



U.S. Department of Agriculture

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Office of Inspector General  
Southwest Region

# **Audit Report**

## **Rural Utilities Service Texas Community Connect Grantee Close-Out Audit**

Report No. 09601-6-Te  
July 2008

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



JUL - 3 2008

REPLY TO

ATTN OF: 09601-6-Te

TO: James M. Andrew  
Administrator  
Rural Utilities Service

THROUGH: John Purcell  
Director  
Financial Management Division

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

SUBJECT: Texas Community Connect Grantee Close-Out Audit

This report presents the results of the subject audit. Your written response to the draft report, dated June 18, 2008, is included as exhibit C with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant Finding and Recommendation sections of the report.

Although we agree with the planned corrective action, management decision could not be reached on Recommendation 1. Documentation and action needed to reach management decision for this recommendation is described in the OIG Position section of the report.

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 implementing the recommendation for which management decision has not been reached. Please note that the regulation requires a management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during this audit.

# Executive Summary

## Rural Utilities Service Texas Community Connect Grantee Close-Out Audit (Audit Report 09601-6-Te)

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### Results in Brief

During fiscal years 2002 and 2003, the Rural Utilities Service (RUS) provided \$31 million to the Broadband Pilot Grant (community-oriented connectivity grant) Program to help establish broadband service in rural communities that might not otherwise have a provider. These grants are intended to make broadband available to a wide range of rural, economically challenged, communities, including schools, libraries, education centers, health care providers, law enforcement agencies, and public safety organizations, as well as residents and businesses. Companies that apply for and receive Federal grant funds as a part of RUS' community-oriented connectivity grant program are expected to comply with Federal regulations and guidelines regarding the appropriate use of grant funds.

At RUS' request, and in response to a National Appeals Division opinion, the Office of Inspector General (OIG) initiated an audit to close out seven grants issued to Blue Moon Solutions, Inc. (grantee). In 2003, the grantee was approved for approximately \$2.7 million in grant funds. In 2004, the grantee received approximately \$1.9 of the \$2.7 million. The agency suspended the grantee and subsequently terminated all seven grants on November 9, 2005. OIG began this close-out audit in March of 2007.

We found that the grantee failed to abide by the terms of its grant agreements and did not comply with Federal regulations. Due to these problems, we found that the grantee spent \$429,159 on unallowable expenses.

We found that the grantee's requests for funding far exceeded the immediate need for disbursement. Specifically, the grantee requested the entire amount budgeted for line items, even though it had not expended that amount almost 2 years later. According to Federal regulations grantees are required to expend funding within a reasonable time.<sup>1</sup> In May 2006—2 years after the grantee had received funds from RUS based on its original Requests for Advance or Reimbursement, Standard Form 270 (SF-270)—the grantee submitted amended SF-270s. By signing the amended SF-270s, the grantee stated that they had not received previous payment for these expenses, which was false.

We also found many instances in which the grantee claimed reimbursement for expenses that were not allowable, according to the Federal Acquisition Regulation.<sup>2</sup> The grantee stated that it was unaware of this regulation;

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<sup>1</sup> Title 7, Code of Federal Regulations (CFR), 3015.61(e).

<sup>2</sup> 48 CFR 31.2.

therefore, the grantee did not know what sort of activities or items were eligible grant expenses. However, it was required to maintain records, including supporting documentation, that adequately demonstrated that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles.<sup>3</sup> In addition, the grantee also mistakenly believed that it had a construction budget<sup>4</sup> and that it therefore did not need the agency's approval to move funds between approved budget line items. However, the grantee had a combined construction and nonconstruction budget which required prior written approval from the agency before moving funds.

In summary, the grantee received approximately \$1.9 million in grant funds from RUS but could not provide support for \$550,341. However, we found that the grantee had support for an additional \$121,182 in expenses for approved budgeted line items for which they had not received grant reimbursements. Therefore, the agency should require the grantee to return a total of \$429,159.

**Recommendations  
in Brief**

Recover \$429,159 from the grantee in funds received that were expended for unallowable expenditures.

**Agency Response**

The agency appreciated the time and effort expended on the close-out audit by OIG and believed that it complied with the scope and intent of the NAD director's determination. They agreed with the finding and planned to take action within 30 days from the date of the final audit report. Specifically, Rural Development will transmit the results of the close-out audit to the grantee as specified by the director of NAD and make a demand for the \$429,159.

**OIG Position**

We agree with the planned corrective action. However, to reach management decision for Recommendation 1, RUS needs to provide documentation showing an accounts receivable has been established and that the grantee has been billed for the funds that were expended for unallowable expenditures.

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<sup>3</sup> 48 CFR 31.2.

<sup>4</sup> Construction budget revision does not require prior approval from the awarding agency unless provided otherwise in the terms of the grant agreement.

***Abbreviations Used in This Report***

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FY	Fiscal Year
CFR	Code of Federal Regulations
NAD	National Appeals Division
OIG	Office of Inspector General
RF	Radio Frequency
RUS	Rural Utilities Service
SF-270	Request for Advance or Reimbursement
USDA	U.S. Department of Agriculture

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# ***Background and Objective***

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## **Background**

In fiscal year (FY) 2002, Rural Utilities Service (RUS) established the Rural Broadband Pilot Grant Program as authorized by the Agriculture, Rural Development Appropriation Act.<sup>5</sup> This act offered grants to applicants providing broadband transmission service on a “community-oriented connectivity” basis. The “community-oriented connectivity” approach targeted rural, economically challenged communities and offered a means for deploying broadband to rural schools, libraries, education centers, health care providers, law enforcement agencies, and public safety organizations, as well as residents and businesses. Because of widespread interest in FY 2002 and the limited FY 2003 budget, RUS continued the program in FY 2003 without soliciting new applications.

To be eligible for a grant, applicants must be a legal entity, which has the authority<sup>6</sup> to own and operate the broadband facilities as proposed in their application. They must also be able to enter into contracts and otherwise comply with applicable Federal statutes and regulations. Proposed projects must serve a rural area where service did not already exist within a U.S. Census recognized community. The project must also deploy basic broadband service to all critical community facilities (health care, law enforcement and public safety organizations) and establish a community center with a minimum of 10 computer access points or access points equal to one percent of the service area population free of charge for at least 2 years, and offer service to the community’s residents and businesses.

Grant funds are to be used to finance the construction, acquisition, or leasing of facilities; the improvement, expansion, construction, or acquisition of a community center; purchase of necessary end-user equipment; operating expenses incurred while providing the service for 2 years and providing training and instruction. Applicants were also required to provide a matching contribution equal to at least 15 percent of the total grant amount requested. To apply, applicants must submit a completed application consisting of several documents such as an application for Federal assistance, summary overview of project, system design, financial information and sustainability, statement of experience, evidence of legal authority and existence, funding commitment from other sources, compliance with other Federal statutes, and a scope of work. Specifically, the scope of work must include a description of the

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<sup>5</sup> Public Law 107-76—Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act, 2002, dated November 28, 2001.

<sup>6</sup> Applicant must have the legal capacity to enter into contracts.

project's specific activities and services, who will perform these activities and services, the timeframes for accomplishing the project's objective and activities, a budget for all capital and administrative expenditures reflecting the line item costs for eligible grant purposes, the matching contribution, and other sources of funds necessary to complete the project.

Once applications are reviewed and approved by a panel of RUS employees, grantees sign an agreement with RUS and the funds are made available. Grantees may then request funds, a process that includes providing documentation such as paid or unpaid invoices, or other documentation supporting the expenses. RUS was responsible for monitoring grantees to ensure that the project was completed in accordance with the approved scope of work and that the grant funds were expended for eligible project-related purposes.

Between May and September 2003, RUS approved a total of seven grants for the grantee; from January through July 2004, the grantee received the following advances (Table 1):

Table 1

Summary of Grant Funding			
Community	Grant Amount	Total Amount Received	Not Advanced
Falcon Lake	\$ 324,136	\$ 197,822	\$ 126,314
San Ygnacio	324,136	197,822	126,314
Batesville	275,000	236,014	38,986
La Pryor	275,000	215,127	59,873
Progreso	500,000	340,735	159,265
Crystal City	500,000	418,957	81,043
Zapata	500,000	329,569	170,431
Total	\$2,698,272	\$1,936,046	\$ 762,226

From January 2004 through April 2005, OIG conducted an audit of the Broadband Grant and Loan Programs.<sup>7</sup> During the early stages of the review, we found a number of concerns related to these grants. Specifically, based on field visits conducted at the project sites, OIG concluded that the grantee had made misrepresentations to RUS in its grant applications. In response, RUS initiated a compliance review. In March 2005, RUS' compliance review found that \$910,830 of the grantee's expenditures was unallowable. As a result, OIG recommended

<sup>7</sup> Audit Report 09601-4-Te, Broadband Loan and Grant Program, dated September 30, 2005.

that RUS recover the \$1.9 million received and deobligate the remaining grants funds of \$762,226.

On September 30, 2005, RUS suspended the grants based on the grantee's failure to comply with the provisions of the grant agreements. RUS then terminated the seven grants on November 9, 2005, basing it again on the grantee's failure to comply with the provisions of the grant agreements and the opinion expressed in a certified public accountant's audit that material weaknesses existed in the grantee's records and procedures and demanded repayment of \$910,830. The grantee appealed to the National Appeals Division (NAD) of the Department of Agriculture (USDA) on December 14, 2005, claiming that RUS had improperly terminated the grants and that RUS should advance the remaining \$762,226 in grant funds. On October 4, 2006, the NAD hearing officer held that RUS erroneously terminated the grants and that the grantee had incurred allowable grant expenses equal to the disallowed amount. The NAD hearing officer concluded that the grantee need not repay these funds. RUS then appealed this decision to the NAD director who overturned the NAD hearing officer's decision and found that the grants had been validly terminated. Moreover, the NAD director did not agree with the NAD hearing officer's conclusion that the grantee had incurred allowable expenditures at least equivalent to the amount demanded by RUS. The NAD director ruled that the RUS claim for \$910,830 was premature and that a close-out audit needed to be conducted to ascertain any additional allowable expenses incurred by the grantee.

According to Federal regulations, if a USDA agency considers a final audit to be necessary, it shall contact the OIG region within the recipient location for a final audit.<sup>8</sup> Therefore, on February 23, 2007, RUS requested that OIG conduct a close-out audit in connection with seven community-connect grants awarded to the grantee.

## **Objective**

Our objective was to conduct a close-out audit of seven grants funded by RUS and determine if the grantee incurred any allowable expenditures between the last date of the RUS compliance review, March 18, 2005, and the suspension date of the grants, September 30, 2005, or if there were any other costs incurred that RUS should credit. These costs included all allowable expenses the grantee may have incurred from the date of the grant applications, November 1, 2002, but which had not been previously claimed during the RUS compliance review.

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<sup>8</sup> Title 7, Code of Federal Regulations (CFR) 3015.120.

# ***Finding and Recommendation***

## **Section 1. Grantee Failed to Comply with Federal Regulations and the Requirements of its Grant Agreements**

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### **Finding 1**

### **Grantee Failed to Comply with Federal Regulations and the Requirements of its Grant Agreements**

The grantee failed to abide by the terms of its grant agreements and comply with Federal regulations. Of the approximately \$2.7 million RUS authorized for seven broadband projects, the grantee received \$1.9 million, yet we identified problems in how these funds were used. The grantee submitted to RUS false and erroneous Requests for Advance or Reimbursement, Standard Form (SF-270) and did not use all of the funds received in accordance with Federal regulations. These problems occurred because the grantee did not maintain an accounting system that tracked expenditures by their approved and budgeted line items. Additionally, the grantee disregarded regulations concerning what sort of activities or items it could—allowably—expend grant funds on. Finally, the grantee mistakenly believed that it did not need the agency’s approval to move funds between budgeted line items. Due to these problems, the grantee used \$429,159 in Federal grant funds received (28 percent) for unallowable expenses.

Federal regulations and guidelines for how grant funds may be used are set forth in the Federal Acquisition Regulation,<sup>9</sup> the Uniform Federal Assistance Regulation,<sup>10</sup> and the Notices of Funds Available.<sup>11</sup> When the grantee signs the grant agreement and participates in the community-oriented connectivity grant program, it agrees to abide by these regulations. Grantees are responsible for understanding the terms of the agreements they choose to enter into; if grantees have any questions concerning their obligations under the grant agreements, they may request clarification.

Between May and September 2003, the grantee was approved for seven individual grants, totaling approximately \$2.7 million. The grantee submitted to RUS SF-270s from December 2003 through March 2004. Between January and July 2004, RUS approved the SF-270s and released funds totaling approximately \$1.9 million. We reviewed expenditures by approved budget line item related to the \$1.9 million received by the grantee and the other expenses the grantee claimed to have incurred for

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<sup>9</sup> 48 CFR 31.2.

<sup>10</sup> 7 CFR 3015.

<sup>11</sup> *Federal Register*, vol. 67, no. 130, “Broadband Pilot Grant Program,” dated July 8, 2002, and *Federal Register*, vol. 68, no. 138, “Broadband Pilot Grant Program,” dated July 18, 2003.

which it had not yet received grant funds. In total, we reviewed approximately \$2.6 million in expenditures that the grantee claimed to have expended on allowable, supported, project-related costs for the seven community-oriented connectivity grants. Of the \$2.6 million the grantee claimed on its Schedule of USDA Grant Activities – Summary, we verified that \$1.5 million<sup>12</sup> was spent on budget line items related to the projects, which means that we could not verify the allowability of \$1.1 million in claimed expenditures. Of the \$1.9 million the grantee actually received, we determined that \$550,341 was spent on unallowable expenditures (see exhibit B).

#### *The Grantee Submitted to RUS False and Erroneous SF-270s*

When grantees want to be reimbursed for allowable expenses they have incurred while working on a grant project, they submit to RUS an SF-270 in which they certify that, to the best of their knowledge, the data is correct and that all outlays were made in accordance with the grant agreements. We found, however, that the grantee submitted SF-270s for expenses it had not yet incurred, and would not incur for some time. The grantee stated that it submitted these documents because company officials did not understand how to fill out an SF-270. However, the grantee requested and received verbal guidance on how to prepare SF-270s from RUS before submitting the first request for the seven grants. Due to this problem, we found that at the time of our review, the grantee still could not support \$550,341 in grant funds received.

According to the Federal regulation<sup>13</sup> and the grant agreements, grantees are to request funding using an SF-270. The regulation also requires that advanced funds received must be expended within a reasonable time to minimize the time elapsing between the advance of grant funds and their subsequent disbursement.<sup>14</sup> Reimbursements may be submitted monthly or more frequently if authorized by the awarding agency. The signed grant agreements between RUS and the grantee state that funding will be advanced from time to time, but not more frequently than once every 30 days.

We found that the grantee requested the entire amount budgeted for each line item, regardless of whether an expense of that amount had been incurred. For example, for the Batesville project, the grantee requested reimbursement for \$31,050 on February 9, 2004. This reimbursement was for the budgeted line item “web content,” but we found that the grantee had only spent \$3,552 on “web content” by the time the grant was

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<sup>12</sup> Of the 1.5 million in allowable expenditures, \$121,182 had not yet been received by the grantee.

<sup>13</sup> 7 CFR 3015.84.

<sup>14</sup> 7 CFR 3015.61(e).

terminated on November 9, 2005. This would be almost 2 years after drawing down the funds for “web content.”

We concluded that the grantee’s request for reimbursement for “web content” totaling \$31,050 was erroneous because the funds had not yet been expended at the time of request or within a reasonable time after receiving the funds. For all seven grants, we determined the grantee requested and received \$101,431<sup>15</sup> beyond the actual cost of its “web content,” as illustrated in Table 2.

Table 2

Summary of Web Content						
Project	Date Requested	Date Funded	Total Budgeted	Total Requested	OIG Verified Expenses	Grantee’s Schedule of Expenditures
Falcon Lake	01/22/04	03/25/04	\$ 31,050	\$ 31,050	\$ 20,579	\$ 21,895
San Ygnacio	01/21/04	02/23/04	31,050	31,050	21,243	23,450
Batesville	02/09/04	03/25/04	31,050	31,050	3,552	4,423
La Pryor	02/09/04	03/25/04	31,050	31,050	3,510	4,423
Progreso	12/15/03	01/30/04	31,050	31,050	26,210	27,519
Zapata	01/09/04	02/10/04	31,050	31,050	24,312	30,293
Crystal City	02/09/04	03/25/04	31,050	31,050	16,513	17,637
Total			\$217,350	\$217,350	\$115,919	\$129,640
Total excess claimed					\$101,431	\$ 87,710

In order to receive compensation for expenses, the grantee submitted to RUS internal invoices<sup>16</sup> which were contradicted by the grantee’s financial documents.<sup>17</sup> These internal invoices billed RUS for the entire amount of a line item, such as “web content,” even though the grantee had not incurred this expense. This was supported by the fact that the grantee’s Schedule of USDA Grant Activities – Summary for the year ended FY 2005, financial documents, indicated that they had not expended \$87,710 in “web content” expense. In other words, even the grantee’s own records indicate that the funds requested exceeded actual expenditures. The grantee stated that it did not need approval from the

<sup>15</sup> \$217,350 received less \$115,919 verified in expenses equals \$101,431 not expended by November 9, 2005.

<sup>16</sup> Grantee created invoices, by budgeted line item, to support claim for funding prior to expending funds.

<sup>17</sup> Grantee’s financial reports of grant activities which summarize grant funds received and grant funds expended for each year.

agency to move funding from one budgeted line item to another and therefore used these funds received for web content for other expenses; however, the grantee was mistaken, as the agreement did require approval to move funds between budget line items. We concluded that the grantee had submitted requests for reimbursement for expenses that had not been incurred and therefore, were false and erroneous.

Of the approximately \$1.9 million in funds the grantee requested for the seven grants, we found that \$550,341 in grant funds received still had not been expended on allowable budget line item expenditures at the time of our review. This was supported by the grantee's own records which indicated that grant funds were received in excess of costs incurred. According to the grantee's USDA Grant Activities – Summary for the year ending December 2005, \$364,335 was received in excess of the costs the grantee actually incurred.

In May 2006—2 years after the grantee had received funds from RUS based on its false and erroneous SF-270s, 6 months after the grants were terminated and 14 months after RUS' compliance review—the grantee attempted to submit amended SF-270s. These amended SF-270s listed the expenses on an annual basis and the internal invoices were changed from the invoices submitted with the original SF-270s. RUS denied these requests for reimbursement as the grantee had already received funds for the costs in question and RUS does not allow amended SF-270s after payment.

Even though the grantee claimed reimbursement for a majority of the grant funds, we noted that three of the projects were not operational. RUS visited the Batesville and La Pryor grant projects in October 2006 and found that the community centers were never operational even though the grantee received \$236,014 (86 percent) of Batesville's total grant and \$215,127 (78 percent) of La Pryor's. The grantee confirmed that these two centers were never operational during our fieldwork, despite the fact that these grants were two of the first three approved by RUS.

In addition, RUS learned that the community center, for the Crystal City grant project, had been opened briefly in 2005, but shut down a few months later. Nevertheless, the grantee had received \$418,957 (84 percent) of the total grant. The grantee confirmed that it was unable to provide continuing service to this community.

The grantee has argued that it failed to provide ongoing internet service to these three communities because RUS terminated its grants and thereby made it impossible for it to complete these projects. We found, however, according to the grantee's schedules of USDA grant activity, the grantee had received more funding than it spent on these projects. For Batesville,

the grantee received \$236,014, but spent only \$200,734. Likewise, for La Pryor, the grantee received \$215,127, but spent only \$197,127. Finally, for Crystal City, the grantee received \$418,957 but spent \$411,660. The net excess funding for these three projects is approximately \$60,577. We determined that the grantee moved its grant funds for the seven projects into the corporate bank account upon receipt. This bank account had a balance of just under \$6,500 on December 31, 2005.

We concluded that the grantee used USDA grant funds on activities other than the activity for which the funds were requested. The grantee's requests for reimbursement on the SF-270s were therefore false and erroneous.

#### *The Grantee Claimed Reimbursement for Unallowable and Excessive Expenses*

The grantee claimed reimbursement for expenses that were not allowable according to Federal regulations or exceeded the budgeted line items. The grantee explained that these problems occurred because company officials were unaware of the Federal Acquisition Regulation, as described in detail in the various subsections, below. This regulation describes in detail what grantees can and cannot acquire with grant funds. These officials also believed that their expenses were part of the grantee's ordinary business operations and that they were reasonable. In addition, the grantee failed to maintain an accounting system that could track expenses by line item, and believed that it could move funds from one budget line item to another, without RUS' approval. As a result, for the seven grants, we could not verify the allowability of approximately \$1.1 million of the approximately \$2.6 million in claimed expenses.

##### *i. Unallowable Expenses*

To determine the allowability of the grantee's expenses, we compared the grantee's supporting documentation with Federal regulations and the grant agreements.<sup>18</sup> This analysis resulted in many unallowable expenses. The following are examples of the unallowable expenses we identified during our review:

- The grantee spent approximately \$21,915 for a trip to Las Vegas to sponsor a trade show and a "Super Bowl" party, including hotel, food, and alcohol costs. According to regulations, entertainment and any associated expenses are not an allowable expense.<sup>19</sup> A grantee may sponsor a trade show, but only if the event was predominately for the dissemination of technical

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<sup>18</sup> 48 CFR 31.2.

<sup>19</sup> 48 CFR 31.205-14.

information or stimulation of the grant program.<sup>20</sup> Our review of the event's newsletter indicated that this trade show did not meet these requirements. We concluded that the grantee spent \$21,915 for this unallowable expense.

- The grantee spent an additional \$49,392 in grant funds for unallowable travel costs—\$13,415 of this sum was for meals in Lubbock, Texas, the grantee's home office location. Federal regulations clearly state that, in order to be reimbursed for travel expenses, the grantee's employees must be traveling for more than 12 hours;<sup>21</sup> they must also be traveling for documented purposes directly related to the projects.<sup>22</sup> We found, however, that the grantee's employees were charging meals while at their official duty station (where they could not, in fact, be in travel status). The remaining \$35,977 was used for other travel expenses to communities unrelated to the grant projects.
- The grantee spent \$5,790 from Progreso's community grant funds to wrap a trailer with an advertising decal. The total cost of this wrap was \$11,815 but the remaining \$6,025 was never allocated to any of its other projects. Federal regulations state that advertising and public relations costs must be specifically required by the contract<sup>23</sup> and cannot be primarily to promote the sale of products or services by stimulating interest in the product or by calling favorable attention to the contractor.<sup>24</sup> This decal that was placed on the trailer only included information on grantee and its business partners. We concluded that this cost was unallowable.
- The grantee spent \$1,560 to pay fines and vehicle damages resulting from an employee running a red light and causing an accident. According to regulations, this expense is unallowable.<sup>25</sup>

When we discussed our findings with the grantee's representatives, they disagreed. They stated that these expenses were part of their ordinary business operations and that they were reasonable; they also explained that they were unaware of the regulations we cited, even though they did have a copy.<sup>26</sup> OIG maintains that the grantee was responsible for being aware of all pertinent regulations, and that the reasonableness of the expenditures was not the sole condition of

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<sup>20</sup> 48 CFR 31.205-43 and 31.205-1(f)(2).

<sup>21</sup> 41 CFR 301-11.1.

<sup>22</sup> 48 CFR 31.205-46(a)(7).

<sup>23</sup> 48 CFR 31.205-1(d)(l).

<sup>24</sup> 48 CFR 31.205-1(f)(l).

<sup>25</sup> 48 CFR 31.205-15(a).

<sup>26</sup> 48 CFR 31.2.

whether they are allowable. Reasonable, allowable expenditures must also conform to the contract the grantee signed with RUS. These expenditures did not conform to that contract, and they are therefore unallowable.

We also identified and disallowed claimed expenses because the grantee could not provide supporting documentation. When participants sign the grant agreements, they agree to keep all documentation for 3 years after they submit the final annual project performance activity report. The grantee is also responsible for accounting for costs appropriately and for maintaining records, including supporting documentation.<sup>27</sup>

We found, however, that the grantee did not always maintain documentation as required. For example, the grantee spent approximately \$57,469 for various small expenses but did not maintain the receipts for these expenses, including charges at a hotel for \$406, at a home improvement store for \$285, and at an electronics store for \$184. In addition, the grantee also claimed \$8,425 in capital asset expenditures for community centers, but maintained no documentation for these expenses. Without documentation, we could not determine how these expenses contributed to the goals of the community-oriented connectivity grant program. When we discussed this problem with the grantee and its representatives, they disagreed. They explained that they lost some of the receipts and invoices.

The grantee had also claimed approximately \$802,581 in salary and labor expenses without maintaining required timesheets for the claimed hours. Although the grant agreements specifically require grantees to provide RUS with timesheets as part of their supporting documentation,<sup>28</sup> the grantee did not maintain individual detailed timesheets for all projects or phases of the projects. The only individual detailed timesheets provided to us were for direct deployment and web content for each project, which was only part of the grantee's total labor costs. The grantee did not provide us with individual detailed timesheets for any indirect or other direct labor claimed by its employees. Given the documentation provided, we could not support the actual hours that the grantee's employees worked on RUS grants.

OIG requested copies of the grantee's time management system reports but was informed that they were kept electronically and had been archived. We were told that it was not possible to retrieve and provide them electronically but that company officials would provide the

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<sup>27</sup> 48 CFR 31.201-2(d).

<sup>28</sup> Community-Oriented Connectivity Broadband Grant Agreements, specials conditions or limitations section, advances and reimbursements (a).

information needed to verify employees' labor. However, the documentation provided did not permit us to track each employee's claimed hours to work performed on each project. Instead, the documentation the grantee provided was a summary of monthly totals for each employee by project. Some of these monthly summaries were allocated based on the individual grant size. There was no detail or other support of work performed which would confirm that work was attributable to any one of the projects.

Since the grantee also had projects other than these grants, we could not determine from the summary hour schedules provided whether the work was actually performed for any one of the grants. The time could have been spent on other nongrant activities. We concluded that it was impossible to verify whether labor costs for any item other than web content and direct project deployment contributed directly to the goals of community-oriented connectivity grant program.

When we asked company officials how they could adequately document their labor costs for one part of the project, but not for the others, they stated that it was not standard business practice for a technology company to account for its labor in such a detailed manner.

*ii. Expenses that Exceeded the Agency-Approved Budget*

We also found that the grantee disregarded the revised budget approved by RUS and moved grant funds received between activities and line items without seeking agency approval. This occurred because the grantee mistakenly believed that it had a "construction budget," and that it was not required to seek agency approval before moving funds. The grantee, however, did not have a construction budget. Instead the grantee's budget consisted of capital expenditures, cost of sales, and operations. Therefore, the grantee's budget was a combination construction and nonconstruction budget, for which the agency may require prior approval for any budget transfers between these two types of work.<sup>29</sup> RUS' grant agreements required the grantee to seek prior written approval. As a result of this problem, we found that the grantee exceeded the agency-approved budgeted line items by a total of approximately \$65,027.<sup>30</sup>

According to the Notice of Funds Available the grantee must submit a budget as part of its scope of work in its grant applications, which the agency must approve. The grantee also agrees that it will obtain agency

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<sup>29</sup> 7 CFR 3015.116.

<sup>30</sup> \$65,027 includes \$44,901 in expenditures that the grantee had initially budgeted from revenue from the grant projects. Since most of the projects never produced any revenue, the grantee—without agency approval—used grant funds to cover these costs.

approval for any material changes to the objective, activities or scope of work for each grant project.<sup>31</sup>

We found, however, that the grantee disregarded the budget approved by RUS and moved funds received between activities and line items without seeking agency approval. For example, the grantee exceeded the approved budget for the Zapata grant in two capital expenditures line items—Base Station and Repeater Equipment (\$3,299) and End-User Equipment (\$3,153) by a total of \$6,452. Combined with excessive expenditures claimed for operational costs, expenditures for the Zapata grant project exceeded the agency approved budget by \$11,701.

We also noted that the grantee's accounting system did not track expenditures by budgeted line items for the seven grants, which did not allow the grantee to determine how much was expended by budgeted line item. For example, the Zapata budget the grantee submitted to RUS had two separate budget line items for base station equipment (\$16,941) and repeater equipment (\$106,613). However, the grantee's accounting system combined these two budgeted line items into one line item. This resulted in a total budgeted amount of \$123,554 for these two items. The grantee confirmed that these two equipment items were not tracked by separate budget line items. Therefore, when we verified these expenses, we had to review all the invoices as one line item. We verified \$126,853 in base station and repeater equipment costs which exceeded the combined budget line items by \$3,299.

The grantee also did not keep supporting documentation in a manner that was conducive to determining exactly how much was expended for each budgeted line item. When we requested the documentation for each budgeted line item to support the funds requested on the SF-270s, we were told that the records were not kept in this manner. In fact, the grantee had to go through all the records and assemble the supporting documentation that was applicable to each budget line item. During this process, the grantee amended which line item the expense was attributed to as the review progressed.

We concluded that the grantee did not know what it had expended at any given time for any given budgeted line item. This practice resulted in the grantee exceeding its approved budget by \$65,027 for the seven grants.

When we discussed with the grantee's representatives how the grantee had disregarded the agency-approved budget and exceeded budgeted

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<sup>31</sup> Community-Oriented Connectivity Broadband Grant Agreement, para. 8.

line items, they stated that they moved funds received between line items because they had a “construction budget,” which meant that they were not required to seek agency approval before doing so.

OIG disagrees with this explanation. First, the grantee had made several changes to some of its budget line items and notified RUS so that the agency could approve these changes. This indicated that it understood that approval was necessary. Second, the grantee had a combination construction and nonconstruction budget. Federal regulation states that the awarding agency could require prior approval for any budget transfers between the two types of work.<sup>32</sup> The grantee was obliged to be aware of the terms of the grant agreements it had signed, and to abide by those terms which required the grantee to notify RUS of any material change to its scope of work, the budget was an element of the scope of work.

Finally, we noted that the grantee had not met the matching requirement for any of the seven projects. The matching requirement established for this program was at least 15 percent of the grant amount requested. According to the special conditions or limitations of the grant agreements, the supporting documentation for the expenditures associated with satisfying the matching commitment should be submitted no later than the expiration date of the grant agreements. RUS terminated these grants on November 9, 2005, and we found that the grantee’s supporting documentation indicated that it had provided only \$379,798 of the \$617,500 in matching funds required for the seven grants. If these grants had been allowed to continue until their expiration dates, the grantee would have needed to meet the matching requirement as late as September 24, 2006.

Overall, we concluded that of the approximately \$2.6 million in expenses the grantee claimed, only \$1.5 million was expended on allowable budget line items related to the project. Our review determined that \$550,341 of the \$1.9 million the grantee received was not expended on allowable budget line items for which the funds were received.

However, the grantee did produce evidence of allowable budget line item expenses for which it had not received funding in the amount of \$121,182. Therefore, the agency should recover from the grantee a total of \$429,159 (see exhibit B).<sup>33</sup>

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<sup>32</sup> 7 CFR 3015.116.

<sup>33</sup> In exhibit B, this finding is described in detail for each of the seven grants.

## **Recommendation 1**

Recover \$429,159 from the grantee in funds received that were expended for unallowable expenditures.

### **Agency Response.**

Within 30 days from the date of the final audit report, RUS will transmit the results of the close-out audit to the grantee as specified by the director of NAD and make a demand for the \$429,159.

### **OIG Position.**

We agree with the planned corrective action. However, to reach management decision, RUS needs to provide documentation showing an accounts receivable has been established and that the grantee has been billed for the funds that were expended for unallowable expenditures.

## Scope and Methodology

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We performed a close-out audit of the grantee's seven grants obtained under the community-oriented connectivity grant program. Initially, we intended to review supporting documentation for the \$910,829 in expenses RUS had disallowed and the \$762,226 in grant funds that had not been advanced to the grantee. This involved reviewing documentation supporting allowable expenses incurred from the date RUS' compliance review was concluded (March 18, 2005) to the date of the grantee's suspension (September 30, 2005), as well as any additional costs the grantee could claim from the grant applications date of November 1, 2002, but which had not been claimed during RUS' review. We reviewed approximately \$2.6 million in expenditures claimed by the grantee during this time period.

Due to how the grantee had organized its records, we reviewed all expenditures from November 1, 2002, through September 30, 2005. The grantee did not maintain copies of what was previously provided to and accepted by the RUS accountant. As a result, the scope of the audit was revised to include a review of all source documents provided by the grantee to support allowable expenses incurred from the date of the grant applications (November 1, 2002) through the suspension date (September 30, 2005) of the grants. It was later determined that the grantee was allowed to claim expenses that could not be avoided from the suspension date through the termination date of November 9, 2005. These additional costs were then included in the review. Our scope was limited to a review of the grantee and their records. We conducted our fieldwork from April 2007 through January 2008.

To begin a close-out audit of the grantee's seven grants, we obtained and reviewed the Uniform Federal Assistance Regulations,<sup>34</sup> Contracts with Commercial Organizations,<sup>35</sup> Federal Travel Regulations,<sup>36</sup> the Notice of Funds Available for FYs 2002 and 2003,<sup>37</sup> and the signed grant agreements. We then interviewed RUS officials to obtain information related to the grantee and the seven grants and to confirm the guidance necessary to conduct a close-out audit. In addition, OIG obtained and reviewed documentation from the RUS National Office in Washington, D.C. These documents included all data collected and used during RUS' compliance audit of the grantee, including the grant agreements, requests

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<sup>34</sup> 7 CFR 3015.

<sup>35</sup> 48 CFR 31.2.

<sup>36</sup> 41 CFR 301.

<sup>37</sup> *Federal Register*, vol. 67, no. 130, "Broadband Pilot Grant Program," dated July 8, 2002, and *Federal Register*, vol. 68, no. 138, "Broadband Pilot Grant Program," dated July 18, 2003.

for funds, support the grantee submitted for claimed expenses, and RUS' schedules identifying the amounts they disallowed. In addition, we reviewed transcripts from the NAD hearing and the NAD director's review and conducted interviews with the Office of the General Counsel attorneys.

We also visited the grantee's office in Lubbock, Texas, to examine support for allowable expenses incurred for the seven grants. We requested and reviewed documentation to support the \$1.9 million in funds received by the grantee along with any other supporting documentation for which grant funds had not been received. We requested that the grantee provide this information by the budget line items submitted with the relevant application. This was also the manner in which the funds were requested by the grantee from RUS on the SF-270.

The supporting documentation we reviewed included paid invoices and receipts, cancelled checks, bank statements, credit card statements, timesheets, and Wage and Tax Statement or the Miscellaneous Income Form. We created a spreadsheet for each of the seven grants to schedule our review of the expenses the grantee claimed and to document our determination of allowable expenses, disallowed expenses, and the regulations used to determine the disallowance. We conducted numerous interviews with grantee officials to obtain clarification or additional support for the expenses claimed. We reviewed the budgets approved by RUS for each grant and the grantee's accounting records to determine if the grantee had expended funds in accordance with the budget. The supporting documentation was also reviewed and grantee officials were interviewed to determine if they used the grant funds in accordance with the approved budgeted line items. Finally, the grant applications and support for matching funds were reviewed to determine if the grantee met the matching requirements of the grants.

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

## **Exhibit A – Summary of Monetary Results**

Exhibit A – Page 1 of 1

<b>FINDING NUMBER</b>	<b>RECOMMENDATION NUMBER</b>	<b>DESCRIPTION</b>	<b>AMOUNT</b>	<b>CATEGORY</b>
1	1	Advanced Grant Funds Not Expended on Allowable Expenditures	\$429,159	Questioned Costs Recovery Recommended

# Exhibit B – Consolidated Summary of Funding Expenditures

<b>Consolidated Summary of Funding Expenditures</b>				
<b>Grant Projects</b>	<b>Advanced Grant Funds (SF-270)</b>	<b>Allowable Expenditures by Budget Line Item</b>	<b>Advanced Grant Funds Not Expended on Allowable Expenditures</b>	<b>Additional Allowable Expenditures</b>
	<b>A = B+C-D</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>Falcon Lake</b>	\$197,822.00	\$172,613.29	\$47,525.84	\$22,317.13
<b>San Ygnacio</b>	197,822.00	160,425.33	58,554.55	21,157.88
<b>Batesville</b>	236,014.00	127,097.28	109,204.62	287.90
<b>La Pryor</b>	215,127.00	114,739.45	100,387.55	0.00
<b>Progreso</b>	340,735.00	310,557.70	60,627.74	30,450.44
<b>Zapata</b>	329,569.00	330,326.01	43,377.84	44,134.85
<b>Crystal City</b>	418,957.00	291,127.47	130,663.13	2,833.61
<b>Total</b>	<b>\$1,936,046.00</b>	<b>\$1,506,886.53</b>	<b>\$550,341.28</b>	<b>\$121,181.81</b>
<b><u>Total Excess Advanced (C – D)</u></b>			<b>\$429,159</b>	

# Exhibit C – Agency Response

Exhibit C – Page 1 of 2



United States Department of Agriculture  
Rural Development

JUN 18 2008

SUBJECT: Utilities Programs – Texas Community Connect Grantee Close-Out Audits Blue Moon (Audit No. 09601-006-TE)

TO: Robert W. Young  
Assistant Inspector General  
for Audit

Attached for your review is the response dated June 9, 2008, from James Andrew, Administrator, Utilities Programs, to the official draft for the subject audit.

This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendation.

If you have any questions, please contact Arlene Pitter of my staff at 202-692-0083.

A handwritten signature in cursive script that reads "John M. Purcell".

JOHN PURCELL  
Director  
Financial Management Division

Attachment

1400 Independence Ave, SW • Washington, DC 20250-0700  
Web: <http://www.rurdev.usda.gov>

Committed to the future of rural communities.

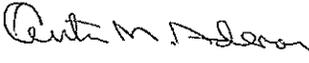
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United States Department of Agriculture  
Rural Development

June 9, 2008

TO: Robert W. Young  
Assistant Inspector General for Audit  
Office of Inspector General

FROM: James M. Andrew   
Administrator  
Rural Development – Utilities Programs

THROUGH: John Purcell  
Director  
Financial Management Division

SUBJECT: Texas Community Connect Grantee Close-Out Audit  
Office of Inspector General (OIG) Report 09601-6-Te

This provides a written response to the above subject OIG Audit Report which provided a close-out audit on the above subject Rural Development Community Connect Grant. The requirement for a close-out audit was specifically addressed in a Director Review Determination (#2006W000303) of the National Appeals Division (NAD).

We appreciate the Office of Inspector General's time and effort on this close-out Audit. To quote the OIG Report,

*"Objective: Our objective was to conduct a close-out audit of seven grants funded by RUS and determine if the grantee incurred any allowable expenditures between the last date of the RUS compliance review, March 18, 2005, and the suspension date of the grants, September 30, 2005, or if there were any other costs incurred that RUS should credit. These costs included all allowable expenses the grantee may have incurred from the date of the grant application, November 1, 2002, but which had not been previously claimed during the RUS compliance review."*

OIG's close-out Audit complied with the scope and intent of the NAD Director's determination. The OIG Report contained one Finding and one Recommendation. In brief, OIG found that the grantee "failed to comply with Federal regulations and the requirements of the Grant Agreement" and that the close-out audit revealed that "\$429,159.00 was expended for unallowable expenditures" and must be collected from the grantee.

Rural Development agrees with OIG's Audit Report. Within 30 days from the date of the Final Audit Report, Rural Development will transmit the results of the close-out Audit to the grantee as specified by the Director of NAD and make a demand for the \$429,159.00 that OIG concluded was expended for unallowable expenditures.

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