



U.S. Department of Agriculture
Office of Inspector General
Northeast Region
Audit Report

Rural Business Enterprise Grant
Vivero Caimito Project
Puerto Rico Rural Development State Office
San Juan, Puerto Rico



Report No.
34004-04-Hy
July 2000



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: July 11, 2000

REPLY TO

ATTN OF: 34004-04-Hy
Vivero Caimito Project

SUBJECT: Rural Business Enterprise Grant
Puerto Rico Rural Development State Office

TO: Jill Long Thompson
Under Secretary
Rural Development

ATTN: Sherie Hinton Henry
Director
Financial Management Division

This report presents the results of our audit of the Rural Business Enterprise Grant to the Vivero Caimito Project in San Juan, Puerto Rico. The April 18, and May 5, 2000, responses to the official draft report are included as Exhibit C. Excerpts from the responses and the Office of Inspector General's position have been incorporated into the Findings and Recommendations section of the report.

We have accepted your management decisions on Recommendations Nos. 6 and 11. However, management decision has not yet been reached for the remaining recommendations. The Findings and Recommendations section of the report includes a description of the status of the management decision for each of these recommendations.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation for those recommendations for which management decisions have not yet been reached. Please note the regulation requires a management decision be reached on all findings and recommendations within a maximum of 6 months from report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the cooperation and assistance provided during the audit.

/S/
JAMES R. EBBITT
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

RURAL BUSINESS ENTERPRISE GRANT VIVERO CAIMITO PROJECT PUERTO RICO RURAL DEVELOPMENT STATE OFFICE SAN JUAN, PUERTO RICO

AUDIT REPORT NO. 34004-04-Hy

PURPOSE

The Rural Business Enterprise Grant (RBEG) program, one of several programs operated under the Rural Development mission area, is designed to support the development of small and emerging private business enterprises in rural areas. We conducted an audit of the RBEG disbursed by the Puerto Rico Rural Development State office (SO) to Vivero Caimito (the Grantee); a plant and tree nursery operated in the Caimito barrio of the San Juan Municipio, in San Juan, Puerto Rico. The audit was conducted in response to Hotline Complaints PS-0401-0894 and PS-3401-0021 which expressed concern that the Grantee, a nonprofit corporation, had received RBEG funding of \$850,000 for which it was not eligible because the Grantee's operation was not located in a rural area, as defined in Title 7, Code of Federal Regulations (7 CFR) § 1942, Subpart G.

The determination of whether the operation's geographic location is in a rural area is significant because RBEG funds can only be disbursed to grantees located in rural areas. The SO officials are required to review the decennial census data for the entire territory under their jurisdiction to identify that area which meets the definition of rural area. Regulations¹ define rural and rural area as that territory not within the outer boundary of any city having a population of 50,000 or more, and its immediately adjacent urbanized and urbanizing areas with a population density of more than 100 persons per square mile. Regulations¹ define urban area as a city with a population of 50,000 or more, define urbanized area as an area immediately adjacent to the urban area, and define urbanizing area as a community which is not now, or within the foreseeable future not likely to be, clearly separate from, and independent of an urban area and its immediately adjacent urbanized areas. Regulations¹ further explain a community is considered "independent of"

¹ 7 CFR § 1942.304, effective January 1, 1994.

when its government, education, business, industry, and employment opportunities are not dependent on the city and its immediately adjacent urbanized area.

To evaluate the allegations, we determined whether (1) the SO's methodology for classifying territory as rural areas to be eligible for RBEG grants in Puerto Rico, was in accordance with the RBEG regulations, (2) the SO properly performed and documented the site eligibility determination for this Grantee, and (3) the funds disbursed to the Grantee were in accordance with RBEG requirements.

RESULTS IN BRIEF

Our analysis of the SO's methodology used to classify areas as rural and, as such, be eligible for RBEG funding disclosed the methodology was flawed. SO officials classified 165.9 of 3,426.5 square miles in Puerto Rico as non-rural areas ineligible for RBEG funding. This occurred primarily because SO officials did not follow Rural Development regulations requiring that all urban, urbanized, and urbanizing areas be identified and excluded from areas eligible for RBEG funding. We analyzed census data; applied the Rural Development definitions of urban, urbanized, and urbanizing; and concluded that at least 9 separate areas containing 1,666 square miles, including the Caimito barrio, should have been excluded from the eligible funding area. As a result, the SO officials incorrectly determined the Grantee's project was eligible for RBEG funding of \$850,000.

Because the SO's methodology for identifying eligible rural areas was flawed, we expanded our review to determine whether RBEG funding was provided to other operations located in ineligible urban, urbanized, and urbanizing areas. During fiscal years (FY) 1996, 1997, and 1998, the SO approved 17 grants to 14 grantees totaling \$3.5 million. Our review disclosed three other grants totaling \$601,260 were disbursed to grantees not actually located in rural areas. Consequently, \$1.4 of the \$3.5 million in RBEG funding disbursed during the last 3 fiscal years, or 40 percent, has been spent on operations located in ineligible areas.

We also believe that other Rural Development mission areas such as Business and Industry (B&I), Rural Housing (RH), and Rural Rental Housing (RRH) could be impacted because rural area classifications are also required for determining eligibility for funding. During FY 1998, B&I loan funding was \$31 million, RH loan disbursements totaled \$103.5 million, and RRH loan disbursements totaled \$2.4 million in Puerto Rico. Therefore, we believe the potential effect of the misclassification of rural areas on U.S. Department of Agriculture (USDA) program payments within Puerto Rico could be significant.

Our review of the SO's actions to determine and document this Grantee was eligible for RBEG funding disclosed the SO records were incomplete and misleading. We found no records documenting the project's location on a map of eligible rural areas or evidence that Rural Development officials had visited the project location either prior to, or after, grant approval. At the time we initiated our audit, SO officials did not know that the Northern part of the Caimito barrio had been determined by the State engineer to be ineligible for RBEG funding and, as such, the specific location of the project within the Caimito barrio was critical. The SO officials we interviewed did not know where the project was located on an eligible area map. Further, once questions arose from the Rural Development National office (NO), and the USDA Office of the Inspector General (OIG), regarding the eligibility determination for this Grantee, the SO officials did not objectively reassess their prior eligibility determination. Rather, they attempted to use other agencies' comments to support the eligibility of the Grantee. Consequently, we concluded that the SO did not make a thorough analysis of all eligibility issues for this applicant.

Our review of Rural Development controls over the Grantee's use of RBEG funds disclosed the SO officials did not ensure the funds were used only to pay allowable costs that were approved in the grant budgets. The SO officials did not identify that \$2,400 was disbursed to pay costs not included in the budget, \$30,150 was disbursed to pay costs not related to the project, \$29,035 was disbursed to pay costs only partially related to the project, \$19,774 was disbursed to pay costs not supported by receipts, \$57,237 was disbursed to pay costs already paid under a general management services agreement, and \$30,400 was disbursed to pay rent costs not allowable since the owner was a related-party to the project. As a result, we question disbursements totaling \$168,996 from the \$850,000 grant.

KEY RECOMMENDATIONS

We recommend the NO assist the SO in performing a rural area classification analysis for each Rural Development program operating

in Puerto Rico; remove any territory from the rural area that is identified as urban, urbanized, or urbanizing; and cease disbursing Rural Development funding in any identified non-rural area. Also, procedures and/or guidance are needed to clearly define the terms municipio, barrio, city, zona urbana, urbanized, and urbanizing within Puerto Rico. Once the 2000 census data is available, the NO should assist the SO in performing another rural area classification. We also recommend that the NO determine whether the five RBEG grants totaling \$1,451,260 made to grantees located in ineligible areas should be recovered.

To strengthen SO operations, we recommend the NO provide training to the SO officials on how to perform and document individual project eligibility

determinations. In addition, procedures should be established to assist the SO in properly administering grant funds. We also recommend that the NO perform a follow up review to ensure RBEG requirements are met.

We recommend the SO recover grant funds expended by the Grantee for unallowable costs of \$89,787 and unsupported costs of \$19,774. In addition, the SO should require the Grantee to properly allocate cited costs of \$29,035 between the benefiting programs and determine the amount of ineligible rent costs of \$30,400 that can be justified as a depreciation or use allowance; and recover the excessive disbursements.

AGENCY RESPONSE

In the April 18, and May 5, 2000, responses to the draft report, the Rural Business-Cooperative Service (RBS) NO generally agreed with the key recommendations presented. The officials acknowledged the methodology used by the Puerto Rico SO was flawed and Grantee's project was actually located in an ineligible area. The Puerto Rico SO will attempt to recover \$850,000 in grant funds from the Grantee. The RBS NO officials also provided the following guidance to aide the Puerto Rico SO in re-evaluating its territory.

For the purpose of Puerto Rico, any area identified by the Bureau of the Census as urban, which exceeds program population limits or, where applicable, its immediately adjacent urbanized and contiguously urbanizing area is to be considered non-rural. Within these urbanized and urbanizing areas, any area which is separated by open country, less densely settled areas or natural boundaries, such as forests and water, is considered rural. The term urban or "zona urbana" is to be synonymous with the Bureau of the Census term "place", i.e., the dark gray area shown on its maps and all such areas which are contiguous will be considered a single unit for the purpose of determining population. Thus, once a unit is identified as having a population greater than 50,000 persons, the identification of urbanized and urbanizing areas must be made.

Since the Puerto Rico SO has not re-evaluated its territory on the basis of the recently provided guidance, the eligibility of the other three grants totaling \$601,260, has not been established. Further, because the RBS has determined the Vivero Caimito Project was not eligible for RBEG funding, other questioned disbursements will be dealt with only if a determination is made that the entire grant is not recoverable.

We have incorporated excerpts of the RBS's responses along with our position within the Findings and Recommendations section of the report. The responses, excluding attachments, are contained in exhibit C of the report.

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INTRODUCTION

BACKGROUND

The RBEG program provides grants to finance and facilitate development of small and emerging private enterprises. The program regulations at 7 CFR § 1942 Subpart G, provide that RBEG funds must be awarded for projects located in rural areas. Grants are made from rural development funds under authority of the Consolidated Farm and Rural Development Act, as amended (7 U.S.C. 1932). Grants may be made to public bodies and private non-profit corporations serving rural areas. According to 7 CFR § 1942.306, effective January 1, 1994, grant funds may be used to develop small businesses including, but not limited to the following: for acquisition and development of land; construction, conversion, enlargement, modernization, or repairs of buildings, plants, machinery, and equipment; technical assistance for private business enterprises; and for operating costs. The limitations on the use of grant funds are contained in 7 CFR § 1942.307, effective January 1, 1994.

According to 7 CFR § 1942.304, effective January 1, 1994, rural and rural area is defined as all territory of a State or the Commonwealth of Puerto Rico that is not within the outer boundary of any city having a population of 50,000, or more, and its immediately adjacent urbanized and urbanizing areas with a population density of more than 100 persons per square mile, according to the latest decennial census of the United States. This regulation also defines urbanized area as an area immediately adjacent to a city having a population of 50,000 or more, which for general social and economic purposes constitutes a single community and has a boundary contiguous with a city. In addition, this regulation defines urbanizing area as a community which is not now, or in the foreseeable future not likely to be, clearly separate from, and independent of a city with a population of 50,000 or more and its immediately adjacent urbanized areas. This regulation explains that a community is "independent of" when its social and economic structure (government, education, employment opportunities, etc.) is not primarily dependent on the city and its immediately adjacent urbanized area. Thus, once an area with a population of 50,000 or over is identified, a review to determine where the population density declines to less than 100 persons per square mile must be performed to identify where the rural area begins.

The U.S. Department of Commerce, Bureau of the Census, published the results of the 1990 decennial census taken in Puerto Rico in a book entitled 1990 Census of Housing, General Housing Characteristics, Puerto Rico

(census book). This book identifies, both on maps and in charts, those geographic areas that are urbanized. Within each urbanized area, the maps identify, by shading, the components of the entire area. The urbanized area on the map that is categorized as urban with a population of 50,000 or more is shaded dark gray. The area on the map that is categorized urbanized and which is immediately adjacent to the urban area is shaded light gray. The remaining unshaded areas are not classified by the Bureau of the Census and the Bureau of the Census does not use the Rural Development term "urbanizing."

The census book is written in English and Spanish but the population data uses Spanish terms to categorize the areas. Following are the terms and their English meanings.

- Area Urbanizadas - Urbanized Area
- Zona Urbana - Urban Area
- Otra Area - Other Area, but part of the Urbanized Area
- Lugar - Place, and Urban area
- Municipio - Municipality, but more similar to a county or township as there is no incorporated city in Puerto Rico
- Barrio - Ward within a township or a subtownship

This census book also lists the population and square miles of each municipio, barrio, area urbanizadas, zona urbana, and otra area within Puerto Rico. The Bureau of the Census separated the island into 78 municipios. Each municipio is separated into barrios. Within some barrios, the Bureau of the Census has identified that one part the area is urban, another part is urbanized, and another part is not categorized.

According to 7 CFR § 1942.305, effective January 1, 1994, the State Director is to determine whether the areas are urbanized or urbanizing and determine the population density per square mile. All such density determinations are to be made on the basis of minor civil division or census county division, as used by the Bureau of the Census. The SO performed the rural area classification in 1994 after receiving the 1990 decennial census data and will not update the classification until the results of the 2000 decennial census is received. The Bureau of the Census published maps that show the areas classified as urban and urbanized and charts that identify population density information by barrio and, in some cases, subbarrio. Therefore, the SO staff needed only to evaluate those barrios surrounding the urban and urbanized areas identified by the Bureau of the Census, to determine the urbanizing areas.

According to the 1990 census data, Puerto Rico contains 3,426.5 square miles of land area and has a population of 3,522,037. The island is divided into 78 municipios which contain 899 barrios. For example, the San Juan municipio contains 18 barrios. Within the San Juan municipio, the map shows that 15 barrios are urban; areas within 2 barrios are, either urban, urbanized, or not categorized, and areas within the other barrio are either urbanized or not categorized.

This audit was performed in response to Hotline Complaints OIG received in August and September 1998 which alleged that Centro Sor Isolina Ferre, a nonprofit corporation which is the parent corporation of Vivero Caimito which is the Grantee; received RBEG funds to operate a tree and plant nursery business not physically located in a rural area.

In July 1998, the Rural Development's NO received a similar anonymous complaint and requested that the Puerto Rico SO reevaluate the Grantee's eligibility. On July 29, 1998, the Puerto Rico SO responded that their reassessment concluded the Grantee's operation was located in a rural area and, as such, was eligible for the RBEG.

Regulations governing the management of grant funds are contained in 7 CFR § 3015, effective January 1, 1994. These regulations require that Office of Management and Budget (OMB) Circular A-122, Cost Principles for Nonprofit Organizations, be used to determine the allowability of costs.

OBJECTIVES

The audit objectives were to determine whether (1) the SO's methodology for classifying areas as rural to be eligible for RBEG grants in Puerto Rico was in accordance with the regulation, (2) the SO properly performed and documented the site location eligibility determination for this Grantee, and (3) the funds disbursed to the Grantee were used in accordance with RBEG requirements.

SCOPE

Audit work was performed at the Rural Development SO located in Hato Rey, Puerto Rico. We also made site visits to the Grantee's project located in the barrio of Caimito in the San Juan municipio, San Juan, Puerto Rico. Our review of the RBEG and B&I rural area classification process covered the most recent classification which was performed in November 1994. Our review of project eligibility records and disbursements covered the period May 1996 through February 1999.

The SO approved two grants totaling \$850,000 to the Grantee. The first grant, approved in May 1996, provided funding primarily to create the

necessary infrastructure and to train the personnel. The second grant, approved in January 1998, provided funding to establish ten satellite producers. As of February 24, 1999, grant funding of \$833,904 had been disbursed to the project. On that date, a balance of \$16,096 had not been disbursed from the second grant. We reviewed documents available to support the 19 separate disbursements totaling \$833,904 made by the SO to the project for allowability of the costs reported.

The audit was conducted in accordance with generally accepted government auditing standards. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objectives.

METHODOLOGY

To accomplish the audit objectives and evaluate whether the methodology used by SO officials to identify eligible rural areas was in compliance with program requirements, we: (1) interviewed the SO officials who performed the rural area classification review, (2) visited the project site, (3) interviewed various SO officials, including the State director, to determine how they performed project eligibility determinations and their understanding of the Rural Development classification process and the Rural Development definition of rural area, (4) obtained and reviewed the source documents the SO officials used in doing the rural area classifications, (5) obtained from the Bureau of the Census book additional data of land areas and population for the 9 urbanized areas and 41 municipios identified by the Bureau of the Census as having a population of 50,000 or over, (6) reviewed the population density of all 491 barrios located in the 41 municipios to identify those barrios with a population of over 100 persons per square mile, (7) located on the eligibility area maps the location of the Grantee's project and the other 14 projects that received RBEG funding during FYs 1996, 1997, and 1998, and (8) obtained urbanized area maps for the Municipios of San Juan, Mayaguez, Ponce, and Caguas, directly from the Bureau of the Census. We also discussed the rural area classification process and applicable Rural Development regulations with Rural Development NO officials. We interviewed the former Office of the General Counsel (OGC) attorney who reviewed various project legal documents. We also interviewed an official of the Government of Puerto Rico's Planning Board who, during the audit, responded in writing to the SO regarding their question of whether the project site was urban or rural.

To test the adequacy of controls used by SO in disbursing funds to the Grantee, we (1) obtained project files, (2) interviewed SO officials to become familiar with the review process, (3) obtained and reviewed grant approval and budget documents, (4) obtained and reviewed fiscal reports

of expenses and project progress reports, and (5) evaluated supporting documents such as contracts, invoices, and payrolls for each item of cost reviewed.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	RURAL AREA CLASSIFICATIONS NOT ACCORDING TO REGULATIONS AND RESULTED IN GRANTS MADE IN INELIGIBLE AREAS
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FINDING NO. 1

Our analysis of the SO's methodology for classifying geographic areas as rural and, as such, being eligible for RBEG funding disclosed the methodology was flawed. The

SO classified only 165.9 of 3,426.5 square miles in Puerto Rico as non-rural areas ineligible for RBEG funding. This occurred because the SO officials failed to follow pertinent RBEG regulations. We analyzed census data; applied the Rural Development definitions of urban, urbanized, and urbanizing; and concluded that at least 9 areas containing 1,666.4 square miles, including the Caimito barrio, should have been excluded from the eligible funding area. As a result, the SO officials incorrectly determined the Grantee project was eligible for RBEG funding of \$850,000. Further, we found that this rural area misclassification caused SO officials to incorrectly determine three other projects eligible for RBEG funding totaling \$601,260 within the last 3 fiscal years. Moreover, because rural area classifications are made for eligibility determinations in other Rural Development programs, we believe other ineligible USDA program payments may have occurred.

Initially, the SO did not develop a working definition of "city" to conform with the Spanish terminology used by the Bureau of the Census to identify places within Puerto Rico as a starting point in the classification process. Rather than use the census data that clearly identified the urban and urbanized areas within Puerto Rico, the SO staff classified 8 areas with a total of 165.9 square miles as non-rural based on their perception of the meaning of "urban." The SO also failed to apply the Rural Development definitions of urbanized and urbanizing to the adjacent areas surrounding those seven urban areas identified to determine whether these adjacent areas were also not eligible for RBEG funding.

According to regulations², Rural Development officials were to identify those areas that are urban, urbanized, and urbanizing according to census data. These regulations define urban area as a city with a population of

² 7 CFR § 1942.304 and .305, effective January 1, 1994.

50,000 or more, urbanized area as an area immediately adjacent to the urban area (with a population density of more than 100 persons per square mile), and urbanizing area as a community (with a population density of more than 100 persons per square mile) which is not now, or not likely to be, clearly separate from, and independent of an urban area and its immediately adjacent urbanized areas.

We interviewed SO officials and reviewed their documentation to determine how Rural Development officials classified only 165.9 of the 3,426.5 square miles of land area in Puerto Rico as not eligible for RBEG funding. The SO used the following methodology to designate rural areas within Puerto Rico.

- On November 9, 1994, the State Director assigned the responsibility for classifying rural areas for the Business and Industry loan program and the RBEG program to the State engineer. On that same date, the engineer completed the rural area classifications for a presentation to potential borrowers interested in the Business and Industry loan program.
- The engineer obtained the book entitled 1990 Census of Housing, General Housing Characteristics, Puerto Rico published by the Bureau of the Census. He then located the map section entitled Areas Metropolitanas, Municipios, Y Lugars Seleccionados; identified seven places (lugares) with a population of over 50,000, and concluded that the municipios in which the places were located contained some non-rural areas. He also determined that the remaining 71 municipios were 100 percent rural.
- The engineer then reviewed the seven Bureau of the Census Urbanized Area municipio maps to determine whether any land area within the municipio's geographic boundary was rural. The engineer decided that any dark gray shaded area on the map was non-rural and that all light gray shaded and unshaded areas were rural. He also concluded that the Catano Municipio, which is adjacent to the San Juan Municipio, was also urban.

Our analysis of the Rural Development regulations and the 1990 Census of Housing, General Housing Characteristics, Puerto Rico and the 1990 Census of Population and Housing, Supplementary Reports, Urbanized Areas of the United States and Puerto Rico disclosed flaws in the engineer's methodology as follows.

- The engineer did not apply the Rural Development definitions of urban, urbanized, and urbanizing in his classification process. He only

selected some of the areas identified as urbanized by the Bureau of the Census. He told us he was not fully familiar with RBEG requirements at 7 CFR, § 1942.304 and .305 and his classification was not supervised by SO management officials. He explained he basically applied his perception of what a rural area was. We found no documentation to show that his analysis was reviewed by SO management. Further, SO personnel now in those management positions told us they did not believe anyone validated his analysis.

- The engineer's use of the map section entitled Areas Metropolitanas, Municipios, Y Lugars Seleccionados was not appropriate. This map's identification of place (lugar) with a population of 50,000 or more does not identify a city or town including its urban, urbanized, and urbanizing areas. The Bureau of the Census definition of place explains that it has no legal status and may only be the governmental center of a municipio or town. In practice, place may be part of a town with a total population of 50,000 or more. For example, the map used by the engineer shows Arecibo is a place designated as having a population between 25,000 and 49,999. However, other census data shows that the urbanized area of Arecibo has a population of 51,578 persons living in a 16.2 square mile area (about 4 miles by 4 miles), with a population density of 3,181 persons per square mile. Since Rural Development regulations³ classify cities with a population of 50,000 or more as urban areas, Arecibo is not rural. Therefore, the engineer's use of place did not accurately identify urban, urbanized, and urbanizing areas as defined by Rural Development and the Bureau of the Census. The maps which should have been used as a starting point in the classification process and which were also provided in the Bureau of the Census book, were the Urbanized Areas maps. The Urbanized Area maps, which were on the following four pages of the book the engineer had used show, by shading, the urban and urbanizing areas. The census data also shows the population density of the adjacent areas.
- The engineer's analysis of the seven municipios he identified as having a population of 50,000 or more did identify the urban areas within the seven municipios. However, he failed to separate the non-rural urbanized and urbanizing areas from the rural areas. This occurred because the engineer did not understand the meaning of the map shading and the Rural Development definitions. The municipio maps he used presented the two components of each urbanized area to be (1) place (urban area) highlighted in dark gray and (2) other area (urbanized area) highlighted in light gray. However, his analysis classified only place (urban area) as non-rural. His analysis did not consider that the other area identified by the Bureau of the Census as

³ 7 CFR § 1942.304 and .305, effective January 1, 1994.

of \$31 million during FY 1998, the potential for ineligible program payments exists. Further, rural area classifications were performed for the RH and RRH programs and, during FY 1998, loan disbursements of \$105.9 million occurred. Therefore, we believe the potential effect of the misclassification of rural areas within Puerto Rico could be significant.

RECOMMENDATION NO. 1

Assist the SO in performing a rural area classification analysis for each Rural Development program operating in Puerto Rico; remove any area from the rural area classification that is identified as urban, urbanized, or urbanizing; and cease disbursing Rural Development funding in any identified non-rural area.

RBS Response

The RBS NO letter dated May 2, 2000, provided guidance for the Puerto Rico SO to follow regarding its programs and the RBS requested the Puerto Rico SO to re-evaluate the territory to properly determine rural areas within Puerto Rico.

OIG Position

The guidance provided by the RBS NO is the beginning of the process for re-evaluating the territory for RBS programs. However, we recommended the RBS NO assist in the classification process and cease disbursing funding in non-rural areas. Further, our recommendation addressed all Rural Development programs operating in Puerto Rico.

To reach management decision, other Rural Development agencies need to assist the Puerto Rico SO in performing a rural area classification analysis. Also, the RBS needs to actively participate with the Puerto Rico SO in performing the re-evaluation of its territory for RBS programs. Targeted completion dates are needed for completion of the classification analysis for Rural Development programs in Puerto Rico.

RECOMMENDATION NO. 2

Develop procedures and/or guidelines that would clearly define terms including municipio, barrio, city, zona urbana, urbanized, and urbanizing.

RBS Response

The RBS NO guidance stated that for the purpose of Puerto Rico, any area identified by the Bureau of the Census as urban, which exceeds program population limits or, where applicable, its immediately adjacent urbanized and contiguously urbanizing area is to be considered non-rural. Within these urbanized and urbanizing areas, any area which is separated by open country, less densely settled areas, or natural boundaries, such as forests and water, is considered rural. Further, the term urban or “zona urbana” is to be synonymous with the U.S. Census Bureau term “place,” *i.e.*, the dark gray areas shown on its maps, and all such areas which are contiguous will be considered a single unit for the purpose of determining population. Thus, once an area is identified as having a population greater than 50,000 persons, the identification of surrounding urbanized areas and urbanizing areas must be made.

OIG Position

Most of the guidance provided by the RBS met the intent of our recommendation. However, the guideline for urbanizing needs further clarification. According to regulations⁴, for an urbanizing area (population greater than 100 persons per square mile) to be considered rural, it must be determined that the area is now, or in the future, likely to be clearly separate from and independent of the urban and urbanized area. The guidance provided only explains how an urbanizing area can be separate from an urban area. The guidance omits the regulatory caveat that the area must also be determined to be “independent of” the urban and urbanized area. The regulations⁴ explain that to be “independent of,” the area’s social and economic structure, *e.g.*, government, education, health, and recreational facilities; and tax base, business, industry, and employment opportunities are not primarily dependent on the urban and urbanized area.

We believe this determination of “independent of” is a key to the classification process in Puerto Rico. Most areas within each Municipio do not appear to meet this “independent of” definition as government, business, industry, tax base, and employment opportunities are identified on a Municipio basis. Therefore, to reach management decision, RBS needs to clarify the guidelines for identifying urbanizing areas by directing that these areas must also be determined to be “independent of,” the urban or

⁴ 7 CFR § 1942.304, effective January 1, 1994.

urbanized area to be considered rural and provide a date when the guidelines will be applied.

RECOMMENDATION NO. 3

Assist the SO in completing its review of the 2000 census data and its classification analysis of eligible rural areas.

RBS Response

The RBS agrees to implement this recommendation as soon as the data is available.

OIG Position

Our recommendation addressed all Rural Development programs operating in Puerto Rico. Therefore, to reach management decision, the Rural Development agencies need to agree to implement Recommendation No. 3, and provide a targeted completion date for the classification analysis.

RECOMMENDATION NO. 4

Determine whether the five RBEG grants totaling \$1,451,260 should be recovered.

RBS Response

The RBS agrees that the \$850,000 in grants to the Vivero Caimito Project was unauthorized assistance and the grants will be serviced under 7 CFR, § 1951, subpart O, Unauthorized Assistance. The RBS NO concluded the other three grants totaling \$601,260, were made in eligible areas. However, on the basis of their response, the Puerto Rico SO has not completed its re-evaluation of the territory within Puerto Rico to confirm the NO's initial conclusion.

OIG Position

To reach management decision, the RBS NO needs to implement Recommendations Nos. 1 and 2, as presented, and then begin servicing all unauthorized assistance identified in accordance with 7 CFR 1951, subpart 0.

FINDING NO. 2

The SO's records documenting that the Grantee project was located in a rural area were incomplete and misleading. This occurred because the officials did not follow applicable regulations. Further, the SO officials did not acknowledge the lack of eligibility documentation when questioned by both Rural Development NO and OIG officials. Without adequate documentation in the grant docket, the SO could not support that the project was located in an area classified as rural and eligible for RBEG funding of \$850,000. Our review disclosed significant problems with the SO's classification methodology (see Finding No. 1). We concluded that the SO did not make a thorough analysis of all eligibility issues for this Grantee and, based upon Finding No. 1, the Grantee was not eligible for the RBEG funding of \$850,000.

According to Rural Development regulations⁵, support documentation necessary to make an eligibility determination shall be forwarded to the State director for approval.

In mid-1998, the Rural Development NO requested that the SO follow up on allegations that the Grantee project was not eligible for the grants because it was not located in a rural area. On July 29, 1998, the SO officials responded to the NO. They stated that Rural Development of Puerto Rico makes a thorough analysis of all eligibility issues for each applicant of any program. They stated that the ward (barrio) where the project is located had a population of 19,413 according to the 1990 Census data and, as such, did not exceed the population eligibility limit of 50,000. The SO officials also explained that they had requested assistance from the OGC in determining applicant eligibility. They cited the following quotes from the OGC response as support for their belief that the location was in an eligible rural area. The OGC response stated, in part, "The proposed project is located in the community of Caimito in the City of San Juan"...."There is no doubt that this is a Rural Area."

We analyzed SO records; the SO's response to the NO request for support that the Grantee project was in a rural area; census data; and interviewed Rural Development, former OGC, and Puerto Rico Planning

⁵ 7 CFR § 1942.2, effective January 1, 1994.

Board officials. We noted the following problems with the SO's documentation to support the eligibility decision for this grant.

- We found no records documenting the project's location on a map of eligible rural areas or evidence that SO officials had visited the project location either prior to, or after, grant approval. At the time we initiated our audit, SO officials did not know that the Northern part of the Caimito barrio had been determined by the State engineer to be ineligible for RBEG funding and, as such, the specific location of the project within the Caimito barrio was critical. SO officials we interviewed did not know where the project was located on an eligible area map. Even though no documentation was available to show the project's location, current Rural Development officials, including the State director, assured us that the Caimito barrio was a rural area.
- The SO officials told their NO in a July 29, 1998, memorandum that the ward (barrio) where the project is located had a population of 19,413 according to the 1990 Census data and, as such, did not exceed the population eligibility limit of 50,000. However, SO officials did not disclose that the part of the Caimito barrio where the project is located abutted the adjacent ineligible area of San Juan with a population of over 400,000. Further, SO officials did not disclose that the population density for the 5.4 square mile Caimito barrio was 3,595 persons per square mile. We believe that, had these two facts had been disclosed to the NO, additional questions would have been raised about the area's eligibility. We could not conclude whether the lack of disclosure was intentional or arose due to SO officials lack of knowledge of the actual location of the project.
- The SO officials initially told us that the Caimito barrio of the San Juan Municipio was an eligible area because the barrio had a population of 19,413 and, as such, did not exceed the population eligibility limit of 50,000. Later, they acknowledged that the population of a barrio, as a stand-alone fact, did not identify whether the area was rural or urban and that additional analysis should be warranted to make that determination.
- A key document SO officials provided to their NO and to OIG to support that the project was in a rural area was a letter dated May 23, 1996, from OGC. The letter stated, in part... "The proposed project is located in the community of Caimito in the City of San Juan"... "There is no doubt that this is a Rural Area." This letter was OGC's response to the State Director's May 14, 1996, request for an opinion on the applicant's legal existence and authority to operate a nursery in Caimito. The OGC letter cites the records reviewed to render the opinion on the applicant's legal existence and authority to operate the nursery. The records reviewed by OGC do not include any census data or maps which would be required to determine whether the project is located in a rural area.

Moreover, had the SO disclosed to the NO that the City of San Juan has a population of over 400,000, the NO officials may have noted that the two OGC statements contradicted each other; i.e., how can a rural area have a population of over 400,000. The SO officials acknowledged to us they had relied on the OGC statement that the project was in a rural area to determine project eligibility. However, Rural Development, not OGC, is responsible for RBEG eligibility determinations.

- We interviewed the individual who signed the May 23, 1996, letter from OGC. He explained this letter was part of his normal responsibilities as he did a legal review of each RBEG grantee's authority to do business. He told us he did not believe OGC had been provided the Rural Development eligible area maps. He said he was not aware of Rural Development's specific definition of rural and probably based his comment on general information provided by Rural Development and his perception of rural. He said he had not visited the project site.
- During the audit, SO officials obtained a letter from the Government of Puerto Rico's Planning Board dated December 29, 1998, to support their belief that the Caimito barrio was a rural area. This letter stated that the location of the project is outside of the "urban zone" of the San Juan municipio. Since the letter did not define "urban zone," we contacted the Planning Board to clarify the statement. We were told that "urban zone" i.e., zona urbana in Spanish, came from the Bureau of the Census maps and was one of two parts of the urbanized area. The Planning Board official told us the project was located in the "otra area" or the other part of the urbanized area according the Bureau of the Census map. We applied the Rural Development definition of rural⁶ which excludes urban and urbanized areas, and concluded the Grantee is not located in a rural area.

In summary, the SO did not initially clearly and accurately document the rural area eligibility for this Grantee's project. Further, once questions arose from their NO and OIG regarding the eligibility determination for this Grantee, the SO officials did not objectively reassess their prior eligibility determination. Rather, they attempted to use other agencies' comments to support the eligibility of the Grantee. Consequently, we concluded that the SO did not make a thorough analysis of all eligibility issues for this applicant.

⁶ 7 CFR § 1942.305, effective January 1, 1994.

RECOMMENDATION NO. 5

Provide training to SO officials on how to perform and document individual RBEG project eligibility determinations.

RBS Response

There has been nearly a 100 percent turnover in the Puerto Rico RBS staff since the cited grants were made. The current SO staff is knowledgeable in making determinations concerning rural area eligibility under the RBEG program.

OIG Position

Since the RBS NO has requested the Puerto Rico SO to re-evaluate its rural area designations on the basis of the guidance provided in Recommendation No. 2, we believe that the RBS NO does need to provide the additional training recommended. Therefore, our recommendation remains as presented.

RECOMMENDATION NO. 6

Perform a follow up review after the training is provided to determine whether the RBEG eligibility requirements are being met.

RBS Response

Post reviews will be conducted in the RBS NO on each RBEG made since August 1999 through the end of the FY 2000. The officials stated the reviews will be completed by December 31, 2000, and the RBS will provide further guidance, training, assistance, and followup as needed.

OIG Position

On the basis of this response, we have reached management decision.

FINDING NO. 3

The SO's grant management was not effective in ensuring the grant funds disbursed were used for eligible costs approved in the grant budgets. We determined the SO reviews performed before funds were disbursed to the Grantee did not identify that \$2,400 was disbursed to pay costs not included in the budget, \$30,150 was disbursed to pay costs not related to the project, \$29,035 was disbursed to pay costs only partially related to the project, \$19,774 was disbursed for costs not supported by receipts, \$57,237 was disbursed to pay costs already paid under a general management services agreement, and \$30,400 was disbursed to pay rent costs not allowable since the owner was a related party to the project. The SO officials attributed these deficiencies to their reorganization, and staff reductions, which impaired their ability to effectively manage grant funds. As a result, we question the authorization of disbursements to the Grantee totaling \$168,996.

According to regulations⁷, OMB Circular A-122 shall be used in determining the allowable costs of activities conducted by nonprofit corporations. According to OMB Circular A-122, Cost Principles for Nonprofit Organization, Attachment A, General Principles, to be allowable, the costs shall be scrutinized to determine if the amount does not exceed the amount that would be incurred by a prudent person under same circumstances and be adequately documented.

The SO approved two grants totaling \$850,000 to the Grantee. The first grant, approved in May 1996, provided funding primarily to create the necessary infrastructure and to train the personnel. The second, approved in January 1998, provided funding to establish ten satellite producers. As of February 24, 1999, \$833,904 had been disbursed for the project. On that date, a balance of \$16,096 was available from the second grant. We reviewed the disbursements and found the following.

- Disbursements Nos. 2 and 10 included funding for unallowable costs totaling \$2,400; \$900 and \$1,500, respectively, for activities not approved in the budget. The \$900 payment was for preparation of the grant application and the \$1,500 payment was for a property appraisal.

⁷ 7 CFR § 3015.193, effective January 1, 1994.

- Disbursements Nos. 1 and 3 included funding for unallowable costs totaling \$30,150; \$150 and \$30,000, respectively, for costs not related to the project. The \$150 payment was for a salary advance paid to a non-project employee and the \$30,000 payment was to fund a revolving advance to producers. We found no further documentation after the \$30,000 was advanced to show that the project actually used the funding for project purposes.
- Disbursements Nos. 4, 7, and 9 included funding for questioned costs totaling \$29,035; \$1,915, \$10,000, and \$17,120, respectively, as the costs incurred were not properly allocated between the RBEG grant and other non-grant related activities. The \$1,915 disbursement was for professional services rendered by the parent corporation, which were not 100 percent related to the RBEG grant; and the \$10,000 and \$17,120 disbursements were made to purchase vans which were used for the RBEG grant, as well as other purposes.

Our review also disclosed unsupported costs of \$19,774 as follows:

- Disbursements Nos. 1 and 2 included funding for questioned costs totaling \$642; \$580 and \$62, respectively, for material costs and petty cash reimbursements that were not supported by receipts.
- Disbursements Nos. 9, 10, and 11 included funding for questioned costs totaling \$17,888; \$8,944; \$4,472; and \$4,472; respectively, for costs of rental equipment that were not supported by receipts.
- Disbursement No. 11 also included funding for questioned costs of \$1,244 for payroll costs that were not supported by time and attendance or other records.

We also performed an indepth review of the transactions between the Grantee and its parent corporation because they are considered to be related-parties which may enter into less-than-arms-length transactions. OMB Circular A-122 Attachment A, (3), Reasonable costs, requires additional considerations when transactions are with related-parties. In addition, the allowability of rent costs are limited to a depreciation or use allowance by Attachment B, Selected Item of Cost No. 42, Rental Costs. Selected Item of Cost No. 9, requires the computation of the allowable depreciation or use allowance to exclude the cost of the land. The Grantee and the parent corporation entered into a 3-year contractual agreement whereby the parent corporation provides the Grantee general management services for \$2,000 per month and rents the property to the Grantee for \$1,600 per month. We found the following.

- The \$2,000 per month cost of management services; including accounting, purchasing, audit, reception, payments to suppliers, equipment use, personnel, and payroll which were performed at the parent corporation offices appeared reasonable based upon Rural Development's RRH management cost information. However, we found that the parent corporation also billed, and the Grantee paid, additional management service costs that should have been covered by the \$2,000 monthly fee. The Grantee was billed and paid \$10,737 for equipment used by the staff performing the off-site management services, \$900 for audit services, and \$45,600 for the salary of the staff performing the off-site management services. We concluded these additional costs totaling \$57,237 were covered in the monthly management fee and are unallowable costs.
- The monthly rent cost of \$1,600 was not allowable. According to OMB Circular A-122, rental costs under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. Therefore, only a depreciation or use allowance would be allowable. We consider the \$30,400 paid from July 1996 through November 1998 to be unallowable costs.

Our review of disbursements totaling \$833,904 disclosed the Grantee disbursed \$89,787 for unallowable costs (items one, two, and seven) \$19,774 for costs that were not adequately documented (items four, five, and six), \$29,035 for the entire cost of three transactions that should have been allocated among the benefiting programs (item three), and \$30,400 for rental costs that are not allowable because the payments went to a related-party (item eight).

RECOMMENDATION NO. 7

If the grant is not recovered in total under Recommendation No. 4, recover the unallowable costs of \$89,787 from the Grantee.

RBS Response

The RBS agrees that the Grantee is located in an ineligible area of Puerto Rico. Therefore, the entire \$850,000, plus accrued interest, represents unauthorized assistance. The Grantee will be serviced under 7 CFR, § 1951, subpart O, Unauthorized Assistance. This regulation allows for collection efforts to be initiated once a grantee is given an opportunity to refute the RBS findings and provide information to support its position.

OIG Position

We recognized in this recommendation that the potential exists for recovery of the entire grant under the RBS cited regulation. However, it is possible that the RBS could determine the entire grant cannot be recovered because the RBS, not the Grantee, failed to follow the rural area eligibility regulations. Therefore, we believe these unallowable costs incurred because the Grantee failed to follow regulations, should be recovered if the entire \$850,000 in grant funds are determined not recoverable. Our recommendation remains as presented.

RECOMMENDATION NO. 8

If the grant is not recovered in total under Recommendation No. 4, recover the unsupported costs of \$19,774 from the Grantee.

RBS Response

The Grantee will be required to provide support documentation for these costs along with a written explanation, in English, to the Puerto Rico SO to determine if the \$19,774, should be recovered in the event the entire grant of \$850,000, is not recoverable.

OIG Position

Management decision can be reached when a targeted completion date is provided for the proposed actions and/or a bill for collection is issued.

RECOMMENDATION NO. 9

If the grant is not recovered in total under Recommendation No. 4, advise the Grantee that the costs for the vans and other services totaling \$29,035 are not allowable, allow the Grantee to allocate the costs among the benefiting programs, and recover the difference between the amount disbursed and the amount determined to be allowable under the grant.

RBS Response

The Grantee will be required to provide support documentation for these costs along with a written explanation, in English, to the Puerto Rico SO to determine if the \$29,035, should be recovered in the event the entire grant of \$850,000 is not recoverable.

OIG Position

Management decision can be reached when a targeted completion date is provided for the proposed actions and/or a bill for collection is issued.

RECOMMENDATION NO. 10

If the grant is not recovered in total under Recommendation No. 4, advise the Grantee that the rent costs totaling \$30,400, are not allowable; allow the Grantee to determine the amount of depreciation or use allowance that can be claimed for using facilities of its parent company; and recover the amount disbursed for rent payments in excess of the allowance.

RBS Response

The Grantee will be required to provide support documentation for these costs along with a written explanation, in English, to the Puerto Rico SO to determine if the \$30,400, should be recovered in the event the entire grant of \$850,000 is not recoverable.

OIG Position

Management decision can be reached when a targeted completion date is provided for the proposed actions and/or a bill for collection is issued.

RECOMMENDATION NO. 11

Provide training to SO staff on how to properly manage grant funds.

RBS Response

Post reviews will be conducted in the NO on each RBEG made by the Puerto Rico SO since August 1999 through the end of the FY 2000, with additional training to be provided on grant management at the upcoming August 2000 training session for all SO employees.

OIG Position

On the basis of the response, management decision has been reached.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Recommendation No.	Description	Amount	Category
4	Questioned Grants	\$1,451,260	Questioned Cost No Recovery
7	Unallowable costs	\$89,787	Questioned Cost Recovery Recommended
8	Unsupported Costs	\$19,774	Questioned Cost Recovery Recommended
9	Improper cost allocation between grant and non-grant activities	\$ 29,035	Questioned Cost Recovery Recommended
10	Unsupported rental costs	\$ 30,400	Questioned Cost Recovery Recommended

EXHIBIT B – LAND AREA RECLASSIFICATION

LAND AREA RECLASSIFICATION

Following are the 9 urbanized areas, the municipios within each, the square miles of urbanized areas, the square miles of potential urbanizing areas, and the square miles of potentially rural areas.

Note: Puerto Rico contains 3,426.5 square miles and has a total population of 3,522,037 according to the 1990 census data.

Name of Area	Land Area Square Miles Total Per Census A	Land Area Square Miles Urbanized Per Census B	Land Area Square Miles Urbanizing Per OIG C	Land Area Square Miles with Population Less than 100 - Rural = D	Land Area Square Miles RD Classif. as Non- Rural E	Land Area Square Miles OIG Believes 'Non-rural (B+C) F	Population Per Census Data G
1 Aguadilla urban area	117.8	46.4	68.6	2.8			99,936
Aguada municipio	30.9	16.9	11.2	2.7	0.0	28.1	
Aguadilla municipio	36.6	22.9	13.5	0.1	0.0	36.4	
Moca municipio	50.3	6.6	43.7	0.0	0.0	50.3	
2 Arecibo urban area	214.5	37.7	157.8	19.0			88,967
Arecibo municipio	126.3	16.2	91.1	19.0	0.0	107.3	
Camuy municipio	46.4	7.4	39.0	0.0	0.0	46.4	
Hatillo municipio	41.8	14.1	27.7	0.0	0.0	41.8	
3 Caguas urban area	208.3	57.5	149.9	1.0			190,922
Aguas Buenas Municipio	30.6	0.3	30.3	0.0	0.0	30.6	
Caguas Municipio	58.7	28.6	30.1	0.0	12.7	58.7	
Canovanas Municipio	7.4	0.3	7.1	0.0	0.0	7.4	
Cidra Municipio	2.5	2.5	0.0	0.0	0.0	2.5	
Gurabo Municipio	27.8	5.3	21.5	1.0	0.0	26.8	
Juncos Municipio	26.6	11.4	15.2	0.0	0.0	26.6	
Las Piedras Municipio	1.5	0.3	1.2	0.0	0.0	1.5	
San Lorenzo Municipio	53.2	8.7	44.5	0.0	0.0	53.2	
4 Cayey urban area	116.8	15.1	101.7	0.0			53,945
Aibonito Municipio	31.3	0.8	30.5	0.0	0.0	31.3	
Cayey Municipio	51.9	7.1	44.8	0.0	0.0	51.9	
Cidra Municipio	33.6	7.2	26.4	0.0	0.0	33.6	

LAND AREA RECLASSIFICATION

Name of Area	Land Area Square Miles Total Per Census A	Land Area Square Miles Urbanized Per Census B	Land Area Square Miles Urbanizing Per OIG C	Land Area Square Miles with Population Less than 100 - Rural = D	Land Area Square Miles RD Classif. as Non- Rural E	Land Area Square Miles OIG Believes 'Non-rural (B+C) F	Population Per Census Data G
5 Humacao urban area	184.2	22.4	151.0	10.7			57,144
Humacao Municipio	44.8	15.0	19.1	10.7	0.0	34.1	
Las Piedras Municipio	32.4	6.6	25.8	0.0	0.0	32.4	
Naguabo Municipio	51.7	0.8	50.9	0.0	0.0	51.7	
Yabucoa Municipio	55.3	0.1	55.2	0.0	0.0	55.3	
6 Mayaguez Urban area	253.1	36.5	203.5	13.1			110,904
Anasco Municipio	39.3	0.9	34.5	3.9	0.0	35.4	
Cabo Rojo Municipio	70.4	0.7	69.7	0.0	0.0	70.4	
Hormigueros Municipio	11.3	6.3	1.0	4.0	0.0	7.3	
Mayaguez Municipio	77.6	27.9	44.5	5.2	21.2	72.4	
San German Municipio	54.5	0.7	53.8	0.0	0.0	54.5	
7 Ponce Urban area	160.7	41.9	97.0	21.8			190,079
Penuelas Municipio	44.6	3.7	36.1	4.8	0.0	39.8	
Ponce Municipio	116.1	38.2	60.9	17.0	29.0	99.1	
8 San Juan Urban Area	379.0	197.5	150.9	30.6			1,221,086
Bayamon Municipio	44.4	33.3	11.1	0.0	28.2	44.4	
Canovanas Municipio	25.5	4.8	20.7	0.0	0.0	25.5	
Carolina Municipio	45.3	30.6	10.5	4.2	23.7	41.1	
Catano Municipio	4.8	4.8	0.0	0.0	4.8	4.8	
Dorado Municipio	5.4	2.7	0.1	2.6	0.0	2.8	
Guaynabo Municipio	27.1	21.8	5.3	0.0	17.1	27.1	
Loiza Municipio	19.4	4.5	7.3	7.6	0.0	11.8	
Naranjito Municipio	27.2	6.7	20.5	0.0	0.0	27.2	
Rio Grande Municipio	60.7	3.9	45.9	10.9	0.0	49.8	
San Juan Municipio	47.8	44.2	3.6	0.0	39.5	47.8	
Toa Alta Municipio	27.4	12.7	14.7	0.0	0.0	27.4	
Toa Baja Municipio	23.2	13.9	4.0	5.3	0.0	17.9	

LAND AREA RECLASSIFICATION

Name of Area	Land Area Square Miles Total Per Census A	Land Area Square Miles Urbanized Per Census B	Land Area Square Miles Urbanizing Per OIG C	Land Area Square Miles with Population Less than 100 - Rural =	Land Area Square Miles RD Classif. as Non-Rural	Land Area Square Miles OIG Believes Non-rural (B+C)	Population Per Census Data
Trujillo Alto Municipio	20.8	13.6	7.2	0.0	0.0	20.8	
9 Vega Baja-Manati Urban Area	136.8	37.0 a	93.8	5.9			112,272
Dorado Municipio	17.9	4.0	13.9	0.0	0.0	17.9	
Manati Municipio	45.2	7.4	34.0	3.8	0.0	41.4	
Vega Alta Municipio	27.8	11.4	16.4	0.0	0.0	27.8	
Vega Baja Municipio	45.9	14.3	29.5	2.1	0.0	43.8	
Total of 9 urban areas	1,771.2	455.0	1,174.2	104.9	176.2	1,666.1	2,125,255
Percent Total Puerto Rico	0.5169	0.1328	0.3427	0.0306	0.0514	0.4862	0.6034
a/ This is the total from the census data. It does not agree with the total of the individual municipios due to rounding.							

EXHIBIT C – AGENCY RESPONSES

Page 1 of 10



United States
Department of
Agriculture

Rural Development

Operations and
Management

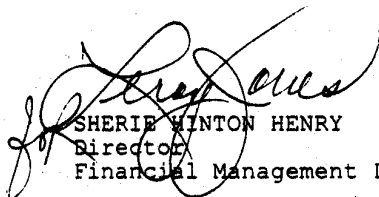
Washington, DC
20250

MAY 05 2000

SUBJECT: Rural Business Enterprise Grant Program
Puerto Rico Rural Development State Office
Vivero Caimito Project
(Audit No. 34004-004-Hy)

TO: James R. Ebbitt
Assistant Inspector General
for Audit
Office of Inspector General, USDA

Attached for your review is a memorandum dated May 2, 2000, with accompanying attachments from the Deputy Administrator, Business Programs, Rural Business-Cooperative Service, responding to recommendation 2 of the official draft report of the above subject audit. This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendation.


SHERIE WINTON HENRY
Director
Financial Management Division

Attachments



United States
Department of
Agriculture

Rural Business-
Cooperative Service

Washington, DC
20250

MAY -2 2000

SUBJECT: Office of the Inspector General
Official Draft Audit Report No. 34004-04-HY

TO: Leroy Jones
Acting Director
Financial Management Division

This is a clarification of the Rural Development response to Recommendation No. 2 of the subject draft audit, in which the definition of the term "city and zona urbana" was made, as follows:

"For the purpose of Puerto Rico, any area identified by the U. S. Census Bureau as urban, which exceeds program population limits or, where applicable, its immediately adjacent urbanized and contiguously urbanizing area. Within these urbanized and urbanizing areas, any area which is separated by open country, less densely settled areas, or natural boundaries, such as forests and water, is considered rural."

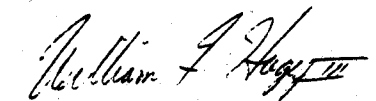
The Agency response is amended to further elaborate that the term "urban" or "zona urbana" is to be synonymous with the term "place", i.e., dark gray area shown on the maps referenced as Exhibit C of Attachment 1 of the Trip Report. This means that all such areas which are contiguous will be considered as a single unit for the purposes of determining population. Page G-31, which has the legend for the maps of the Island, from the Bureau of the Census "1990 Census of Housing for Puerto Rico", is attached as an example. Due to the lack of clarity in photo copying, the dark gray areas of the sample map have been outlined for emphasis.

Furthermore, the terms "urbanized area" and "urbanizing area" are defined, to be consistent with the rest of the United States, RD Instruction 1980-E, section 1980.405(a) and (b) (copy attached). This definition is consistent with Section 310B of the Consolidated Farm and Rural Development Act, which authorizes both the Rural Business Enterprise Grant (RBEG) and the Business and Industry (B&I) Guaranteed and Direct Loan Programs. An urbanized area has a population density of 1,000 or more people per square mile. An urbanizing area has a population density of 100 or more people per square mile.

Official Draft Audit Report No. 34004-04-HY

2

We are requesting that the Puerto Rico State Office re-evaluate Exhibit D of the Trip Report to consider the impact of contiguous urban, urbanized, and urbanizing areas upon their determination of eligible rural areas for the purpose of the B&I Guaranteed and Direct Loan and the RBEG programs.



WILLIAM F. HAGY III
Deputy Administrator
Business Programs
Rural Business-Cooperative Service

Attachments



United States
Department of
Agriculture

Rural Development

Operations and
Management

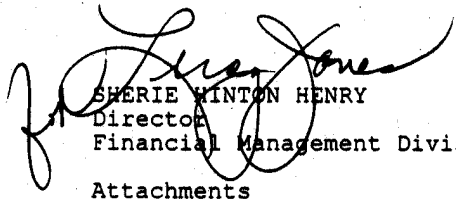
Washington, DC
20250

APR 18 2000

SUBJECT: Rural Business Enterprise Grant Program
Puerto Rico Rural Development State Office

TO: James R. Ebbitt
Assistant Inspector General
for Audit
Office of Inspector General, USDA

Attached for your review is a memorandum dated April 5, 2000, with accompanying attachments from the Deputy Administrator, Business Programs, Rural Business-Cooperative Service, responding to the recommendations and findings in the official draft report of the above subject audit. This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendations.


SHERIE WINTON HENRY
Director
Financial Management Division
Attachments



United States
Department of
Agriculture

APR -5 2000

Rural Development

SUBJECT: Rural Business Enterprise Grant Program
Puerto Rico Rural Development State Office (34004-04-Hy)

Rural Business-
Cooperative Service

Rural Housing
Service

TO: Sherie Henry Hinton
Director
Financial Management Division

Rural Utilities Service

Washington, DC
20250

Attached is the Rural Business-Cooperative Service (RBS) response concerning the Office of Inspector General (OIG) draft audit report performed by the U. S. Department of Agriculture, OIG, Northeast Region. The audit refers to five grants administered by the Puerto Rico State Office. The five projects are as follows:

<u>Project</u>	<u>Location</u>	<u>Grant Amount</u>
1. Vivero Caimito	Caimito, San Juan Urban Area	\$ 500,000
2. Vivero Caimito	Caimito, San Juan Urban Area	\$ 350,000
3. P.E.C.E.S.	Humacao, Humacao Urban Area	\$ 200,000
4. Expresas A.P.A.R.I.	Cidra, Caguas Urban Area	\$ 150,000
5. Cooperativa Ricamir	Vega Baja, Bega Bajz-Manati Urban Area	\$ 251,260
Total		\$1,451,260

We have addressed the 11 audit report recommendations and the draft report concerning the above-mentioned projects.

RECOMMENDATION NO. 1:

Assist the State Office in performing a rural area classification analysis for each Rural Development program operating in Puerto Rico; remove any area from the rural classification that is identified as urban, urbanized, or urbanizing; and cease disbursing Rural Development funding in any identified non-rural area.

Rural Development Response:

The Puerto Rico State Office has provided the National Office with a listing of eligible and ineligible areas. The National Office has thoroughly reviewed this listing and is in agreement with the State Office that the areas listed as eligible and ineligible are correct, using the Agency definition of rural area. The National Office staff has met with the Puerto Rico State Director, Business Programs Director, and other program staff to discuss the rural area issue. The Agency is comfortable that the present State Director and staff are fully

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aware of how to determine rural area eligibility and are making these determinations appropriately.

The Vivero Caimito (grantee) was identified as being located in an unauthorized area, and all advances of RBEG funding has been stopped.

(See Attachment 1 (Trip Report) and Exhibit B (State Office Eligibility Chart))

RECOMMENDATION NO. 2:

Develop procedures and/or guidelines that would clearly define terms, including municipio, barrio, city, zona urbana, urbanized, and urbanizing.

Rural Development Response:

We agree to amend applicable program instructions; i.e., any program which, by statute, is required to define rural areas, through the use of the term "city", with a single definition for both city and zona urbana, as follows:

For the purpose of Puerto Rico, any area identified by the U.S. Census Bureau as urban, which exceeds program population limits or, where applicable its immediately adjacent urbanized area and contiguously urbanizing area. Within these urbanized and urbanizing areas, any area which is separated by open country, less densely settled areas, or natural boundaries such as forests and water is considered rural.

This definition is consistent with the existing process implemented and used by the State Office and with the regulatory provisions of the various Rural Development loan and grant programs used in other areas of the United States.

Since both the U.S. Census Bureau and OIG consider municipios as the equivalent of counties in the other parts of the United States, it is the opinion of the National and State Offices that the use of these terms in defining rural areas is inconsistent with both program instructions (see Attachment 1, Exhibit F) and the enabling legislation which defined rural areas. Furthermore, the term "barrio" (county subdivision, i.e., ward within a township or sub-township) would not have any meaning under this scenario.

The terms "urbanized" and "urbanizing" are already defined in applicable existing program instructions, e.g., RD Instruction 4279-B, Business and Industry (B&I) Guaranteed Loans; RD Instruction 1980-E, B&I Direct Loans; and RD Instruction 1942-G, RBEGs and Television Demonstration Grants.

RECOMMENDATION NO. 3:

Assist the State Office in completing its review of the 2000 census data and its classification analysis of eligible rural areas.

Rural Development Response

The recommendation is acceptable as written. However, it should be noted that past census data has not been available for 2 or more years after a census was taken. With the advent of more powerful computing capabilities, this process may be significantly accelerated. In any case, this recommendation will be complied with as soon as data is available.

RECOMMENDATION NO. 4:

Determine whether the five RBEG grants totaling \$1,451,260 should be recovered.

Rural Development Response:

The Agency has performed on-site visits and file reviews and held in-depth discussions with Commonwealth officials, State Office personnel, and others regarding eligibility of the projects. The Agency has determined that the following grantees, representing \$601,260 of the \$1,451,260 listed in the audit as possible recoverable funds, are located in areas that meet the rural area definition and should not be recovered based on eligibility of the project:

- | | | | |
|----|---------------------|--|-----------|
| 1. | P.E.C.E.S. | Humacao, Humacao Urban Area | \$200,000 |
| 2. | Expresas A.P.A.R.I. | Cidra, Caguas Urban Area | \$150,000 |
| 3. | Cooperativa Ricamir | Vega Baja, Bega Bajz-Manati Urban Area | \$251,260 |

The Agency is in agreement with the audit findings regarding the ineligibility of Vivero Caimito in Caimito, San Juan. The grantee received a total of \$850,000 in grant funds, all of which is determined to be "unauthorized assistance." This grantee will be serviced under 7 C.F.R., part 1951, subpart 0, Unauthorized Assistance, to attempt recovery of ineligible grant funds. RBS is in the process of notifying our Puerto Rico State Director to immediately proceed with servicing the Vivero Caimito account in accordance with 7 C.F.R., part 1951, subpart 0. The notice and the beginning processes of servicing under Unauthorized Assistance will take place within 45 days of the date of this memorandum.

Supporting documentation for our decision is presented in Attachment 1 (Trip Report).

RECOMMENDATION NO. 5:

Provide training to State Office officials on how to perform and document individual RBEG project eligibility determinations.

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Rural Development Response:

There has been nearly a 100 percent turnover in the Puerto Rico RBS staff since the reviewed grants were made. At the time these grants were made, the Program Director was relatively new to the staff and was learning the programs.

The current State Office staff is knowledgeable in making determinations concerning rural area eligibility under the RBEG program. The Business Programs Director and Loan Specialist were trained by Agency staff during the August 3-4, 1999, annual policy meeting (see Attachment 2 (RBEG portion of August Training Meeting)). The RBEG training provided guidance on program issues and clarified issues for implementation and servicing of the program. The current Loan Specialist and Program Director each received 1-week of intense National Office training in all program areas, including the RBEG program. The Loan Specialist attended training during the week of May 4-7, 1999; the Program Director training was conducted during the week of December 1-5, 1997, with only one other Program Director in attendance. This allowed for a detailed hands-on, face-to-face, training session with actual case studies. National Office program personnel were able to work directly with the Program Director on program issues and to critique his progress.

In addition to the training, National Office staff performed an on-site visit in conjunction with this audit and found that the Program Director and Loan Specialist were cognizant of what constitutes a rural area.

RECOMMENDATION NO. 6:

Perform a follow-up review after the training is provided to determine whether the RBEG eligibility requirements are being met.

Rural Development Response:

Post reviews will be conducted in the National Office on each RBEG made since August 1999 through the end of the Fiscal Year 2000. Reviews will be completed by December 31, 2000, and the National Office will provide further guidance, training, assistance, and follow-up as needed.

RECOMMENDATION NO. 7:

If the grant is not recovered in total under Recommendation No. 4, recover the unallowable costs of \$89,787 from the grantee.

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Rural Development Response:

The Agency has determined that the grantee, Vivero Caimito, is located in an ineligible area of Puerto Rico. Therefore, the entire amount of grant funds, \$850,000, plus accrued interest, represents unauthorized assistance. The Agency has determined that the grantee will be serviced under 7 C.F.R., part 1951, subpart 0, unauthorized assistance. This regulation was promulgated for servicing cases where unauthorized loans or other financial assistance was received. This regulation allows for collection efforts to be initiated once the borrower is given an opportunity to refute the Agency findings and provide information to support its position.

Because the Agency has determined the grantee to be ineligible for RBEG funding, the other issues raised in the audit regarding this grantee will be dealt with in accordance with remedies provided in 7 C.F.R., part 1951, subpart 0.

RECOMMENDATION NO. 8:

If the grant is not recovered in total under Recommendation No. 4, recover the unsupported costs of \$43,292 from the grantee.

Rural Development Response:

We are requiring the grantee, through the State Office, to provide supportable documentation and an explanation, in English, to determine whether these costs (\$43,292) should be recovered in the event the entire grant of \$850,000 is not recoverable.

RECOMMENDATION NO. 9:

If the grant is not recovered in total under Recommendation No. 4, advise the grantee that the costs for the vans and other services totaling \$29,035 are not allowable, allow the grantee to allocate the costs among the benefiting programs, and recover the difference between the amount disbursed and the amount determined to be allowable under the grant.

Rural Development Response:

We are requiring the grantee, through the State Office, to provide supportable documentation and an explanation, in English, to determine whether these costs (\$29,035) should be recovered, in the event the entire grant of \$850,000 is not recoverable.

RECOMMENDATION NO. 10:

If the grant is not recovered in total under Recommendation No. 4, advise the Grantee that the rent costs totaling \$30,400 are not allowable, allow the grantee to determine the amount of depreciation or use allowance that can be claimed for using facilities of its parent company, and recover the amount disbursed for rent payments in excess of the allowance.

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Rural Development Response:

We are requiring the grantee, through the State Office, to provide supportable documentation and an explanation, in English, to determine whether these costs (\$30,400) should be recovered, in the event the entire grant of \$850,000 is not recoverable.

RECOMMENDATION NO. 11:

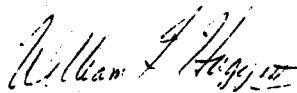
Provide training to State Office staff on how to properly manage grant funds.

Rural Development Response:

Post reviews will be conducted in the National Office on each RBEG made by Puerto Rico since August 1999 through the end of the Fiscal Year 2000. Reviews will be completed by December 31, 2000. The National Office will provide additional training on grant management at the upcoming August 2000 training sessions for all State employees.

At this writing, the Agency is comfortable that the present Business Programs staff is performing adequately and that no additional separate training is needed.

Based on the above responses to the recommendations, we feel concerns raised in Recommendation Number 1 have been resolved, and, therefore, we respectfully request that the recommendation not be a part of the final audit report.



WILLIAM F. HAGY III
Deputy Administrator
Business Programs
Rural Business-Cooperative Service

Attachments

ABBREVIATIONS

7 CFR	
Title 7, Code of Federal Regulations.....	i
FY	
fiscal year.....	ii
NO	
Rural Development National Office.....	iii
OGC	
Office of the General Counsel.....	4
OIG	
Office of Inspector General.....	iii
OMB	
Office of Management and Budget.....	3
RBEG	
Rural Business Enterprise Grant.....	i
RBS	
Rural Business-Cooperative Service.....	iv
RRH	
Rural Rental Housing.....	ii
SO	
State Office.....	i
U.S.C.	
United States Code.....	1
USDA	
U.S. Department of Agriculture.....	iii