



UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL  
Washington D.C. 20250



**MEMORANDUM FOR THE SECRETARY**

FROM: Phyllis K. Fong [original signed August 30, 2004]  
Inspector General

SUBJECT: Management Challenges

The Reports Consolidation Act of 2000 requires the Department of Agriculture (USDA), Office of Inspector General (OIG) to identify and report annually the most serious management challenges the Department and its agencies face. Overall, OIG has identified 10 Department-wide and 2 agency-specific challenges we believe are the most significant management issues facing USDA.

To identify these management challenges, we (1) examined previously issued audit reports where corrective actions have not been implemented, (2) assessed ongoing audit and investigative work to identify issues where significant vulnerabilities have been identified, and (3) analyzed new programs and activities, which could pose significant challenges due to their breadth and complexity. We discussed these challenges with USDA officials to obtain their input.

This year, we have again summarized USDA's most serious management challenges by issue area, rather than by mission. USDA's major management challenges frequently cross organizational lines within the Department and should be dealt with on a coordinated basis. While progress has been made in each challenge facing USDA, more can be done to strengthen management controls, ensure USDA benefits go to those intended, and protect the integrity of USDA's programs and activities. We have removed the implementation of the 2002 Farm Bill from our challenge list. Over the approximately 2 years since the 2002 Farm Bill was signed, we have been monitoring the Department's implementation of the Bill and, based on these efforts, have concluded that the Department has made significant progress in implementing many of the provisions of the Bill. However, we have added a new challenge to better coordinate the development and implementation of a program integration process where common information is shared by agencies in the course of administering their programs.

While the Department has set in motion actions to address these challenges, OIG audits and investigations have shown that additional actions are necessary. We look forward to working with the Department to evaluate actions taken to address these issues and will make recommendations, where necessary, for further improvements.

If you have any questions or would like to discuss these management challenges, please contact me at 720-8001, or have a member of your staff contact Robert W. Young, Assistant Inspector General for Audit, at 720-6945.

Attachment

cc:  
Deputy Secretary  
Secretary's Subcabinet  
Chief Financial Officer  
Agency Administrators

**OFFICE OF INSPECTOR GENERAL  
MAJOR USDA MANAGEMENT CHALLENGES  
(August 2004)**

**DEPARTMENT-WIDE CHALLENGES**

1. Homeland Security Considerations Should be Incorporated Into Program Design and Implementation
2. Increased Oversight and Monitoring of Food Safety Inspection Systems Are Needed
3. Risk Must be Examined and Improper Payments Minimized Within USDA
4. Financial Management – Improvements Made but Additional Actions Still Needed
5. Information Technology Security – Much Accomplished, More Needed
6. Controls Over Germplasm Storage Material and Genetically Engineered Organism Field Testing Are Critical to U.S. Markets
7. Civil Rights Complaints Processing Still a Concern at USDA
8. Research Misconduct Policy Not Consistently Implemented
9. Agencies Need to Better Coordinate Program Delivery and Control – *New Challenge*
10. Integrity of the Federal Crop Insurance Programs Must be Strengthened Through Improved Quality Control Systems and IT Processing

**AGENCY-SPECIFIC CHALLENGES**

11. A Strong Internal Control Structure is Paramount to the Delivery of Forest Service Programs
12. Improvements and Safeguards Needed for the Rural Multi-Family Housing Program

**OFFICE OF INSPECTOR GENERAL  
MAJOR USDA MANAGEMENT CHALLENGES  
(August 2004)**

**DEPARTMENT-WIDE CHALLENGES**

**CHALLENGE:       HOMELAND SECURITY CONSIDERATIONS SHOULD BE  
INCORPORATED INTO PROGRAM DESIGN AND  
IMPLEMENTATION**

**DETAILS:** The events of September 11, 2001, and subsequent heightened concern about potential terrorist attacks and threats have added a new dimension to the Department's missions and priorities. At issue are USDA's missions to ensure the safety and abundance of the Nation's food supply, from the farm to the table, and to protect the health of American agriculture from the introduction of foreign animal and plant pests and diseases. With renewed urgency, USDA must identify its assets, thorough security risk assessments, and establish appropriate safeguards to prevent or deter deliberate acts to contaminate the food supply, disrupt or destroy American agriculture, or harm U.S. citizens. At the same time, USDA and the Department of Homeland Security (DHS) must also ensure that the current inspection and safeguard processes for the unintentional introduction of pests, diseases, and contaminants on imported products are not overlooked. While the Department has been both proactive and responsive to specific vulnerabilities identified by OIG, it faces ongoing and future challenges in its efforts to shift from a focus on safety goals to both safety and security in each of its mission areas; foster effective coordination and communication across jurisdictional lines to better define roles and responsibilities; and increase Departmental oversight of, and accountability by, USDA agencies. In response to such vulnerabilities, the Department has participated in or implemented a number of initiatives, such as the National Animal and Plant Health Laboratory Networks and the National Interagency Incident Management System.

Coordination and communication across not only USDA agencies but across the Federal departments and State and local entities is critical if Homeland Security Presidential Directive 9 (HSPD-9) is to be effectively implemented. Issued on January 30, 2004, HSPD-9 established a comprehensive national policy to defend the agriculture and food system against terrorist attack, major disasters, and other emergencies. With DHS as the lead Federal agency, HSPD-9 prescribed USDA, the Department of Health and Human Services (HHS), the Environmental Protection Agency, and the Attorney General to develop and implement systems and networks in the following areas: awareness and warning, vulnerability assessments, mitigation strategies, and response planning and recovery. For example, USDA working with these agencies needs to develop a coordinated agriculture and food-specific standardized response plan integration into the National Response Plan and a National Veterinary Stockpile.

**OIG AUDIT/INVESTIGATION ACTIONS:** In our review of Homeland Security issues for USDA commodity inventories, OIG found that the Farm Service Agency (FSA) needs to conduct vulnerability and risk assessments to determine the appropriate levels of protection for these agricultural commodities, and that FSA needs to formulate clear directions on food safety and security over commodities that it manages, handles, transports, stores, and distributes.

OIG audits conducted prior to the transfer of inspection duties to DHS disclosed serious control weaknesses involving inspection activities at the borders or ports of entry for agriculture and other food products.

We recently initiated a review to evaluate the Department's coordination and memorandum of agreement (MOA) with DHS to implement effective control systems to ensure the safety and security of agriculture and food crops entering the country. We also plan to start in the near future a review evaluating the Department's role and coordination with other Federal departments in implementing the provisions of the Public Health Security and Bioterrorism Preparedness and Response Act of 2002.

Recently, the Government Accountability Office (GAO) provided in testimony an overview of the potential vulnerabilities of the food supply and agriculture sector to deliberate contamination. In its testimony, GAO referred to four recent GAO reports that identified problems with Federal oversight over the Nation's agriculture and food supply. Problems in several of these reports overlap with the specific issues included in the above-cited OIG reports. For example, GAO found that (1) border inspection controls needed to be strengthened by providing adequate guidance to border inspectors for foot-and-mouth disease detection and prevention and (2) inspection resources could not handle the magnitude of international passengers and cargo. In another report, GAO found that Federal overseers did not have clear authority to impose requirements on food processors to ensure secure facilities. GAO recommended that both HHS and USDA study and identify what additional authorities they need with respect to ensuring security at these food-processing facilities.

In addition, OIG investigations continue to uncover illegal smuggling of plant and animal products that may threaten American agriculture by introducing foreign pests and diseases. OIG agents cooperate with USDA agencies and other law enforcement agencies on all levels to pursue leads into possible threats to American agriculture and the American food supply.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** HSPD-9 specifically directed USDA, HHS, and DHS to expand and continue vulnerability assessments of the agriculture and food sectors, and to develop mitigation strategies to reduce vulnerable critical nodes of food production or processing. In our review of Homeland Security issues for USDA commodity inventories, we recommended that FSA work with the Department's Homeland Security Office to conduct vulnerability or risk assessments of its agricultural commodity and inventory operations and related programs. We also recommended that FSA, in collaboration with the Food and Drug Administration and Department's Homeland Security Office, establish and implement measures to mitigate these vulnerabilities.

HSPD-9 also called for USDA, HHS, and DHS to build on their existing efforts to expand development of common screening and inspection procedures for agriculture and food items entering the United States. In March 2003 there was a significant transfer of responsibilities and personnel from USDA to DHS. A major challenge now faced by USDA is timely and effective coordination and communication, not only within USDA, but also with DHS.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** In response to our review of Homeland Security issues pertaining to USDA commodity inventories, FSA generally agreed with our recommendations and agreed to work with USDA's Office of Homeland Security to complete risk and vulnerability assessments and to develop appropriate guidelines and procedures. Further emphasis is needed to ensure timely implementation of these measures.

The Animal and Plant Health Inspection Service (APHIS) generally agreed with the recommendations OIG made on safeguards to prevent the entry of prohibited animal and plant diseases and pests and has taken, or is in the process of taking, corrective actions for those functions remaining in USDA. The inspection function at borders and ports of entry was transferred to DHS, while APHIS retained functions such as quarantine, risk analysis, destruction and reexportation, user fees, and adjudication of violations. USDA entered into a MOA with DHS to address how the Departments will coordinate. Individual appendices have or are being written to address issues such as training and transfer of funds; functions and employees transferred to DHS; and regulations, policies and procedures. Appendices for training, policy development, and communication have not been finalized.

**CHALLENGE: INCREASED OVERSIGHT AND MONITORING OF FOOD SAFETY INSPECTION SYSTEMS ARE NEEDED**

**DETAILS:** In response to prior OIG audits and known problems, the Food Safety and Inspection Service (FSIS) has issued directives to address specific weaknesses and to clarify existing policies, and has provided training to inspectors. However, FSIS still faces a significant challenge to: (1) ensure that plants and FSIS effectively fulfill their responsibilities under the Hazard Analysis and Critical Control Point (HACCP) system, (2) improve controls over the recall process, and (3) complete an in-depth assessment of the organizational and control structure involving the imported meat and poultry process. OIG considers this a management challenge because of the risk to the public's health should adulterated meat and poultry products be permitted to enter the food supply. Key to addressing this challenge is establishing an ongoing management control structure to know how well directives and policies are being implemented and carried out by plants and inspectors, and whether problems are promptly addressed as they become known.

**OIG AUDIT/INVESTIGATION ACTIONS:** In 1998, the Department, through FSIS, implemented a major change to its food safety system and created a new regulatory system for meat and poultry plants it regulates. The Pathogen Reduction and HACCP rule is the centerpiece of the new regulatory approach because it mandates HACCP, sets certain food safety performance standards, establishes testing programs to ensure those standards are met, and assigns new tasks to inspectors to enable them to ensure regulatory performance standards are met. In 2000, OIG reported on FSIS's implementation of HACCP, concluding that while FSIS had taken positive steps in its implementation of the science-based HACCP system, HACCP plans were not always complete; FSIS needed to place greater emphasis on pathogen testing; and it needed to define its oversight role in the HACCP system and hold plants accountable for noncompliance.

During 2002, USDA experienced some of the largest recalls in its history. OIG's reviews of two of these recalls in the past year indicate that FSIS still faces significant challenges to ensure that plants and FSIS effectively fulfill their responsibilities under HACCP. Most critical to this process are FSIS's assessment of plant HACCP plans and resolution of any deficiencies; establishment of management controls to accumulate and analyze data to monitor and assess the adequacy of food safety systems; establishment of criteria to initiate enforcement actions; baseline studies to define the goals, objectives, and performance measurements for pathogen testing programs; and better supervision and oversight of field inspection processes. Also, FSIS must reassess its recall process, including traceback policies, to identify the product source, and improve monitoring to ensure timely notification of the recall and maximum recovery of the product. Further, FSIS needs to implement controls to ensure that it adequately supports its conclusion regarding future recalls. Finally, FSIS needs to implement a process for selecting customers for effectiveness checks and establish timeframes for completing and reviewing the effectiveness checks. While FSIS has generally been responsive to these issues and has made some changes to its inspection policies and procedures, corrective actions are ongoing.

OIG's investigations continue to identify some unscrupulous plant operators and others who work in the meat and poultry industry that place profit or other motives ahead of public safety and knowingly introduce adulterated meat and poultry into the Nation's food supply. Gathering evidence necessary to bring these individuals to justice is paramount for protecting public health and safety.

An additional challenge for FSIS is to complete its proposed actions in response to OIG's prior audit of the imported meat and inspection process. OIG's followup review reinforced the need for FSIS to revise its in-depth assessment of its organizational structure and establish a system of control objectives and processes to ensure the goals of the import inspection process are achieved.

GAO has also issued a number of reports in 2001 and 2002 concerning food safety in general, because three Federal departments have responsibility for inspection activities depending on the type of food, and specifically concerning FSIS's HACCP system. GAO, in its January 2003, report on "Major Management Challenges and Program Risks, Department of Agriculture" reported "Enhancing the Safety of the Nation's Food Supply" as a management challenge facing USDA. While the challenge was seen as extending beyond FSIS' jurisdiction, because of the fragmented nature of the food safety regulatory system, it noted problems in the effective implementation of FSIS's HACCP system as a challenge specifically for USDA.

**BSE – An Emerging Issue:** With the discovery of a BSE-infected cow in Washington State in December 2003, the Department faces another challenge in food safety, as well as the related impact on the health of the U.S. cattle population. OIG recently completed audit and investigative reviews focusing on the BSE surveillance program's purposes, objectives, policies, procedures, and related management controls. During the audit we found the following challenges in identifying, obtaining, and testing cattle in the high-risk population: cattle condemned at slaughter were not always tested for BSE; there was no formal process for testing rabies-negative samples for BSE; a process for obtaining samples from animals that "died on the farm" has not been developed; and confusion may arise regarding non-standardized age requirements for BSE.

Our investigation of the BSE-positive cow in Washington State did reveal procedural errors and inconsistent descriptions that gave rise to some of the public concerns that the identification of the BSE-positive cow may have been mishandled. We also investigated the cow identified as having Central Nervous System (CNS) symptoms by an FSIS veterinarian in Texas that was not tested for BSE after it had been slaughtered. Evidence shows that at the time of this incident, communication problems occurred between the APHIS and FSIS employees involved. Taken together, the statements of both APHIS and FSIS personnel and other evidence indicate inconsistencies in their understanding of procedures for BSE tissue sampling of CNS suspect cattle in certain circumstances, and the handling of the carcass pending test results.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** FSIS needs to identify management controls for all levels of the organization in monitoring HACCP, improving recall activities, and completing an in-depth assessment of the organizational and control structure over the imported meat and poultry process. FSIS has issued new or updated directives, which will provide enhancements; however, the directives have not always been responsive to specific OIG recommendations or provided enough detail for OIG to determine what will actually be implemented.

For BSE, the Department needs to have a supportable methodology for assessing the effectiveness of its overall surveillance program. A supportable methodology is essential to provide credibility for any USDA assertion regarding the prevalence of BSE in the United States. Also, performance measures and continuous risk analyses are needed to better target limited resources and assess whether all program participants are fulfilling their respective roles and responsibilities.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** FSIS has addressed some of the *e. coli*-related OIG recommendations with the updating of Directive 10.010.1, Microbial Testing Program for *Escherichia Coli* O157:H7 in Raw Ground Beef. The Centers for Disease Control and Prevention, in its annual report on the incidence of infections from foodborne pathogens, noted significant declines from 1996 to 2003 in illnesses caused by *E. coli* O157:H7 (42 percent), Salmonella (17 percent) Campylobacter (28 percent) and Yesinia (49 percent). Between 2002 and 2003, illnesses caused by *E. coli* O157:H7, typically associated with ground beef, dropped by 36 percent. However, other *e. coli*-related issues including defining the goals, objectives, and methods of testing remain to be addressed. Training has been provided to inspectors through the new Food Safety Regulatory Essentials curriculum, with emphasis on inspectors' assignments. Training has also been provided to compliance and consumer safety officers. FSIS has revised the handbook on verifying an establishment's food safety system and recently reissued Directive 8080.1, Recall of Meat and Poultry Products.

USDA began its enhanced BSE surveillance program June 1, 2004. In addition to expanding the numbers of cattle to be tested, USDA is providing comprehensive training on USDA BSE sampling collection protocols to APHIS and FSIS employees, State veterinarians, accredited veterinarians, and participating veterinary technicians. USDA has planned to evaluate the program's effectiveness, periodically analyze data to determine if mid-course corrections are warranted, and has arranged with the Agricultural Marketing Service to perform quality assurance reviews.



**CHALLENGE: RISK MUST BE EXAMINED AND IMPROPER PAYMENTS MINIMIZED WITHIN USDA**

**DETAILS:** The Federal Government faces a major challenge in implementing the Improper Payments Information Act of 2002. The Act requires agency heads to annually review all programs and activities that they administer, identify those that may be susceptible to significant improper payments, and estimate the annual amount of the improper payments. If the estimate exceeds \$10 million, agencies are to report the causes of the improper payments and corrective actions taken. OIG considers this to be a major challenge because of the number and complexity of USDA programs and activities which fulfill the Act's criteria. The methodology to be employed to identify improper payments consists of a detailed risk assessment of programs' internal controls, a highly complex undertaking. The degree of the challenge is further heightened because reporting is due in the Department's September 30, 2004, Report on Performance and Accountability (PAR). The impact of the challenge cannot yet be forecast but the Office of Management and Budget (OMB) has estimated improper payments of about \$35 billion, an amount widely viewed as understated, Governmentwide. To varying degrees, all of USDA's outlays of over \$112 billion in FY 2003 were vulnerable to being improperly paid.

**OIG AUDIT/INVESTIGATION ACTIONS:** OIG audits frequently include the objective of evaluating the propriety of the use of agency funds, thus effectively testing for improper payments. For example, prior audits reported that \$285 million in Rural Rental Housing loans and \$287 million in associated interest credit payments would not have been made over a 3-year period, had the loan making criteria not been lax. In addition, previous audits found 16 sponsors in the Child and Adult Care Food Program, who received almost \$35 million annually, had misdirected Federal funds to such an extent that they were eventually terminated from the program. In another audit, we found that the controls were so weak over investments made by the Alternative Agricultural Research and Commercialization Corporation that the great majority of its \$27 million portfolio was at risk. In response to our audit, Congress eliminated the program in its entirety. OIG recently reviewed the Food and Nutrition Service's (FNS) action to implement the Improper Payments Information Act and previous OMB-directed budget statements and is concerned that FNS will not be able to report improper payment information in the FY 2004 PAR for any of its major programs, other than the Food Stamp Program (FSP). We have recommended that FNS develop benchmarks that can be used in these programs until improper payments can be reported. While FNS has obtained funding and has initiated efforts to obtain benchmark information on improper payments for the National School Lunch (NSLP) and School Breakfast (SBP) Programs and the Special Supplemental Food Program for Women, Infants, and Children (WIC), the agency will not be reporting information from these studies before FY 2007. Further, we are currently reviewing the implementation of the Department's guidance by four other agencies. We anticipate expanding our coverage in this area during FY 2005.

OIG investigations have identified millions of dollars of benefits obtained fraudulently in some of the Department's largest programs, including FSP, crop insurance, and FSA loan programs. From FY 1999 through the first half of FY 2004, OIG investigations revealed total monetary results of \$493 million, of which \$250 million was restitution ordered by courts to repay the amount of losses directly due to criminal activity. The focus of investigations is on specific subjects and specific allegations of criminal violations, and generally the results achieved in individual investigations pertain directly to individuals, rather than identifying broad agency-wide problems in benefit delivery. However, investigative findings can help identify problem areas, such as common schemes used to obtain undeserved payments, and can assist in other ways as well. For example, building on analytical tools developed to identify suspicious patterns of activity in food stamp electronic benefit transfer investigations, FNS now routinely disqualifies retailers based on electronic benefit redemption data that evidences fraud, thus stopping the misuse of food stamp benefits by certain authorized retailers far more quickly than would have been possible in the past.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** USDA agencies need to aggressively implement the requirements of the law and OMB's related direction. An analysis of the internal control structure of all major programs must be performed, weaknesses which could create vulnerabilities to improper payments need to be identified, and remediation plans developed.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** The Office of the Chief Financial Officer has published guidance to the individual agencies on how to implement the Improper Payments Information Act. In addition, FNS has been reporting the status of its improper payments identification and reduction efforts in the FSP, NSLP, SBP, and WIC Programs, as has FSA, in the Commodity Loan Program, pursuant to OMB requirements. With the exception of the FSP, however, the information reported to date has been limited because, per the agencies, funding to support these initiatives has been lacking.

**CHALLENGE: FINANCIAL MANAGEMENT – IMPROVEMENTS MADE BUT ADDITIONAL ACTIONS STILL NEEDED**

**DETAILS:** The Department has made significant improvements, culminating in two consecutive unqualified audit opinions on its financial statements; however, the adequacy of Forest Service’s financial management processes remains a particular concern. Errors disclosed subsequent to the release of the fiscal year (FY) 2002 financial statements required their restatement. In addition, extraordinary efforts were required to correct significant deficiencies in the agency’s FY 2003 financial statements after the fiscal year but before the issuance of the statements. OIG considers this to be a major challenge because of the number and extent of material internal control weaknesses still resident in the Forest Service’s financial management systems, the extent and complexity of the undertaking to remediate them, and the impact of the accelerated timeframe for the issuance of the FY 2004 statements. In addition, the Commodity Credit Corporation (CCC) needs to improve its ability to fully monitor, control, and report budgetary resources for all of its programs. Inadequate financial management processes can have a pervasive effect on agency operations, to include impaired service, reduced effectiveness and efficiency, and unreliable decision making.

**OIG AUDIT/INVESTIGATION ACTIONS:** OIG’S prior audits, and those more recently performed by certified public accounting (CPA) firms with OIG’s monitoring, have disclosed weaknesses which have affected the accuracy of the Department’s financial management data. In addition, GAO has continually reported the Forest Service’s financial management systems to be high risk. The FY 2004 audit will be performed by CPA firms of selected individual agencies (to include the Forest Service) with OIG’s oversight. OIG will perform audits of FNS, Rural Development, and the Department as a whole (the consolidated audit).

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** The Department, specifically the Forest Service and CCC, needs to establish financial management systems and processes, including a reliable system of controls, which will generate reliable and timely financial data.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** The Forest Service, with the Department’s assistance and guidance, has developed an extensive “Financial Management Improvement Plan” for the purpose of sustaining an unqualified audit opinion and building a highly reliable and cost effective financial management organization. The plan contains immediate, short-term, and long-term actions to address and rectify the longstanding weaknesses. Among the long-term actions is the initiative to centralize financial management operations. Although these actions are much needed in that they should significantly strengthen internal controls, timely completion of the plan will be difficult in that its implementation will require a complete revamping of the agency’s operations and even the agency’s culture.

**CHALLENGE: INFORMATION TECHNOLOGY SECURITY – MUCH ACCOMPLISHED, MORE NEEDED**

**DETAILS:** USDA depends on information technology (IT) to efficiently and effectively deliver its programs and provide meaningful and reliable financial reporting. One of the most significant dangers USDA faces is a cyber attack on its IT infrastructure, whether by terrorists seeking to destroy unique databases, criminals seeking economic gain, or disgruntled internal staff members. OIG considers this to be a major challenge because of the extraordinary risk incumbent in the Department's automated data systems, expressed in terms of billions of dollars in payments flowing through them, the untold disruption which could occur in the world's financial and agricultural markets, and the potential negative impact on the health and safety of the world's population.

**OIG AUDIT/INVESTIGATION ACTIONS:** OIG has had an extensive IT security audit program in place for several years which has enabled us to provide coverage to virtually every agency in the Department. Our audits have found that despite strong guidance provided by the Office of the Chief Information Officer (OCIO), agency implementation of IT security requirements has been inadequate. These material weaknesses stem from lack of compliance with OMB Circular A-130 provisions such as the development of security plans, the performance of risk assessments, the preparation of disaster recovery plans, the completion of security awareness training, and the performance of system certification and accreditation plans. In addition, our annual audits of general controls at the National Finance Center (NFC) and National Information Technology Center (NITC) have disclosed security weaknesses which could jeopardize the confidentiality, integrity, and availability of the data the Centers process. OIG is currently evaluating controls over selected agency application systems, which are the methods and measures that ensure that individual automated systems process data as intended. In addition, we plan to followup at several agencies to assess their progress implementing IT security, and conduct our annual audits of NFC and NITC.

On the investigative side, OIG established in 1987 a Computer Forensics Unit (CFU) which was expanded in 2001 to include three computer specialists. These specialists are uniquely trained to detect high-tech criminal activity, collect and analyze digital evidence, and preserve it for use in court. The computer specialists are on call at all times and prepared to travel to any location in the country to provide computer support in criminal investigations. Additionally, we plan to expand the CFU's responsibility in order to provide USDA agencies' forensics units with support, training, and advice on evidence collection and analysis.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** USDA agencies need to aggressively implement IT security requirements to reduce the level of vulnerability. Plans, assessments, and controls need to be performed and/or established as required.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** OCIO has worked diligently to facilitate and assist the agencies to achieve conformance with security mandates. Significantly, OCIO created a framework to contract for the certification and accreditation of

application and general support systems by fiscal 2004 year end. The majority of the systems are currently under review and most of the reviews should be completed by fiscal year end. The certification and accreditation process should address the preponderance of the IT security weaknesses identified. Further, OCIO has taken action to become actively involved in the budget process to ensure, among other initiatives, that cyber security and the Federal Information Security Management Act requirements are addressed in IT acquisitions. We view these as extremely positive steps to reduce the challenges ahead.

**CHALLENGE: CONTROLS OVER GERMPLASM STORAGE MATERIAL AND GENETICALLY ENGINEERED ORGANISM FIELD TESTING ARE CRITICAL TO U.S. MARKETS**

**DETAILS:** The use of biotechnology-derived or genetically engineered crops has grown significantly over the past decade, particularly in the United States. In 2001, approximately 88 million acres of such crops were planted in the United States. For the 2004 crop year, as much as 86 percent of the planned 75.4 million acres of soybeans, approximately 46 percent of the planned 79 million acres of corn, and approximately 76 percent of the 14.4 million acres of cotton were planted with genetically engineered seeds; in total, approximately 112 million acres are planned or planted for such crops. These crops constitute a major portion of American exports of agricultural production. The acceptance of genetically engineered crops in the world market, however, is mixed. The loss of major export markets could seriously impact the American agricultural economy. Recently, the Food and Agriculture Organization of the United Nations issued a report supporting the benefits of genetically engineered crops: boosting yields; lowering costs; reducing pesticide use; and making crops more resistant to disease, pests, and drought.

USDA plays a major role in regulating and monitoring genetically engineered crops – from the storing of germplasm used to produce seeds for such crops, to approving field testing of genetically engineered crops, to monitoring the interstate shipment and import of these crops, to providing assistance for export of American agricultural production. The Department must balance the goals of (1) maintaining adequate accountability and integrity of genetically engineered versus non-genetically engineered seeds and crops, (2) ensuring the health and safety of the American food supply, and (3) maintaining the export levels of American agricultural production against the added costs to implement such controls and the uncertainty of the effects of genetically engineered crops. The integrity of the Department’s germplasm storage system is critical in responding to a major catastrophe or major infestation. As described in the recently issued HSPD-9, the Department’s germplasm storage system will be the primary source of genetic resources for re-building agriculture production in the event of a national or regional agricultural disaster.

**OIG AUDIT/INVESTIGATION ACTIONS:** In our recent review of the Department’s germplasm storage system, we found the need for and recommended increased accountability and tracking controls over genetically engineered germplasm if USDA is to provide assurance to other markets. Specifically, the Department needed to strengthen controls over the identification, shipment, inventory, and disposal of genetically engineered organisms (GEO).

In our ongoing review of the Department’s accountability and monitoring of field testing of genetically engineered crops, we evaluated the Department’s controls over issuance of GEO release notifications and permits. We found insufficient or inadequate controls over the complete process, from the initial applications for such notifications and permits through devitalization of the crops under the approved notifications and permits.

We are planning an audit to evaluate the Department's controls over genetically engineered food crops once in the American food process.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** In our review of the germplasm storage system, we recommended that the Department establish proper identification and documentation procedures for GEOs entering the germplasm storage system and routine physical inventory procedures for such storage facilities.

We are also making recommendations to the Department to strengthen the field-testing application process by developing a standard review guide for such applications and by requiring specific standards for field-testing and more detailed information from applicants. To adequately account for such field-testing, the Department needs to maintain an updated comprehensive inventory of approved field-testing and movement applications. Without strengthening these upfront controls, effective monitoring and oversight by the Department is hampered and there is less assurance that proper surveillance is in place to preclude such crops from entering the human food process. We are recommending that the Department strengthen its monitoring of field-testing by clearly defining line authority over the field inspectors, developing standard reviews, and providing consistent training to field inspectors. Our report will be issued in October 2004.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** In its response to our draft report, the Department generally agreed with the findings and stated that the affected agencies within the Department will be collaborating and coordinating to draft policy guidelines to address the issues at the Department level.

We have additional GEO audit work currently underway and more is planned for the coming year. To date, OIG and the Department have worked to craft meaningful recommendations which the Department has aggressively implemented. There is still much to be done in the GEO area. We anticipate our strong working relationship with the Department to continue through the completion of our GEO audit work.

**CHALLENGE: CIVIL RIGHTS COMPLAINTS PROCESSING STILL A CONCERN AT USDA**

**DETAILS:** Based on a series of audits, OIG recommended that the Office of Civil Rights (CR) implement a management plan that would address effective leadership, change the organizational culture, focus on customers, and reengineer its processes. While the plan has been developed, until it is fully implemented, timely resolution of civil rights complaints will remain a management challenge at USDA. OIG considers civil rights to be a management challenge because of the risk to program participants' and employees' rights, which could reduce the public's confidence in USDA's ability to administer and address civil rights activities.

**OIG AUDIT/INVESTIGATION ACTIONS:** From February 1997 through March 2000, OIG issued a series of audit reports dealing with CR's handling of program-related civil rights complaints and one audit report on employment civil rights complaints. In March 2000, OIG reported that minimal progress had been made in overcoming inefficiencies in processing civil rights program and employment complaints. Deficiencies reported in OIG's prior audit reports had not been corrected. The March 2000 report noted that CR did not reengineer its complaint resolution process, its database and file room remained poorly managed, and a large backlog of cases was stalled in the "intend-to-file" category and/or may not have received due care. Based on the conditions found, OIG recommended that CR develop a management plan that would address effective leadership, change organizational culture, focus on customers, and reengineer its processing of complaints.

In September 2002, GAO reported that the processing of program complaints continued to exceed required timeframes. Based on its report and those of OIG, GAO, in its January 2003 report entitled "Major Management Challenges and Program Risks, Department of Agriculture," cited that "...the resolution of discrimination complaints continues to be a serious management challenge at USDA."

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** Following the appointment of the Assistant Secretary for Civil Rights on April 1, 2003, management developed a set of 13 initiatives, one of which specifically addresses complaint processing. There are still eight recommendations from the prior audit reports that have not reached management decision. These concern such items as completing employment case file reviews and finalizing procedures on settlement of program cases and performance of agency civil rights evaluations.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** USDA has demonstrated the importance it places on civil rights when the first Assistant Secretary for Civil Rights was sworn into office in April 2003. There has also been progress in developing action plans and timeframes to implement previous OIG recommendations in that 88 of the 96 recommendations have reached management decision; many of the recommended actions, however, have not been fully implemented. The U.S. Commission on Civil Rights issued a report on June 12, 2003, evaluating the extent to which USDA and three other Departments have implemented the Commission's 1996 recommendations made in *Federal Title VI Enforcement to Ensure*



*Nondiscrimination in Federally Assisted Programs.* Overall the Commission found that the Department had not made significant strides to address the 1996 recommendations or improve civil rights enforcement. One of the Commission's conclusions was that while ensuring consistency in complaint processing, CR must reduce the backlog and shorten and accurately track the average processing time.

**CHALLENGE: RESEARCH MISCONDUCT POLICY NOT CONSISTENTLY IMPLEMENTED**

**DETAILS:** USDA plays a major role in U.S. agricultural research activities, expending over \$2 billion in FY 2003 for research to increase American agriculture production and to protect and treat American agricultural crops against foreign plants and animal pests and diseases. Research integrity is critical to the mission of USDA. In December 2000, the President's Office of Science and Technology Policy (OSTP) issued a Federal policy to establish uniformity among Federal agency definitions and treatment of research misconduct involving any federally funded research. OSTP defines research misconduct and establishes basic guidelines for conducting fair and timely investigations of alleged or suspected infractions. This Government-wide policy required Federal agencies to implement their individual research requirements, either by regulations or administrative mechanisms.

**OIG AUDIT/INVESTIGATION ACTIONS:** In our audit report on research misconduct, we noted that USDA has not implemented a coordinated Department-wide policy or procedure for the treatment of research misconduct; responsibility for implementing the Federal policy was delegated to each agency within USDA. We found that most USDA agencies have not implemented any research misconduct policies and procedures. In those agencies (including the Agricultural Research Service (ARS)) that had implemented a policy, procedures were inconsistent; for example, in the monitoring of research activities under extramural agreements, these agencies had disparate approaches. These agencies also relied primarily on in-house resources to review allegations of research misconduct. In the absence of consistent policies, USDA has no assurance that potential research misconduct involving USDA funds is being timely referred, independently adjudicated, and appropriately resolved, including determining whether criminal investigation is warranted. Also, one of our investigations uncovered research misconduct in USDA-funded research into a swine pneumonia vaccine by a graduate student who attempted to hide his misconduct by staging a laboratory break-in. The student has been sentenced to 10 months in prison and ordered to pay \$70,000 in restitution. The agency's administrative action is still pending. A consistent Department-wide policy on handling research misconduct would ensure that such matters are concluded appropriately.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** In order to ensure compliance and consistency across USDA, the Department needs a coordinated, Department-wide initiative and Department-wide policy and procedures.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** In USDA's 2003 Report on Performance and Accountability, the Department cited that ARS worked closely with OSTP in drafting the Federal policy and had updated in June 2003 the agency's policy to ensure compliance with Federal policy.

**CHALLENGE: AGENCIES NEED TO BETTER COORDINATE PROGRAM DELIVERY AND CONTROL – NEW CHALLENGE <sup>1</sup>**

**DETAILS:** USDA’s work crosses jurisdictional lines within the Department, most notably between the Risk Management Agency (RMA) and the Farm Service Agency (FSA) and FSA and the Natural Resources Conservation Service (NRCS) in the conduct of USDA’s crop insurance, crop disaster, and conservation programs. USDA’s challenge is to develop and implement a comprehensive program integration process whereby information is shared by USDA agencies in the course of administering the programs. Such information sharing will reduce duplication of information collection from program participants, will increase the utility of information collected from customers, and will increase the utility of information developed by the agencies through internal and external reviews, etc., thus streamlining operations, reducing expenditures, and improving program efficiency, compliance, and integrity. Although the Department has made some progress in adopting such an integrated approach to its programs, we have found much additional work remains to be done.

**OIG AUDIT/INVESTIGATION ACTIONS:** Participation in FSA’s 1998-2002 crop disaster programs was predicated on crop production data managed by RMA. The Agricultural Risk Protection Act of 2000 (ARPA), enacted in part to improve the efficiency and integrity of the Federal crop insurance program, requires RMA and FSA, beginning with the 2000 crop year, to annually reconcile data received by the agencies from producers. However, OIG’s reviews of the crop disaster programs and ARPA implementation have shown that such data sharing and data reconciliation efforts are hindered by the lack of common data standards and common program and data definitions. Differences in the definitions of “producer” versus “insured,” “farm” versus “unit,” and in the numbers of decimal places to which a percentage crop share is carried, for example, hamper data reconciliation as well as data sharing. To date RMA has been unable to satisfactorily complete the legislatively mandated data reconciliation for a single year, and FSA finds itself in many cases unable to use the data downloaded from RMA for the disaster programs.

Under the Wetlands Reserve Program (WRP) administered by NRCS, the law requires that the owners and operators of land subject to WRP easements agree to the permanent retirement of any existing cropland bases for such land under any USDA program. In our ongoing review of WRP we noted specifically that NRCS is not consistently coordinating with FSA to ensure such bases are permanently reduced (retired) for farm program purposes. As a result, in some cases USDA is both compensating the producers for the value of the base acres under WRP, and issuing farm program payments on the base acres to the producers under the farm programs.

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<sup>1</sup> Last year’s challenge, “USDA Faces Major Challenges in Implementing the 2002 Farm Bill and Disaster Assistance Legislation,” was removed from this year’s top challenges facing the Department. Over the approximately 2 years since the 2002 Farm Bill was signed, we have been monitoring the Department’s implementation of the Bill and, based on these efforts, have concluded that the Department has made significant progress in implementing many of the provisions of the Bill.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** Comprehensive program integration necessitates collaboration among the agencies. In order to implement a fully integrated program system, USDA must coordinate its programs at the Department level to identify information common to the agencies' programs and to create common data standards and definitions across the Department to enable sharing and re-use of such information. Moreover, the Department must foster an information-sharing environment so information collected or developed by one agency can be leveraged to enhance program efficiency, compliance, and integrity across other USDA programs.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** The Department has made progress in implementing the eGovernment initiative of USDA Enterprise Architecture, including developing a comprehensive implementation plan. With respect to databases, the Department has established a number of guidelines in this enterprise: data will be shared to provide new and/or enhanced services, when applicable, and USDA will strive to create common data standards across the enterprise. Common data standards will facilitate sharing, including compliance, and re-use of such user-provided information will cut integration and consolidation costs. In response to our report on the implementation of the ARPA provision, the Department stated that it had established an interagency task force to develop such common data standards. RMA and FSA are actively working on the Common Information Management System (CIMS) that was mandated in the 2002 legislation. CIMS will allow RMA, FSA, other USDA agencies, and insurance providers to share and report on common information that producers must report. Also, in response to GAO's report on electronic filing in USDA, the Department responded that it had assigned a Department-level official to oversee its Department-wide initiative and to develop a comprehensive plan for this effort. Many of these efforts have been geared to enhancing public use of and access to the Department's programs. However, the Department must also foster the integration and coordination of the common information to enhance program compliance and integrity across USDA programs and agencies. These efforts will also facilitate achieving compliance with the Improper Payments Information Act.

**CHALLENGE: INTEGRITY OF THE FEDERAL CROP INSURANCE PROGRAMS MUST BE STRENGTHENED THROUGH IMPROVED QUALITY CONTROL SYSTEMS AND IT PROCESSING**

**DETAILS:** The Federal crop insurance programs, administered by the Federal Crop Insurance Corporation (FCIC) in conjunction with RMA, have become American agricultural producers' primary "safety net." Over the years, as Congress mandated changes to the programs, the Federal crop insurance programs have grown significantly, particularly after the passage of the Agricultural Risk Protection Act (ARPA). Under ARPA, Congress encouraged participation by American agricultural producers by increasing the level of subsidized premiums. By crop year 2003, crop insurance coverage increased to 217 million acres with a total Government insurance liability of over \$40 billion. However, indemnity payments and subsidy reimbursements have also increased: for the 2003 crop year, indemnity payments totaled approximately \$3.2 billion, while the Government's subsidized share of the insurance premium totaled approximately \$2 billion. To ensure quality assurance and integrity in its programs, RMA relies on a number of complementary and/or independent control systems; these include quality control reviews (QCR) by the reinsured companies and compliance activities by its own staff.

In March 2002, we addressed RMA's continuing problems in implementing an effective and reliable QCR system capable of evaluating the private sector's delivery of Federal crop insurance. We recommended that a standard QCR system be established by regulation rather than through inclusion in the Standard Reinsurance Agreement (SRA), which is a negotiated document with the insurance companies. As part of the QCR system, we recommended that RMA define what constitutes an error and provide consistent and comprehensive review procedures for all reinsured companies. Such a QCR system would also provide RMA with the information needed to comply with the mandated improper payment requirements.

**OIG AUDIT/INVESTIGATION ACTIONS:** Our past audits have reported the need for RMA to strengthen its quality assurance and compliance activities to ensure compliance with program requirements. In our audit of the Department's implementation of ARPA, we found that RMA took the lead in performing the required data reconciliation for crop year 2001. However, this reconciliation was not completed, and data reconciliations for the following crop years have not been performed. We also found from our earlier audit of the QCR system that RMA had not ensured that QCRs conducted by the reinsured companies were being effectively and adequately performed. We are currently in the process of evaluating RMA's overall compliance activities. OIG investigators working jointly with RMA program investigators have found significant fraud in the Federal crop insurance program, which also indicates the need for an effective quality control system.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** To adequately address this management challenge, RMA needs to (1) continue its effort with FSA to develop a common information system to facilitate common data collection and usage by combining RMA and FSA data; (2) establish a consistent and comprehensive QCR process for all reinsured companies, including a system to evaluate the overall effectiveness and reliability of QCRs performed by the companies; (3) move the procedural requirements for the QCR process from the SRA to Federal regulations; (4) establish a statistical sampling plan that will provide an overall error rate that will improve compliance with improper payment legislation and help to evaluate reinsured company performance; and (5) establish an acceptable base line error rate to measure reinsured company performance for delivering and servicing insurance programs.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** Initially, RMA planned to contract with a private consultant group to develop a QCR system, which would be incorporated by regulation. However, RMA for the near term has opted to keep the QCR system as part of Appendix IV of the SRA, which RMA recently renegotiated with the reinsured companies. Although the QCR system in Appendix IV of the SRA appears to include improvements, we believe that the QCR system will result in many of the same weaknesses previously reported. Each reinsured company will submit its own QCR program, resulting, we believe, in inconsistent results. There is no requirement for a statistically valid sample review. As a result, RMA will not be able to determine an overall error for the Federal crop insurance program and will not be able to comply with the improper payment requirements.

We have also been informed that RMA intends to develop a random-sampling-of-claims plan for each company program review that will be conducted by RMA employees as a means to develop an overall program error rate. However, only a limited number of program reviews will be completed each year and the complete process will be staggered over several years. It also plans on developing standard performance and reporting procedures to be followed by the companies when performing required QCRs under the SRA. RMA has also started working with FSA to develop a common reporting system which RMA believes will eliminate the need for the required data reconciliation between RMA and FSA data. However, all this is a long-range plan and RMA does not have reasonable alternatives for the interim. For example, RMA officials have stated it does not have the resources to perform both a statistical sample review for improper payment purposes and the data reconciliation required by ARPA.

We have met with RMA officials to discuss and to provide our feedback to their proposed corrective actions. We informed them that we would need a formal response documenting their corrective actions; the document should include specific details of their corrective actions and a timetable for implementing the corrective actions.

## AGENCY-SPECIFIC CHALLENGES

**CHALLENGE:       A STRONG INTERNAL CONTROL STRUCTURE IS  
PARAMOUNT TO THE DELIVERY OF FOREST SERVICE  
PROGRAMS**

**DETAILS:** The Forest Service (FS) needs to continue to enhance and improve its system of internal controls to ensure the agency is accountable for the efficient and effective delivery of its programs. FS has the responsibility for providing leadership in the protection, management, and use of the Nation's grasslands and aquatic ecosystems on public and private lands. The National Forest System covers 191.8 million acres of forest, grass, and shrub lands. FS also cooperates with State and local governments and private landowners in the management of forest resources, and provides leadership in forest and rangeland research. The decentralized organizational structure of the agency makes it imperative that a well-defined system of controls be in place and effectively operating. Historically, audits have disclosed weaknesses in the agency's internal control systems. OIG and GAO audits have found that policies and procedures provided to field units through the FS directive system are inadequate to ensure programs are implemented in accordance with applicable laws and regulations. Additionally, the agency's internal review process has not provided the necessary feedback to agency managers regarding how its programs are being delivered to the public.

**OIG AUDIT/INVESTIGATION ACTIONS:** OIG and GAO audits and investigations have disclosed significant issues related to the weaknesses in FS's internal controls, including the agency's financial operations (see management challenge on financial management). Our recent audits of FS's implementation of the National Fire Plan found that controls were not adequate to ensure that funds were spent as intended. We found that funds designated for rehabilitation of areas destroyed by wildfires were not being spent in accordance with agency guidelines. We also found budget estimates provided by FS for the implementation of the fire plan did not accurately reflect all agency needs and therefore were understated. Our audit of the FS procurement of aircraft for its fire program disclosed that controls over the procurement process were not adequate to ensure the agency would acquire aircraft that would best meet its needs. Additionally, we found that the number of aircraft FS had proposed acquiring was not supported by mission requirements and was thus overstated. We made recommendations and FS concurred to change the acquisition procedures to ensure it acquired the aircraft that best meet its requirements and to reevaluate the number of aircraft it planned to acquire. We currently have audit work underway within the FS looking at internal controls concerning the fire safety program, contracting for equipment used in fire suppression activities, FS implementation of the Government Performance Result Act (GPRA) requirements, and FS use of collaborative ventures and partnerships. Each of these audits will focus on the controls related to these programs to determine if they are adequate and functioning as designed.

OIG is mandated by Public Law 107-203 to investigate any FS employee death related to wildland fire burnover or entrapment. Our Office of Investigations has ongoing work resulting from the 2003 Cramer Fire in Idaho. The investigation seeks to determine the cause of the fatalities and contributing factors and to determine if applicable FS regulations, policies, and procedures are appropriate and were followed by those involved in fighting the Cramer Fire.

In addition, GAO has completed a number of recent reviews that have identified internal control weaknesses as a significant problem for the agency. GAO reported the FS had made little progress implementing requirements under GPRA (GAO-03-503, released May 2003). GPRA is a primary internal control mechanism for measuring and reporting an agency's performance and progress towards its goals and objectives. According to GAO, the FS still does not have an internal control process to ensure the accurate, timely, and reliable reporting of its performance. GAO's review of FS's use of purchase cards identified weakness in the internal controls that left the agency vulnerable to improper, wasteful, and questionable purchases (GAO-03-786, released August 2003). In its review of Wildland Fire Management (GAO-03-35, released August 2003) GAO found there were not sufficient controls to ensure that lands were properly identified and prioritized for fuels reduction programs.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** FS needs to follow through on its plans to initiate improvements to its overall internal control structure. Two of the major activities they plan are an assessment of high-risk processes within the agency and strengthening of the agency's internal review process. FS has stated these actions are being implemented over a 2-year period and are scheduled for completion by the end of FY 2005. We believe that if FS completes these actions and effectively implements GPRA, the agency will have made significant progress in addressing this management challenge.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** FS responded in USDA's 2003 Report on Performance and Accountability that it planned to address its internal control weaknesses by conducting a risk assessment to determine the high-risk processes within the agency. FS also stated that it was planning on reaffirming its internal review process to ensure its effectiveness.



**CHALLENGE: IMPROVEMENTS AND SAFEGUARDS NEEDED FOR THE RURAL MULTI-FAMILY HOUSING PROGRAM**

**DETAILS:** The Rural Housing Service (RHS) faces several challenges in the management of its direct Multi-Family Housing (MFH) program. Substantial numbers of RHS's Rural Rental Housing (RRH) properties are over 20 years old. Our past audits have disclosed significant physical deterioration of projects that threaten the health and safety of rural residents. Our past audits have also reported the diversion or theft of millions of dollars of RRH project funds to non-project purposes (equity skimming). These conditions have persisted and have been reported as a material internal control weakness by RHS in the Federal Manager's Financial Integrity Act (FMFIA) since 1996. We are currently working with RHS to ensure that their proposed re-write and consolidation of a substantial portion of its regulations is sufficient to resolve the material weakness. In 1999 and 2003, we also reported significant amounts of excessive rental assistance payments resulting from RHS's inability to detect residents that do not report their full incomes. Many properties are also eligible to leave the program by prepaying their loans, possibly resulting in the loss of housing to thousands of rural residents.

**OIG AUDIT/INVESTIGATION ACTIONS:** Audits dating back to at least 1994 have reported equity skimming, physical deterioration of RRH projects, and excessive rental assistance payments. In March 1999, we issued a report of our combined RHS and OIG nationwide review of RRH projects that found 18 owners and management companies had stolen over \$4.2 million of project funds while neglecting the physical condition of their properties. Our current audit to determine the status of corrective actions found that RHS has not implemented all corrective actions agreed upon at that time to effectively resolve these long reported deficiencies. Investigations, including some stemming from this review, have also confirmed equity skimming and embezzlement by owners and management companies. One such case in Louisiana resulted in a prison sentence of 5 years for a major real estate developer, who was also ordered to pay fines and restitution of \$3.7 million, as well as fines and restitution of another \$700,000 and sentences ranging from probation to 5 months in prison for several associates.

OIG is also conducting a followup audit to our 1999 nationwide report that had disclosed excessive rental assistance payments. Our current review has found that RHS has failed to take effective corrective actions to resolve the excessive rental assistance. RHS needs to seek legislation that would allow it to actively pursue securing wage and income information of RRH tenants for use by RRH owners and management companies that are responsible for verifying tenant incomes.

**ACTION NEEDED TO ADDRESS THE CHALLENGE:** RHS needs to compare the benefits of repairing existing projects to constructing new projects; inspect and repair its aging projects to ensure safe, decent, and affordable housing for low to moderate-income rural residents; implement procedures to detect and prevent equity skimming, including the use of CPA engagements focused to uncover equity skimming; develop wage and benefit matching authority to identify and recover excessive rental assistance costs; and properly use equity or other

incentives to keep RRH projects in the program. RHS could address many of these challenges by implementing the corrective actions recommended in our two nationwide audits issued in 1999.

**DEPARTMENTAL/AGENCY ACCOMPLISHMENTS/PLANS:** RHS has initiated an inspection program for a statistical sample of its RRH projects. However, our current review has found the current inspection process to be ineffective, generally consisting of only an exterior “walk about” of the RRH projects. RHS has taken steps, in consultation with OIG, to re-write their proposed regulations to better prevent equity skimming of project funds and to resolve past audit recommendations, including the long-standing, FMFIA material weakness. OIG is writing the Rural Development audit program to assist CPAs (hired by borrowers) in focusing on and detecting project account transactions that are highly susceptible to equity skimming. RHS plans to require the use of the audit program and to incorporate it into its regulations. RHS stated that they have also undertaken innovations to collaborate with States to improve wage and benefit matching programs to detect unreported tenant incomes and reduce excessive rental assistance. At the same time, RHS is addressing related concerns raised on the rental assistance program by a recent GAO report. RHS also stated that they have taken several steps to keep properties in the RRH program, such as equity loans, increasing rental assistance, increasing returns on investment for owners, releasing excess reserve account funds, and reducing loan interest rates through interest credit provisions.