated that the estimated completion date for the corrective action is March 31, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 10

Develop and implement procedures to fully utilize the Social Security Administration's death match database on a monthly or at least quarterly basis to determine if and when borrowers have passed away.

Agency Response

Rural Development stated that the Rural Housing Service will submit the data requirements and portal access requirements to match a file that would be created from the Loan Servicing System database and matched against the Social Security Administration's death master file. Once the report is available through the Do Not Pay portal page, the agency will code the deceased borrower's account to reflect his/her deceased status. If all borrowers on the account are deceased, the account will be referred for acceleration to collect the recapture due. This process will be performed at a minimum on a quarterly basis and existing desk procedures will be modified to reflect the new Do Not Pay process. Rural Development stated that the estimated completion date for the corrective action is March 31, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 11

Obtain a formal OGC opinion on the occupancy requirement, as it is applied to the SFH Direct Loan Program, specifically in relation to payment subsidy recapture calculation and repayment requirements when a borrower who has paid off a loan and deferred recapture "ceases to occupy the property." Based on the opinion received from OGC, revise regulations and guidance as necessary to clarify the occupancy requirement, as it specifically relates to payment subsidy recapture calculation and repayment requirements.

Agency Response

Rural Development stated that the Rural Housing Service will consult with and obtain legal written opinion(s) from Rural Development's OGC as to the definition of when the borrower "ceases to occupy the property" as it relates to recapture receivable accounts. Based on the OGC opinion, amendments to either the 7 CFR 3550 regulation, the CSC Handbook (HB-2-3550) or both will be submitted to further define when subsidy recapture must be repaid. Rural Development stated that the estimated completion date for the corrective action is May 30, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 12

Obtain a formal OGC opinion on the occupancy requirement, as it is applied to the SFH Direct Loan Program, specifically in relation to payment subsidy recapture calculation and repayment requirements when a borrower with an active loan "ceases to occupy the property." Based on the opinion received from OGC, revise regulations and guidance as necessary to clarify the occupancy requirement as it specifically relates to payment subsidy recapture calculation and repayment requirements.

Agency Response

Rural Development stated that the Rural Housing Service will consult with and obtain legal written opinion(s) from Rural Development's OGC as to the definition of when the borrower "ceases to occupy the property" as it relates to the calculation of subsidy recapture on an open active loan. Based on the OGC opinion, amendments to either the 7 CFR 3550 regulation, the CSC Handbook (HB-2-3550) or both will be submitted to further define when subsidy recapture must be repaid. Rural Development stated that the estimated completion date for the corrective action is May 30, 2015.

OIG Position

We accept management decision for this recommendation.

Section 2: Payment Subsidy Renewals

Finding 4: CSC Needs to Ensure that All Household Incomes are Reported

Of 100 borrower accounts reviewed, we found that, for 18 accounts, unreported household members may have been residing in the Rural Development-financed properties. These household members may have been receiving income that is not being reported to Rural Development; thus allowing the borrowers to obtain more payment subsidy than they were eligible to receive. In 1 of the 18 cases, we confirmed that the borrower received unauthorized assistance of over $3,500.[49] In a second case, we found evidence in the account notes of suspicious and potentially fraudulent activities. We immediately reported this case to CSC for further review and for potential fraud investigation. CSC officials were not aware of these instances because the agency does not have proactive procedures to verify that all household members and their respective incomes are reported. Based on our overall sample results, we estimate that 20,015 accounts (18 percent of the universe), receiving a projected total value of about $91 million in payment subsidy over the course of their payment subsidy agreement, may have similar indicators of long-term (3 months or more) unreported household members.[50] We recognize it is unlikely that all of these cases will result in unauthorized assistance; however, the dollar value at risk necessitates additional analysis and evaluation by the agency.

CSC renews payment subsidy by reviewing borrower-certified income and household composition on regular intervals, based on the stability of the borrower's income.[51] Borrowers are required to list all household members on their payment subsidy renewal certification.[52] The total income of all household members is used to determine eligibility for, and actual calculation of, payment subsidy.[53] Borrowers who provide inaccurate or false information are considered to have received unauthorized assistance.[54] CSC has procedures in place to recover unauthorized assistance.

To determine the composition of household members for our sample properties, we utilized a tool called "skiptracing." CSC generated and provided skiptrace reports on all of our sample borrower accounts. The skiptrace reports identified all individuals associated with the property address. An individual is associated with an address when they use it to apply for credit. Additionally, we conducted internet searches to verify information found in the borrowers' accounts or skiptrace reports. Using the information we had available, we questioned whether

[49] We did not project the $3,500 in overpayments to the estimated total 20,015 borrower accounts with indicators of long-term unreported household members because CSC was still in the process of confirming unauthorized assistance in the other 17 accounts in our sample.
[50] We are 95 percent confident that indicators of unreported household members may exist in borrower accounts ranging between 11,500 (about 10 percent) and 28,531 (about 26 percent) accounts in our total universe of 111,197 borrower accounts receiving payment subsidy. These borrower accounts have a projected value of payment subsidy between $46 million and $136 million. See Exhibit B for the statistical sample design.
[51] Borrowers earning Social Security Administration benefits or with stable wage income renew payment subsidy every 24 months. Self-employed borrowers and those with wages that vary renew every 12 months. Temporarily unemployed borrowers renew every 9 months.
[52] Form RD 3550-21.
[53] 7 CFR 3550.54(c) and 7 CFR 3550.54(b).
[54] 7 CFR 3550.164.

there were additional, unreported household members living in 36 of our 100 subject properties. Since the skiptrace reports identify the dates that household members resided in the property, we concluded that there was more risk associated with 18 of the 36 accounts, due to the fact that the individuals appeared in the home from 3 months to as many as 16 years. The other 18 accounts presented less risk, as individuals appeared in the home for 2 months or less.

CSC was unaware that additional individuals may be residing in the subject properties because it did not have a procedure in place to monitor household composition periodically or with every renewal. Rather, CSC relied on the borrowers' self-certification to identify all household members during the renewal process. CSC utilizes skiptrace reports, but only for cases that are (1) referred by the public, (2) identified by processors, or (3) randomly selected in a 1 percent review as part of CSC's Improper Payments Elimination and Recovery Act (IPERA) review.

Additional Household Members at Property for Extended Time Periods

We questioned whether the borrowers disclosed all household members in 18 cases, totaling $82,000 in payment subsidy over the term of their payment subsidy agreements. The skiptrace reports for these cases showed additional household members in the home for periods ranging from 3 months up to 16 years. We also found evidence in the account notes or through internet searches that borrowers married without formally notifying CSC of a change in household composition or including this information in their previously submitted renewal packet.

For example, we identified a case with additional household members listed at the property. We then looked at the account notes and found that the borrower had called CSC in March 2011, stating that she would be getting married soon and asking how to cancel her payment subsidy. After further research, we discovered evidence that indicated the borrower did marry prior to August 2011, but did not take the steps necessary to notify CSC and amend her household composition. The borrower continued to receive payment subsidy through November 2012 that was based solely on her income. We concluded that this borrower may have received unauthorized assistance because she did not formally notify CSC of a change in household composition. CSC subsequently investigated this case and found that the borrower received over $3,500 in unauthorized assistance. The borrower is currently in the process of reamortizing her loan to repay the unauthorized assistance.

We also found a case where a borrower certified that only she and her daughter resided in the home and both earned limited, fixed incomes. However, the skiptrace report indicated three additional adult household members lived in the home, one of whom was listed as the borrower's spouse who had been residing in the home for the past 16 years. In another case, we identified unreported household members listed at the property on the skiptrace report and found evidence in the account notes of suspicious and potentially fraudulent activities. We immediately reported this case to CSC for further review and for potential fraud investigation.

We discussed these 18 cases with CSC and recommended that actions should be taken to further evaluate these borrowers and recover any unauthorized assistance. CSC officials said they would investigate each of the 18 accounts where unreported household members were identified for extended periods of time. They would use the results of these investigations to analyze and

identify risk-based characteristics and ultimately perform risk-based sampling of borrower accounts to review household size in the future.

Additional Household Members at Property for a Short Term

In addition to the 18 cases where we identified household members who appeared to have been living at the residence for more than 3 months, we identified another 18 cases where additional household members may have been residing at the Rural Development-financed property for up to 2 months. However, simply because the skiptrace report designated individuals at the subject property for a short period of time does not mean that they may not have been residing in the home for longer periods of time. Skiptracing utilizes credit history to determine the location of individuals; therefore, a person typically appears on the skiptrace report only when requesting credit. Consequently, we recommended to CSC that it evaluate these 18 cases. CSC officials agreed that these short-term cases could also put the agency at risk of providing unauthorized assistance and plan to review a sample of these accounts in order to appropriately assess the level of risk these cases pose.

OIG concluded that CSC needs to develop procedures to better identify household members who may be contributing income. CSC officials noted that new procedures to identify any unreported household members and recover unauthorized assistance will help the agency reduce the program's improper payment rate. Therefore, we are recommending that CSC develop and implement proactive procedures to utilize skiptrace or any other comparable research tool to identify household composition and investigate questionable cases on a more regular basis.

Recommendation 13

Review the 18 borrower accounts with potential unreported household members in the home for more than 3 months and sample from the 18 additional accounts with shorter-term household members in order to evaluate the risk posed. Based on the results of this review, develop and implement proactive procedures to: (1) identify all adult household members for accounts receiving payment subsidy and (2) follow up on high risk accounts which appear to have omitted adult household members for investigations into possible unauthorized assistance.

Agency Response

Rural Development stated that the Rural Housing Service completed a review of the 18 borrower accounts where possible additional household members were reported on the skiptrace for more than 3 months and a sample of 5 of the remaining 18 additional accounts with shorter-term potential additional household members. The review determined that the majority of the possible additional household members were family members using the borrower's address to receive mail due to being displaced during the housing crisis or away at college. In many of the cases, documentation was provided to certify that those individuals resided at another address. The review found a correlation between the fewer the number of months on the skiptrace report, the lesser the likelihood that the household had unreported income. However, the review did find a few cases with unauthorized assistance based on unreported household members which was recovered through existing policies and procedures. Due to the risk of unauthorized assistance,

the agency will implement a new procedure (Household Verification Audit) to skiptrace each account receiving subsidy at least once every 5 years to determine if existing and/or past agreements had unreported household members. When unreported household members are found to exist, the agency will pursue recovery through the existing unauthorized assistance process. Rural Development stated that the estimated completion date for the corrective action is December 31, 2014.

OIG Position

We accept management decision for this recommendation.

Finding 5: CSC Did Not Always Calculate Borrower Payment Subsidy Accurately

We found that, overall, CSC processors correctly calculated payment subsidy amounts for the program borrowers. However, for 7 of the 100 borrower accounts we reviewed, we found that CSC inaccurately calculated the borrowers' payment subsidy due to processor oversight or untimely implementation of instructions by management. Inaccurately calculated payment subsidy increases the risk of Rural Development granting unauthorized assistance, which may not be recaptured from the borrower. Based on our overall sample results, we estimate that the payment subsidy for 7,784 borrower accounts (7 percent of the universe), with a projected total value of $4.9 million over the term of the payment subsidy agreement, may also be inaccurately calculated.[55] This equates to an error rate of just over 1 percent,[56] which is less than the threshold for being declared susceptible to significant improper payments under IPERA.[57]

The agency reviews borrower eligibility for payment subsidy on an annual basis and determines the appropriate level of payment subsidy[58] in relation to the borrower's income.[59] Borrowers complete a "Payment Subsidy Renewal Certification," which includes information on household income, expenses, and composition. The loan servicer verifies the information provided and determines the amount of payment subsidy for which the borrower qualifies, if any, by using the borrower's adjusted income.[60] Adjusted income is the annual income of all household members, less certain deductions for which the household may qualify.[61] Processors project the borrower's income over the next 12 months, based on a comparison and analysis of the totals derived from using all applicable calculation methods: (1) straight-based, (2) average, (3) year-to-date (YTD),[62] and (4) historical.[63]

Additionally, the Loan Servicing System calculates payment subsidy after CSC processors determine and input the appropriate adjusted annual income. Processors are expected to

---

[55] We are 95 percent confident that between 2,128 (about 2percent) and 13,439 (about 12 percent) borrower accounts of the total universe of 111,197 borrower accounts currently receiving payment subsidy may have errors in payment subsidy calculations. The amount of payment subsidy in question ranges between $495,000 and $9.4 million. See Exhibit A for summary of Monetary Results and Exhibit B for the statistical sample design.
[56] $4,958,096 / $432,270,917 = 1.1 percent.
[57] "Improper Payments Elimination Act of 2010" (IPERA), 31 U.S.C. 3301(2)(a)(3). The threshold for being susceptible to significant improper payments under IPERA is when improper payments in the previous year exceed $10 million and 1.5 percent of program outlays or $100 million at any percentage of program outlays. We did not perform an IPERA review; the objective of our audit was to determine if borrowers received the amount of payment subsidy for which they qualified by examining the program controls.
[58] 7 CFR 3550.157(a)(1).
[59] HB-2-3550.4.2.
[60] HB-2-3550.4.6(A).
[61] Annual income is the income of all household members from all sources except those listed in (b)(1) through (b)(12) of this section (7 CFR 3550.54(b). Adjusted income is used to determine program eligibility and the amount of payment subsidy for which the household qualifies (7 CFR 3550.54(c)). Allowable deductions are described in 7 CFR 3550.54(c)(1) through (c)(5).
[62] YTD gross earnings are divided by the number of days worked then multiplied by 365. This method can only be used if the person receiving the income has continuously worked for the same employer or received the benefit since January 1st and the reported YTD income is for a period ending after March 1st.
[63] HB-2-3550.4.8(F).

maintain a 90 percent accuracy rate in the processing of payment subsidy renewals. According to CSC officials, they test processor accuracy by reviewing at least 3 percent of the processors' work monthly through their quality control review, as well as conducting an improper payments review. Processors receive training based on the results identified during their reviews to ensure that errors are corrected going forward and that the processor maintains the prescribed accuracy rate. To improve effectiveness and minimize improper payments, CSC officials adopted the varying payment subsidy terms based on the risk of changes in income.

As a result of our testing, we identified 7 of 100 borrower accounts where the payment subsidy was inaccurately calculated. When income is calculated too high, very-low income borrowers may not receive enough assistance. Conversely, if income is too low, the agency may be providing payment subsidy to borrowers who are not eligible. We also found an additional seven borrower accounts where the processor did not follow agency guidance and instructions. However, these seven instances did not have a dollar effect and were not included within our projections.[64] These inaccuracies occurred for various reasons. We found that: (1) processors did not utilize the proper method to estimate income as prescribed in the applicable desk procedures, (2) processors excluded relevant renewal information, and (3) CSC officials did not implement Social Security Administration's cost of living adjustments in a timely manner.

Processor Used Incorrect Income Calculation Methods

During the renewal process, agency guidance instructs processors to apply more than one income calculation method and perform an analysis to determine which method provides the income that would be most representative of what a borrower would receive during the next 12 months. CSC procedures outline the accepted annual income estimate methodologies[65] and the appropriate use for each.[66] However, we questioned the method used by processors to estimate annual income in five of the borrower accounts. In all of these cases, the adjusted income that CSC calculated for the borrowers was lower than adjusted income estimated using more appropriate methodologies. This resulted in borrowers receiving higher payment subsidy amounts than should have been allowed, totaling more than $4,400 over the terms of the payment subsidy agreements.

- For example, a processor estimated the borrower's income for the next year at just under $28,000 using the historical method. However, one of the borrower's pay stubs listed a total income of $28,892 paid as of October 21st. Using the year-to-date method, we estimated the borrower's income at about $35,000. As a result, the borrower would not have been eligible for payment subsidy. The borrower received just under $900 over the period of the payment subsidy agreement. CSC agreed that the processor used an incorrect income estimate and commented that this case could be used as a good training example. While this account may exceed the $550 threshold for recovery of unauthorized assistance, we are not recommending recovery because the borrower has already declared bankruptcy and stated the intent to surrender the property.

[64] Our conclusions are based on compliance testing and differ from an IPERA-based review.
[65] The desk procedures list the following income calculation methods: (1) hourly, (2) weekly, (3) biweekly, (4) bimonthly, (5) monthly, and (6) year-to-date. According to HB-2-3550.4.8(F), the four income calculation methods include: (1) straight-based, (2) average, (3) year-to-date, and (4) historical.
[66] CSC Payment Assistance Desk Procedures, Part II—Income Calculation, Paragraph C Income Computation.

- In another case, a processor used an average of two pay stubs, which did not represent the typical hours worked, as the pay stubs covered the holiday season. We noted that the estimated income used to compute payment subsidy was over $3,000 less than the total actual income as of December 30th. CSC concurred that the processor erred in determining the estimated income. As a result, the borrower received excess payment subsidy, totaling almost $580 over the period of the payment subsidy agreement. We are not recommending recovery of unauthorized assistance for this account either, as it has already been referred for repayment acceleration.

  In the other three cases, the processors used historical information when more current information was available or used YTD income when the borrower had not been at that job since January 1, and overpaid payment subsidy based on the available information by almost $2,500. We discussed all five of the cases with CSC officials, who generally agreed that more appropriate income determinations should have been made. In each of these cases, the processors did not use the income calculation method most representative of the borrower's income going forward nor did they adequately assess the timing of the income information. The processors either used historical income when more recent information was available; used the year-to-date method that was not allowed, given the circumstances; or did not adjust for periodic fluctuations in income.

Processor Did Not Correctly Utilize All Renewal Packet Information

In one case, the CSC processor did not consider a borrower's capital gains as income when estimating adjusted income. This resulted in the borrower receiving over $320 for the period of the payment subsidy agreement. CSC officials agreed that this was due to a processor error and noted it was under the $550 threshold for recovery of unauthorized assistance.

Processors Overlooked or Were Not Informed of Cost of Living Adjustment for Certain Government Payments

We found three cases where the borrower's income did not include the cost of living adjustment for Social Security Administration payments. However, only one of these instances affected the payment subsidy calculation and is included within our projection. In this instance, the borrower received almost $170 more than she was eligible for over the 24 month period of the payment subsidy agreement. These instances occurred as a result of processor oversight or untimely implementation of instructions. CSC concurred that the Social Security Administration's cost of living adjustments were omitted. They admitted a few of these instances occurred after the Social Security Administration released its cost of living adjustments, but prior to CSC implementing updated guidance. The Social Security Administration releases cost of living adjustments in October, which processors may unintentionally overlook. Renewal notices are sent to borrowers 90 days prior to the expiration date of the payment subsidy agreement. Therefore, January renewals are processed around the time that the Social Security Administration releases its updates. If borrowers respond timely to the renewal packet, the cost of living adjustments may not be implemented yet. Therefore, we are recommending that CSC implement the necessary guidance to avoid these circumstances in the future. CSC officials

proposed delaying the processing of January renewals to allow publication and dissemination of cost of living adjustments.

While these seven monetary and additional seven compliance exceptions fell into various categories, CSC agreed that these issues happened because of two underlying causes: processor oversight and management's untimely implementation of guidance. However, in all 14 cases, CSC officials stated that their quality control review process, which holds processors to a 90 percent accuracy rate, would consider the discrepancies we noted during our review as processor errors. They also stated that incurring additional labor costs to further examine the payment subsidy renewals is not in the best interest of the agency when there is no monetary impact to either the agency or the borrower. As the agency's resources continue to be limited, we understand the reasons for this risk based approach. However, there may be instances when the same error may or may not result in a monetary impact. The 14 errors we found were made by 12 different processors for various reasons. Therefore, we cannot conclude any one area or individual is the source of the issue. Rather, we are recommending that all of the processors are trained on each of the issues noted as a result of our audit work to reduce the risk of the questioned $4.9 million in potentially inaccurate payment subsidy and ensure that these errors do not continue in the future.

Recommendation 14

Provide targeted training to all processors on the topics noted as a result of our audit work to reduce the risk of the questioned $4.9 million in potentially inaccurate payment subsidy calculations.

Agency Response

Rural Development stated that the Rural Housing Service will expand and strengthen training on the policies and procedures as they relate to selecting the best method to estimate income and ensuring all income sources are included when subsidy is calculated. The agency will hold a refresher training course with all processors by the end of fiscal year 2014 to discuss the OIG findings related to the use of incorrect income calculation methods and failure to identify all income sources. Rural Development stated that the estimated completion date for the corrective action is December 31, 2014.

OIG Position

We accept management decision for this recommendation.

Recommendation 15

Revise current guidance to ensure that processors are made aware of upcoming cost of living adjustments prior to processing payment subsidy renewals around the timeframe when updates are released by the Social Security Administration.

Agency Response

Rural Development stated that the Rural Housing Service will update their desk procedures to reflect the new practice to delay processing renewals for loans receiving Social Security for the coming year (January renewals or later) until management has released its official memo indicating the new cost of living adjustment. Rural Development stated that the estimated completion date for the corrective action is August 31, 2014.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We conducted our audit of payment subsidy renewal and recapture accounts for the Single Family Housing Direct Loan Program at the Rural Development national office, located in Washington, D.C., and the Rural Development Centralized Servicing Center (CSC), located in St. Louis, Missouri. We conducted our audit work in our regional office as we were granted access to CSC's information systems: the Loan Servicing System and the Rural Development Imaging Repository.

CSC services a loan portfolio of over 325,000 loans, with an outstanding principal balance exceeding $16 billion. Of these loans, 47 percent receive payment subsidy. Loans that are paid off, either by final payment or sale of the property, may be subject to recapture of all or part of the payment subsidy received.

Our audit covered borrower accounts where payment subsidy was renewed during fiscal years 2011 and 2012. We statistically selected 100 borrower accounts from a universe of 111,197 accounts, representing $432 million in payment subsidy over the term of the agreements. Our audit also covered borrower accounts where payment subsidy recapture was established or repaid during fiscal years 2008 through 2012. We statistically selected 100 borrower accounts from a total universe of 62,331 accounts[67] subject to recapture with an estimated $514 million in billed and/or collected recapture receivables.[68] Both samples were selected using a simple random sample (see Exhibit B). We performed our fieldwork from November 2012 to December 2013.

To accomplish our audit objectives, we performed the following procedures:

- Identified and reviewed Rural Development and CSC published regulations, guidance, instructions, handbooks, and desk procedures that detailed the controls over and procedures for processing payment subsidy renewals and establishing payment subsidy recapture amounts.

- Developed electronic templates for reviewing borrower accounts to determine if CSC established timely and accurate payment subsidy recapture amounts, properly determined borrower eligibility for continued payment subsidy, and accurately calculated amounts for continued payment subsidy.

- Reviewed 200 statistically selected accounts using the appropriate electronic template to determine if CSC followed policies and procedures, made proper payment subsidy

[67] The initial audit universe included 62,332 accounts; however, during fieldwork, we removed one borrower account with payment subsidy recapture billed totaling $12,958 from the audit sample at the request of OIG Office of Investigations and reviewed the next statistically valid sample borrower account.

[68] During our file review of the 100 statistically selected sample units, we determined CSC billed these accounts a total of $825,971 in payment subsidy recapture due. We are 95 percent confident that the billed payment subsidy recapture amount for our audit universe was between $368,801,698 and $660,870,581. During fieldwork, CSC officials were unable to provide us with the total payment subsidy recapture billed for the borrowers in the audit universe and requested that we statistically estimate the total payment subsidy recapture billed for the audit universe.

eligibility determinations, and established correct payment subsidy recapture receivables in a timely manner.

- Met with CSC personnel to discuss identified irregularities and issues based on our review of the data contained in their applicable information systems.

- Discussed with Rural Development and CSC officials the issues we found during our review to obtain their positions and response.

We obtained payment subsidy renewal and recapture data from CSC. The payment subsidy renewal data were derived directly from the Rural Development data warehouse. The payment subsidy recapture data were derived from data queries performed by CSC staff and validated by OIG. While we did not perform a complete general and application review, we assessed the reliability of the information systems utilized by CSC for processing payment subsidy renewal and recapture by comparing specific data within the Loan Servicing System to documentation and information in the sampled borrower accounts. The results of this testing are explained within this audit report.

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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Abbreviations

AMI.....Area Median Income
CFR.....*Code of Federal Regulations*
CSC.....Centralized Servicing Center
HB.....Handbook
IPERA.....Improper Payments Elimination and Recovery Act
OIG.....Office of Inspector General
OGC.....Office of the General Counsel
PRAS.....Principal Reduction Attributed to Subsidy
RD.....Rural Development
RHS.....Rural Housing Service
SFH.....Single Family Housing
U.S.C.....United State Code
USDA.....Department of Agriculture
USPAP.....*Uniform Standards of Professional Appraisal Practice*
YTD.....Year-to-Date

Exhibit A: Summary of Monetary Results

Exhibit A summarizes the monetary results for our audit report by finding and recommendation number.

Finding	Recommendation	Description	Amount	Category
2	3	Understated due to inaccurate calculation of final recapture amount.	$32,404	Questioned Costs/Loans, Recovery Recommended
2	4	Overstated due to inaccurate calculation of final recapture amount.	$20,689	Underpayments and Over Collections
2	5	Final recapture receivables not calculated accurately.	$33,040,317[69]	Questioned Costs/Loans, No Recovery
2	6	Final recapture receivables not calculated accurately.	$1,934	Questioned Costs/Loans, Recovery Recommended
5	14	Inaccurately Calculated Borrower Payment Subsidy	$4,958,096[70]	Questioned Costs/Loans, No Recovery
Total			**$38,053,440**	

[69] OIG is 95 percent confident that the error rate is no less than $2,602,062 and no more than $63,584,758 with a midpoint of $33,093,410 (see Statistical Exhibit B, Table 1). We estimate that CSC inaccurately calculated final payment subsidy recapture totaling $33,093,410. The actual amount ($32,404 understated and $20,689 overstated) is subtracted from the total $33,093,410 ($33,093,410 – 32,404 – 20,689 = $33,040,317).

[70] OIG is 95 percent confident that the error rate is no less than $495,430 and no more than $9,420,763 with a midpoint of $4,958,096 (see Statistical Exhibit B, Table 2).

Exhibit B: Statistical Exhibit

Section 1: Payment Subsidy Recapture

Objective
This sample was designed to support the OIG audit of SFH Direct Loan Servicing and Payment Subsidy Recapture. The objective of this audit is to review the servicing of SFH direct loans, specifically, to determine if CSC performs yearly reviews of borrower income and whether the borrower is eligible for payment subsidy and if the borrower is receiving the correct payment subsidy. Also, to determine if CSC correctly computes the amount of payment subsidy recapture in cases where recapture is triggered and the extent of collections on identified payment subsidy recapture amounts.

To support the objectives of the audit, we developed a random statistical sample of payment subsidy recapture accounts for review.

Audit Universe
The audit universe consisted of 62,331 payment subsidy recapture accounts. When trying to determine a universe dollar value total, we encountered the following limitation: when a borrower repays their loan balance, a maximum recapture receivable is established. Maximum recapture receivable amounts are the total payment subsidy that the borrower has received during the life of the loan. Once the current market value of the subject property has been determined, the maximum recapture receivable is removed and a final adjusted recapture receivable amount is calculated and posted to the borrower's account. In some instances, borrowers are required to, or choose to, pay the maximum billed amount in full. In other instances, borrowers elect to partially repay the recapture billed amount. Therefore, the universe of data that we used to select our sample from is simply a snapshot as of the date it was pulled, not necessarily the true values that need to be attributed to the accounts.

Sample Design
We did not have any historical information about the universe we were working with, and did not know what error rate and variation we would find during our review. In our sample planning, we applied travel and resource costs as limiting factors in choosing a sample size and design in order to affect prudent use of resources. Since a simple random sample provides the smallest sample size for a given precision and confidence levels, we selected 100 cases at random, without replacement, for review. Each sampled unit had an equal probability of being selected and carried the same sampling weight. We chose a sample size of 100 because we wanted to report findings for attributes with a +/- 10 percent precision, for a 50 percent error rate, at a 95 percent confidence level.

Results
Results are projected to the audit universe of 62,331 cases. Margin of error, which is indicated by the confidence interval, is reported here for a 95 percent confidence level. All projections are made using the normal approximation to the binomial as reflected in standard equations for a simple random sample.[71]

The summary and table below shows the projected number of cases and dollar value estimates. For each estimate where we question criteria we tested, we show the upper and lower bounds of a 95 percent confidence interval. Precision (or margin of error) for each estimate is also included. We provide interpretation of our results following the table.

[71] Scheaffer, Mendenhall, Ott, Elementary Survey Sampling, Fourth Edition (Chapter 5), Duxbury Press, c1990.

Table 1: Payment subsidy recaptures projections

Issue	Estimate	Standard Error	95% Confidence Interval		Coefficient of Variation	Actual Found	Margin of Error	
			Lower	Upper				
Finding 1 - delay in receiving docs for calculating the recapture amount	11,220 [18% of universe]	2,404.811	6,448 [10% of universe]	15,991 [26% of universe]	.214	18	+/-	4,772 [8% of universe]
Dollar projection for total billings for Finding 1	$160,004,237.98	$45,343,979.81	$70,031,944.59	$249,976,531.37	.283	$256,700.90	+/-	56%
Finding 2 - Calculation errors	8,103 [13% of universe]	2,105.083	3,926 [6% of universe]	12,280 [20% of universe]	.260	13	+/-	4,177
Absolute value dollar projection for Finding 2	$33,093,410.30	$15,366,942.63	$2,602,062.24	$63,584,758.35	.464	$53,093.02	+/-	92%
Finding 3 – failed to occupy	3,117 [5% of universe]	1,364.221	410 [1% of universe]	5,823 [9% of universe]	.438	5	+/-	2,707 [4% of universe]
Finding 1 - Dollar projection for the total amount billed for our universe	$514,836,139.84	$73,598,021.36	$368,801,698.26	$660,870,581.42	.143	$825,971.25	+/-	28%

The projection narrative follows:

- Based on our sample, we estimate that for 11,220 payment subsidy recapture accounts (18 percent of the universe) the payment subsidy recapture receivables may not have been established in a timely manner. We are 95 percent confident that between 6,448 (about 10 percent) and 15,991 (about 26 percent) borrower accounts of our total universe of 62,331 accounts subject to recapture may be calculated in an untimely manner. The total payment subsidy recapture billed for these borrower accounts is estimated at $160,004,238 for the point in time when the universe data were obtained. We are 95 percent confident that the dollar estimate is between $70,031,945 and $249,976,531 based on a projected estimate of recapture receivables for our universe totaling $514.8 million.
- Based on our sample, we estimate that in 8,103 payment subsidy recapture accounts (13 percent of the universe) the CSC processors inaccurately calculated the final recapture receivable. The projected dollar value for this estimate is $33,093,410 in absolute value for the point in time when the universe data were obtained. We are 95 percent confident that between 3,926 (6 percent of the universe) and 12,280 accounts (20 percent) have this issue. We are 95 percent confident that the dollar estimate is between $2,602,062 and $63,584,758 in absolute value.
- Based on our sample, we estimate that in 3,117 recapture receivable accounts (5 percent of the audit universe) the borrowers no longer occupy the property or have transferred title. We are 95 percent confident that between 410 (1 percent of the universe) and 5,823 accounts (9 percent) have this issue.
- Our sample of 100 accounts added up to $825,971 billed. Based on this, we estimate that the total amount billed is $514,836,140. We are 95 percent confident that this estimate is between $368,801,698 and $660,870,581.[72]

[72] This statistical design is provided as evidence of the statistical sample and projections. It is simply an explanation of statistics involved with the audit work and results. This is not a reflection of the monetary results of this audit report. See Exhibit A and the related findings for the actual monetary results.

Section 2: Payment Subsidy Renewal

Audit Universe
The audit universe consisted of 111,197 borrower accounts totaling $23,653,637 in payment subsidy.

Sample Design
We did not have any historical information about the universe we were working with, and did not know what error rate and variation we would find during our review. In our sample planning, we applied travel and resource costs as limiting factors in choosing a sample size and design in order to affect prudent use of resources. Since a simple random sample provides the smallest sample size for a given precision and confidence levels, we selected 100 cases at random, without replacement, for review. Each sampled unit had an equal probability of being selected and carried the same sampling weight. We chose a sample size of 100 because we wanted to report findings for attributes with a +/- 10 percent precision, for a 50 percent error rate, at a 95 percent confidence level.

Results
Results are projected to the audit universe of 111,197 cases. Margin of error, which is indicated by the confidence interval, is reported here for a 95 percent confidence level. All projections are made using the normal approximation to the binomial as reflected in standard equations for a simple random sample.[73]

The summary and table below shows the projected number of cases and dollar value estimates. For each estimate where we question criteria we tested, we show the upper and lower bounds of a 95 percent confidence interval. Precision (or margin of error) for each estimate is also included. We provide interpretation of our results following the table.

[73] Scheaffer, Mendenhall, Ott, Elementary Survey Sampling, Fourth Edition (Chapter 5), Duxbury Press, c1990.

Table 2: Payment subsidy renewal projections

Issue	Estimate	Standard Error	95% Confidence Interval		Coefficient of Variation	Actuals Found	Margin of Error	
			Lower	Upper				
Finding 4 – Indicators of Unreported Income	20,015 [18% of universe]	4,291.640	11,500 [10% of universe]	28,531 [26% of universe]	.214	18	+/-	8,516 [8% of universe]
Dollar Projection for Indicators of Unreported Income for Finding 4	$91,186,966.41	$22,676,785.90	$46,191,303.42	$136,182,629.41	.249	$82,004.88	+/-	49%
Finding 5 - CSC Inaccurately Calculated Borrower Payment Subsidy	7,784 [7% of universe]	2,850.169	2,128 [2% of universe]	13,439 [12% of universe]	.366	7	+/-	5,655 [5% of universe]
Dollar Projection for Inaccurate Calculation for Finding 5	$4,958,096.31	$2,249,081.83	$495,430.02	$9,420,762.61	.454	$4,458.84	+/-	90%

Based on our sample, we project that:

- Based on our sample, we project that 20,015 accounts (18 percent of the universe), receiving a projected total value of about $91 million in payment subsidy over the course of their subsidy agreement, may have long-term (3 months or more) unreported household members. We are 95 percent confident that indicators of unreported household members exist in accounts ranging between 11,500 (1 percent) and 28,531 (26 percent) of our total universe of 111,197 SFH direct loans receiving payment subsidy. Those accounts have a projected value of payment subsidy between $46 million and $136 million.
- Based on our sample, we project that 7,784 accounts (7 percent of the universe), with a projected total value of $4.9 million, over the term of the payment subsidy agreement, may have been inaccurately calculated. We are 95 percent confident that the number of questionable accounts receiving payment subsidy ranges between 2,128 (2 percent) and 13,439 (12 percent) of the total universe of 111,197 accounts currently receiving payment subsidy. The amount of payment subsidy in question ranges between $495,000 and $9.4 million.[74]

[74] This statistical design is provided as evidence of the statistical sample and projections. It is simply an explanation of statistics involved with the audit work and results. This is not a reflection of the monetary results of this audit report. See Exhibit A and the related findings for the actual monetary results.

Exhibit C: Monetary Results Detail

Exhibit C itemizes the specific monetary results recommended for recovery for our audit report by sample number.

Sample Number	Finding 2	
	Overstated	**Understated**
6	15,897	
9	283	
24	521	
29		17,496
30	620	
46		160
60	3,368	
65		169
70		5,607
72		3,946
75		3,231
87		235
89		1,560
TOTALS	**$20,689**	**$32,404**[75]

[75] Sample number 85 unsupported costs and loans recovery recommended of $1,934 reported separately on Exhibit A, Summary of Monetary Results.

USDA'S
RURAL DEVELOPMENT

RESPONSE TO AUDIT REPORT

United States Department of Agriculture

Rural Development

Tony Hernandez
Administrator
Housing and
Community Facilities
Program

1400 Independence
Ave SW
Washington, DC
20250

Voice 202-690-1533
Fax 202-690-0500

TO: Gil H. Harden
Assistant Inspector General for Audit

THRU: John Dunsmuir \s\ John Dunsmuir - 5/27/14
Acting Director
Financial Management Division

FROM: Tony Hernandez /s/ Tony Hernandez
Administrator
Housing and Community Facilities

SUBJECT: Audit Number 04601-0001-31Rural Development:
Single Family Housing Direct Loan Servicing and
Payment Subsidy Recapture

Thank you for providing the U.S. Department of Agriculture (USDA) Rural Development (RD) and Rural Housing Service (RHS) with the Office of Inspector General (OIG) draft report entitled "Rural Development: Single Family Housing Direct Loan Servicing and Payment Subsidy Recapture," Audit Number 04601-0001-31. We appreciate the opportunity to respond to OIG's review of RHS compliance with the granting of payment subsidy and calculation of payment subsidy recapture under the Single Family Housing Direct Loan Program (SFHDLP). The agency generally agrees with the recommendations in this report which will further strengthen RD's compliance related to improper payments and subsidy recapture. However, we do not agree with the monetary amounts reflected for finding #2 in Exhibit A: Summary of Monetary Results. For your consideration, USDA offers the following comments and requests that a copy of these comments be included in the final report.

Finding 2 Comments

During the audit, OIG and RD had several discussions relating to how the agency calculated final payment subsidy recapture amounts for program borrowers. We agree with OIG's overall observation and recommendation that RD needs to expand the current secondary review process to include all recapture calculations prior to release of the lien documents. However, we differ with OIG's assessment that the agency's failure to perform this secondary review may have results in an absolute monetary difference of

USDA is an equal opportunity provider and employer.

If you wish to file a Civil Rights program complaint of discrimination, complete the USDA Program Discrimination Complaint Form, found online at http://www.ascr.usda.gov/complaint_filing_cust.html, or at any USDA office, or call (866) 632-9992 to request the form. You may also write a letter containing all of the information requested in the form. Send your completed complaint form or letter to us by mail at U.S. Department of Agriculture, Director, Office of Adjudication, 1400 Independence Avenue, S.W., Washington, D.C. 20250-9410, by fax (202) 690-7442 or email at program.intake@usda.gov.

$33,093,410 in inaccurate recapture calculations over a five year period. We believe the $33,093,410 monetary amount is not an accurate or creditable estimate and by OIG's own assertion the absolute amount could be as low as $2,602,062 (Page 32, second bullet) over the five year period. The agency understands OIG's limited available time resulting in auditing only 100 of the 62,331 (.16%) recapture receivable accounts, however this small sample places the confidence level of the stated amount in question. To further support our position, as discussed with the OIG, the agency implemented in July 2012 a secondary review process for final recapture calculations. In short, since July 2012, the agency performs a full secondary review of over half of all recapture calculations. Thus, OIG's stated monetary result does not factor in the impact of this secondary review. Nor do they indicate that since July 2012, the agency has reduced its recapture error rate by 53%.

Responses to Recommendations

Specific responses to individual recommendations can be found in the attachment.

Once again, we appreciate the opportunity to respond to OIG's report on RHS's compliance with the granting of payment subsidy and the calculation of payment subsidy recapture under the SFHDLP. We hope that our comments will help in the preparation of the final report. If you have questions, please contact Mr. John Dunsmuir, Acting Director, RD Financial Management Division, at (202) 692-0082.

Attachment

Management Response
Rural Development: Single Family Housing Direct Loan Servicing and Payment Subsidy Recapture
Audit No.: 04601-0001-31

Recommendation No. 1: Develop and implement a tracking system or edit check to alert the Centralized Servicing Center (CSC) and field office staff of overdue requests for market valuations and establish internal controls to ensure that final recapture amounts are timely and accurately calculated.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will develop a database to track and age tasks sent to the field office requesting market valuations until a nationwide contract is created to eliminate the need for field offices to individually obtain market valuations.

2) The agency will develop procedures to track the receipt of market valuation appraisals and to follow-up on delinquent (more than 75 days old) tasks to ensure all market valuation appraisals are received.

3) The agency will update the existing desk procedures in conjunction with recommendation # 5 to implement additional controls and procedures to ensure the final recapture amount is computed timely and accurately.

Date Corrective Action Will Be Completed: March 31, 2015

Recommendation No. 2: Ensure that the necessary steps are taken to calculate and establish the receivables for the remaining identified 1,498 borrower accounts from the special project and any other outstanding accounts with maximum recapture receivables outstanding.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will resume the special project to review the remaining 1,498 account with maximum recapture receivable balances to determine the correct recapture amount.

2) The agency will identify all accounts with overdue recapture calculations not included in the special project and compute the recapture amount using current market valuations as provided by the field offices.

3) To allow field office staff sufficient time to obtain the market values, the agency will review 250 accounts per month.

4) The agency will develop a tracking database to monitor and ensure all 1,498 borrower accounts and additional accounts identified are completed. This database will ensure that requests for market valuations are received, final recapture calculations are created and the completion status is documented.

Date Corrective Action Will Be Completed: May 30, 2015

Recommendation No. 3: Evaluate recovery options for $32,404 in payment subsidy recapture amounts payable from the eight sample borrowers where the agency under-billed the borrowers.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will review each of the eight accounts and pursue recovery of funds from each borrower if the under-billed amount is enforceable and collectable.

2) For those borrowers whose under-billed amount is enforceable and collectable:
   a. The recapture account will be re-established
   b. A receivable for the under-billed amount will be created on the account.
   c. A demand letter for payment and appeal rights will be provided to each borrower.

Date Corrective Action Will Be Completed: November 30, 2014

Recommendation No. 4: Refund or adjust the five borrowers' accounts by $20,689 in over-billed final payment subsidy.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will recalculate the recapture amount for the 5 borrowers who were over-billed.

2) Borrowers who have paid their recapture balance in full will receive a refund check for the amount of the over payment and a letter of explanation will be provided.

3) For borrowers whose account was not paid in full, the recapture receivable amount will be reduced by the over-billed amount. The borrowers will be sent a letter explaining the reduction in the recapture receivable.

Date Corrective Action Will Be Completed: August 30, 2014

Recommendation No. 5: Expand the current secondary review process to include all final recapture calculations prior to release of the lien documents to reduce the potential of the questioned $33 million in inaccurate recapture calculations.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will expand its current secondary review process to include all final recapture calculations prior to releasing the lien documents.

2) The agency will modify existing desk procedures and internal control processes to implement and document the expanded secondary review process to include all final recapture calculations.

Date Corrective Action Will Be Completed: December 31, 2014

Recommendation No. 6: Obtain a formal Office of the General Counsel (OGC) opinion on the regulatory requirements for collecting principal reduction attributable to subsidy. Depending on the outcome of this opinion, update guidance and instructions to reflect this policy and evaluate the recovery options for the $1,934 in payment subsidy recapture amount payable from the sample borrower where the agency under-billed the borrower.

Management Response: Concur. The agency will re-evaluate the recovery options for the $1,934 in payment subsidy recapture (including Principal Reduction Attributable to Subsidy (PRAS)) after consulting and receiving legal advice and guidance from Rural Development's OGC.

The following action will address this recommendation:

1) The agency will consult and obtain legal written opinion(s) from RD's OGC on the regulatory requirements for collecting PRAS and whether the current method of calculating subsidy recapture is in accordance with the regulations. If the OGC opinion is that the current method of calculating subsidy recapture is not in accordance with the regulations, the agency will perform the following:

a. The recapture calculation will be modified based on the legal opinion.
b. The CSC Handbook (HB-2- 3550) will be updated to specify the change in calculation.
c. The desk procedures will be modified to reflect the change in calculation.

2) The agency will consult with OGC and obtain legal written opinion(s) as to whether the under-billed amount of $1,934 can be collected from the borrower in question. If the under-billed amount on the sample account can be collected, the agency will re-establish the account, establish a receivable for the under-billed amount and issue a demand letter for payment to the borrower along with appeal rights.

Date Corrective Action Will Be Completed: May 30, 2015

Recommendation No. 7: If the OGC opinion confirms OIG's interpretation, apply the effect of the opinion to the entire portfolio of SFH direct loans by performing a portfolio-wide review and corrections, including recovery of under-billed payment subsidy recapture where warranted.

Management Response: Concur.

The action required to resolve this recommendation is contingent on the OGC opinion received under recommendation #6.

The following action will address this recommendation:

1) The agency will utilize the OGC opinion received in recommendation #6. If the OGC determines that the current method of calculating subsidy recapture related to Principal Reduction Attributable to Subsidy (PRAS) is not in accordance with the regulations, the agency will perform the following:
   a. Identify all open recapture receivable accounts established by the Centralized Servicing Center whose loans received payment subsidy (interest credit) between October 1, 1979, and December 31, 1989.
   b. Recompute the recapture amount and compare it to the original recapture amount on the identified accounts.
   c. Adjust all recapture accounts where the amount is different.
   d. The borrowers will be sent a letter explaining the change in the recapture amount.
   e. Update existing desk procedures to reflect the change in recapture calculation.

Date Corrective Action Will Be Completed: May 30, 2015

Recommendation No. 8: Develop and implement tools and procedures to actively monitor borrower occupancy after the loan is paid in full and recapture is deferred, in order to determine when a borrower ceases to occupy the property to ensure that recapture receivables become due and payable at the time the borrower vacates the property.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will amend the language on the annual recapture receivable statement to include language stating that the borrower must occupy the property and not transfer title in order to defer the recapture due.

2) The agency will develop and implement a follow-up system to investigate borrowers whose annual receivable statements are returned by the USPS as undeliverable. All returned annual receivable statements will be researched thoroughly to determine if the former borrower no longer resides in the property. Borrowers who are determined to be no longer residing in the property will be accelerated to recover the amount of the recapture receivable. Existing desk procedures will be modified to reflect the new follow-up process.

Date Corrective Action Will Be Completed: March 31, 2015

Recommendation No. 9: Develop and implement a procedure to be followed when CSC is notified that a borrower is deceased or no longer occupying a property to ensure that recapture receivables become due and payable at the time the borrower vacates the property.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will utilize the Do Not Pay process being developed under recommendation #10 to identify deceased borrowers.

2) The agency will modify its current methodologies and practices when notified in writing or verbally that a borrower is deceased or no longer occupying a property. This change will include notification to the Payoff Research Section who will refer the account for acceleration upon verification of non-occupancy or death. Existing desk procedures will be modified to reflect the change.

Date Corrective Action Will Be Completed: March 31, 2015

Recommendation No. 10: Develop and implement procedures to fully utilize the Social Security Administration's death match database on a monthly or at least quarterly basis to determine if and when borrowers have passed away.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will meet with representatives from the U.S. Treasury Department, the Financial Management Division of the Office of the Chief Financial Officer and the Deputy Chief Information Officer to submit our data requirements and portal access requirements to match a file that would be created from the LoanServ database and matched against the Social Security Administration's death master file.

2) Once U.S. Treasury has developed the report showing the matches and made the report available through the Do Not Pay portal page, the agency will code the deceased borrower's account to reflect his/her deceased status. If all borrowers on the account are deceased, the account will be referred for acceleration to collect the recapture due. This process will be performed at a minimum on a quarterly basis and existing desk procedures will be modified to reflect the new Do Not Pay process.

Date Corrective Action Will Be Completed: March 31, 2015

Recommendation No. 11: Obtain a formal Office of the General Counsel (OGC) opinion on the occupancy requirement, as it is applied to the SFH Direct Loan Program, specifically in relation to payment subsidy recapture calculation and repayment requirements when a borrower who has paid off a loan and deferred recapture "ceases to occupy the property." Using the opinion received from OGC, revise regulations and guidance to clarify the occupancy requirement, as it specifically relates to payment subsidy recapture calculation and repayment requirements.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will consult and obtain legal written opinion(s) from RD's OGC as to the definition of when the borrower "ceases to occupy the property" as it relates to recapture receivable accounts.

2) Based on the OGC opinion, amendments to either the 7CFR 3550 regulation, the CSC Handbook (HB-2-3550) or both will be submitted to further define when subsidy recapture must be repaid.

Date Corrective Action Will Be Completed: May 30, 2015

Recommendation No. 12: Obtain a formal OGC opinion on the occupancy requirement, as it is applied to the SFH Direct Loan Program, specifically in relation to payment subsidy recapture calculation and repayment requirements when a borrower with an active loan "ceases to occupy the property." Using the opinion received from OGC, revise regulations and guidance to clarify the occupancy requirement as it specifically relates to payment subsidy recapture calculation and repayment requirements.

Management Response: Concur.

The following action will address this recommendation:

1) The agency will consult and obtain legal written opinion(s) from RD's OGC as to the definition of when the borrower "ceases to occupy the property" as it relates to the calculation of subsidy recapture on an open active loan.

2) Based on the OGC opinion, amendments to either the 7CFR 3550 regulation, the CSC Handbook (HB-2-3550) or both will be submitted to further define when subsidy recapture must be repaid.

Date Corrective Action Will Be Completed: May 30, 2015

Recommendation No. 13: Review the 18 borrower accounts with potential unreported household members in the home for more than 3 months and sample from the 18 additional accounts with shorter-term household members in order to evaluate the risk posed. Based on the results of this review, develop and implement proactive procedures to: (1) identify all adult household members for accounts receiving payment subsidy and (2) follow up on high risk accounts which appear to have omitted adult household members for investigations into possible unauthorized assistance.

Management Response: Concur.

The agency has completed a review of the 18 borrower accounts where possible additional household members were reported on the skip trace for more than 3 months and a sample of 5 of the remaining 18 additional accounts with shorter-term potential additional household members. Our review has determined that in the majority of the cases the names listed on the skip trace where not actual household members, but were family members using the borrower's address to receive mail. The reasons identified in several of these cases were that the family members did not have permanent residency due to being displaced by the impacts of the housing crisis (i.e. living with friends or in temporary housing) or that they were students in college. In

many of the cases, the names listed on the skip trace provided tax returns or lease agreements certifying that they resided in another address. Also, we found a correlation where the fewer the number of months reported on the skip trace the lesser the likelihood that the household had unreported income.

Although the majority of the reviews didn't result in any unauthorized assistance (UNA), we did find a few cases that did have UNA based on unreported household members. In those cases, the agency was able to recover the UNA through its existing UNA process and procedures. The agency recognizes some risk and will implement a new procedure (Household Verification Audit) to skip trace each account receiving subsidy at least once every 5 years to determine if existing and/or past agreements had unreported household members. When unreported household members are found to exist, the agency will pursue recovery through the existing UNA process.

The following action will address this recommendation:

1) Provide OIG with the results of the audit of the accounts they identified during the audit.
2) Provide a copy of the new Household Verification Audit procedures.

Date Corrective Action Will Be Completed: December 31, 2014

Recommendation No. 14: Provide targeted training to all processors on the topics noted as a result of our audit work to reduce the risk of the questioned $4.9 million in potentially inaccurate payment subsidy calculations.

Management Response: Concur.

Although the agency already has a strong training program in place, we agree to provide additional training and guidance to all personnel.

The following action will address this recommendation:

Management agrees to expand and strengthen training on the Agency's policies and procedures as they relate to selecting the best method to estimating income and ensuring all income sources are included when subsidy is calculated. The Agency will hold a refresher training course with all processors by the end of FY 2014 to discuss the OIG findings related to the use of incorrect income calculation methods and failure to identify all income sources.

Date Corrective Action Will Be Completed: December 31, 2014

Recommendation No. 15: Revise current guidance to ensure that processors are made aware of upcoming cost of living allowances prior to processing payment subsidy

renewals around the timeframe when updates are released by the Social Security Administration.

Management Response: Concur.

The following action will address this recommendation:

The desk procedures will be updated to reflect the new practice to delay processing renewals for loans receiving Social Security for the coming year (January renewals or later) until Agency management has released its official memo indicating the new Cost of Living Adjustment (COLA).

Date Corrective Action Will Be Completed: August 31, 2014

To learn more about OIG, visit our website at
www.usda.gov/oig/index.htm

How To Report Suspected Wrongdoing in USDA Programs

Fraud, Waste and Abuse
e-mail: USDA.HOTLINE@oig.usda.gov
phone: 800-424-9121
fax: 202-690-2474

Bribes or Gratuities
202-720-7257 (24 hours a day)

The U.S. Department of Agriculture (USDA) prohibits discrimination in all of its programs and activities on the basis of race, color, national origin, age, disability, and where applicable, sex (including gender identity and expression), marital status, familial status, parental status, religion, sexual orientation, political beliefs, genetic information, reprisal, or because all or part of an individual's income is derived from any public assistance program. (Not all prohibited bases apply to all programs.) Persons with disabilities who require alternative means for communication of program information (Braille, large print, audiotape, etc.) should contact USDA's TARGET Center at (202) 720-2600 (voice and TDD).

To file a complaint of discrimination, write to USDA, Assistant Secretary for Civil Rights, Office of the Assistant Secretary for Civil Rights, 1400 Independence Avenue, S.W., Stop 9410, Washington, DC 20250-9410, or call toll-free at (866) 632-9992 (English) or (800) 877-8339 (TDD) or (866) 377-8642 (English Federal-relay) or (800) 845-6136 (Spanish Federal relay).USDA is an equal opportunity provider and employer.