

MEMORANDUM

To: Mary L. Kendall, Deputy Inspector General

Through: Michael Black, Acting Assistant Secretary—Indian Affairs
Jack Stevens, Acting Director, OIEED

From: David Johnson, Acting Chief, DCI

Subject: Response to Draft Evaluation Report – *Stronger Internal Controls Needed Over Indian Affairs Loan Guarantee Program*, Report No. 2016-CR-036

Date: September 14, 2017

As requested in your transmittal memorandum of July 24, 2017, the Division of Capital Investment (DCI) responds to the Office of Inspector General’s Draft Evaluation Report No. 2016-CR-036, issued in July of this year (hereafter, the Report), as follows:

Recommendation 1.

Stop approving loan guarantee applications that result in total indebtedness exceeding \$500,000 for borrowers incorporated as the sole owner of an Indian business entity.

Response. DCI concurs with Recommendation 1.

This recommendation stems from a technical glitch involving the interpretation of 25 U.S.C. § 1484 and its corresponding regulatory provisions in 25 CFR § 103.5. Despite the wording of 25 CFR § 103.5, DCI officials have been advised over the years that a one-person LLC or S corporation could avoid the restriction in 25 U.S.C. § 1484 because the borrower was not an “individual Indian.” While that might be correct as far as the statute is concerned, that is not the way the regulation is written. The long term fix is to harmonize the regulation with the preferred interpretation of 25 U.S.C § 1484. But until then, DCI must stop approving loan guarantees and/or insurance in excess of \$500,000 to entities with fewer than 2 members.

At the first weekly DCI staff call following the May 30, 2017 OIG evaluation exit conference, the DCI Acting Chief announced the discovery of this problem and required immediate compliance with the strict wording of 25 CFR § 103.5.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: Done.

Recommendation 2.

Communicate the importance of approving loan guarantees in compliance with 25 C.F.R. § 103.5.

Response. DCI concurs with Recommendation 2.

As stated above, the DCI Acting Chief promptly announced the discovery of this problem at the weekly staff meeting following the May 30, 2017 exit conference relating to the Report. He then issued written direction to all DCI personnel to the same effect.

In addition, DCI plans to issue specific written guidance on this subject in a policies and procedures manual that OMB is having DCI prepare.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: Done.

Recommendation 3.

Implement a process to periodically verify that loan guarantees are being approved in accordance with 25 C.F.R. § 1.05.

Response. DCI concurs with Recommendation 3.

DCI plans to issue specific written guidance on this subject in a policies and procedures manual that OMB is having DCI prepare. DCI is also exploring the possibility of having its new loan accounting and management software, LMS, configured with a prompt or other requirement to remind DCI staff to assure compliance with 25 CFR § 103.5. Either way, DCI is in the midst of implementing a process to periodically verify compliance with § 103.5.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: March 31, 2018 if LMS can be configured to help DCI officials verify; if not, August 1, 2018 when new policies and procedures are issued.

Recommendation 4.

Develop and implement clarifying guidance for how to interpret the equity and collateral sections of the loan guarantee rule to ensure consistent application.

Response. DCI concurs with Recommendation 4.

Recommendation 4 may suggest a closer connection between the concepts of equity and collateral than is the case, but the confusion surrounding the interplay of these topics is genuine, and found among lending officials both inside and outside DCI.

DCI plans to review and refine the definition of equity in 25 CFR § 103.44 when it is able to issue revised regulations. The effort will hopefully create sufficient clarity on the topic such that no definition of “collateral” will be necessary. (There is no definition of collateral in current Program regulations, and except for occasional confusion associated with the tougher concept of equity, none should be necessary.) But in the shorter term, OMB is having DCI write new, comprehensive policies and procedures, and it is in this effort DCI plans to issue clarifications answering Recommendation 4.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: August 1, 2018.

Recommendation 5.

Have the Solicitor review the guidance to ensure it is in compliance with the collateral and equity sections of the loan guarantee rule.

Response. DCI concurs with Recommendation 5.

DCI will seek whatever guidance and approval SOL is able to offer.

Responsible party(ies): David Johnson, Acting Chief, DCI
John Hay, SOL
Andrew Caulum, SOL

Target Date: August 1, 2018.

Recommendation 6.

Develop and implement a process where the credit committee declines to review incomplete applications.

Response. DCI concurs with Recommendation 6.

DCI has tasked its Collections Coordinator, Sherrie Miller, with scheduling credit committee meetings, with specific instructions not to do so until she is certain all the prerequisites to application consideration have been met and documented. This procedure is already in place, and will be memorialized in our forthcoming policies and procedures manual.

Responsible party(ies): David Johnson, Acting Chief, DCI
Sherrie Miller, Collections Coordinator, DCI

Target Date: Done.

Recommendation 7.

Require the DCI chief to document justifications for disagreeing with the credit committee's recommendations for a loan guarantee application.

Response. DCI concurs with Recommendation 7.

DCI has now adopted the policy of fully documenting any future disagreements with credit committee's recommendations in order to justify a different determination by the deciding official. The policies and procedures manual we are preparing for OMB will address this topic, too. To the extent Recommendation 7 requires documenting the Acting Chief's past rejection of two cited credit committee recommendations, the first concerns the [REDACTED] loan to [REDACTED], but the Acting Chief will need clarification as to which loan guarantee the Report

mentions as the second instance. Pending identification of that matter, documentation of the Acting Chief's rationale can occur shortly after commencement of fiscal year 2018.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: November 30, 2017.

Recommendation 8.

Review instances where the DCI chief's determination differs from the credit committee's decision, and make the final determination on approving or disapproving the loan application.

Response. DCI concurs with Recommendation 8.

All future disagreements with the credit committee's recommendations will be spelled out, and depending on who has authority to commit the Program, any disagreements will be clearly presented and decided at that level pursuant to the procedure articulated in the forthcoming policies and procedures manual we are preparing for OMB.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target Date: August 1, 2018.

Recommendation 9.

Redesign functions to segregate duties of staff, including when delegating authority to staff, and update position descriptions as necessary. If unable to segregate duties due to staffing size, then mitigating controls should be established.

Response. DCI concurs with recommendation 9.

DCI has already re-designed the various functions of its small staff to more clearly delineate specified tasks under the headings of Zone Manager, Zone Assistant, Reporting Officer, and Collections Coordinator. In this manner, decisions concerning the approval of loan guarantees are separated from actions taken to collect loans that have gone bad, and both of those functions are separated from the duties of persons who track Program statistics and report them to internal and external oversight performed by Treasury, OMB, and others. DCI has also reinstated the regular use of a credit committee, which would have provided a check on the one large loan approval noted in the Report as an example of poor separation of duties. Note also that AS-IA's Loan Accounting Section (LAS) performs the actual movement of Program money in FBMS, including the payment of claims, collection of premiums, and application of debt recoveries. As part of a separate office within AS-IA, its actions are not under the control of DCI.

In seeking any further separation of duties, DCI must live with inherent limits presented by its staffing level. It is currently delivering the Program with the smallest staff ever – less than half of what the Bureau of Indian Affairs is believed to have had to prior to the Program being aligned under AS-IA's Office of Indian Energy and Economic Development (IEED). DCI position descriptions therefore must overlap, to allow for continuity in the event of further attrition, prolonged illness, or details. But to the maximum extent possible, DCI will revise its EPAPs and SEPAPs to further narrow the scope of specified

duties expected of personnel within a given fiscal year, thereby addressing OIG's recommendation. Much of the Program promotional work has already been given to a designated IEED official. Application review and recommendation is already provided by Zone Managers and Zone Assistants. The function of monitoring existing loans is currently shared between Zone officials, Reporting Officers, and LAS. Loan modifications are considered and recommended at the Zone level, then determined (as OMB has requested) at the level of DCI's Chief. Collections are handled by our Collections Coordinator, in conjunction with input from the DCI Chief, SOL, the Department of Justice, and Treasury. EPAPs and SEPAPs can be fashioned to clarify these roles, eliminating references to functions not actually expected of individual officials during the current fiscal year.

Policies and procedures locking these current practices into place are being developed, as requested by OMB. Most if not all of these topics are expected to be finalized by approximately August, 2018. DCI also expects that LMS, when complete, will provide greater transparency concerning Program decision-making, providing new tools for tracking accountability. LMS is expected to come online as early as the end of this calendar year.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target date: EPAP/SEPAP modifications by November 30, 2017; policies and procedures by August 1, 2018.

Recommendation 10.

Implement a tracking process to ensure that loan guarantee conditions, including quarterly reporting, are monitored regularly.

Response. DCI concurs with Recommendation 10.

Tracking the progress of existing loans guaranteed or insured under the Program, for instance by assuring receipt of quarterly history reports, is currently complicated by staff shortages and a lack of Program software. Program guarantees and insurance can cover loans with terms as long as 30 years, meaning that current staff must monitor Program commitments made by other Department officials, sometimes many years before DCI took over responsibility. DCI is in the process of securing new software to simplify this task, and that is expected to vastly improve DCI's capacity to keep up with this need.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target date: March 31, 2018

Recommendation 11.

Conduct an A-129 strategic program review within the current fiscal year, and conduct a review every 2 years or under such other timeframe as approved by OMB.

Response. DCI concurs with Recommendation 11.

DCI has solicited bids for an A-129 review, and is currently considering three proposals it has received in response. Assuming one of these is adequate to properly fill the need, we will have a kick-off meeting for the selected contractor on or before September 25, 2017.

DCI notes with interest that A-129 review compliance appears to be rare. Extensive inquiry among Department offices and other agencies has turned up very few examples of any sincere effort by other Federal organizations to meet this requirement. Even much larger organizations appear either never to have conducted a proper A-129 review, or else performed a review significantly reduced in scope to meet perceived financial, staffing, or time restrictions. DCI will nonetheless pursue compliance as directed.

DCI also notes that it had a review conducted in 2014-2015 by the Department's Office of Policy Analysis (OPA), which the Department pursued in lieu of an A-129 review at a time DCI was just about to solicit an outside A-129 review. Department officials at the time instructed DCI to terminate its solicitation of an outside review, to avoid the possibility of inconsistent conclusions when compared with OPA's review. OPA's review was briefed to OMB, but its written report was never finalized due to serious concerns about it.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target date: December 31, 2017.

Recommendation 12.

Modify the performance measure to mitigate the incentive (to rush application reviews, sacrificing quality for quantity).

Response. DCI concurs with Recommendation 12.

DCI is in the process of evolving SEPAP and EPAP performance measures to further separate functions and responsibilities, heighten accountability, and allow for more objective year-end grading. Recommendation 12 has already been addressed to some extent in FY 2017 EPAPs and SEPAPs. With the benefit of OIG's Report, these standards will receive further refinement in the FY 2018 versions of these documents.

Responsible party(ies): David Johnson, Acting Chief, DCI

Target date: November 30, 2017.

Recommendation 13.

Work with the Office of the Solicitor to clarify DCI's authority and update the Program regulations.

Response. DCI concurs with Recommendation 13.

DCI has already consulted with SOL to learn who now has authority to sign Program commitments. DCI has also engaged in preliminary discussions about how best to restore signature authority to the level of DCI, and how to ratify 67 outstanding, unenforceable IFA commitments issued while DCI was unaware of the May 5, 2015 changes made to 110 DM 8. We are awaiting confirmation that our proposed

Secretarial Order (concerning a new delegation of authority) and ratification procedures (to be followed for each of the 67 unenforceable commitments) are acceptable, or if not, what should take their place.

DCI also has revised regulations written and prepared for renewed Department scrutiny, tribal consultation, OMB critique, public comment, refinement and finalization. Staff and work levels, including administrative distractions, are the only impediments to pursuing this task.

Responsible party(ies): David Johnson, Acting Chief, DCI
John Hay, SOL
Andrew Caulum, SOL
Tim Murphy, SOL

Target date: March 31, 2018 for re-delegation of authority and commitment ratifications.