



U.S. Department of Agriculture



Office of Inspector General
Great Plains Region

Audit Report

Rural Business-Cooperative Service Value-Added Agricultural Product Market Development Grant Program

Report No. 34601-3-KC
April 2004



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE:

REPLY TO

ATTN OF: 34601-3-KC

SUBJECT: Survey of Value-Added Agricultural Product Market Development Grant Program

TO: John Rosso
Administrator
Rural Business-Cooperative Service

THROUGH: John M. Purcell
Director
Financial Management Division

This report presents the results of the subject audit. Your January 29, 2004, written response to the official draft report is attached as exhibit A. Excerpts from the response and the Office of Inspector General's position are incorporated into the Findings and Recommendations section of the report. Rural Business-Cooperative Service (RBS) officials expressed agreement with many of the conditions cited in the official draft report but disagreed with the recommendation that these conditions be addressed through specific regulations for the Value-Added Agricultural Product Market Development Grant (VAPG) program. In addition, RBS officials elected to make the fiscal year 2003 VAPG grant awards before finalizing the VAPG rules and regulations.

Please note that we have revised Recommendation No. 1, based on your response. However, we continue to believe the many critical program policies and procedures must be published in the regulation to strengthen the agency's enforcement ability of these provisions. As described in the report, additional actions and information are needed before management decisions can be achieved for Recommendations Nos. 1 and 2.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing corrective actions taken or planned and the timeframes for accomplishing final action. Please note that the regulation requires management decisions to be reached on all findings and recommendations within 6 months from the date of report issuance, and final action should be completed within 1 year of management decision. We appreciate the assistance provided during our review.

/s/

ROBERT W. YOUNG
Assistant Inspector General
for Audit

Executive Summary

Rural Business-Cooperative Service Value-Added Agricultural Product Market Development Grant Program (Audit Report No. 34601-3-KC)

Results in Brief

This report presents the results of our audit survey of the Rural Business-Cooperative Service (RBS) procedures used to implement the Value-Added Agricultural Product Market Development Grant Program (VAPG). Our objective was to determine whether RBS had established sufficient management controls for the VAPG to ensure the grants were properly awarded and used in accordance with the Grant Agreements and whether the need existed for further audit coverage. The primary objective of the VAPG is to help independent producers of agricultural commodities and other eligible entities develop and implement business plans for viable marketing opportunities and develop strategies to create marketing opportunities. VAPG grants are intended to facilitate greater participation in emerging markets and create new markets for value-added products. Grants are to be awarded only if projects or ventures are determined to be economically viable and sustainable.¹

We found that VAPG grants, totaling about \$20.4 million and \$37.5 million in fiscal year (FY) 2001 and FY 2002, respectively, were awarded without sufficient internal management control policies and internal operating procedures necessary to both ensure appropriate delivery of the program benefits and grant recipient compliance with their agreements. Also, VAPG grant awards totaling about \$28.5 million were made for FY 2003 without first developing and implementing comprehensive regulations or internal operating procedures necessary to administer the program. RBS stated that this occurred because sufficient time was not available to develop, publish, and finalize program regulations and internal operating procedures while at the same time obligating FY 2003 VAPG funding.

RBS published proposed VAPG regulations during June 2003,² although it did not implement them prior to the end of FY 2003. The Office of the General Counsel (OGC) and the Office of Management and Budget permitted RBS National office officials to implement the program as a pilot program during FY 2001 after the program was authorized by the Agricultural Risk Protection Act. During FY 2002, the Farm Security and Rural Investment Act subsequently clarified the VAPG eligibility requirements for agricultural products and producers, and RBS asserted they needed to solicit project proposals and make grant awards within reduced timeframes after both acts

¹ The VAPG program was authorized by section 231 of the Agriculture Risk Protection Act of 2000 and amended by section 6401 of the Farm Security and Rural Investment Act of 2002.

² Proposed Rural Development (RD) Instruction 4284 includes definitions and requirements common to all RBS grant programs. Proposed RD Instruction 4284(J) includes instructions specific to the VAPG program. The Proposed Rules were published in the Federal Register on June 13, 2003.

were enacted. Also, RBS asserted that the need to obtain final clearance for the VAPG regulations from OGC and the Office of Management and Budget delayed implementation of the final regulations during FY 2003. As a result, there was reduced assurance that RBS grants of about \$86.4 million (FYs 2001 to 2003) were awarded to the most worthy applicants whose proposals reflected the legislative intent of the program.

We provided written comments, dated August 12, 2003, to RBS regarding our concerns on the proposed VAPG regulations. These concerns are also included in this report. Based on our survey results, we plan to perform additional audit work to determine whether grant funds were properly awarded and were being used according to Grant Agreements.

Recommendations In Brief

We recommend that RBS consult with OGC officials and obtain their written guidance regarding those areas cited in this audit report that must be addressed through revision of the proposed VAPG rules and regulations, and those areas that can be satisfactorily addressed through the planned VAPG handbook, Letters of Conditions, Grant Agreements, Requests for Proposals, etc. Also, we recommend that RBS revise the proposed rules and regulations, as recommended by OGC, as well as other program procedures, agreements, etc., as applicable. Also, we recommend that RBS obtain a written determination from OGC officials whether actions taken, regarding VAPG rulemaking, program procedures, agreements, etc., have met the requirements of the Administrative Procedures Act. In addition, we recommend that RBS consult with OGC officials to determine the need to postpone awarding VAPG grant funds for future years until the cited regulations and internal operating procedures are finalized and implemented.

RBS Response

RBS officials provided written comments, dated January 29, 2004, expressing agreement with many of conditions cited in the official draft report (see exhibit A). However, RBS officials disagreed that the conditions should be addressed through revisions of the VAPG regulations. RBS officials stated that implementing the Office of Inspector General's suggestions for strengthening the VAPG through regulation would severely hamper the agency's ability to effectively and efficiently deliver the VAPG. Rather, RBS officials stated most of the concerns should be addressed through the planned VAPG handbook, annual Requests for Proposals, and the Letters of Conditions provided to all approved projects. In addition, RBS officials stated that, in their opinion, substantive performance requirements must be developed on a project-by-project basis because of the great diversity of projects. In addition, RBS officials stated that they believe the aforementioned actions can be substantially completed prior to the release of additional program funds.

OIG Position

The written response to the official draft report indicates RBS generally plans to take positive actions to correct the conditions cited in this report. However, we continue to believe RBS needs to consult with OGC officials to obtain their written guidance regarding those areas which need to be included in the VAPG regulations and those that can be addressed satisfactorily through handbook procedures, Requests for Proposal, Letters of Conditions, and Grant Agreements. The Findings and Recommendations section of the report provides the full details of the additional information needed to achieve management decisions on Recommendations Nos. 1 and 2. Also, we will need to be advised of the specific actions contemplated or planned along with acceptable timeframes for completing the proposed actions.

Abbreviations Used in This Report

CFR	Code of Federal Regulations
FY	Fiscal Year
NOFA	Notice of Fund Availability
OGC	Office of the General Counsel
RBS	Rural Business-Cooperative Service
RD	Rural Development
USDA	U.S. Department of Agriculture
VAPG	Value-Added Agricultural Product Market Development Grant Program

Table of Contents

Executive Summary	i
Abbreviations Used in This Report.....	iv
Background and Objectives.....	1
Findings and Recommendations.....	3
Section 1. VAPG Grants Awarded Without Final Published Rules.....	3
Finding 1 VAPG Controls Were Inadequate	3
Recommendation No. 1.....	7
Recommendation No. 2.....	12
Scope and Methodology.....	13
Exhibit A – RBS Reply to Official Draft.....	14

Background and Objectives

Background

The Value-Added Agricultural Product Market Development Grant Program (VAPG) was authorized by the Agriculture Risk Protection Act of 2000 and amended by the Farm Security and Rural Investment Act of 2002. The primary objective of the VAPG is to help eligible independent producers of agricultural commodities, producer groups, farmer and rancher cooperatives, and majority-owned producer-based business ventures develop business plans for viable marketing opportunities and develop strategies to create marketing opportunities. VAPG grants are intended to facilitate greater participation in emerging markets and create new markets for value-added products. The Agriculture Risk Protection Act provided that the total grant award provided to a VAPG recipient could not exceed \$500,000. Grants are to be awarded only if projects or ventures are determined to be economically viable and sustainable.

The Secretary of Agriculture delegated administration of the VAPG to the Rural Business-Cooperative Service (RBS) upon its enactment in fiscal year (FY) 2001. During each FY, RBS announces the availability of VAPG grant funds through publication of a Notice of Fund Availability (NOFA) in the Federal Register. RBS uses the NOFAs to request project proposals from eligible producers interested in obtaining a competitively awarded VAPG grant. Each NOFA includes brief descriptions of the program background, recipient and product eligibility, eligible grant and matching fund uses, and the methods for evaluating and ranking applications. Applications and project proposals must be submitted to the appropriate Rural Development (RD) State office on or before the date specified in the NOFA.

RBS State office personnel initially review applications for completeness and responsiveness to the NOFA. For all applications where it is determined the application is complete and the proposed project is eligible for a grant award, three separate formal indepth evaluations are performed of the proposed project. The formal in-depth evaluations are based on the Evaluation Criteria section of the NOFA and point scores are assigned to the project proposals based on each review. State office personnel perform the first formal indepth evaluation. The National office then selects an independent contractor to conduct two additional formal indepth evaluations of all complete and eligible project proposals. All accepted and formally evaluated applications are forwarded to the National office and ranked according to their established scores. The ranked applications are then presented, along with the recommended individual funding levels, to the RBS Administrator, who selects and awards the grants.

RBS is one of three major program areas operating under the RD mission area. Public Law 103-354, the Federal Crop Insurance Reform and

Department of Agriculture Reorganization Act of 1994, established RBS. The mission of RBS is to enhance the quality of life for all rural residents by assisting new and existing cooperatives and businesses through partnership with rural communities. The Washington, D.C., National office, 47 State offices, and over 800 field offices administer RBS programs.

Objectives

The primary survey objective was to determine if RBS had established sufficient management controls to ensure VAPG grant funds were properly awarded and effectively used for authorized purposes according to Grant Agreements and program regulations and procedures.

Findings and Recommendations

Section 1. VAPG Grants Awarded Without Final Published Rules

Finding 1

VAPG Controls Were Inadequate

We concluded that the proposed VAPG regulations published by RBS in the Federal Register during June 2003, as well as the interim NOFAs used to administer the program for FYs 2001, 2002, and 2003, did not include sufficient internal management or administrative control policies and procedures necessary to ensure appropriate delivery of the program benefits or recipient compliance with Grant Agreements. We also observed an absence of internal agency directives to administer the program. According to National office officials, required rulemaking procedures were not followed because the VAPG was implemented as a new pilot program for FY 2001 and continued in pilot program status for FY 2002. RBS officials stated they did not have sufficient time available after the enactment of the legislation for both years' programs to develop the regulations and operating procedures before they published the required solicitations for project proposals and made grant awards. Also, they said the VAPG was unique from other RBS grant and loan programs, which made their identification and development of the internal control policies and procedures more difficult. As a result, there was not reasonable assurance that VAPG grant awards were always properly awarded in accordance with the Agricultural Risk Protection Act, as amended, and funds were provided only to eligible applicants with the ability to protect the Government's investment in projects and perform all activities required by the Grant Agreement and program regulations.

The Administrative Procedure Act³ provides rulemaking requirements for all Federal programs. A Secretarial Memorandum⁴ established a policy to apply the Administrative Procedure Act's rulemaking procedures to matters relating to all U.S. Department of Agriculture (USDA) grant and loan programs.

Before issuing a notice of proposed rulemaking, each agency should, where appropriate, seek the involvement of those who are intended to benefit from and those expected to be burdened by any regulation.⁵ Regulations may only be issued on an emergency basis with no prior opportunity for comment if there is good cause not to solicit comments on the rule and the reason is set forth in the rule as published. This "good cause" exception is to be construed narrowly and used only in unusual circumstances.⁶ RD Instructions also

³ Title 5 United States Code (553).

⁴ USDA Secretary Hardin Memorandum, dated July 20, 1971.

⁵ Departmental Regulation 1512-1, dated March 1997, and Executive Order 12866, section 6(a).

⁶ Departmental Regulation 1512-1, paragraph 6(d)(1), dated March 1997.

confirm regulations must be published in the Federal Register if they affect the rights, responsibilities, duties, or obligations of the public.⁷

During FY 2001 and 2002,⁸ the only public notifications made by RBS of VAPG grant fund availability and eligibility requirements were NOFAs published in the Federal Register. RBS did not seek to involve agricultural product producers in the rulemaking and did not include a reason for not soliciting comment from the public in the NOFAs. The NOFAs included brief sections describing eligible products and producers, project proposal preparation, eligible grant fund uses, methods for evaluating and ranking project proposals, and evaluation criteria and weighting factors. However, the NOFAs did not adequately describe the management policies and administrative control procedures the agency would utilize in receiving, processing, and awarding grants. Controls were not specified to ensure VAPG grants were provided only to qualified applicants, VAPG grant award recipients complied with all Grant Agreement and program requirements, and grant funds were used for authorized purposes. We further noted an absence of internal agency directives and procedures showing those management control policies and procedures to be followed in administering the program.

The Office of the General Counsel (OGC) personnel interviewed told us that they waived publication of the regulations for the first 2 years because they had approved the VAPG as a pilot program and the use of NOFAs to announce grant availability. For FY 2003, OGC officials said they initially informed RBS the use of a NOFA, prior to release of final program regulations, would not be approved. OGC directed RBS to follow required Departmental Regulations for rulemaking requirements, including seeking public comments, prior to soliciting proposals for FY 2003 VAPG projects. However, on September 4, 2003, OGC permitted RBS to subsequently publish a NOFA soliciting FY 2003 project proposals without first finalizing its draft regulation. The provisions contained in the NOFA were very similar to those in prior NOFAs and did not further elaborate on the policies and procedures the agency would follow in receiving, processing, and awarding grants for that year. OGC officials explained they approved the FY 2003 NOFA because clearance of the final regulation by the Office of Budget and Program Analysis division of the Office of Management and Budget was delayed. According to the NOFA, FY 2003 project proposals were required to be submitted to the applicable State office by October 20, 2003.

We found the proposed VAPG regulations published in the Federal Register during June 2003, as well as the interim NOFAs used for FYs 2001, 2002,

⁷ RD Instruction 2006.167.

⁸ RBS published two NOFAs on March 6, 2001. The first solicited proposals for a VAPG Information Resource Center. The second solicited proposals for two rounds of FY 2001 producer grants with deadlines of April 23, 2001, and June 27, 2001, respectively. (The deadline for the second round was subsequently extended to July 27, 2001.) The NOFA soliciting proposals for FY 2002 projects was published on June 24, 2002.

and 2003, provided insufficient operating procedures. Controls were not established to provide reasonable assurance that VAPG funds were provided only to eligible applicants with the ability to protect the Government's investment in projects and to perform all activities required by the Grant Agreements. Specifically, we found that the proposed regulation did not ensure participant eligibility because it did not:

1. Require entities and/or individual applicants to disclose any previous individual, partner, or cooperative participation in Federal grant and loan programs; fully document whether the application was for a new or existing operation; require credit checks before VAPG Grant Agreements were approved; and require background checks or contacts with references to verify the applicant's suitability and integrity.
2. Specify adequate procedures to effectively ensure grant award recipients would complete their responsibility to provide the required matching funds, or inkind contributions, and that inkind contributions were properly valued.
3. Require that applicants fully disclose any planned related-party transactions, including purchases of goods or services between the entity making the VAPG grant proposal and any affiliated company or individual. Also, applicants were not required to disclose planned related-party payments for salaries, consulting or other fees, commissions, rent payments, or fund transfers to any principal, officer, or other entity or individual that provided management, labor, goods, or services to the grant award recipient.
4. Require evidence that other proposed expenditures from VAPG grant funds were reasonable and typical compared to similar projects. (RBS servicing officials were not required to compare proposed project costs to prevailing costs of doing similar business in the market area.)
5. Specify corrective actions necessary or sanctions to be imposed if noncompliance with Grant Agreement requirements or RBS policies and procedures is disclosed.
6. Provide specific requirements to RBS servicing officials on conducting site visits and meeting regularly with project management. Instead, the National office provided supplemental letters to State office personnel requesting them to perform nonspecific fund reviews for projects receiving grant awards. The proposed regulation did not specify the frequency, procedures, and timeframes in which site visits should be completed, or require servicing officials to comprehensively document their visits, conclusions, and recommendations to project management. Also, requirements did not specify that project management must maintain an acceptable financial accounting and management system and

RBS officials were not required to verify the accuracy of the project financial statements. Also, specific requirements were not in place for conducting physical inspections and verifying the accuracy of the accomplishment and performance reports of the project.

7. All requirements for grant award recipients were not included into a formalized document. This would include State offices obtaining previously completed feasibility studies prior to approving use of VAPG grant funds for project working capital and providing advance approval of contracts for feasibility studies for planning projects.

Further, according to the proposed regulations, RBS plans to solicit future applications on a competitive basis by publication of one or more Requests for Proposals.⁹ However, the proposed regulations do not provide specific details of the process RBS plans to use to determine producer and product eligibility, rank project proposals, and select grant award recipients. Instead, the proposed regulations state the specific details of the proposed agency process are to be subsequently included in the planned Requests for Proposals. RBS does not plan to solicit public comment on the planned Request for Proposal provisions prior to seeking future project proposals and making VAPG grant awards. Therefore, the planned process of using Requests for Proposals, instead of NOFAs, will not significantly improve the RBS process and allow sufficient opportunity for public comment. Specifically:

8. Adequate opportunity will not be provided to agricultural product producers to give RBS comments and recommendations for clarification or improvement of any planned changes to the final project proposal evaluation criteria, scoring weights, and ranking methodology included in future solicitations of project proposals.
9. The description of the planned project proposal evaluation process for future years does not provide specific details of the process RBS officials will use to select agricultural economists or other technical experts from the RBS staff or select outside contractors to evaluate VAPG project proposals.¹⁰
10. Details are not provided regarding the circumstances in which the Administrator will award additional points to project proposals in order to increase the potential that VAPG grant awards will be more evenly distributed throughout the Nation.

We concluded the proposed regulation does not provide sufficient description of policies and procedures to be used in administering the VAPG. Also, RBS

⁹ Proposed RD Instruction 4284.910.

¹⁰ Proposed RD Instruction 4284.912.

has not provided adequate opportunity for agricultural product producers to comment on all relevant program provisions and for agency officials to include appropriate improvements and address their concerns in the final regulations and future solicitations for VAPG project proposals. We also noted internal directives and procedures concerning agency administration of the program were lacking.

Recommendation No. 1

Consult with OGC officials and obtain their written guidance regarding which of those areas cited in this audit report must be addressed through revision of the proposed VAPG rules and regulations, and those areas that can be satisfactorily addressed through the planned VAPG handbook, Letters of Condition, Grant Agreements, Requests for Proposals, etc. Revise the proposed rules and regulations, as recommended by OGC, as well as other program procedures, agreements, etc., as applicable. Obtain a written determination from OGC officials whether actions taken regarding VAPG rulemaking, program procedures, agreements, etc., have met the requirements of the Administrative Procedures Act.

RBS Response.

RBS' written response (see exhibit A), shows it agrees with many of the concerns outlined in the report, but it strongly disagrees with the recommendation that these concerns be addressed via regulation. It is RBS' position that implementing the Office of Inspector General's suggestions in a regulation would severely hamper RBS' ability to deliver the VAPG. RBS believes that most of the Office of Inspector General's issues can be addressed in its planned program handbook, the annual Request for Proposals, and through individual Letters of Conditions. While RBS declined to reissue the proposed regulation to address the 10 factors cited in the report, it agrees that the issues are relevant, but prefers to address them in an alternative manner.

RBS noted it planned to take several actions to address the conditions cited in the report. Specifically, RBS officials plan to:

- Develop a "high-risk" status to address financial concerns after an applicant has been selected for VAPG grant funding. RBS plans to include the procedure to check applicants for suspension or debarment in the planned VAPG handbook (audit detail issue No. 1).
- Include in the standard VAPG Grant Agreement an additional statement regarding grantor authority to verify matching funds valuation and expenditures. RBS plans to develop procedures to verify the matching

fund valuation and expenditures and publish the procedures in the planned VAPG handbook (audit detail issue No. 2).

- Modify the standard VAPG Grant Agreement to require VAPG grant recipients to disclose any and all related-party agreements and/or financial transactions (audit detail issue No. 3).
- Incorporate in the planned VAPG handbook recommendations for determining the reasonableness of expenditures from VAPG grant funds, and require grant monitors to review the expenditures for reasonableness (audit detail issue No. 4).
- Develop procedures for implementing sanctions if a grantee fails to comply with Grant Agreement requirements and include the procedures in the planned VAPG handbook (audit detail issue No. 5).
- Publish requirements for project site visits in the planned annual Request for Proposal and VAPG handbook (audit detail issue No. 6).
- Publish procedures for approval in the VAPG handbook (audit detail issue No. 7).
- Continue to publish review procedures, funding levels, and award procedures in the Requests for Proposals (audit detail issues Nos. 8, 9, and 10).

OIG Position.

Based on RBS' response, we revised the recommendation. We continue to believe RBS officials must consult with OGC officials to obtain definitive written guidance to establish those areas cited in this audit report that must be included in the VAPG regulations. We note the general regulations covering USDA grant programs cited by RBS in their response do not specifically address the VAPG or requirements for grants made to profit-oriented enterprises. Neither the Uniform Federal Assistance Regulations¹¹ nor the Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education,¹² provide provisions that sufficiently address the issues cited by RBS and covering the issues included in this audit report.

OGC officials informed us they do not normally review for legal sufficiency any requirements placed on program participants that are published only in agency handbooks. In addition, OGC officials cautioned us that National

¹¹ 7 Code of Federal Regulations (CFR) 3015.

¹² 7 CFR 3019.

Appeals Division hearing officers would review and consider only the formal program regulations published by the agency in the course of considering evidence in their legal proceedings on grantee appeals of agency actions. Therefore, program provisions and requirements contained only in internal agency handbooks would not normally be considered at the appeal hearings. OGC officials also informed us that various other RD regulations referenced the NOFAs or the Grant Agreements, as being applicable to the VAPG, could contain contradictory requirements or include other requirements that could be confusing because they are not applicable to the VAPG. Therefore, OGC officials informed us that the most critical policies and procedures should be published as a regulation to strengthen RBS' enforcement ability of these provisions instead of relying on references to regulations for other RD or Departmental programs.

In addition, OGC officials noted that a Federal appellate court recently determined that a USDA agency did not comply with the Administrative Procedures Act when it implemented a program using only a "Notice of Program Implementation" and did not follow required rulemaking procedures, including publication of all program requirements for the public in the regulations.

Specifically, we believe RBS officials should consult with OGC officials and obtain their written guidance regarding which of the issues we cited can be appropriately addressed in VAPG handbook procedures, Requests for Proposals, Letters of Conditions, and Grant Agreements and which ones definitely require codification in the regulations. The determination should address the following concerns:

- We continue to believe that RBS should obtain OGC direction regarding whether VAPG applicants should be required to disclose whether they are subject to Federal judgment or offset of payments as a result of participation in USDA programs. We note the Uniform Federal Assistance Regulations¹³ and the Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education¹⁴ have provisions for special restrictive terms and conditions if the applicant has a history of poor performance or is not otherwise responsible. We note that these regulations require the awarding agency to tell the recipient, in writing, why it is imposing the special conditions and what corrective action is needed. Therefore, RBS should obtain OGC guidance regarding the need to codify in the program regulations the process it plans to use to identify "high-risk" projects and potentially impose special conditions on grant recipients, including considerations included in the regulations (audit detail issue No. 1).

¹³ 7 CFR 3015.4.

¹⁴ 7 CFR 3019.14.

- Because many VAPG grants are awarded which specify nonmonetary contributions by the grant recipients, RBS should obtain OGC guidance regarding whether the VAPG regulations need to include the requirements for nonmonetary inkind contributions and the planned process to ensure inkind contributions are properly valued. RBS should obtain guidance from OGC officials regarding its decision to only include in the VAPG Grant Agreement a more specific statement concerning the grant recipient's responsibility to provide sufficient verification of matching fund valuation and expenditure and other generally applicable requirements¹⁵ (audit detail issue No. 2).
- RBS should obtain clearance from OGC regarding their plan to incorporate identity-of-interest disclosure requirements only into the VAPG Grant Agreement. RBS should also obtain OGC guidance regarding the need to (1) include identity-of-interest disclosure principles and specific definitions for related-party and identity-of-interest transactions in the VAPG regulations and (2) require program participants to sign identity-of-interest disclosure statements (audit detail issue No. 3).
- RBS should obtain OGC direction regarding the need to also incorporate into the program regulations a specific requirement that all grant fund expenditures must be reasonable and typical compared to similar projects and the procedures RBS will use to make this determination. We question RBS' plans to only incorporate recommendations for determining reasonableness into the planned handbook because there may not be sufficient authority to enforce RBS' determination of unreasonable expenditures (audit detail issue No. 4).
- We recognize that 7 CFR 3015.124 and 7 CFR 3019.62 (a) provide several potential remedies for noncompliance with Grant Agreements or program regulations, including (1) temporary withholding of cash payments, (2) disallowance of use of grant funds, (3) suspension of the Grant Agreement, or (4) termination of the Grant Agreement. However, RBS should obtain OGC guidance whether RBS could successfully take an enforcement action regarding noncompliance with the requirements for disclosure of identity-of-interest relationships, related-party transactions, and the reasonableness of project costs if such provisions are only included in the planned handbook for grant monitors but not specified in the VAPG regulations. In addition, OGC should provide advice whether the VAPG regulations should include those specific corrective actions or sanctions expected to be imposed when grant monitors determine the grant expenditures were unreasonable or the grantee failed to properly disclose any identity-of-interest relationships or related-party transactions and agreements (audit detail issue No. 5).

¹⁵ Including requirements contained in 7 CFR 3019.23.

- OGC should also provide advice whether applicable regulations restrict VAPG grant recipients from using identity-of-interest firms to perform the work included in the project proposals or engage in related-party financial transactions. Regulations require all procurement transactions to be conducted in a manner that provides maximum open and free competition and states that the recipient's officers, employees, or agents shall neither accept gratuities, favors, or anything of monetary value from contractors or proposed contractors.¹⁶ In addition, regulations¹⁷ state that no employee, officer, or agent of a grant recipient shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved (audit issue Nos. 4 and 5).
- RBS noted VAPG regulations should provide servicing officials with some flexibility regarding the need to complete project site visits. However, we believe RBS needs to obtain OGC guidance regarding whether publishing the project site visit requirements only in the handbook will adequately inform the public of RBS' intent to perform onsite verification of the projects' financial, performance, and accomplishment reports and deter project managers from using VAPG grant funds for improper or unauthorized purposes (audit issue No. 6).
- We continue to believe RBS should obtain OGC direction regarding the need to include all requirements of grant award recipients and servicing officials into a consolidated regulation (audit issue No. 7).

As long as OGC concurs, we have no objection to RBS specifying in the annual Request for Proposal (1) the process to be used to select RBS staff or outside contractors to evaluate VAPG project proposals and (2) the circumstances in which the Administrator will award additional points to project proposals in order to increase the potential that VAPG grant awards will be more evenly distributed throughout the Nation (audit issue Nos. 8, 9, and 10).

In order to achieve a management decision for Recommendation No. 1, we need to be informed that RBS has obtained written direction from OGC, regarding those areas cited in this report, that must be addressed through revision of the proposed VAPG rules and regulations and those areas that can be satisfactorily addressed through issuance of a VAPG handbook, Letters of Conditions, Grant Agreements, or Requests for Proposals. Also, we need to be informed that RBS has obtained written guidance from OGC regarding whether the proposed VAPG rules and regulations, program procedures, Letters of Conditions, Grant Agreements, Requests for Proposals, etc., meet the requirements of the Administrative Procedures Act. In addition, we need

¹⁶ 7 CFR 3015.182 and 7 CFR 3015.181 (a)(2).

¹⁷ 7 CFR 3015.181 and 7 CFR 3019.42.

to be advised of the specific actions taken or planned by RBS to satisfactorily address the cited issues along with acceptable timeframes for completing the proposed actions, including the specific date for issuing the planned handbook or revising program documents.

Recommendation No. 2

Obtain OGC guidance regarding the need to delay awarding VAPG grant funds for future years until the cited regulations and internal agency operating procedures are finalized and implemented.

RBS Response.

In the written response to the official draft report, RBS officials stated:

The Agency declines to delay the awarding of future VAPG grant funds. The Agency believes it can substantially implement the aforementioned positions prior to the release of additional program funds.

OIG Position.

In order to achieve a management decision for Recommendation No. 2, we need to be informed that RBS has obtained OGC direction regarding whether the awarding of grant funds for future years should be delayed until the revised regulations and internal agency operating procedures are in place. In addition, we need to be advised of the timeframes for completing actions determined necessary under the guidance of OGC officials.

Scope and Methodology

We initiated our review by gaining an understanding of the VAPG administered by RBS. We reviewed the NOFAs related to the VAPG published in the Federal Register by RBS during FYs 2001, 2002, and 2003. Also, we reviewed a draft of the proposed VAPG regulations provided to us by RBS National office officials in February 2003. The proposed VAPG regulations were subsequently published in the Federal Register during June 2003. Also, we reviewed and monitored the VAPG Internet site maintained by RBS National office officials. In addition, we reviewed the CFR requirements for other grant and loan programs administered by RBS and RD agencies to identify the internal management control policies and operating procedures established for those grant and loan programs.

We reviewed all 20 FY 2001 and all 6 FY 2002 appeal files related to the applicant eligibility determinations and project proposal evaluations completed under the guidance of RBS officials. We also reviewed RBS officials' correspondence with agricultural product producers, OGC attorneys, and independent contractors engaged by RBS officials to assist in performing evaluations of FY 2002 project proposals. We conducted our review through interviews with RBS National office officials and OGC attorneys in Washington, D.C., and Kansas City, Missouri. We performed this audit in accordance with Government Auditing Standards.

The survey universe was comprised of 294 projects that received RBS VAPG grant awards totaling \$57,812,034. During FY 2001, RBS made 63 VAPG grant awards totaling \$20,356,719 that were selected from 537 unique project proposals totaling \$136,252,258. Also, during FY 2002, RBS made 231 VAPG grant awards totaling \$37,455,315 that were selected from a total of 714 project proposals submitted. In addition, during December 2003, RBS announced 184 FY 2003 VAPG grant awards totaling about \$28.5 million. RBS published the NOFA used to solicit FY 2003 project proposals and made the subsequent grant awards after survey fieldwork was completed.

Exhibit A – RBS Reply to Official Draft

Exhibit A – Page 1 of 6



United States
Department of
Agriculture

FEB 04 2004

Rural Development

Operations and
Management

Washington, DC
20250

SUBJECT: Value-Added Agricultural Product Market
Development Grant Program (VADG)
(Audit No.34601-003-KC)

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

Attached for your review is the response from John Rosso,
Administrator, Rural Business-Cooperative Services, dated
January 29, 2004, to the official draft for subject audit.

If you have any questions, you may contact Steven Maged of my
staff at 202-692-0330.

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

JOHN M. PURCELL
Director
Financial Management Division

Attachment

Rural Development is an Equal Opportunity Lender. Complaints of
discrimination should be sent to: Secretary of Agriculture,
Washington, DC 20250



Exhibit A – RBS Reply to Official Draft

Exhibit A – Page 2 of 6



**United States
Department of
Agriculture**

Rural Business-
Cooperative Service

Washington, DC
20250

JAN 29 2004

TO: John M. Purcell
Director
Financial Management Division

SUBJECT: Survey of Value-Added Agricultural Product Market Development Grants
(Audit No. 34601-003-KC)

In response to your memorandum dated January 8, 2004, attached are the Rural Business-Cooperative Service's comments on the Office of Inspector General's official draft report.

If you have any questions concerning our comments, please contact Marc Warman of my staff at 690-1431.

A handwritten signature in cursive script that reads "John Rosso".

JOHN ROSSO
Administrator
Rural Business-Cooperative Services

Attachment

The Rural Business - Cooperative Service replaces the Rural Development Administration. RBS is an Equal Opportunity Lender. Complaints of discrimination should be sent to: Secretary of Agriculture, Washington, D.C. 20250



RURAL BUSINESS-COOPERATIVE SERVICE
Response to the Office of Inspector General Audit Report
Survey of Value-Added Agricultural Product Market Development Grant Program
Audit No. 34601-3-KC

The U.S. Department of Agriculture's (USDA) Office of Inspector General's (OIG) Report on the Value-Added Agricultural Product Market Development Grant (VAPG) program outlines 10 points of concern related to internal control weaknesses. The OIG Report recommends that these weaknesses be addressed through the program regulation. The Rural Business-Cooperative Service (Agency) agrees with many of the concerns outlined in the OIG Report but strongly disagrees with the recommendation that these concerns be addressed via regulation. It is the Agency's position that implementing OIG's suggestions in a regulation would severely hamper the Agency's ability to effectively and efficiently deliver the VAPG Program.

The VAPG program serves a very broad clientele. An individual farmer or rancher, as well as large and established agricultural cooperatives, are eligible for program benefits. There is a very large range in abilities and available resources among eligible applicants. The program covers all agricultural products produced, as well as renewable energy on the farm, including wind and sunlight. There are also numerous value-added ventures that qualify for program benefits. As a result, a "one size fits all" regulation will impair delivering program benefits to all who are eligible. An example is performance requirements. Substantive performance requirements must be developed on a project-by-project basis because of the great diversity of projects.

The Agency believes that most of the OIG issues can be addressed in the program handbook and the annual Request for Proposals (RFP), and through individual Letters of Conditions. The Agency also believes a couple of the issues are moot and do not need to be addressed. The following addresses the 10 points and 2 recommendations outlined in the OIG Report.

Recommendation No. 1

Revise the proposed rules and regulations to address each area cited in this report. (Refer to factor no. 1 through 10.)

Agency Response

The Agency declines to revise the proposed regulation to address the 10 factors. Again, the Agency does agree that the issues are relevant and prefers to address them as follows:

1. The Agency's position on this issue is that it is overly burdensome to require the level of disclosure recommended by OIG from an applicant. Applicants currently submit a signed form (SF-424) indicating any delinquency on Federal debt. If an applicant is merely behind on loan payments or an owner of the entity applying has personal debt problems, the Agency believes that the applicant is still eligible for the program. No Federal, departmental, or agency regulation prohibits the Agency from awarding a VAPG grant to an applicant that merely has credit problems rather than an actual delinquency.

Also, because nearly 800 applications were received during the last funding cycle, it would be too difficult to process the applications in a timely manner if all of the credit checks recommended by OIG were implemented.

The Agency believes that any recipients of the program can be placed on a “high-risk” status, if necessary, to address financial concerns. This high-risk status is better determined after an applicant has been selected for funding. In addition, the monitoring official for all tentatively selected recipients should be checking to make sure the recipient is not suspended or debarred prior to obligating funds. All recipients must also sign a certification indicating they are not suspended or debarred prior to receiving Federal funds. The Agency believes the procedure to check for suspension and debarment should be published in a program handbook for its employees and is currently working to develop the manual.

The Agency also does not believe that grant funds are at a level of unacceptable risk because of lack of credit check procedures. The reason for this belief is that most recipients in the program are paid by reimbursement rather than advance. Most recipients of a VAPG grant are not experienced grantees, so they often lack sophisticated financial management systems. While this situation may not seem ideal, it allows the grant monitors to very closely evaluate all requests for funds disbursement because the requests are made on a reimbursement basis. Many of our grantees are small businesses, and it does not make sense to require a sophisticated financial management system. Rather, the grant monitor can review expenditures and receipts over the course of the grant period and determine whether the costs are allowable before any grant funds are paid out, thus, ensuring in almost all cases that the funds are expended as intended and within the bounds of the law.

2. The Agency does not believe it is necessary to address the matching funds requirement in the program regulation in any more detail than is already present. The regulation is already very clear that verification of matching funds is required to be submitted as part of the application package. Applications that do not provide sufficient verification of matching funds need not be considered for funding. Current departmental regulations also address appropriate matching funds requirements (see 7 CFR 3015, subpart G and 7 CFR 3019.23).

The Agency believes that procedures to verify matching funds would be more appropriate in the program handbook and intends to publish them in such a format. The Agency suggests that the following statement be inserted into the VAPG Grant Agreement: “The Grantee agrees to provide sufficient verification of matching funds valuation and expenditure to the Grantor as necessary for the Grantor to verify that the matching funds are obtained from eligible sources and expended in accordance with all applicable laws, regulations, Executive Orders, and other generally applicable requirements, including those contained in 7 CFR 3019.23.” The Agency also believes that the request for verification of matching funds contained in the program regulation can be expanded, if necessary, in the RFP.

Furthermore, the program regulation states that matching funds must be spent in advance of grant funds (see Section 4284.3 Definitions, Matching Funds). This component of the regulation allows monitoring officials to confirm that matching funds are expended in accordance with applicable requirements.

3. The Agency believes that it is overly burdensome to require this level of disclosure from its applicants. Reviewing this level of disclosure is also not beneficial to the Agency because of the significant level of resources involved. Only 24 percent of applicants were funded during the last funding cycle. It makes more sense to review any disclosures once the tentative selections have been made. Also, subject transactions may not be known at the time of application. Applicants are not required to have contracted for goods or services at the time of application. Because so few applicants are funded, many choose to delay contracting for goods or services until they have received notice of selection for funding. The Agency intends to include a statement, such as the following, in the Grant Agreement that requires recipients to disclose any subject transactions when those transactions are known: “The Grantee agrees to disclose any and all related party transactions or agreements.” The Agency will also incorporate the procedures for reviewing these transactions in the program handbook.
4. The Agency agrees that expenditures from VAPG grant funds should be reasonable. It plans to incorporate recommendations for determining reasonableness into its program handbook and requires monitors to review expenditures for reasonableness. The Agency wishes to reserve its right to handle each grant and its associated expenditures on a case-by-case basis. However, because the recipients vary significantly, as do the projects, it is impossible to develop procedures that address the gamut of recipients and their projects. For example, the Agency has funded projects ranging from making candles out of beeswax to operating a 40-million gallon-per-year ethanol plant.
5. Departmental regulations already specify the types of sanctions that may be imposed if a grantee fails to comply with grant agreement requirements. The Agency does agree that procedures for implementing these sanctions should be developed and will include such procedures in its program handbook.
6. The Agency believes that different site visit requirements are necessary for different grants. Again, this is a function of the type of project, the size of the operation, the number of sites used by the venture, and other factors. Because of these factors, the Agency believes it is necessary to preserve flexibility in conducting site visits. Thus, rather than publish site visit requirements in the program regulation, it would prefer to publish the requirements in the RFP and program handbook. This method of conveying requirements would allow the Agency to accommodate resource levels on a funding-cycle-basis while still publishing its intent to its current recipients and monitoring officials.
7. The Agency believes that it is unnecessary to combine all requirements for grantees into one document. The Grant Agreement makes reference to the known applicable laws, regulations, Executive Orders, and other generally applicable requirements. The Letter of

Conditions can be used to tailor requirements to the individual recipients. Feasibility study and business plan approval are currently required for grantees receiving working capital funds and monitoring officials approve contracts for feasibility studies for planning projects. The Agency believes that procedures for approval should be published in a program handbook to provide consistent guidance for grant monitors.

8. The Agency regrets that it cannot obtain annual comments from producers regarding its evaluation criteria and selection process. However, the evaluation criteria did receive public comments during the publication of the proposed regulation. Other aspects of the selection process, including how many reviews each proposal will receive, the scoring weights, and the timeframe in which the proposals will be reviewed, cannot be determined for multiple years in advance. The Agency does not receive any appropriated administrative funds to implement the program. Instead, it relies on funds from USDA's Salaries and Expenses account to administer the program each year. These funds vary in availability and the Agency must be able to modify its review procedures in accordance with available funding. Also, the number of applicants is not known in advance. The Agency is able to predict the approximate number of applications for the next funding cycle but not in future funding cycles. The Agency believes that by specifying its review procedures in the RFP, it is providing sufficient notice to applicants of the procedures to be used while maintaining the flexibility needed to accommodate varying funding levels and varying levels of applications.
9. As stated above, because funding levels and application levels are expected to vary from year to year, the Agency prefers to specify this process in the RFP to preserve flexibility.
10. The Administrator points are meant to allow the Agency to focus on initiatives specific to a particular administration and to allow the Agency to accommodate current agricultural issues. Publishing specific criteria in the regulation removes the flexibility the points are meant to afford. The Agency prefers to publish its intentions in the RFP.

Recommendation No. 2

Delay awarding VAPG grant funds for future years until the cited regulation and internal agency operating procedures are finalized and implemented.

Agency Response

The Agency declines to delay the awarding of future VAPG grant funds. The Agency believes it can substantially implement the aforementioned positions prior to the release of additional program funds.

