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HEARING ON
ECONOMIC DEVELOPMENT ADMINISTRATION
REAUTHORIZATION ACT OF 2008

BEFORE THE
SUBCOMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
UNITED STATES SENATE

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Mr. Chairman, Ranking Member, and Members of the Subcommittee:

Thank you for inviting us to testify today on the Economic Development Administration (EDA) Reauthorization Act and our oversight of EDA's grant programs.

EDA is one of six grant-making agencies within the Department of Commerce that together typically dispense roughly $2 billion annually to state and local jurisdictions, nonprofit agencies, and private firms. These federal funds support a variety of economic, scientific, and technological initiatives to further the Department's mission. EDA ranked third in terms of grant dollars dispensed by the Department in FY 2007—awarding $249 million to support a variety of local and regional development activities (table 1).

Effective grants management has been a long-standing challenge for the federal government because federal grant programs are susceptible to fraud, waste, and abuse if not adequately monitored.

Grant oversight by the Department of Commerce has been a significant, ongoing focus of the audit and investigative work of my office. We are currently conducting an audit of grant oversight activities used by the Department's various grants management offices, including EDA. We expect to issue our report early next fiscal year.

With regard to EDA, our work historically has focused on the agency's two largest programs—Public Works and the Revolving Loan Fund (RLF) component of the Economic Adjustment Assistance program (table 2).

Table 1. Commerce Grant-Making Agencies (FY 2007 Awards)

1. NTIA	$1.01 billion*
2. NOAA	$ 975 million
3. EDA	$ 249 million
4. NIST	$ 196 million
5. MBDA	$ 11 million
6. ITA	$ 9.8 million

*NTIA typically awards approximately $20 million in grants annually. The FY 2007 amount includes $1 billion in 1-year money from the Digital Television Transition and Public Safety Act.

Table 2. EDA FY 2008 Program Budget (in thousands)

Public Works	$ 148,050
Economic Adjustment	$ 142,300*
Planning	$ 25,380
Trade Adjustment	$ 14,100
Technical Assistance	$ 9,400
Global Climate Change	$ 9,400
Research	$ 470
Total	$ 349,100

*In recent years, EDA has typically received about $250 million in program funds, including approximately $45 million for Economic Adjustment. The FY 2008 amount includes $100 million from a supplemental appropriation for disaster relief.

Since EDA's last reauthorization in 2004, we have issued 20 audit reports on individual RLFs and public works projects, and have conducted a number of investigations into the activities of individual grant recipients. My testimony today is based primarily on our RLF audit work, which over the years has identified a series of recurring problems in recipients' management of funds and weaknesses in EDA's regional and headquarters oversight of them.

Between 2001 and 2006, we conducted 50 audits of individual RLF recipients to determine whether they were properly managing the loan funds and complying with federal requirements. Some of these audits were requested by EDA, but most of them were initiated as a result of our own surveys of active loan funds. This body of work identified a series of common problems, prompting us to conduct a comprehensive audit of the program. In March 2007 we issued our report on EDA's oversight, monitoring, and management of its entire portfolio of RLFs—estimated to be 607 at the time—and EDA's progress in resolving the problems we had identified in the 50 audit reports on individual recipients. I would like to first share with the subcommittee our findings with regard to the RLF program and then briefly comment on our public works audits and investigative work.

STRONGER MANAGEMENT AND LEADERSHIP BY EDA ARE NEEDED TO CORRECT PERSISTENT PROBLEMS IN THE RLF PROGRAM

The Revolving Loan Fund Program, established in 1975, provides grants to local communities to operate a lending program that offers low-interest loans to businesses that cannot get traditional bank financing. Grant recipients contribute matching dollars to capitalize the funds. As loans made from the original funding pool are repaid with interest and fees, the fund is replenished and new loans are made.

Agencies and organizations interested in administering an RLF must demonstrate that the fund is an integral part of a comprehensive economic development strategy and essential to meeting its goals. The federal interest in the RLF exists as long as either the fund or its assets exist.

The RLF program represents a significant federal investment: EDA estimates there are currently 584 entities operating revolving loan funds, with combined portfolios worth approximately $850 million—or roughly 3.5 times the size of the agency's FY 2008 program budget. Despite these sizable assets, at the time of our March 2007 review, staff assigned to monitor and manage the program averaged only one person in each of EDA's six regions.

Ineffective oversight has been a common finding in our 50 audits of individual grantees conducted since 2001, as evidenced by three persistent problems:

1. ***Grantees retained too much cash in their loan funds***—EDA requires grantees to ensure that a certain percentage of total RLF dollars are loaned out at all times, typically 75 percent. When grantees routinely fail to do so, they accumulate excess cash and are limiting the RLF's potential benefits to the community's revitalization.

   EDA may lower the capital utilization requirements for RLFs that anticipate making large loans relative to the size of their capital base and raise the requirement for funds that have a capital base exceeding $4 million. Determining appropriate utilization rates for larger RLFs is an important part of managing a fund's lending and excess cash status. EDA failed to make such determinations for larger RLF operators we audited: specifically, we identified 23 RLFs that had a capital base of over $4 million, yet EDA regional management had evaluated only 1 of the 23 for a possible adjustment to the capital utilization standard.

2. ***EDA did not ensure that grantees consistently sequestered excess cash***. When a grant recipient fails to meet its capital utilization target for two consecutive reporting periods, EDA may direct the recipient to sequester the excess funds—that is, transfer them to another interest-bearing account and remit the government's portion of the interest to the U.S. Treasury. Recipients must get EDA approval to withdraw sequestered funds. We audited 33 RLFs for evidence of retaining excess cash. Of these, 30 percent maintained excess cash for prolonged periods.

3. ***Grantees did not comply with federal auditing and reporting requirements.*** RLF grantees are required to submit annual or semiannual reports detailing their loan activities, typically within 30 days of the close of a reporting period. It is essential that they submit these reports and do so on time so that EDA can monitor RLF projects and ensure that operators are complying with federal grant terms and conditions. The individual RLF operators we audited often filed reports late or did not file them at all.

   By the same token, regional EDA staff generally did not give sufficient review to the reports that were filed and often did not follow up with nonreporting operators to attempt to obtain their reports. EDA needs to use these reports to more effectively monitor the operations of RLF recipients and better manage the RLF program.

   EDA staff also often did not ensure that eligible RLF operators complied with the Single Audit Act. The act requires RLFs with annual federal expenditures of $500,000 or more to obtain a single audit, prepared by independent auditors, and submit the resulting report to the Federal Audit Clearinghouse—the central collection point and distribution center for all single audit reports. EDA staff should compare these reports against an RLF's financial reports to look for discrepancies. We found that even when an RLF operator submitted a single audit report, EDA did not use the data it contained to help manage the program.

As part of our 2007 review, we looked at what actions EDA had taken to address these problems. We assessed the effectiveness of the agency's oversight, monitoring, and management of the overall program and of its entire portfolio of RLFs. We analyzed levels of excess cash by reviewing available annual and semiannual reports for all active RLFs in EDA's six regions. We also reviewed the extent to which EDA uses single audit reports to monitor grantees' administration of their revolving loan funds.

Despite the issues consistently raised in our audit reports over the years and EDA's own recognition of serious problems, EDA had not made sufficient progress in strengthening management of the RLF program.

- **EDA did not have a useful central database** containing current, accurate information on RLF fund balances or an adequate tracking and oversight system—something an EDA task force recommended the agency implement in 1999. If EDA had an effective, practical data system that enabled headquarters and regional staff to track the status of individual RLFs and oversee the RLF program, it would have the information it needs to avoid many of the persistent problems we found. EDA did have a limited database that contained some information related to the RLF program, but not of the kind and quantity needed to effectively manage it. The database reflected an individual fund's original capitalization, but it did not track changes that subsequently occur at each RLF, such as income, losses, and securitizations. As a result, EDA managers could not readily determine the current value of the entire RLF portfolio or make timely, informed decisions about recipient capital utilization and excess cash.

  The agency's reported RLF assets at the time of our review were $1 billion. We could only identify assets of $716 million because EDA did not have reports for all the active RLFs. At our recommendation, EDA has since collected all reports and determined that the current value of RLF assets is $850 million. A more sophisticated tracking system coupled with regular RLF reporting will give EDA the comprehensive data it needs to quickly and accurately determine the value of the RLF assets it is responsible for monitoring and to identify some portion of the $150 million still unaccounted for. It will also allow EDA to track the performance of individual loans and to estimate, for the first time, the economic benefits of the RLF program separate from the overall Economic Adjustment Assistance program.

- **Recipients were still maintaining excess cash.** For the period of our audit, we were able to locate reports for 529 of the 607 active RLFs in EDA's database. We determined that 236 of the reporting funds had a combined total of $70 million in excess cash; roughly $57 million of this amount represented the federal share (table

3). The actual amount was likely higher because 78 RLFs had not filed financial reports and we therefore could not ascertain their fund balances.

For the RLF program to achieve its goals, the money it provides needs to be used to make appropriate loans and not allowed to sit inactive for extended periods in the recipients' bank accounts.

Table 3. RLF Excess Cash and Fund Balance at September 30, 2005

EDA Regions	Number of RLFs with Excess Cash	Total Excess Cash	Federal Share of Excess Cash	Total # RLFs that Filed Reports	Fund Balance	Federal Share of Fund Balance
Atlanta	43	$10,922,618	$8,494,863	90	$133,978,891	$107,244,424
Austin	24	3,430,517	2,920,681	43	41,926,748	35,816,330
Chicago	48	11,494,903	8,929,075	97	119,469,401	85,761,298
Denver	28	2,136,991	1,574,862	92	72,037,693	52,395,068
Philadelphia	48	18,986,483	13,680,418	121	216,523,437	158,158,316
Seattle	45	23,304,476	21,009,876	86	132,010,858	105,131,605
Total	236	$70,275,988	$56,609,775	529	$715,947,028	$544,507,041

One of the reasons cited by some EDA staff and RLF administrators for the high amounts of excess cash is that when commercial lending rates are low, as they were at the time of our audit, EDA's required minimum 4 percent interest rate may not be acceptable to potential loan recipients. Excess cash may then accumulate because the RLF cannot make loans at attractive rates. We did not evaluate whether the interest rate requirement has been a factor in a loan fund's excess cash status. EDA has informed us that it is considering ways to make this requirement more flexible. Beyond that, the agency needs to determine the range of factors that contribute to the excess cash problem and address them accordingly.

- **EDA was not sequestering the bulk of eligible funds.** We found that EDA did not have clear guidance, and EDA regions had inconsistent practices for sequestering excess funds. For example, the Austin regional office sought to terminate RLFs that reported excess cash for two consecutive reporting periods rather than sequester the funds. Atlanta based its sequestration decisions on such factors as a fund's lending plans and the local economic environment, in addition to consistent excess cash balances. At the time of our review, RLFs in five of the six regions were carrying $59 million in excess cash (Chicago was excluded from this calculation); $44 million of this amount was eligible for sequestration but only $15 million had actually been sequestered (table 4). The portion of eligible funds that was not sequestered cost the federal government approximately $1 million in interest payments that under current regulations should have been returned to the Treasury.

Table 4. Excess Cash Sequestered (as of September 30, 2005)

EDA Regions[a]	Excess Cash Amount 9/30/2005 $ (millions)	Amount Eligible for Sequestration	Sequestered Amount 09/30/2005
Atlanta	$10.9	$ 9.3	$ 1.8
Austin	3.4	3.2	.0
Denver	2.1	1.6	.0
Philadelphia	19.0	10.4	10.5
Seattle	23.3	19.9	2.3
Total	$58.7	$44.4	$14.6

[a]Chicago was judgmentally excluded from this calculation.

- **Recipients were not meeting reporting requirements.** We found that all EDA regional offices had problems obtaining required reports (table 5). Approximately 39 percent of the active RLFs that had filed reports filed them late for the period we examined. Nearly 40 percent of the late reports were filed more than 90 days beyond the due date. Thirteen percent did not file reports at all. In addition, we found many of the reports that were filed were inaccurate. The regions differed in their practices for and attention to monitoring grantee compliance with reporting requirements, and headquarters did not enforce a consistent approach. Without current, accurate reports, EDA managers lack the information they need to make timely and informed decisions about a fund's capital utilization and excess cash, the agency risks losing accountability for RLF assets, and there is greater opportunity for waste, fraud, and abuse of federal dollars.

Table 5. Status of Grantee Reports Due September 30, 2005

EDA Regions	Reports Due	Number Not Filed	Percent Not Filed	Reports Filed	Number Filed Late	Percent Filed Late
Atlanta	90	0	0	90	30	33
Austin	43	0	0	43	13	30
Chicago	107	10	9	97	36	37
Denver	94	2	2	92	23	25
Philadelphia	178	57	32	121	43	36
Seattle	95	9	9	86	60	70
Total	607	78	13	529	205	39

EDA was not effectively using single audit reports to manage RLF assets. We queried the Federal Audit Clearinghouse to determine whether the required audit reports were filed for three of the six EDA regions. We found that nearly 25 percent of the 197 eligible grantees had not filed these reports for the period of our review. Single audit reports contain information that enables EDA to ensure recipients have appropriate internal controls for safeguarding federal funds and that they are using funds in accordance with grant terms and conditions. They are a good management tool, and EDA officials should therefore ensure that grantees have the audits conducted and file them with the clearinghouse, and that regional staff use the information in the reports to help manage the program. Having said that, we note that at the time of our review, EDA had an average of only six staff assigned to monitor the 607 active RLFs.

RECOMMENDATIONS TO IMPROVE THE RLF PROGRAM FOCUS ON COMPREHENSIVE, TOP-DOWN MANAGEMENT REFORMS

Our 2007 audit findings indicated that many of the problems with the RLF program were rooted in lax EDA leadership and management attention to the program for at least as far back as our audit work extends. Simply put, the RLF program had insufficient staff devoted to monitoring, and there was no official with direct responsibility for the program. Our primary recommendation to EDA was to develop a comprehensive strategy and plan that has specific, measurable goals and milestones and is built on strong oversight from the top down. In our view, EDA needed to vest responsibility for oversight and the program's successes or failures in a senior agency official who would ensure that staff at each level in the RLF management chain is held accountable for specific outcomes and performance measures that target the program's known problems and issues.

EDA's action plan, submitted in May 2007 in response to our report, made this recommendation a priority. The agency has since given the director of the Office of Regional Affairs responsibility for monitoring the program, implementing the action plan, and meeting the milestone dates for EDA's 30 proposed actions. The Office of Regional Affairs is responsible for all appropriated funding including Economic Adjustment Assistance, under which the RLF program operates.

Another of our recommendations addressed in the action plan is that EDA promptly develop and implement an automated tracking system that provides current, reliable information on the entire RLF portfolio, such as original capitalization data for individual RLFs, as well as any subsequent award amendments, deobligations, terminations, and other changes in fund balances. In addition, it should track grantee reports due and EDA's steps to enforce compliance with reporting requirements.

A web-based management/reporting system is under development and EDA officials expect the system to be in place by March 2009. In the interim, EDA has implemented a limited database that tracks grantee reporting and sequestration data.

Our work highlighted the need for EDA to develop guidance to ensure greater consistency among the regions in enforcing RLF requirements. At a minimum, regional staffs need to ensure that grantees keep required amounts of capital loaned out; submit accurate, timely financial reports; and undergo single audits. They must sequester excess cash that sits in loan funds for longer than permissible. And they should recommend terminating funds that do not meet requirements or do not fulfill the economic development goals envisioned. Finally, they need to be trained on how to use single audit reports and other available tools to properly monitor RLF recipients in their jurisdictions.

EDA's action plan addressed each of these concerns. To date EDA has completed new guidance for determining appropriate capital utilization rates and sequestering excess cash; revised performance plans for regional staff that contain measurable RLF oversight metrics; and conducted training for EDA staff in all six regions as well as for RLF grantees. My office participated in the training efforts by conducting sessions on Single Audit requirements for EDA staff and RLF administrators.

EDA has also assigned an additional RLF staff person to five of the regions. Once the automated tracking system is operational, however, EDA should reevaluate its staffing needs to ensure sufficient oversight of the program to include enforcing reporting requirements and thoroughly analyzing the reported information so it can be used to better manage the RLF program.

OUR CRIMINAL INVESTIGATIONS AND AUDITS OF PUBLIC WORKS GRANTS UNDERSCORE THE NEED FOR CLOSER EDA SCRUTINY

I would now like to briefly discuss some of the issues we have noted in our audits of public works projects and criminal investigations of grant recipients.

Public works projects account for the bulk of EDA's program spending, with $2.86 billion in awards for 1,050 active grants. Public works grants fund projects intended to upgrade an area's economic infrastructure—they may be used to build new roads, enhance water or sewer systems, refurbish commercial facilities, or support a variety of other redevelopment projects intended to expand a region's existing economic base or attract new industry. These are multimillion-dollar projects, and the government's investment in them is sizable.

We have audited 10 public works projects with a total value of $45 million since EDA's 2004 reauthorization. This number represents only a small portion of its public works portfolio, and we initiated many of these audits at EDA's request. So while we cannot generalize our findings, the issues we identified are worth noting.

We questioned significant costs and identified funds to be put to better use of $13 million because of various violations of EDA grant requirements, such as financial accounting irregularities, conflicts of interest, and improper procurement procedures. Four of the10 projects were never completed.

- For example, our audit of a $6.7 million project that was intended to develop a technology park and learning center disclosed the county failed to carry out numerous responsibilities, could not finance the local share, and did not provide the necessary engineering supervision. More than a year after the grant had expired, the park remained without water and other infrastructure and had no prospects for use. We questioned all claimed costs, pending EDA's valuation of the completed portions of the project. EDA ultimately disallowed $1.9 million in claimed costs and sought to recover the federal share of $900,000.

- Our audit of a $2.3 million grant awarded to a city for infrastructure improvements to a proposed industrial park questioned all claimed costs and recommended termination of the project. The city's violations included awarding a subgrant for project management to a for-profit developer, failing to ensure full and open competition in procuring materials and services, and allowing conflicts of interest—the developer, as project manager, executed contracts with a company he controlled and with a firm owned by his son-in-law.

- Our audit of an $8 million EDA grant for construction of a 40,000 square-foot business incubator resulted in termination of the project after we found the grantee was on the brink of insolvency and had used the grant funds to stay afloat. At our recommendation, EDA directed repayment of $2 million in grant funds that had been dispersed for construction.

- Our investigation of an RLF established in 1985 with a $500,000 EDA grant found that four of the RLF's administrators had over the years been using the funds from this and other federal programs to compensate themselves as "consultants," to make rent payments for property they owned, and to finance extravagant trips. They were convicted in 2004 and ordered to pay restitution and fines totaling nearly $1.7 million. Two of the defendants were sentenced to 41 months' in prison.

- Another case involved a director and assistant director of a community development corporation administering an RLF, who made nearly $500,000 in unauthorized loans to themselves and to businesses they operated or controlled. They also paid themselves approximately $400,000 in fraudulent wages. They authorized the salary checks with the signature stamp of the corporation's secretary-treasurer. The two were sentenced in 2005—the director received a 2-year prison term and was ordered to pay restitution of nearly $500,000. The assistant director received 36 months' probation and a $5,000 fine.

Mr. Chairmen and Members of the Subcommittee, this concludes my statement. I would be happy to answer questions at this time.