



United States Department of Agriculture  
Office of Inspector General  
Washington, D.C. 20250



DATE: November 19, 2010

REPLY TO  
ATTN OF: 09703-1-At (1)

TO: Dallas Tonsager  
Under Secretary  
Rural Development

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

SUBJECT: Controls Over Water and Waste Disposal Loans and Grants – Inappropriate Use  
of Unexpended Grant Funds

The American Recovery and Reinvestment Act of 2009 (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 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.<sup>1</sup> 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 Loan and Grant Program and provides loans and grants for sewer, storm water, and solid waste disposal systems in cities and towns having populations of up to 10,000 people. The program is delivered through Rural Development State offices. Since the inception of the Recovery Act and through September 30, 2010, RUS had obligated over \$3.2 billion in grants and loans, using Recovery Act funds for 854 projects throughout the United 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 is our first report on our oversight activities related to this audit of the Water and Waste Disposal Program. As part of our current audit, this Fast Report describes a concern with the State of Maine's method of using unexpended grant funds from previous projects for new projects. This issue, along with any others identified, will be compiled into a rollup report at the conclusion of our audit.

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<sup>1</sup> On April 3, 2009, the Office of Management and Budget issued "Updated Implementing Guidance for the Recovery and Reinvestment Act of 2009."

We are currently performing an audit of RUS' administration of the Recovery Act funding provided to the Water and Waste Direct Loan and Grant Program. To accomplish our objectives, we assessed the program's policies and procedures,<sup>2</sup> as well as its internal controls, and discussed them with the agency's national, State, and area officials. We also obtained and reviewed any guidance issued by the agency since the inception of the Recovery Act which might be pertinent to the program. This guidance includes the Rural Development Recovery Act implementation plan issued on May 1, 2009 (revised May 15, 2010), which states that Recovery Act loan and grant funding will be provided to eligible applicants pursuant to existing Water and Waste Disposal Loan and Grant Program regulations and guidelines.

We found that the Maine Rural Development Office inappropriately funded a Water and Waste Disposal Loan and Grant Program Recovery Act project, with unexpended grant funds from previous projects approved for the borrower. The State officials claimed that they authorized the rollover of funds because the borrower had already been approved for the funding during the previous underwriting process and this funding would be carried forward for eligible program purposes involving the next project. As a result, RUS' action provided the Town of Farmington with unfair advantage over new applicants for unused funds, as well as violated grant limitation requirements.

RUS policy<sup>3</sup> states that any applicant contributions will be the first funds expended in a project and grant funds will be the last funds expended.<sup>4</sup> Once projects are completed, this same policy states that grant funds not expended for authorized purposes will be cancelled.<sup>5</sup> In addition, RUS policy<sup>6</sup> provides that the maximum allowable percentage of grant funds is 75 percent of the total RUS project costs.

According to a Maine Rural Development State Office official, the Town of Farmington is updating its sewer system through a series of projects. In Rural Development's Community Program Application Processing System and the preliminary engineering report, documentation showed that the most recent project, the Tannery Brook Line Improvements project,<sup>7</sup> was designed to replace lines in that system. In August 2009, Rural Development approved Recovery Act funding for the project that included a \$370,000 grant, a \$131,000 loan, and \$79,000 in applicant contributions.

While tracing these funds back to their source, we discovered that the \$79,000 in applicant contributions were actually unexpended grant funds left over from a prior RUS non-Recovery Act project for the Town where an influent pump station was constructed and completed in October 2009. A Rural Development official acknowledged there was approximately \$79,000

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<sup>2</sup> RUS Instruction 1780, dated June 4, 1999, and associated administrative notices.

<sup>3</sup> RUS Instruction 1780.45(f)(3), June 4, 1999.

<sup>4</sup> Rural Development letters of condition for the Town of Farmington, dated April 1, 2009, and August 12, 2009.

<sup>5</sup> Cancelled grant funds would be returned to the RUS national office for reobligation to other projects.

<sup>6</sup> RUS Instruction 1780.10, June 4, 1999.

<sup>7</sup> This project was selected as part of the statistical sample utilized in this audit. Our audit scope and sample represent loans and grants obligated in fiscal year 2009 with Recovery Act funds. Fiscal year 2009 obligations represent 48 percent of the total Water and Waste Disposal Recovery Act funds.

remaining in grant funds from the influent pump station project. The Rural Development officials at both the State and area offices subsequently reported this same \$79,000 as applicant contributions available in the Tannery Brook Line Improvements project's underwriting process. In addition, while reviewing the underwriting for the influent pump station project, we found that the influent pump station project similarly utilized \$9,279 in RUS grant funding from another Rural Development project for this town that was completed prior to the influent pump station project.

The Tannery Brook Line Improvements project for this town received approximately 73.8 percent<sup>8</sup> of its funding through a grant according to the underwriting documentation. However, when considering all the funding from Rural Development, including the \$79,000 in unexpended grant funds from the influent pump station project, Rural Development will actually finance 77.4 percent<sup>9</sup> of this project with grant funds, which exceeds the maximum allowable grant funding of 75 percent of project costs.

We could not determine if this condition was an isolated case or occurred frequently in Maine. Upon discussion with the State office staff, we were informed that this was not the only time the staff rolled forward unexpended grant funds to new projects with the same borrower. However, the Maine State office provided a subsequent response citing that the Town of Farmington is the only occurrence that they were aware of where a project's carryover funds were rolled into a new project.

The State office staff believed that they were not violating any RUS regulation, as the applicant had already applied for the previous grant and the funds left over from the previous project would be spent on eligible project expenses, even though the expenses would be for a different project. RUS national office officials agreed with our conclusion that the regulation prohibited the rolling forward of grant funds from previous projects regardless of whether the projects are for the same borrower. However, RUS national office officials did state that they believed this was an isolated incidence. A RUS national office official further stated the remaining grant funds should have been spent for items within the scope of the previous project, if possible, and if not, should have been deobligated and returned to RUS for reobligation. By not cancelling the unused funds for reobligation at the national office level, the Maine Rural Development State Office gave the Town of Farmington an unfair advantage over new applicants for the unused funds. This unused funding, if returned to the national office when cancelled, would have been placed in a pool that all applicants nationwide could compete for rather than being held in the town's account for the next project.

We did not perform an analysis to determine the full extent to which the Maine Rural Development Office has rolled forward unexpended grant funding to other new projects or otherwise inappropriately used unexpended grant funds; therefore, we have no conclusions on

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<sup>8</sup> Total Rural Development project funding according to the documentation is a loan in the amount of \$131,000 and a grant in the amount of \$370,000 totaling \$501,000.  $\$370,000/\$501,000 = 73.8$  percent.

<sup>9</sup> Total Rural Development project funding, including the grant funding from the prior project, raises the total project cost to \$580,000 with a total grant amount of \$449,000 (\$370,000 for this project in addition to \$79,000 from the previous project).  $\$449,000/\$580,000 = 77.4$  percent.

the overall impact to the program. We recommend that Rural Development recover the \$79,000 in rolled over grant funding from the Town of Farmington. We also recommend that Rural Development perform a review of grants approved by the Maine State office to determine the extent to which funds from one project have been rolled over to another project and correct any discrepancies noted. If any discrepancies result in funds being due to the agency, as in the case of the Town of Farmington, we recommend Rural Development recover those amounts.

Please provide a written response within 5 days that outlines your corrective actions planned 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.

**USDA'S**

**RURAL DEVELOPMENT**

**RESPONSE TO AUDIT REPORT**



United States Department of Agriculture  
Rural Development

November 29, 2010

TO: Gil H. Harden  
Assistant Inspector General for Audit

THROUGH: John M. Purcell /s/ John Dunsmuir for  
Director  
Financial Management Division

THROUGH: Jonathan Adelstein /s/  
Administrator  
Rural Utilities Service

FROM: Dallas Tonsager /s/ William F. Haggy for  
Under Secretary  
Rural Development

SUBJECT: Response to OIG ARRA Fast Report 09703-1-At (1): Controls Over Water  
and Waste Disposal Loans and Grants – Inappropriate Use of Unexpended  
Grant funds

This memorandum is our response to the OIG ARRA audit number 09703-1-At (1) draft FAST report dated November 19, 2010. The draft report noted that the Maine Rural Development Office inappropriately funded one Water and Waste Disposal Recovery Act Project (Town of Farmington, Tannery Brook Phase) with unexpended grant funds from previous project approved by the Agency (Town of Farmington, 2009 Influent Pump Station Project). It was questioned whether this occurrence is an isolated incident in Maine. It was recommended that the Program recover the \$79,000 in grant funds from the Town of Farmington and conduct a study of the Maine Office to determine the extent to which rollover funds have been used in subsequent projects funded by the Agency. The final recommendation is that if any other discrepancies are found that those funds be recovered as well.

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One important clarification is that the \$79,000 has not been disbursed to the town. Rather, it is currently part of unliquidated grant funds from the influent pump station project and within the control of the Agency. In addition, it is important to highlight the full scope of the regulations related to proper disposition of unused funds. The draft report states that, “grant funds not expended for authorized purposes will be cancelled.” However, the full text of 7 CFR 1780.45 (f) provides additional guidance regarding the use of remaining funds. The full text is below:

*(f) Use of remaining funds. Funds remaining after all costs incident to the basic project have been paid or provided for will not include applicant contributions. Funds remaining, may be considered in direct proportion to the amounts obtained from each source. Remaining funds will be handled as follows:*

*(1) Remaining funds may be used for eligible loan or grant purposes, provided the use will not result in major changes to the facility(s) and the purpose of the loan and grant remains the same;*

*(2) RUS loan funds that are not needed will be applied as an extra payment on the RUS indebtedness unless other disposition is required by the bond ordinance, resolution, or State statute; and*

*(3) Grant funds not expended under paragraph (f)(1) of this section will be canceled. Prior to the actual cancellation, the borrower, its attorney and its engineer will be notified of RUS's intent to cancel the remaining funds. The applicant will be given appropriate appeal rights.*

We have spoken at length with our Rural Development Maine Office regarding the project in question. We agree that it was an error for the loan specialist in the State Office to use the remaining grant funds from a previously funded project in the underwriting for the Tannery Brook phase of sewer improvements. It was also an error to refer to the remaining grant dollars as applicant contribution. The State Office was directed to, and has, contacted the Town of Farmington to inform them that they will not be able to utilize the \$79,000 of grant funds remaining from the 2009 Influent Pump Station project for the Tannery Brook project.

The Town of Farmington has subsequently requested that the \$79,000 be utilized on the 2009 Influent Pump Station project to install a SCADA computer system. The SCADA computer system was included in the original scope, but not included in the bid, due to concerns by the community regarding sufficient funding.

RUS policy is to fund stand alone projects with specific funding packages for each project. While the applicable regulations state that unused funds that cannot be utilized within the original scope of work for which funding was provided should be cancelled, 7 CFR 1780.45(f)(1) does permit remaining funds to “be used for eligible loan or grant purposes, provided the use will not result in major changes to the facility(s) and the purpose of the loan and grant remains the same.” Eligible items include, but are not limited to, reasonable items within the original project scope that will insure the system will operate more efficiently.

The proposed SCADA system on the influent pump station would enhance the operational efficiency of the plant and, therefore, is an appropriate use of the remaining funds. If approved, the funds would not be returned to the Government. None of the remaining funds will be used for the Tannery Brook project or any other project.

Regarding the concerns of rollover funds used in other Maine water and waste projects, the Rural Development State Office has indicated that this occurrence is an isolated incident. To confirm, RUS will review loan and grant assistance provided in Maine over the past two years (FY 09 & FY10) and to determine whether other similar instances exist. We will provide the results of our review by May 15, 2010.

### **Conclusion**

Rural Development is committed to administering the Water and Waste Disposal Loan and Grant Program effectively and to ensure that funds are appropriately utilized pursuant to statute and regulation. We will conduct the requested file reviews and take corrective action if needed.

Cc: AAWEP file            FMD Purcell            S/O ME  
Draft: AAWEP 11/29/10; final mw 11/29/10  
Recall:s/wep/OIG/WEP Response to OIG Audite 09703-1AT(1) Dec 2010