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Office of Inspector General
Midwest Region

Audit Report

Farm Service Agency's Progress To Implement the Improper Payments Information Act of 2002

Report No. 03601-0013-Ch
March 2006

UNITED STATES DEPARTMENT OF AGRICULTURE

USDA

OFFICE OF INSPECTOR GENERAL

WASHINGTON, D.C. 20250

DATE: March 6, 2006

REPLY TO
ATTN. OF: 03601-0013-Ch

TO: Teresa C. Lasseter
Administrator
Farm Service Agency

THROUGH: T. Mike McCann
Director
FSA Operations Review and Analysis Staff

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

SUBJECT: Farm Service Agency's Progress to Implement the Improper Payments Information Act of 2002

This report presents the results of our audit of the Farm Service Agency's (FSA) fiscal year (FY) 2005 efforts to implement the Improper Payments Information Act (IPIA) of 2002.[1] Your agency's response to the draft report, dated December 22, 2005, is included in its entirety as exhibit A, with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant sections of the report.

Our audit of FSA was conducted as part of a Departmentwide effort to evaluate the progress to implement the IPIA, focusing on the most recent guidance issued by the Office of the Chief Financial Officer (OCFO). Our review of the risk assessments for 4 FSA programs from a universe of the 26 FSA programs, with estimated outlays of $50 million or more each, disclosed that FSA had not compiled sufficient evidence to support its conclusion that the programs were at low risk for improper payments. As a result, FSA is not in compliance with the IPIA and we were unable to independently determine if the FSA rankings were appropriate.

[1] Public Law 107-300, November 26, 2002.

Based on the FSA response dated December 22, 2005, we have not reached management decisions on Recommendations 1 and 2. Management decisions on these recommendations can be reached once you have provided us with the additional information outlined in the report sections, OIG Position, following each recommendation.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned and the timeframes for implementation of the recommendations. Please note that the regulation requires a management decision to be reached on all findings within a maximum of 6 months from report issuance, and final action to be taken within 1 year of each management decision.

BACKGROUND

In November 2002, the President signed the IPIA, which requires the head of each agency to annually review all programs and activities the agency administers to identify those that may be susceptible to significant improper payments. For each program or activity identified, the agency is required to estimate the annual amount of improper payments. If the estimate is over $10 million, the agency must report the estimate to Congress along with the actions the agency is taking to reduce those improper payments. In May 2003, the Office of Management and Budget (OMB) issued guidance to agencies for estimating and reporting improper payments. As the lead agency for coordinating and reporting the Department's efforts to implement the IPIA, OCFO provided instructions to USDA agencies in August and October 2003. Within FSA, the Financial Management Division (FMD) is responsible for preparing the agency risk assessments.

In FY 2004, we performed audits of six agencies' programs, including FSA,[2] to determine whether the agencies performed risk assessments in compliance with the OMB and OCFO guidance for implementing the IPIA. Our review of FSA's risk assessments disclosed that FSA officials did not identify program-specific vulnerabilities to improper payments. To assess their programs, the officials used sample indicators of risks provided by OCFO and supplemented those with indicators generic to all FSA programs. We also performed an audit of OCFO[3] in FY 2004, to evaluate its actions to implement the IPIA—specifically, its efforts to assess the Department's programs for the risk of improper payments. Based on the results of that audit and the conditions reported in the agency audit reports, we recommended that OCFO strengthen its guidance to agencies for performing risk assessments.

OCFO issued more prescriptive guidance in November and December 2004. The revised OCFO guidance included specific instructions for agencies to follow in order to meet

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[2] Farm Service Agency Compliance with the Improper Payments Information Act of 2002, Report No. 03601-46-Te, dated March 2005.

[3] USDA Compliance with the Improper Payments Information Act of 2002, Report No. 50601-0008-Ch, dated January 2005.

IPIA requirements, focusing on those programs most likely to be at significant risk of improper payments. The guidance divided programs into 6 categories, ranging from programs with less than $10 million in outlays to programs exceeding $400 million in outlays. As part of the guidance, OCFO issued instructions for performing tests of transactions in each program to determine the effectiveness of internal controls in preventing improper payments. The guidance states that a judgmental sample of transactions should be taken that is sufficiently large to support the agency's assertion that internal controls are working. To support their conclusions regarding programs' susceptibility to improper payments, agencies were to include the results of these tests in each program's risk assessment. The guidance also included key milestones for agencies to submit information, allowing OCFO and OMB to assess the agencies' progress in completing all risk assessments by the established deadline of April 30, 2005.

OBJECTIVE

The objective of the audit was to assess the adequacy of FSA's implementation of OCFO's revised guidance regarding improper payment reporting requirements, including (1) agency efforts to conduct risk assessments of selected programs and report results to OCFO, and (2) agency conclusions that the programs were at low risk for improper payments.

SCOPE AND METHODOLOGY

We performed our audit of FSA compliance with the IPIA at the FSA National Office in Alexandria, Virginia. We conducted our fieldwork from June through August 2005. The audit was performed in accordance with *Government Auditing Standards*.

Of the risk assessments submitted to OCFO as of April 30, 2005, we judgmentally selected five FSA programs: Conservation Reserve Program (CRP), Counter-Cyclical Payments Program (CCP), Crop Disaster Program (CDP), Direct Payments Program (DP), and Export Credit Guarantee Program (ECGP),[4] with total reported estimated outlays of over $14 billion. We based our selection on our preliminary analysis of vulnerability criteria, outlay dollars, and the extent and adequacy of the risk assessment documentation provided to OCFO. We later excluded the ECGP from our review because we determined that it did not have any outlays. The 4 programs reviewed represented 47 percent of the reported estimated outlays of the 26 FSA programs[5] that fell into OCFO's top 3 categories for program outlays.

To accomplish our audit objectives, we interviewed the appropriate officials and reviewed the following documents:

[4] The ECGP had estimated outlays of $3.4 billion, due to the lack of defaults or payments for loss claims, there were none.
[5] Sample of 4 programs with estimated outlays totaling $10,654.8 million from a universe of 26 programs with estimated outlays totaling $22,526.1 million, or 47 percent of the universe.

- the IPIA, OMB guidance, and OCFO directives,
- regulations, program procedures, handbooks, and FSA fact sheets,
- prior Government Accountability Office and OIG audit reports,
- FY 2005 budget summaries, and
- agency risk assessments.

FINDINGS AND RECOMMENDATIONS

FSA Did Not Collect and Analyze Sufficient Information To Determine the Extent of Improper Payments

FMD officials did not properly determine the extent of improper payments to justify the programs' risk categorizations reported to OCFO. Specifically, the agency's FMD did not consider the results of compliance reviews, audits, and the FSA County Operations Review Program (CORP) when determining the programs' risk for improper payments. In addition, FSA's test of transactions was not always fully documented, conclusions were not always reached, and samples were not always representative of the universe being tested. Controls were not in place to provide reasonable assurance that the risk assessment process adhered to OCFO's guidance regarding follow up on prior reviews or tests of transactions. FMD concluded the programs' risk based on inadequate tests of transactions and management's personal knowledge and experience with the particular programs instead of considering program vulnerabilities disclosed by audits and compliance reviews. As a result, FSA is not in compliance with the IPIA or the OCFO guidance and the reported programs' risk categories for improper payments may not be correct.

The IPIA requires the head of each agency to annually review all programs it administers and identify those that may be susceptible to significant improper payments. It further states that any payment made to an ineligible recipient is an improper payment. Therefore, an adequate test of transactions should include verification of participant eligibility. According to OCFO guidance,[6] agencies must test a judgmentally selected sample of transactions "to determine the effectiveness of program design and internal controls in the prevention of improper payments." This guidance further states that "the sample should be sufficiently large to support the agency's assertion that internal controls are working."

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[6] USDA FY 2005 Tests of Transactions Guidance, dated December 8, 2004.

Direct Payments and Counter-Cyclical Payments Programs

In their attempt to determine the extent of DP and CCP improper payments, FMD officials did not conduct adequate tests of transactions and did not consider the results of FSA compliance reviews.

The tests of transactions were inadequate due to many reasons. FMD officials did not identify the universe for each program and select a sample that was autonomous. Instead, they considered the payments from both programs as one universe and selected a sample of those transactions to evaluate controls for both the DP and CCP programs. The sample only included 22 payments from 2 States (Connecticut and Maine) from a universe of over 13.7 million payments nationally. FMD officials did not provide documentation of their sample selection process. According to the documented results of the test of transactions, FMD could not confirm that 8 of the 22 payments (36 percent) were correct. In addition, we found that six of the eight payments were shown as "undetermined" and no further analyses or followup ensued. For the 14 payments confirmed as correct, FMD officials did not verify eligibility beyond ensuring that eligibility forms were present and completed; they did not verify that the information included on the forms was accurate. FMD's test of transactions consisted solely of recalculating payments based on the forms received from the FSA field offices. The purpose of the tests of transactions in the risk assessment process, in part, is to evaluate the adequacy of the design of the control structure and its functionality. If the tests are not adequately performed, no assurances can be garnered.

FMD officials reported in the risk assessment that audits and CORP assessments of DP and CCP revealed weaknesses that would have supported a high risk ranking. The CCP risk assessment, for example, stated that, "It appears that the controls are established and in place but can be manipulated by collusion of producers and/or county office personnel as documented in the audit reports." However, based on their test of transactions, they decided to rank the programs as low risk. In reconciling the difference, the FMD official responsible for the risk assessments ranked these programs as a low risk for improper payments because of his personal knowledge and experience. He stated that he is in contact with State offices, the programs have been operating for several years, and he was not aware of any trends to suggest that improper payments were increasing in the programs. Although management's experience and knowledge can also be useful, OCFO guidance provides that the determination of a program's risk to improper payments should be based on a formal assessment of the vulnerabilities and internal controls that exist to mitigate those vulnerabilities. Furthermore, the effectiveness of the controls should be confirmed by tests of transactions.

Conservation Reserve and Crop Disaster Programs

FMD officials did not obtain and analyze sufficient information to determine that CRP and CDP improper payments were occurring. Specifically, FMD's tests of transactions were inadequate and the compliance review results were not considered.

FMD's tests of transactions for CRP were insufficient to evaluate controls intended to deter improper payments. The test included a sample of 25 payments from a universe of 25,859. FMD did not provide any documentation of the sample selection process, the results of the analyses performed, or the conclusions reached. FMD officials did not verify eligibility beyond ensuring that eligibility forms were present and completed. Instead of verifying that the information included on the forms was accurate, FMD's test of transactions process consisted solely of recalculating the payments based on the forms received from the field offices.

Similarly, the test of transactions for CDP was not sufficient to evaluate controls intended to deter improper payments. The process was limited to a recalculation of the payments that were selected. The test included a sample of 25 payments from a universe of 91,322. FMD officials could locate documentation for only 14 of the 25 sampled CDP payments; they were unable to explain why documentation for the remaining 11 payments (44 percent) was unavailable. FMD did not provide details of the sample selection process, the results of the analyses, or the conclusions reached.

FMD officials reported in the CRP risk assessment that an audit and County Office Review (COR) disclosed findings that could have resulted in erroneous payments. Specifically, FSA referred to the 2004 audit of the CCC financial statements performed by KPMG LLP. According to this risk assessment, "KPMG LLP noted that County Offices are not in compliance with policies and procedures as they related to processing of producer payments and, as a result, program payments made to some producers are incorrect and some producer program files contain incomplete documentation. KPMG LLP noted the cause of the findings were attributed procedural noncompliance (sic) to oversight, poor documentation practices, workloads, and misplaced documentation." The risk assessment also referred to the 2004 COR stating, "The COR found that local offices were continuing to make the same procedural errors that were discovered in previous year audits." Further it noted that "26 to 41 percent of the county offices did not follow written procedures in handling CRP applications." Nonetheless, the ranking of low was based on one official's personal knowledge and experience.

Compliance and Internal Reviews

FSA's national, State, and county offices perform numerous compliance and internal control reviews of their many different programs. However, officials still have not begun to incorporate the results of these reviews as an integral part of the risk assessment process to determine the extent of improper payments. This is the third audit in which we reported this problem. Our most recently completed audit[7] disclosed that FSA conducts many compliance reviews in each of their programs; however, officials did not collect and analyze the results at the National level in order to determine whether improper payments exist. In response to this audit, FSA officials stated that they will initiate corrective actions.

We discussed these findings with FMD officials and they generally concurred with our conclusions. The officials agreed that better support for conclusions in the risk assessments is needed and that the agency needs to utilize the results of FSA's compliance reviews to identify improper payments. The officials recognized the inadequacy of the tests of transactions for the programs selected and stated that improvement is needed for the FY 2006 program risk assessments.

At the exit discussion, FSA officials stated that the four programs we reviewed were among those that had initially been determined to be at "medium" risk to improper payments; but, they had been instructed by OCFO that risk to programs could only be categorized as high or low. FSA officials stated that they then used their program knowledge and experience, together with the tests of transactions, to offset the results of audits and CORP assessments and to determine that the four programs discussed in the report were at low risk. However, as discussed previously, FSA's tests of transactions, as performed, were not adequate to support this conclusion. In addition, FSA's Controller stated that the IPIA was an unfunded mandate and that compliance with OCFO' guidance was difficult because FSA had experienced staff cuts recently and did not have staff that could be dedicated to the risk assessment process.

SUMMARY

Based on our evaluation of the risk assessments and the available supporting documentation, we concluded that FMD officials had not collected and analyzed sufficient information or performed adequate tests of transactions for the four programs reviewed. Accordingly, the officials were unable to determine whether the internal control measures established for the programs were effective in deterring improper payments and therefore could not support the ranking of the programs as being of low risk for improper payments. Additionally, the FSA official responsible for preparing these risk assessments stated that the conclusions were based on his personal knowledge

[7] Farm Service Agency Compliance Activities, Report No. 03601-12-Ch, dated September 2005.

and experience (together with tests of transactions that we found deficient) which is not compliant with OCFO's guidance or otherwise acceptable.

Recommendation 1

Develop and implement procedures for tests of transactions to ensure the agency obtains and analyzes sufficient information to conclude as to the adequacy of internal controls to deter improper payments.

Agency Response

FSA officials generally agreed with the recommendation. The officials stated that FSA would develop a standard operating procedure creating the criteria for reviewing program transactions and determining key pass/fail requirements that if failed, would result in an improper payment by January 2006. Additionally, FSA officials stated they would develop a revised process for selecting transactions and a standard for maintaining documentation to support the evaluation of the transactions.

OIG Position

To reach management decision, FSA officials need to provide details of the development and implementation of the standard operating procedure, revised sample selection process, and standard for maintaining supporting documentation, to include timeframes for implementation.

Recommendation 2

Strengthen controls over the risk assessment process to, at a minimum, provide for adequate staffing and oversight to ensure that OCFO's guidance is met.

Agency Response

FSA officials generally agreed with the recommendation. The officials stated that a team has been formed, as of November 30, 2005, to accomplish the IPIA risk assessments for FY 2006. FSA officials also stated they would develop a project plan to accomplish the risk assessments and tests of transactions and to provide target completion dates. Officials stated that all risk assessments would be documented and peer reviewed and also reviewed by senior (Financial Management Division) management prior to submission to OCFO.

OIG Position

To reach management decision, FSA officials need to provide details about the team and the plan that is being developed to accomplish the risk assessments. In addition, please provide details regarding how and by whom peer reviews and senior management reviews would be performed. FSA officials need to provide the timeframe for implementation of the plan and reviews and confirm whether the plan, in conjunction with the review, will address all foreseeable future risk assessments or only the FY 2006 assessments.

We appreciate the courtesies and cooperation extended to our staff during this review.

USDA

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United States Department of Agriculture

Farm and Foreign Agricultural Services

Farm Service Agency

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Washington, DC 20250-0581

TO: T. Michael McCann
Director, Operations Review and Analysis Staff
Office of Business and Program Integration

FROM: John W. Williams
Deputy Administrator for Management
Farm Service Agency

SUBJECT: The Office of the Inspector General's (OIG) Draft Audit Report of the Farm Service Agency's (FSA) Progress To Implement the Improper Payments Information Act (IPIA) of 2002 (03601-0013-Ch)

This memorandum is in response to the November 22, 2005, subject draft report sent through your office on December 2, 2005.

OIG's Recommendations:

1. **Develop and implement procedures for tests of transactions to ensure the agency obtains and analyzes sufficient information to conclude as to the adequacy of internal controls to deter improper payments.**

2. **Strengthen controls over the risk assessment process to, at a minimum, provide for adequate staffing and oversight to ensure that the Office of the Chief Financial Officer's (OCFO) guidance is met.**

FMD Response:

The audit disclosed that FSA did not sufficiently test a sample of transactions to determine the extent of improper payments, nor did FSA collect and analyze adequate supporting documentation of the samples selected. The audit concluded that because of the lack of quality testing FSA could not sufficiently determine if the internal controls established to prevent erroneous payments for the programs were operating effectively.

The proposed corrective actions to respond to these recommendations are as follows:

1. To resolve the findings in Recommendation 1 FSA will take the following actions by January 2006:

   a. FSA will develop a standard operating procedure (SOP) for developing the criteria for reviewing program transactions and determining key pass/fail requirements that if failed would result in an improper payment. This SOP will serve as the basis for the development of each programs evaluation criteria and documentation.

b. FSA will develop a process for selecting transactions that will allow for a more random identification of the transactions and better distribution across the universe of payments.

c. FSA will develop a standard for maintaining the documentation to support the evaluation of the transactions.

2. To resolve the findings in Recommendation 2 FSA has taken or will take the following actions:

   a. Establish a team to accomplish the IPIA risk assessments for fiscal year (FY) 2006. This team was formed on November 30, 2005. Additional staff has been added to the project plan, so the workload will be spread out more to conduct quality assessments and adequate tests of transactions.

   b. Develop a project plan that will accomplish the 10 risk assessments and 9 tests of transactions for the selected programs. The project plan will provide target completion dates to include and align with OCFO's delivery schedule. OCFO's approval for the project plan has a target completion date of December 20, 2005.

   c. All risk assessments will be documented and peer reviewed. All assessments will be reviewed by senior Financial Management Division (FMD) management prior to the final submission to OCFO. Completion target dates for submission will be based upon the approved project plan.

   d. OCFO's plan has specified that FSA should complete the risk assessments and testing of transactions by the June 2006 due date.

FMD anticipates that with the completion of the above tasks, the FY 2006 IPIA risk assessment project will provide a more complete and improved documented evaluation in which the conclusions are standardized, fully supported, and tied to the test results, thus satisfying the concerns noted in the audit.

If there are any questions or concerns regarding this memorandum, please contact FMD's Audit Liaison, Elizabeth Russell, at 703-305-1273.

Informational copies of this report have been distributed to:

Administrator, Farm Service Agency	
Through: Director, Operations Review and Analysis Staff	10
U.S. Government Accountability Office	1
Office of the Chief Financial Officer	
Director, Planning and Accountability Division	1
Office of Management and Budget	1