U.S. Department of Agriculture

Office of Inspector General
Southwest Region

Audit Report

Farm Service Agency Compliance with the Improper Payments Information Act of 2002

Report No. 03601-46-Te
March 2005

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

WASHINGTON, D.C. 20250

DATE: March 21, 2005

REPLY TO
ATTN. OF: 03601-46-Te

SUBJECT: Farm Service Agency Compliance with the Improper Payments Information Act of 2002

TO: James R. Little
Administrator
Farm Service Agency

THROUGH: T. Mike McCann
Director
Operations Review and Analysis Staff
Farm Service Agency

This report presents the results of our audit of the Farm Service Agency's (FSA) compliance with the Improper Payments Information Act (IPIA) of 2002,[1] and the requirements and implementing guidance issued by the Office of Management and Budget (OMB) and the Office of the Chief Financial Officer (OCFO). The audit was conducted as part of a Department-wide audit of the U.S. Department of Agriculture's implementation of the IPIA. Our audit disclosed that although FSA generally complied with OCFO's guidance, the process could be improved. The primary cause of the weaknesses was the need to strengthen the OCFO instructions, which we are pursuing in a separate report to the Department.

BACKGROUND

The IPIA 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. OMB issued guidance for implementing the IPIA on May 21, 2003. This guidance required each agency to report the results of its estimates for improper payments, and corrective actions, in the Management Discussion and Analysis section of U.S. Department of Agriculture's Performance and Accountability Report for fiscal years (FY) ending on or after September 30, 2004. OMB also defined a threshold for significant improper payments[2] and specified that if programs or activities exceeded this threshold, agencies must develop a statistically valid estimate to report to Congress. Finally, OMB required agencies to submit their implementation plans by November 30, 2003.

[1] Public Law 107-300, dated November 26, 2002.
[2] OMB defined significant improper payments as annual erroneous payments exceeding both 2.5 percent of program payments and $10 million. (See OMB Memorandum M-03-13, dated May 21, 2003.)

The OCFO, designated as the lead agency for coordinating and reporting the Department's efforts to implement the IPIA, provided instructions to agencies in August and October 2003. The August memorandum transmitted Departmental policy and instructions for implementing program reviews to identify erroneous payments. The instructions included the detailed guidance from OMB regarding implementation and requirements for the IPIA.[3] The guidance from OMB provided that agencies examine the risk of erroneous payments in all programs and activities they administer. In a memorandum dated October 9, 2003, OCFO provided additional guidance to FSA on implementing the requirements of the IPIA and requested that all agencies provide an IPIA implementation status report.[4] The memorandum required that all programs with outlays of $10 million or more annually must undergo a risk assessment to determine if there is significant risk of erroneous payments. The memorandum also requested: (1) a chart detailing dates for risk assessments that have been completed, (2) planned dates for completion of remediation plans for programs with significant erroneous payments, and (3) planned dates when the agency will have determined its baseline plus improvement targets for the next 3 fiscal years.

FSA reported 35 programs with outlays of $35.8 billion for FY 2004 that met OCFO's threshold for performing risk assessments. These programs included the Farm Loan Program, Conservation Reserve Program, Price Support, Loan Deficiency Program, and Milk Income Loss Contract Program. FSA concluded that none of its programs to be of high risk to significant improper payments.

OBJECTIVE

The objective of the audit was to evaluate the actions taken by FSA to assess the susceptibility of its programs to improper payments in accordance with the IPIA and the implementing guidance of OMB and OCFO.

SCOPE AND METHODOLOGY

We performed our audit at the FSA National Office in Alexandria, Virginia. We conducted our audit from August through September 2004.

We selected the first 19 of 35 FSA program risk assessments. The assessments were reviewed in the order provided by FSA.

To accomplish our audit objective, we reviewed:

- Risk assessments and methodologies used;
- The IPIA, OMB requirements and guidance, and OCFO directives;
- FYs 2003 and 2004 budget estimates;
- Prior Government Accountability Office (GAO) and Office of Inspector General (OIG) reports;

[3] OCFO Guidance, Requirements for Implementing IPIA, dated August 11, 2003.
[4] OCFO Guidance, Update on Requirements for Implementing the IPIA, Public Law 107-300, dated October 9, 2003.

- GAO's Internal Control Management and Evaluation Tool;
- FY 2002 Performance and Accountability Report and the FY 2004 Annual Performance Plan; and
- Federal Managers Financial Integrity Act (FMFIA) reports for 2001, 2002, and 2003.

We also conducted interviews with FSA officials from the Financial Management Division (FMD). These officials were charged with the responsibility coordinating and directing the performance of program risk assessments in FSA to determine the controls and procedures used to estimate improper payments. Furthermore, we attended meetings with the agency's staff to gain knowledge of their process for conducting risk assessments.

The audit was performed in accordance with Government Auditing Standards.

FINDING AND RECOMMENDATION

FSA Needs to Improve Its Program Assessments

We found that, although FSA generally complied with OCFO's guidance, improvements could have been made in its risk assessment process. The primary cause was deficiencies in OCFO's direction, which we have sought to rectify via recommendations in a separate report to the Department. As a result, the risk assessments that were performed may not accurately reflect FSA programs' susceptibility to improper payments.

According to OCFO's monetary guidelines, FSA was to assess 35 of its programs for susceptibility to improper payments because the budgeted outlays were greater than $10 million. These 35 programs' budgeted outlays totaled $35.8 billion. The 19 programs we reviewed totaled $17.991 billion. (See exhibit A.) Based on our review of 19 of the 35 assessments, we determined that FSA program managers/team leaders used sample improper payment indicators (of risk) provided by OCFO and supplemented these with 22 additional risk indicators generic to FSA programs. However, they had not always identified risk indicators unique to each program. Because of this, the results of the 19 risk assessments, all of which showed the programs to be at low risk for improper payments, may not be complete.

Each FSA program is unique and was created by specific regulations contained within different Farm Bills or other Federal legislation to meet various needs in rural America. Even though making payments is among each FSA program's goals, in our opinion the risk environments in which these payments are made are different. For example, price support loans are different from FSA salaries and expenses, and these are different from the Milk Income Loss Contract Program. However, for the 19 program assessments we reviewed, FSA program managers used the same generic risk factors, even though the factors may not have applied to the particular program under review.

Program managers were provided with a suggested format based on a template provided by OCFO to use in establishing risk factors. OCFO's suggested format consisted of five categories (internal control, documentation, potential fraud, financial, and programmatic) with multiple generic risk factors under each category. Agencies were then to develop risk factors specific to the programs being assessed.

The Director of FMD added additional columns requiring program managers to explain their rationale for risk ranking and to substantiate their rationale. The Director of FMD said these additional columns would ensure that supporting documentation would be readily available.

In a letter dated November 23, 2004, the Director of FMD stated that OCFO provided a format containing columns to rank risk factors as high, medium, and low, and that FSA added a column so an explanation of the mitigating factors and the related source document references could be recorded. This additional column required program managers to explain their rationale for the risk ranking and to ensure that supporting documentation would be readily available for examination. In the Interest Expenditures Program, we found that one risk factor was ranked as high risk. It was listed under the programmatic category as "recipient has outstanding debt." The program manager explained the rationale for this ranking by recording "**Read the Newspapers**" in the extra column.

FMD senior management told OIG that they provided the team leaders and program managers with a template to use in establishing risk factors. FMD's template had the five categories provided by OCFO with the multiple generic risk factors under each category. (See exhibit A.) Several blank lines were added after the generic risk factors. FMD stated that it assumed the team leaders/program managers would add risk factors specific to their programs. FSA officials subsequently noted that we did not interview any of the team leaders assigned by the agency to coordinate the risk assessment process. Our primary source of information pertaining to the agency's activities, however, was the Deputy Chief Financial Officer who purported to have responsibility over this area.

We found that although some additional risk factors had been added, it was not done so extensively. For example, under the category "documentation," the template had 5 generic risk factors, yet only 3 of the 19 programs we reviewed (Non-Insured Assistance Program, Livestock Assistance Program, and Interest Expenditures) had added 1 additional risk factor. For the category of "finance," 1 program failed to have this section, and only 9 of 19 programs added 1 or 2 additional generic risk factors. Under the category of "internal control," 3 of 19 programs added 1 additional generic risk factor. Under "potential fraud," 10 of 19 programs added 1 additional generic risk factor. Finally, for the category of "programmatic," 1 of 19 programs added 7 risk factors, and 1 program deleted 4 risk factors. (See exhibit A.)

In FMD's letter, dated November 23, 2004, it stated that it had added and/or revised the following risk factors applied by OCFO:

- Internal Controls – added 8, revised 3
- Documentation – none
- Potential Fraud – added 2, revised 1
- Programmatic – added 3, revised 2
- Financial – added 1 new risk factor and revised 2 risk factors from other categories.

Also, in the same November 23, 2004, letter, the Director of FMD agreed the agency used generic risk factors in order to review programs in a uniform manner. However, this approach does not provide an acceptable process of measuring the risks unique to individual programs.

During an interview with FMD senior managers charged with leading the risk assessment process, they stated program managers did not use qualitative and quantitative ranking factors, management conferences, forecasting and strategic planning, and consideration of findings from audits and other assessments to determine their programs' level of risk. Instead, they said the program managers used their personal judgment.

Further, FMD advised program managers to provide a "not applicable" (N/A) response and state the reason why the risk factor did not apply. Our review of the Milk Income Loss Contract Program showed that one program manager followed the guidance provided by FMD. When the program manager used an N/A response, the manager also gave a reason why. Although this one program manager followed the guidance provided by the Director of FMD, the majority of the program managers did not. Contrary to FMD guidance, the information shown below illustrates a partial list of risk factors (within a category) where no reason for an N/A determination was given.

Interest Expenditures Program:

1. Internal Control - 9 of 15 risk factors
2. Documentation - 5 of 6 risk factors
3. Potential Fraud - 5 of 8 risk factors
4. Programmatic - 6 of the 11 risk factors
5. Financial - 26 of 31 risk factors

Farm Loan Program:

1. Potential Fraud - 3 of 7 factors
2. Programmatic - 1 of 7 risk factors
3. Financial - 21 of 31 risk factors

Purchases – Export:

1. Internal Controls - 1 of 15 risk factors
2. Documentation - 1 of 5 risk factors
3. Potential Fraud - 2 of 8 risk factors
4. Programmatic - 1 of 7 risk factors

In addition, in developing risk factors for improper payments, program managers did not take into account previous OIG and GAO audits and their own internal reviews. For example, a recent OIG audit,[5] reported that an FSA County Service Center was not aware of changes in the applicable FSA handbook, resulting in improper payments of approximately $1.4 million. Instead of incorporating this documented problem as a risk factor, the program manager responsible for the risk assessment used only the generic risk factors. We noted other similar

[5] Audit Report No. 03099-166-At, Peanut Quota Buyout Program, issued August 2003.

cases in which program managers did not address previously identified risks in their risk assessments. In fact, the Director of FMD wrote on November 23, 2004, that program managers did not tailor risk factors to fit their programs' special needs.

The risk assessment process that FSA employed also needed to be improved because the support provided in the assessments to justify the risk rating was not always a description of internal controls designed to mitigate risk, but rather a statement of the operational procedure in place to implement the program requirements. In only selected instances did operational procedures include internal controls, describing how erroneous payments may be mitigated. Because of the manner in which programs were assessed, there is reduced assurance that the susceptibility to improper payments was identified and the requirements of the IPIA met.

Agencies have been required for over 20 years to assess the internal controls in their programs and financial management activities pursuant to the FMFIA of 1982 and other legislative and administrative initiatives. The FMFIA requires ongoing evaluations of the adequacy of the systems of internal accounting and administrative control of each agency and requires the head of each agency to issue an annual report that discloses material weaknesses identified through the assessment process and the actions planned to correct those weaknesses. With this knowledge and experience, FSA should be able to effectively assess its programs and activities for improper payments, determine those that are susceptible to significant improper payments, and meet the IPIA reporting requirements.

As noted, FSA made a good faith effort to adhere to OCFO's guidance and complied to a much greater degree that the other five agencies we assessed. Nonetheless, in order to provide the insights needed to evaluate a program's susceptibility to improper payments, FSA needed to conduct a risk assessment employing methodologies such as:

- Identification of program risk factors,
- Identification of the control measures prescribed to mitigate those risks and an evaluation as to their adequacy, and
- Tests of transactions to ensure the controls are functioning as prescribed; the results of this examination would yield the estimated degree of noncompliance.

As a result of our evaluation of the implementation of the OCFO guidance by FSA and the other agencies included within our overall scope, we concluded that the requirements and instructions issued by the Department need to be made more prescriptive, detailed, and clarified. We have made a recommendation to that effect to OCFO in our rollup report to the Department.

RECOMMENDATION

Conduct more thorough risk assessments of all programs with outlays of $10 million or more by: developing criteria to identify program vulnerabilities, determining acceptable risk levels, ranking the risk factors, evaluating the design and the functionality of the internal controls in place to mitigate improper payments, and establishing controls to ensure the timely and accurate completion of the assessments.

FSA RESPONSE

FMD concurred with the recommendation in their response, dated February 15, 2005 (see exhibit B). FSA agreed to modify assessment worksheets to incorporate steps to conduct research regarding a specific program for previously identified weaknesses or potential risks, specifically addressed in audit or review reports, and to meet the new approach required by the OCFO for FY 2005. FMD also agreed that improvements can be made to the risk assessment process and will incorporate enhancements according to guidance from OCFO. Through follow up correspondence on February 24, 2005, the agency stated that the modifications to the risk assessment worksheets would be completed by March 31, 2005.

OIG POSITION

We concur with the management decision. To achieve final action, FSA needs to comply with the effective OCFO guidance and complete corrective action in accordance with the specified timeframes.

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

/s/ R. W. Young
ROBERT W. YOUNG
Assistant Inspector General
for Audit

Exhibit A *– Programs Reviewed by OIG Showing the Number of Risk Factors Under Each Category*

PROGRAM	CATEGORIES OF RISK FACTORS				
	Finance	**Internal Control**	**Documentation**	**Potential Fraud**	**Programmatic**
Purchases - Export	**Missing**	15	5	**8** (+1)	11
MILC (1)	31	15	5	7	11
FLP (2)	31	15	5	7	**7** (-4)
Emerging Markets	31	15	5	7	11
NAP (3)	**33** (+2)	15	**6** (+1)	**8** (+1)	**18** (+7)
Sugar Cane Hurricane	**33** (+2)	15	5	7	11
CRP (4)	31	15	5	7	11
ECP (5)	31	15	5	7	11
Transportation	**32** (+1)	15	5	**8** (+1)	11
Sugar Beet Disaster	**33** (+2)	**16** (+1)	5	**8** (+1)	11
LAP (6)	**33** (+2)	**16** (+1)	**6** (+1)	**8** (+1)	11
Purchases - Milk	**32** (+1)	15	5	**8** (+1)	11
Bioenergy	**32** (+1)	**16** (+1)	5	**8** (+1)	11
Cotton Marketing	31	15	5	7	11
Processing	**32** (+1)	15	5	**8** (+1)	11
Storage - Processed Commodities	**32** (+1)	15	5	**8** (+1)	11
Price Support Loans	31	15	5	7	11
LDP (7)	31	15	5	7	11
Interest Expenditures	31	15	**6** (+1)	**8** (+1)	11

Note:
The column headings represent the five categories FMD provided the FSA team leaders and program managers.
The numbers under each category represent the number of generic risk factors FMD supplied for the applicable FSA program.
The numbers in “( )” represent the number of generic risk factors dropped or program-specific risk factors added by FSA team leaders and program managers.

(1) Milk Income Loss Contract Program
(2) Farm Loan Program
(3) Non-Insured Assistance Program
(4) Conservation Reserve Program
(5) Emergency Conservation Program
(6) Livestock Assistance Program
(7) Loan Deficiency Program

USDA

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FEB 15 2005

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

FROM: for Kristine M. Chadwick
Director, Financial Management Division

SUBJECT: The Office of the Inspector General's (OIG) Audit of the Farm Service Agency's (FSA) Compliance with the Improper Payments Information Act of 2002 (03601-0046-Te)

This memorandum is in response to the undated subject draft report sent through your office on January 24, 2005.

OIG's Recommendation: Conduct more thorough risk assessments of all programs with outlays of $10 million or more by: developing criteria to identify program vulnerabilities, determining acceptable risk levels, ranking the risk factors, evaluating the design and the functionality of the internal controls in place to mitigate improper payments, and establishing controls to ensure the timely and accurate completion of the assessments.

FMD Response: The Financial Management Division (FMD) does not agree with some of the content contained in the report, but does concur with the recommendation. FSA is modifying the assessment worksheets to incorporate steps to conduct research regarding a specific program for previously identified weaknesses or potential risks, specifically addressed in audit or review reports, and to meet the new approach required by the Office of the Chief Financial Officer (OCFO) for Fiscal Year 2005. FMD also agrees improvements can be made to the risk assessment process and is incorporating enhancements according to guidance from OCFO.

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