United States Department of Agriculture

OFFICE OF INSPECTOR GENERAL

Review of Rural Rental Housing's Tenant and Owner Data Using Data Analytics



04901-0001-13
September 2015

Review of Rural Rental Housing's Tenant and Owner Data Using Data Analytics

Audit Report 04901-0001-13

What Were OIG's Objectives

OIG's objective was to use data analytics to determine whether owners of RRH projects, or their management agents, report reasonable and accurate project operation information, and whether tenants report eligibility information accurately.

What OIG Reviewed

We reviewed reserve account information for active RRH projects as of July 2014, and each project's FY 2013 year-end actual expenses. We reviewed expense reports for 11 non-statistically sampled projects selected based on analyses of expense information, a computed risk score, and physical proximity.

What OIG Recommends

RHS should improve controls over reserve accounts and project expenses, provide program guidance training, recover unallowable costs identified by OIG, review the management agents in our sample and recover other unallowable costs, and review a representative sample of projects from the list of projects provided by OIG with potentially unallowable costs.

OIG used data analytics to review RRH program data to determine whether project operation information is being reported reasonably and accurately.

What OIG Found

The Office of Inspector General's (OIG) analysis of expenses submitted by Rural Rental Housing (RRH) management agents found unallowable expenses charged to projects during the projects' fiscal year (FY) 2013. These unallowable expenses included charges for Christmas parties, summer picnics, dinners, alcoholic beverages, and gifts to management agent staff. Our review of 11 projects, managed by 2 management agents, determined that 1 management agent misused almost $28,000 in RRH project funds by hosting parties and charging expenses to RRH projects, and another management agent charged unallowable expenses to RRH projects as part of a staff training event in 2013.

In addition, our audit found issues with values recorded in project reserve accounts, which are primarily used to meet the major capital expense needs of the project:

- 13 projects had erroneously reported reserve accounts with negative actual balances.
- 20 projects erroneously reported actual reserve account balances for future dates. On the date of our extract, five of these dates were more than 90 days in the future.
- 77 projects erroneously reported a fully-funded reserve amount that was $1 or less, 74 of which were $0.

The Rural Housing Service (RHS) agreed with our findings and we accepted management decision on eight of nine recommendations.

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

DATE: September 24, 2015

AUDIT NUMBER: 04901-0001-13

TO: Tony Hernandez
Administrator
Rural Housing Service

ATTN: John Dunsmuir
Director
Financial Management Division

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Review of Rural Rental Housing's Tenant and Owner Data Using Data Analytics

This report presents the results of the subject audit. Your written response, dated September 8, 2015, is included in its entirety at the end of this report. Excerpts from your response and the Office of Inspector General's position are incorporated into the relevant sections of the report. Based on your September 8, 2015, response, and subsequent correspondence received on September 14, 2015, we have accepted management decision on eight of nine recommendations.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendations for which management decisions have not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. For agencies other than OCFO, please follow your internal agency procedures in forwarding final action correspondence to OCFO.

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.

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Background and Objectives

Background

Rural Development's (RD) Rural Housing Service (RHS) is responsible for administering the Rural Rental Housing (RRH) program. The RRH program was established to provide affordable rental housing to low- and moderate-income families, the elderly, and persons with disabilities living in rural areas. RHS provides loans to individuals, public agencies, cooperatives, and profit and non-profit organizations to construct and operate RRH-funded apartment complexes.

In fiscal year (FY) 2014, RHS had more than 14,000 RRH properties in its loan portfolio. The outstanding principal loan balance on those properties amounted to over $10.6 billion as of July 2014. Additionally, RHS provided more than $1.1 billion in rental assistance (RA) to these property owners on behalf of eligible tenants in FY 2014.[1,2]

The owners of apartment complexes financed through the RRH program may hire management agents to operate their properties.[3] The owners and their management agents are responsible for complying with all applicable laws, regulations, and loan terms and conditions pertaining to the program. According to regulations, RRH property owners can realize a return on their initial investment, capped at 8 percent of an owner's equity contribution.[4] The management agent can receive a monthly fee for administrative costs such as employee salary, bookkeeping, supervising staff, and submitting financial reports to RHS.[5] The property's rental income is to be used for operating and maintenance expenses, and to fund a reserve account for capital improvements.[6] Rental income includes RHS RA payments to RRH property accounts on behalf of qualifying tenants.[7]

A project's reserve account is primarily used to meet the major capital expense needs of a project. Examples of such improvements include replacing a roof, windows, and rewiring dwellings. If these expenditures are not made, the property begins to deteriorate, loses value, and becomes less attractive to tenants, thus placing the agency's financial interest at risk. The RHS loan servicer must review the reserve account level and contributions to ensure that they are consistent with the loan agreement, and review the borrower's project account bank statements to validate the actual reserve account balance.

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[1] U.S. Department of Agriculture (*USDA) FY 2016 Budget Summary and Annual Performance Plan.*
[2] According to the Multi-Family Housing (MFH) Asset Management Handbook, the Rental Assistance (RA) Program provides assistance to individual residents to ensure that elderly, disabled, and low-income residents are able to afford rent payments. With the help of the RA Program, a qualified applicant/tenant pays no more than 30 percent of his or her income for housing. In addition to RA, Department of Housing and Urban Development (HUD) Section 8 Program rental subsidy and other local forms of rental subsidy are available.
[3] 7 CFR 3560.101, January 1, 2013.
[4] 7 CFR 3560.68, January 1, 2013.
[5] *Multi-Family Housing Asset Management Handbook 2-3560* Chapter 3.8(A), and Attachment 3-D, February 24, 2005.
[6] *Multi-Family Housing Asset Management Handbook 2-3560* Chapter 3.8(D), and Attachment 3-E, February 24, 2005.
[7] *Multi-Family Housing Asset Management Handbook 2-3560* Chapter 8.2(A), February 24, 2005.

Project budgets are planning documents that provide a picture of the project's financial operations. They reflect the project's expected revenues and expenses, including plans for maintenance, capital improvements, reserve account activity, and the owner's return on investment for the next year. Borrowers must submit annual project budgets to RHS for approval.

Budgets must be reasonable and realistic. Revenues and expenses must be consistent with past project budgets and comparable projects. Any differences must be due to legitimate operating needs of the project. Project expenses can include only those expenses necessary to properly maintain the project. Annually, loan servicers are required to review the actual budget submitted for the project, record the actual income and expenses in the Multi-Family Integrated System (MFIS), and note any unexpected variance.

RRH program data reside in MFIS, which is designed to assist its Servicing Office personnel in monitoring the management of RRH properties. MFIS provides the capabilities to track all of the management and servicing associated with each property.[8]

The Tabular Data Warehouse (TDW) contains Department-wide data that are refreshed nightly from various systems, including data from MFIS. It is designed to provide program personnel from the major RD program areas with the information needed to make sound management decisions that efficiently and effectively support the needs of their customers.[9] The audit team retrieved data extracts from TDW for use in this audit.

Objective

At the beginning of this audit, our overall objective was to determine whether owners of RRH projects, or their management agents, are reporting reasonable and accurate project operation information, and whether tenants are reporting eligibility information accurately. Our focus was to use data analytics to identify and verify anomalies in the data and evaluate the internal controls—in place or missing—related to those anomalies. Our reason for reviewing tenant eligibility information was to verify tenant income data. During fieldwork, however, we discovered that tenant income verification data would need to be obtained from each State's Department of Labor, and that the income verification process varies, based on whether a wage and benefit matching agreement is in place for the State. As a result, the audit team concluded that we could not perform tenant income verification queries within the purview of this audit.

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[8] *System Security Plan for Multi-Family Integrated System*, June 18, 2015.
[9] *System Security Plan for Tabular Data Warehouse*, November 17, 2013.

Section 1: Unallowable Expenses Charged to Projects

Finding 1: Management Agents Charged Unallowable Expenses to Projects

Based on our data analytics, we found that 2 management agents charged unallowable expenses to 11 RRH projects in 2013. These unallowable expenses included charges for staff Christmas parties, summer picnics, dinners, alcoholic beverages, and gifts to their staff.

The *Multi-Family Housing (MFH) Asset Management Handbook* states that "certain [administrative] expenses are not allowable such as legal fees, association dues, bonuses or monetary performance awards, *parties*, computer hardware and some software, and telephone purchases (emphasis added)."[10] Further, the handbook states that "housing project funds may not be used for…*parties that are large or unreasonable*, such as renting expensive party halls or hotel rooms and *payment for alcoholic beverages or gifts to management agent staff* (emphasis added)."[11]

We used data analytics to identify 546 projects with the highest administrative & operating and maintenance (A&OM) expenses per unit from our universe of 14,162 projects. From those 546 projects, we selected 11 projects for review. We found that all 11 projects we reviewed were charged for unallowable expenses by their respective management agents. We identified that one management agent misused almost $28,000 in RRH project funds by hosting parties and charging expenses to RRH projects and another management agent was charging unallowable expenses to RRH projects as part of its staff training event in 2013.

This occurred because RHS does not have adequate controls to identify the misuse of RRH funds. Without proper oversight of management agent expenditures, RRH funds are vulnerable to misuse. Consequently, the misuse of program funds by management agents jeopardizes the integrity of the RRH program, burdens low-income and elderly tenants with higher rents, and unnecessarily increases RHS' RA payments.

The handbook also states that "loan servicers must perform regular reviews of multi-family housing projects to monitor project performance and ensure compliance with program regulations and civil rights laws. Loan servicers will make efforts to plan and prioritize monitoring activities to focus on the projects that need the most Agency attention." [12]

We found that both management agents for our reviewed projects charged unallowable expenses to their respective RRH projects in 2013.

OIG visited seven locations in Maryland with unusually high A&OM expenses per unit. [13,14] During the review of the 7 projects in our sample, we discovered that unallowable expenses,

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[10] *Multi-Family Housing Asset Management Handbook 2-3560,* Appendix 1 page 68, February 24, 2005.
[11] *Multi-Family Housing Asset Management Handbook 2-3560,* Appendix 1 page 124, February 24, 2005.
[12] *Multi-Family Housing Asset Management Handbook 2-3560,* Chapter 2.13(G), February 24, 2005.
[13] Administrative expenses per unit are calculated by dividing the total project administrative expenses by the number of units (apartments) in the project.
[14] Operating and maintenance expenses per unit are calculated by dividing the total project operating and maintenance expenses by the number of units (apartments) in the project.

totaling $27,718.66, were charged to all 18 RRH projects managed by the agent, including the 7 in our sample.[15] (See Exhibit A.)

The following unallowable expenses were included:

- $3,912.37 for a staff summer picnic at Six Flags America in 2013.
- $11,411.74 for a staff Christmas party in 2012, paid in 2013.
- $12,394.55 for a staff Christmas party in 2013.

According to the management agent staff, these events occur annually.

We also noted payments for alcoholic beverages, staff dinners, and gifts to management agent staff that are specifically prohibited.

Additionally, we conducted site visits of four RRH projects in Maine. We found that this management agent charged unallowable expenses to all four RRH projects we visited. Further review disclosed that this agent, like the Maryland agent, also allocated unallowable expenses to the other 63 RRH projects it managed.[16] These expenses centered on a staff training event, labeled as a "fall retreat." While this "fall retreat" included some allowable costs, such as training, it also included unallowable costs, such as alcoholic beverages, staff dinners, and gifts for staff. Management agent staff indicated that this retreat is held approximately every 18-24 months.

RHS' program oversight did not detect these unallowable RRH expenses because its controls are inadequate. Although RHS performs various data analytics on its RRH portfolio, we believe enhancements can be made to strengthen program oversight. We noted that the RHS national office periodically provides MFIS reports on a SharePoint site for the State offices' use.[17] RHS also provides loan servicers access to run their own ad hoc reports in MFIS and TDW, and has provided training to loan servicers on how to run these reports. In addition, loan servicers are required to perform a budget analysis of each project's proposed budget and year-end actual income and expenses.[18] According to an RHS official, the budget analysis is performed twice each year for every project before approving:

1. The upcoming year's proposed budget, which is compared to the previous year-end actual income and expenses; and
2. Year-end actual income and expenses, which are compared to that year's proposed budget.

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15 We found that the management agent was charging unallowable expenses to all 18 RRH projects in its portfolio, based on the documentation provided for the 7 projects in our sample.
16 We found that the management agent was charging unallowable expenses to all 67 RRH projects in its portfolio, based on the documentation provided for the 4 projects in our sample.
17 SharePoint is a secure website used by organizations to store, organize, share, and access information.
18 *Multi-Family Housing Asset Management Handbook 2-3560,* Chapter 4.32(F), Exhibit 4-7, and Chapter 9.13(4) and (5), dated February 24, 2005.

We found that, where the budget analysis indicated an anomalous value for an expense line item, the field office staff was not making full use of the data available to them. According to RHS documentation, the budget analysis process produces a document that contains "one or more general observations or situations that raise questions on the viability of the budget." Results from the budget analysis are categorized as either observations or "review" items. Further, "[o]bservations are just the results of a test performed that may be of importance to the [loan servicer]. All 'Review' items must have their check box clicked to indicate they have been reviewed before the budget is considered analyzed and therefore can be approved."

According to an RHS information technology official, RHS has developed "norms" for line items for use during the budget analysis. These norms are intended to compare selected values for the project under review to values for similar projects based on project size, region, and other factors.[19] Norms are displayed during the budget analysis process to give the loan servicer an idea of how the proposed budget line items compare to similar projects. However, this information is not being fully used. RHS does not require any justification to approve line items that exceed these norms, no matter how large the variance that exists between the norm and proposed value. During the budget analysis, it is simply listed as an observation. The loan servicer is not required to review and justify the observation, nor require an explanation from the owner or management agent. On average, the budget analyses for all 11 projects in our sample displayed monthly total expenses for each unit that were approximately 100 percent above the norm values. Because loan servicers are not required to review and justify deviations from the norm values, there is no evidence that they detected the unallowable expenses we found in our review.

In addition, RHS stated that management agents have not been adequately trained on the program's regulations in recent years.

During our review, we found that one management agent misused almost $28,000 in RRH project funds by hosting parties and charging expenses to RRH projects in 2013. In addition, we found that another management agent was charging unallowable expenses to RRH projects as part of its staff training event in 2013. We used data analytics to identify 546 projects with the highest A&OM expenses per unit from our universe of 14,162 projects. From those 546 projects, we ultimately selected 11 projects for review. Since we found that all 11 projects reviewed were charged for unallowable expenses by their respective management agents, we believe there is some probability that this condition also exists in the 535 projects we did not review. We will provide a list of these projects to RHS staff for further action.

Without proper oversight of management agent expenditures, RRH funds are vulnerable to misuse. Misuse of RRH funds "can result in inadequate funds to meet other essential project needs, including expenditures for repair and maintenance needed to keep the project in sound physical condition."[20] If projects are unable to fund these essential project needs, the misuse of RRH funds puts the agency's financial interest at risk, as the properties may begin to deteriorate,

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[19] Projects are also grouped based on whether the project receives HUD Section 8 Program rental subsidies, and the type of tenants residing in the project.

[20] *Multi-Family Housing Asset Management Handbook 2-3560,* Appendix 1 page 68, February 24, 2005.

lose value, and become less attractive to tenants. In order to meet these essential project needs, projects may be forced to increase rents, thereby unnecessarily increasing RHS' RA payments.

Recommendation 1

Develop and implement a management control that will ensure that budget analysis observation items exceeding norms, by an agency-established threshold, are reviewed, justified, and documented.

Agency Response

In its September 8 and 14, 2015, responses, RHS stated:

> The Agency will develop a Hyperion report for use by Multifamily (MFH) field staff in their review and analysis of proposed and actual operating expenses. The Agency will add specific questions on the State Internal Review (SIR) Guide related to servicing specialist actions taken on reviews of project operating expenses exceeding norms. [The Agency] agree[s] to change the budget analysis review of line 41 from an observation to a review item.[21]
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Develop and implement a process and procedures to ensure that borrowers and their management agents are kept informed of program guidance and regulations, including information on allowable and unallowable Administrative & Operating and Maintenance (A&OM) expenses.

Agency Response

In its September 8, 2015, response, RHS stated:

> The Agency will issue periodic Unnumbered Letters (ULs) that focus on specific topics related to property expenses intended to provide guidance to MFH borrowers and management agents. The Agency will make training material about allowable and unallowable expenses available to industry groups that represent the majority of property management firms.

[21] Line 41 of the budget analysis process compares similar projects' per-unit, per-month total expenses for proposed budgets or year-end actual expenses.

> The Agency will continue its efforts in working with the Information Technology department to develop a "customer portal" that would provide borrowers and management agents with a "one-stop" access point for training and guidance material. No completion date is available for this action.
>
> Timeframe: Estimated Completion: September 30, 2016 for issuance of training material and ULs.

OIG Position

We accept management decision for this recommendation.

Recommendation 3

Recover the $27,718.66 in unallowable expenses charged by the Maryland management agent to Rural Rental Housing (RRH) projects.

Agency Response

In its September 8, 2015, response, RHS stated:

> The Maryland Rural Development State Office will submit a demand letter to the management company for repayment of the amount.
>
> Timeframe: Estimated date: November 30, 2015.

OIG Position

We do not accept management decision for this recommendation. To achieve management decision, RHS must provide a copy of the bill for collection for amounts owed to the Government and documentary support that the amounts have been entered as a receivable in the agency's accounting records.

Recommendation 4

Determine the amount of unallowable expenses charged to RRH projects by the Maine management agent during staff training in 2013 and recover that amount from the management agent.

Agency Response

In its September 8, 2015, response, RHS stated:

> The Maine Rural Development State Office will review the expenses charged by the Maine management agent during staff training in 2013 and recover unallowable expense amounts from the management agent.
>
> Timeframe: Estimated Completion: November 30, 2015.

OIG Position

We accept management decision for this recommendation.

Recommendation 5

Perform a comprehensive review of the two management agents in our sample to determine if there are any additional unallowable expenses charged to projects, and recover any expenses found during the review.

Agency Response

In its September 8 and 14, 2015, responses, RHS stated:

> The Maine and Maryland Rural Development State Offices will review the training expenses of the two management agents included in the OIG report for 2014 and 2015, and will determine if there are any additional unallowable expenses charged to projects, and recover any such expenses found during the review.
>
> We are in agreement to change the State Offices' requirement to review all "administrative and operating and maintenance" expenses instead of just the "training" line item. To clarify this would cover… …Form RD 3560-7, Part II lines 1 – 11 & 19 – 33.
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Recommendation 6

Select a representative sample from the OIG-provided list of 535 anomalous projects, complete a comprehensive review of the selected projects to determine if unallowable expenses have occurred, and recover any unallowable expenses identified during this review.

Agency Response

In its September 8 and 14, 2015, responses, RHS stated:

> The Agency will select a sample from the list provided by OIG. Depending on the number of properties selected, MFH State Offices will conduct a review of selected projects during the period of 2013 and 2014 to determine if unallowable expenses have occurred, and recover any unallowable expense identified during this review.
>
> We are in agreement with conducting a random sample of 10 projects (one project from 10 different management agents for a total of 10 projects) and conducting a "comprehensive" review of all administrative and operating and maintenance expenses. To clarify this would cover on Form RD 3560-7, Part II lines 1 – 11 & 19 – 33.
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Section 2: Inaccurate Reserve Account Information

Finding 2: Field Office Staff Did Not Perform Required Reviews of Reserve Account Information

Agencies within the U.S. Department of Agriculture (USDA) are required to establish and maintain management and application controls to provide reasonable assurance that programs are operating properly and are free from error. However, RHS lacked adequate controls over the RRH program to ensure accurate reporting of reserve account information within MFIS.

Of the 14,162 projects in our universe, we found 13 projects that had reported negative actual reserve account balances, 20 future-dated actual reserve account balances, and 77 reserve accounts that were only required to have $1 or $0 when fully-funded.[22] RHS officials were not sure why application controls were not in place to prevent the future-dated and negative actual balances, and they indicated employee inattention to detail as the cause of the low dollar fully-funded amounts. Because these reserve accounts are used to fund major capital expenditures, and in some cases emergency repairs, not properly monitoring the accounts can result in deferred maintenance, and potential health and safety issues on RRH properties.

RHS requires borrowers to establish a reserve account as part of their loan agreement.[23] The reserve account is funded through contributions from project operating funds. Its primary use is to fund large planned expenses for maintenance and capital improvement expenses.[24] Examples of such improvements include replacing a roof, windows, and rewiring dwellings. When such expenditures are not made, properties deteriorate, lose value, become less attractive to tenants, and put the agency's financial interest at risk. Further, RHS is responsible for monitoring the borrower's compliance with the reserve account requirements. Specifically, the agency is required to review the project reserve accounts annually. RHS is also responsible for monitoring project accounts through project reports and onsite monitoring. We found several instances where RHS could improve its monitoring.

Departmental regulations state that USDA managers are responsible for establishing, maintaining, evaluating, improving, and reporting on controls for their assigned areas.[25] These general control standards also apply to all information systems and application system development and maintenance. Application controls are designed to help ensure the completeness, accuracy, authorization, and validity of all transactions during application processing. Controls should be installed at an application's interfaces with other systems to ensure that all inputs are received and are valid, and that outputs are correct and properly distributed.

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[22] At a minimum, the borrower must agree to make monthly contributions to the reserve account at the rate of 1 percent annually of the amount of total development cost until the reserve account equals 10 percent of the total development cost. According to the information in MFIS, these 77 projects were only required to have $1 or $0 as a fully-funded amount.

[23] *Multi-Family Housing Asset Management Handbook 2-3560,* February 24, 2005.

[24] *Multi-Family Housing Asset Management Handbook 2-3560,* February 24, 2005.

[25] *Management's Responsibility for Internal Control, Departmental Regulation 1110-002,* June 17, 2013.

Our audit found problems with three specific fields within the data:

- Actual balance amount (the actual reserve account balance as reported by the borrower);

- Balance "as of" date (date the actual reserve account balance was recorded from bank statements provided by the borrower); and

- Fully-funded amount (the maximum amount required to be deposited in the reserve account in accordance with the borrower's loan agreement or loan resolution).

Our review disclosed that controls over these reserve accounts were not functioning as designed, and that certain application controls that could improve data accuracy were absent. Employees responsible for monitoring these reserve accounts were not adequately performing required reviews of the accounts. In addition, MFIS did not contain application controls to prevent negative reserve account balances or to exclude borrowers from entering future-dated balances into the system.

OIG performed various analyses of the reserve account information in MFIS. We found that 13 borrowers had reported negative balances for their reserve accounts, which, according to RHS, should not happen, since reserve accounts do not have overdraft capacity. While MFIS will warn a borrower of an erroneous entry, it will accept the entry when a warning prompt is cleared by the user. A simple edit check, which prevents the user from entering a negative balance in the first place, could remedy this problem.

Additionally, OIG found that 20 projects in MFIS reported actual reserve account balances as of a future date. Five of these dates were more than 90 days in the future. This date should represent the date the actual reserve account balance was recorded by the bank. While the inaccuracy of these dates may not pose a serious risk to the project's financial health, they are problematic because borrowers cannot truly know the balance of their account in the future, and they weaken the overall integrity of the data.

We also found 77 projects for which RHS had entered a fully-funded amount of $1 or less. Of these 77 projects, 74 were $0. We submitted these 77 projects to RHS for further explanation. RHS stated that 32 projects had no fully-funded amount or automatic deposits set up in the system, 21 had never established a reserve account in the system, 8 had subsequently been established (since we originally extracted the data), 6 had separate project numbers that had been erroneously established for the same property, 6 had other unique explanations, and RHS could not explain 4 of the total submitted by OIG. RHS also stated that field office staff were not performing adequate reviews of reserve account information, even though it has been identified and, according to RHS staff, "clearly provided on the budget analysis," which is an annual financial review required by the MFH asset management handbook. When asked why MFIS did not have edit checks to help ensure data integrity for these specific items, RHS staff stated they did not know.

As a result, RHS does not have reasonable assurance as to the true financial position of some of its borrowers. This hampers the agency's ability to identify and assist borrowers in distress, who may need to establish a workout plan to alleviate an inadequate reserve account. An inadequate reserve account can lead to deferred maintenance issues, which can potentially:

- Become health and safety hazards for tenants;
- Reduce the borrower's ability to pay for capital expenditures; and
- Jeopardize the economic welfare of the project.

MFIS is a robust database that contains information that RHS staff can use to monitor its sizable loan portfolio. We believe that additional controls would improve the accuracy of MFIS data and provide further assurance as to the financial health of RHS' loan portfolio.

Recommendation 7

Develop and implement application controls to prevent the entry of negative actual reserve account balances.

Agency Response

In its September 8, 2015, response, RHS stated:

> The Agency will write a Request for Automation change to the Multifamily Information System (MFIS) database to incorporate an edit check to prevent the entry of negative actual reserve account balances.
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Recommendation 8

Develop and implement application controls to prevent the entry of future dated actual reserve account balances.

Agency Response

In its September 8, 2015, response, RHS stated:

> The Agency will write a Request for Automation change to the MFIS database to incorporate an edit check to prevent the entry of future dated actual reserve account balances.
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Recommendation 9

Develop and implement internal controls to identify low dollar fully-funded reserve account values (e.g., $0 or $1) and require corrective action by the agency upon detection in active RRH projects.

Agency Response

In its September 8 and 14, 2015, responses, RHS stated:

> The Agency will write a Request for Automation change to the MFIS database to incorporate an edit check to identify low dollar fully-funded reserve account values, and modify the existing MFH TRK1500 "Missing Data Report" to include these items. Besides adding this element to the MFH TRK1500 "Missing Data Report" we propose to include this item on the budget analysis as a reviewable item that action must be taken before the budget can be coded as "approved" (for proposed) or "reviewed" (for actuals).
>
> Timeframe: Estimated Completion: September 30, 2016.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

Our audit focused on detecting anomalies found in RRH data while utilizing data analytics. Fieldwork was performed from April 2014 to June 2015. We interviewed program officials, project management agent staff, and tenants. In addition, we analyzed information in the Tabular Data Warehouse (TDW), which stores information from RRH's system of record, MFIS. We examined and assessed the reliability of available computer-processed data in order to fulfill the audit objectives. Specifically, we performed analyses of RRH project owner and management agent data in order to identify potential anomalies, determined that further review of a sample of the anomalies was warranted, and reviewed pertinent source documentation to determine the validity of the anomalies.

Our fieldwork began by obtaining a universe of projects to analyze. At the time of our data extract (July 2014), the RRH portfolio consisted of 14,162 active projects. We found that 13,462 projects had submitted end-of-year actual expenses totaling $1.68 billion, of which nearly $1.11 billion was administrative & operating and maintenance (A&OM) expenses. The remaining 700 projects had not yet reported year-end-actual income and expenses for their FY 2013 because the program allows borrowers to operate on their own fiscal year, borrowers were late in submitting their information, or projects had been consolidated or transferred to another project.[26]

Based on our analysis of the RRH portfolio, we identified 546 projects that had the highest administrative and/or operating and maintenance expenses per unit, and we developed and performed additional queries to compute a risk score for each project.[27] From these 546, we computed a risk score for anomalous projects that appeared to pose the highest risk of fraud, waste, or misuse, based on certain queries and combinations of queries. The audit team decided to focus on queries that identified projects based on the existence of an identity-of-interest relationship, the cents values of individual line item A&OM expense subtotals, and excessive A&OM subtotal expenses per unit.[28,29,30] Based on the risk score of projects and per-unit A&OM expenses, the audit team non-statistically selected two States that were flagged most frequently, Maine and Maryland. We did not rely solely on the final score or per-unit A&OM expenses for each project; however, they did play a role in our non-statistical selection. Based on proximity to other anomalous projects, we ultimately selected four projects in Maine and seven projects in Maryland. Coincidentally, the selected Maine projects were managed by one

[26] The fiscal year for all 11 projects in our sample runs synchronously with the calendar year.
[27] We listed the top 300 projects with the highest per-unit administrative expenses and operating and maintenance expenses separately, and found that 54 of these projects were found on both lists, creating a combined list of 546 unique projects with the highest administrative and/or operating and maintenance expenses.
[28] According to the MFH Asset Management Handbook, "an [identity-of-interest] relationship exists when an individual or entity that provides goods, management, or other services to the project has a relationship with the project borrower that is such that selection of the management agent and determination of the management fee will not be determined through an arms-length transaction."
[29] Cents values of A&OM line item expenses were analyzed based on the value after the decimal place for line item subtotals.
[30] We considered any project with per-unit A&OM expenses greater than two standard deviations above the average for our universe to be excessive.

management agent, and the Maryland projects were managed by another. Our selected sample represented approximately $1.98 million in A&OM expenses of the nearly $1.11 billion in A&OM expenses in our universe. We conducted site visits to the management agent offices and project sites.

We were unable to address the portion of the objective regarding tenant eligibility information. Our reason for reviewing tenant eligibility information was to verify tenant income data. During fieldwork, however, we discovered that tenant income verification data would need to be obtained from each State's Department of Labor, and that the income verification process varies based on whether a wage and benefit matching agreement is in place for the State. As a result, the audit team concluded that we could not perform tenant income verification queries within the purview of this audit. Accordingly, we did not collect or analyze tenant eligibility information.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Abbreviations

A&OM ....Administrative & Operating and Maintenance
FY ....Fiscal Year
GAO ....Government Accountability Office
HUD......................................Department of Housing and Urban Development
MFH......................................Multi-Family Housing
MFIS ....Multi-Family Integrated System
OIG ....Office of Inspector General
RA ....Rental Assistance USDA
RD ....Rural Development
RHS.......................................Rural Housing Service
RRH ....Rural Rental Housing
SIR ....State Internal Review
TDW ....Tabular Data Warehouse
ULs..Unnumbered Letters
USDA....................................U.S. Department of Agriculture

Exhibit A: Summary of Monetary Results

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

Finding	Recommendation	Description	Amount	Category
1	3	Unallowable Expenses Charged by the Management Agent to RRH Projects	$27,718.66	Questioned Costs, Recovery Recommended

USDA'S
RURAL HOUSING SERVICE
RESPONSE TO AUDIT REPORT

USDA

United States Department of Agriculture

Rural Development

Operations and Management

Office of the Chief Financial Officer

Financial Management Division

1400 Independence Ave SW
Washington, DC 20250
Voice 202.692.0080
Fax 202.692.0088

Date: September 9, 2015

TO: Gil Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: John L. Dunsmuir /S/Arlene Pitter Bell (for)
Director
Financial Management Division

SUBJECT: OIG Audit: Review of Rural Rental Housing's Tenant and Owner Data using Data Analytics (Audit No. 04901-0001-13)

Attached for your review is the Rural Housing Service's September 8, 2015, response to the official draft for the subject audit.

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

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

Attachment

United States Department of Agriculture

September 8, 2015

TO: John Dunsmuir
Director
Financial Management Division

FROM: Bryan Hooper /S/ Bryan Hooper
Deputy Administrator
Multi-Family Housing Programs

SUBJECT: Review of Rural Rental Housing's Tenant and Owner Data using Data Analytics (Audit No. 04901-0001-13)

This memorandum is in response to the above-referenced official draft report.

Recommendation No. 1

Develop and implement a management control that will ensure that budget analysis observation items exceeding norms, by an agency-established threshold, are reviewed, justified, and documented.

Agency Response

The Agency will develop a Hyperion report for use by Multifamily (MFH) field staff in their review and analysis of proposed and actual operating expenses. The Agency will add specific questions on the State Internal Review (SIR) Guide related to servicing specialist actions taken on reviews of project operating expenses exceeding norms.

Timeframe: Estimated completion: September 30, 2016.

Recommendation No. 2

Develop and implement a process and procedures to ensure that borrowers and their management agents are kept informed of program guidance and regulations, including information on allowable and unallowable Administrative and Operating and Maintenance expenses.

Agency Response

The Agency will issue periodic Unnumbered Letters (ULs) that focus on specific topics related to property expenses intended to provide guidance to MFH borrowers and management agents. The Agency will make training material about allowable and unallowable expenses available to industry groups that represent the majority of property management firms.

The Agency will continue its efforts in working with the Information Technology department to develop a "customer portal" that would provide borrowers and management agents with a "one-stop" access point for training and guidance material. No completion date is available for this action.

Timeframe: Estimated completion: September 30, 2016 for issuance of training material and ULs.

Recommendation No. 3

Recover the $27,718.66 in unallowable expenses charged by the Maryland management agent to Rural Rental Housing (RRH) projects.

Agency Response

The Maryland Rural Development State Office will submit a demand letter to the management company for repayment of the amount.

Timeframe: Estimated date: November 30, 2015.

Recommendation No. 4

Determine the amount of unallowable expense charged to RRH projects by the Maine management agent during staff training in 2013 and recover that amount from the management agent.

Agency Response

The Maine Rural Development State Office will review the expenses charged by the Maine management agent during staff training in 2013 and recover unallowable expense amounts from the management agent. The Agency will submit a demand letter to the management company for repayment of the amount.

Timeframe: Estimated completion: November 30, 2015.

Recommendation No. 5

Perform a comprehensive review of the two management agents in our sample to determine if there are any additional unallowable expenses charged to projects, and recover any expenses found during the review.

Agency Response

The Maine and Maryland Rural Development State Offices will review the training expenses of the two management agents included in the OIG report for 2014 and 2015, and will determine if there are any additional unallowable expenses charged to projects, and recover any such expenses found during the review.

Timeframe: Estimated completion: September 30, 2016.

Recommendation No. 6

Select a representative sample from the OIG-provided list of 535 anomalous projects, complete a comprehensive review of the selected projects to determine if unallowable expenses have occurred, and recover any unallowable expenses identified during this review.

Agency Response

The Agency will select a sample from the list provided by OIG. Depending on the number of properties selected, MFH State Offices will conduct a review of selected projects during the period of 2013 and 2014 to determine if unallowable expenses have occurred, and recover any unallowable expense identified during this review.

Timeframe: Estimated completion: September 30, 2016.

Recommendation No. 7

Develop and implement application controls to prevent the entry of negative actual reserve account balances.

Agency Response

The Agency will write a Request for Automation change to the Multifamily Information System (MFIS) database to incorporate an edit check to prevent the entry of negative actual reserve account balances.

Timeframe: Estimated completion: September 30, 2016.

Recommendation No. 8

Develop and implement application controls to prevent the entry of future dated actual reserve account balances.

Agency Response

The Agency will write a Request for Automation change to the MFIS database to incorporate an edit check to prevent the entry of future dated actual reserve account balances.

Timeframe: Estimated completion: September 30, 2016.

Recommendation No. 9

Develop and implement internal controls to identify low dollar fully-funded reserve account values (e.g., $0 or $1) and require corrective action by the agency upon detection in active RRH projects.

Agency Response

The Agency will write a Request for Automation change to the MFIS database to incorporate an edit check to identify low dollar fully-funded reserve account values, and modify the existing MFH TRK1500 “Missing Data Report” to include these items.

Timeframe: Estimated completion: September 30, 2016.

If you have any questions regarding this, please contact Stephanie White at (202) 720-1615 or Janet Stouder at (202) 720-9728.

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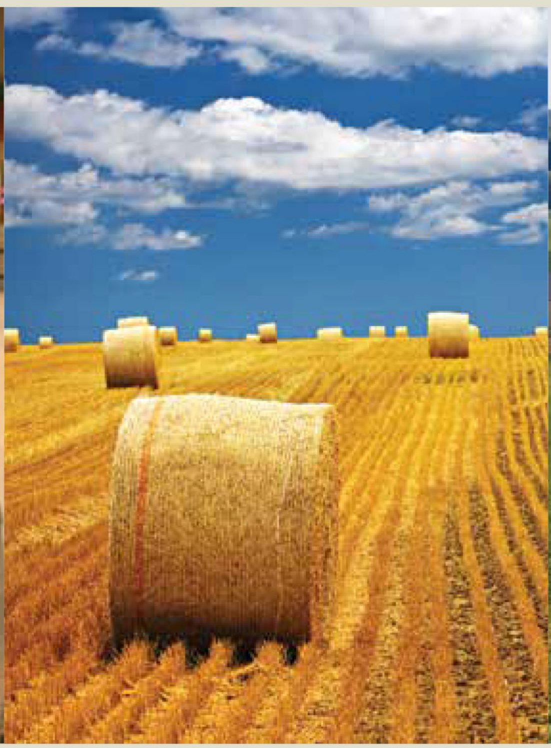

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