



United States Department of Agriculture



OFFICE OF INSPECTOR GENERAL



Intermediary Relending Program

Audit Report 34601-0001-22

OBJECTIVE

Our objective was to determine if RBS' corrective actions have been effective at eliminating or reducing previously identified weaknesses applicable to loans made for ineligible purposes, loans exceeding loan limits, loans made in non-rural areas, and intermediaries not promptly relending funds.

REVIEWED

We reviewed IRP regulations and the prior IRP audit report, conducted site visits at selected locations, and interviewed RBS employees.

RECOMMENDS

We recommend that RBS develop a process to oversee the use of revolved funds and revise relevant program regulations, provide training on the credit elsewhere regulation, revise instructions so a debt instrument cannot be used as intermediary contribution, clarify that removing cash from the revolving loan fund requires national office approval, and stress that an approved budget is required from intermediaries.

OIG reviewed whether RBS' corrective actions from a prior audit have been effective at eliminating or reducing IRP program weaknesses.

WHAT OIG FOUND

The Intermediary Relending Program (IRP), a Business Program run by the Rural Business- Cooperative Service (RBS), is designed to enhance economic activity and employment in rural communities. A 2010 audit of IRP found that intermediaries were noncompliant with program requirements for making and relending loans with their revolving funds. Following the audit, RBS updated its IRP regulations effective September 2014.

We determined RBS had not eliminated all reported weaknesses from the 2010 audit. Specifically, we found that three of the six intermediaries we reviewed did not promptly relend their IRP revolved funds and maintained excessive cash balances. Furthermore, the intermediaries we reviewed did not sufficiently document why ultimate recipients did not finance their proposed projects through commercial credit or other programs. As a result, RBS needs additional controls to correct these recurring program weaknesses.

In addition, we identified further concerns. First, we found that one RD State office is allowing intermediaries to use long-term debt instruments as their intermediary contribution for the purposes of scoring and funding projects. Next, we found that an intermediary transferred non-IRP loans into an IRP portfolio in exchange for cash. Lastly, we found that one RD State office did not require its intermediaries to submit approved administrative cost budgets annually.

RBS concurred with the majority of our recommendations and OIG was able to accept management decision for 9 of the 12 recommendations. Further action from the agency is needed before management decision can be reached for the remaining recommendations.



United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: April 21, 2017

AUDIT
NUMBER: 34601-0001-22

TO: Chad Parker
Acting Administrator
Rural Business-Cooperative Service

ATTN: John Dunsmuir
Director
Financial Management Division

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Intermediary Relending Program

This report presents the results of the subject audit. Your written response to the official draft report is included in its entirety at the end of this report. Your response and Office of Inspector General's (OIG) position are incorporated into the relevant sections of the report. Based on your written response, we are accepting management decision on Recommendations 1, 2, 5, 6, 7, 8, 10, 11 and 12. Management decision has not been reached for Recommendations 3, 4, and 9. The actions needed to reach management decision for these recommendations are described under the relevant OIG Position sections.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendations for which management decisions have not been reached. Please note that the regulation requires 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 Agency Financial Report. For agencies other than OCFO, please follow your internal agency procedures in forwarding final action correspondence to OCFO.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publicly available information and will be posted in its entirety to our website (<http://www.usda.gov/oig>) in the near future.

Table of Contents

Background and Objectives.....	1
Section 1: RBS Has Not Eliminated All Reported Concerns from the Prior Audit.....	4
Finding 1: RBS Needs to Establish National Oversight for Relending Funds to Ensure IRP Funds Are Being Fully Used to Create and Save Jobs in Rural Communities	4
Recommendation 1.....	6
Recommendation 2.....	7
Recommendation 3.....	7
Recommendation 4.....	8
Finding 2: Program Instructions Need to Clarify Documentation Requirements for Ultimate Recipient’s Access to Other Credit to Ensure Program’s Intent of Aiding Smaller and Emerging Businesses.....	10
Recommendation 5.....	11
Recommendation 6.....	11
Recommendation 7.....	12
Section 2: Program Weaknesses Not Identified in Prior Audit	13
Finding 3: Intermediaries Used Debt Instruments as Source of Equity Contributions to Revolving Loan Fund, Allowing for Competitive Advantage in Application Scoring and Reduction of Project Funds in Rural Communities	13
Recommendation 8.....	14
Finding 4: Revolving Loan Transfers Reduced Available Capital for Eligible Borrowers	15
Recommendation 9.....	18
Recommendation 10.....	18
Finding 5: RD State Office Did Not Require Administrative Cost Budgets....	19
Recommendation 11	20
Recommendation 12.....	21
Scope and Methodology	22
Abbreviations.....	24

Exhibit A: Summary of Monetary Results 25
Agency's Response 26

Background and Objectives

Background

The Department of Agriculture's (USDA) Rural Development (RD) mission area is dedicated to increasing economic opportunity and enriching the lives of rural Americans. One way RD fulfills its mission is through the promotion of economic development via loans to businesses through banks, credit unions, and community-managed lending pools. The Rural Business-Cooperative Service (RBS), an agency within RD, helps provide capital in rural areas¹ through its Business Programs, often in partnership with private-sector lenders and community-based organizations. One such Business Program is the Intermediary Relending Program (IRP).

IRP's purpose is to enhance economic activity and employment in rural communities. To achieve this purpose, loans are distributed at a 1 percent interest rate for terms of up to 30 years. The loans are disbursed to eligible intermediaries² for the establishment of a revolving loan fund.³ Intermediaries, in turn, relend these funds at higher, but reasonable interest rates to ultimate recipients in their communities.⁴ Borrowers must show they are unable to obtain credit elsewhere at reasonable rates in order to receive the loan. According to the Code of Federal Regulations (CFR), ultimate recipients must use these loans "for community development projects, the establishment of new businesses, expansion of existing businesses, creation of employment opportunities, or saving existing jobs."⁵ As of September 2016, RBS had made 1,062 IRP loans and had a loan portfolio outstanding balance of over \$392 million.

To receive an IRP loan, intermediaries must demonstrate a need for the funds, a plan to use them, and the ability to administer loans according to regulatory requirements. Intermediaries seeking an IRP loan are required to submit an application with the RD State office where the intermediary's headquarters is located. RBS uses a point system to determine an applicant's priority for available IRP loan funds. A total of 250 points can be awarded to an intermediary's loan application based on factors such as unemployment rate, population of service area, amount of non-RD funds the applicant contributes into the IRP revolving fund (intermediary contribution), and experience in the program. If an intermediary contribution is 25 percent or more of the requested loan amount, the application can be awarded up to 50 points. Applications are ranked quarterly nationwide. Those with the highest scores are considered to have higher priority and are funded first.⁶ As ultimate recipients repay their loans, intermediaries use the funds to increase the available capital in the revolving loan fund accounts and to repay RBS. Any revolved funds beyond those needed for certain operating expenses (e.g., administrative costs) should be used to make more loans to eligible ultimate recipients.

¹ Rural areas are defined by RBS as areas outside a city or town with a population of less than 50,000.

² An intermediary is the entity requesting or receiving RBS IRP loan funds for establishing a revolving fund and relending to ultimate recipients.

³ Revolved funds can be used for debt service, reasonable administrative costs, reserves, and for making additional loans (7 CFR §4274.332(b)(1), "Post Award Requirements" (September 2014)).

⁴ An ultimate recipient is an entity or individual that receives a loan from an intermediary's IRP revolving fund.

⁵ 7 CFR §4274.314 (b).

⁶ 7 CFR §4274.344 (b).

However, the rules governing the revolved funds that intermediaries receive from ultimate recipients are somewhat different from the rules for the initial loan funds that intermediaries receive from RBS. Prior to making a loan with initial RBS funds, an intermediary must obtain RBS approval for the loan. Specifically, RBS must be able to determine, via the intermediary, the purpose of the loan, the location of the project, and the project’s nature and scope. However, loans made with revolved funds do not need an agreement with RBS; the intermediary is responsible for determining whether the loan meets regulatory requirements. In both cases, the intermediary is expected to keep documentation supporting that loans meet program requirements.

RBS delegates loan servicing actions to the RD State offices. The RD State offices are responsible for monitoring intermediaries’ revolving loan fund balances and activity through online reports and field visits. Intermediaries report their financial and loan activity to RBS through a web-based system called the Lender Interactive Network Connection. Depending on the age of the loan, intermediaries are required to report to RBS on a quarterly or semiannual basis.⁷ In addition, RD State office officials conduct field visits⁸ on an annual or triennial basis, depending on how the loan is classified.⁹ As part of the field visit, reviewers are required to determine if intermediaries are adequately relending revolved funds.

Prior Audit

In our prior audit report of IRP,¹⁰ we found that 33 of 435 loans—totaling \$7.9 million—did not comply with program requirements such as loan limits, purpose, or eligibility. In many cases, this noncompliance occurred because intermediaries made the loans with revolved funds they considered exempt from Federal requirements due to confusing regulatory language. We also determined that two of the seven intermediaries we reviewed did not promptly relend their revolved funds, which totaled over \$1.7 million. Regulations required intermediaries to relend funds promptly, but the regulations did not clearly define “prompt,” nor provide a specific timeframe for relending.

The report included two recommendations to help the agency develop guidance that quantifies both the timeframe for prompt relending and the amount that must be relent for intermediaries to qualify for subsequent IRP loans. RBS updated its regulations, which went into effect September 2, 2014. The revised regulations stipulate that:

- all revolving loan fund cash not needed for debt service, approved administrative costs, or reasonable reserves must be available for additional loans to ultimate recipients;

⁷ 7 CFR §4274.338(b)(4)(ii)(A) Loan agreements between the Agency and the intermediary state, “Reports will be required quarterly during the first year after loan closing and, if all loan funds are not utilized during the first year, quarterly reports will be continued until at least 90 percent of the Agency IRP loan funds have been advanced to ultimate recipients. Thereafter, reports will be required semiannually.”

⁸ 7 CFR §1951.882 Field visits.

⁹ 7 CFR §1951.885 Loan classifications. (Loan classification categories include seasoned loan; current non-problem; special mention; substandard; doubtful; and, loss.)

¹⁰ Audit Report 34601-6-At, *Rural Business-Cooperative Service’s Intermediary Relending Program*, June 2010.

- if funds in excess of \$250,000 have not been used to make loans to ultimate recipients for six months or more, the excess funds should be returned to RBS unless an exception is granted;
- for intermediaries that have already received an IRP loan and wish to apply for additional loans, RBS would consider the additional loans as long as the intermediary is promptly relending revolved funds in excess of what is needed for debt service, approved administrative costs, and a reasonable reserve for uncollectible accounts; and
- in consideration of applying for a new loan, the intermediary must provide documentation that demonstrates that funds available for relending do not exceed the greater of \$150,000 or the total amount of loans closed during a calendar quarter on average over the last 12 months.

Objective

Our objective was to determine if RBS' corrective actions have been effective at eliminating or reducing previously identified weaknesses applicable to loans made for ineligible purposes, loans exceeding loan limits, loans made in non-rural areas, and intermediaries not promptly relending funds.

Section 1: RBS Has Not Eliminated All Reported Concerns from the Prior Audit

Finding 1: RBS Needs to Establish National Oversight for Relending Funds to Ensure IRP Funds Are Being Fully Used to Create and Save Jobs in Rural Communities

Although RBS has taken action to strengthen IRP program controls, we determined that additional controls are needed to ensure program objectives are being met. Specifically, we found that three of six intermediaries we reviewed did not promptly relend their IRP revolved funds, and they maintained excessive cash balances within their revolving loan fund account. This occurred because RBS does not effectively oversee revolved funds maintained by intermediaries. As a result, these idle funds are not being used to create or save jobs in rural communities.

In a prior audit, we reported that RBS should establish guidance for promptly relending loan funds.¹¹ The report recommended that RBS establish a timeframe for updating IRP regulations to require that intermediaries relend accumulated revolved funds within a specified period of time, or repay any associated outstanding loan principal and accrued interest to RBS. In addition, we recommended that RBS institute guidance defining what constitutes “prompt” lending for the purposes of receiving additional loans and how much must be lent. As a result, RBS updated IRP regulations effective September 2014.¹² The updated regulations stipulated that if funds in excess of \$250,000 have not been used to make loans to ultimate recipients for six months or more, the excess funds should be returned to Rural Development [RBS] unless an exception is granted.¹³ These regulations also stipulate that intermediaries that have received one or more IRP loans may apply for and be considered for subsequent IRP loans, provided they submit documentation to demonstrate that funds available for relending do not exceed the greater of \$150,000 or the total amount of loans closed during a calendar quarter on average over the last 12 months.

For IRP loans made to intermediaries prior to September 2, 2014, the updated rules only apply to those intermediaries that made a written request to RBS to be serviced under the new regulations. The three intermediaries we cite below did not make that request, therefore, they were not subject to these new provisions. RBS included this provision in the regulation because of legal concerns that imposing new regulations on prior IRP loans would essentially change the terms of those loans. So while we commend RBS’ action to update the regulation to improve program performance in the future, we also recognize that not all prior IRP loans will be covered by the new rules. Since idle funds in revolved accounts are not being used to create or save jobs in rural areas, we believe more should be done to give intermediaries an incentive to loan those funds.

¹¹ Audit Report 34601-06-At, *Rural Business-Cooperative Service’s Intermediary Relending Program*, June 2010.

¹² 7 CFR §4274.331 Loan Limits and 7 CFR §4274.332 Post Award Requirements.

¹³ The State Director has the authority to allow the intermediary additional time if the intermediary shows good cause for not using the revolved funds. Any exception would be based on evidence satisfactory to RD that every effort is being made by the intermediary to utilize the IRP funding in conformance with program objectives.

We found that an intermediary made no loans with revolved funds between February 16, 2012, and April 6, 2015. This intermediary had received a total of four IRP loans from RBS, and as of September 2015, had accumulated \$2 million in a revolving loan account from loans made to borrowers since 1991. The RD State office was aware of the intermediary's idle cash in the revolved loan fund accounts; however, the office did not take any action to recover the funds. The RBS Program Director stated he was unaware of any action that could be taken against the intermediary to relend IRP revolved funds promptly. In addition, we found the intermediary invested a total of \$1 million of IRP revolved funds into a 12-month certificate of deposit. IRP regulations state that funds may not be used for any investments in securities or certificates of deposit of over 30-day duration without the concurrence of RBS.¹⁴ According to the intermediary, RBS did not grant approval to invest IRP revolved funds into certificates of deposit for over 30 days. Had the State or national office been monitoring funds that remained idle in intermediary accounts, they might have been able to recover the \$1 million for the program before the funds were invested contrary to program regulations. RBS officials agreed this was a mishandling of IRP funds and would discuss options to recover them. We consider this intermediary's handling of the IRP loans to be a particularly egregious misuse of IRP funds, and RBS should take appropriate action to recover them.

Also during our review, we determined that two other intermediaries maintained high cash balances within their revolving loan account with minimum loan activity, yet they applied for new IRP loans with RBS. For example, one intermediary consistently showed a revolving loan balance of over \$250,000 from May 2013 to November 2015. The revolving loan account balance was \$412,932 as of November 18, 2015. During this time period, this intermediary only made two loans to borrowers using revolved funds,¹⁵ yet the intermediary requested and was approved by RBS to receive an additional \$1 million IRP loan in July 2014. Another intermediary we visited operated 3 separate revolving funds, had received a total of 12 IRP loans from RBS, and had a combined cash balance of \$2.3 million as of December 2015. We reviewed one of the revolving loan funds and found the intermediary made no loans to borrowers using revolved funds between January 2012 and September 2015. The cash balance for this particular IRP revolving loan fund was \$1.3 million as of December 2015. Despite having a significant amount of revolved money available for relending, the intermediary requested and received an additional \$1 million loan from RBS in September 2015. Although RBS updated its regulation to require intermediaries seeking subsequent IRP loans to provide documentation demonstrating the prompt relending of funds, RBS does not account for prompt relending in its scoring process for awarding new loans. There is no ability for the reviewers to award points for intermediaries that are promptly relending funds and furthering program objectives.

The RD State offices primarily monitor intermediaries' revolving loan fund balances and activity through review of online financial reports and field visits. However, our findings show that prompt relending is still a recurring problem, and we believe additional controls are needed to correct this program weakness. We agree with the changes RBS made to the IRP regulations to help define "prompt" lending of IRP revolved funds; however, RBS should take additional steps

¹⁴ 7 CFR §4274.332(b)(4) Post award requirements.

¹⁵ The intermediary made one loan on May 16, 2014, for \$69,600 and made another loan in the amount of \$50,000 on September 2, 2015.

to strengthen its controls to ensure intermediaries are relending revolved funds to achieve program objectives.

Currently, IRP's loan servicing activities are delegated to the States (i.e. the RD State Director). As such, the State Director has the authority to allow the intermediary additional time if the intermediary shows good cause for not utilizing revolved funds. Going forward, we believe RBS should change its regulation instructions by placing responsibility with the national office for requiring funds to be returned to RBS in cases where an intermediary is maintaining revolving loan funds in excess of \$250,000 for 6 months or more. We believe this will improve accountability over the use of revolved funds and will effectively address any reluctance a State Director may have for requiring such an action from an intermediary within the state. Lastly, RBS should implement policies, procedures, and protocols for conducting revolving loan fund cash monitoring and tracking at the national office level and intervene with the State offices and intermediaries when warranted. RBS officials agree that intermediaries not promptly relending funds is still a problem within the program and generally agree that additional action is needed to solve this program weakness.

We conclude that IRP's objectives of alleviating poverty and increasing economic activity and employment in rural communities cannot be met if intermediaries are not promptly relending IRP revolved funds. Intermediaries that do not promptly recycle program funds back into the local rural economy are undermining IRP's ability to create jobs. In order to remedy this recurring problem, RBS should revise current program regulations governing the application and application scoring process for intermediaries seeking subsequent loans to account for an intermediary's recent loan activity and the intermediary's revolving fund cash available for relending.

Recommendation 1

Develop a formal monitoring process at RBS to oversee the use of revolved funds by intermediaries and intervene with RD State offices and intermediaries when warranted.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will develop a formal monitoring process at the RBS national office level to further encourage the use of revolved funds by intermediaries and intervene with RD State offices and intermediaries when warranted, however the process will rely heavily on State recommendations, as the States work directly with the borrowers on a regular basis. The Agency already has regulatory guidance in place which requires States to take action when funds in excess of \$250,000 have been unused for 6 months. Each State is required to follow 7 CFR 4274.332 (b)(4) which states:

"(4) If funds in excess of \$250,000 have been unused to make loans to ultimate recipients for 6 months or more, those funds will be returned to Rural Development unless Rural Development provides an exception to the intermediary. Any exception would be based on evidence satisfactory to Rural Development that every effort is being made by the intermediary to utilize the IRP funding in conformance with program objectives."

While we understand and support OIG's desire for intermediaries to promptly relend program funds, there are varying reasons why balances greater than \$250,000 could appear to exist for longer than 6 months. Generally, over 70 percent of IRP borrowers are repeat lenders and these loans are constantly being repaid and relent. Although it may appear that some intermediaries are carrying a balance over \$250,000, in reality the actual amount of funds available for distribution could be much less. Other intermediaries may be serving low capacity areas where project pipelines could take time to develop for them to be able to responsibly relend. Nonetheless, the Agency will remain committed in supporting and increasing the oversight and utilization of IRP funds by using its regulation, collaborating with field staff, and developing a formal monitoring process as recommended. The process will be developed and rolled out to the field within 1 year. RBS estimates this corrective action will be completed by January 1, 2018.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Revise current regulation instructions to ensure that the RBS national office is responsible for determining whether funds should be returned to RD in cases where an intermediary is maintaining revolving loan funds in excess of \$250,000 for 6 months or more as outlined at 7 CFR §4274.332(b)(4).

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS can update its current regulatory instructions to take into account the formal monitoring process which the Agency will be establishing, as noted in Recommendation 1 above, and ensure that the authority to determine if funds should be returned to RD will be held at the national office. The instructions will be completed at the same time a formal process is being developed, with an estimated completion time of 1 year. RBS estimates this corrective action will be completed by January 1, 2018.

OIG Position

We accept management decision for this recommendation.

Recommendation 3

RBS should take appropriate action to recover funds from the intermediary that invested \$1 million of IRP revolved funds in a 12-month certificate of deposit.

Agency Response

In its March 28, 2017, response, RBS does not concur with this recommendation. RBS does not agree in recovering \$1 million of IRP revolved funds from this particular intermediary since they only owe approximately \$500,000. RBS also does not agree that the only resolution is to force the entity to return the funding to RBS, by doing so it would prohibit the money from being used to fulfill its original purpose. However, RBS will still take steps to work with the field office and the borrower to bring them back into compliance with the program regulation. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We are unable to accept management decision for this recommendation. The intermediary in question maintained an excessive cash balance and made no loans with IRP revolved funds for over 3 years. In addition, the excessive cash was invested in a certificate of deposit without RBS approval, contrary to program regulations. Since the intermediary has been inactive within the program for an extensive period of time and had invested idle cash without proper RBS approval, to reach management decision, RBS should take appropriate action to recover funds from the intermediary invested in certificates of deposit or provide justification as to why the funds cannot be recovered.

Recommendation 4

Establish a timeframe to revise current program regulations governing the application and application scoring process for intermediaries seeking subsequent loans to account for an intermediary's recent loan activity and revolving fund cash available for relending.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. Except, RBS believes the existing regulation published July 2014 and effective as of September 2014, section 4274.331 (a)(ii), accounts for an intermediary's loan activities in reference to future funding. It states, "The intermediary provides documentation to demonstrate that funds for relending do not exceed the greater of \$150,000 or the total amount of loans closed during a calendar quarter on average, over the last 12 months." This language adequately inhibits intermediaries with excessive un-revolved balances from competing for funding. RBS has proposed scoring criteria in the draft IRP program regulation currently being developed that will reward existing intermediaries that continuously revolve their funds. However, the regulation will be published as a proposed rule and is subject to change with public comment. RBS estimates this corrective action will be completed between July and September 2019, dependent on administration approval.

OIG Position

We are unable to accept management decision for this recommendation. We understand that the issuance of a final regulation will take longer than the 1 year. Therefore, to reach management decision, RBS should establish a timeframe for its proposed regulation change to account for an intermediary's recent loan activity and revolving fund cash available for relending in the IRP application scoring process for awarding new loans. The time frame should include the milestone of issuing the proposed rule within 1 year.

Finding 2: Program Instructions Need to Clarify Documentation Requirements for Ultimate Recipient's Access to Other Credit to Ensure Program's Intent of Aiding Smaller and Emerging Businesses

Intermediaries are not adequately documenting the rationale for ultimate recipients not financing their proposed projects through other available sources. This occurred because RBS does not effectively enforce instructions defining the expected level of due diligence from intermediaries when determining the ultimate recipient was unable to obtain other sources of financing. As a result, IRP loan funds are provided to ultimate recipients who may have been able to obtain other non-IRP sources of credit. This reduces the amount of IRP capital available to eligible ultimate recipients and is contrary to the program's intent of alleviating poverty and increasing economic activity in rural communities.

To be eligible for a loan from an intermediary's IRP revolving loan fund, an ultimate recipient must be unable to finance the proposed project from its own resources or through commercial credit or other Federal, State, or local programs at reasonable rates and terms.¹⁶ RD instructions stipulate that an intermediary should document why the ultimate recipient is unable to access other credit. Currently, RBS does not require denial or turn-down letters from other lenders, but expects RD State office personnel to ensure the intermediary is knowledgeable of the commercial lenders' credit standards in their area as well as other Federal, state, or local programs. RD instructions further state that the intermediary's documentation should address commercial lending credit standards such as collateral requirements, debt service requirements, and debt-to-equity ratios.¹⁷

We found that some intermediaries did not clearly document the reason why the ultimate recipient was unable to access other credit. Out of 56 files reviewed, we determined that 39 did not have adequate documentation of the credit elsewhere provision.¹⁸ In addition, 9 of 23 ultimate recipients stated they had not tried or could have obtained loans from other sources. One ultimate recipient independently hired someone to do a competitive rate search of local banks and informed OIG that the intermediary had the best interest rates available. Another ultimate recipient also canvassed multiple lenders and ascertained the intermediary had the best interest rate.

RBS agrees that the level of effort some intermediaries spend in documenting the credit elsewhere provision needs improvement. The RD Acting Specialty Programs Director stated that training has been provided to staff on the credit elsewhere provisions, but more training was

¹⁶ 7 CFR §4274.308 Eligibility requirements – ultimate recipients.

¹⁷ Collateral is defined as security pledged for the payment of a loan. Debt service is defined as the cash that is required to cover the repayment of interest and principal on a debt for a particular time period. Debt-to-equity ratio is defined as the debt ratio used to measure a company's financial leverage, calculated by dividing a company's total liabilities by its stockholders' equity.

¹⁸ 7 CFR §4274.308 (b) (3) states to be eligible to receive loans from the IRP revolving loan fund, ultimate recipients must be unable to finance the proposed project from his or her own resources or through commercial credit or other Federal, State, or local programs at reasonable rates and terms. We refer to this as the credit elsewhere provision. Also, reasonable rates and terms may be defined as commercial rates and terms which borrowers are expected to meet when borrowing for similar purposes and similar periods of time.

needed. We conclude that RBS needs to provide clarifying instructions that conveys to field office staff the importance of requiring intermediaries to adequately document why an ultimate recipient could not obtain other non-IRP sources of reasonable financing. Further training should be provided in regards to the level of effort required from intermediaries when satisfying the credit elsewhere provision, and RBS should develop the use of instruments, such as a standard template, that could be used to survey local lenders' (commercial and governmental) requirements for making small business loans. RBS officials generally agreed with this approach.

Recommendation 5

RBS should provide clarifying instructions to the field conveying the importance of intermediaries adequately documenting the reasons a prospective ultimate recipient could not have obtained other non-IRP sources of financing for their projects.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will issue an unnumbered letter to clarify to the field what is required under the IRP program's "credit elsewhere" provision. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Recommendation 6

Along with clarifying instructions, RBS should provide targeted training for field office staff specifying the level of effort and documentation required from intermediaries in satisfaction of the credit elsewhere regulation.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will be hosting a webinar March 28, 2017, to train State office staff on the credit elsewhere requirements, and will provide a template to the State offices that could be used to document the credit elsewhere test. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Recommendation 7

RBS should instruct field office staff to inform intermediaries of the required level of effort for documenting the reasons an ultimate recipient could not have obtained other sources of non-IRP financing. At a minimum, RBS should require the use of templates that would be used to summarize the lending requirements of commercial banks and other governmental (Federal, State, local) lending programs within the intermediary's service area.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will be hosting a webinar March 28, 2017, to train field office staff on the credit elsewhere requirements who will then pass the information on to their respective intermediaries, and will provide a template to the State offices that could be used to document the credit elsewhere test. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Section 2: Program Weaknesses Not Identified in Prior Audit

Finding 3: Intermediaries Used Debt Instruments as Source of Equity Contributions to Revolving Loan Fund, Allowing for Competitive Advantage in Application Scoring and Reduction of Project Funds in Rural Communities

We found that one RD State office allowed intermediaries to use long-term debt instruments (notes receivable) as their intermediary contribution for the purposes of scoring and funding projects. This occurred because of unclear regulatory language that does not define “funds” specifically as cash or cash equivalents.¹⁹ Differing RD State office interpretations of regulations provide intermediaries a competitive advantage in the application scoring process regarding points awarded for their intermediary contribution and ultimately the selection of IRP loans to fund. In addition, placing notes receivable into the revolving loan fund instead of cash or a cash equivalent limits the intermediary’s ability to lend funds to the rural community.

RBS uses a point system to determine an applicant’s priority for available IRP loan funds.²⁰ Applications are ranked quarterly based on the highest application scores and are funded in the order of priority ranking.²¹ A total of 250 points are awarded to a loan based on factors such as unemployment rate, population of the service area, and experience in the program. Another factor an applicant can receive points for is the amount of non-RD funds the applicant contributes into the IRP revolving fund known as the intermediary contribution. The points awarded for the intermediary contribution to the IRP revolving fund as a percentage of the IRP loan amount is as follows: (1) at least 5 percent, but less than 15 = 15 points; (2) at least 15 percent, but less than 25 = 30 points; or (3) 25 percent or more = 50 points.²²

We found that three of six intermediaries, whose loans are serviced by the same RD State office, used debt instruments instead of cash to fund their portion of the intermediary contribution in the revolving fund. For example, one intermediary was allowed to use a 10-year note receivable with an outstanding balance of approximately \$246,125 as the intermediary’s contribution to the IRP revolving fund. Even though the intermediary contributed a note receivable, the intermediary was awarded the maximum number of points for stipulating that \$250,000 cash (25 percent of a \$1 million IRP loan) would be deposited into the IRP revolving fund. Two other intermediaries serviced by the same RD State office were also allowed to use debt instruments as their contribution to the revolving loan fund. Officials at the two other RD State offices we visited stated they did not believe that funding an intermediary contribution with a debt instrument was allowed to count in the application scoring process.

RD State offices that do not allow applicants to fund their intermediary contribution with debt instruments would not give the 50 points available for intermediary contribution allowed in the application scoring process. The 50 points available for intermediary contributions is 20 percent of the total points available in the priority scoring process. This difference in interpreting the

¹⁹ A cash equivalent is a highly liquid investment having a maturity of three months or less.

²⁰ 7 CFR §4274.344 (c).

²¹ 7 CFR §4274.344 (b).

²² 7 CFR §4274.344 (c) (3).

regulations by RD State offices provides a competitive advantage to those applicants who are able to use a debt instrument instead of cash to fund a project when comparing intermediaries' application scores at the national level. The projects given points for equity contribution using debt instruments might not have been funded given limited IRP resources if the projects had been scored similarly to those using cash equivalents as their equity contribution. The higher the amount of points awarded, the better the chance of being funded. In addition, the use of debt instruments reduces cash in the revolving loan fund available to fund projects in the rural community.

RBS officials admitted that the program's regulations do not clearly define what is acceptable for intermediary contributions, and the regulation could therefore be interpreted differently by each RD State office. The regulation in question simply states that the contribution is an asset of the applicant, and on a balance sheet, a note receivable does represent an asset. RBS officials further stated that funds are to be cash and cash equivalents, and the regulation needs to be modified to specifically define what qualifies as "funds." The funds in the revolving loan fund should be available to relend to the rural community as opposed to being tied up in a less liquid security. We believe clarifying the program instructions in regards to intermediary contributions should ensure all RD State offices are allowing cash or cash equivalents only to fund their intermediary contributions.

Recommendation 8

RBS should revise its instructions to specify that the term "funds" used in the context of an intermediary's contribution to the IRP revolving fund means cash or cash equivalents. The instructions should make it clear that a debt instrument, such as a note receivable, is not an acceptable form of intermediary contribution.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will revise its regulatory instructions to ensure States understand that the term "funds" means cash or cash equivalents. RBS has already informed all of the States at our monthly national call, as well as trained the State associated with the identified intermediary, that cash equivalents are required. The intermediary identified has been notified and is no longer using a note receivable as their contribution. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Finding 4: Revolving Loan Transfers Reduced Available Capital for Eligible Borrowers

An intermediary transferred 13 non-IRP loans into an IRP portfolio in exchange for cash from the IRP revolving loan fund. This intermediary requested the loans-for-cash transfer because of a recent RBS approval for a new IRP loan of \$1 million and subsequently wanted to make \$1.8 million in the IRP revolving loan account available for projects not eligible for IRP funding. The RD State office approved this transaction because it determined that the intermediary's request is not addressed in RBS instructions governing loan-making and servicing of IRP loans; therefore, the State office broadened its assessment of the request to give consideration to program intent. However, removing cash from the IRP revolving loan fund that should be used to make loans to borrowers in rural areas is a direct contradiction of the program's objectives. As a result, the removal of cash from the IRP revolving loan fund effectively reduced the available capital intended for eligible borrowers. In addition, the non-IRP loans were not processed under IRP regulations, and RBS had no assurance that the non-IRP loans would have been eligible under IRP rules, thus jeopardizing the integrity of the IRP revolving loan.

RBS regulations state that, for as long as any part of an IRP loan to an intermediary remains unpaid, the intermediary must maintain the IRP revolving fund. The intermediary may transfer additional assets into the IRP revolving fund. Loans to ultimate recipients are advanced from the IRP revolving fund. The portion of the IRP revolving fund that consists of revolved funds may be used for debt service, reasonable administrative costs, or for making additional loans. Any cash in the IRP revolving fund from any source not needed for debt service, approved administrative costs, or reasonable reserves must be available for additional loans to ultimate recipients.²³

In June 2013, an intermediary made an initial cash-for-loans request to the RD State office to replace existing IRP ultimate recipient loans with a like amount of cash to be deposited into the intermediary's IRP revolving loan fund account. The reason for this request was to assist the intermediary in aggregating and separating loans made to ultimate recipients in both IRP and other loan programs operated by the intermediary.²⁴ Doing this would help the intermediary's internal accounting, whereby it could report separately on its programs. RBS approved the intermediary's request, provided that the cash for loans comes from a non-IRP source and is equal to or greater than the principal amount. The RD State office notified the intermediary of the national office's approval for transfer of IRP ultimate recipient loans for cash equivalent and provided transfer requirements for the intermediary to follow. The intermediary and RBS agreed to transfer 14 loans out of the intermediary's IRP loan portfolio for the cash equivalent of \$1.8 million to be inserted into the intermediary's IRP revolving loan fund.

²³ 7 CFR §4274.332.

²⁴ The intermediary wanted to consolidate assets for its State financing programs to help comply with State legislation changes and to establish best practices for internal reporting requirements. Essentially, the intermediary made some loans to ultimate recipients using funds from both the IRP and State financed programs. It wanted to segregate loans so that no IRP funds would be part of its State programs' portfolio.

Less than 6 months later, in December 2013, the intermediary requested concurrence from the RD State office for a loans-for-cash exchange that essentially reversed the June 2013 cash-for-loans transaction. Specifically, the intermediary requested to transfer loans currently held in a general loan portfolio in exchange for cash from the IRP revolving loan fund. According to the intermediary, the reason for this request was to help the intermediary use a new \$1 million IRP loan expected to close December 17, 2013, and to make an additional \$1.8 million available to the intermediary's general loan fund for projects not eligible for IRP loans. The intermediary noted in the request that there was over \$2 million in unrestricted cash split among three IRP revolving account funds.²⁵ After receiving the intermediary's request, the RD State office concluded it was not sufficient for approval. Specifically, the RD State office IRP specialist stated he was not inclined to approve this request because having significant cash balances in the IRP fund is not a detriment to using the new \$1 million loan awarded, and there was no proof that this transfer demonstrated a need to meet the financing needs of small businesses.

In February 2014, the intermediary made a follow-up inquiry with the RD State office regarding the loans-for-cash transfer request. The intermediary explained the current cash level at the time was \$2.18 million. In addition, RBS had recently approved the intermediary for \$2 million of new IRP loans, bringing the total available funds for IRP projects to \$4.1 million. Again, the intermediary requested to transfer loans totaling \$1.8 million from its current general portfolio in exchange for a like amount of cash. According to the intermediary, the loans selected for the transfer would be current—seasoned a minimum of 24 months²⁶—and in the intermediary's best quality risk classification. The intermediary said the proposed benefit to the IRP revolved fund would be an increase in the overall revenue of the fund by exchanging cash earning 0.25 percent for loans earning 5.31 percent. It would also allow \$1.8 million of lending capacity to make non-IRP eligible loans in the future. We conclude this transfer would not benefit the IRP.

In March 2014, the RD State office replied to the intermediary:

The transaction contemplated is not expressly addressed in the RD Instructions governing loan making and servicing of IRP loans; therefore, we broadened our assessment to give consideration to program intent. We also felt it was important to view the request within the context of recent events relating to [the intermediary's] IRP loan funds. In mid-2013 RD concurred in an exchange of approximately \$1.8 million in cash (into the IRP funds) for loans to allow [the intermediary] to better align sources and uses between its many different loan funds. Less than 6 months later we were asked to concur in a loans-for-cash exchange that essentially contemplates a reverse of the earlier cash-for-loans transaction. We're concerned that the similarities in dollar size and timing of these transactions could raise a red flag during a program review. A finding that these transactions resulted in a circumvention of IRP's governing regulations could result in a requirement that [the intermediary] replace questionable ultimate recipient loans with

²⁵ This intermediary operates the IRP under two separate component units of the organization. The intermediary has received a total of 12 IRP loans. Most recently, RBS approved a \$1 million IRP loan Sept. 26, 2013 and another \$1 million IRP loan Jan. 21, 2014.

²⁶ A seasoned loan is defined as a loan that has been on the lender's books for more than one year and has a good repayment record.

cash. After carefully considering all pertinent factors, we see a path to move forward with the understanding that our decision represents a one-time event. Concurrence will be subject to satisfactory written confirmation from [the intermediary] that loan files contain sufficient documentation and information to support a determination that each loan met all requirements for Ultimate Recipient loans under the Intermediary Relending Program (IRP) when it was initially approved/closed.

Despite the RD State office concerns, it approved the loans-for-cash transfer with the understanding the decision represented a one-time event and concurrence would be subject to satisfactorily written confirmation from the intermediary that loans to be transferred contained sufficient documentation to support a determination that each loan met all requirements for ultimate recipient loans under the IRP when it was initially approved and closed. RBS was not aware of the loans-for-cash transaction and did not review or approve it. The RD Acting Specialty Programs Director stated she would not have approved this transaction.

The RD State office requested that the intermediary create a compliance checklist to assist the intermediary in the review of IRP eligibility prior to the transfer of the loans into the IRP portfolio. The RD State office provided clarifying guidance to ensure the intermediary checked the IRP regulations and its work plan for each loan at the time the loan was made. The intermediary complied with the State office's request and self-certified to the RD State office that the loans transferred into the IRP loan portfolio complied with certain IRP program requirements. These requirements included that work plan loan limits and eligibility purposes be complied with, that the loan was made in an area with less than 25,000 people to meet rural area requirements, that borrower equity in the approval loan was at least 10 percent of the project, and that IRP funds represented no more than 75 percent of the total project. Also, the intermediary certified there was a completed loan application, Civil Rights and Equal Credit Certification, and an Assurance Agreement located in the loan file. In April 2014, the intermediary transferred 13 loans into the IRP loan portfolio in exchange for \$1.9 million in cash from the IRP revolving loan fund and provided the RD State office with a self-certification checklist for each loan transferred.

We conclude the intermediary's loans-for-cash transaction goes against the intent of the program and should not have been approved by the State office. The intent of the IRP revolving fund is to assist with financing business and economic development activity to create or retain jobs in disadvantaged and remote communities. The entire \$1.9 million cash balance in the revolving loan fund should have been used to make new loans to eligible ultimate recipients, which further IRP program objectives. Additionally, we conclude that the intermediary's certification that the loans transferred into the IRP portfolio met certain IRP requirements is insufficient, as it does not address all the requirements of the program that the loans would have been subject to during the initial application process. For example, the intermediary did not self-certify in the checklist that borrowers of the loans being transferred were unable to receive credit elsewhere, which is an IRP program requirement. Given that these loans were initially funded under another program, the intermediary would have been unable to state the inability to obtain credit elsewhere. Given none of the loans transferred into the program would qualify based on the credit elsewhere provisions, we conclude that RBS should require the intermediary to replace the cash in the revolving loan fund and remove these loans from the IRP portfolio. Furthermore, RBS should

take steps to ensure that the RD State offices consult the RBS national office on any request by an intermediary to remove cash from the IRP revolving loan fund. As RBS is the Federal steward of the fund, it should take responsibility for ensuring those program assets are protected and utilized for appropriate purposes.

Recommendation 9

RBS should require the intermediary to return the \$1.9 million into the revolving loan fund and remove the non-IRP loans from the portfolio.

Agency Response

In its March 28, 2017, response, RBS does not concur with this recommendation. The RBS employee involved in approving the transfer had the actual authority to approve the loan transfer at the time of the initial request. Though the authority currently exists at the State office, RBS agrees to move the authority to the national office through a notice to the field. Upon consultation with the Office of the General Counsel, RBS is bound to the prior approval of the transfer and the intermediary has been informed they will not allow any transfers in the future. RBS estimates this corrective action will be completed by March 31, 2017.

OIG Position

We are unable to accept management decision for this recommendation. Although the State office approved the transfer of the \$1.9 million of non-IRP loans into the IRP portfolio in exchange for cash, this approval was improper and prevented the use of this capital to make IRP loans to eligible borrowers. To reach management decision, RBS needs to provide a legal opinion to support why it is unable to require the intermediary to return the \$1.9 million that was improperly removed from the IRP revolving loan fund in exchange for non-IRP loans.

Recommendation 10

RBS should provide instructions to the RD State offices clarifying that the removal of cash from the revolving loan fund for any reason must be reviewed and approved by the national office.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS is developing instructions that clarify that States must receive concurrence from the national office before approving the removal of cash from a revolving loan fund. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Finding 5: RD State Office Did Not Require Administrative Cost Budgets

We found that one RD State office did not require the intermediaries whose loans it serviced to submit approved administrative cost budgets annually. RBS uses approved administrative cost budgets to ensure that administrative costs claimed by an intermediary do not exceed the actual cost of operating the IRP revolving fund and are otherwise reasonable, so an intermediary does not reduce the available capital that could be used for loans to ultimate recipients. This occurred because the RD State office mistakenly believed that intermediaries in the State did not remove funds from the revolving loan fund to pay for administrative costs—an indication that the officials were unclear as to what an administrative cost is and did not understand that processing and other loan servicing fees intermediaries extracted from the revolving loan fund constitute an administrative cost to the program. As a result, without approved administrative cost budgets, RBS is not well-positioned to ensure that intermediaries are charging reasonable and appropriate administrative fees. By not requiring annually approved administrative cost budgets, intermediaries could be draining the IRP revolving loan fund for non-IRP expenses, thereby reducing the amount of funds that could be used to make loans that benefit the rural economy.

IRP intermediaries must submit an annual budget of proposed administrative costs for RD approval. The amount removed from the IRP revolving fund for administrative costs in any year must be reasonable, must not exceed the actual cost of operating the IRP revolving fund, including loan servicing and providing technical assistance, and must not exceed the amount approved by RD in the intermediary's annual budget.²⁷

However, we found one RD State office did not require or maintain documentation of annually approved administrative cost budgets for intermediaries. The RBS Program Director told us the reason it did not require annually approved administrative cost budgets was that intermediaries in the State do not claim administrative costs for operating IRP. However, two intermediaries in the State were removing funds from the IRP revolving fund for administrative costs.²⁸ One intermediary visited told us she claimed a total of \$75,082 for loan servicing expenses between the years 2011-2015, but there was no approved budget provided by RBS. The other intermediary told us that she did not have an approved administrative cost budget and had not been asked by the State office to produce one. However, we noted that this intermediary actually reported administrative costs to RBS on required quarterly or semi-annual reports. As mentioned, the RBS Program Director specifically told us that intermediaries within his State did not claim administrative costs in response to our question concerning the reason we did not see any approved administrative cost budgets within intermediary case files. After we discussed this issue with the RBS national office, its officials followed up with the RBS Program Director concerning the lack of approved budgets.

The RBS Program Director responded that he had originally misunderstood OIG's question. He told RBS officials that he does require intermediaries to submit administrative cost budgets for

²⁷ 7 CFR §4274.332 (b) (2).

²⁸ Both intermediaries referred to the administrative costs pulled from the revolving loan fund as loan processing or servicing fees. These fees were used as a means to recover the intermediaries' costs of operating the IRP revolving loan fund.

review. He also said that during the course of OIG's review, the RD State office had found that one of the intermediaries OIG reviewed had not submitted an administrative cost budget. The Program Director said the State office implemented corrective action, including asking the intermediary to submit the annual budget, and discussed State office internal processes, making sure that withdrawals from revolving loan funds are reviewed during annual site visits. He also told RBS that the RD State office believed the intermediary's failure to submit a budget was an isolated incident and that discussions with the intermediary in question would prevent further occurrences. However, based on our review, we conclude this was not an isolated incident as we found no approved administrative cost budgets at both intermediaries we visited.

Without an approved administrative cost budget, RBS does not have any assurance the costs claimed were reasonable and the composition of the claimed costs would otherwise have been an allowable expense to the IRP. Since we believe the lack of administrative cost budgets within the State is a systematic problem, RBS should conduct a comprehensive review of fiscal years (FY) 2014 through 2016 of all intermediaries within the State claiming administrative costs on IRP quarterly/semi-annual reports. The costs should be examined to ensure they are reasonable and allowable and do not exceed the actual cost of operating the IRP revolving fund. Any costs deemed unreasonable or excessive should be repaid by the intermediary.

RBS officials agreed that administrative cost budgets should be submitted by intermediaries and approved by the RD State office on an annual basis. They also said they have provided training to the States on administrative costs in the past.

We conclude that more specialized training is needed for RD State office personnel, particularly given the response we received from RD State office officials who stipulated that intermediaries in their State did not claim administrative costs. Regardless of whether an intermediary calls the costs of operating the IRP revolving loan fund administrative costs, loan processing costs, or servicing fees, it is unlikely that an intermediary would participate in the IRP without some means of recouping the costs to administer that program. RBS should provide training to its State office personnel and emphasize that an approved administrative cost budget is required from all intermediaries. Also, RBS should review the administrative costs charged by all the intermediaries in the State for the last three FYs to identify possible unallowable costs being charged to the IRP. Lastly, RBS should expand the scope of its review if unallowable costs are identified and consider repayment of any unallowable or unreasonable costs claimed by the intermediaries.

Recommendation 11

RBS should provide specialized training for personnel in the one RD State office and stress that an approved administrative cost budget is required from all intermediaries.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS has scheduled training for the State in April of 2017. The training will provide detailed instructions on how to

review administrative costs, specifying when and what are appropriate administrative expenses. RBS estimates this corrective action will be completed by April 30, 2017.

OIG Position

We accept management decision for this recommendation.

Recommendation 12

RBS should assess the administrative costs charged by all the intermediaries in the one State for potential unallowable costs being charged to the IRP program. RD should assess administrative costs for the last 3 FYs and expand the scope if significant unallowable costs are identified. They should consider requiring intermediaries to repay any unallowable or unreasonable costs claimed by the intermediaries.

Agency Response

In its March 28, 2017, response, RBS concurred with this recommendation. RBS will review administrative costs for the approximately eight existing intermediaries in the State. If there are any unallowable administrative costs, RBS will work to recoup the unauthorized expenses. The review and subsequent, if any, notice to recoup funds will be completed in 6 months. RBS estimates this corrective action will be completed by September 30, 2017.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We conducted an audit to determine if RBS' corrective actions have been effective at eliminating or reducing previously identified issues,²⁹ including loans made for ineligible purposes, loans exceeding limits, loans made in non-rural areas, and intermediaries failing to promptly relend funds during FY 2011 to FY 2015.

To evaluate RBS' controls over IRP, we obtained an understanding of program operations at the national and State level and reviewed IRP regulations, RBS instructions, administrative and procedure notices, and pertinent letters. We also reviewed the Office of Inspector General's prior audit report on IRP, *Rural Business-Cooperative Service's Intermediary Relending Program*, issued June 2010 (34601-6-At), and the corrective actions taken related to this report. We conducted audit fieldwork at RD's national office in Washington, D.C., and State offices in Vermont/New Hampshire (Concord, New Hampshire office), Missouri (Columbia office), and Georgia (Athens office). We conducted site visits at selected intermediaries and ultimate recipients' locations. We performed our fieldwork from October 2015 to September 2016.

At RD's national office, we interviewed RBS employees with IRP responsibilities. We obtained and reviewed program objectives, agency organization, and the Management Control Review process.³⁰ We obtained an understanding of the program's process—from applying for loans to scoring applications and servicing loans. We obtained and reviewed policies and procedures describing internal controls over and administration of the program.

Our overall scope included RBS' IRP active loan portfolio from FYs 2011-2015, which included 190 loans to intermediaries totaling \$88.3 million in obligations. To gain a perspective on the most active States using IRP during the scope of the audit, the audit team utilized Audit Command Language.³¹ We judgmentally selected State offices to review RBS' implementation of IRP during the period of our scope based on factors such as the number of new IRP loans granted, number of intermediaries that opted-in to the new regulations,³² and geographical diversity by RBS region.³³

As a result, we selected the Vermont/New Hampshire RD State office, part of RBS' Northeastern Region, based on the number of total IRP loans granted. Vermont/New Hampshire intermediaries were awarded 15 IRP loans in the amount of \$10.23 million. Then we selected the RD State offices in Missouri and Georgia for review based on a combination of total IRP loans granted and total dollars obligated for IRP loans only for intermediaries that opted-in to the

²⁹ Audit Report 34601-6-At, *Rural Business-Cooperative Service's Intermediary Relending Program*, June 2010.

³⁰ RBS performs Management Control Reviews on the IRP every five years. These reviews evaluate if policies and procedures for making and servicing loans and making grants are being implemented and identify weaknesses or deficiencies in program operations with specific corrective actions for their elimination or reduction.

³¹ We identified that Vermont and New Hampshire had received 15 combined IRP loans, South Dakota had 13 IRP loans, Pennsylvania had 10 IRP loans, California had 9 IRP loans, and Montana had 8 IRP loans from FY 2011 to 2015.

³² For IRP loans made to intermediaries prior to Sept. 2, 2014, the updated regulations only apply to those intermediaries that made a written request to RBS to be serviced under the new regulations.

³³ RBS has four geographical regions across the country, each with its own Regional Coordinator.

new regulations that went into effect September 2, 2014. The Missouri RD State office, located in RBS' Midwestern Region, had the third highest total number of loans that were subjected to the new regulations (five loans) and the highest amount of IRP loans with at least one new intermediary loan. The Georgia RD State office, located in RBS' Southern Region, had the second highest total number of loans (six) and largest dollar value of IRP loans (\$6.5 million) that were subjected to the new regulations, but no loans that were awarded between FY 2011 to 2015.

At the three RD State offices, we interviewed RBS officials who administer IRP. We reviewed IRP field site review reports and the offices' intermediary loan files. We also reviewed the State's oversight controls and reporting requirements for IRP. We reviewed RD's "Business and Cooperative Program Assessment Reviews" for these States.

At each office, we selected two intermediaries (a total of six) for onsite reviews. We selected the intermediaries under the Vermont/New Hampshire RD State office based on the number and dollar value of loans received from RBS and the intermediaries' location (one intermediary in each State). We selected the intermediaries under the Missouri and Georgia RD State offices based on whether the intermediary opted-in to the new regulations that went into effect on September 2, 2014. In both Missouri and Georgia, we selected one intermediary that was actively lending and one intermediary that was not actively lending as measured by the volume of ultimate recipient loans.

We selected a total of 49 borrowers (7 borrowers had multiple loans) to review 56 loan files based on loan purpose, loan amount, and location.³⁴ Of the 49 borrowers reviewed, we selected a total of 23 borrowers to visit.³⁵ There, we interviewed principals, reviewed documents supporting their use of IRP loan funds, and verified the assets acquired with the loans. We also compared jobs-created numbers reported by borrowers with those held in RBS' Guaranteed Loan System database.

During the course of our audit, we did not solely rely on or verify information in any agency electronic information systems, and we make no representation regarding the adequacy of any agency computer systems, or the information generated from them.

We conducted this performance audit in accordance with generally accepted government auditing standards. These 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

³⁴ We reviewed 14 borrowers in New Hampshire, 16 borrowers in Vermont, 10 borrowers in Missouri, and 9 borrowers in Georgia.

³⁵ We visited 5 borrowers in New Hampshire, 5 borrowers in Vermont, 7 borrowers in Missouri, and 6 borrowers in Georgia.

Abbreviations

CFR.....	Code of Federal Regulations
FY	fiscal year
IRP	Intermediary Relending Program
OIG	Office of Inspector General
RD.....	Rural Development
RBS.....	Rural Business-Cooperative Service
USDA.....	Department of Agriculture

Exhibit A: Summary of Monetary Results

Exhibit A summarizes the monetary results for our audit report by finding and recommendation number.

Finding	Recommendation	Description	Amount	Category
1	3	Ineligible use of loan funds	\$1,094,008	Questioned Costs, Recovery
4	9	Ineligible IRP loans transferred for cash	\$1,956,151	Questioned Costs, Recovery

**USDA'S
RURAL BUSINESS–COOPERATIVE
SERVICE
RESPONSE TO AUDIT REPORT**



Rural Development
Chief Financial Officer
Office of the Financial
Management Division
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20250
Voice 202.692.0080
Fax 202.692.0088

DATE: March 29, 2017
TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General
FROM: Roger Glendenning *Roger Glendenning*
Acting Deputy Under Secretary
Rural Development
SUBJECT: Intermediary Relending Program
Audit Number: 34601-0001-22

Please find attached Rural Development's Agency Response to the Office of Inspector General's Official Draft report, dated March 6, 2017, entitled "**Intermediary Relending Program**" - **Audit Number: 34601-0001-22**. The Rural Business-Cooperative Service (RBCS) agrees with recommendations 1, 2, 4, 5, 6, 7, 8, 10, 11 and 12. RBCS does not agree with recommendations 3 and 9.

If you have any questions please contact Mr. John Dunsmuir, Director, Financial Management Division at (202) 692-0082 or John.Dunsmuir@wdc.usda.gov.

Attachment
RBCS Agency Response

USDA is an equal opportunity provider and employer.

If you wish to file a Civil Rights program complaint of discrimination, complete the USDA Program Discrimination Complaint Form (PDF), found online at http://www.ascr.usda.gov/complaint_filing_cust.html, or at any USDA office, or call (866) 632-9992 to request the form. You may also write a letter containing all of the information requested in the form. Send your completed complaint form or letter to us by mail at U.S. Department of Agriculture, Director, Office of Adjudication, 1400 Independence Avenue, S.W., Washington, D.C. 20250-9410, by fax (202) 690-7442 or email at program.intake@usda.gov.



United States Department of Agriculture
Rural Development

MAR 28 2017

TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Chad Parker
Acting Administrator
Rural Business-Cooperative Service

A handwritten signature in black ink that reads "Chad Parker". The signature is written in a cursive, flowing style.

SUBJECT: Audit Number 34601-0001-22
Intermediary Relending Program

Thank you for the opportunity to comment on the Office of Inspector General (OIG) recent audit of the Rural Business-Cooperative Service (RBS), Intermediary Relending Program (IRP). RBS appreciates the Inspector General's input to ensure IRP meets its statutory and regulatory mission and that RBS has established effective controls to eliminate or reduce program weaknesses previously identified by OIG in its audit from 2010.

We are pleased to learn that OIG found the Agency responsive, compliant, and on target with many of the issues identified by the Inspector General in its previous audit. In general, the IRP is a high performing and oversubscribed program, where only 30 percent of applications score high enough to receive funding and has a low default rate of less than 1 percent. Although there are still issues needing to be addressed, we are committed in resolving them in partnership with our State Offices and the customers we serve.

Detailed below are the specific Agency responses to the individual findings and recommendations.

OIG Recommendation 1: Develop a formal monitoring process at RBS to oversee the use of revolved funds by intermediaries and intervene with RD State Offices and intermediaries when warranted.

Agency Response: RBS agrees with the recommendation to develop a formal monitoring process at the RBS National Office level to further encourage the use of revolved funds by intermediaries and intervene with RD State Offices and intermediaries when warranted, however the process will rely heavily on state recommendations, as the states work directly with the borrowers on a regular basis. The Agency already has regulatory guidance in place which requires states to take action when funds in excess of \$250,000 have been unused for 6 months. Each state is required to follow 7 CFR 4274.332 (b)(4) which states:

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

Committed to the future of rural communities.

"USDA is an equal opportunity provider, employer and lender."
To file a complaint of discrimination, write USDA, Director, Office of Civil Rights,
1400 Independence Avenue, S.W., Washington, DC 20250-9410 or call (800) 795-3272 (Voice) or (202) 720-6382 (TDD).

"(4) If funds in excess of \$250,000 have been unused to make loans to ultimate recipients for 6 months or more, those funds will be returned to Rural Development unless Rural Development provides an exception to the intermediary. Any exception would be based on evidence satisfactory to Rural Development that every effort is being made by the intermediary to utilize the IRP funding in conformance with program objectives."

While we understand and support OIG's desire for intermediaries to promptly relend program funds, there are varying reasons why balances greater than \$250,000 could appear to exist for longer than 6 months. Generally, over 70 percent of IRP borrowers are repeat lenders and these loans are constantly being repaid and relent. Although it may appear that some intermediaries are carrying a balance over \$250,000, in reality the actual amount of funds available for distribution could be much less. Other intermediaries may be serving low capacity areas where project pipelines could take time to develop for them to be able to responsibly relend. Nonetheless, the Agency will remain committed in supporting and increasing the oversight and utilization of IRP funds by using its regulation, collaborating with field staff, and developing a formal monitoring process as recommended. The process will be developed and rolled out to the field within 1 year.

Completion Date: January 1, 2018

OIG Recommendation 2: Revise current regulation instructions to ensure that the RBS National Office is responsible for determining whether funds should be returned to Rural Development in cases where an intermediary is maintaining revolving loan funds in excess of \$250,000 for 6 months or more as outlined at 7 CFR §4274.332(b)(4).

Agency Response: RBS agrees and can update its current regulatory instructions to take into account the formal monitoring process which the Agency will be establishing, as noted in Recommendation 1 above, and ensure that the authority to determine if funds should be returned to Rural Development will be held at the National Office. The instructions will be completed at the same time a formal process is being developed, with an estimated completion time of 1 year.

Completion Date: January 1, 2018

OIG Recommendation 3: RBS should take appropriate action to recover funds from the intermediary that invested \$1 million of IRP revolved funds in a 12-month Certificate of Deposit.

Agency Response: RBS does not agree in recovering \$1 million of IRP revolved funds from this particular intermediary since they only owe approximately \$500,000. We also do not agree that the only resolution is to force the entity to return the funding to RBS, by doing so it would prohibit the money from being used to fulfill its original purpose. However, RBS will still take steps to work with the field office and the borrower to bring them back into compliance with the program regulation.

Completion Date: September 30, 2017

OIG Recommendation 4: Establish a timeframe to revise current program regulations governing the application and application scoring process for intermediaries seeking subsequent loans to account for an intermediary's recent loan activity and revolving fund cash available for relending.

Agency Response: RBS agrees that the regulation must have provisions governing the application and application scoring process for intermediaries seeking subsequent loans to account for an intermediary's recent loan activity and revolving fund cash available for relending. Except, we believe the existing regulation published July 2014 and effective as of September 2014, section 4274.331 (a)(ii), accounts for an intermediary's loan activities in reference to future funding. It states, "The intermediary provides documentation to demonstrate that funds for relending do not exceed the greater of \$150,000 or the total amount of loans closed during a calendar quarter on average, over the last 12 months." This language adequately inhibits intermediaries with excessive un-revolved balances from competing for funding. RBS has proposed scoring criteria in the draft IRP program regulation currently being developed that will reward existing intermediaries that continuously revolve their funds. However, the regulation will be published as a proposed rule and is subject to change with public comment.

Completion Date: July-September 2019. Dependent on Administration Approval.

OIG Recommendation 5: RBS should provide clarifying instructions to the field conveying the importance of intermediaries adequately documenting the reasons a prospective ultimate recipient could not have obtained other non-IRP sources of financing for their projects.

Agency Response: RBS agrees with the recommendation of providing clarifying instructions to the field about the importance of intermediaries adequately documenting the reasons a prospective ultimate recipient could not have obtained other non-IRP sources of financing for their projects. We will issue an unnumbered letter to clarify to the field what is required under the IRP program's "credit elsewhere" provision.

Completion Date: September 30, 2017

OIG Recommendation 6: Along with clarifying instructions, RBS should provide targeted training for field office staff specifying the level of effort and documentation required from intermediaries in satisfaction of the credit elsewhere regulation.

Agency Response: RBS agrees with the recommendation and will be hosting a webinar March 28, 2017, to train State Office staff on the credit elsewhere requirements, and will provide a template to the State Offices that could be used to document the credit elsewhere test.

Completion Date: September 30, 2017

OIG Recommendation 7: RBS should instruct field office staff to inform intermediaries of the required level of effort for documenting the reasons an ultimate recipient could not have obtained other sources of non-IRP financing. At a minimum, RBS should require the use of templates that

would be used to summarize the lending requirements of commercial banks and other governmental (Federal, State, local) lending programs within the intermediary's service area.

Agency Response: RBS agrees with the recommendation and will be hosting a webinar March 28, 2017, to train field office staff on the credit elsewhere requirements who will then pass the information on to their respective intermediaries, and will provide a template to the State Offices that could be used to document the credit elsewhere test.

Completion Date: September 30, 2017

OIG Recommendation 8: RBS should revise its instructions to specify that the term "funds" used in the context of an intermediary's contribution to the IRP revolving fund means cash or cash equivalents. The instructions should make it clear that a debt instrument, such as a note receivable, is not an acceptable form of intermediary contribution.

Agency Response: RBS agrees with the recommendation and will revise its regulatory instructions to ensure states understand that the term "funds" means cash or cash equivalents. RBS has already informed all of the states at our monthly national call, as well as trained the State associated with the identified intermediary, that cash equivalents are required. The intermediary identified has been notified and is no longer using a note receivable as their contribution.

Completion Date: September 30, 2017

OIG Recommendation 9: RBS should require the intermediary to return the \$1.9 million into the revolving loan fund and remove the non-IRP loans from the portfolio.

Agency Response: RBS does not agree with the recommendation of requiring the intermediary to return the \$1.9 million into the revolving loan fund and remove the non-IRP loans from the portfolio because the RBS employee involved in approving the transfer had the actual authority to approve the loan transfer at the time of the initial request. Though the authority currently exists at the State Office, RBS agrees to move the authority to the National Office through a notice to the field. Upon consultation with the Office of the General Counsel, RBS is bound to the prior approval of the transfer and the intermediary has been informed they will not allow any transfers in the future.

Completion Date: March 31, 2017

OIG Recommendation 10: RBS should provide instructions to the RD State offices clarifying that the removal of cash from the revolving loan fund for any reason must be reviewed and approved by the National Office.

Agency Response: RBS agrees with the recommendation, and is developing instructions that clarify that states must receive concurrence from the National Office before approving the removal of cash from a revolving loan fund.

Completion Date: September 30, 2017

OIG Recommendation 11: RBS should provide specialized training for personnel in the one RD State Office and stress that an approved administrative cost budget is required from all intermediaries.

Agency Response: RBS agrees with the recommendation and has scheduled training for the State in April of 2017. The training will provide detailed instructions on how to review Administrative costs, specifying when and what are appropriate administrative expenses.

Completion Date: April 30, 2017

OIG Recommendation 12: RBS should assess the administrative costs charged by all the intermediaries in the one State for potential unallowable costs being charged to the IRP program. Rural Development should assess administrative costs for the last 3 fiscal years and expand the scope if significant unallowable costs are identified. They should consider requiring intermediaries to repay any unallowable or unreasonable costs claimed by the intermediaries.

Agency Response: RBS agrees with the recommendation and will review administrative costs for the approximately eight existing intermediaries in the State. If there are any unallowable administrative costs, RBS will work to recoup the unauthorized expenses. The review and subsequent, if any, notice to recoup funds will be completed in 6 months.

Completion Date: September 30, 2017

Thank you for the opportunity to review and provide feedback. If you have any questions or need additional information, please do not hesitate to contact Kristi Kubista-Hovis, Director of Specialty Programs Division, at Kristi.kubista-hovis@wdc.usda.gov or at 202-720-1400.

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