U.S. Department of Agriculture

Office of Inspector General

American Recovery and Reinvestment Act Direct Farm Operating Loans (Phase 2)

Audit Report 03703-2-Te
January 2011

United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250

DATE: January 13, 2011

AUDIT NUMBER: 03703-2-Te

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SUBJECT: American Recovery and Reinvestment Act – Direct Farm Operating Loans (Phase 2)

Summary

This report presents the results of our review of the Farm Service Agency's (FSA) controls over its loan-making process for direct operating loans. In enacting the American Recovery and Reinvestment Act of 2009 (Recovery Act), Congress authorized a loan level of up to $173 million in direct operating loans, but also emphasized the need for accountability and transparency in the expenditure of funds. As part of the Office of Inspector General's (OIG) review of the expenditure of these Recovery Act funds, we judgmentally selected and reviewed 120 borrowers who received $14.4 million in Recovery Act funds. Our purpose was to validate, through testing, the eligibility of producers participating in the program, to verify that funds were used for eligible purposes, and to evaluate the effectiveness of FSA's compliance with loan-making management controls.

Overall, for these 120 borrowers, we found that FSA generally made direct operating loans to eligible producers and for eligible purposes. The agency had adequate control over its loan-making process, and the agency's employees generally complied with the agency's operating procedures for processing loans. We did find that the FSA employees involved in processing these loans sometimes did not follow all of FSA's procedures; however, the deficiencies were not significant.

The deficiencies we noted for three borrowers should have caused FSA to question whether to approve these loans, totaling $321,500. However, since all three of the borrowers reviewed either had repaid their loans or were in the process of repaying them, we did not feel that these minor errors justified formal corrective actions.

Most of the other deficiencies we found involved minor issues, such as not having producers sign portions of their farm business plan, not ensuring that documentation of lien searches was included in the file, or not following procedures to ensure that borrowers' security was adequate for their loans. We discussed these deficiencies with attorneys at the Office of the General Counsel, who assured us that these minor deficiencies would not prevent the Department of Agriculture (USDA) from seeking redress if borrowers failed to repay their loans. We also found that FSA's credit quality reviews, which verify that FSA employees' loan-making decisions comply with the agency's procedures,[1] did not always document that the reviewers had detected deficiencies in the loan-making process for direct operating loans. This occurred because instructions were unclear on how reviewers were to report instances of non-compliance on the credit quality review form.

In our conversations with FSA farm loan programs officials, we did communicate our concern that, in the future, minor deficiencies of this sort could result in loans being issued to borrowers who might be unable to repay their loans. FSA officials responded that they would consider implementing automated controls that would help prevent the types of minor deficiencies we found, that they would provide guidance to their employees to help them verify that a loan package was complete before they approved the loan, and that they would revise the credit quality review instructions to clarify how reviewers should report instances when employees do not fully comply with the agency's loan-making procedures.

OIG considers these actions adequate to resolve the issues we noted in our review. Accordingly, we are not making any recommendations in this report and no further action or response to us is required.

Background

FSA's mission is to equitably serve all farmers, ranchers, and agricultural partners through the delivery of effective, efficient agricultural programs for all Americans. FSA makes direct operating loans to family farmers and ranchers to help them finance their farming and ranching operations. In some cases, these farmers have suffered financial setbacks from natural disasters; others lack the resources necessary to establish and maintain profitable farming operations.

FSA makes and services direct operating loans so that borrowers can purchase livestock, farm equipment, fertilizer, pesticide, and utilities; borrowers can also use direct operating loan funds to pay for farm reorganization and to make payments on their farms.

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[1] FSA Handbook 1-FLP (Rev. 1), amendment 9, paragraph 27C, dated June 17, 2008.

FSA will approve loans to applicants only if it determines that:

- the applicant's farm business plan is feasible;
- the proposed use of loan funds is authorized for the type of loan requested;
- the applicant has been deemed eligible for the type of loan requested;
- all security requirements for the type of loan requested have been met or will be met before the loan is closed;
- the applicant's total indebtedness to FSA, including the proposed loan, will not exceed the maximum limits;
- there have been no significant changes in the farm business plan, or the applicant's financial condition since FSA received a completed application; and
- all other pertinent requirements have been met or will be met before the loan is closed.[2]

As part of ensuring that FSA is issuing quality loans, the agency reviews its employees who are processing loan applications to verify that they are following the agency's operating procedures. These reviews, known as credit quality reviews, can affect FSA employees' authority to make future loans. Employees who are making accurate loans can be granted authority to make more loans, while employees who are making inaccurate loans can have their loan threshold reduced.

Objectives

Our objective was to test controls over the loan-making process for direct operating loans. Specifically, we determined (1) if controls over the loan-making process were adequate and functioning as prescribed to ensure that Recovery Act funds were distributed only to eligible applicants and used for eligible loan purposes, and (2) the effectiveness of FSA's management controls that ensure compliance with the direct operating loan program policies and procedures (eligibility, use of funds, security of collateral, etc).

Scope and Methodology

We conducted our audit of direct farm operating loans funded by the Recovery Act at FSA's national office in Washington, D.C., and at 15 service offices in 6 States. We performed our audit fieldwork between October 2009 and June 2010.

For fiscal year 2009, FSA obligated 14,086 direct farm operating loans, totaling about $845 million. Within this larger program, the Recovery Act appropriated $20 million for direct farm operating loans, resulting in an available loan level of Recovery Act funds totaling $173 million. Based on our review of loan data in FSA's direct loan system as of November 18, 2009, we determined that there were 2,636 Recovery Act loans, totaling about $169.5 million.[3] From these loans, we excluded loans made in noncontiguous States and territories (due to travel considerations) as well as youth loans (since the amounts were not

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[2] FSA Handbook 3-FLP (Rev. 1), amendment 1, paragraph 262C, dated December 31, 2007.

[3] We make no representation as to the accuracy of the agency's Direct Loan System or the information generated from it. We accepted the data on face value and used them to select our samples.

significant). Our universe for the audit consisted of 46 States, 500 service offices, and 1,750 borrowers with 2,229 loans totaling $168 million.

Of the $168 million in Recovery Act loans, we judgmentally selected 6 States, 15 service offices, and 120 borrowers with 169 loans totaling $14.4 million. We reviewed loans in Georgia, South Carolina, Iowa, Nebraska, and Texas because these 5 States had a minimum of 20 borrowers each, at least 2 service offices in different districts, and because they are proximate to OIG's office in Temple, Texas.[4]

The sixth State we judgmentally selected was Oklahoma. Although Oklahoma is proximate, it did not have a minimum of 20 borrowers with at least 2 service offices in different districts. We included Oklahoma because we had reviewed it in Phase 1 of this audit. As part of our review of loans in Oklahoma, we added an additional eight borrowers from two additional service offices.

To accomplish our audit objectives:

- We reviewed applicable laws, regulations, policies, and procedures to gain an understanding of direct operating loans.
- We interviewed FSA officials to identify and assess FSA's oversight of direct operating loans funded by the Recovery Act.
- We obtained and reviewed the most recent Federal Manager's Financial Integrity Act Report for information related to audit coverage.
- We obtained and reviewed the most recent USDA Performance and Accountability Report to identify performance measures related to direct operating loans and to determine if FSA has established additional performance measures consistent with Recovery Act reporting requirements.
- We evaluated whether FSA had quantified the number of jobs created or maintained and met the reporting requirements for direct operating loans funded by the Recovery Act.
- We evaluated whether FSA had met the recipient reporting requirements.
- We reviewed borrower loan files to determine if the borrowers met eligibility requirements and used loan funds for eligible purposes. We recorded the file review results in a standardized collection document and communicated with FSA staff as needed to resolve discrepancies identified during the file reviews.
- We evaluated FSA's policies and procedures for conducting its internal control program and review processes, including district director oversight reviews, county operations

[4] Four other States met the criteria of having a minimum of 20 borrowers each and at least 2 servicing offices in different districts, but these States were more distant and were not reviewed due to costs associated with travel.

reviews, and credit quality control reviews. We reviewed and analyzed internal control and review process reports related to loans funded by the Recovery Act.

- We evaluated whether information for borrowers who are FSA employees was entered correctly into the FSA database, in order to ensure that loans were made according to FSA procedures.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objective. The evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.