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Office of Inspector General



Controls Over Rural Community Facilities Direct Loan and Grant Program Recovery Act Activities – Phase 1

Audit Report 04703-0001-Hy
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UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington D.C. 20250



DATE: June 29, 2010

REPLY TO
ATTN OF: 04703-0001-Hy

TO: Dallas Tonsager
Under Secretary
Rural Development

Tammye H. Trevino
Administrator
Rural Housing Service

ATTN: John Purcell
Director
Financial Management Division

FROM: Gil H. Harden /s/
Assistant Inspector General
for Audit

SUBJECT: Controls Over Rural Community Facilities Direct Loan and Grant Program
Recovery Act Activities-Phase 1

Summary

This report presents the results of our audit of Rural Development's controls over the funds provided under the American Recovery and Reinvestment Act of 2009 (Recovery Act) to the Rural Housing Service's (RHS) Community Facilities Direct Loan and Grant Program. RHS is an agency under the Rural Development mission area. The Recovery Act included measures to modernize the nation's infrastructure, enhance energy independence, expand educational opportunities, preserve and improve affordable health care, provide tax relief, and protect those in greatest need. The Recovery Act authorized approximately \$28 billion in loans, loan guarantees, and grants to the Rural Development mission area to assist in achieving the purposes of the Recovery Act. The Community Facilities Direct Loan and Grant Program received \$1.136 billion for direct loans and \$61 million for grants to develop essential community facilities for public use in rural areas and provide essential services. These essential facilities and services include schools, libraries, childcare, hospitals, medical clinics, assisted living facilities, fire, police and rescue stations, community centers, public buildings, streets, sidewalks, street lighting, buses, and vehicles. As of the end of our Phase 1 review on April 30, 2010, Rural

Development had obligated \$591.7 million in direct loan funds and \$46.3 million in grant funds to recipient organizations.

Congress, in enacting the Recovery Act on February 17, 2009, emphasized the need for accountability and transparency in the expenditure of the funds. On February 18, 2009, the Office of Management and Budget (OMB) issued the first installment of guidance¹ that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act. Further, on April 3, 2009, OMB issued the second installment of guidance² to supplement, amend, and clarify the initial guidance.

The Office of Inspector General's (OIG) role, as mandated under the Recovery Act, is to monitor agency activities and ensure that funds are expended in a manner that minimizes the risk of improper use. During this first phase of our audit, we evaluated the agency's policies, procedures, and internal controls for distributing Recovery Act funds. We did not test to verify recipient compliance with Rural Development policies and procedures in this phase. As such, we did not make any conclusions on this aspect of program operations. Our audit work will continue with a review and assessment of recipient eligibility in Phase 2 of our audit.

Rural Development's approach for meeting the objectives of the Recovery Act is outlined within its Implementation Plan dated May 1, 2009, which also outlined the applicable internal controls. The plan documents that the agency plans to use existing resources, reporting mechanisms, and internal controls to adequately mitigate the risk of fraud, waste, and abuse. We performed tests at two State offices and two area offices in each of those States to assess the controls Rural Development has in place. Our review found that Rural Development has adequate management controls in place for administering the Community Facilities Direct Loan and Grant Program. Therefore, we are not making any recommendations in this report. No further action or response is required by Rural Development.

Background

Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of the funds. On February 18, 2009, OMB issued guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act. OMB issued additional guidance on April 3, 2009, to reinforce ongoing work by clarifying existing requirements and establishing additional steps that must be taken to facilitate the accountability and transparency objectives of the Recovery Act.

Rural Development uses Management Control Reviews (MCR) and State Internal Reviews (SIR) to examine and evaluate the controls over the agency's programs and administrative functions.

¹ "Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009".

² "Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009".

These reviews are conducted at every applicable level and, on a rotational basis, once every 5 years.

The Recovery Act provided funding to the Rural Development Community Facilities Direct Loan and Grant Program totaling \$1.136 billion for direct loans and \$61 million for grants. This funding was in addition to the annual appropriation for this program. The Community Facilities Direct Loan and Grant Program is administered by Rural Development through its State and area offices. The program is designed to develop essential community facilities for public use in rural areas with a population of 20,000 or less. These facilities include schools, libraries, childcare, hospitals, medical clinics, assisted living facilities, fire and rescue stations, police stations, and community centers. Eligible applicants include public entities, units of local government, Federally-recognized Indian tribes, and nonprofit organizations.

Rural Development's National Office coordinates, plans, and maintains control of the Community Facilities Direct Loan and Grant Program. In addition, the national office approves all loan and grant requests over \$3 million. Rural Development's State and area offices process direct loan and grant applications. Area offices accept loan and grant applications, serve as a point of contact and, based on review of applications and supporting documentation, provide recommendations for the State offices to approve the loans and grants. The State offices monitor loan and grant activities and provide assistance to area offices. With the implementation of the Recovery Act, the Secretary issued guidance dated March 23, 2009, to ensure that the funds received under the Recovery Act are expended responsibly and in a transparent manner. As a result of this guidance, State offices are now required to submit all requests for direct loans and grants funded with Recovery Act funds to the national office. The national office reviews and submits the project data to the Office of the Secretary for review and concurrence before obligating funds.³ In addition, the Office of the Secretary submits this data to OMB for its review and concurrence. Once the Office of the Secretary and OMB have concurred, Rural Development officials announce in a press release the projects the Secretary has selected to receive Recovery Act funding. The funds for the approved projects announced are transferred from the national office to the State office's account.

The application process is a two-stage procedure consisting of pre-applications and applications. Pre-applications are submitted to area offices where applicant/project requirements such as the applicant's eligibility, intended use of funds, and the project's priority status are evaluated. This process takes up to 45 days and may also identify any additional information needed to complete this stage. Once a pre-application is approved, the project moves to the application stage. During this stage, projects involving construction require a more in-depth review to address engineering, environmental, or other concerns. Processing times may vary depending on the complexity of the project. The State offices review and approve the applications during this two-stage process before sending them to the national office for clearance.

Objectives

Our audit objective was to ensure that Rural Development implemented the Recovery Act's provisions as intended. This included ensuring that agency officials (1) timely and effectively

³ Rural Development officials refer to this as the clearance process, which consists of reviews by the Office of the Secretary and OMB.

implemented program guidance and requirements for distributing Recovery Act funds, (2) established proper internal control procedures to determine recipient eligibility; and (3) established compliance and monitoring activities to ensure that program requirements are met. During this phase of the audit, we focused on the internal controls in place to determine whether, as designed, they would provide reasonable assurance that direct loans and grants would be made only for eligible projects and to eligible recipients, and that program requirements would be followed.

Details

Our review found that Rural Development's National, States, and area offices had adequate controls in place to ensure the proper review and approval of projects for Recovery Act funding based on our review of two State and four area offices. As of April 30, 2010, Rural Development had obligated \$591.7 million of the \$1.136 billion authorized for direct loans and \$46.3 million of the \$61 million authorized for grants. To determine if Rural Development had adequate controls to effectively manage Recovery Act funds provided to the Community Facilities Direct Loan and Grant Program, our review included the following:

- (1) We interviewed key personnel and obtained an overview and written documentation of the program's policies and procedures. We also obtained details from agency officials explaining their implementation of the Recovery Act and requirements, as well as any supplemental guidance issued governing the eligibility and funding requirements for the Community Facilities Direct Loan and Grant Program. We obtained and reviewed the Rural Development Recovery Act Implementation Plan which described the processes and controls to ensure that Recovery Act Funds are timely disbursed and used for intended purposes. We found that Rural Development officials implemented program guidance and requirements for distributing Recovery Act funds in a timely and effective manner.
- (2) We visited two State and four area offices to determine if adequate controls were in place and operating to ensure direct loans and grants met eligibility requirements, such as being in rural areas and providing essential services. We reviewed applications and supporting documentation for recipients in a limited sample of four area offices, and found that these recipients met the eligibility requirements. We also found that the area offices we reviewed had adequate controls in place for the recommendations they made to State officials for applications submitted for approval. Our review of documents that area officials used to support their recommendations included the agency checklist, which area office personnel use as a guide to process loans and disburse funds. During the next phase of our audit, we will include visits to the recipient locations to evaluate compliance with program requirements and to test whether disbursements were for authorized uses.
- (3) We also reviewed the MCRs and the SIRs to determine the extent of Rural Development's compliance and monitoring activities. We will review whether appropriate corrective actions were taken in a timely manner in response to MCR and SIR recommendations in the next phase of our audit.

During this phase of our audit, we determined that Rural Development has adequate management controls in place for administering the Community Facilities Direct Loan and Grant Program.

We did not identify any significant reportable issues and, as such, are not making any recommendations to Rural Development.

Scope and Methodology

We performed audit work at the Rural Development National Office in Washington D.C., and at two State offices located in Syracuse, New York,⁴ and Davis, California.⁵ We judgmentally selected the two States and two area offices in each State. This selection was based on the area offices that served counties with the highest number of projects and that were within close proximity of each other. We selected all applications the area offices had on file that were identified as being funded by the Recovery Act at the time of our visit. We reviewed 55 applications to determine if applicants and projects met the eligibility requirements of the Community Facility Loan and Grant Program and the Recovery Act. These applications were for various types of projects involving public safety, health care, education, public facilities, and transportation. We also verified that documents were on file to support the eligibility determinations. We performed our audit fieldwork from May through November 2009. However, we updated the obligation data through April 2010.

To accomplish our objectives we interviewed officials at the national office, and at selected State and area offices. We obtained and reviewed the Rural Development Recovery Act Implementation Plan, which describes the agency's process and controls in place. We analyzed pertinent laws, regulations, policies, and procedures which describe the agency's responsibilities for operating the program under the Recovery Act. We examined guidance provided by the Rural Development National Office to the State and area offices, evaluated Rural Development's planned oversight activities and reviewed documents on file to support project applications the State offices submitted for Recovery Act funding. We also performed reviews to test internal controls at all sites visited.

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

⁴ The area offices we visited in New York were located in Canton and Marcy (end of field visit was July 13, 2009 and July 16, 2009 respectively).

⁵ The area offices we visited in California were located in Visalia and Fresno (end of field visit was August 11, 2009 and August 13, 2009 respectively).