

GAO

Report to the Ranking Minority Member,  
Subcommittee on Agriculture, Rural  
Development, and Related Agencies,  
Senate Committee on Appropriations

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September 2004

# RURAL HOUSING SERVICE

## Updated Guidance and Additional Monitoring Needed for Rental Assistance Distribution Process



G A O

Accountability \* Integrity \* Reliability

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**GAO**  
 Accountability Integrity Reliability  
**Highlights**

Highlights of [GAO-04-937](#), a report to Ranking Minority Member, Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations.

## Why GAO Did This Study

The Rural Housing Service's (RHS) Section 521 rental assistance program provides rental subsidies for about 250,000 rural tenants. Because the program has a waiting list of 80,000 eligible tenants and there are over 1.3 million rural low-income renters eligible for housing subsidies, it is important to effectively distribute resources to extend assistance to as many needy tenants as possible. Therefore, GAO was asked to assess (1) how RHS distributes rental assistance funds to properties and tenants, (2) how RHS monitors the use of rental assistance funds, and (3) whether there are sufficient internal controls in place to ensure that these funds are being effectively administered and used.

## What GAO Recommends

GAO recommends that the Secretary of Agriculture require that program officials establish centralized guidance on transferring unused rental assistance, improve sampling methods to select tenant household files for supervisory reviews, and improve verification of tenant information. To help the agency verify tenant information, Congress may wish to consider giving RHS access to the Department of Health and Human Services' National Directory of New Hires.

The Department of Agriculture generally agreed with GAO's recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-04-937](http://www.gao.gov/cgi-bin/getrpt?GAO-04-937).

To view the full product, including the scope and methodology, click on the link above. To view the survey results, click on the following link [www.gao.gov/cgi-bin/getrpt?GAO-04-978SP](http://www.gao.gov/cgi-bin/getrpt?GAO-04-978SP). For more information, contact William B. Shear at (202) 512-4325 or [shearw@gao.gov](mailto:shearw@gao.gov).

# RURAL HOUSING SERVICE

## Updated Guidance and Additional Monitoring Needed for Rental Assistance Distribution Process

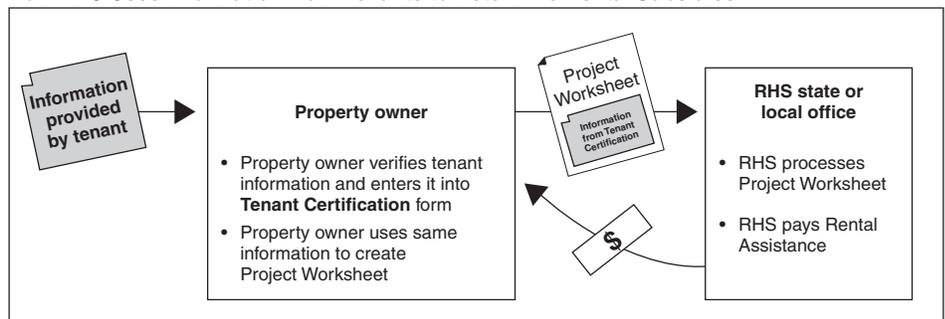
### What GAO Found

RHS's national office pays rental assistance funds to property owners through a variety of contracts and transfers of unused rental assistance from one property to another. RHS staff calculate the payment amounts using information provided by tenants and verified by property owners. The current system requires RHS staff to enter payment data into the agency's database manually. However, RHS's national office is upgrading two systems to streamline the payment process. But some local RHS staff are concerned that the new process may eliminate a layer of review.

RHS's national, state, and local offices share responsibility for monitoring the rental assistance program, with the local offices performing the primary review every 3 years. The national office outlines the monitoring activities for the rental assistance program in its Rural Development Instructions and provides other guidance, such as administrative notices and unnumbered letters. We found that state and local offices follow this guidance inconsistently and sometimes consider it unclear. National office staff are planning a number of initiatives to increase monitoring of the rental assistance program, but a number of key management positions in the national office are unfilled, which could limit the effectiveness of program monitoring.

RHS's internal controls do not provide adequate oversight of rental assistance funds because RHS guidance is inadequate and tenants' incomes are not adequately verified. First, insufficient guidance on the transfer process limits RHS's ability to move unused rental assistance to properties that have tenants with the greatest unmet need. Second, the triennial supervisory review does not provide reasonable assurance that tenants income and assets, and ultimately rental assistance payments, are adequately verified. Alternate methods of verifying tenant information also have limited effectiveness but could help improve internal control if properly designed and implemented.

### How RHS Uses Information from Tenants to Determine Rental Subsidies



Source: GAO.

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**Abbreviations**

AMAS	Automated Multi-Housing Accounting System
FLH	Farm Labor Housing
HUD	U.S. Department of Housing and Urban Development
MFIS	Multi-Family Housing Information System
MINC	Management Agency Interactive Network Connection
RD	Rural Development
RHS	Rural Housing Service
RRH	Rural Rental Housing
USDA	U.S. Department of Agriculture

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United States Government Accountability Office  
Washington, D.C. 20548

September 13, 2004

The Honorable Herbert Kohl  
Ranking Minority Member  
Subcommittee on Agriculture, Rural Development  
and Related Agencies  
Committee on Appropriations  
United States Senate

Dear Senator Kohl:

The Rural Housing Service (RHS) of the U. S. Department of Agriculture (USDA) provides rental subsidies through the Section 521 rental assistance program to about 250,000 low-income rural tenants living in federally subsidized properties.<sup>1</sup> The rental subsidies, which are provided to property owners through multiyear contracts, are intended to limit tenants' rent payments to 30 percent of the household's adjusted monthly income. With a fiscal year 2004 budget of almost \$600 million, the program is RHS's largest line-item appropriation. Given its size, internal controls are a significant factor in administering the program in order to distribute resources effectively and reduce the possibilities for fraud, waste, and abuse. Because the program already has a waiting list of 80,000 eligible tenants and over 1.3 million low-income renters not receiving housing subsidies reside throughout rural America, effectively distributing resources is important in extending assistance to as many needy tenants as possible.<sup>2</sup>

We recently reported on the activity level of rental assistance contracts and the accuracy of RHS's budget estimates for the Section 521 rental

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<sup>1</sup>The Section 515 Multifamily Direct Rural Rental Housing Loans program provides subsidized loans to developers to build rental housing. The Section 514 Multifamily Housing Farm Labor Loans program provides grants and subsidized loans to build rental housing for farm laborers, either off or on the farmer's property. Only "off-farm" labor housing is eligible for rental assistance subsidies. All properties must be established on a nonprofit or limited profit basis to receive rental assistance.

<sup>2</sup>GAO analysis of the 2003 American Housing Survey. This figure excludes cash renters, and rural areas include rural parts of metropolitan areas and excludes urbanized parts of non-metropolitan areas. The American Housing Survey is the largest, regular national housing sample survey in the United States. The U.S. Census Bureau conducts the American Housing Survey to obtain up-to-date housing statistics for the Department of Housing and Urban Development.

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assistance program.<sup>3</sup> To further assist you in your oversight of the program, you also asked us to assess (1) how RHS distributes rental assistance funds to properties and tenants, (2) how RHS monitors the use of rental assistance funds, and (3) whether RHS has sufficient internal controls in place to ensure that these funds are being effectively administered and used.

To respond to these objectives, we collected written information from RHS and talked with its representatives about the processes for distributing rental assistance and the means of monitoring those processes. We reviewed RHS's guidance for the program and internal control standards that apply to the processes. We also conducted a nationwide survey of all RHS state and local offices with rental assistance responsibilities. Finally, we visited RHS state and local offices and property owners or managers in five states to obtain documentation related to specific aspects of the rental assistance distribution process and to observe how RHS staff implement the internal controls that RHS has established to oversee the program. Details of our scope and methodology appear in appendix I, and appendixes II and III contain state office responses to a number of survey items. The survey and a more complete tabulation of the results can be viewed at [www.gao.gov/cgi-bin/getrpt?GAO-04-978SP](http://www.gao.gov/cgi-bin/getrpt?GAO-04-978SP).

We conducted our work from September 2003 through June 2004 in a number of locations, including Connecticut, Massachusetts, Mississippi, New York, South Carolina, Utah, and Washington, D.C., in accordance with generally accepted government auditing standards.

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## Results in Brief

Rental assistance funds are paid monthly to property owners through multiyear, renewable contracts that designate a set amount of funding per rental unit in RHS-subsidized properties. Property owners may also request that RHS transfer unused rental assistance from one property to another. The actual amount of the payments property owners receive is calculated using information provided by tenants, verified by property owners, and reviewed by staff at RHS state and local offices. Plans to streamline the payment process are under way, but some RHS staff are concerned that the new process may eliminate a layer of review.

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<sup>3</sup>*Rural Housing Service: Standardization of Budget Estimation Processes Needed for Rental Assistance Program*, GAO-04-424, (Washington, D.C.: March 25, 2004).

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Responsibility for monitoring the rental assistance program is divided among RHS's national, state, and local offices, with the local offices performing the primary review of the rental assistance distribution process. The national office provides guidance on procedures for monitoring the distribution of rental assistance funds, but we found that state and local offices apply the guidance inconsistently and that some of these offices consider it unclear. Following the guidance, local offices conduct supervisory reviews every 3 years, and these reviews are RHS's primary tool for detecting misreporting of tenant income, and ultimately, unauthorized rental assistance payments. Initiatives to increase monitoring of the rental assistance program are under way at the national office. However, unfilled management positions at the national level could limit RHS's ability to effectively monitor the program.

RHS's internal controls do not provide adequate oversight of rental assistance funds. First, insufficient and unclear guidance on the transfer process limits RHS's ability to transfer unused rental assistance to properties with the most needy tenants. Second, RHS's triennial supervisory reviews, the primary internal control activity to verify the information tenants and property owners submit, are conducted infrequently using samples that may be too small to effectively mitigate the risks associated with providing unauthorized rental assistance. RHS uses alternate methods, such as internal database checks and wage matching, to verify tenant and payment information. These methods have limited effectiveness in governing the rental assistance distribution process but could help to improve internal control if they were properly designed and implemented.

This report contains three recommendations for executive action and one matter for congressional consideration.

- To ensure that rental assistance funds are effectively distributed to properties that have tenants with the greatest need in the multifamily housing portfolio, we recommend that the Secretary of Agriculture require program officials to (1) establish centralized guidance on transferring unused rental assistance, (2) improve sampling methods to ensure that a sufficient number of tenant household files are selected for supervisory reviews, and (3) improve verification of tenant information, including more effective use of alternate methods of income verification.

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- To enable RHS to improve its verification of tenant income, this report includes a matter for congressional consideration. We recommend that RHS be added to Section 453 (j)(7) of the Social Security Act, “Information comparisons for housing assistance programs.”<sup>4</sup> This action would give RHS access to the National Directory of New Hires administered by the Department of Health and Human Services.

In response to our recommendations, RHS agreed to provide centralized guidance on transferring unused rental assistance through a new administrative notice and to institute broader use of alternate income verification methods, such as improved access to wage matching and new hires data. However, RHS did not agree to change its sampling methods for selecting tenant files when performing supervisory reviews. Instead, RHS said that it would revamp the supervisory review process to improve its effectiveness and consistency. We agree that the supervisory review process should be revised to improve its effectiveness and consistency and are encouraged that USDA is taking steps to accomplish this. However, to make this process an effective control to provide reasonable assurance that rental assistance payments are correct, RHS must also improve its sampling methodology, using a statistically valid sample to estimate an overall error rate. Thereby, RHS would have a firmer basis for determining an approximate sample size for its reviews.

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## Background

The Section 521 rental assistance program, started in 1978, is administered by RHS’s Multifamily Housing Portfolio Management Division. The program provides rental assistance for tenants living in units created through RHS’s Multifamily Direct Rural Rental Housing Loans and Multifamily Housing Farm Labor Loans programs. These programs provide loans subsidized with interest rates as low as 1 percent to help build rental housing for rural residents and farm workers. Under the rental assistance program, eligible tenants pay no more than 30 percent of their income toward the rent, and RHS pays the balance to the property owner.<sup>5</sup>

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<sup>4</sup>42 USC 653 (j)(7).

<sup>5</sup>Eligible tenants are persons with very low and low incomes, the elderly, and persons with disabilities who are unable to pay the basic monthly rent within 30 percent of their adjusted monthly income. Very low income is defined as below 50 percent of the area median income; low income is between 50 and 80 percent of area median income.

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RHS allocates rental assistance subsidies through 5-year contracts with property owners; 20-year contracts were also issued to units in newly constructed properties from 1978 through 1982. In fiscal year 2004, contracts were issued for a term of 4 years. The contracts specify that owners will receive payments on behalf of tenants in a designated number of units at the property. Contracts may be renewed as many times as funds are made available, and additional rental assistance units may be allocated if funds become available.

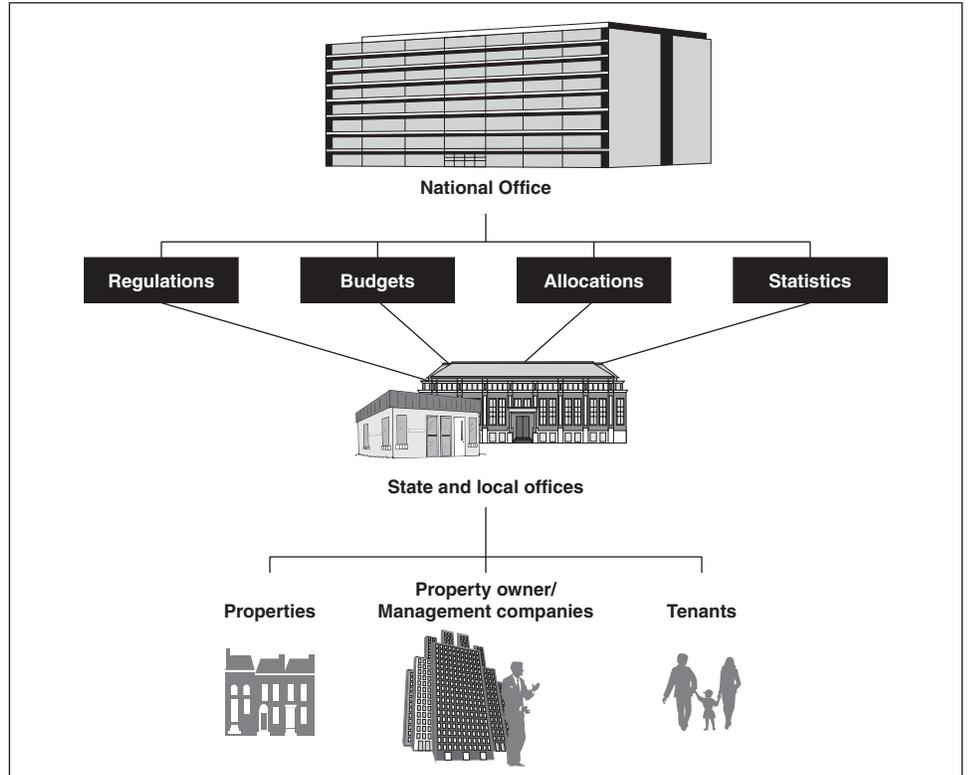
Property owners are required to follow RHS guidance in managing their properties.<sup>6</sup> Each month, they must document how many units designated for rental assistance are occupied. If a unit is empty and rental assistance is not being used, the property owner is required to assign another eligible tenant. If no eligible tenants are waiting for the unit, the property owner can work with RHS to transfer the rental assistance to another property.

As shown in figure 1, RHS's national, state, and local offices share administrative duties for the rental assistance program.

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<sup>6</sup>Rural Development Instructions allow property owners to delegate or assign management responsibilities, in full or in part, to a property manager. Therefore, the term "property owner" used throughout this report may also refer to a designated property manager, unless property manager is specifically stated.

**Figure 1: Duties of RHS National, State, and Local Offices**



Sources: GAO and Art Explosion (images).

The national office develops and implements regulations for the rental assistance program and other RHS programs (Rural Development Instructions). The current Rural Development (RD) Instruction for the rental assistance program has been in effect since the 1980s and was last revised in 1993. Other subparts of the RD Instructions also outline processes for monitoring RHS programs, including the rental assistance program. A proposed rule designed to streamline and consolidate the RD Instructions governing the multifamily grant, loan, and rental assistance programs was published in the *Federal Register* in June 2003. The proposed rule is intended to modify tenant recertification rules, relieve the burden on property owners of recovering unauthorized rental assistance from tenants, and reduce the amount of time RHS must wait before transferring unused rental assistance.

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The national office also distributes administrative notices and unnumbered letters on an as-needed basis. Administrative notices clarify for state and local offices activities outlined in RD Instructions. For example, the national office plans to clarify the tenant income verification process and provide further guidance on monitoring unused rental assistance for transfer through forthcoming administrative notices. Unnumbered letters, which address specific issues and are less formal than administrative notices, relay important information to state and local offices, but they do not pertain to policies and procedures. For example, an unnumbered letter released in December 2003 included data aggregated at the national office broken down by state and by rental assistance distribution goals, such as percentage of supervisory reviews completed, unit vacancies, and unused rental assistance.

The national office also estimates program budgets; allocates funds; and tracks nationwide program statistics. State and local offices work directly with property owners, property management companies, and tenants to monitor the program. State and local offices are responsible for conducting financial, management, and physical reviews of the properties; executing rental assistance contracts with property owners; approving rent increases; and processing rental assistance payments. State and local office staff also collect and maintain property and tenant data for their areas.

Support for the program is also provided through two offices in St. Louis, Missouri. The Rural Housing Service Branch of the Information Resources Management Office maintains the database systems used to manage program data. The Office of the Deputy Chief Financial Officer uses the program data to generate and maintain the general ledger and financial statements for the program. RHS uses two key database systems to manage their multifamily housing programs, including the rental assistance program. The Automated Multi-Housing Accounting System (AMAS) stores data on rental assistance contract obligations, rental assistance payments to property owners, and transfers of rental assistance. The Multi-Family Housing Information System (MFIS) tracks property and tenant information that determine the monthly request for rental assistance.

As mandated by the Federal Managers' Financial Integrity Act of 1982, the Comptroller General issues standards for internal control in the federal

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government.<sup>7</sup> These standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement. According to these standards, internal control comprises the plans, methods, and procedures used to meet missions, goals, and objectives. It is the first line of defense in safeguarding assets, and preventing and detecting fraud and errors. Internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources. No matter how well designed and operated, internal control cannot provide absolute assurance that all agency objectives will be met, and thus, once in place, internal control provides reasonable, not absolute, assurance of meeting agency objectives.

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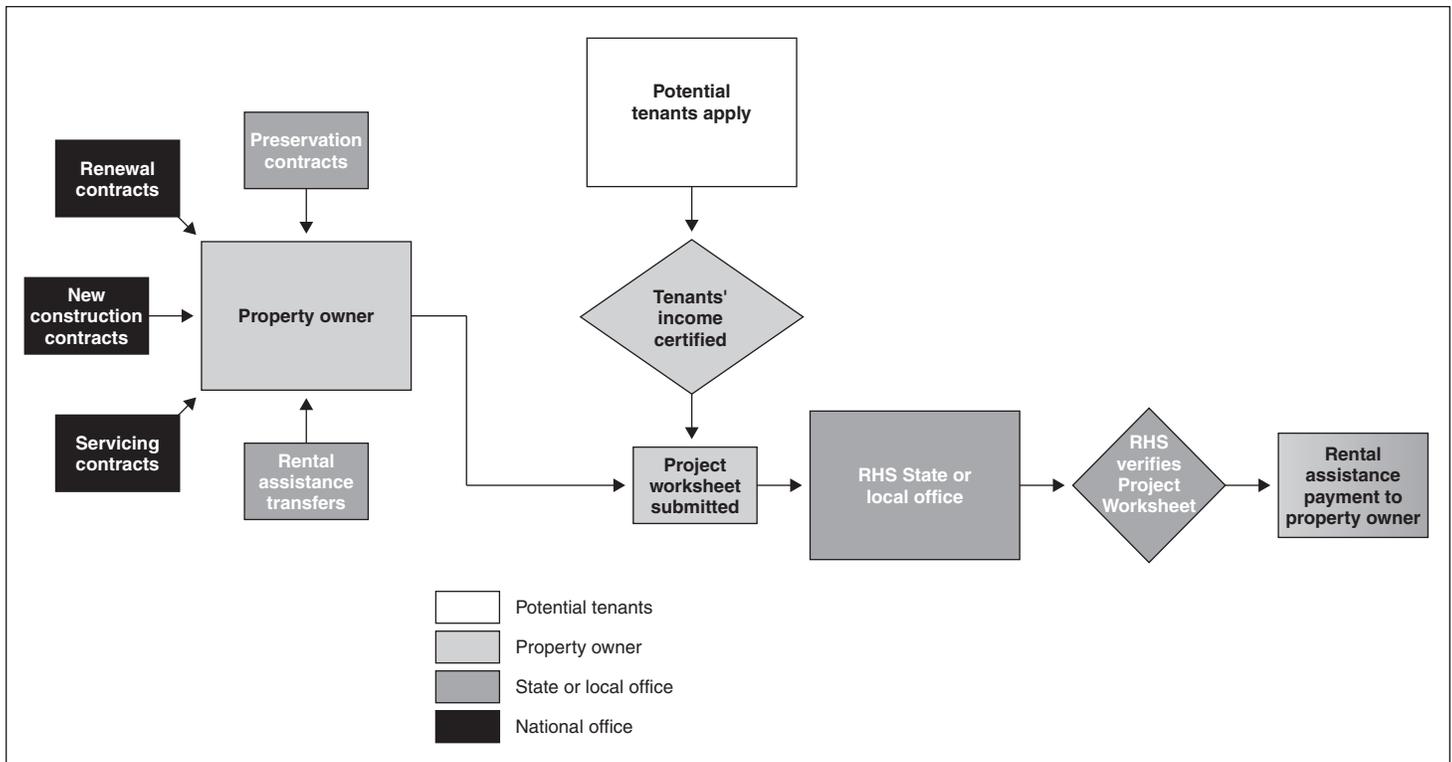
## RHS Distributes Rental Assistance Funds through Contracts and Sets Per-Unit Payments Based on Tenants' Verified Income Levels

RHS's national office provides rental assistance funds to property owners through a variety of contracts. Rental assistance can also be transferred, under certain conditions, from one property to another. RHS calculates the payments property owners receive using information supplied by tenants and verified by property owners, who then use the information to create a tenant certification form. Tenants' income must be certified yearly on the tenant certification form or whenever significant changes occur—for instance, when income increases by a specified amount. Property owners send the tenant certification form to the responsible state or local office, where RHS staff review the information and calculate the amount of the subsidy. In order to receive the monthly payments, property owners must provide the appropriate RHS office with a project worksheet— a monthly statement showing how many units that are eligible for subsidies are occupied by tenants in the program. Figure 2 shows the steps that are involved in the distribution process. Plans are under way to streamline the payment process, although local office staff are concerned this may eliminate their chance to review the information on the project worksheet.

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<sup>7</sup>*Internal Control: Standards for Internal Control in the Federal Government*, GAO, (Washington, D.C.: November 1999).

**Figure 2: Rental Assistance Distribution Process**



Source: GAO.

## Funds Are Distributed to Properties through Contracts and Transfers of Unused Rental Assistance

The rental assistance program provides four types of contracts: renewal, construction, servicing, and preservation. RHS officials report that in the last few years, 96 percent of annual rental assistance appropriations have been used for renewal contracts—that is, contracts that renew expiring obligations at existing properties. Construction contracts, which support new units in recently constructed properties, account for only 1 percent. The remaining 3 percent cover servicing and preservation contracts. Property owners who take out loans to rehabilitate properties and then raise rents to cover the servicing costs associated with the loan, for example, are eligible for servicing contracts that provide additional rental assistance to help tenants cope with the rent increase. Preservation contracts are offered as an incentive to property owners who are considering leaving the program and provide subsidies for additional units on the property.

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According to the authorizing statute, unused rental assistance is to be transferred to properties where the assistance is needed. Transfers can occur when state and local offices identify unused rental assistance at a property or when a property owner requests such a transfer. For example, a property owner may want to transfer unused rental assistance from a property that has no eligible potential tenants to one that has many. During fiscal year 2003 unused rental assistance on approximately 6,800 units, or about 3 percent of all rental assistance units—with a total value of \$67 million—were transferred through about 2,000 transactions. An RHS national office official noted that a portion of these units were rental assistance transfers accompanying a property transfer, during which an eligible property owner assumes another property owner's loan.

Property owners may initiate the transfer of unused rental assistance from their properties at any time. If the property owner has not used the rental assistance on one or more of the covered units for any consecutive 12-month period, RHS may transfer the unused rental assistance, as long as at least one unit at the property remains covered.<sup>8</sup> In either case, before the transfer can occur, RHS must verify that the rental assistance has been properly marketed by the owner and is not needed at the current property. Property owners may appeal decisions to transfer rental assistance from their properties by contacting USDA's National Appeals Division, an independent office within USDA.

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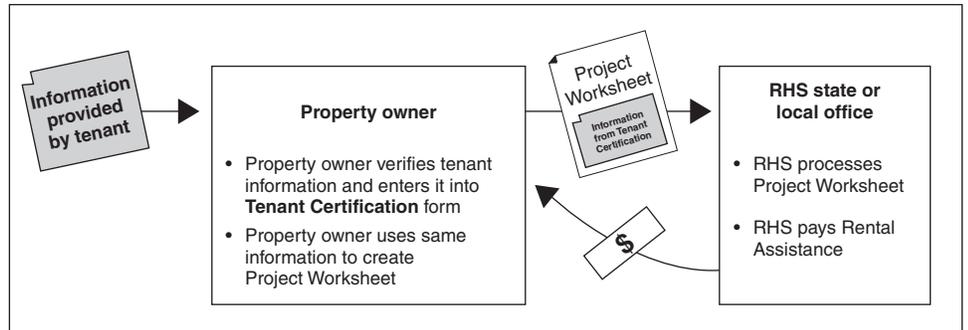
### RHS Makes Payments on the Basis of Information Provided by Tenants and Verified by Property Owners

As figure 2 shows, a number of steps take place between the time rental assistance contracts are made or transferred and the time property owners receive payments. The two key steps in this process involve certifying tenants' income information on the tenant certification form and using that information to calculate the payments to property owners on the project worksheet. (fig. 3).

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<sup>8</sup>The consecutive 12-month period can begin only after the end of the first year of the rental assistance agreement. RHS's proposed rule to update the current RD Instructions gives the agency the authority to transfer rental assistance that has not been used for a 4-month period. (See 7 C.F.R. Part 3560.259, Proposed Rule).

**Figure 3: How RHS Uses Information from Tenants to Determine Rental Subsidies**



Source: GAO.

RD Instructions require that tenants be certified at least annually so that state and local office staff can document their income and determine their rental contributions. Property owners certify tenants initially and then every year, or when a tenant's income rises by \$40 or more per month (\$480 per year) or decreases by \$20 or more per month (\$240 per year). In these cases, the income must be verified again. According to RD Instructions, the property owner must obtain verification of the tenant's stated income, in writing, from the tenant's employer. If the owner is not able to immediately obtain written verification, the tenant's income may be temporarily verified by examining income checks or check stubs. Income listed from other sources, such as Social Security or public assistance, must be verified in writing by those sources. Although tenant certifications and income verifications help ensure accurate payments to property owners, errors can occur when tenants do not accurately report all sources of income or when property owners do not adequately verify them.

Calculating the amount of rental assistance and submitting the information to RHS is the second key step. Project worksheets document the rent and income levels of tenants for whom the property owner can request rental

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assistance and calculate the amount of rental assistance due.<sup>9</sup> Property owners submit the project worksheets by mail to state or local offices, where, according to RHS guidance, staff are to compare the worksheet information with information from MFIS. Once a month, MFIS also generates project worksheets, based on the previous month's occupancy reports and the tenant certifications in the system. RHS staff finish processing the worksheets by entering the information into AMAS, triggering payments to the property owners.

In over half of the states, individual local offices are responsible for processing project worksheets. However, approximately 39 percent (17 out of 44) of the state offices we surveyed have chosen to centralize their processing function (fig. 4).<sup>10</sup>

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<sup>9</sup>Rental assistance is used in conjunction with RHS loans, and is provided directly to the owners of some RHS-financed properties. The amount of rental assistance requested by the property owner is subtracted from the amount of the property owner's monthly mortgage payment. If the expected amount of rental assistance exceeds the amount of the property owner's monthly mortgage payment, then RHS will issue a rental assistance check to the property owner.

<sup>10</sup>We surveyed only RHS state offices with rental assistance responsibilities. Also, in certain instances RHS has a single state office for selected groupings of states. For example, the state office for Connecticut, Massachusetts, and Rhode Island is located in Massachusetts. Thus, the total number of state offices is less than 50.

**Figure 4: Centralized and Decentralized Processing, by State**



Source: GAO.

Note: In certain instances, RHS has a single state office for selected groupings of states. To depict centralized status in these selected state groupings, this figure only shades the state where the state office is located. See appendix I for more details on RHS's state groupings.

Program officials in one of these states told us their centralized processing center promotes consistency in administering regulatory requirements. In another centralized state, an official stated that their centralized payment center had helped to cut costs and increase satisfaction, because property owners had one place to call when questions or payment issues arose. However, program officials in two decentralized states told us that they believed that centralized payment systems distanced RHS staff from the properties and property owners or managers.

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## RHS's Plans to Streamline the Payment Process Have Raised Concerns about Eliminating a Layer of Review

RHS's national office is upgrading two systems to streamline the payment process. The Management Agency Interactive Network Connection (MINC) is a Web-based electronic transmission process that will upgrade the current modem-based process, known as the Industry Interface, that property owners can use to transmit tenant certifications to RHS. RHS will also be upgrading MFIS in order to create electronic project worksheets, so that state and local offices will no longer be required to enter data from the project worksheets manually into AMAS. Once the property owners approve their electronic project worksheets through MINC, the information will be transmitted automatically into AMAS to trigger rental assistance payments. As of May 2004, five states have been using the MFIS upgrade in conjunction with MINC to process payments and the national office expects all states will be using it by the end of calendar year 2004.

Local office staff whom we spoke with during one of our site visits were concerned that allowing property owners to approve and submit project worksheets electronically will eliminate the local office's chance to review the information while entering it into AMAS. National office staff overseeing these changes stated that electronic project worksheets would not affect this review, because the property owner would not be able to make any changes directly to the electronic project worksheet if he or she did not agree with the amount of rental assistance calculated. Rather, any modifications to the project worksheets would have to be submitted separately to RHS.

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## RHS's National and State Offices Monitor the Use Of Rental Assistance, with Local Offices Performing the Primary Review Every 3 Years

RD Instructions provide guidance for monitoring the use of rental assistance funds. The guidance requires reviews at the national, state, and local levels. However, the triennial supervisory review is the primary tool for verifying the accuracy of rental assistance payments. National office staff are planning a number of initiatives to increase rental assistance monitoring, but a number of key management positions in the national office have been unfilled, potentially limiting the effectiveness of monitoring efforts.

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**Guidance from the National Office Establishes Monitoring Procedures but Is Used Inconsistently and Considered Unclear**

Two main sets of RD Instructions establish procedures for distributing rental assistance. These include:

- RD Instruction 1930-C, Management and Supervision of Multiple Family Housing Borrowers and Grant Recipients, particularly exhibits B and E, which establishes criteria for tenant and property eligibility for rental assistance, among other things.
- RD Instruction 1951-K, Exhibit A, Processing Multiple Housing Payments, which outlines the rental assistance payment process.

Although four offices we visited reported following RD Instruction 1930-C to process tenant certifications, we found little consistency in the guidance RHS offices used to process payments, specifically when processing project worksheets. Three offices we visited reported using the AMAS Online Cash Manual, which provides instructions on using the AMAS database to process payments, but two of those offices also reported using different parts of the RD Instructions issued by the national office. One of these two offices reported using the RD Instruction 1951-K. One other office was unaware of official guidance, and another office told us that they referred questions to their AMAS coordinator in the state office.

Likewise, two sets of RD Instructions provide explicit procedures for monitoring the rental assistance program, including the purpose, frequency, content, and planning and follow-up procedures:

- RD Instruction 2006-M, Management Control System, which outlines the reviews used at the national and state office levels: the Management Control Review and the State Internal Review; and
- RD Instruction 1930-C, which outlines the triennial supervisory review for local offices.

The national office conducts the Management Control Review on a 5-year cycle to review rental assistance administration in randomly selected states. A Management Control Advisory Group, which is made up of national and local office employees, determines the time frames, objectives, and work plan for the Management Control Review cycle. Generally, the objectives are designed to assess state-level administrative operations, including financial management, internal control, and automated systems. RHS national office staff visit the selected properties and review a sample of tenant household files from each. Based on the

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results of the review, the national office has the authority to make recommendations to the state offices for improving rental assistance administration.

State offices are required to conduct the State Internal Review at least once every 5 years. This review is designed to, among other things, ensure that RHS local offices properly implement Rural Development policies and procedures. During these reviews, state office staff evaluate program and administrative functions at local offices. Reports on the findings from these reviews are provided to the state director.

Local offices are to conduct supervisory reviews at least every 3 years, examining a random sample of tenant household files at each property in their portfolios, and RD Instructions mandate more frequent reviews for delinquent or problem properties. Local office staff in one state we visited told us that they conduct approximately one supervisory review per month in order to review each property once every 3 years.<sup>11</sup> To conduct the review, staff are to pull a random sample of at least six tenant household files at each property, or review all tenant household files if the property has six units or fewer. RHS provides sample forms including a pre-visit worksheet to help staff sample units, plan objectives, and assemble required documentation for each visit.<sup>12</sup> Table 1 shows the number of rental assistance units subject to triennial supervisory review at each of the five local offices we visited.

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<sup>11</sup>Based on a Connecticut local office portfolio of 34 properties and 920 rental assistance units.

<sup>12</sup>RD Instruction 1930-C, Exhibits F and F-1.

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**Table 1: Triennial Supervisory Review Workload, Selected RHS Local Offices**

<b>State where local office is located</b>	<b>Number of rental assistance units</b>	<b>Number of dedicated office staff</b>	<b>Number of rental assistance units per staff</b>
Connecticut	920	2	460
Mississippi	500	4	125
New York	480	2	240
South Carolina	2,149	2	1,075
Utah	368	2	184

Source: GAO.

In written responses to survey questions, certain respondents cited issues related to RHS guidance in the conduct of their rental assistance responsibilities. For example, one survey respondent stated that RHS guidance needed to be simplified and issued in a timely manner. Another survey respondent stated that RHS guidance is sometimes unclear. This respondent added that administrative notices helped to some degree but added that the office was receiving more guidance from unnumbered letters, which do not carry the same force as RD Instructions or administrative notices.

Despite these comments, 80 percent of respondents considered national administrative notices helpful or very helpful at clarifying policies and procedures established by the national office. However, approximately 50 percent of respondents were unable to say how many notices the national office had issued between January 2003 and January 2004.

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## Triennial Supervisory Reviews Are RHS's Primary Monitoring Tool for the Rental Assistance Program

The triennial supervisory review is the chief activity RHS local offices use to verify tenants' income, assets, and expenses—that is, the information on which the tenant certifications and project worksheets, and ultimately rental assistance payments, are based. RHS staff look for supporting documentation that confirms tenants' eligibility and income during tenant household file reviews and examine the property owner or manager's waiting list, rental rates, and budget. While property owners are required to collect supporting documentation for tenants' claims of income, assets, and expenses—a process referred to as third party income verification—RHS staff do not see the original documentation tenants provide at any time

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other than during triennial supervisory reviews.<sup>13</sup> Local office staff in all five states selected for site visits told us that triennial supervisory reviews were the mechanism they used to monitor the accuracy and completeness of tenant certification data. Further information collected from the local office staff emphasized the value of triennial supervisory reviews. For example, four out of five local offices we visited recalled finding errors or questionable tenant documentation during triennial supervisory reviews.

RHS uses the triennial supervisory review and other mechanisms to detect unauthorized rental assistance payments but faces challenges recapturing the unauthorized payments. Tenant household file reviews can help detect erroneous claims that lead to unauthorized payments. For example, during a triennial supervisory review, RHS staff in one state found that a property owner had allowed a tenant to overstate medical expenses, which could lower the tenant's net income and thus increase the payment RHS makes on the rental unit. Employers may also file erroneous third-party income verification forms. According to a property owner we visited, such errors can occur when employers falsify income information in order to maximize rental assistance payments for their employees. RHS can detect such errors through wage matching, the process of comparing statements of income by tenants or employers to data collected by state wage information collection agencies.

According to RHS officials, recapturing unauthorized rental assistance payments once they have been made is difficult. Though RHS can report false statements of income to state agencies, these agencies seldom have recourse against tenants or employers. When surveyed, 49 percent of RHS staff stated that they collect unauthorized rental assistance payments from property owners. Owners can, in turn, attempt to collect the unauthorized payments from tenants through a repayment agreement. Twenty-nine percent of the RHS offices that indicated that their office is able to reclaim unauthorized rental assistance reported that they had attempted to initiate payment agreements with tenants. However, in written responses to survey questions, one respondent noted that the office is not able to recapture unauthorized rental assistance in over 95 percent of the cases. Another survey respondent stated that the office is successful in recapturing unauthorized rental assistance in about 30 to 50 percent of the cases.

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<sup>13</sup>In one local office we visited, RHS staff stated that they have augmented their review process to include spot checks of tenant documentation on an annual basis.

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Additionally, survey respondents stated that tenants typically vacated the units before the debt was repaid.

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### Initiatives to Increase Monitoring of the Rental Assistance Program Could Be Hindered by the Lack of Key Managers in the National Office

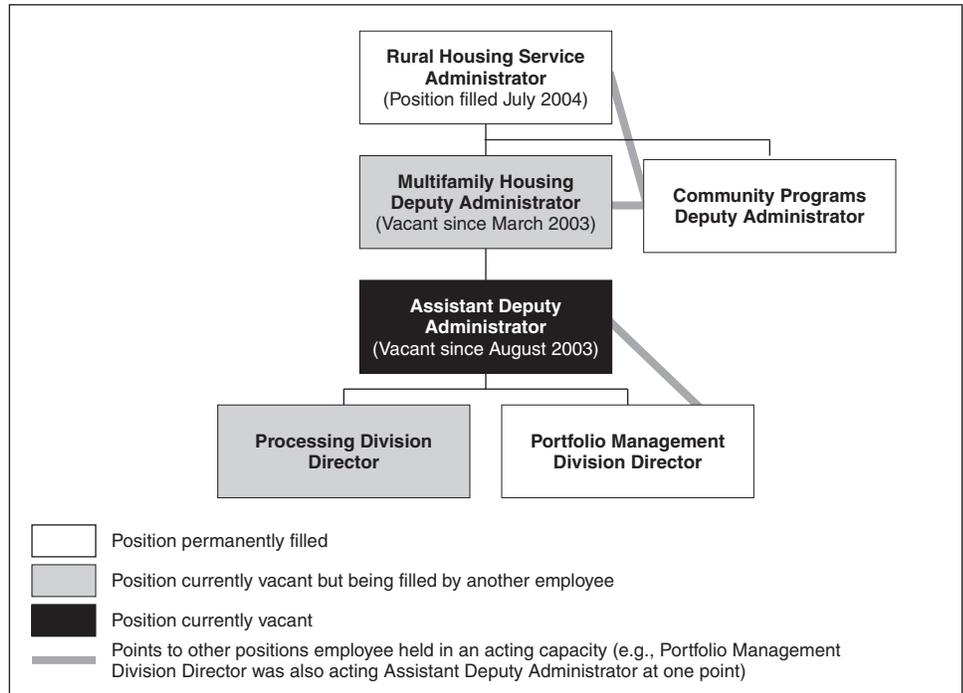
Initiatives are under way at the national office to strengthen monitoring of the rental assistance distribution process at all levels. In response to the Improper Payments Information Act, the national office is conducting a review of properties to determine a nationwide erroneous rental assistance payments rate.<sup>14</sup> The national office is also attempting to gain access to the National Directory of New Hires, which is administered by the Department of Health and Human Services. This database would give RHS state and local offices access to national wage-matching data that could be used to further verify tenants' income.

A number of key positions in the Rural Development mission area, particularly in the Multifamily Housing Division, have been unfilled since approximately March 2003, and existing staff were filling two or more administrative roles (fig. 5).

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<sup>14</sup>The Improper Payments Information Act of 2002 requires that agencies review all their programs and activities annually and identify those that may be susceptible to significant improper payments. The act further requires those agencies with improper payments exceeding \$10 million to provide a report on the actions being taken to reduce the payments.

**Figure 5: Key Management Positions in the Rural Housing Service, as of July 2004**



Source: GAO.

For example, as of July 2004 the Deputy Administrator of Multifamily Housing and Assistant Deputy Administrator of Multifamily Housing positions had been unfilled since March 2003 and August 2003, respectively.<sup>15</sup> Additionally, at times the Deputy Administrator for Community Programs filled the roles of both acting Rural Housing Service Administrator and acting Deputy Administrator of Multifamily Housing.<sup>16</sup> Finally, the Director of the Portfolio Management Division, which administers the rental assistance program, had also at one time filled the role of acting Assistant Deputy Administrator for Multifamily Housing. The leadership gap could have a negative effect on program staff's ability to

<sup>15</sup>The Deputy Administrator of Multifamily Housing position was filled in August 2004.

<sup>16</sup>Community Programs, a division of the Rural Housing Service, is part of USDA's Rural Development mission area. Community Programs administers programs designed to develop essential community facilities for public use in rural areas.

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develop and administer new policies in a timely fashion. For example, the national office planned to release administrative notices clarifying procedures on, among other things, income verification in July 2004. However, because of staffing constraints due to the consolidation of RHS regulations, the issue date was extended.

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## RHS's Internal Controls Do Not Provide Adequate Oversight of Rental Assistance Funds

RHS's internal controls do not provide reasonable assurance that rental assistance funds are used efficiently or that tenants' incomes and assets are adequately verified. First, RHS lacks sufficient guidance to oversee the transfer process, creating difficulty in moving unused rental assistance throughout the multifamily housing portfolio. Second, the triennial supervisory review does not provide reasonable assurance that errors in tenants' income statements and thus in rental assistance payments will be prevented or detected in a timely manner. The guidance is inconsistently interpreted and the reviews are conducted infrequently using methods, specifically the selection of an appropriate sample size to review, which may be insufficient. Alternate methods of verification, such as internal MFIS database checks and wage matching, could help improve RHS's existing internal controls if properly designed and implemented.

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## Insufficient Guidance on Transfers Limits Ability to Move Unused Rental Assistance to Properties with the Neediest Tenants

The majority of survey respondents (52 percent) very frequently or fairly frequently encountered high vacancy rates as a cause of unused rental assistance. Additionally, when asked to identify the three greatest challenges to their offices, survey respondents most frequently listed monitoring and filling unit vacancies as the greatest challenge facing RHS state and local offices. The current lack of clear guidance on transferring unused rental assistance may prevent RHS officials from using transfers as a tool to fill vacancies within and outside of a state.

We found that RHS's guidance on transfers was not sufficient to meet GAO's *Standards for Internal Control in the Federal Government*. GAO's standards state that for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events. For communications to be effective, information must flow down, across, and up the organization. RD Instructions state that transferred rental assistance must be directed to properties with tenants or applicants that have the greatest need, based on income level. However, RD Instructions are silent on whether state and local offices should transfer unused rental assistance to properties within their portfolios or redirect it

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to properties outside their portfolios—either within or outside the state—where the need is greater. As a result, the guidance is interpreted inconsistently, potentially preventing RHS from effectively transferring rental assistance.

During our site visits, an RHS official in one state said that her office most often conducted transfers within the property owners' portfolios, but officials in other states prioritized transfers to benefit the most needy tenants throughout the state. An official noted that RD Instructions did not explicitly prioritize such transfers. Further, because RD Instructions do not state whether rental assistance is to be transferred only within states or among states, three state offices interpreted the RD Instructions as allowing the transfer of unused rental assistance to other states with a greater need. However, 76 percent of survey respondents reported that their office did not have, or they did not know if it had, formal procedures for conducting state-to-state transfers.

In written responses to our survey questions, certain respondents noted that RHS guidance on transferring unused rental assistance was insufficient. For example, one survey respondent noted that states were currently responsible for transferring unused rental assistance without a great deal of guidance from the national office. Another respondent noted that regulatory and instructional requirements for transferring rental assistance were “not efficient.” Yet another noted that RD Instructions did not outline procedures for transferring unused rental assistance among properties or states.

Officials in the national office told us that one of their functions was to encourage the transfer of rental assistance both within and among states. One official stated that RD Instructions did offer guidance on where to transfer rental assistance but could not point to specific details. The official also stated that the goal of the transfer policy was to provide rental assistance to the tenant with the greatest need. However, the current RD Instruction on transfers does not provide the necessary control to ensure that this goal is met. In addition, to determine where the greatest need exists, RHS national office would have to consistently assess need within portfolios, within states, and among states. RHS officials acknowledged that they were reviewing the guidance on transfers and stated that RHS planned to issue an administrative notice to clarify procedures for transferring unused rental assistance.

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The issue of unclear guidance on transfers is complicated by the fact that RD Instructions give property owners certain protections that limit transfers of unused rental assistance. While RHS can transfer unused rental assistance on covered units after 12 months, at least one unit must remain covered at the property. RHS must also notify property owners 30 days in advance of its intent to make a transfer and ensure that the property owners know their appeal rights. According to RHS officials in the states we visited, property owners most often instigated transfers when they occurred, typically to other properties they owned. An official in one state estimated that property owners initiated 95 percent of transfers in that area.

We found that RHS officials in one state hesitated to recommend transferring unused rental assistance outside of the property owner's portfolio because of the appeals process. The State Director of Rural Development in that state said that it could take at least 18 months to transfer unused rental assistance to another property if the property owner appealed, as the appeals process could take up to 6 months. Additionally, one survey respondent would have liked to have the authority to transfer unused rental assistance without giving the property owner appeal rights. RHS national office officials noted that, since 2001, there had been only two requests for review of a property owner's appeal. In both cases, RHS's National Appeals Director decided against the property owner, and allowed RHS to transfer the unused rental assistance to properties outside of the property owner's portfolios.

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### Triennial Supervisory Reviews Are Not Adequate as the Primary Monitoring Tool for the Rental Assistance Program

Approximately 56 percent of survey respondents reported that they were able to verify the accuracy of information provided during the tenant certification process. Of those, 56 percent said they did so during the triennial supervisory review. Likewise, all of the local offices we visited during our site visits stated that information provided for tenant certifications was verified during or in preparation for triennial supervisory reviews. And approximately 83 percent of survey respondents reported that triennial supervisory reviews provided them with the information necessary to effectively monitor properties in their portfolios to a great or very great extent.

However, we found that the triennial supervisory review was not a sufficient means of detecting problems such as misreported income, verification errors, and unauthorized rental assistance payments. GAO's standards state that internal control should generally be designed to assure

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that ongoing monitoring occurs in the course of normal operations, is performed continually, and is ingrained in the agency's operations. RHS's triennial supervisory reviews did not meet this standard because they are conducted infrequently using a sample size that may be too small to provide reasonable assurance that all tenant certifications are reviewed at least once or more than once every several years. RD Instructions require a sample of at least six tenant household files from a property with more than six units, and all tenant household files for properties with six units or fewer. With a sample size this small, however, tenants could move from a unit they had rented before the local office has a chance to sample their household file during a supervisory review.

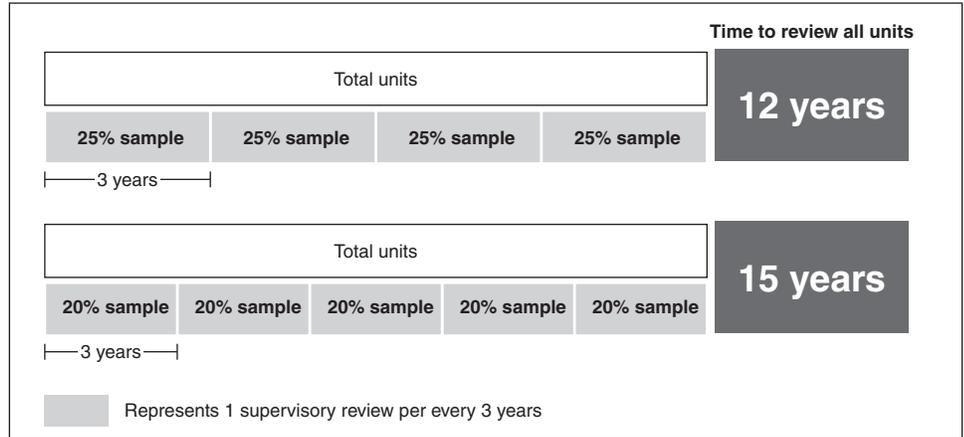
Local offices in the states we visited said that they interpreted RD Instructions as requiring a 20- or 25-percent sample of tenant household files. However, we found that staffing and time limitations did not allow staff to conduct the reviews this way.<sup>17</sup> For example, an official in one local office stated that her office reviewed six tenant household files for every property, even if 20 percent of the property comprised a greater number of units. Furthermore, about 20 percent of survey respondents reported not having sufficient staff to conduct reviews, and about 27 percent reported not having sufficient time to conduct the reviews according to the RD Instructions. A local office official in another state we visited said that staff reviewed either six tenant household files or 10 percent of the total-whichever was greater. Even if the local offices consistently used a 20 percent or 25 percent sample of tenant household files, however, as figure 6 shows a rental assistance unit could go without review for 12 to 15 years.<sup>18</sup>

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<sup>17</sup>A national office official stated that local offices likely interpret the Instructions this way because Exhibit F-1 in RD Instruction 1930-C uses 25 percent as an example sample size. Ultimately, according to the Instructions, the percentage of units a local office should review is based on that office's "preference for sample size," as long as local offices select at least six units for properties with six or more units.

<sup>18</sup>This figure assumes a 20 percent or 25 percent sampling of tenant household files. The figure also assumes that RHS local staff sample tenant household files without replacement. That is, the portion of files selected on an initial supervisory review will not be selected for subsequent supervisory reviews.

**Figure 6: Frequency of Supervisory Reviews of Tenant Household Files**



Source: GAO.

Note: This figure assumes a 20 percent or 25 percent sampling of tenant household files. This figure assumes that RHS local office staff sample tenant household files without replacement. That is, the portion of files selected on an initial supervisory review will not be selected for subsequent supervisory reviews.

RHS’s national office does not have a basis for determining whether sampling a minimum of six tenant household files per property is sufficient to provide reasonable assurance that errors in tenant and payment information are adequately detected. In order to design a cost efficient sampling strategy that can provide reasonable assurance with respect to tenant income and rental assistance payments, RHS needs information on the overall error rates. One way to determine an overall error rate is to conduct a national statistically valid random sample of tenant household files. Information gathered from this sample would provide RHS with a better idea of the level of erroneous income tenants were reporting and enable RHS to estimate the level of improper rental assistance payments that are being made throughout the program. In addition, it would provide RHS officials with valuable information on how to structure future supervisory reviews in a more efficient and effective manner.

In a June 2003 report assessing controls over the tenant certification process and accuracy of rental subsidies conducted by the USDA Office of Inspector General, the audit team found that in Florida, tenant certifications for an estimated 20.8 percent of the 14,705 units contained errors that resulted in households receiving an estimated \$4.7 million in

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improper rental subsidies.<sup>19</sup> This finding emphasizes the importance of being able to detect errors in tenant information in a timely manner.

In March 2004, RHS began a review of properties to determine an overall error rate for rental assistance payments to comply with the Improper Payments Information Act. RHS officials selected a sample of 539 assisted units in 321 RHS properties, and the national office expects to report their findings by the end of September 2004.<sup>20</sup> Until RHS determines an overall error rate using a statistically valid sample, RHS will not be able to determine an appropriate sampling strategy for use with supervisory reviews to estimate error rates and compliance with internal controls.

GAO's internal control standards also state that agencies should evaluate their monitoring activities, and the evaluations should depend on the assessment of risks and the effectiveness of the monitoring procedures. RHS officials in the states we visited said that they found errors or questionable tenant documentation during triennial supervisory reviews. For example, RHS officials in one state said that they would follow up with the property owner if they found errors in the data that are being verified. The official added that property owners might be given a 15- or 30-day period to correct any deficiencies. An RHS official in another state said that RHS staff sometimes found questionable supporting documents during triennial supervisory reviews. The official explained that the staff note the problem in the triennial supervisory review report and request that the property owner obtain the correct documentation. These examples suggest that, if properly designed and implemented, the triennial supervisory review can be valuable in detecting tenant and payment errors.

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<sup>19</sup>The 95 percent confidence interval for the 20.8 percent estimate is from 11.3 to 30.2 percent. The estimated \$4.7 million, reported in "Rural Development, Rural Housing Service, Rural Rental Housing Program, Tenant Income Verification, Gainesville, Florida, Audit No. 04004-3At," consisted of estimated overpayments of \$4.4 million and underpayments of \$0.3 million. The 95 percent confidence interval for this total amount extends from \$2.4 to \$7.0 million.

<sup>20</sup>We did not assess the validity of RHS's sample selection methods.

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## Alternate Controls Used by RHS to Verify Tenant and Payment Information Have Had Limited Effectiveness

RHS staff use alternate controls, such as MFIS database checks and wage matching, to verify tenant and payment information. According to RHS officials, the MFIS system has internal checks that help RHS officials avoid and catch errors. When tenant certifications are submitted electronically through the Industry Interface, MFIS automatically rejects those that are problematic. For example, a tenant certification would be rejected if it showed that the tenant might already reside at another property—that is, if the tenant’s Social Security number already existed within the system.

Also, MFIS allows RHS officials to reject tenant certifications for certain reasons and thus flag them for review. For example, as we have seen tenants must recertify their eligibility for rental assistance if their income increases by \$40 a month (\$480 a year) or decreases by \$20 a month (\$240 a year). MFIS allows each office to compare incoming tenant certifications to the prior batch of tenant certifications. RHS staff in each office can then establish a threshold in MFIS to reject tenant certifications that show a change in income of more than an established amount, for example, 20 percent, and hold them for further review.

Although RD Instructions determine income changes in terms of dollar amounts, the MFIS database check has been implemented to use percentages to set the threshold for rejecting tenant certifications. However, setting the threshold in terms of dollar amounts would be consistent with the RD Instruction that describes how to determine changes in income. For example, if a tenant reported zero income on an initial certification, any subsequent increase in income would be more than 20 percent, thereby triggering a rejection, although the dollar increase could be less than \$40. Likewise, if a tenant’s reported income increased from \$30 to \$40 per month, for example, the MFIS system would also reject this certification because the percentage increase is greater than 20 percent. However, a \$10 increase in income is not enough to warrant recertification. But if a tenant’s reported income increased from \$300 to \$345 per month, MFIS would accept this certification because the percentage increase in income is less than 20 percent, although the dollar increase is more than \$40.

An RHS official in the national office stated that the MFIS database check could be designed to use dollar amounts instead of percentages to establish the threshold. In either case, however, the national office does not currently have an established percentage benchmark in MFIS for all offices

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to use, and RHS local offices are not setting the thresholds consistently.<sup>21</sup> In one local office we visited, RHS staff established their threshold to reject tenant certifications that change by 20 percent. However, in another state we visited, local office staff set MFIS to reject changes in income of 25 percent or more. Setting the threshold higher than an established benchmark would make this control less effective at detecting changes in income. Setting a threshold lower than an established benchmark would make this control more effective but would result in a higher number of pending certifications that would likely require more staff resources.

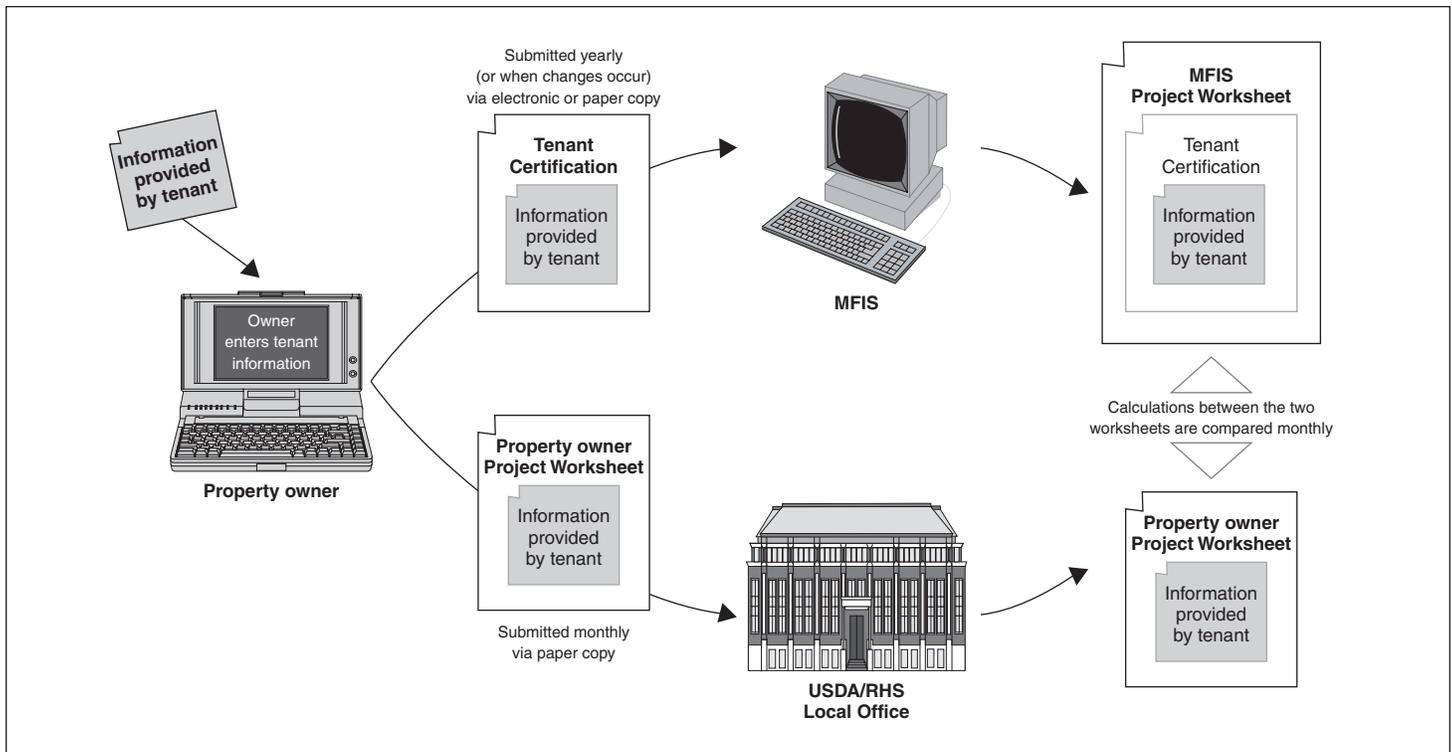
Although the RHS national office has established the MFIS database check as a control, we identified and were told of errors on tenant certifications. For example, in one state we identified a tenant certification that listed two dependents as living in a unit receiving rental assistance. However, the dependents were not listed in MFIS. RHS local office officials stated that, in such a situation, the two dependents would not change the amount of rent owed by the tenant or the amount of rental assistance due to the property owner. But because rental assistance payments are based on household size, among other things, the presence or absence of dependents could influence rental assistance payments. For example, if a tenant got married an additional person would be living in the unit and would possibly have an additional source of income. If a tenant gave birth, the tenant would receive an income deduction for the newborn, decreasing the amount of income used in determining the amount of the rental assistance payment.

Further, RHS officials in four of the states we visited stated that, following RHS guidance, they verified the accuracy of rental assistance payments by comparing property owners' project worksheets with project worksheets generated using MFIS. According to an RHS official, any errors on the property owners' project worksheets should be detected during the comparison with the MFIS-generated project worksheet. But since the MFIS project worksheet is generated with the same information from tenant certifications that property owners used to generate their project worksheets, RHS is essentially comparing duplicate data from the same source (see fig. 7).

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<sup>21</sup>A national office official stated that the benchmark was 10 percent when this database check was designed, but noted that MFIS had been redesigned to give local offices the flexibility to establish their own thresholds.

**Figure 7: Process Used to Verify the Accuracy of Rental Assistance Payments**



Sources: GAO and Art Explosion (images).

According to *GAO Standards for Internal Control in the Federal Government*, such a check is not sufficient. Internal control calls for comparisons and assessments using different sets of data so that relationships can be analyzed and appropriate actions taken. In order for RHS to have a meaningful reconciliation, MFIS data would need to be compared with a different data source to identify differences in reported tenant and payment information.

An RHS official in the national office believed that this internal control standard is not applicable to this situation. The official stated that discrepancies between the MFIS-generated project worksheet and the property owner's project worksheet often arise because the property owner may not send complete information. For example, if a property owner did not submit a form indicating that a tenant had vacated a unit, or if the owner did not perform a calculation correctly, a discrepancy would

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occur that RHS would look into. We agree that this system can catch errors of inconsistency. But a property owner could consistently be submitting complete, but inaccurate, information reported by the tenant. In such cases, RHS would not be able to detect errors or improper rental assistance payments by comparing the two project worksheets. RHS would need to consult another source of information, such as data on earned income that could be used for wage matching, to verify that information reported by the tenant and submitted by the property owner is accurate. Wage matching would allow staff to verify tenant's reported income using wage information collected by the state.

RHS was told by the USDA Office of the Inspector General over 5 years ago to continue their efforts to ensure that RHS state and local offices utilize wage matching to detect misreported tenant income.<sup>22</sup> In a February 1999 report, the Inspector General's audit team evaluated methods RHS and property owners used to ensure that tenants' incomes were properly reported on tenant certifications. The audit team found that 47 percent of tenant certifications in six states (29,238 out of 62,815) were incorrect due to inaccurately reported income, income changes, and property managers that did not properly verify income reported by tenants. Further, the audit team found that about 93 percent of the income errors involved tenants that had reported earned income. The Inspector General recommended that RHS be more aggressive in expanding its wage-matching efforts.

Some RHS state offices are granted access to wage-matching data through agreements between the offices and wage collection agencies, such as state labor departments. These agreements follow state laws. Our survey results showed that 64 percent of RHS state offices (28 of 44 RHS state offices that responded) had access to state employment information to conduct wage matching (see fig. 8.)

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<sup>22</sup>USDA Office of the Inspector General Evaluation Report No. 04801-0004-Ch, *Rural Housing Service, Rural Rental Housing Program, Tenant Income Verification Process*, Washington, D.C., Feb. 1999.



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language originally proposed by HUD for the authority to use the directory.<sup>23</sup> The National Directory of New Hires, which includes centralized sources of state wage, unemployment insurance, and new hires data for all 50 states, would provide nationwide data for wage matching. Access to this directory would likely help solve the problem of verifying income for tenants who work across state lines. Also, wage data from the National Directory of New Hires is more recent than state data and captures all earned income.

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## Conclusions

RHS's internal controls do not provide reasonable assurance that rental assistance resources are used effectively. RHS national office transfer guidance is insufficient and RHS local offices have inconsistently interpreted what is available. As a result, rental assistance funds may not be directed to the most needy tenants or may go unused. Additionally, the infrequency of the triennial supervisory reviews using a sampling methodology that may be insufficient cannot reasonably ensure that tenants' income and assets, and ultimately rental assistance payments, are adequately verified. RHS does not have a basis for determining what constitutes a sufficient sample size for the triennial supervisory reviews without establishing an overall error rate for rental assistance payments. These shortcomings increase the risk that RHS will provide rental assistance to tenants that may not be eligible.

RHS currently uses alternate methods of income verification, including MFIS database checks that, if properly designed and implemented, could provide reasonable assurance that errors in tenant and payment information are detected in a timely manner. However, the effectiveness of these alternate methods is limited because of their faulty design and implementation. RHS officials stated that access to the National Directory of New Hires would help with income verification and has made efforts to gain access to this information.

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<sup>23</sup>Through Section 453 (j)(7) of the Social Security Act, "Information comparisons for housing assistance programs," 42 USC 653 (j)(7), HUD was given the authority to access nationwide tenant wage information through the National Directory of New Hires. According to RHS, its request for inclusion, however, came too late.

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## Recommendations for Executive Action

To ensure that rental assistance funds are effectively distributed to properties that have tenants with the greatest need, GAO recommends that the Secretary of Agriculture require program officials to (1) establish centralized guidance on transferring unused rental assistance, (2) improve sampling methods to ensure that a sufficient number of tenant household files are selected for supervisory reviews and (3) improve verification of tenant information including more effective use of alternate methods of income verification.

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## Matter for Congressional Consideration

Congress may wish to consider adding RHS to Section 453 (j)(7) of the Social Security Act, "Information comparisons for housing assistance programs."<sup>24</sup> This action would grant RHS access to the Department of Health and Human Services' National Directory of New Hires for wage-matching purposes. If such access were granted, RHS and the Department of Health and Human Services would have to develop specific procedures to facilitate it.

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## Agency Comments and Our Evaluation

We provided USDA with a draft of this report for review and comment. The Acting Undersecretary for Rural Development provided written comments that are presented in appendix IV. The letter included a summary of activities that were planned or had recently begun at RHS that the Acting Undersecretary said were designed to improve the oversight, monitoring, and guidance of the multifamily housing program.

In response to our recommendation on establishing centralized guidance on transferring unused rental assistance, the Acting Undersecretary for Rural Development agreed to establish this guidance in an administrative notice. Concerning our recommendation that RHS improve sampling methods to ensure that a sufficient number of tenant files are selected for supervisory reviews, the Acting Undersecretary responded that USDA would instead revamp the supervisory review process to improve its effectiveness and consistency. We agree that the supervisory review process should be revised to improve its effectiveness and consistency and are encouraged that USDA is taking steps to accomplish this. However, to make this process an effective control to ensure that the rental assistance

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<sup>24</sup>42 USC 653 (j)(7).

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payments are correct, or that incorrect payments are discovered in the normal course of business, USDA must also improve its sampling methodology as we described in the report. In particular, RHS must determine an overall error rate using a statistically valid sample to determine how many tenant household files are sufficient to detect errors. Unless this methodology is improved in conjunction with the supervisory review process, USDA will continue to lack any assurance as to the propriety of the rental assistance payments that are not reviewed. The Acting Undersecretary agreed with our recommendation that RHS improve its methods for verifying tenant information, including using alternate income verification methods. He stated that USDA would institute broader use of alternate income verification methods, such as improved access to wage matching and new hires data, but noted that USDA needed to be able to share this data with third parties, particularly the property owners. As noted in this report, if RHS were granted access to data from the National Directory of New Hires, RHS and the Department of Health and Human Services would have to develop specific procedures to facilitate such access.

The Acting Undersecretary also noted that GAO said in the report that streamlining and automating borrower's requests for rental assistance payments could remove an important layer of agency review. However, GAO did not take a position on this issue. We merely summarized concerns expressed by RHS local office staff we visited, attributing the comments appropriately. We also noted that national office staff overseeing the changes had told us that streamlining the payment process would not eliminate this review and that not all states were currently using the streamlined process. Finally, we incorporated updated information USDA provided on RHS staffing.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to interested Members of Congress and congressional committees. We will also send copies to the Secretary of the Department of Agriculture and the Director of the Office of Management and Budget and make copies available to others upon request. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>. Our survey of RHS state and local offices administering Section 521 rental assistance and a more complete tabulation of the survey results (GAO-04-978SP) will also be available on the GAO Web site at [www.gao.gov/cgi-bin/getrpt?GAO-04-978SP](http://www.gao.gov/cgi-bin/getrpt?GAO-04-978SP).

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Please contact me at (202) 512-4325, or Andy Finkel at (202) 512-6765, if you or your staff have any questions concerning this report. Key contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "William B. Shear". The signature is written in a cursive style with a large initial 'W' and a long, sweeping tail on the 'r'.

William B. Shear  
Director, Financial Markets and  
Community Investment

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# Scope and Methodology

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To determine how RHS distributes rental assistance funds and monitors the rental assistance program, and to identify the internal controls RHS has established to ensure that rental assistance funds are administered and used effectively, we collected written and testimonial information from agency officials in the national office and in the Office of the Deputy Chief Financial Officer in St. Louis, Missouri on the rental assistance distribution process and the guidance governing the distribution process. We consulted GAO's *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1) to review control activities that apply to RHS's distribution of rental assistance funds. We used these standards to assess whether RHS's current internal controls were sufficient to effectively monitor the rental assistance program.

We also surveyed RHS state and local offices that were identified as having rental assistance responsibilities by their respective State Directors or the appropriate designee. We identified 248 state and local offices with rental assistance responsibilities.<sup>1</sup> These consisted of 46 RHS state offices and 202 local offices in existence as of December 2003.<sup>2</sup> To ensure security and data integrity, we provided each of the 248 offices with a web address, a unique identification number, and a password to allow the office access to one questionnaire.

The questionnaire covered topics related to the rental assistance program. Specifically, the questions covered general office and staff information, renewal contracts, unused rental assistance, transfers, tenant certifications, project worksheets, rent setting, reserve accounts, and technology and resources. To prepare for the survey, we conducted interviews in three state offices: the combined state office of Maryland and Delaware, and the Texas and Illinois state offices, and interviewed RHS local offices in Texas and Illinois. Of these, Maryland and Delaware and Texas had centralized their processing of rental assistance payments. We also pretested the questionnaire with state and local offices in Pennsylvania and Wisconsin to determine whether respondents would

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<sup>1</sup>Consistent with its use throughout this report, the term "local office" encompasses RHS local, area, servicing, and field offices.

<sup>2</sup>The following state groupings have a combined state office: Delaware and Maryland; Florida and the Virgin Islands; Hawaii, American Samoa and the Western Pacific; Massachusetts, Connecticut and Rhode Island; and Vermont and New Hampshire. Also, we only surveyed state offices with rental assistance responsibilities. Thus, the number of state offices we surveyed was less than 50.

understand questions the way we intended. Since the questionnaire was administered via the Internet, we conducted a usability pretest with yet another RHS local office in Virginia to observe respondents answering the questionnaire as it would appear when activated.

We took the following steps to increase the response rate for all sectors of the population. We sent one reminder notice via e-mail and conducted follow-up telephone calls to those offices that did not respond to our survey by the initial deadline. Collection of survey data ended on May 3, 2004. We received responses from 230 offices, providing an overall response rate of 92.7 percent. Specifically, 44 state offices and 186 local offices responded, resulting in response rates of 95.7 percent and 92.1 percent, respectively. We did not independently verify the information obtained through the survey.

The practical difficulties of conducting any survey may introduce certain types of errors, commonly referred to as nonsampling errors. For example, differences in how a particular question is interpreted, the sources of information available to respondents, or the types of people who do not respond can introduce unwanted variability into the survey results. Steps such as pretesting and follow-up contacts to increase response rates serve to minimize nonresponse error. In addition, steps such as performing statistical analyses to identify inconsistencies and having a second independent reviewer for the data analysis can further minimize such error.

Data from the Web survey were entered electronically by participants and imported into an electronic data file. Close-ended questionnaire items were analyzed using statistical software. A coding scheme was developed, and open-ended questionnaire items were content analyzed by two trained coders, who revised their codes until 100 percent agreement was reached. The results of the content analysis apply only to those survey participants who provided responses. We only content analyzed open-ended responses that were discussed in this report. We conducted our survey work from April 2003 through July 2004 in accordance with generally accepted government auditing standards.

To obtain more in-depth information, we conducted site visits to RHS state and local offices in five states: Utah; South Carolina; New York; Mississippi; and the Connecticut, Massachusetts, and Rhode Island state grouping. We designed a site visit interview guide that enabled the team to follow the distribution process beginning with the property owner or manager and proceeding to the local office, and finally, to the state office. Using the

interview guide, we observed and discussed with RHS staff the tenant certification, project worksheet, and transfer processes, among others.

To determine the states where we would conduct the site visits, we conducted a stratified random sample. Two centralized and three decentralized states were randomly selected from a list of state offices, after eliminating the offices we visited to prepare and pretest the survey.<sup>3</sup> After the state offices were selected, we randomly selected one local office from the local offices available in that state. We judgmentally selected the property owners based on their distance from the local office and their most recent rental assistance transfer. However, the experiences of these states are not necessarily representative of the experiences of any other state.

During each of the site visits, we interviewed a property owner or manager, RHS officials in a local office, and RHS officials in the state office. Using the interview guide, we also obtained key documents related to the three processes that were being discussed. Specifically, the interview guide required the team to obtain from the property owner or manager the most recent, completed project worksheet; tenant certifications associated with certain rental assistance units; tenant applications corresponding to the tenant certifications; a current waiting list; and documentation of a recent transfer of rental assistance. We tracked these documents through the local offices and the state offices to observe internal controls at each level. After all site visits were completed, we interviewed officials from RHS's Office of the Deputy Chief Financial Officer to obtain information on their role in the rental assistance distribution process. Last, we interviewed the RHS national office to determine its role in monitoring the rental assistance distribution process and to assess the internal controls they have established to oversee rental assistance funds.

We also consulted GAO's *Standards for Internal Control in the Federal Government* to review control activities that apply to RHS's distribution and monitoring of rental assistance funds. We reviewed site visit documents to provide examples of RHS's internal controls. We performed our site visit work from March through May 2004 in accordance with generally accepted government auditing standards.

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<sup>3</sup>During our site visits, we learned that one of the two centralized states selected was, in fact, a decentralized state for rental assistance payment processing.

# State Office Survey Responses for Rural Rental Housing (RRH) Properties

<b>State</b>	<b>RRH properties</b>	<b>RRH units</b>	<b>RRH units occupied by zero income tenants, as of 1/1/04</b>	<b>RRH units occupied by rent-overburdened tenants, as of 1/1/04</b>	<b>RRH units receiving rental assistance</b>
Alaska	42	897	32	44	784
Alabama	495	16,191	954	3,206	8,033
Arkansas	361	9,908	174	1,076	6,092
Arizona	118	3,775	140	217	3,080
Delaware	221	6,975	581	320	4,210
Georgia	478	15,427	233	4,134	7,972
Hawaii	22	903	3	3	680
Iowa	679	11,717	242	170	8,884
Kansas	409	6,651	111	613	3,858
Kentucky	456	12,284	291	525	6,437
Louisiana	415	12,637	347	2,360	7,537
Massachusetts	143	4,949	491	349	3,487
Michigan	723	18,653	NR	NR	8,905
Minnesota	673	12,064	DC	DC	6,389
Missouri	896	19,868	DK	1,964	8,493
Mississippi	564	16,416	669	1,252	8,825
Montana	168	2,634	87	184	1,939
North Dakota	253	3,365	187	102	2,147
Nebraska	280	3,908	197	141	2,566
New Jersey	83	3,347	78	445	2,009
New Mexico	116	4,005	347	211	3,072
Nevada	80	1,800	DK	DK	1,100
New York	471	13,210	148	1,101	5,194
Ohio	402	14,912	553	1,429	8,905
Oklahoma	302	8,111	224	140	5,130
Pennsylvania	330	10,640	DC	DC	6,840
South Carolina	352	12,309	430	2,847	5,880
South Dakota	503	6,844	DK	70	4,570
Tennessee	386	13,038	DK	DK	6,539
Texas	804	26,466	707	4,046	14,397
Utah	93	2,095	DK	DK	1,595
Virginia	272	10,498	DC	DC	6,461

**Appendix II  
State Office Survey Responses for Rural  
Rental Housing (RRH) Properties**

*(Continued From Previous Page)*

<b>State</b>	<b>RRH properties</b>	<b>RRH units</b>	<b>RRH units occupied by zero income tenants, as of 1/1/04</b>	<b>RRH units occupied by rent-overburdened tenants, as of 1/1/04</b>	<b>RRH units receiving rental assistance</b>
Washington	298	8,989	97	909	6,205
West Virginia	255	7,221	281	977	4,240
Wyoming	62	1,655	118	252	1,188

Source: GAO.

Notes:

DC = Don't collect

DK = Don't know

NR = No response

We surveyed only state offices with rental assistance responsibilities. Also, in certain instances, RHS has a single state office for selected groupings of states. For these selected groupings, this chart only displays the state name where the state office is located. Thus, the total number of state offices is less than 50. See appendix I for more details on RHS's selected state groupings.

This chart displays survey responses for RHS state office respondents only, if they indicated that they had Rural Rental Housing (Section 515) properties in its portfolio and if they provided data other than Don't Collect, Don't Know, or No Response for at least one of the above questions.

# State Office Survey Responses for Off Farm Labor Housing (FLH) Properties

State	Off FLH properties	Off FLH units	Off FLH units occupied by zero income tenants, as of 1/1/04	Off FLH units occupied by rent-overburdened tenants, as of 1/1/04	Off FLH units receiving rental assistance
Hawaii	1	31	0	0	10
Massachusetts	2	48	2	1	46
Michigan	2	44	0	0	43
New Mexico	5	111	19	5	103
Oklahoma	2	42	0	0	39
Texas	20	1,415	13	36	1,000
Virginia	2	46	DK	DK	34
Washington	24	753	9	21	521

Source: GAO.

Notes:

DK = Don't know

We surveyed only state offices with rental assistance responsibilities. Also, in certain instances, RHS has a single state office for selected groupings of states. For these selected groupings, this chart only displays the state name where the state office is located. Thus, the total number of state offices is less than 50. See appendix I for more details on RHS's selected state groupings.

This chart displays survey responses for RHS state office respondents only, if they indicated that they had Off Farm Labor Housing (Section 514/516) properties in its portfolio and if they provided data other than Don't Collect, Don't Know, or No Response for at least one of the above questions.

# Comments from the U.S. Department of Agriculture



DEPARTMENT OF AGRICULTURE  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C. 20250

AUG 3 | 2004

William B. Shear  
Director, Financial Markets and Community Investment  
United States Government Accountability Office  
441 G Street, NW  
Room 2A10  
Washington, DC 20548

Dear Mr. Shear:

Thank you for providing the United States Department of Agriculture (USDA), Rural Development with your draft report on "RURAL HOUSING SERVICE: Updated Guidance and Additional Monitoring Needed for Rental Assistance Distribution Process, Audit No. GAO-04-937." I would like to offer the following comments for your consideration, and ask that a copy of this response be included in your final report.

USDA provides affordable multi-family housing to almost a half-million residents in rural America. One of the most important tools available is the Rental Assistance (RA) program, which enables eligible very low and low-income residents to pay only 30 percent of their income towards rent. USDA takes very seriously its stewardship of this program.

We welcome the review done by Congress and appreciate their efforts to highlight those areas where we need to improve. As noted in your report, many of these weaknesses were already known to us and were the subject of planned improvements. We are pleased to present an overview of activities we have designed to improve oversight, monitoring and guidance of the multi-family housing program.

With respect to the recommendations put forth by the Government Accountability Office (GAO), 1) we agree to establish centralized guidance on transferring unused RA and to do so through issuance of an Administrative Notice (AN); 2) GAO suggests that we change sampling methods in selecting tenant files; however, we will instead revamp the supervisory visit process to improve its effectiveness and consistency; and 3) we agree to increase local office monitoring of tenant income verifications and to institute broader use of alternate income verification methods, such as wage matching and new hires data, where available. It is important to stress that we must have the ability to share this data with third parties, particularly with the borrower and his management agent. Having the data without the ability to share it will make no difference because actual verification of tenant incomes is done by the borrower and not Agency staff.

Issues noted in the GAO report.

GAO stated in the report that the streamlining and automation of receiving and reviewing borrowers' requests for subsidy may remove an important layer of Agency review. The improvement of the current process does not change any review by Agency staff, but automating this process eliminates human error during data entry. This automation will improve the effectiveness, efficiency, and customer service of every local office in Rural Development.

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Automation will also free up staff time to undertake independent reviews of flagged discrepancies and reviews of problem borrowers or problem management agents. The intent of this automation is not to remove or eliminate a level of review but rather enable and empower staff with the additional time to investigate anomalies and errors.

The GAO recommendation for centralized guidance on unused RA is very timely. A review of unused rental assistance was started within the Agency earlier this year, both as a part of the comprehensive property assessment study and as a management tool to stretch available resources. As a result of the review, State Offices stepped up efforts to use languishing RA for rent overburdened tenants, rehabilitation projects, and some states shared RA with other states. The overall result of this effort was more efficient use of rental assistance and better service to our tenants. Additionally, the National Office made some efficiency changes in the new regulation 3560. However, we also recognize the need for additional and targeted National Office guidance on recapturing and prioritizing unused RA and we expect to issue such guidance later this year.

GAO states in the report that oversight and effective program management are at risk because key management positions have been vacant. We are pleased to advise you that the Administrator's position has been filled by Russell T. Davis and the Multi-Family Housing (MFH) Deputy Administrator's position has been filled by Jack Gleason. The Assistant Deputy Administrator position, still vacant, is not involved in day-to-day operations and has no supervisory responsibility over the two multi-family divisions of Processing and Portfolio Management. This assistant position acts as an advisor and program advocate. We are also very pleased to advise you that all program staff positions within the two divisions are filled and we now have a full complement of program staff, following seven retirements in the last year.

Activities Underway at Rural Housing Service (RHS) MFH.

In addition to the Unused RA AN, we have been working on a comprehensive AN to address tenant income verifications. One of the major findings from the most recent management control review done on the rental assistance program (2004) was the inconsistency of property managers in verifying tenant income and the lack of this discovery during monitoring through supervisory visits.

One of the key authorities that the new regulation 3560 will provide is the ability of the Agency to recapture unauthorized rental assistance and to invoke civil money penalties. An improved tenant certification form will alert tenants to the Agency's intent to pursue reimbursement of such unauthorized assistance.

The Agency also intends to undertake an effort to educate the tenants directly about our expectations regarding income verification and use of the Treasury Offset Program to recapture unauthorized assistance. We hope this effort will educate tenants more clearly on their responsibilities with respect to income reporting and our responsibilities with respect to verification.

The streamlining we currently have underway for the tenant certification form and borrower subsidy request (project worksheet) are some of the most sweeping technological changes that Multi-Family has undertaken. The latest phase of improvements to our primary database include automation of borrower reporting, automation of payment processing, and automation of debiting and crediting of borrower bank accounts. All of these automation improvements eliminate the possibility of human error when inputting data. These improvements continually improve our ability to monitor Agency-financed properties.

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**Appendix IV**  
**Comments from the U.S. Department of**  
**Agriculture**

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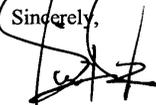
Training and process improvements are areas where we intend to focus in the upcoming fiscal year. Training will be undertaken on the new regulation and budget reviews, process improvements will be undertaken on the property classification system, State Office servicing goals, and revamping of the supervisory visit procedure. The supervisory, or triennial, visit encompasses a review of many management, physical and occupancy areas, primarily because it is performed only once every three years and tries to capture everything going on at a property. During the upcoming year, we intend to break down this activity and improve its efficacy, including the probability of separating review of certain activities and increasing the frequency of reviews.

Overall, we anticipated most of the findings in the GAO report and look forward to the opportunity to review the results from the State Office surveys. We believe this information will provide us with a better sense of trends in the field within the MFH programs and not just in the RA program. We have found our own management control reviews and State Internal Reviews to be of invaluable importance when considering program policy changes. The GAO report confirmed some of the trends we had previously identified.

USDA is committed to the future of rural communities and we continue to work towards improving the RA Program.

Thank you for this opportunity to comment on the report. If you have any questions, please contact John M. Purcell, Director, Financial Management Division, at (202) 692-0080.

Sincerely,



GILBERT GONZALEZ  
Acting Under Secretary  
Rural Development

# GAO Contacts and Staff Acknowledgments

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## Staff Acknowledgments

In addition to those named above, William Bates, Emily Chalmers, Jamila Jones, Austin Kelly, Alison Martin, Marc Molino, and Julie Trinder made key contributions to this report.

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