



**U.S. Department of Agriculture**

**Office of Inspector General**



# **Controls Over Recovery Act Rural Business Enterprise Grants**

**Audit Report 34703-1-KC  
March 2010**



U.S. Department of Agriculture  
Office of Inspector General  
Washington, D.C. 20250



DATE: March 31, 2010

REPLY TO  
ATTN OF: 34703-1-KC

TO: Dallas Tonsager  
Under Secretary  
Rural Development

TO: Judith A. Canales  
Administrator  
Rural Business-Cooperative Service

ATTN: John Purcell  
Director  
Financial Management Division

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

SUBJECT: Controls Over Recovery Act Rural Business Enterprise Grants

This report presents the results of our audit of the internal controls over the Rural Business Enterprise Grants Program as part of the American Recovery and Reinvestment Act of 2009. The report compiles the results of our work that we reported to you in two Fast Reports dated August 26, 2009. Excerpts of your September 2, 2009, and March 24, 2010, responses, along with the Office of Inspector General's position, are incorporated into the report.

Based on your responses, we were able to reach management decision for all recommendations in the report. Please follow your agency's internal procedures in forwarding documentation for the final action to the Office of the Chief Financial Officer. In accordance with Departmental Regulation 1720-1, all final actions need to be completed within 1 year of each management decision to preclude 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.

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# ***Controls Over Recovery Act Rural Business Enterprise Grants***

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## **Executive Summary**

### **Results in Brief**

This report presents the results of our first phase of audit work related to the adequacy of controls over grant making and servicing for recipients who obtain assistance through the Rural Business Enterprise Grant (RBEG) program. The American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> was signed into law on February 17, 2009. The purposes of the Recovery Act include preserving and creating jobs, promoting economic recovery, and assisting those most impacted by the recession. The Recovery Act included \$20 million for the U.S. Department of Agriculture (USDA) to make grants to businesses and entities in rural areas. The Rural Business - Cooperative Service (RBS) under Rural Development, a mission area within USDA, is responsible for establishing agency policy and procedures for the RBEG program to provide Recovery Act grant funds to eligible entities during fiscal years 2009 and 2010. These grants are directly funded by the Government and are available for rural projects that finance and facilitate development of small and emerging rural businesses, to help fund distance learning networks, and help fund employment related adult education programs. RBEGs may be made to public bodies, private nonprofit corporations, Indian Tribes on Federal and State reservations, and other Federally-recognized Indian Tribal groups in rural areas.

Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of funds. Further, on February 18, 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.<sup>2</sup> According to guidance issued by the Secretary of Agriculture, agencies shall develop transparent merit-based criteria that will guide their discretion in committing, obligating, and expending funds under the Recovery Act.

Our role, as mandated by the Recovery Act, is to oversee agency activities and to ensure agencies expend funds in a manner that minimizes the risk of improper use. We are using a multi-phase approach in performing our review of the Recovery Act funded RBEG program. The objectives of Phase I were focused on identifying Rural Development's internal controls to ensure the Recovery Act RBEG program was timely and effectively implemented. In Phase I, we reviewed the design of grant processing controls over RBEGs, such as application processing, recipient eligibility determinations, and grant reporting and servicing. In Rural Development's American Recovery and Reinvestment Act Implementation Plan dated May 1, 2009, RBS determined that its existing controls were sufficient to adequately mitigate the risk of waste, fraud, and abuse and it did not plan any changes to its existing internal controls. Therefore, we looked at the controls in place for determining eligibility and servicing of RBEGs existing prior to the expenditure of Recovery Act funds. Although we found that existing controls were not always followed, we did not find any apparent control deficiencies in the design of these controls as part of our Phase I review.

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<sup>1</sup> Public Law 111-5, dated February 17, 2009.

<sup>2</sup> On April 3, 2009, OMB issued *Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009*.

During this initial phase, we identified two internal control issues where existing controls were not always followed. We reported these as findings to the Under Secretary for Rural Development in two Fast Reports. The findings address (1) properly reporting the status of grant funds in quarterly reports and (2) obtaining adequate documentation to support the payment of the grant funds to recipients. The Fast Reports were issued on August 24, 2009, and in early September, Rural Development agreed to take action on the recommendations in their response. In Phase II, we plan to focus on testing the effectiveness of these controls over grants in the Recovery Act RBEG program via a statistical sample.

Rural Development officials began taking corrective actions to resolve the issues during the course of the audit and provided an update on actions taken on January 12, 2010. Specifically, Rural Development issued an un-numbered letter to re-emphasize the need to ensure reporting is accomplished both in a timely fashion and in accordance with OMB and regulatory guidance. Also, Rural Development plans to discuss the RBEG reporting requirements at the Administrator's monthly teleconference and to conduct a web based training session to review RBEG reporting requirements. In addition, notification of the need for better documentation was made at the Rural Development Policy and Training Conference by the Specialty Programs Division in August 2009.

### **Recommendation Summary**

Rural Development needs to (1) provide additional training to the States to clarify and reinforce the quarterly reporting requirements in Rural Development Instruction 1942-G, Attachment 1 (revision 2); (2) develop a formal process for monitoring and ensuring that each State adheres to reporting requirements as specified in 1942-G; (3) assess all Rural Development State and area offices to determine whether adequate documentation is obtained from RBEG recipients to support their requests for reimbursement and provide additional training to State office staff where insufficient documentation is observed; and (4) develop additional guidance to define the type of support necessary for grant-related reimbursements.

### **Agency Response**

The agency responses are posted on our website with the applicable Fast Reports and are summarized in this report. The responses can be found at [http://www.usda.gov/oig/recovery/recovery\\_reports.htm](http://www.usda.gov/oig/recovery/recovery_reports.htm).

### **OIG Position**

We agreed with the agency's proposed corrective actions and reached management decision on all recommendations in the report.

## **Background & Objectives**

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### **Background**

In response to the current economic downturn, Congress passed the American Recovery and Reinvestment Act of 2009 (Recovery Act) (P.L. 111-5, dated February 17, 2009). The Recovery Act included \$20 million to provide funding for a broad variety of programs to support business development in rural areas through the RBEG program.

Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of the funds. On February 18, 2009, the Office of Management and Budget (OMB) issued guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act. OMB issued additional guidance on April 3, 2009, to reinforce ongoing work by clarifying existing requirements and establishing additional steps that must be taken to facilitate the accountability and transparency objectives of the Recovery Act.

The RBEG program is administered by the Rural Development State office (SO) and/or area office (AO) where the project is located. RBS officials determine applicant eligibility through a ranking system based on population, economic conditions (such as unemployment, etc.), applicant experience, evidence of small business development, commitment of nonfederal funding sources, evidence of jobs to be created/saved, grant amount requested, and State Director discretionary points. Applicants can include public bodies, private non-profit corporations, and Federally recognized Indian Tribal groups, and must be located in a rural area with a population of less than 50,000.

As of December 31, 2009, Rural Development had obligated funds for 145 projects totaling \$15.3 million of the \$20 million allocated to the RBEG program from the Recovery Act. Historically, RBEG funds have been used for a wide variety of projects. For example, these projects include business-based infrastructure such as sidewalks, downtown plazas, improved lighting for shopper safety, and parking; job-specific training to improve worker skills; and establishment of rural revolving loan funds for small businesses. However, according to Rural Development's Implementation Plan, dated May 1, 2009, Rural Development intends to use Recovery Act funding specifically for training, job-related education, business incubators,<sup>3</sup> and capitalization of loan funds in order to ensure that Recovery Act RBEG program funds have short and long term effects on the economy.

### **Objectives**

The overall objectives of our audit oversight of the Recovery Act monies were to ensure that; (1) USDA Recovery Act-related programs are timely and effectively implemented; (2) proper internal control procedures are established; (3) program participants meet eligibility guidelines; (4) participants properly comply with program requirements; and (5) agencies establish effective compliance operations.

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<sup>3</sup> Facility established to nurture young (startup) firms during their early months or years. It usually provides affordable space, shared offices and services, hands-on management training, and marketing support.

We are using a multi-phased approach for this audit. The Recovery Act funding for RBEG is available during Fiscal Years 2009 and 2010. The objectives of our Phase I review were to:

- Monitor the development of program guidance and requirements for distributing Recovery Act funding to program participants, including eligibility requirements;
- Identify and evaluate internal controls utilized to ensure program objectives are achieved and program participants fully meet eligibility requirements; and
- Identify and evaluate compliance controls the RBS plans to use to monitor and oversee the obligation and expenditures of the Recovery Act RBEG program.

## ***Section 1: Increased Oversight through Effective Use of Quarterly Reports***

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### **Finding 1: Rural Development Oversight of RBEGs Needs Improvement**

We evaluated agency compliance activities for RBEG projects that were funded prior to the Recovery Act, but which are being used to monitor the use of RBEG Recovery Act funds. We found that some grant recipients were not submitting quarterly performance reports, while others submitted inadequate ones. Without these reports, Rural Development is unable to detect if projects meet their intended goals or whether grant projects were being completed in a timely manner.

According to Rural Development's Implementation Plan, the RBS will monitor and evaluate program implementation and the approval and expenditure of Recovery Act funds. The Plan states that Rural Development's existing controls are sufficient to adequately mitigate the risk of waste, fraud, and abuse. Rural Development National office officials have not issued any additional guidance for RBEG Recovery Act funds. Rural Development is also planning on using their existing compliance activities to review the RBEG program.

Rural Development Instruction 1942-G, Attachment 1, dated August 20, 1992, describes the RBEG reporting requirements, which include a quarterly SF-269, Financial Status Report, a quarterly Project Performance Activity Report, and a Final Performance Report. The quarterly Project Performance Activity reports are to include a comparison of actual accomplishments to the project objectives; reasons objectives were not met; problems, delays, or adverse conditions affecting attainment of project objectives; and objectives and timetables established for the next reporting period.

RBS uses Management Control Reviews (MCR) and Business and Cooperative Program Assessment Reviews (BCPAR) as the foundation of its compliance and monitoring control activities. The MCRs serve as detailed examinations by the RBEG National office program staff of State and local grant making and servicing controls for the RBEG program. The BCPAR process is conducted to evaluate the effectiveness of State delivery systems for Business and Cooperative Programs and to ensure compliance with applicable regulations.

As part of our review of RBEG program controls, we reviewed the 2006 MCRs and all of the 2007 and 2008 BCPARs. These reviews reported the most recent deficiencies with the State office performance of compliance reviews in relation to RBEG quarterly reporting requirements. We visited three State offices (New Jersey, Michigan, and Wisconsin) where problems were reported to determine if corrective actions were taken.

We found that these States were still not obtaining all of the quarterly and/or final performance reports from grant recipients. We reviewed 51 RBEG files and found 20 files that did not contain a quarterly and/or final report. In those instances where grant recipients did submit performance reports, six did not meet all reporting requirements by addressing reasons for delays, work completed as the project progressed, and actual accomplishments at the end of the

project. These performance reports are necessary for RBS to ensure objectives are achieved in a timely manner by the grant recipients.

We reviewed the three RBEG recipients that had been approved for grants in New Jersey. Only one grant recipient had submitted a quarterly report at the request of a program specialist, but the report did not meet the reporting requirements of Rural Development Instruction 1942-G. Although they had been approved in June 2008, none of the grant recipients had requested a disbursement of grant funds. We were told by the New Jersey State office program specialists that grant recipients were not required to submit the quarterly performance reports until after grant funds were disbursed. However, Rural Development Instruction 1942-G requires quarterly performance reports whether grant funds are disbursed or not.

At the Michigan State office, the seven program specialists interviewed were aware of the need for quarterly performance reports, but three of them mistook the SF-269 Financial Status Report for the quarterly report. As a result, 13 out of 22 grant files were missing quarterly performance reports. Of the nine files that contained reports, five were insufficient in that the reports did not meet Rural Development Instruction 1942-G reporting requirements. At the Wisconsin State office, 4 of 26 grant files were missing the quarterly performance reports.

Timely submission of complete quarterly performance reports by RBEG recipients and Rural Development's timely review of these reports are needed to ensure that the goals of the grant are accomplished. The National office also needs to provide additional training on the reporting requirements to ensure program specialists are aware of the differences between the SF-269 Financial Status Report and the quarterly performance reports before Recovery Act funds are disbursed.

When we discussed these issues with Rural Development on August 5, 2009, National office officials acknowledged that some States were not obtaining the quarterly performance reports. Rural Development officials discussed the need for additional training for State and area office personnel regarding the servicing requirements for grant recipients to submit the quarterly performance reports and the possibility of modifying an Administrative Notice to re-emphasize the requirements for grant recipients to submit complete quarterly performance reports that address the objectives of the project.

### **Recommendation 1**

Provide training to the States to clarify and reinforce the quarterly reporting requirements in Rural Development Instruction 1942-G, Attachment 1 (revision 2).

### **Agency Response**

Quarterly performance reports are required under this program and the Agency will continue to stress the need for such reports to be completed properly and in a timely manner.

The Agency plans to:

- A. Issue an un-numbered letter to re-emphasize the need to ensure reporting is accomplished both in a timely fashion and in accordance with OMB and regulatory

- requirements by December 31, 2009.
- B. Discuss RBEG reporting requirements at the Administrator's monthly teleconference. This will be accomplished by December 31, 2009.
  - C. Schedule separate meetings (via electronic media or telephone) with the Program Directors identified in the report and advise the State Directors of the noted deficiencies. This will be accomplished by December 31, 2009.
  - D. Conduct a web based training session to review RBEG reporting requirements and to include additional Recovery Act reporting requirements as they relate to RBEG. Rural Development discussed the information at the Rural Development Policy Conference in August 2009 and further training will be provided by March 31, 2010. Also, ARRA reporting requirements training was completed on October 2, 2009.
  - E. Obtain and review a random sampling of Recovery Act RBEG project folders to ensure that reporting is effective. This will be accomplished by March 31, 2010.

This will provide a broader sampling than that used by the OIG and will be conducted after some Recovery Act grants are disbursed and projects begun.

On January 12, 2010, Rural Development provided an update on the actions taken to date. Rural Development now plans to issue additional guidance to State Directors and Agency Administrators on March 1, 2010, to re-emphasize the need for accurate reporting. Also, Rural Development discussed the reporting requirements and advised State Directors of the noted issues during the January 21, 2010, Administrator's monthly teleconference. In addition, on January 14, 2010, the RBS National Office discussed the noted deficiencies identified in the report with the Rural Development State Office RBS Program Directors.

### **OIG Position**

We accept management decision for this recommendation.

### **Recommendation 2**

Develop a formal process for monitoring and ensuring that each State adheres to reporting requirements as specified in 1942-G.

### **Agency Response**

Based on the report, the MCR and BCPAR formal processes are working. Therefore, there is no need to develop a formal reporting process in addition to those two processes. There is, however, a need to ensure full follow-up to the reports. Oversight/Resources Coordination Staff (OCS) indicates that the current risk assessment tools (MCR and BCPAR):

- Assist with the enhancement of policies and procedures through better program management and internal controls
- Improve training and monitoring by improving program administration and reducing improper actions
- Improve analysis and reporting of data, and

- Ultimately reduce the Agency's exposure to risk.

The issue here should not be developing another process. However, better follow through and training will address the reporting issues. Therefore, RBS suggests following the plan provided in response to Recommendation 1 above and improving follow through using the systems already in place.

### **OIG Position**

We accept management decision for this recommendation.

## **Section 2: Documentation Needed to Ensure Grant Disbursements Meet Project Objectives**

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### **Finding 2: Grant Recipient Requests for Grant Funds Need Enhanced Reviews**

We found that Rural Development State offices did not ensure that RBEG program grant recipients submitted required documentation to support grant expenditures. We also found that Rural Development approved unsupported or ineligible uses of the grant funds.

As previously noted, Agency officials followed their existing guidance to process RBEG program revolving business loans and grants obligated under the Recovery Act. Rural Development National office officials do not plan on issuing any additional guidance for RBEG Recovery Act funds. According to the Plan, RBS will monitor and evaluate the expenditure of Recovery Act funds. They believe their existing controls are sufficient to mitigate the risk of waste, fraud, and abuse.

RBS also uses BCPARs as part of its compliance activities. The BCPAR process is to evaluate the effectiveness of State delivery systems for Business and Cooperative Programs, ensure compliance with applicable regulations, and focus on actions within the State office's control. Each State Office is given 90 calendar days to respond to any issues identified through BCPAR. We obtained the 2007 and 2008 BCPARs from Rural Development National office officials. Ten State offices are reviewed each year on a rotating basis. The BCPARs reported that Rural Development State offices did not ensure that the disbursement of grant funds to RBEG recipients was properly supported by required documentation. We visited three State offices (New Jersey, Michigan, and Wisconsin) for follow-up on the items noted in the 2007 and 2008 BCPARs and reviewed all the 2008 RBEG projects within those States to verify if corrective actions had been taken on these reported deficiencies.<sup>4</sup>

For the 2008 RBEG program year, we noted deficiencies in 7 of 22 grants we reviewed at the Michigan State office. We noted that documentation to support grant disbursements was not adequate to ensure that all program funds were used for authorized purposes. Specifically, reimbursement requests lacked supporting documentation and, in some instances, were for ineligible purposes.<sup>5</sup> For example, one grant recipient requested, and received, reimbursement for erecting a sign for a business park even though the objectives of the grant were to install sewer and water lines. Another recipient requested and received reimbursement for a feasibility study without providing any supporting documentation. Another request included reimbursement for the preparation of two RBEG applications, which is an ineligible expense. All of these reimbursement requests were reviewed by the program specialists in area offices and/or personnel in the State office. In addition, we noted grant recipient files in Wisconsin lacked verification that matching funds were expended by the grant recipient. Grant recipients are given additional points during the ranking process for providing a portion of matching funds themselves.

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<sup>4</sup> At the time of our review, none of the 2008 RBEG projects in New Jersey had submitted requests for reimbursement.

<sup>5</sup> The Michigan State office took corrective action to rectify this deficiency after we notified it of the ineligible reimbursement request.

OMB Circular No. A-123, Management Responsibility for Internal Control, requires Agencies to report any insufficient documentation in support of payments. Rural Development requires grantees to read and understand the requirements of 7 CFR 3015.61(g), which states that accounting records shall be supported by source documentation to include cancelled checks, paid bills, and contracts. However, this requirement is not specific enough to describe to grantees the documentation needed by Rural Development to determine whether project costs were eligible and whether the objectives of the projects were met. Rural Development needs to provide written procedures specifying how requests for reimbursements are to be supported by proper documentation and used for their intended purpose.

When we discussed these issues with Rural Development on August 5, 2009, National office officials acknowledged that the lack of documentation to support reimbursements was an ongoing issue, and that additional training at both the State and area office level is needed.

### **Recommendation 3**

Assess all Rural Development State and area offices to determine whether adequate documentation is obtained from RBEG recipients to support their requests for reimbursement. Provide additional training to State office staff where insufficient documentation is observed.

### **Agency Response**

Rural Development acknowledges that additional training will assist in meeting the ultimate goal of ensuring proper documentation for each request for advance or reimbursement. To meet that goal, rather than conduct new and separate assessments, RBS will review the BCPAR reports to determine the adequacy of documentation as noted by the reviewers. Based on the report indications, RBS will contact those offices that are more deficient than others and pursue training supplemental to that addressed in the responses to Fast Report 1 [Section 1 above]. RBS will accomplish these actions by March 31, 2010.

As related to the three States cited in this initial phase of our audit, each of the States have been contacted to obtain a synopsis of their documentation activities so that RBS can begin to concentrate on those States as needed. RBS planned to accomplish these actions by November 30, 2009.

In addition, notification of the need for better documentation was made at the Rural Development policy and training conference by the Specialty Programs Division. The reporting information was discussed at the Rural Development Policy Conference in August 2009 and further training will be provided by March 31, 2010. The Recovery Act reporting requirements training was completed on October 2, 2009.

On January 12, 2010, Rural Development provided an update on the actions taken to date. RBS contacted the three States cited in our audit on January 14, 2010, and obtained a synopsis of their documentation activities.

## **OIG Position**

We accept management decision for this recommendation.

## **Recommendation 4**

Develop additional guidance to define the type of support necessary for grant-related reimbursements.

## **Agency Response**

OMB Circular No. A-123 is a government-wide guide to appropriate use of grant funding. It is relied upon by scores of agencies other than Rural Development, and that guidance is not something that Rural Development can change. However, RBS does understand that circular and regulatory language can sometimes be complicated and less clear than the average grantee may be able to appropriately react to. Rural Development will review these circulars and regulations and compare them to the documentation being currently obtained as evidence in the BCPAR assessments. In the event Rural Development is able to agree that the development of further guidance would be beneficial, and while any written procedures will stem from Circular No. A-123, other circulars, and 7 CFR 2015, Rural Development will attempt to ease the language and provide clear examples to assist end users. Rural Development will also refer to the already published language in the training suggested in Fast Report 1 [Section 1 above].

These issues will be completed as part of the training to be provided as a result of Recommendation 3. Rural Development will complete these assessments by March 31, 2010. Although Rural Development does not have the authority to ease the language published by the Office of Management and Budget, Rural Development will attempt to clarify the reporting language by March 31, 2010.

## **OIG Position**

We accept management decision for this recommendation.

## ***Scope and Methodology***

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We conducted our audit of the RBEG program at the RBS National office and Rural Development State Offices in Mt. Laurel, New Jersey; East Lansing, Michigan; and Stevens Point, Wisconsin. At the National Office, we reviewed the Rural Development published implementation plan for their Recovery Act grants. At the State Offices, we reviewed the RBEG program internal controls that Rural Development had in place prior to the Recovery Act. On March 20, 2009, Rural Development was authorized to begin distributing Recovery Act funds. Rural Development announced the approval for RBEGs to 145 projects for over \$15.3 million in Recovery Act RBEGs on July 28, 2009. By September 30, 2009, all of the grants had been obligated.

In Rural Development's American Recovery and Reinvestment Act Implementation Plan, Rural Development Business Programs determined that their existing controls were sufficient to mitigate the risk of waste, fraud, and abuse adequately. Therefore, we looked at the existing controls in place for determining eligibility and servicing of regular RBEGs prior to the expenditure of Recovery Act funds. To accomplish our audit objectives, we also:

- Identified and reviewed Rural Development published guidance, instructions, handbooks, and regulations that detail the controls and procedures over the RBEG program;
- Reviewed Rural Development's Recovery Act Plan for its RBEG program;
- Reviewed 2008 RBEG program files at three State Offices; and
- Obtained and reviewed documents, such as OMB guidance, to gain an understanding of the provisions and requirements related to Rural Development's RBEG program.

We performed our audit fieldwork from April through August 2009. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We plan to perform needed testing during the second phase of our audit.

## ***Abbreviations***

BCPAR .....	Business and Cooperative Program Assessment Reviews
CFR.....	Code of Federal Regulations
MCR.....	Management Control Reviews
OIG .....	Office of Inspector General
OMB .....	Office of Management and Budget
RBEG.....	Rural Business Enterprise Grant
RBS .....	Rural Business-Cooperative Service
USDA.....	U.S. Department of Agriculture