



U.S. Department of Agriculture

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Office of Inspector General  
Southwest Region

# Audit Report

Farm Service Agency  
Payment Limitation Attestation Review  
in Wharton County, Texas

Report No. 03099-182-Te  
October 2008

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

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October 23, 2008

REPLY TO

ATTN OF: 03099-182-Te

TO: John Fuston  
State Executive Director  
Texas State Farm Service Agency Office  
College Station, Texas

FROM: Timothy R. Milliken /s/  
Regional Inspector General  
for Audit

SUBJECT: Farm Service Agency - Payment Limitation Attestation Review in Wharton County, Texas

On March 11, 2008, the Texas State Farm Service Agency (FSA) office requested that we review a business operation in Wharton County, Texas. As a four-member<sup>1</sup> partnership, this business had pursued, prior to 2003, interests in ranching, oil and gas, farming, and other investments. The members received approximately a quarter of the business' profits and losses. However, in 2003, the fourth member of the partnership exceeded the adjusted gross income limitation, and was no longer eligible for FSA farm program payments. As a result, the other three members of the partnership informed FSA that they were now operating their farming operation as a three-person joint venture with each member possessing a 33.33-percent share. In essence, they stated that they were separating their farming operation from the fourth member of the partnership, while the four-way partnership continued to pursue its business interests in ranching, oil and gas, and other investments.

As a result of a routine FSA review of the farming operations reported by the three-person joint venture, agency officials had concerns and requested that the Office of Inspector General (OIG) answer the following questions:

1. Did the members of the three-person joint venture maintain funds or accounts separate from those of any other individual or entity for their 2005 farming operation?

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<sup>1</sup> The four members are four testamentary trusts. Black's Law Dictionary defines a testamentary trust as a trust that is created by a will and takes effect when the settler (testator) dies. It can also be termed a trust under will.

2. Did the three persons involved in the joint venture make commensurate contributions to the 2005 farming operation, and did the partnership's accounting system correctly record those contributions?
3. Did the fourth member of the partnership share in the profits and losses of the 2005 three-person joint farming venture?

Based on our review, we are presenting the following answers for the Texas State FSA office's consideration in determining whether the farming operation in question met payment limitation requirements<sup>2</sup> for 2005.

1. The three members of the 2005 joint venture did not maintain bank accounts separate from the fourth member; however, the accounting system and related record keeping procedures of the partnership were adequate to differentiate between the 2005 joint venture's business interests and those of the fourth member.
2. The partnership's accounting practices recorded commensurate contributions by the three members of the 2005 joint venture.
3. The fourth member did not receive a share of the profits or losses of the 2005 three-person joint venture's farming operation.

## **BACKGROUND**

The Texas State FSA office requested OIG's assistance in reviewing financial records of the 2005 joint venture. The requested assistance related to questions raised during FSA's end-of-year payment limitation review of the joint venture's 2005 farm program participation in Wharton County and the payments received from that participation.

A key question arose when FSA officials reviewed the partnership's 2005 tax return and found that the four members were dividing the partnership's profits and losses approximately into quarters. This led FSA to question whether the three-person joint venture excluded the fourth person from the farming operation. Representatives of the partnership met with FSA and explained that the partnership's accounting system was separating all four person's income and expenses, and that payment limitation rules were being met. This explanation did not sufficiently satisfy the key question raised from the review of the partnership's 2005 tax return, and FSA State officials therefore requested OIG's assistance.

Prior to 2003, the four members of the partnership shared in the gains and losses of their wider business interests, each receiving approximately a quarter of the business' profits and losses. However, in 2003, the fourth member of this business exceeded the adjusted gross income limitation and could not qualify for FSA program payments. The other three members submitted a new farm operating plan to FSA showing that they were now operating their farm as a three-person joint venture with each member receiving a 33.33-percent share. Essentially, the fourth member was excluded from the partnership's farming activities.

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<sup>2</sup> Our answers only address FSA's questions concerning payment limitation rules for maintaining funds or accounts separate from that of any other individual or entity.

The new three-person joint venture was virtually in name only—there was no written agreement and no separate entity identification number.<sup>3</sup> The fourth member of the partnership leased its portion of land and equipment to the other three members for \$196,832 and \$9,500, respectively—these were considered reasonable rates by FSA. Although program payments were made to the four-person partnership's identification number, the business' accounting system credited these payments to the three members of the 2005 joint venture.

## **OBJECTIVE**

The objective of the review was to answer the Texas State FSA office's three questions. Basically, the Texas State FSA office requested that we determine if the three-person joint venture shared profits or losses of its 2005 farming operation with any other entity or individual, if the three members contributed to the 2005 farming operations commensurate with their claimed interests, and if the fourth member received a share of the 2005 joint venture's profits and losses from farming.

## **SCOPE AND METHODOLOGY**

To achieve the objective, we reviewed agency regulations; interviewed one of the principal beneficiaries in the farming operation; reviewed business, bank, and tax records of the partnership relating to its business operations for 2005; and interviewed the public accountant who prepared the tax returns of the partnership and three of the four members. Income tax returns of the partnership for years prior to 2005 were obtained for comparative analysis to similar records applicable to the 2005 program year. We reviewed program documents related to the 2005 farm program participation as provided by FSA personnel. Additionally, we interviewed staff at the Wharton County FSA office.

This review was performed in accordance with Government auditing standards for attestation agreements.<sup>4</sup>

## **DETAILS**

Regulations and the FSA Handbook<sup>5</sup> both state that in order for an individual or entity to be considered a separate person, the individual or entity must maintain funds or accounts separate from that of any other individual or entity for such interest.

The tax returns for the members of the 2005 three-person joint venture showed that they received all of the 2005 financial benefits (including FSA program payments) of the farming operation. Each reported 33.33 percent of the benefits from the farming operation on their respective tax returns. These three members continued to have other business relationships with the fourth

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<sup>3</sup> Black's Law Dictionary states that one of the elements of a joint venture is that it can be an expressed or implied agreement. The identification number used by the joint venture was the partnership's identification number.

<sup>4</sup> An attestation agreement is an examination, review, or an agreed-upon procedures report on a subject matter that is the responsibility of another party. In this case, ultimate responsibility for determining if the farming operation in question complied with payment limitation requirements belongs to FSA.

<sup>5</sup> Title 7, *Code of Federal Regulations*, section 1400.3, dated January 1, 2005, and *FSA Handbook* 1-PL (Revision 1), amendment 23, paragraph 110 B, dated April 25, 1994.

member through the partnership, independent of farming. The profits and losses of these nonfarming business endeavors were shared on an approximately quarterly basis.

For 2005, the revenues of the three-person joint venture were deposited into a bank account common to all four members' business enterprises, with the farming expenses and other farming expenditures paid from that account. However, the partnership's accounting and record systems were adequate to separate the income and expenditures of all four members. Our review disclosed that profit and loss from the three-person, joint-venture farming operation (an operating loss occurred for 2005) was distributed equally to the three participating members, as evidenced by the partnership's and each respective member's tax returns, as well as by the accounting records provided to us in support of the tax returns.

Furthermore, for program year 2005, the three members either owned or leased the land and equipment utilized by the joint venture. From these facts, we concluded that the three members' contributions to the farming operation—relative to land, equipment, and capital—were commensurate with the equal shares reported to FSA for the 2005 program year.

We concluded that the three members of the 2005 joint venture received, on an equal basis, the entire financial benefit of the 2005 farming operation, including 2005 FSA program payments.

## **CONCLUSIONS**

Based on the above information, we concluded:

1. The fourth member did not share in the profits or losses (including program payments) of the 2005 three-person, joint-venture farming operation.
2. The members conducting the 2005 three-person joint venture contributed to the farming operation commensurately since they owned or controlled the land and equipment.
3. Although neither the joint venture nor the three members maintained separate bank accounts for the farming operation, the partnership's accounting system distinguished its income and expenses from other business interests, including those of the fourth member.

If you have any questions, please call me at (254) 743-6565, or have a member of your staff contact Assistant Regional Inspector General for Audit Billy Engelke at (254) 743-6575.