

DEPARTMENT OF VETERANS AFFAIRS

Changing Demographics and Limited Funding Threaten the Long-Term Viability of the Cal-Vet Program While High Program Costs Drain Current Funding

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Audit Highlights . . .

Our review of the California Veterans Farm and Home Purchase Program reveals that:

- By the end of the decade, eligibility for one type of loan and the limited funds available for the two remaining types of loans will severely diminish the program's value to most veterans.***
 - Poor budget controls, improper administrative charges, and inefficient and inconsistent operations have raised program costs and further eroded funds otherwise available for loans.***
 - Mismanagement of the implementation of a new integrated information system resulted in its failure to meet the needs of the program without an additional investment of time and program funds.***
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At the request of the Joint Legislative Audit Committee (audit committee), we conducted a fiscal and program compliance audit of the California Veterans Farm and Home Purchase Program (Cal-Vet program). Specifically, given the aging population of eligible veterans, the audit committee was concerned about the program's future. The committee was also concerned with conclusions by the Legislative Analyst's Office that the Cal-Vet program was not competitive with other loan programs. Based on our review of the Cal-Vet program, we found the following:

Finding #1: A rapid decline in the population of eligible California veterans and limited funding threaten the long-term viability of the Cal-Vet program.

The Cal-Vet program provides loans to thousands of qualified veterans at below-market interest rates. Because federal restrictions severely limit eligibility for the Cal-Vet program's major source of funding for loans, proceeds from tax-exempt Qualified Veterans Mortgage Bonds (QVMBs), demand for these loans will drop dramatically over the next 10 years. The Department of Veterans Affairs (department) has lobbied Congress over the years to modify the restrictions on QVMBs, but it has been unsuccessful. The program has two other sources of funding, Qualified Mortgage Bonds (QMBs) and unrestricted funds, but approval to issue QMBs is difficult to obtain and unrestricted funds are drying up.

The department's lending strategy is to increase the total value of its loan portfolio. For the eight-month period of July 1999 through February 2000, the Cal-Vet program loaned \$361 million, \$25 million above its goal for the entire fiscal year. During this period, the Cal-Vet program charged 5.95 percent for QMB loans and 6.65 percent for both QVMB and unrestricted loans. Because

the program's interest rates are as much as 2 percent below market interest rates, it is attracting many loan applicants; however, the frequency at which the department is now making loans will substantially exhaust the available QMB and unrestricted funds by 2006, with only residual recycled principal and interest from unrestricted funds available for loans.

We recommended that the department should determine how to use its remaining funding to best serve veterans in purchasing farms and homes. If it decides to continue its present strategy of using available funds to provide loans at the lowest possible rates, it should plan for the future curtailment of new loan activity. If the department determines that veterans are best served with loans having interest rates closer to market rates and expands its pool of funds with alternate financing methods, it should maintain current demographic data to identify veterans eligible for, and likely to participate in, the Cal-Vet program and adapt the program to provide home loans to the greatest number of qualifying veterans for as long as possible.

In the absence of sufficient tax-exempt financing to ensure the continued viability of the Cal-Vet program, we recommended that the Legislature consider using state funds to establish a new program to aid California veterans in purchasing farms and homes.

Department Action: Partial corrective action taken.

The department reports it is taking actions to adapt the Cal-Vet program to provide a home loan benefit to the greatest number of veterans for as long as possible. Using veteran population demographic data collected from the federal Department of Veterans Affairs, the department will identify changes in the veterans population for the next 10 years. In addition, the department has gained approval from the California Veterans Board and the Veterans Finance Committee of 1943 for a rate-setting methodology that will allow the Cal-Vet program to more quickly adjust its interest rates in reaction to fluctuations in market interest rates. Further, the department continues its efforts, along with other states with similar loan programs, to convince Congress to extend the eligibility requirements for QVMBs to veterans of more recent combat actions.

The department reports it will also vigorously pursue additional sources of program funding to benefit as many veterans as possible, and has identified some new sources of funding. However, the department, along with its quantitative consultant, has determined that there is no immediate need to implement new sources of funding at the present time.

Legislative Action: Unknown.

We are unaware of any legislative action to implement our recommendation.

Finding #2: Improperly charged administrative expenses and inefficient loan processing deplete the already limited funds available for loans to veterans.

Additional concerns in the Cal-Vet program are poor budget controls and a lack of consistency and efficiency in program operations. Most significantly, department records indicate as much as \$1.3 million of Cal-Vet program funds in a single year were paid for the costs of administrative staff who did not provide service to the program or for staff whose service to the program had not been documented. The department has implemented improvements in the efficiency of its Cal-Vet program operations, such as centralizing loan contract servicing, adopting new loan underwriting standards, instituting mortgage insurance, and improving its management of delinquent and foreclosed loan contracts. However, it has not fully implemented other reengineering changes in the Cal-Vet program that it has identified as necessary to become more efficient in its operations. Because the department has not completed its reengineering efforts, which include the centralization of its loan-processing operations and implementation of workload standards for its field and headquarters offices, the average cost to process loan applications has increased, costs vary significantly by field office, and loan applications take longer to process than is common in the industry.

We recommended that the department ensure its direct and indirect administrative costs are properly and equitably charged to all programs served by administrative staff, that it identify the amount of Cal-Vet funds it has used for activities outside the program, and that it seek reimbursement from other appropriate state funds. In addition, to further increase the efficiency and consistency in the Cal-Vet program's operations, and thereby reduce costs and improve loan-processing times, we recommended that the department complete its reengineering efforts.

Department Action: Partial corrective action taken.

The department reports it has developed and tested a process to allocate direct and indirect budgeted program expenditures to the programs actually incurring the costs. Under the department's new process, direct labor hours are charged directly to the program on which employees work. Indirect labor, employee benefits, space costs, and other indirect costs are allocated based on a ratio of direct allocated labor costs. The department reports that all cost centers will be time studied each quarter on a continuous and rotating basis starting in June 2001, and it will request funds through the budgeting process for any amounts due to the Cal-Vet program from other funds as identified through the allocation process. However, the department does not believe it has reliable data from the past and cannot confidently identify the amount of Cal-Vet funds it has used outside the program in years prior to fiscal year 2000–01.

The department reports it has completed centralizing its loan processing and is reducing the time it takes to process a loan, as well as resolving system issues. Further, it is gathering task data from its own operations and industry standards to be used in developing workload standards, duty statements, and work class specifications for positions in its field and headquarters offices. The department's goal is to have the workload standards implemented after it has determined that staff is in the proper classifications by the end of fiscal year 2001–02. Other future efforts to improve efficiency reported by the department include steps to develop a field office staffing model; updating its loan underwriting manual and employee training plan; and training, certifying, and monitoring mortgage brokers who process Cal-Vet loan applications.

Finding #3: Inadequate management of the Cal-Vet program's new integrated information system increases costs and creates doubt about the reliability of program data.

Another obstacle the department faces in controlling excessive program costs is implementing the Cal-Vet program's integrated information system. This system is intended to provide reliable program and financial data needed to operate the Cal-Vet program. Even though the department has devoted significant time and money to get the system running, the system still does not meet its needs. The department cannot be certain that the system will properly maintain borrowers' file records and accurately accumulate program and financial data because it has not completed necessary testing. The

implementation project has also been marred by problematic management. When key staff left in the middle of the project, management abandoned its original implementation plan and did not ensure staff adhered to prudent project implementation practices.

Furthermore, the department has not adequately safeguarded the data stored in its system by following prudent procedures for approving, testing, and documenting changes to the system software, or provided adequate security over authorized system access to prevent the loss or misuse of information in the system.

We recommended that the department convene a centralized implementation team to ensure the system functions reliably. As part of this effort, we recommended that the department contract with an outside consultant with experience in project management to oversee the team. The team should gather all data from prior implementation efforts, assess which tasks remain incomplete, and identify steps needed to properly test the modules and the system. We further recommended that the department adequately safeguard program data and assets by implementing a security policy to limit system access to employees who are properly authorized and ensuring access is not incompatible with their other duties.

Department Action: Partial corrective action taken.

The department reports it hired consultants to perform extensive tests of the accuracy of system data and outputs and to review the information technology and business processes employed. The department reports its consultants found that the system accurately calculates critical information and that the data within the system is reliable and can be used with confidence in the department's day-to-day farm and home loan program. In performing their testing, the consultants also identified some processes and procedures that should be strengthened to assure the department does not repeat some of its earlier implementation errors. These include improving the system's user manual and increasing training, and changing control procedures, security policies, and central documentation files. The department is in the process of developing user manuals and has implemented ongoing additional training. In addition, the department reports it is maintaining a central file for documenting its implementation efforts and has developed a method for tracking issues from discovery to resolution. Further, the department has implemented a new change control policy and is continuing to review and develop security policies regarding access to the information system.

