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Office of Inspector General
Southwest Region

Audit Report

Farm Service Agency
Nonrecourse Marketing Assistance
Farm-Stored Loans

Audit Report 03601-47-Te
September 2006

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

September 13, 2006

REPLY TO
ATTN OF: 03601-47-Te

TO: Teresa C. Lasseter
Administrator
Farm Service Agency

ATTN: T. Mike McCann
Director
Operations Review and Analysis Staff

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

SUBJECT: Farm Service Agency Nonrecourse Marketing Assistance Farm-Stored Loans

This report presents the results of the subject audit. Your response to the official draft report, dated August 4, 2006, is included in its entirety as exhibit E with excerpts and the Office of Inspector General's (OIG) position incorporated into the Findings and Recommendations section of the report. Your response contained sufficient justification to reach management decisions on Recommendations 1, 5, 6, 8, 9, 10, 12, and 15. Please follow Departmental and your internal agency procedures in forwarding final-action correspondence to the Director, Planning and Accountability Division, Office of the Chief Financial Officer.

Based on the response, management decisions have not been reached for Recommendations 2, 3, 4, 7, 11, 13, 14, and 16. The information needed to reach management decisions is set forth in the OIG Position section after 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 for those recommendations for which a management decision has not yet been reached. Please note that the regulation requires a management decision be reached for all recommendations within a maximum of 6 months from the date of report issuance. Final action on the management decisions should be completed within 1 year of the date of the management decisions to preclude being listed in the Department's annual Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during the audit.

Executive Summary

Farm Service Agency Nonrecourse Marketing Assistance Farm-Stored Loans (Audit Report 03601-47-Te)

Results in Brief

Administered by the Commodity Credit Corporation (CCC) and operated by the Farm Service Agency (FSA), marketing assistance loans help farmers store their crops at harvest when prices are low and then sell them later at more advantageous prices. The Office of Inspector General (OIG) initiated this audit to determine if FSA had adequate controls over nonrecourse[1] marketing assistance loans that are stored on producers' farms. Because FSA anticipated disruptions in the transportation of commodities to Gulf Coast ports in the wake of Hurricanes Katrina and Rita, the agency authorized producers to store crops used as collateral for marketing assistance loans on-ground.[2] OIG included a review of FSA's controls for ensuring the value of collateral stored on-ground in this audit.

The 7 States included in our review had 11,685 outstanding nonrecourse marketing assistance loans for crop year 2005. We reviewed 121 loans, or nearly $17.8 million of the $554 million in total loans.[3] Our sample included 22 nonrecourse marketing assistance loans with collateral stored on-ground. Based on our review of this sample of 121 loans, we concluded that FSA's controls over these loans were, generally speaking, adequate, but that the agency could nonetheless improve its controls over how it secures this collateral.

We identified two problems. First, FSA's procedures were not always clear enough to ensure that county offices handled marketing assistance loans correctly and consistently. Second, even when procedures were clear, county offices did not always comply with them. We identified $2.2 million in questionable costs that resulted from these two problems (see exhibit A).

<u>FSA Should Clarify its Procedures for Farm-Stored Marketing Assistance Loans</u>

Due to ambiguities in FSA's procedures for administering marketing assistance loans, we found that county offices did not always handle these loans consistently and correctly. When low-quality, high-moisture crops are used as collateral for marketing assistance loans, FSA requires that the value of the collateral be reduced accordingly; however, because the handbooks establishing these guidelines were confusing and, in places, contradictory,

[1] Nonrecourse loans are those for which the producer may deliver the pledged collateral to CCC as full payment of the loan at maturity. Recourse loans must be repaid by cash, including principal and charges plus interest.
[2] Notice LP-2002, "CCC Authorizes On-Ground Farm Storage for Marketing Assistance Loans and Loan Deficiency Payments for Crop Years 2005 and 2006," dated September 8, 2005.
[3] Arizona, Arkansas, Illinois, Indiana, Iowa, Kansas, and Montana.

two of the seven States reviewed did not apply them correctly. This occurred because FSA allowed State committees to establish their own maximum acceptable moisture levels for commodities, but did not monitor the State-established levels to ensure that they were consistent and reasonable. As a result, these 2 States overstated the value of collateral for 16 loans by nearly $1.6 million. Furthermore, the widely varying maximum acceptable moisture levels set by State offices nationwide may result in the inequitable treatment of producers.

Since FSA's procedures allow county committees the discretion to determine if they will use commodity loan seals (a document used to identify bins of commodities as collateral for loans), we found that county offices did not use these seals consistently—3 of 16 counties did not use them at all. To ensure consistency, we concluded that FSA should either prescribe that seals be used for all marketing assistance loans, or specify under what circumstances they should be used.

<u>FSA County Offices Did Not Always Comply with FSA's Procedures for Issuing and Administering Farm-Stored Loans</u>

When issuing and administering farm-stored marketing assistance loans, county offices did not always comply with FSA's procedures. Of 16 county offices, 7 did not always perform required spot checks of commodities used as collateral to secure loans. While the availability of sufficient personnel was a problem in four county offices, we found that three county offices had not implemented the spot-check control as written. Since the marketing assistance loan program allows producers to self-certify their collateral, FSA lacks assurance that collateral is sufficient if these spot checks are not performed.

Of 16 county offices, we also found that 10 did not complete required loan documents when processing applications for marketing assistance loans. This occurred because the second-party review process FSA has established to review these applications is not designed to detect these errors; moreover, we found that 14 of 16 county offices did not perform these second-party reviews at all. Without completing required spot checks, loan documents, and second-party reviews, FSA lacks assurance that marketing assistance loans are being processed in compliance with all applicable laws, regulations, and procedures.

Finally, we noted that the Pinal County FSA Office in Arizona made a number of errors when administering marketing assistance loans to a cooperative marketing association, including mistakenly issuing premiums for collateral, issuing loans for collateral stored in an ineligible structure, and failing to provide the cooperative marketing association with critical loan documentation. Because county and State officials were unfamiliar with

FSA's procedures concerning cooperative marketing associations, the Pinal County Office issued $603,431 in questionable loans[4] to this cooperative marketing association.

We concluded that, by clarifying its procedures and ensuring that its county offices comply with those procedures, FSA can improve its controls over the marketing assistance loan program and obtain greater assurance that sufficient collateral exists to secure these loans.

Our audit also was conducted in conjunction with the President's Council on Integrity and Efficiency as part of its examination of relief efforts provided by the Federal Government in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report has been forwarded to the President's Council on Integrity and Efficiency, Homeland Security Working Group, which is coordinating Inspectors' General reviews of this important subject.

Recommendations In Brief

FSA should clarify its procedures for reducing the value of low-quality, high-moisture commodities used as collateral for marketing assistance loans, as well as its procedures specifying when county offices should use commodity loan seals. FSA needs to determine those States which had a policy of not reducing the loan values due to low-quality, high-moisture commodities and to instruct those States to determine the potentially overstated value of the collateral and to take appropriate corrective actions.

FSA should take steps to strengthen its system for performing spot checks of loan collateral, and for completing and reviewing marketing assistance loan documents.

Finally, FSA should provide training to the Arizona State and county offices regarding the marketing assistance farm-stored loan program.

Agency Response

In a letter dated August 4, 2006, FSA generally concurred with the findings and recommendations and provided proposed corrective actions. FSA's written response is included as exhibit E of the report.

OIG Position

We generally concur with FSA's response and accept the management decisions for 8 of 16 recommendations. We have explained in the Findings and Recommendations section of the report the actions FSA needs to take for acceptance of management decisions on the remaining recommendations.

[4] $120,425 + $483,006 = $603,431.

Abbreviations Used in This Report

CCC	Commodity Credit Corporation
FSA	Farm Service Agency
OIG	Office of Inspector General
OCFO/PAD	Office of the Chief Financial Officer, Director, Planning and Accountability Division
USDA	U.S. Department of Agriculture

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Background and Objective

Background

Administered by the Commodity Credit Corporation (CCC) and operated by the Farm Service Agency (FSA), marketing assistance loans provide interim financing to meet producers' needs so that they are not obliged to sell their commodities when market prices are low. Allowing producers to store crops at harvest also facilitates the orderly marketing of commodities throughout the year. FSA issues two types of marketing assistance loans—those secured with collateral stored in warehouses and those secured with collateral stored on producers' farms.

To qualify for a farm-stored loan, growers must produce an eligible commodity[5] and meet certain requirements.[6] They must comply with conservation and wetland protection requirements, report how they use their cropland acreage on the farm, have beneficial interest in the commodity at the time of the loan and retain that beneficial interest throughout the loan period, and ensure that the commodities meet CCC minimum-grade and quality standards.

Recourse and Nonrecourse Loans

Marketing assistance loans are described as "nonrecourse" because the commodity is pledged as collateral, and producers may deliver the pledged collateral to CCC as full payment of the loan at maturity. If the commodity is not eligible for a nonrecourse loan, then producers may receive recourse loans for which loan collateral cannot be forfeited as payment of the loan at maturity. Recourse loans must be repaid by cash, including principal and charges plus interest.

Low-Quality, High-Moisture Commodities

Throughout the life of a marketing assistance loan, producers are required to maintain certain quality standards for commodities pledged as collateral. These standards are established by the Grain Inspection Packers and Stockyards Administration and published in FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1).[7] For each eligible commodity, FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1), establishes standard weight measured in pounds per bushel, and moisture standards in percent of moisture. Commodities found to have moisture in excess of this standard are considered low quality and classified as containing excess moisture. High-moisture commodities must have a shrink factor applied to adjust their

[5] FSA *Handbook* 8-LP (Revision 1), "Marketing Assistance Loans and Loan Deficiency Payments for 2002 and Subsequent Crop Years," as amended, states barley, corn, grain sorghum, oats, canola, peanuts, soybeans, oilseeds, wheat, dry peas, lentils, small chickpeas, rice, and other crops designated by CCC are eligible commodities.
[6] The amount of the marketing assistance loan is equal to the loan rate per unit multiplied by the quantity pledged as collateral.
[7] FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1), "Commodity Data Specific to Wheat, Feed Grains, and Oilseeds," as amended.

quantity, and the value of these commodities must be reduced to 20 percent of their original value to adjust their quality.

Commodity Seals

FSA allows county offices the option of requiring producers to identify commodities held as collateral with FSA Form CCC-683, "Commodity Loan Seal." This seal provides county offices with a means of identifying specific collateral that secures particular loans. Seals are a useful reminder to producers that the U.S. Department of Agriculture (USDA) needs to be notified before they move the commodity, and the seals also help commodity inspectors identify collateral during spot checks.

Spot Checks

Although producers are responsible for maintaining the quality and quantity of commodities used as collateral throughout the loan period, FSA representatives verify through spot checks that the quality and quantity of farm-stored commodities pledged as collateral is maintained. Outstanding loans are selected for spot checks through an automated random selection process.

County commodity inspectors performing spot checks are required to verify that: the commodity is in existence and in storable condition; the storage structure will safely store and protect the commodity from natural elements; the commodity is stored in approved bags; the commodity is properly labeled; commodity loan seals are attached as required; loan collateral is properly identified; CCC's interest is adequately protected; and the quantity is reasonable based on a maximum eligible quantity.

Cooperative Marketing Associations

In addition to producers, cooperatives may apply for farm-stored loans. Before cooperatives may participate, they must apply for cooperative marketing association status. Once cooperatives achieve cooperative marketing association status, they are treated the same as any other eligible producer; the cooperatives may apply for loans on behalf of their member producers. Cooperatives are then responsible for ensuring the collateral is free of liens.

On-Ground Storage

On September 8, 2005, FSA issued Notice LP-2002, "CCC Authorizes On-Ground Farm Storage for Marketing Assistance Loans and Loan Deficiency Payments for Crop Years 2005 and 2006," as a response to Hurricanes Katrina and Rita. Set to expire in September of 2006, this notice allowed on-ground storage of eligible commodities offered as collateral for 9-month nonrecourse loans for crop years 2005 and 2006.

During the storage period for a nonrecourse marketing assistance loan with collateral stored on-ground, producers must maintain control of the commodity, protect the commodity from animals, and position the commodity so that water drainage will not seriously affect the quality and quantity of the commodity pledged as collateral for marketing assistance loans.

On February 22, 2006, FSA issued Notice LP-2018, "CCC Authorizes On-Ground Farm Storage for Marketing Assistance Loans and Loan Deficiency Payments for Crop Year 2005." This notice removed on-ground storage as an option for crop year 2006 and stated that the distress loan[8] program was available to producers who might require a loan for collateral stored on-ground.

Objective

Our audit objective was to determine if FSA had adequate controls over nonrecourse marketing assistance farm-stored loans.

[8] Distress loans are available for commodities stored in ineligible structures and are limited to a 90-day period.

Findings and Recommendations

Section 1. FSA's Procedures for Farm-Stored Loans Need Clarification

FSA's procedures allow counties and States considerable discretion in how they administer farm-stored loans. Such discretion resulted in inconsistencies in how different counties and States applied two handbooks.

- Because FSA's handbooks for the marketing assistance loan program provide ambiguous and, in some cases, contradictory guidance regarding adjusting the value of low-quality, high-moisture collateral, we found that two of seven States reviewed did not apply those regulations correctly. In these two States, collateral was overstated by nearly $1.6 million**.** We determined that inequitable treatment of producers might result from the widely varying maximum acceptable moisture levels for commodities that were set by State offices across the nation.

- Because FSA's handbooks for the marketing assistance loan program allow county committees to determine whether or not counties will use commodity loan seals, we found county offices were not using these seals consistently. Of the 16 counties reviewed, 3 did not use the seals.

By improving how consistently county offices apply these regulations and by clarifying the relevant sections of its handbooks, FSA can better ensure that its interests are fully protected and the loans it issues are fully secured.

Finding 1 — FSA Did Not Correctly Apply Moisture Regulations

In two of the seven States reviewed, we found that although market assistance loans were secured with low-quality, high-moisture commodities, the collateral's value had not been reduced according to FSA's regulations. This occurred because the two FSA handbooks[9] used for the marketing assistance loan program contradict one another, and States interpreted these handbooks differently. If FSA does not adjust for low-quality collateral, then it is overestimating the value of collateral used to secure marketing assistance loans. Of the 121 loans reviewed, we identified 16 loans secured with low-quality collateral that should have been valued at $390,891 instead of $1.95 million—a difference of nearly $1.6 million.

[9] FSA *Handbook* 8-LP (Revision 1), and FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1), as amended.

Two FSA handbooks set forth the regulations essential to the marketing assistance loan program. FSA *Handbook* 8-LP (Revision 1)[10] (henceforth referred to as the general handbook) provides general instructions for administering the program, while FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1)[11] (referred to as the specific handbook) explains program requirements for specific commodities, such as U.S. grading standards, quality grading factors, and crop year-specific premiums and discounts.[12]

FSA's general and specific handbooks, however, contain contradictory information concerning how much moisture is allowable in a commodity before it is deemed low quality—once a commodity is considered low quality, an adjustment in the collateral's value is triggered. Although the general handbook instructs State committees to annually determine maximum *acceptable* moisture levels for their States, the specific handbook provides maximum *eligible* moisture levels (determined by the Grain Inspection, Packers and Stockyards Administration), above which commodities are deemed to be of low quality. Thus, there are potentially two moisture levels for each commodity—the maximum acceptable moisture level set by the State committee according to the general handbook's instructions and the maximum eligible moisture level set in the specific handbook.[13] The handbooks, however, did not explain the relationship between these two thresholds, or even if they were, in fact, different thresholds.

Although FSA's Price Support Division had not monitored where States set their maximum acceptable moisture levels, at our request FSA officials obtained the maximum acceptable moisture levels for corn, sorghum, soybeans, and wheat for 38 States. We found that most of the maximum acceptable moisture levels for these four commodities exceeded the limits established in the specific handbook, sometimes by large margins, as illustrated in table 1, below. (See exhibit D for a more detailed presentation of this material.)

[10] FSA *Handbook* 8-LP (Revision 1), as amended.
[11] FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1), as amended.
[12] Premiums and discounts are determined according to the grade and quality of a specific quantity of a commodity that a producer pledges as loan collateral. On a per-unit basis, premiums are added to and discounts are subtracted from the loan rate when the loan is made.
[13] The handbooks exacerbated this problem by referring to the threshold at which a commodity is deemed to be of low quality with several terms, including "applicable standard moisture levels," "maximum moisture level," "maximum eligible moisture levels," and "maximum acceptable moisture level."

	Maximum Eligible Moisture Level Set In The Specific Handbook	Mean Maximum Acceptable Moisture Level Set By These 38 States	Highest Maximum Acceptable Moisture Level Set By These 38 States
Corn	15.5 percent	31 percent	45 percent
Sorghum	14 percent	27 percent	45 percent
Soybeans	14 percent	21 percent	35 percent
Wheat	13.5 percent	21 percent	35 percent

Table 1

For these four commodities, States raised the maximum acceptable moisture levels to an average of 176 percent of the maximum eligible moisture level established by the specific handbook. Securing loans with commodities containing so much moisture poses a serious problem when the loan will not mature for up to 10 months. Extension university research indicates that commodities stored with moisture levels above those established in FSA's specific handbook cannot be stored safely for longer than 6 months.[14]

In two of the seven States visited, we found that although collateral exceeding the maximum eligible moisture level was used to secure marketing assistance loans, the value of that collateral was not reduced according to FSA's regulations—collateral for 16 of the 121 loans[15] reviewed exceeded the specific handbook's threshold. According to the specific handbook,[16] the $1.95 million in collateral for these 16 loans should have been valued at 20 percent of its original appraisal, or $390,891. Thus, this collateral was overvalued by nearly $1.6 million.[17]

When we spoke to FSA officials in Kansas and Iowa about this problem, they contended that the general handbook gave States the authority to set the maximum acceptable moisture level and to disregard the threshold in the specific handbook. Iowa officials also stated that it would be unrealistic to refuse a loan for corn with 16 or 17 percent moisture (the specific handbook establishes a threshold of 15.5 percent for corn, while Iowa's threshold is 45 percent), and that producers would not request a marketing assistance loan if they had to take an 80 percent reduction in the loan rate.[18] Officials in Iowa also stated that if the guidelines in FSA's specific handbook were correct, then they disagreed with the policy as written. Because Kansas and Iowa contended that the general handbook gave States the authority to set

[14] Agricultural Engineers' Digest 20, "Managing Dry Grain in Storage," Purdue University, dated July 1995. AE-905 (Revised), "Grain Moisture Content Effects and Management," North Dakota State University, dated March 1995.
[15] Of these 16 loans, 3 were in Kansas and 13 were in Iowa.
[16] FSA *Handbook* 2-LP, paragraphs 200 E, 300 E, 400 E, etc., dated April 4, 2002. FSA *Handbook* 8-LP, paragraph 422, dated September 23, 2004.
[17] All the loans should have been repaid by July 31, 2006.
[18] Loan rates (expressed per production unit) are based on each commodity's national average loan rate and may be adjusted by CCC with premiums and discounts to reflect quality factors. On a per-unit basis, premiums are added to and discounts are subtracted from the loan rate when the loan is made.

the maximum acceptable moisture level and to disregard the threshold in the specific handbook, neither State reduced the loan rate for low-quality commodities. Loans were secured either with commodities containing less moisture than the relevant State-established limit, or refused if the moisture level exceeded that limit.

Montana State FSA officials clarified this problem by stating that the procedures intended to establish a range for low-quality commodities used as collateral and that there were, in fact, two thresholds. They explained that States could establish their own "maximum acceptable moisture level," but that commodities with more moisture than the "maximum eligible moisture level" established in the specific handbook but less than the State-established "maximum acceptable moisture level" were eligible for a nonrecourse loan at a reduced loan rate of 20 percent.[19] (See table 2, below.)

Sample Commodity	**Percent Moisture Content**		
Corn	≤ 15.5[20]	> 15.5 but ≤ 45	> 45[21]
Sorghum	≤ 14	> 14 but ≤ 45	> 45
Soybeans	≤ 14	> 14 but ≤ 25	> 25
Wheat	≤ 13.5	> 13.5 but ≤ 25	> 25
Result	Eligible for full loan rate	Eligible for 20 percent of full loan rate	Ineligible for nonrecourse loan

Table 2

Commodities with more moisture than the State-established threshold would be ineligible for a nonrecourse loan, but they could receive a recourse loan.[22] We concurred with Montana's interpretation of these procedures, as it takes into account the relevant procedures in both of FSA's handbooks.

Officials at FSA's Price Support Division agreed that low-quality commodities used as collateral should receive a loan rate reduction, and that the range of thresholds for commodities of different moisture levels (as explained in table 2, above) is correct. They also agreed that the general handbook needs to be clarified to use the same language as the specific handbook. They further explained that any collateral with moisture greater than the threshold established by the specific handbook requires a loan rate reduction.

We expressed concern that allowing States to set their own rates for various commodities' maximum acceptable moisture levels could result in producers in different States being treated differently. FSA's Price Support Division agreed that allowing State committees to set these thresholds may not be the best policy. They explained that States had been authorized to set their own thresholds as a way of increasing commodities' eligibility for loan

[19] This reduction is in addition to any quantity reductions required for shrinkage, as established in the general handbook.
[20] The moisture thresholds in this column represent the "maximum eligible moisture" level set in the specific handbook.
[21] The moisture thresholds in this column represent Iowa's State committee-set "maximum acceptable moisture level" from the general handbook.
[22] See footnote 1 for an explanation of recourse and nonrecourse marketing assistance loans.

deficiency payments —a separate but related program. Federal regulations state that to be eligible to receive loan deficiency payments, a producer must meet marketing assistance loan eligibility requirements.[23] Producers may receive loan deficiency payments for commodities eligible for nonrecourse market assistance loans if producers forgo the nonrecourse marketing assistance loan. Allowing the States to set higher moisture limits was understood as a way of making more commodities eligible for loan deficiency payments, but this decision has had unintended consequences for moisture limits in the marketing assistance loan program.[24] Geographically unequal treatment of producers may result from the widely varying moisture levels.

We concluded that FSA should take steps to revise these procedures and ensure that all States are applying the agency's moisture procedures correctly and consistently.

Recommendation 1

Determine if States should continue setting their own "maximum acceptable moisture levels." If so, implement controls to monitor the reasonableness of State-established levels and compliance with loan rate reduction procedures.

Agency Response.

FSA's written response, dated August 4, 2006, stated the agency determined that the State committees shall continue to establish maximum moisture levels for eligible loan commodities produced and harvested within their respective States. The agency has instructed State committees to annually establish and submit the State-established maximum moisture levels to the Price Support Division by September 1, 2006. The Price Support Division will review each State's maximum levels to ensure consistency among State-established levels. A notice was to be drafted to instruct FSA State offices to provide the Price Support Division a copy of the State-established maximum moisture levels by September 1, 2006. The notice was expected to be issued by August 18, 2006. FSA *Handbooks* 8-LP (Revision 1) and 2-LP Grains and Oilseeds (Revision 1) will be amended to incorporate the policy included in the notice by November 15, 2006.

OIG Position.

We accept the management decision for Recommendation 1.

[23] Title 7, Code of Federal Regulations, section 1421.200.

[24] We did not evaluate how State-established moisture levels affected the loan deficiency program.

Recommendation 2

Determine which States had a policy to not adjust the loan value for low-quality commodities used as collateral and instruct those States to determine the extent of the potential overstated collateral value resulting from that policy, and to take corrective actions, as appropriate.

Agency Response.

FSA's written response, dated August 4, 2006, stated a notice was to be drafted to instruct FSA county offices to inform the State price support specialists of any outstanding excess moisture commodity loans that were disbursed in error and to take necessary corrective action as soon as possible. Corrective action is only necessary if the marketing assistance loan was disbursed incorrectly according to the clarified procedure stated in FSA's response to Recommendation 1. The notice was expected to be issued by August 18, 2006.

OIG Position.

We cannot accept the management decision for Recommendation 2. Although we agree with your planned corrective action, the extent of the potentially overstated collateral cannot be determined until the policies and procedures for low-quality commodities are clarified in Recommendation 3.

Recommendation 3

Amend the general handbook (FSA *Handbook* 8-LP (Revision 1)) so that it clearly agrees with the specific handbook (FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1)) regarding the "maximum eligible moisture level," the "maximum acceptable moisture level," and the application of discounted loan rates for low-quality, high-moisture commodities so that the value of collateral is not overstated (such as the nearly $1.6 million in Kansas and Iowa).

Agency Response.

FSA's written response to Recommendation 3 stated the agency is drafting the amendment to FSA *Handbook* 8-LP (Revision 1) to clarify the excess moisture and low-quality commodity marketing assistance loan policies and procedures. FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1) will be amended to reflect the applicable settlement rate for low-quality, nonrecourse loans that are delivered in satisfaction of the loan. FSA *Handbooks* 8-LP (Revision 1) and 2-LP Grains and Oilseeds (Revision 1) are targeted to be amended by November 15, 2006.

FSA's response to Recommendation 1 stated the agency agrees that low-quality commodities can be pledged as collateral for a nonrecourse loan at 20 percent of the loan rate. The inconsistency of the handbook policy is based on the definition of "low-quality." Low-quality commodities do not include excess moisture commodities. The audit report's Finding 1 stated that, of the 121 loans reviewed, 16 marketing assistance loans were disbursed for $1.95 million, but should have been disbursed for $390,891. The agency disagrees with the dollar amount cited. If the commodity pledged as collateral contained moisture at or below the State committee maximum levels, the quantity was reduced to the acceptable moisture levels as provided by FSA and the marketing assistance loans were disbursed at the full rate, then the marketing assistance loan was correctly disbursed. Therefore, the marketing assistance loan collateral was not overvalued by $1.6 million.

OIG Position.

We cannot accept the management decision for Recommendation 3. We continue to believe that FSA needs to amend the general handbook (FSA *Handbook* 8-LP (Revision 1)) and the specific handbook (FSA *Handbook* 2-LP Grains and Oilseeds (Revision 1)) regarding the application of discounted loan rates for low-quality, high-moisture commodities. FSA needs to ensure that the definition of low-quality commodities is consistent throughout its procedures and with regulations and statute. We agree with FSA's procedures to adjust the loan collateral quantity if high moisture is detected. However, in the recently issued FSA Notice LP-2040, dated July 31, 2006, FSA did not make it clear that an adjustment is also needed for quality. The specific handbook states that commodities with moisture levels that exceed the levels determined by the Grain Inspection, Packers and Stockyards Administration are considered low quality. Securing loans with commodities containing high moisture poses a serious problem when the loan will not mature for up to 10 months. Low-quality commodities are eligible for a nonrecourse loan at a reduced loan rate according to the general handbook. We believe this includes adjusting the value of the loan collateral when the loan is disbursed at settlement and when high moisture is detected during spot checks. Based on this interpretation, the loan collateral with high moisture, reviewed during OIG spot checks, was overvalued by $1.6 million.

Recommendation 4

Issue a national notice clarifying the procedures for processing loans with excess moisture.

Agency Response.

FSA's written response, dated August 4, 2006, stated a notice was to be drafted to clarify the policies and procedures for approving and issuing marketing assistance loans for excessive moisture commodities pledged as collateral for nonrecourse loans. The notice was expected to be issued by August 18, 2006.

OIG Position.

We cannot accept the management decision for Recommendation 4. Although we agree with your planned corrective action, the notice may have to be revised after the definition of low-quality commodities is clarified in Recommendation 3.

Finding 2 FSA Did Not Consistently Identify Collateral with Commodity Loan Seals

Of 16 counties reviewed, we found that 3 did not require commodity loan seals,[25] a form identifying commodities used as collateral for marketing assistance loans. This inconsistency occurred because FSA's general handbook[26] for the marketing assistance loan program does not specify when commodity loan seals should be used, and instead allows county committees to decide whether or not they will use them. Since these seals are FSA's best means of identifying specific bins of commodities, and of marking those commodities as collateral for loans, if they are not used the agency has less control over collateral securing marketing assistance loans.

The general handbook for the marketing assistance loan program grants county committees the authority to determine whether commodity loan seals should be required.[27] Officials at FSA's Price Support Division explained that this authority was granted to county committees in the early 1990s to give county offices greater authority over the marketing assistance loan program.

[25] FSA Form CCC-683, "Commodity Loan Seal."
[26] FSA *Handbook* 8-LP (Revision 1), amendment 1, exhibit 18, dated June 9, 2003.
[27] FSA *Handbook* 8-LP (Revision 1), amendment 1, exhibit 18, dated June 9, 2003.

FSA employees in counties requiring commodity loan seals stated that the seals act as a useful control, reminding producers that the commodity is under loan and that USDA needs to be notified before the commodity is moved (text on the seal states that the contents should not be removed without the Department's written consent). According to FSA employees, the seals also help inspecting officials identify bins of commodities related to specific loans.

Of the 121 loans reviewed, we found that 48, or 40 percent, were secured with $6.5 million in collateral that had not been identified with commodity loan seals. During a site visit to one county, OIG auditors and the accompanying FSA county measurement official mistakenly measured two bins containing commodities unrelated to the loan under review. Without commodity seals present to mark the bins, it can be difficult even for experienced inspectors to distinguish one bin from another.

Although the general handbook allows counties to decide if commodity loan seals will be used, States may, at their discretion, require their county offices to use the seals. We found that States were inconsistent in whether they required seals or not. Of the seven States visited, three required their county offices to use commodity loan seals on all collateral, but four did not. When we spoke to officials at FSA's Price Support Division about the inconsistency with which the seals were applied, they stated that they had not monitored whether States required the seals or not. They agreed that county offices were using commodity loan seals inconsistently and that the procedure for their use should be clarified. After our fieldwork ended, we learned that one of the States reviewed issued an amendment requiring its county offices to use commodity loan seals on collateral for all marketing assistance loans.

We concluded that FSA should determine if commodity loan seals should be used for all marketing assistance loans. If not, the agency should alter its regulations to specify when the seals should be required and when they should not.

Recommendation 5

Determine if commodity seals should be mandatory for all farm-stored loans. If it is determined that commodity seals will be mandatory, then amend FSA *Handbook* 8-LP (Revision 1) to require them.

Agency Response.

FSA's written response, dated August 4, 2006, stated the agency has determined that commodity bin seals shall be mandatory for all farm-stored loans. The agency agrees that the commodity bin seals are a useful control and help commodity field inspectors identify on-farm storage bins when conducting spot checks. FSA *Handbook* 8-LP (Revision 1) will be clarified to require commodity bin seals for all farm-stored loans. The target date for updating FSA *Handbook* 8-LP (Revision 1) is November 15, 2006.

OIG Position.

We accept the management decision for Recommendation 5.

Recommendation 6

If it is determined that commodity seals will not be mandatory, then amend FSA *Handbook* 8-LP (Revision 1) to indicate the specific conditions in which commodity seals will not be required.

Agency Response.

FSA's written response, dated August 4, 2006, stated FSA has determined that commodity bin seals shall be mandatory; therefore, no further action will be taken on this recommendation.

OIG Position.

We accept the management decision for Recommendation 6.

We found county offices did not comply with FSA's procedures for issuing and servicing farm-stored loans, even though those procedures were clearly set forth in the relevant handbooks.

- FSA requires that county offices perform spot checks of collateral used to secure farm-stored loans, but we found that 7 of 16 counties did not complete these spot checks. County offices often cited the scarcity of resources, especially personnel, for completing these checks. However, we found that the cause was more complicated, and that some county offices had not implemented the control as written. If these spot checks are not performed, FSA's best control for ensuring the integrity of collateral is not functioning as designed, and the agency cannot be certain that this collateral will cover the value of loans at maturity. This control is especially important since many of the farm-stored loans are self-certified and because we noted that FSA did not always correctly apply moisture regulations for low-quality commodities (see Finding 1).

- FSA requires that county employees complete loan documents when processing applications for farm-stored loans, but we found that 10 of 16 counties left important loan documents incomplete (the most prevalent problems were failure to enter loan and farm numbers on the required forms). These incomplete forms were not detected in the second-party review process because the second-party review was not designed to detect these errors and, moreover, was seldom being completed. Without completing these forms, FSA lacks assurance that these loans were issued in accordance with all applicable laws, regulations, and procedures.

- Finally, although FSA requires county and State officials to be familiar with procedures for the programs they administer, we found that the FSA county office in Pinal County, Arizona, made a number of errors when administering farm-stored loans for a cooperative marketing association, including mistakenly issuing premiums, issuing loans for collateral stored in an ineligible structure, and failing to provide the loan recipient with critical documentation. The Pinal County FSA Office thus issued questionable loans totaling \$603,431.[28]

[28] \$120,425 + \$483,006 = \$603,431.

By addressing these problems, FSA can improve its controls over how county offices process, issue, and administer farm-stored loans as part of the marketing assistance loan program, as well as obtain greater assurance that nonrecourse marketing assistance loans are secured with sufficient collateral.

Finding 3 — FSA County Offices Did Not Always Perform Spot Checks of Collateral for Farm-Stored Loans

In 7 of 16 counties, FSA did not complete all required monthly spot checks of loan collateral. Officials at FSA's Price Support Division asserted that, generally speaking, established controls for monthly spot checks were not functioning as designed because county offices did not have sufficient staff to perform the checks. We found, however, that the cause was more complicated, and that county offices failed to perform their spot checks for varying reasons. While county offices in Kansas and Montana lacked sufficient personnel to perform these spot checks, county offices in Indiana and Arkansas had not implemented the spot-check requirements as written. In Indiana, personnel wrongly believed that they were not required to spot check measured loans issued within the past 30 days. In Arkansas, personnel did not spot check the specific loans selected by the automated process, but chose other, more conveniently located loan collateral. Additionally, one county office in Arizona was unaware that it needed to generate a spot-check register and perform checks for a cooperative marketing association. Without performing these checks, one of FSA's most effective controls for preventing abuse in its farm-stored loan program is not functioning as designed and cannot ensure the sufficiency of collateral used to secure these loans.

Because the marketing assistance loan program allows producers to self-certify their collateral when they apply for a loan, FSA requires county offices to make onsite spot checks of 2.5 percent of all outstanding farm-stored loans and loan deficiency payments.[29] On a monthly basis, FSA uses an automated process to select the loans county offices will review. Loans selected by this process must be reviewed regardless of whether the collateral has recently been measured during the regular servicing of farm-stored loans. Counties then certify the completion of monthly spot checks on a performance report, which they send to the State office.[30] FSA considers approved cooperative marketing associations as eligible producers, but assigns them a unique county code. Loans to cooperative marketing associations also are subject to spot checks, but because they

[29] FSA *Handbook* 12-PS, paragraphs 1500 A and B, revision 2, amendment 1, dated May 18, 2001.
[30] FSA *Handbook* 8-LP, paragraph 516 B, dated June 9, 2003. FSA *Handbook* 12-PS, paragraph 1500 G, revision 2, amendment 1, dated May 18, 2001.

have a different county code, the administrative county must generate a spot-check register distinct from the county's regular register.[31]

We found, however, that 7 of the 16 FSA county offices reviewed had not completed these spot checks as required, as illustrated in table 3, below.

States Where Spot Checks Were Not Performed	Counties Where Spot Checks Were Not Performed	Cause
Kansas	Washington	Lacked sufficient personnel resources
Montana	Judith Basin	Lacked sufficient personnel resources
	Sheridan	Lacked sufficient personnel resources
	Roosevelt	Lacked sufficient personnel resources
Indiana	White	Spot checks not implemented as required
Arkansas	Clay	Spot checks not implemented as required
Arizona	Pinal	Did not generate spot-check register for cooperative marketing associations

Table 3

FSA County Offices Lacked Sufficient Personnel Resources to Perform Spot Checks

FSA officials in Washington County, Kansas, explained that they had been unable to complete FSA's required spot checks of loan collateral because they were unable to hire a field reporter who could work during peak periods. Immediately before we arrived for our visit, however, the county hired a field reporter and was beginning to process the backlog of overdue spot checks.

FSA offices in Judith Basin, Sheridan, and Roosevelt Counties, Montana, also failed to complete the required spot checks because they lacked sufficient personnel. State and county officials maintained that they simply did not have the budgetary resources to hire the personnel necessary to complete all required monthly spot checks.

FSA County Offices Did Not Implement the Spot-Check Control as Written

FSA officials in White County, Indiana, explained that they did not complete FSA's required spot checks of loan collateral because they believed that if county employees had recently measured the collateral during the regular servicing of farm-stored loans, then the additional spot check was unnecessary. Although county officials stated that this practice was standard procedure, they could not provide evidence of this procedure. Moreover, the program handbook clearly states that checks are required,

[31] FSA *Handbook* 8-LP, paragraph 103, revision 1, amendment 8, dated January 6, 2005. FSA *Handbook* 1-CMA, paragraphs 53 B and 73 B, revision 1, amendment 1, dated April 19, 2004.

even if the commodity was previously measured during the regular servicing of farm-stored loans.[32]

Although the FSA office in Clay County, Arkansas, did complete the required number of spot checks, we found that the county's field reporter was not checking the loans selected by the agency's automated process. Instead, the field reporter explained that he substituted other loans for those selected by the automated system because he was running behind and tried to save time by reviewing loans in closer proximity to his other work.

Due to this problem, we reviewed FSA's controls over its "Monthly Spotcheck Performance Report," which county offices must use to certify completion of their spot checks. This report only indicates the number of checks performed and does not identify the specific loans checked.

<u>FSA County Office in Pinal County, Arizona, Did Not Generate Spot-Check Register for Cooperative Marketing Associations</u>

Although the FSA office in Pinal County, Arizona, did generate a spot-check register and performed spot checks for ordinary farm-stored loans, it did not do so for loans issued to a cooperative marketing association. County officials were unaware that they were required to generate a separate spot-check register since cooperative marketing associations assigned their own county codes. Because Pinal County officials did not generate this register, they did not perform required spot checks of this cooperative marketing association.

As we learned during our fieldwork at FSA's Price Support Division, officials there were aware that some county offices were not able to complete spot checks because they lacked the personnel. FSA has established a Compliance Task Force to review current spot-check procedures, and officials in the Price Support Division stated that they are waiting for the task force's conclusions before taking action to alter current spot-check procedures.

We concluded that since these spot checks are an internal control developed by FSA to monitor collateral for farm-stored loans, the agency should take steps to revise its procedures so that county offices can reasonably complete the checks with their existing, limited personnel. In addition, FSA should take steps to ensure that county offices implement required procedures as written.

[32] FSA *Handbook* 8-LP, paragraph 516 B, dated June 9, 2003.

Recommendation 7

Based upon the conclusions of FSA's Compliance Task Force, revise procedures for performing spot checks so that all counties can reasonably complete them with their existing, limited personnel.

Agency Response.

FSA's written response, dated August 4, 2006, stated the FSA Compliance Task Force is reviewing various options concerning how compliance checks shall be conducted across respective program areas under the Deputy Administrator for Farm Programs. Upon the completion of the FSA Compliance Task Force, recommendations will be submitted to the Deputy Administrator for Farm Programs, and, if accepted, the existing marketing assistance loan spot-check procedures will be modified. The agency will determine whether implementation of the accepted FSA Compliance Task Force recommendations will address this report's recommendation. Based on FSA's determinations, the agency will make the necessary automation changes to the spot-check process within a reasonable timeframe of the final decision. FSA believes it will be in the best interest of the marketing assistance loan program not to take corrective action on this recommendation until a final decision is rendered by the Deputy Administrator for Farm Programs. A specified timeframe cannot be determined at this time. All software changes and enhancements must be reviewed by the Automation Branch and the Information Technology Systems Division before a development time can be established.

OIG Position.

We cannot accept the management decision for Recommendation 7. Until the FSA Compliance Task Force has completed its activities, FSA needs to provide instruction to the States that outlines an interim plan for monitoring spot checks. An estimated date for the completion of the Compliance Task Force activities needs to be provided.

Recommendation 8

Instruct the Indiana State FSA Office to provide training to the county offices on how to perform spot checks, regardless of whether the loan was recently measured during the regular servicing of farm-stored loans, and direct the appropriate personnel (i.e., district director, State specialist) to monitor compliance with the procedures after county office personnel have received the training.

Agency Response.

FSA's written response, dated August 4, 2006, stated the Deputy Administrator for Field Operations has instructed the Indiana State FSA Office to provide training to county offices for conducting spot checks. The memorandum also instructed the Indiana State FSA Office to monitor the county office spot-check activity to ensure that the monthly spot checks are being conducted and are recorded properly in the Automated Price Support System.

OIG Position.

We accept the management decision for Recommendation 8.

Recommendation 9

Instruct the Arkansas State FSA Office to provide training to the Clay County FSA Office on how to perform spot checks on the loans selected by the automated system, and direct the appropriate personnel (i.e., district director, State specialist) to monitor compliance with the procedures after county office personnel have received the training.

Agency Response.

FSA's written response, dated August 4, 2006, stated the Deputy Administrator for Field Operations has instructed the Arkansas State FSA Office to provide training to county offices for conducting spot checks. Also, the Arkansas State FSA Office has been instructed to monitor county office spot-check activity to ensure that the monthly spot checks are being conducted and are recorded properly in the Automated Price Support System.

OIG Position.

We accept the management decision for Recommendation 9.

Recommendation 10

Instruct the Arizona State FSA Office to provide training to the Arizona county offices on how to generate spot-check registers for all county codes, including cooperative marketing association county codes, and direct the appropriate personnel (i.e., district director, State specialist) to monitor compliance with the procedures after county office personnel have received the training.

Agency Response.

FSA's written response, dated August 4, 2006, stated, according to the information provided in Finding 3, the Pinal County FSA Office did generate a spot-check register and performed the spot checks for the applicable farm-stored loans. The Pinal County FSA Office did not generate a spot-check register or perform spot checks for the cooperative marketing association county code. Cooperative marketing associations are assigned a separate county code; therefore, a separate spot-check process must be run for that specific county code. The current automated spot-checking process needs to be modified to efficiently address random spot checks of marketing assistance loan numbers and all related loans associated with the selected loan (producer). Because the cooperative marketing association is the only "producer" in the cooperative marketing association county, all loans and related loans, which may be extremely large, appear each month on the random spot-check report. The cooperative marketing association county random monthly spot-check report is time consuming and extremely large. Some cooperative marketing association county offices have reported system lockups and other system-related failures related to the automated process involved in running the monthly spot-check report.

FSA will not instruct the Arizona State FSA Office, at this time, to provide training on how to generate spot-check registers for cooperative marketing associations. The cooperative marketing association's approval status with FSA has been terminated. However, Price Support Division personnel will work with the FSA Compliance Task Force to determine a more efficient automated spot-check process for cooperative marketing association county offices.

OIG Position.

We accept the management decision for Recommendation 10.

Finding 4 County Offices Did Not Always Follow FSA's Administrative Procedures

In 10 of 16 counties, county employees did not follow FSA's administrative procedures and, thus, did not always complete required loan forms—of 121 loans reviewed, we found that loan forms for 32 of these loans were incomplete.[33] This occurred because the only review of these loans performed prior to disbursing funds is designed to review applicants' eligibility, and not to verify whether all supporting documentation is

[33] FSA Form CCC-666, "Farm-stored Loan Quantity Certification."

complete. We found, moreover, that these second-party reviews were seldom performed, and were not being fully documented. They were thus incapable of serving their intended purpose (that is, reviewing applicants' eligibility) as well as verifying that loan forms were complete. Without completing all required loan forms and reviews, FSA lacks assurance that loans are processed in compliance with all relevant laws, regulations, and procedures, thereby increasing financial risk to the agency.

FSA procedures provide detailed instructions for completing loan forms, including a sample completed form (specifically FSA form CCC-666).[34] Although FSA procedures do require a second-party review of eligibility requirements prior to disbursing loans, that review is not designed to verify that all forms have been completed.[35]

Of the 121 loans reviewed, we found that documentation for 32 loans (FSA form CCC-666) was incomplete. The most prevalent problems were failure to enter loan and farm numbers. Since the second-party review performed for these loan applications was designed only to review eligibility requirements, it did not detect these errors. Moreover, we noted that few second-party reviews were performed. Of 16 counties, 14 did not perform second-party reviews according to FSA's requirements. Even when second-party reviews were performed, they were not fully documented in the loan file. Though FSA regulations state that the reviewing official must initial applications when completing reviews, this was not always done, and the optional checklist for loan processing was seldom included in the file.

FSA's Price Support Division is aware of county offices' difficulties completing loan application forms and second-party reviews. FSA conducts broad reviews of all programs to assess program performance and compliance. The results of these broad reviews are published in the County Operations Review Program report. The 2004 and 2005 County Operations Review Program reports both identified problems with counties completing necessary forms when processing loan applications. In 2005, FSA also noted that second-party reviews were not always completed. In both years, FSA issued notices intended to address these problems.

When we spoke to officials at FSA's Price Support Division about the ongoing nature of these problems, they stated that most of the errors related to incomplete forms and second-party reviews could best be fixed by modifying their current computer system. That modification should include an automated control to prevent loan disbursement until all required forms are completed and second-party reviews have been conducted.

[34] FSA *Handbook* 8-LP, paragraphs 426 A and B, revision 1, amendment 1, dated June 9, 2003.
[35] FSA *Handbook* 8-LP, paragraph 136 A, revision 1, amendment 1, dated June 9, 2003.

Price Support Division officials stated that budget constraints will prevent them from making this change in the immediate future. We maintain, however, that this is a significant control issue that needs to be addressed. Since FSA is in the process of moving to a new web-based information technology system, it should include such a control in the new system.

Recommendation 11

Implement an automated control in the new web-based system that will prevent loan disbursement until all required loan information has been recorded and second-party reviews have been performed.

Agency Response.

FSA's written response, dated August 4, 2006, stated the Price Support Division has written software user requirements to develop a web-based marketing assistance loan program. User requirements will be amended to require a validation to ensure that the second-party review of the marketing assistance loan has been completed before the loan is disbursed. The deployment (software release) date for the fully functional web-based marketing assistance loan system is to be determined. This date depends heavily on available resources and funding.

OIG Position.

We cannot accept the management decision for Recommendation 11. Until an automated control can be implemented, FSA needs to provide instruction to the States that outlines an interim plan for monitoring that all required loan information has been recorded and second-party reviews have been performed before loan disbursement. An estimated date for the automated control implementation needs to be provided.

Recommendation 12

Instruct State offices to direct the appropriate personnel (i.e., district directors, State specialists) to monitor the completion of the second-party review process, and certify the results for the State office so that it can identify and correct administrative errors in addition to reviewing loan eligibility.

Agency Response.

FSA's written response, dated August 4, 2006, stated a notice is in clearance regarding several issues that were identified during a National County Operations Review Program review of the 2005 crop year marketing assistance loans and loan deficiency payments. One of the findings included second-party reviews not being completed before a loan or loan deficiency payment is made. The notice in clearance references current FSA handbook procedures which instruct the county offices to have a second-party review of eligibility requirements before disbursing a loan or loan deficiency payment. The target date for issuing the notice is August 31, 2006. The agency is developing a training module to address the performance and accountability issues discovered as a result of the County Operations Review Program review. District directors and other designated FSA employees will be required to review the training module and to certify to completion of the training. The training module will be made available to all States in September 2006. Additional instructions will be included in the next amendment to FSA *Handbook* 8-LP (Revision 1) instructing the district directors to review marketing assistance loans to ensure second-party reviews are completed. The next amendment to FSA *Handbook* 8-LP (Revision 1) is targeted for issuance November 15, 2006.

OIG Position.

We accept the management decision for Recommendation 12.

Finding 5 The FSA Office in Pinal County, Arizona, Did Not Follow Procedures for Issuing and Administering Loans to a Cooperative Marketing Association

FSA's office in Pinal County, Arizona, did not follow procedures for issuing and administering eight crop year 2004 and 2005 loans[36] to a cooperative marketing association. Because officials at the Pinal County FSA Office were not familiar with policies and procedures for issuing farm-stored loans, they did not follow controls established by FSA for properly administering these loans. Employees at the county office mistakenly disbursed premiums[37] for farm-stored loans, issued loans for collateral stored in an ineligible structure, and did not provide critical loan documentation to the recipient. In sum, the Pinal County FSA Office issued this cooperative marketing association ineligible loans totaling $603,431.[38]

According to Departmental regulations, FSA county managers are required to establish, maintain, evaluate, improve, and report on controls for their assigned area.[39] For the farm-stored loan program, FSA managers should understand how to administer loans to cooperative marketing associations according to all applicable FSA regulations. Those regulations state that an

36 Three loans were issued in crop year 2004, another five in crop year 2005.
37 Premiums and discounts are determined according to the grade and quality of a specific quantity of a commodity that a producer pledges as loan collateral. On a per-unit basis, premiums are added to and discounts are subtracted from the loan rate when the loan is made.
38 $120,425 + 483,006 = $603, 431.
39 USDA *Management Control Manual* 1110-002, paragraph 6, dated November 9, 2002.

approved cooperative marketing association is considered an eligible producer under the marketing assistance loan program.[40] Cooperative marketing associations must, in other words, meet the requirements and restrictions applicable to any other eligible producer.

We found, however, that because officials at the Pinal County FSA Office were unaware of policies regarding administering loans to cooperative marketing associations, they issued $603,431 in questionable loans. The county office made three errors: (1) it mistakenly issued premiums to a cooperative marketing association for farm-stored loans, (2) it issued loans for collateral stored in an ineligible structure, and (3) it did not provide critical loan documentation to this cooperative marketing association.

<u>Premiums Issued on Farm-Stored Loans</u>

For eight crop year 2004 and 2005 loans, the Pinal County FSA Office issued premiums for which farm-stored loans were ineligible. This occurred because county employees incorrectly believed they could issue premiums for collateral held as security for these loans. Accordingly, they obtained from the cooperative marketing association proof of the commodities' quality and, at the producer's request, then issued premiums totaling $120,425.[41]

While high-quality commodities held as collateral are eligible for premiums for some marketing assistance loans, FSA requires that official quality determinations—required prior to issuing premiums—not be made for farm-stored loans.[42] Thus, no quality determinations should be made, and no premiums should be issued for collateral used to secure farm-stored loans.

We asked county officials why they issued the premiums on farm-stored marketing assistance loans, and they explained that they had called the State office and that officials there had confirmed that issuing premiums was appropriate. Officials at the State office confirmed that they did advise the county office to issue the premiums, and further stated that they had contacted the Price Support Division on the topic. There was, however, no evidence of this contact, and officials at the Price Support Division did not recall any conversation on the subject.

When we spoke to officials at the Price Support Division familiar with the automated system used to process marketing assistance loans, they explained that the system is not programmed to apply premiums and discounts to farm-stored loans. The officials stated that, if the county code[43] is not entered when processing a loan, counties can set their own loan rate.

[40] FSA *Handbook* 8-LP, paragraph 103, amendment 8, revision 1, dated January 6, 2005.
[41] $80,819 was paid in crop year 2004, and $39,606 in crop year 2005.
[42] FSA *Handbook* 8-LP, paragraph 431 B, amendment 1, revision 1, dated June 9, 2003.
[43] FSA assigns each county a three-digit county code; similarly, FSA assigns approved cooperative marketing associations a unique county code.

FSA has included this override in the automated system in order to permit counties to deal with unusual circumstances when a county loan rate cannot be found. Upon further review, we confirmed that none of Pinal County's loans to this cooperative marketing association included the cooperative marketing association's county code. We concluded that the county office did not enter the cooperative marketing association's county code so that it could enter an increased loan rate and prompt the automated system to issue a premium when no premium should have been issued.

We concluded that the Pinal County FSA Office should not have issued the $120,425 in premiums to this cooperative marketing association.

Loans Issued for Ineligibly Stored Collateral

The Pinal County FSA Office issued five crop year 2005 loans for collateral stored on-ground, even though FSA had not approved on-ground storage as of the date of the loans. This occurred because FSA gave written approval in 2004 (and for 2004 only) for Arizona to issue nonrecourse farm-stored loans to one cooperative marketing association for collateral stored on-ground. Pinal County FSA officials wrongly believed that this approval extended to subsequent crop years. Between June and August 2005, when the Pinal County FSA Office issued these five loans, on-ground storage had not been approved and would not be approved until September 8, 2005.[44] Since collateral was not approved to be stored on-ground during this period, Arizona should not have issued the 2005 loans at all, and we question the loan principal disbursements of $483,006 issued to the cooperative marketing association.

According to FSA regulations, approved structures for the farm-stored loan program consist of a storage structure located on or off the farm, excluding public warehouses, that provides safe storage for the commodity through the maturity date and is oxygen-limiting.[45] Under ordinary circumstances, on-ground storage is not approved.

When we asked State and county officials why they approved these loans, they stated that they had the Price Support Division's direct approval to do so. Officials at the Price Support Division, however, provided documentation that the on-ground storage of collateral for marketing assistance loans was approved only for 2004.

We concluded that the Pinal County FSA Office should not have issued total loan principal disbursements of $483,006 to this cooperative marketing association.

[44] Notice LP-2002, "CCC Authorizes On-Ground Farm Storage for Marketing Assistance Loans and Loan Deficiency Payments for Crop Years 2005 and 2006," dated September 8, 2005.
[45] FSA *Handbook* 8-LP, paragraph 424, amendment 1, revision 1, dated June 9, 2003.

Producers Did Not Receive Complete Documentation Concerning Transfer of Collateral

When we visited the Arizona cooperative marketing association’s commodity storage location, we observed that workers were moving the collateral, but the cooperative marketing association had not informed FSA of its intent to do so (see illustration 1, below). We learned that the cooperative marketing association had, in fact, sold the collateral and was transferring it to the buyer. Cooperative marketing association representatives explained that they had not informed FSA of the collateral’s sale and transfer because they were unaware of any requirement to do so, and had operated this way for several years. They explained that FSA had not provided them with FSA Form CCC-601, “Commodity Credit Corporation Note and Security Agreement Terms and Conditions,” a critical form setting forth producers’ responsibility to notify FSA when transferring commodities used as collateral. Officials at the Pinal County FSA Office confirmed that they were unaware of this form and, thus, had not provided it to the cooperative marketing association. Unless producers receive this form, they will be unaware of their responsibilities when transferring commodities held as collateral for FSA’s loans.

Illustration 1: Cooperative Marketing Association Representatives Removing Loan Collateral

According to agency regulations, county offices are required to provide producers with FSA form CCC-601,[46] setting forth the terms for the sale and transfer of collateral.

We concluded that the Pinal County FSA Office did not provide the producer with critical documentation. Because the cooperative marketing association was unaware of its responsibilities, it disposed of loan collateral without proper authorization. As of March 2006, the county committee had taken no action to address this violation.

Overall, we found that FSA should take steps to ensure that the Pinal County FSA Office administers future loans to cooperative marketing associations according to FSA's procedures. As of May 2006, all of the loans have been repaid; however, the financial risk could have been minimized by following FSA procedures.

Recommendation 13

Provide training in the marketing assistance farm-stored loan program to the Arizona State and county offices to ensure that (1) producers receive complete loan documentation, (2) ineligible loans are not disbursed (such as the $483,006), and (3) premiums are not disbursed on farm-stored loans (such as the $120,425).

Agency Response.

FSA's written response, dated August 4, 2006, stated that the Price Support Division is in the process of developing a series of training modules on marketing assistance loan and loan deficiency payments policies and procedures. Electronic loan deficiency payments automation training modules are available to the State and county offices and have been very beneficial in training States and county offices on how to process web-based electronic loan deficiency payments. The Price Support Division is planning to make the marketing assistance loan training modules available by October 2006. Upon completion of the online training modules, State and county office personnel must certify that the training was completed. The issues cited in Recommendation 13 will be covered in the general marketing assistance loan training modules.

OIG Position.

We cannot accept the management decision for Recommendation 13. Although we agree with your planned corrective action, an estimated date for completion of the training needs to be provided.

[46] FSA *Handbook* 8-LP, paragraph 411 D, amendment 1, revision 1, dated June 9, 2003.

Recommendation 14

Instruct the Arizona State FSA Office to direct the appropriate personnel (i.e., district director, State specialist) to review a sample of marketing assistance farm-stored loans disbursed by Pinal County, after county office personnel have received the training in the previous recommendation.

Agency Response.

FSA's written response, dated August 4, 2006, stated that FSA will instruct the Arizona State FSA Office, in writing, after the training has been completed, to review a sample of the outstanding marketing assistance loans disbursed by the Pinal County FSA Office.

OIG Position.

We cannot accept the management decision for Recommendation 14. FSA needs to provide an estimated date for instructing the Arizona State FSA Office, in writing, after the training has been completed, to review a sample of the outstanding marketing assistance loans disbursed by the Pinal County FSA Office.

Recommendation 15

Instruct the Arizona State FSA Office to determine if county offices issued premiums on any other farm-stored loans, and provide the results to the Price Support Division.

Agency Response.

FSA's written response, dated August 4, 2006, stated the Deputy Administrator for Field Operations has instructed the Arizona State FSA Office to review all 2005 crop year farm-stored marketing assistance loans to determine if loans were incorrectly disbursed based on the incorrect loan rate. The Arizona State FSA Office must report findings and the corrective action taken no later than September 18, 2006, to the Price Support Division.

OIG Position.

We accept the management decision for Recommendation 15.

Recommendation 16

Establish and implement an automated control in the farm-stored loan computer system to ensure that premiums are not disbursed on farm-stored loans.

Agency Response.

FSA's written response, dated August 4, 2006, stated the Automated Price Support System's loan-making subsystem has an automated control restricting premiums from being added to the existing county loan rate, as provided on the county loan rate table file. The Automated Price Support System does allow the entry of different loan rates based on the storage location of the commodity pledged for marketing assistance loans. Additional validations for entering different loan rates and eliminating the possibility of county offices arbitrarily modifying loan rates will be addressed and developed in the new web-based marketing assistance loan system. Information technology funds are limited, and all software enhancements to the Automated Price Support System must be reviewed and prioritized before funds will be made available to support the modification; therefore, the agency will not change the existing Automated Price Support System software. The agency will plan to implement this recommendation in the web-based marketing assistance loan system.

OIG Position.

We cannot accept the management decision for Recommendation 16. Until an automated control can be implemented, FSA needs to provide instruction to the States that outlines an alternative plan to ensure that premiums are not disbursed on farm-stored loans. An estimated date for the automated control implementation needs to be provided.

Scope and Methodology

Our audit covered the nonrecourse marketing assistance farm-stored loans for crop year 2005. In order to fully develop an audit issue concerning premium disbursements in Arizona, we also reviewed a limited number of loans from crop year 2004. Fieldwork began on November 2, 2005, and ended April 18, 2006.

At the FSA National Office, we conducted interviews to assess FSA's oversight of the marketing assistance loan program, including the strategic and annual planning process, the Federal Manager's Financial Integrity Act Report, and other internal reviews.

We obtained and analyzed marketing assistance loan program data from FSA's database in Kansas City, Missouri, as of October 26, 2005. Because we focused on relief efforts in response to Hurricanes Katrina and Rita, we selected States utilizing on-ground storage under the provisions of Notice LP-2002.[47] Our universe consisted of 11,685 farm-stored loans totaling nearly $554 million.

On November 2, 2005, officials at FSA's Price Support Division provided a list of all on-ground stored marketing assistance loans in the nation. This list showed on-ground stored loans had been issued in Arizona, Illinois, Iowa, Kansas, and Montana. We selected Arkansas and Indiana because they had especially high nonrecourse marketing assistance loan program activity. We decided to review 22 loans totaling $1,976,363 with collateral stored on-ground, as well as a selection of 99 loans totaling $15.8 million with collateral stored in bins. In total, we reviewed 121 loans valued at nearly $17.8 million in 16 counties in 7 States (see exhibits B and C). Our sample represents 1 percent of the total number of farm-stored loans in our universe and 3 percent of the total loans issued nationwide.

We reviewed loan records to determine if producers met eligibility requirements, if county offices followed administrative procedures, and if loan documentation was complete. In addition, we visited the storage sites for 121 selected loans to verify the quantity and quality of the pledged collateral by measuring and sampling the commodity. When necessary, we interviewed producers and cooperative marketing association representatives. We also reviewed records and interviewed staff regarding the agency's compliance activities for the marketing assistance loan program. Further, we reviewed documentation and assessed the reasonableness of FSA's actions when violations were detected.

[47] Notice LP-2002, "CCC Authorizes On-Ground Farm Storage for Marketing Assistance Loans and Loan Deficiency Payments for Crop Years 2005 and 2006," dated September 8, 2005.

The audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program records as considered necessary to meet the audit objective.

Exhibit A – Summary of Monetary Results

Finding Number	Recommendation Number	Description	Amount	Category
1	3	Loans Inadequately Secured With Low-Quality Collateral	$1,563,565	Questioned Loans, No Recovery[48]
5	13	Ineligible Loan Premium	$120,425	Questioned Loans, No Recovery[49]
5	13	Loans With Ineligibly Stored Collateral	$483,006	Questioned Loans, No Recovery[50]
Total			**$2,166,996**	

[48] All the loans should have been repaid by July 31, 2006.
[49] Loans and premiums paid in full
[50] Loans and premiums paid in full.

Exhibit B – *List of Sites Visited*

FSA Offices Visited	Location
National Office	Washington, D.C.
Arizona State Office	Phoenix, AZ
Pinal County Office	Casa Grande, AZ
Arkansas State Office	Little Rock, AR
Clay County Office	Piggot, AR
Lawrence County Office	Walnut Ridge, AR
Illinois State Office	Springfield, IL
Bond County Office	Greenville, IL
Vermilion County Office	Danville, IL
Indiana State Office	Indianapolis, IN
Montgomery County Office	Crawfordsville, IN
Warren County Office	Williamsport, IN
White County Office	Monticello, IN
Iowa State Office	Des Moines, IA
Cerro Gordo County Office	Mason City, IA
Wapello County Office	Ottumwa, IA
Kansas State Office	Manhattan, KS
Crawford County Office	Girard, KS
Washington County Office	Washington, KS
Montana State Office	Bozeman, MT
Judith Basin County Office	Stanford, MT
Roosevelt County Office	Culbertson, MT
Sheridan County Office	Plentywood, MT
Valley County Office	Glasgow, MT

Exhibit C – Summary of Loans Reviewed

State	Number of Bin-Stored Loans	On-Ground Stored Loans	Outstanding Amount of Loans
Iowa	20	1	$ 2,910,070
Kansas	21	1	$ 1,580,444
Illinois	18	2	$ 2,586,486
Indiana	20	4	$ 4,608,980
Arkansas	20	0	$ 4,860,287
Arizona	0	5	$ 522,791
Montana	0	9	$ 697,950
Totals	**99**	**22**[51]	**$17,767,008**

[51] We performed a desk review of three additional crop year 2004 loans and premiums in Arizona amounting to $1.1 million.

Exhibit D – Summary of State-Established Maximum Acceptable Moisture Levels

State[52] [53]	Corn	Sorghum	Soybeans	Wheat
Standard set in FSA *Handbook* 2-LP (Revision 1)[54]	15.5	14	14	13.5
Alaska	N/A[55]	N/A	N/A	13.5
Arizona	35	35	N/A	N/A
Arkansas	24	20	20	20
California	29	N/A	N/A	N/A
Colorado	45	34	24	24
Connecticut	15.5	14	13	13.5
Georgia	15.5	14	14	13.5
Hawaii	25	20	20	20
Indiana	35	18	20	18
Iowa	45	45	25	25
Kansas	35	35	20	19.5
Kentucky	20	18	17	18
Louisiana	35	35	20	19.5
Maine	15.5	14	14	13.5
Massachusetts	35	30	20	18
Michigan	40	N/A	25	25
Minnesota	45	25	25	25
Mississippi	35	35	22	22
Missouri	35	35	35	35
Montana	16.5	15	15	14.5
Nebraska	30	20	19	20
Nevada	15.5	14	N/A	13.5
New Jersey	40	35	35	35
New York	35	30	20	18
North Carolina	30	30	30	30
North Dakota	30	20	19	20
Ohio	30	30	30	30
Oklahoma	35	35	20	19.5
Oregon	35	N/A	N/A	N/A
Pennsylvania	40	40	24	25
South Carolina	30	26	20	20
South Dakota	35	35	20	20
Texas	35	35	20	19.5
Utah	21.5	20	20	19.5
Vermont	35	35	18	18
West Virginia	30	25	N/A	N/A
Wisconsin	36	35	22	22
Wyoming	30	20	19	20

[52] Illinois and Tennessee reported that the State committee had not established any maximum moisture levels.
[53] The following States did not respond to FSA Price Support Division's request: Alabama, Delaware, Florida, Idaho, Maryland, New Hampshire, New Mexico, Rhode Island, Virginia, and Washington.
[54] Values represent the percentage of maximum eligible moisture for all four commodities.
[55] N/A indicates no response was given by the States for that commodity.

United States Department of Agriculture

Farm and Foreign Agricultural Services

Farm Service Agency

Operations Review and Analysis Staff

Audits, Investigations and State and County Review Branch

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AUG 04 2006

TO: Director, Farm and Foreign Agriculture Division
Office of Inspector General

FROM: Philip Sharp, Chief
Audits, Investigations, and State and County Review Branch

SUBJECT: Audit 03601-47-TE, Farm Service Agency (FSA) – Nonrecourse Marketing Assistance Farm-Stored Loans

This is in response to the official draft of the subject audit.

Recommendation 1:

The Agency agrees that low-quality commodities can be pledged as collateral for a non-recourse loan at 20 percent of the loan rate. The inconsistency of the handbook policy is based on the definition of "low-quality". Low quality commodities do not include excess moisture commodities (commodities with moisture levels that exceed the State Committee (STC) maximum moisture level). The audit report finding No. 1 stated that of the 121 loans reviewed, 16 Marketing Assistance Loans (MAL's) were disbursed for $1.95 million, but should have been disbursed for $390,891. The Agency disagrees with the dollar amount cited. If the commodity pledged as collateral contained moisture at or below the STC maximum levels, the quantity was reduced to the acceptable moisture levels as provided by FSA and the MAL's were disbursed at the full rate, then the MAL was correctly disbursed. Therefore, the MAL collateral was not overvalued by $1.6 million.

The Agency determined that the State committees shall continue to establish maximum moisture levels for eligible loan commodities produced and harvested within their respective State. The Agency has instructed State Committees to annually establish and submit the State-established maximum moisture levels to the Price Support Division (PSD) by September 1. PSD will review each State's maximum levels to ensure consistency among State established levels.

A notice is being drafted to instruct FSA State offices to provide PSD a copy of the State established maximum moisture levels by September 1. The notice is expected to be issued by August 18. Handbooks 8-LP "Marketing Assistance Loans and Loan Deficiency Payments for 2002 Subsequent Crop Years" and 2-LP "Grains and Oilseeds" will be amended to incorporate the policy included in the notice by November 15.

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Recommendation 2:

A notice is being drafted to instruct FSA county offices to inform the State Price Support specialists of any outstanding excess moisture commodity loans that were disbursed in error and to take necessary corrective action as soon as possible. Corrective action is only necessary if the MAL was disbursed incorrectly according to the clarified procedure stated in FSA response to Recommendation 1. The notice is expected to be issued by August 18.

Recommendation 3:

The Agency is drafting the amendment to Handbook 8-LP to clarify the excess moisture and low-quality commodity MAL policies and procedures. Handbook 2-LP Grains and Oilseeds will be amended to reflect the applicable settlement rate for low quality non-recourse loans that are delivered in satisfaction of the loan. Handbooks 8-LP and 2-LP are targeted to be amended by November 15.

Recommendation 4:

A notice is being drafted to clarify the policies and procedures for approving and issuing MAL's for excessive moisture commodities pledged as collateral for non-recourse loans. The notice is expected to be issued by August 18.

Recommendation 5:

The Agency has determined that commodity bin seals shall be mandatory for all farm-stored loans. The Agency agrees that the commodity bin seals are a useful control and help commodity field inspectors identify on-farm storage bins when conducting spot checks. Handbook 8-LP will be clarified to require commodity bin seals for all farm-stored loans. Target date for updating Handbook 8-LP is November 15.

Recommendation 6:

FSA has determined that commodity bin seals shall be mandatory; therefore no further action will be taken on this recommendation.

Recommendation 7:

The FSA Compliance Task Forces is reviewing various options relating to how compliance checks shall be conducted implemented across respective program areas within the Deputy Administrator for Farm Programs (DAFP). Upon the completion of the FSA Compliance Task Force, recommendations will be submitted to DAFP. The existing MAL spot check procedures will be modified to reflect any accepted recommendations. Depending on the accepted recommendations, the Agency will

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determine whether implementation of the accepted FSA Compliance Task Force recommendations will address this recommendation. Accordingly, FSA will implement the accepted recommendations and make the necessary automation changes to the spot check process within a reasonable timeframe of the final decision. FSA believes it will be in the best interest of the MAL program not to take corrective action on this recommendation until a final decision is rendered by the DAFP.

NOTE: A specified timeframe can not be determined at this time. All software changes and enhancements must be reviewed by the Automation Branch and the Information Technology Systems Division before a development time can be established.

A quarterly report on the progress of the Compliance Task Force is already being provided to your office as part of Audit 03601-12-CH.

Recommendation 8:

The Deputy Administrator for Field Operations (DAFO) has instructed the Indiana State FSA Office to provide training to county offices for conducting spot checks. The memorandum also instructed the Indiana State FSA Office to monitor the county office spot check activity to ensure that the monthly spot checks are being conducted and are recorded properly in the Automated Price Support System (APSS).

Recommendation 9:

DAFO has instructed the Arkansas State FSA Office to provide training to county offices for conducting spot checks. Also, the Arkansas State FSA Office has been instructed to monitor county office spot check activity to ensure that the monthly spot checks are being conducted and are recorded properly in APSS.

Recommendation 10:

According to the information provided in finding No. 3, the Pinal County FSA Office did generate a spot check register and performed the spot checks for the applicable farm-stored loans. The Pinal County FSA Office did not generate a spot check register or perform spot checks for the Cooperative Marketing Association (CMA) county. CMA's are assigned a separate county code; therefore, a separate spot check process must be run for that specific county code. The current automated spot checking process needs to be modified to efficiently address random spot checks of MAL numbers and all related loans associated with the selected loan (producer). Because the CMA is the only "producer" in the CMA county, all loans and related loans, which may be extremely large, appear each month on the random spot check report. The CMA county random monthly spot check report loan is time consuming and extremely large. Some CMA county offices have reported system lock-ups and other system related failures related to the automated process involved in running the monthly spot check report.

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FSA will not instruct the Arizona State FSA Office, at this time, to provide training on how to generate spot check registers for CMA. The CMA's approval status with FSA has been terminated.

However, PSD personnel will work with the Compliance Task Force to determine a more efficient automated spot check process for CMA county offices.

Recommendation 11:

PSD has written software user requirements to develop a web-based MAL program. User requirements will be amended to require a validation to ensure that the second party review of the MAL has been completed before the loan is disbursed. The deployment (software release) date for the fully functional web-based MAL system is to be determined. This date depends heavily on available resources and funding.

Recommendation 12:

A notice is in clearance regarding several issues that were identified during a National County Operations Review Program (CORP) review of the 2005 crop year MAL's and Loan Deficiency Payments (LDP's). One of the findings included second party reviews not being completed before a loan or LDP is made. The notice in clearance references current handbook procedures which instruct the county offices to have a second party review of eligibility requirements before disbursing a loan or LDP. The target date for issuing the notice is August 31.

The Agency is developing a training module to address the performance and accountability issues discovered as result of the CORP review. District Directors (DD) and other designated FSA employees will be required to review the training module and to certify to completion of the training. The training module will be made available to all States in September 2006. Additional instructions will be included in the next amendment to 8-LP instructing the DD's to review MAL's to ensure second party reviews are completed. The next amendment to 8-LP is targeted for November 15.

Recommendations 13 and 14

PSD is in the process of developing a series of training modules on MAL and LDP policies and procedures. Electronic LDP (eLDP) automation training modules are available to the State and county offices and have been very beneficial in training States and county offices on how to process web-based eLDP's. PSD is planning to make the MAL training modules available by October 2006. Upon completion of online training module, State and county office personnel must certify that the training was completed. The issues cited in Recommendation 13 will be covered in the general MAL training modules.

FSA will instruct the Arizona State Office, in writing, after the training has been

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completed to review a sample of the outstanding MAL's disbursed by the Pinal County FSA Office.

Recommendation 15:

DAFO has instructed the Arizona State FSA Office to review all 2005 crop year farm-stored MAL's to determine if loans were incorrectly disbursed based on the incorrect loan rate. The Arizona State Office must report findings and the corrective action taken no later than September 18, 2006, to PSD.

Recommendation 16:

The APSS loan making subsystem has an automated control restricting premiums from being added to the existing county loan rate as provided on the county loan rate table file. APSS does allow the entry of different loan rates based on the storage location of the commodity pledged for MAL. Additional validations for entering different loan rates and eliminating the possibility of county offices arbitrarily modifying loan rates will be addressed and developed in the new web-based MAL system. Information Technology funds are limited and all software enhancements to the APSS must be reviewed and prioritized before funds will be made available to support the modification; therefore, the Agency will not change the existing APSS software. The Agency will plan to implement this recommendation in the web-based MAL system.