



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: June 18, 2009

REPLY TO
ATTN OF: 09601-1-At

TO: Dallas Tonsager
Under Secretary
Rural Development

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Controls Over Water and Waste Disposal Loans and Grants (1)

The American Recovery and Reinvestment Act of 2009 (the Recovery Act) included approximately \$3.8 billion in funds for water and waste disposal systems loans and grants in rural areas. Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of the funds. Further, on February 18, 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.¹ On March 30, 2009, Rural Development was authorized to begin distributing Recovery Act funds.

The Rural Utilities Service (RUS), an agency within the Rural Development mission area, administers the water and waste disposal system program and provides loans and grants for sewer, storm water, and solid waste disposal systems in cities and towns having populations up to 10,000 people. The program is delivered through Rural Development State offices. Since the inception of the Recovery Act through April 28, 2009, RUS had awarded over \$615 million in grants and loans with Recovery Act funds for 193 projects in 34 States. Our role, as mandated by the Recovery Act, is to oversee agency activities to ensure funds are expended in a manner that minimizes the risk of improper use. This memorandum is our first to report on our oversight activities related to the water and waste disposal system program. This memorandum describes a concern with RUS' current method for allocating the Recovery Act funds to States that may not target projects in communities with the highest need on a nationwide basis that are most impacted by the recession, which is one of the objectives of the Recovery Act. This issue, along with any others identified, will be compiled into a final report at the conclusion of our audit.

¹ On April 13, 2009, OMB issued, "Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009."

We are currently performing an audit of the RUS administration of the water and waste loan and grant program. This audit was initiated prior to the passage of the Recovery Act. To accomplish our objectives, we assessed the program's policies and procedures, as well as its internal controls, and discussed them with agency national, State, and area officials.² Agency officials followed this guidance to process loans and grants. We visited six Rural Development area offices in three States to examine borrower and grantee eligibility and use of funds and to ensure that loan and grant funds were being used only for the intended purposes.

During our review we identified an issue with the RUS method for allocating funds, including Recovery Act funding for the water and waste disposal system program. RUS' approach to funding projects is twofold: (1) finance projects in its backlog³ that are "shovel ready," i.e., applications are completed and awaiting funding, and (2) allocate the remaining Recovery Act funds to States using RUS' normal allocation formula (this formula includes 10 percent of the Recovery Act funds being held in the national office for projects in designated persistent poverty counties). RUS officials explained that loan and grant funds are allocated to each Rural Development State office based on a formula that uses the demographics of the rural population, rural population below the poverty line, and nonmetropolitan unemployment. RUS officials stated that this allocation method is statutory. According to the statute,⁴ the Secretary shall allocate funding among the States in a fair, reasonable, and appropriate manner that takes into consideration rural population, levels of income, unemployment, and other relevant factors, as determined by the Secretary. Since the statute does not prescribe the formula to be used for allocating funds and allows the use of other relevant factors, we concluded that Rural Development should consider the priority of projects nationwide, not just within a State, when selecting water and waste disposal projects to fund. This is consistent with the Secretary's "ARRA Obligation Clearance" memorandum dated March 23, 2009, which states, in part, that the agency is to ensure that Recovery Act funds are distributed on the merit of the proposed project rather than historical formulae or oral promises.

Rural Development personnel assign points to water and waste disposal projects based on criteria including health hazards or income of the area. For example, a project will receive 30 points if the median household income of the service area is below the poverty line and an additional 25 points if it also alleviates an emergency situation, such as meeting Safe Drinking Water Act requirements. We believe that the priority points assigned to a project should be considered a relevant factor when awarding Recovery Act funds among projects nationwide. RUS should establish a threshold of merit (e.g., 50 priority points) that a project must meet to be eligible for funds.

² Rural Development Instruction 1780, dated June 4, 1999, and associated Administrative Notices.

³ RUS was unable to provide us with a list of projects with completed applications that were ready to be funded.

⁴ Consolidated Farm and Rural Development Act of February 8, 2006, Section 381E (f), "Allocation Among States."

Without considering the relative merit between projects on a nationwide basis, Recovery Act funds may not go to those projects that show the greatest need. Of the 193 projects awarded with Recovery Act funding, 23 projects totaling \$47.8 million received less than 50 priority points. In addition, RUS has yet to assign priority points to 7 projects already approved totaling \$32.8 million. RUS should use its established criteria to guide its decision to award funds to worthy projects nationwide in accordance with the purposes of the Recovery Act.

We have not yet performed testing to determine the extent to which Rural Development is funding water and waste disposal projects with low priority points that may delay funding of projects in communities with the greatest need. As a result, we have no conclusions on the overall impact to the program. Our recommendation is that Rural Development should modify its project selection process to ensure that Recovery Act funds are better targeted to communities most impacted by the recession as well as to projects with the greatest merit.

We discussed this issue in detail with agency national office officials on March 24, 2009. At that time, we recommended that RUS establish a threshold for awarding recovery funds to projects that are consistent with the purposes of the Recovery Act and only fund those projects with the greatest need and the highest priority points on a nationwide basis. Agency national officials did not agree with our recommendation, stating that the funds must be allocated to States according to statute. However, we see nothing in the statute that would prohibit RUS from implementing our recommendation. We continue to believe that this position should be reevaluated given the Secretary's direction to ensure that Recovery Act funds are distributed on the merit of the proposed project rather than historical formulae.

RUS officials also stated that they use a process called pooling, which allows States to fund projects once they have obligated their initial allocation. Pooling is a process in which unobligated funds are pooled from the States at mid-year and year-end and then handed out administratively by the RUS national office on a project-by-project basis. The national office uses the priority point score as a criterion when distributing pooled funds. RUS officials stated that projects with less than 50 points are unlikely to be funded with pooled funds, which gives support to the establishment of a base priority score for approving water and waste projects for Recovery Act funding.

Please provide a written response within 5 days that outlines your corrective action on this matter. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Steve Rickrode, Audit Director, Rural Development and Natural Resources Division, at (202) 690-4483.

cc: Director, Financial Management Division



United States Department of Agriculture
Rural Development
Office of the Under Secretary

June 26, 2009

TO: Robert Young
Assistant Inspector General for Audit

FROM: Dallas Tonsager
Under Secretary
Rural Development

SUBJECT: Controls Over Water and Waste Disposal Loans and Grants (1),
Audit # 09601-10At

Thank you for your memorandum dated June 18, 2009, as a first report on your oversight activities related to the water and waste disposal system program implementation of the funding received through the American Recovery and Reinvestment Act of 2009, P.L. 111-5, (the Recovery Act). We look forward to your preliminary findings and the final report for the audit currently being performed on the administration of the Water and Waste Disposal (WWD) loan and grant program.

The Recovery Act provided a significant level funding for rural water and waste projects through the WWD loan and grant program. This memorandum will serve as our reply to your concern with the Rural Utilities Service (RUS) method for allocating Recovery Act funds to States. Your recommendation is that Rural Development should modify its project selection process by 1) enacting a minimum level of priority points as a fund eligibility to ensure that Recovery Act funds are better targeted to communities most impacted by the recession as well as to projects with the greatest merit, and 2) considering the priority of projects nationwide when selecting projects to fund.

Rural Development is Meeting the Requirements of the Recovery Act

The Office of Management and Budget (OMB) provided guidance documents M-09-10, dated February 18, 2009, which provided an initial level of government-wide guidance for carrying out programs and activities enacted in the Recovery Act and M-09-15, dated April 3, 2009, which enhanced and clarified M-09-10. The actions taken by Rural Development to administer the WWD loan and grant program funding provided in the

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Recovery Act are in compliance with the OMB guidance and the purposes and principles stated in the Recovery Act.

Section 3 of the Recovery Act provided that the purposes of the Recovery Act included: (1) preserving and creating jobs and promoting economic recovery, (2) assisting those most impacted by the recession, (3) providing investments needed to increase economic efficiency by spurring technological advances in science and health, (4) investing in transportation, environmental protection and other infrastructure that will provide long-term economic benefits and (5) stabilizing State and local government budgets, in order to minimize and avoid reductions in essential services and counter productive state and local tax increases. Among the general principles stated in Section 3 is that the heads of Federal departments and agencies shall manage and expend the funds made available to achieve the purposes specified, including commencing expenditures and activities as quickly as possible consistent with prudent management.

The OMB guidance documents, M-09-10 and M-09-15, covered many items and required agencies develop program-specific Recovery Act plans for each program specifically mentioned in the Recovery Act. The Water and Environmental Programs (WEP) prepared its Recovery Act plan after carefully considering how the funding provided could be utilized to meet the purposes, principles, transparency and accountability of the Recovery Act. Included in the plan is a discussion of a two-phased approach to funding pursuant to ARRA. The WEP's plan was approved by OMB and components of it are available on www.recovery.gov.

Minimum Point Threshold

In developing the WWD loan and grant program-specific Recovery Act plan, we considered the statutory authority for the Recovery Act funding, 306 and 310B of the Consolidated Farm and Rural Development Act (CONACT), and the regulatory requirements found in 7 C.F.R. 1780. By design the program is needs-based. Under the existing regulations, applications are selected for processing on a first-come, first-served basis, unless funding is limited. In the case of limited funding, priority points are assigned to projects based on factors such as population, income, and health issues.

The basic eligibility requirements for the WWD loan and grant program require funds be utilized in rural areas (under 10,000 in population), eligible entities (public bodies, non-profit corporation or Tribal governments). In addition, applicants must be unable to obtain credit elsewhere at reasonable rates and terms. Eligible rural communities who are unable to access commercial capital for water and waste infrastructure projects rely on Rural Development to meet their financing needs. Instituting a minimum point eligibility requirement would prevent otherwise eligible applicants, who cannot get reasonable credit elsewhere, from getting assistance from Rural Development because they do not meet an arbitrary priority point level during a period in which program funds are not limited.

Considering Priority Points on a Nationwide Basis

You recommend that Rural Development consider the priority of projects nation-wide, not just within a state, when selecting projects to fund. The funds provided through the Recovery Act are authorized pursuant to 306 of the CONACT. As such, the Agency is implementing these funds through the existing water and waste disposal loan and grant program. The WWD loan and grant program is largely administered through our Rural Development State Offices. Under the existing program, funds are allocated to each state who then determines priority for funding within their state based on the merits of the applications filed. The current process allows each State to set priorities for funding within their State and does not create a “one priority fits all” scenario. Furthermore, 7 C.F.R. 1780, 1780.17 provides for ranking eligible applications when limited funds are an issue. Pursuant to the Recovery Act, the Agency is required to give priority to projects that are ready to proceed. In addition, the Recovery Act funds must be used by September 30, 2010. Applications pending or filed with the Agency are not all ready to proceed at the same time. Therefore, when making selections for funding, the RD program officials must identify priority projects that are able to proceed in a timely fashion.

Rather than relying solely on existing distribution formulas, the program decided to employ a two-phased approach to funding. As announced by the Secretary in a March 9, 2009, press release, the focus of initial funding efforts was on backlogged projects that were ready to proceed. At that time, the Agency had \$1.3 billion in backlogged, completed applications. Projects ready to proceed, regardless of geographic location were funded in Phase I. Had funding been limited, priority points would have been used to rank applications for funding.

Subsequent to the announcement of projects selected for funding in Phase I, funds were allocated to State offices for use. The funding strategy also includes the establishment of a National Office reserve and a pooling process that ensures that states with significant needs have ample access to additional funds for priority projects. We believe that this approach does meet the Secretary’s charge. Although limited funds are not an issue at this time, we will continue to be prudent and consistent with administration of the available funds to ensure the Recovery Act and WWD objectives are obtained.

Effectively Targeting Communities in Need

The WWD loan and grant program-specific Recovery Act funding plan states funding will be provided to eligible applicants through the existing WWD loan and grant program regulations and guidelines. The significant backlog of WWD loan and grant program applications seeking loan and grant funding was an important asset in trying to commence funding activities quickly and in a prudent manner. Recovery funding will be targeted not only to backlogged applications, but to new applications in rural areas of significant need. After an initial phase of funding to address the existing backlog of completed applications ready to proceed, funds were allocated to Rural Development State Offices based on existing allocation formulas, and using the most recent data on

rural population, income level, and unemployment. Ten percent of total funds were held in the National Office and designated for projects to serve communities in persistent poverty counties as directed in the Recovery Act. Rural Development is also encouraging technical assistance providers to reach out to targeted areas with established needs, particularly those in areas with no public water or waste system, aging infrastructure or health issues resulting from inadequate water and waste service. The Agency will coordinate with its Office of Civil Rights and Tribal Coordinator on targeted outreach to minority and tribal stakeholder groups.

The WWD loan and grant program-specific Recovery Act plan ensures responsible spending of Recovery Act funding, producing long-term benefits, optimizing economic and programmatic benefits while targeting assistance consistent with recovery purposes and principles. The WEP is administering the Recovery Act funding consistent with the existing program which is recognized as being “Effective” under the OMB Program Assessment Rating Tool (PART). This is the highest rating a Federal program can receive. Programs rated “Effective” set ambitious goals, achieve results, are well-managed and improve efficiency. The PART found the WEP is successful in targeting assistance for water and wastewater infrastructure to poor rural areas. For instance, while the minimum requirement is that the community being served is less than 10,000 people, the average size of the

Rating Range	
Effective	85-100
Moderately Effective	70-84
Adequate	50-69
Ineffective	0-49

Rural Water and Wastewater Grants and Loans	
Purpose & Design (20%)	80
Planning (10%)	100
Management (20%)	100
Results (50%)	87
PART Score	89

Top Ten	USDA Programs	PART Score	Rating
★	Rural Water and Wastewater Grants and Loans	89	Effective
2	Plant and Animal Health Monitoring Programs	87	Effective
3	Economic Research Service	87	Effective
4	Pest and Disease Exclusion	86	Effective
5	Emergency Pest and Disease Management Programs	83	Moderately Effective
6	Research on Protection and Safety of Agricultural Food Supply	82	Moderately Effective
7	Snow Survey Water Supply Forecasting	82	Moderately Effective
8	Mutual Self-Help Housing -- Technical Assistance Grants	80	Moderately Effective
9	Agricultural Credit Insurance Fund - Guaranteed Loans	80	Moderately Effective
10	Protection and Safety of Agricultural Food Supply (Grants)	79	Moderately Effective

population being served is 4,000, and the average median income within the communities is, on average, 80 percent of the state median income. The PART analysis concluded that the WEP does a good job of collecting program data and using it to manage effectively. Accordingly, over the life of the program, fewer people in rural areas are experiencing problems with access to safe, affordable drinking water and wastewater disposal. In addition, resources are used effectively. In

addition, the program is efficient in managing the loan to grant ratio, which allows the maximum amount of assistance within limited resources. Grant funds are managed for those communities with the greatest need for them.

Other Issues Raised

In response to some specific statements in your memorandum, your statement that “RUS has yet to assign priority points to 7 projects already approved totaling \$32.8 million” is misleading. When the data to support your statement was provided to you, it was accompanied by a statement that these seven projects were not approved and thus the priority points had not been entered into our database. Since the information was provided, three have been obligated and have scores of 110, 95 and 80. Furthermore, the announcement of the \$615 million in loans and grants clearly stated that the list of

projects was selected for funding. Approval was not implied in the announcement. In a footnote, you indicated the RUS was unable to provide a list of projects with completed applications that were ready to be funded. We have no record of receiving such a request. We have data on incomplete applications and complete applications. Obtaining information on complete applications ready to obligate could be obtained through a survey process.

The WEP targets the neediest communities and provides loan and grant funding which results in reasonable water and wastewater user rates for residents. The WWD loan and grant program-specific Recovery Act plan will ensure the purposes and principles of the Recovery Act and the OMB guidance are met. Therefore, we do not intend to implement a priority point minimum as an eligibility for funding criteria.