

U. S. Department of Agriculture

Rural Development

Audit Program

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UNITED STATES DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
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AUDIT PROGRAM	RURAL DEVELOPMENT Rural Housing Service Rural Business-Cooperative Service Audits of Recipients of Rural Development Grants, Loans, and Loan Guarantees
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The attached Audit Program provides important guidance for independent public accountants in conducting financial statement audits of recipients of Rural Development grants, loans, and loan guarantees, except for those audits required to be performed in accordance with Office of Management and Budget Circular A-133. The Audit Program is effective for financial audits of periods ending on December 31, 2004, and thereafter.

This Audit Program may not be changed, altered, revised, or modified without the concurrence of Rural Development.

APPROVED BY /S/ 10/25/04
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Rural Development Audit Program

A. PURPOSE

The following Audit Program provides information for independent, public, Federal, state or local government audit organizations in conducting financial statement audits of recipients of Rural Development loans, grants, and loan guarantees. This Audit Program includes compliance requirements for the Rural Housing Service Rural Rental Housing, and Community Facilities; the Rural Business-Cooperative Service Business and Industry Guaranteed Loans, Intermediary Relending Program, and Rural Economic Development Loan and Grant audits performed in accordance with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS). Auditors conducting financial statement audits in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, should refer to the OMB Circular A-133 Compliance Supplement, Appendix B; as it pertains to audits of state and local governments, non-profit organizations, and Indian tribes that expend \$500,000 or more in Federal funds in a fiscal year. This Audit Program is not intended to address audit requirements that are required under the Single Audit Act Amendments of 1996 and OMB Circular A-133.

The suggested audit procedures provided in this Audit Program are the minimum necessary for uniform and consistent coverage.

B. ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
CFDA	Catalog or Federal Domestic Assistance
CFR	Code of Federal Regulations
CF	Community Facilities
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
IRP	Intermediary Relending Program

OIG	Office of Inspector General
OMB	Office of Management and Budget
RBS	Rural Business-Cooperative Service
RD	Rural Development
RHS	Rural Housing Service
SAS	AICPA's Statements on Auditing Standards

C. BACKGROUND

Rural Development requires its borrowers to provide annual audited financial statements performed in accordance with GAGAS using the publication, "Government Auditing Standards," 2003 Revision. This publication was developed by the Comptroller General of the United States, GAO. Audits must also be performed in accordance with GAAS.

These financial statement audits are the responsibility of the auditee's management. The financial statements should be prepared in conformance with GAAP unless state statutes or other funding sources require otherwise.

To the extent practicable, the financial statements should be presented on a comparative basis for the current and preceding year. An entity submitting its initial audit report to Rural Development may submit single year financial statements.

D. PERTINENT PUBLICATIONS AND REGULATIONS

1. Pertinent Publications

AICPA Statements on Auditing Standards

GAO Government Auditing Standards (2003 or subsequent revisions)

2. Pertinent Regulations

7 CFR Part 1942, Subpart A - Community Facilities Loans

7 CFR Part 1942, Subpart C - Fire and Rescue Loans

7 CFR Part 3570, Subpart B - Community Facilities Grants

7 CFR Part 3575, Subpart A - Community Facilities Guaranteed Loans

7 CFR Part 4274, Subpart D - Intermediary Relending Program (IRP)

7 CFR Part 1951, Subpart R - Rural Development Loan Servicing (for the IRP program)

7 CFR Part 1980, Subpart E - Business and Industrial (B&I) Loan Program

7 CFR Part 4279, Subpart A - General (for B&I Loans)

7 CFR Part 4279, Subpart B - Business and Industry Loans

7 CFR Part 1942, Subpart G - Rural Business Enterprise Grants and Television Demonstration Grants

E. STANDARDS FOR CONDUCTING AUDITS

The Comptroller General of the United States has published GAGAS, 2003 Revision, which contains standards for audits of government organizations, programs, activities, and functions. These standards are to be followed by Federal, state, and independent certified public accountants when auditing entities receiving financial assistance provided by Rural Development.

The AICPA Statements on Auditing Standards (SASs) have been incorporated into GAGAS for financial audits, and must be followed. This audit program is not intended to provide guidance regarding adherence to the SASs.

F. ENGAGEMENT LETTER

The auditor should prepare a written engagement letter for the audited entity, which clearly sets forth the terms, nature, and limitations of the audit engagement. The engagement letter may include terms and conditions that the auditee and the auditor deem appropriate; however, the following provisions should be included in the audit agreement:

1. A statement that the auditor will perform and document the audit work in accordance with GAGAS and the professional standards of the AICPA;
2. A statement that the auditor will submit the completed audit and accompanying audit letters to the entity's governing body 30 days prior to the date the audit is due to Rural Development;

3. A statement that the auditor will make all audit-related documents, including workpapers, available to Rural Development, OIG, or their duly authorized representatives, upon request; and
4. The auditor will report, in writing, all irregularities, as well as indications of fraud, abuse, or illegal acts, whether material or not, to the entity's governing body, Rural Development, and OIG.

G. AUDIT OBJECTIVES

Entities receiving financial assistance from Rural Development are required to submit financial statement audits. The objective of a financial statement audit is to provide reasonable assurance about whether the financial statements present fairly the financial position, results of operations, and cash flows in conformity with GAAP.

H. GENERAL STANDARDS

Independence

In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free both in fact and appearance, from personal, external, and organizational impairments to independence.

Professional Judgment

Professional judgment should be used in planning and performing audits and in reporting the results. This standard requires auditors to exercise reasonable care and diligence and to observe the principles of serving the public interest and maintaining the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work. This standard also imposes a responsibility upon each auditor performing work under GAGAS to observe GAGAS. In addition, auditors should use professional judgment in determining the type of assignment to be performed and the standards that apply to the work; defining the scope of work; selecting the methodology; determining the type and amount of evidence to be gathered; and choosing the tests and procedures for their work. Professional judgment also should be applied in performing the tests and procedures and in evaluating and reporting the results of the work.

Competence

The audit staff assigned to perform the audit should collectively possess adequate professional competence for the tasks required.

Qualifications for staff members conducting audits include:

1. knowledge of GAGAS applicable to the type of work they are assigned and the education, skills and experience to apply such knowledge to the work being performed.
2. general knowledge of the environment in which the audited entity operates and the subject matter under review;
3. skills to communicate clearly and effectively, both orally and in writing; and
4. skills appropriate for the work being performed.

To meet this standard, auditors performing work under GAGAS, including planning, directing, performing field work, or reporting on an audit under GAGAS, need to maintain their professional competence through continuing professional education (CPE). Each auditor performing work under GAGAS should complete, every 2 years, at least 80 hours of CPE that directly enhance the auditor's professional proficiency to perform audits. At least 24 of the 80 hours of CPE should be in subjects directly related to government auditing, the government environment, or the specific or unique environment in which the audited entity operates. At least 20 hours of the 80 should be completed in any 1 year of the 2-year period.

Quality Control and Assurance

Each audit organization performing audits in accordance with GAGAS should have an appropriate internal quality control system in place and should undergo an external peer review.

An audit organization's system of quality control encompasses the audit organization's structure and the policies adopted and procedures established to provide the organization with reasonable assurance of complying with applicable standards governing audits. An audit organization's internal quality control system should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied.

Audit organizations performing audits in accordance with GAGAS should have an external peer review of their auditing practices at least once every 3 years by reviewers independent of the audit organization being reviewed. The external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Audit organizations should take remedial, corrective actions as needed based on the results of the review. Audit organizations seeking to enter into a contract to perform an assignment in

accordance with GAGAS should provide their most recent external peer review report and any letter of comment, and any subsequent peer review reports and letters of comment received during the period of the contract, to the party contracting for the audit.

I. FIELD WORK STANDARDS FOR FINANCIAL AUDITS

General

The work is to be adequately planned and assistants, if any, are to be properly supervised. A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

Auditor Communication

Auditors should communicate information regarding the nature, timing, and extent of planned testing and reporting and the level of assurance provided to officials of the audited entity and to the individuals contracting for or requesting the audit.

In communicating the nature of services and level of assurance provided, auditors should specifically address their planned work and reporting related to testing internal control over financial reporting related to compliance with laws, regulations, and provisions of contracts or grant agreements.

Considering the Results of Previous Audits

Auditors should consider the results of previous audits and follow up on known significant findings and recommendations that directly relate to the objectives of the audit being undertaken.

Auditors should use professional judgment in determining (1) prior periods to be considered, (2) the level of work necessary to follow up on significant findings and recommendations that affect the audit, and (3) the effect on the risk assessment and audit procedures in planning the current audit.

Detecting Material Misstatements Resulting from Violations of Contract Provisions, or Grant Agreements, or from Abuse

Auditors should design the audit to provide reasonable assurance of detecting material misstatements resulting from violations of provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives. If specific information

comes to the auditors' attention that provides evidence concerning the existence of possible violations of provisions of contracts or grant agreements that could have a material indirect effect on the determination of financial statement amounts or other financial data significant to the audit objectives, auditors should apply audit procedures specifically directed to ascertain whether violations of provisions of contracts or grant agreements have occurred or are likely to have occurred.

Auditors should be alert to situations or transactions that could be indicative of abuse, and if indications of abuse exist that could significantly affect the financial statement amounts or other financial data, auditors should apply audit procedures specifically directed to ascertain whether abuse has occurred and the effect on the financial statement amounts or other financial data.

Auditors should exercise professional judgment in pursuing indications of possible fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, in order not to interfere with potential investigations legal proceedings, or both.

Developing Elements of a Finding

Audit findings, such as deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse, have often been regarded as containing the elements of criteria, condition, and effect, plus cause when problems are found. However, the elements needed for a finding depend entirely on the objectives of the audit. Thus, a finding or set of findings is complete to the extent that the audit objectives are satisfied. When problems are identified, to the extent possible, auditors should plan audit procedures to develop the elements of a finding to facilitate developing the auditors' report.

Audit Documentation

Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

J. REPORTING STANDARDS FOR FINANCIAL AUDITS

General

The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles. The report shall identify those circumstances in which such principles have not been consistently observed in the

current period in relation to the preceding period. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, if any, and the degree of responsibility the auditor is taking.

Reporting Auditors' Compliance With GAGAS

Audit reports should state that the audit was performed in accordance with GAGAS.

Reporting on Internal Control and on Compliance With Laws, Regulations, and Provisions of Contracts or Grant Agreements

When providing an opinion or a disclaimer on financial statements, auditors should include in their report on the financial statements either a (1) description of the scope of the auditors' testing of internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements and the results of those tests or an opinion, if sufficient work was performed, or (2) reference to the separate report(s) containing that information. If auditors report separately, the opinion or disclaimer should contain a reference to the separate report containing this information and state that the separate report is an integral part of the audit and should be considered in assessing the results of the audit.

Reporting Deficiencies in Internal Control, Fraud, Illegal Acts, Violations of Provisions of Contracts or Grant Agreements, and Abuse

For financial audits, including audits of financial statements in which the auditor provides an opinion or disclaimer, auditors should report, as applicable to the objectives of the audit, (1) deficiencies in internal control considered to be reportable conditions as defined by the AICPA standards, (2) all instances of fraud and illegal acts unless clearly inconsequential, and (3) significant violations of provisions of contracts or grant agreements and abuse. In some circumstances, auditors should report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties external to the audited entity.

When reporting deficiencies in internal control, auditors should identify those reportable conditions that are individually or in the aggregate considered to be material weaknesses.

To the extent possible, in presenting audit findings such as deficiencies in internal control, auditors should develop the elements of criteria, condition, cause, and effect to

assist management or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the findings, they should provide recommendations for corrective action.

Reporting Views of Responsible Officials

If the auditors' report discloses deficiencies in internal control, fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse, auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as planned corrective actions.

Reporting Privileged and Confidential Information

If certain pertinent information is prohibited from general disclosure, the audit report should state the nature of the information omitted and the requirement that makes the omission necessary. Certain information may be prohibited from general disclosure by Federal, State, or local laws or regulations. In such circumstances, auditors may issue a separate limited-official-use report containing such information and distribute the report only to persons authorized by law or regulation to receive it. If auditors make the judgment that certain information should be excluded from a publicly available report, they should state the general nature of the information omitted and the reasons that make the omission necessary in the report.

Report Issuance and Distribution

Government auditors should submit audit reports to the appropriate officials of the audited entity and to appropriate officials of the organizations requiring or arranging for the audits, including external funding organizations such as legislative bodies, unless legal restrictions prevent it. Auditors should also send copies of the reports to other officials who have legal oversight authority or who may be responsible for acting on audit findings and recommendations and to others authorized to receive such reports. Unless the report is restricted by law or regulation, or contains privileged and confidential information, auditors should clarify that copies are made available for public inspection. Nongovernment auditors should clarify report distribution responsibilities with the party contracting for the audit and follow the agreements reached.

ATTACHMENT I
Rural Rental Housing Loans
10.415/10.427

I. PROGRAM OBJECTIVES

The objective of the RHS Rural Rental Housing (RRH) Loan Program is to provide economically designed and constructed housing suited for independent or congregate living of senior citizens, handicapped persons, and other persons of low and moderate incomes, who live in rural areas.

II. PROGRAM PROCEDURES

Loans are provided to state and local public agencies, individuals, trusts, associations, partnerships, consumer cooperatives, and profit and nonprofit corporations upon approval of an application to construct or rehabilitate rural rental housing. Loan funds can only be used for authorized purposes within the prescribed loan limits and use limitations. Most borrowers are required to contribute a certain percentage of the development costs and initial operating capital.

After the RRH facilities become operational, borrowers have ongoing management and reporting responsibilities. In this regard, borrowers are responsible for complying with applicable Agency regulations and conditions of their Loan Agreement which include, but are not limited to, the following:

- (a) Providing for proper and efficient management of the RRH project;
- (b) Renting only to eligible tenants;
- (c) Verifying and certifying tenant income and/or employment;
- (d) Entering into lease agreements with tenants;
- (e) Properly computing rental charges and obtaining Agency approval for any changes in basic or market rental rates;
- (f) Providing for proper maintenance of the RRH property to protect the Agency's security interests;
- (g) Limiting returns on investments and any advances/paybacks of operating funds;
- (h) Properly accounting for RRH project operations and maintaining required accounts;
- (i) Providing accurate monthly and/or annual reports to the Agency; and
- (j) Promptly computing and remitting loan repayments to reflect interest credits, averages and rental assistance.

III. COMPLIANCE REQUIREMENTS AND AUDIT PROCEDURES

Entities receiving RRH loans are subject to the audit requirements contained in 7 CFR Part 3560, Reinstitution of the Sections 514, 515, 516, and 521 Multi-Family Housing Programs. In addition, for audit periods ending as of December 31, 2004, auditees should submit audited financial statements conducted in accordance with the requirements of Government Auditing Standards (i.e., a GAGAS yellow book audit).

Please note; however, that for audit periods ending in the year 2005, entities receiving RRH loans will be required to submit audit reports using agreed-upon procedures guidance to be issued by the United States Department of Agriculture (USDA) OIG.

ATTACHMENT II
Community Facilities Loans and Grants
10.766

I. PROGRAM OBJECTIVES

As authorized by Section 306 of the Consolidated Farm and Rural Development Act of 1972, as amended (7 U.S.C. 1926), the Rural Housing Service Community Facilities (CF) Program provides direct and guaranteed loan and grant assistance to rural communities to construct, enlarge, expand, or improve essential community facilities in rural communities. These funds are made available for the purpose of providing essential services to rural communities when financing is not available from other sources at reasonable rates and terms. CF loans and grants are administered at the state and local level through the USDA Rural Development mission area.

II. PROGRAM PROCEDURES

CF is authorized to provide direct and guaranteed loan and grant assistance to eligible applicants for essential community facilities in rural areas with populations not to exceed 20,000. Eligible applicants include:

- (a) A public body, such as a municipality, district, county authority, or other political subdivision of a state, territory or commonwealth;
- (b) A non-profit organization; and
- (c) A Federally recognized Indian Tribe.

Grant funds may be used to assist in the development of essential community facilities in rural areas. The Agency will prioritize grant funds to areas with low Medium Household Income and low population. Eligible applicants located in small communities with lower populations and lower median household incomes may receive a higher percentage of grant funds. The amount of grant funds provided for a facility shall not exceed 75 percent of the cost of developing the facility.

The purpose of CF guaranteed loan assistance is to improve, develop, or finance essential community facilities in rural areas. The purpose is achieved through bolstering the existing private credit structure through the guarantee of quality loans which will provide lasting community benefits. Guaranteed loans are loans made by the lender and guaranteed by the Rural Housing Service. The processing of the loan and requirements placed on the organization receiving the loan are the lender's responsibility.

7 CFR Part 3575-A, Subpart A, CF Guaranteed Loans, requires the lender to obtain and analyze financial statements as required by the Loan Agreement. It is the lender's responsibility to notify the Agency of any violation of the Loan Agreement with the borrower within 30 days of such violation. The lender is required to submit the

borrower's annual financial statements to the Agency servicing official within 120 days of the end of the borrower's fiscal year. The lender must analyze the financial statements and provide a written summary of the entity's trends, strengths, weaknesses, extraordinary transactions, and other financial conditions of the borrower. The lender will require an audit in accordance with the requirements of the OMB Circulars.

7 CFR Part 3570, Subpart B, requires the grantee to submit to the Agency certified documentation to support grant funds expended, as required by the Grant Agreement. Documentation shall include either an audit report, annual financial statements or appropriate documentation in accordance with 7 CFR Part 1942, Subparts A, and C or 7 CFR Part 3570, Subpart B, depending upon the purpose and amount of CF grant funds expended. The auditor shall review Form RD 3570-3, "CF Grant Agreement" for information related to financial reporting requirements.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Activities Allowed or Unallowed

Compliance Requirement

Loan funds may be used to: (1) construct, enlarge, extend or otherwise improve essential community facilities; (2) to construct or relocate public buildings, roads, bridges, fences, and utilities necessary for the successful operation of authorized facilities; (3) to relocate private buildings, roads, bridges, fences, and utilities necessary for the successful operations of authorized facilities and (4) to pay certain other expenses when such costs are a necessary part of the financed facilities (7 CFR Part 1942-A, 1942.17(d)(1)).

Loan funds may not be used to finance: (1) on-site utility systems or business and industrial buildings in connection with industrial parks; (2) facilities used for recreational purposes (this restriction does not apply to guaranteed loans); (3) community antenna services; (4) electric generation or transmission facilities and telephone systems; (5) facilities which are not modest in size, design, or cost; (6) loan or grant finders' fees; (7) packagers' fees; (8) new combined sanitary and storm water sewer facilities (7 CFR Part 1942-A, 1942.17(d)(2)); (9) projects located in coastal barrier resources systems that do not qualify for an exception (7 CFR Part 3575-A, 3575.25); and (10) projects located in a mudslide hazard area.

During the disbursement of Federal assistance, the Agency must concur in all expenditures before they are made. The borrower must also monitor the use of funds in accordance with program regulations (7 CFR Part 1942-A, 1942.17(p)).

Suggested Audit Procedures

- Test the borrower's financial records to ascertain that loan funds were only used for eligible purposes.
- The auditor must ascertain the purpose of the loan/grant funds.
- The auditor must refer to the Project Summary in the case file to determine the cost of the project (7 CFR Part 1942-A, 1942.17(d), 7 CFR Part 3575-A, 3575.24 and 3570-B, 3570.61(b)). The Project Summary is prepared by the USDA Rural Development representative.
- The auditor should refer to the section in the regulation pertaining to activities allowed and unallowed. Unallowed activities are contained in 7 CFR Part 1942-A, 1942.17(d)(2) and 7 CFR Part 3575-A, 3575.25.
- Review the current Balance Sheet (Form RD 442-3) to determine if Form RD 442-3 is in material agreement with the entity's accounting records.
- Ascertain whether the borrower obtained prior Agency concurrence for expenditures.
- Review the "Letter of Conditions" (7 CFR Part 1942-A, 1942.5(a) (1)), Letter of Intent to meet conditions (Form RD 1942-45), and additional documentation in the case file that supports the Agency's approval of expenditures.
- Review the Project Summary (Form RD 1942-47) for appropriate signatures by the Rural Development Manager and State Director. Regulation reference (7 CFR 1942-A, Part 1942.5(a)(i)).
- Test the grantee's financial management system to ensure its adequacy to meet financial reporting requirements.
- Review the borrower's accounting and auditing procedures for grants. Reference 7 CFR Part 3570-B, "Community Facilities Grant Program."
- Based on the audit, ascertain whether the borrower's financial management system is designed to ensure the proper use of loan funds.
- Review the borrower's accounting and auditing procedures for loans. Reference 7 CFR Part 1942-A, 1942.17(q).

B. Eligibility

The auditor is not expected to test for eligibility.

C. Matching. Level of Effort, Earmarking

Compliance Requirement

Borrowers may be required to provide funds from other sources as specified in the Loan Agreement, Grant Agreement or Letter of Conditions issued by Rural Development. (7 CFR Part 1942-A, 1942.5(a)(1)(i), 7 CFR Part 3570-B, 3570.71(f), and 7 CFR Part 3775-A, 3575.28 and 3575.64).

Suggested Audit Procedures

- Examine the Grant Agreement, Loan Agreement and Letter of Conditions to ascertain the amount of funds to be provided by the recipient.
- Test the financial records to determine if matching fund requirements were met.
- The auditor must ascertain the amount and source of funds. Determine whether the funds were from state or other nonfederal sources.

The CF program does not require matching funds for the CF grant program. CF can use 75 percent CF grant fund in a project. The other 25 percent has to be either CF direct loan, CF guaranteed loan, or other funds.

- Test to determine if there was a conditional commitment of guarantee.

D. Reporting Requirements

Compliance Requirement

The following financial or management reports must be periodically submitted to Rural Development:

- (1) Annual audited financial statements within 150 days of the entity's fiscal year-end (7 CFR Part 1942-A, 1942.17(q)(4));
- (2) Form RD 442-2, "Statement of Budget, Income and Equity" (7 CFR Part 1942-A, 1942.17(q)(5), and OMB No. 0575-0015). This report covers financial operations relating to the borrower's CF project; or
- (3) Form RD 442-3, "Balance Sheet" (7 CFR Part 1942-A, 1942.17(q)(5) and OMB No 0575-0015). This report presents the financial status of the borrower's CF project.

Suggested Audit Procedure

- Review Forms RD 442-2 and 442-3, and determine whether the information presented is in agreement with the borrower's financial records.

- Review prior period audited financial statements and findings to ascertain whether material deficiencies or significant changes in financial condition exist.

E. Special Tests and Provisions

Compliance Requirement

A Loan Resolution, Form RD 1942-47 (Loan Resolution, Public Bodies) will be adopted by public bodies. The following sections of the Loan Resolution restrict the financial operations of the borrower: Section 6 (sale, transfer and lease of facility); Section 7 (contracts, agreements and liabilities); Section 8 (depositories); Section 10 (revenues); and Section 12 (books and records) (7 CFR Part 1942-A, 1942.5).

Suggested Audit Procedures

- Review the Loan Resolution and applicable regulations.
- Review and test the financial and related records to determine compliance with the restrictions placed on CF borrowers by the Loan Resolution.

Note: The financial requirements are contained in the Letter of Conditions applicable Loan Resolution and Grant Agreement.

Compliance Requirement

A Loan Resolution will be adopted by not-for-profit organizations (Loan Resolution Security Agreement) RD Form 1942-9. The following sections of the Loan Resolution restrict the financial operations of the borrower; Section 4 (protection and disposition of funds); Section 5c (revenues); Section 5e (books and records); Section 5h (contracts, agreements, and liabilities); and Section 5i (sale, transfer or lease of facility) (7 CFR Part 1942-A, 1942.5).

Suggested Audit Procedures

- Review the Loan Resolution and applicable regulations.
- Review and test the financial and related records to determine compliance with the restrictions placed on CF borrowers by the Loan Resolution.

Compliance Requirement

Section 319 of Public Law (P.L.) 101-121, the Department of Interior and Related Agencies Appropriations Act, prohibits applicants and recipients of Federal contracts, grants, and loans from using appropriated funds for lobbying the Federal Government in connection with a specific award. Section 319 also requires each individual who requests or receives a Federal contract, grant, loan, or a Federal commitment to

guarantee a loan, to disclose the expenditure of any funds, other than appropriated funds, for lobbying activities.

RD Instruction 1940-Q, Restrictions on Lobbying, requires that recipients of assistance exceeding certain financial thresholds provide certifications concerning lobbying activities, and submit disclosure statements if nonappropriated funds have been used for certain purposes.

Suggested Audit Procedures

- The auditor will test for compliance with the provisions of Section 319 of P.L. 101-121, by verifying that the required certifications and disclosure statements have been prepared.
- The auditor must check to ensure certifications and disclosure statements are signed and dated by the appropriate officials.

ATTACHMENT III
Business and Industry Guaranteed Loans
10.768

I. PROGRAM OBJECTIVES

The objective of the Business and Industry (B&I) Guaranteed Loan Program is to improve, develop, or finance business, industry, and employment to improve the economic and environmental climate in rural communities.

II. PROGRAM PROCEDURES

Loans by private sector lenders to businesses guaranteed by Rural Development Guaranteed loans can be sold in the secondary market. The lender is responsible for loan servicing. The program is administered through the Rural Development State Director who is the point of contact for all processing and servicing activities. Loans must improve the economic and/or environmental climate of rural communities by bolstering the existing private credit structure through loan guarantees that will provide lasting community benefits.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

Loans may be used for:

- (1) Business and industrial acquisitions, construction, repair and modernization;
- (2) Purchasing and developing land, easements, buildings, rights-of-way and facilities;
- (3) Purchasing equipment, leasehold improvements, machinery and supplies;
- (4) Pollution control and abatement;
- (5) Transportation services incidental to industrial development;
- (6) Startup costs and working capital;
- (7) Interest subject to certain provisions;
- (8) Feasibility studies;
- (9) Debt refinancing; and

(10) Reasonable professional fees and Agency guarantee fees and charges (7 CFR Part 4279-B, section 4279.113).

Compliance Requirements

Loans may not be used for items detailed in 7 CFR Part 4279-B, section 4279.114.

Suggested Audit Procedure

- Test the borrower's financial records to ascertain that loan funds were only used for eligible loan purposes.

B. Eligibility

The auditor is not expected to test for borrower eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

- Test to verify if the lender has maintained the appropriate level of ownership of guaranteed loan (i.e., 5%).

D. Reporting Requirements

Compliance Requirements

The following financial reports must be submitted periodically for this program:

Annual audited financial statements prepared by an accountant in accordance with Generally Accepted Accounting Principles will be required (7 CFR Part 4279-B, section 4279.137(a)).

The Agency may require audited financial statements if loan security concerns warrant, and the proposed guaranteed loan will exceed \$3 million (7 CFR Part 4279-B, section 4279.137(b)).

Suggested Audit Procedures

- Ascertain whether the borrower complied with any special financial reporting requirements, as contained in the loan closing documents or subsequent loan covenant modifications.
- Test the accuracy of the financial reports to the borrower's financial records.
- Ascertain whether the borrower submitted audited financial statements.
- Ascertain whether the lender has adhered to all conditions in the Loan Agreement

and Conditional Commitment and verify that the lender has submitted a certification to Rural Development that these have been met prior to issuance of the Loan Note Guarantee.

E. Special Tests and Provisions

Compliance Requirements

All fees and charges by the lender and others should be similar to those reasonably and customarily charged borrowers in similar circumstances in the ordinary course of business (7 CFR Part 4279-B, section 4279.120).

A minimum of 10 percent tangible balance sheet equity will be required for existing businesses at the time the Loan Note Guarantee is issued. A minimum of 20 percent tangible balance sheet equity will be required for new businesses at the time the Loan Note Guarantee is issued (7 CFR Part 4279-B, section 4279.131(d)).

Interest rates negotiated between the borrower and lender must not be more than those rates customarily charged borrowers in similar circumstances in the ordinary course of business (7 CFR Part 4279-B, section 4279.125).

The lender is responsible for seeing that the borrower has proper and adequate collateral to protect the interest of the lender, and Rural Development (7 CFR Part 4279-B, section 4279.131(b)).

The loan agreement between the lender and borrower may impose other financial and program requirements (7 CFR Part 4279-B, section 4279.161 (b)(11)(xii)).

Suggested Audit Procedures

- Test lender records to determine whether the lender's fees and other professional fees charged to guaranteed borrowers were reasonable and customary. If packaging services were provided by the lender, ascertain from the lender records whether the fees charged guaranteed borrowers were comparable to fees charged on lender nonguaranteed loans.
- Ascertain whether the interest rate negotiated between the lender and borrower on guaranteed loans was comparable to the rate customarily charged borrowers in similar circumstances on lender nonguaranteed loans, adjustments are proper, and appropriate approvals were obtained.
- Through visual inspection or record of collateral, test whether collateral pledged as security for the loan is being maintained by the borrower.
- Ascertain whether the required appraisal reports were prepared by an independent appraiser and were timely obtained.

- Test loans (loan and lender's agreements) relating to the following requirements for compliance:
 1. Prohibition against assuming liabilities or obligations of others;
 2. Restriction on dividend payments;
 3. Limitation on purchase or sale of equipment and fixed assets;
 4. Limitation on compensation of officers and owners;
 5. Minimum working capital requirements;
 6. Maximum debt to net worth ratio;
 7. Restrictions concerning consolidations, mergers or other circumstances; and
 8. Limitations on selling the business without concurrence of the lender and Rural Development.

Compliance Requirement

Section 319 of Public Law (P.L.) 101-121, the Department of Interior and Related Agencies Appropriations Act, prohibits applicants and recipients of Federal contracts, grants, and loans from using appropriated funds for lobbying the Federal government in connection with a specific award. Section 319 also requires each individual who requests or receives a Federal contract, grant, loan, or a Federal commitment to guarantee a loan, to disclose the expenditure of any funds, other than appropriated funds, for lobbying activities.

RD Instruction 1940-Q, Restrictions on Lobbying, requires that recipients of assistance exceeding certain financial thresholds provide certifications concerning lobbying activities, and submit disclosure statements if nonappropriated funds have been used for certain purposes.

Suggested Audit Procedures

- The auditor will test for compliance with the provisions of Section 319 of P.L. 101-121, by verifying that the required certifications and disclosure statements have been prepared.
- The auditor must check to ensure certifications and disclosure statements are signed and dated by the appropriate officials.

ATTACHMENT IV
Intermediary Relending Program
10.767

I. PROGRAM OBJECTIVES

The objective of the RBS' Intermediary Relending Program (IRP) is to alleviate poverty and increase economic activity and employment in rural communities. In particular, IRP targets disadvantaged and remote communities, through financing, primarily towards smaller and emerging businesses, in partnership with other public and private resources, and in accordance with state and regional strategy based on identified community needs.

II. PROGRAM PROCEDURES

Loans are made by the RBS to intermediaries that establish or recapitalize Revolving Loan Fund programs for the purpose of providing loans to ultimate recipients for business facilities and community development. The intermediary is responsible for determining eligibility, credit quality, and loan documentation for the ultimate recipient's loan. Loans must improve community facilities and employment opportunities and increase economic activity in rural areas by financing business facilities and community development.

III. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES

A. Types of Services Allowed or Unallowed

Compliance Requirements

Loans may be used for:

- (1) Business and industrial acquisitions;
- (2) Business construction, conversion, enlargement, repair, modernization, or development;
- (3) Purchasing and developing land, easements, right-of-ways, buildings, facilities, leases, or materials;
- (4) Purchasing equipment, leasehold improvements, machinery and supplies;
- (5) Pollution control and abatement;
- (6) Transportation services;

- (7) Start-up operating costs and working capital;
- (8) Interest (including interest on interim financing) during the period before the facility becomes income producing, but not to exceed 3 years;
- (9) Feasibility studies;
- (10) Debt refinancing;
- (11) Reasonable fees and charges;
- (12) Hotels, motels, tourist homes, bed and breakfast establishments, convention centers, and other tourist and recreational facilities except as prohibited by 7 CFR Part 4274-D, 4274.319;
- (13) Educational institutions; and
- (14) Revolving lines of credit.

Compliance Requirements

Loans may not be used for:

- (1) Payment for administrative costs or expenses for the intermediary;
- (2) Assistance in excess of what is needed to accomplish the purpose of the ultimate recipient's project;
- (3) Distribution or payment to the owner, partners, shareholders, or beneficiaries of the ultimate recipient or members of their families;
- (4) Charitable institutions that would not have revenue from sales or fees to support the operation and repay the loan;
- (5) Assistance to government employees, military personnel, or principals or employees of the intermediary or organizations for which such persons are directors or officers or in which they have ownership of 20 percent or more;
- (6) To an ultimate recipient that has an application pending with a loan outstanding from another intermediary involving an IRP revolving fund;
- (7) Agricultural production;
- (8) Transfer of ownership unless the loan will keep the business from closing or prevent the loss of employment opportunities in the area, or provide expanded job opportunities;

- (9) Community antenna television services or facilities;
- (10) Any illegal activity;
- (11) Any project in violation of either a Federal, state, or local environmental protection law or regulation or an enforceable land use restriction unless the assistance given will result in curing or removing the violation;
- (12) Lending and investment institutions and insurance companies; or
- (13) Golf courses, race tracks, or gambling facilities.

The auditor is not expected to test for types of services allowed or unallowed. (7 CFR Part 4272-D, 4274.319).

B. Eligibility

The auditor is not expected to test for borrower eligibility.

C. Matching, Level of Effort, and/or Earmarking Requirements

There are no matching level or effort, and/or earmarking requirements.

D. Reporting Requirements

Compliance Requirements

The following financial reports must be submitted periodically for this program:

- (1) Annual audited financial statements prepared by an independent certified public accountant in accordance with Generally Accepted Government Auditing Standards (CFR Part 4274-D, 4274.338(b)(4)(i)(A));
- (2) Quarterly and semiannual reports (7 CFR Part 42724-D, 4274.338(b)(4)(ii)(A));
- (3) Annual proposed budget for the following year (7 CFR Part 4274-D, 4274.338(b)(4)(iii)); and
- (4) Other reports as the Agency may require from time to time (7 CFR Part 4274-D, 4274.338(b)(4)(iv)).

Suggested Audit Procedures

- Ascertain whether the borrower complied with any special financial reporting requirements, as contained with the loan closing documents or subsequent loan

covenant modifications.

- Test the accuracy of the financial reports to the borrower's financial records.
- Ascertain whether the borrower submitted audited financial statements, as required.

E. Special Test and Provisions

Compliance Requirements

Loans made by the Agency shall bear interest at a fixed rate of 1 percent per annum over the 30-year term of the loan.

Interest rates charged by intermediaries to ultimate recipients on loans from the IRP revolving fund shall be negotiated by the intermediary and ultimate recipient. The rate must be within limits established by the intermediary's work plan, approved by the Agency (7 CFR Part 4274-D, 4274.325(b)).

Security for all loans to intermediaries must be such that the repayment of the loan is reasonably assured, when considered along with the intermediary's financial condition, work plan, and management ability. It is the responsibility of the intermediary to make loans to ultimate recipients in such a manner that will protect the interests of the intermediary and the Federal Government (7 CFR Part 4274-D, 4274.326(a)).

Suggested Audit Procedures

- Test intermediary records to determine whether the interest rate charged is the lowest rate sufficient to cover the loan's proportional share of the IRP revolving fund's debt service costs, reserve for bad debts, and administrative costs.
- Test other banks or financial institutions to determine if better interest rates and terms are available (7 CFR Part 4274-D, 4274.325(b)).
- Test to determine if all reserves and other cash in the IRP revolving loan fund not immediately needed for loans to ultimate recipients or other authorized uses will be deposited in accounts in banks or other financial institutions. These accounts should be fully covered by the Federal Deposit Insurance Corporation or fully collateralized with U.S. Government obligations, and must be interest-bearing. Any interest earned thereon remains a part of the IRP revolving fund (7 CFR Part 4274-D, 4274.332(b)(5)).
- Ascertain whether the intermediary maintains a separate ledger and segregated bookkeeping and bank accounts for IRP funds as required in 7 CFR Part 4274-D, 4274.332(b).
- Ascertain whether the Agency's IRP loan funds are placed in the intermediary's IRP

revolving fund and used by the intermediary to provide direct loans to eligible ultimate recipients (7 CFR Part 4274-D, 4274.314(a)).

Compliance Requirement

Section 319 of Public Law (P.L.) 101-121, the Department of Interior and Related Agencies Appropriations Act, prohibits applicants and recipients of Federal contracts, grants, and loans from using appropriated funds for lobbying the Federal government in connection with a specific award. Section 319 also requires each individual who requests or receives a Federal contract, grant, loan, or a Federal commitment to guarantee a loan, to disclose the expenditure of any funds, other than appropriated funds, for lobbying activities.

RD Instruction 1940-Q, Restrictions on Lobbying, requires that recipients of assistance exceeding certain financial thresholds provide certifications concerning lobbying activities, and submit disclosure statements if nonappropriated funds have been used for certain purposes.

Suggested Audit Procedures

- The auditor will test for compliance with the provisions of Section 319 of P.L. 101-121, by verifying that the required certifications and disclosure statements have been prepared. The auditor must check to ensure certifications and disclosure statements are signed and dated by the appropriate officials.

ATTACHMENT V
Rural Economic Development Loans and Grants
10.854

I. PROGRAM OBJECTIVES

The purpose of the Rural Economic Development Loan and Grant (REDLG) Program is to promote rural economic development and job creation projects through electric and telecommunication utilities financed by the Rural Utilities Service (RUS).

II. PROGRAM PROCEDURES

Loans and grants are made to RUS electric and telecommunications borrowers to assist in financing a wide range of business and community development projects in rural areas. The program is authorized under the Rural Electrification Act of 1936, as amended, Title III, U.S.C. 930-940c. The program is administered by the Rural Business-Cooperative Service.

III. COMPLIANCE REQUIREMENTS AND AUDIT PROCEDURES

RUS borrowers receiving REDLG loans and grants are subject to the audit procedures and requirements contained in 7 CFR Part 1773, *Policy on Audits of RUS Borrowers*.

ATTACHMENT VI
Office of Inspector General (OIG) Addresses

1. OIG - Audit - Northeast Region
5601 Sunnyside Avenue, STOP 5300
Suite 2-2230
Beltsville, Maryland 20705-5300
(301) 504-2100

States Served: Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia, Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, and Vermont.

2. OIG - Audit - Southeast Region
401 W. Peachtree Street, NW., Room 2328
Atlanta, Georgia 30308
(404) 730-3210

States Served: Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, Puerto Rico, South Carolina, and Tennessee, and Virgin Islands.

3. OIG - Audit - Midwest Region
111 N. Canal Street, Suite 1130
Chicago, Illinois 60606-7295
(312) 353-1352

States Served: Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

4. OIG - Audit - Southwest Region
101 South Main Street, Room 324
Temple, Texas 76501
(254) 743-6565

States Served: Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

5. OIG - Audit - Great Plains Region
8930 Ward Parkway, Suite 3016
Kansas City, Missouri 64114
(816) 926-7667

States Served: Colorado, Iowa, Kansas, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wyoming, and Utah.

6. OIG - Audit - Western Region
75 Hawthorne Street, Suite 200
San Francisco, California 94105-3920
(415) 744-2851

States Served: Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Territory of Guam, Trust Territories of the Pacific, and Washington.