



U.S. Department of Agriculture



Office of Inspector General  
Southwest Region

# **Audit Report**

## **Farm Service Agency Debt Forgiveness Restrictions on Borrower Eligibility for Farm Loan Programs**

**Audit Report 03016-2-Te  
March 2006**

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UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20250



March 31, 2006

REPLY TO

ATTN OF: 03016-2-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 Debt Forgiveness Restrictions on Borrower Eligibility for  
Farm Loan Programs

This report presents the results of the subject audit. FSA's February 15, 2006, written response to the draft report is included as exhibit B. Excerpts from this response, subsequent information provided by FSA, and the Office of Inspector General's positions are incorporated into the relevant Findings and Recommendations sections of the report.

Based on the information provided and actions taken by FSA, management decisions have been reached for all five recommendations contained in the report. Please follow Departmental and your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer, Director, Planning and Accountability Division. Departmental regulation requires final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

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

# Executive Summary

## Farm Service Agency Debt Forgiveness Restrictions on Borrower Eligibility for Farm Loan Programs (Audit Report 03016-2-Te)

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### Results in Brief

The Farm Service Agency's (FSA) Farm Loan Programs (FLP) provide financial assistance in the form of loans to farmers and ranchers unable to obtain commercial credit from other sources. In 2004, for instance, FSA approved 2,685 FLP loans for borrowers across the United States, with total obligations of more than \$323 million. Although most of these loans will be paid back, some will not. When borrowers are unable to repay their FLP loans in full, Congress has required that FSA consider them ineligible for future loans. The Office of Inspector General (OIG) initiated this audit to determine if FSA had implemented an effective system for ensuring that applicants do not receive additional FLP loans if they have had prior FLP debts forgiven, according to the terms of the Consolidated Farm and Rural Development Act (CONACT).<sup>1</sup> We found that, for the 6-year period from 1999 through 2004, FSA's internal controls did not prevent 98 ineligible applicants from receiving 127 FLP loans totaling more than \$9.0 million.

In order to evaluate FSA's system for preventing ineligible applicants from receiving loans, we data mined all 139,466 active direct and guaranteed loans in FSA's database in order to isolate 239 potentially ineligible borrowers.<sup>2</sup> A detailed review of six potentially ineligible borrowers revealed that three were, in fact, ineligible and should not have received FLP loans. FSA, upon further review, confirmed that a total of 98 of these 239 borrowers (41 percent) were ineligible because they had caused the agency a loss when they were forgiven debt on prior CONACT loans. These errors occurred because FLP loan officials did not follow established procedures for determining applicants' eligibility prior to issuing additional loans, and because FSA has not established an independent review process to ensure the accuracy of loan officials' eligibility determinations.

We also found that the automated management tools FLP loan officials rely on to determine applicants' eligibility were either lacking complete information or not being used, as indicated in the following examples.

- In response to a prior OIG audit,<sup>3</sup> FSA agreed to modify its Management of Agricultural Credit System (MAC) to cross-check new applications against borrowers who had defaulted on prior FLP loans. Although FSA had developed the cross-check, we found that defaulted borrower information downloaded to MAC was not

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<sup>1</sup> Consolidated Farm and Rural Development Act (Public Law 87-128), section 373, subsection (b), as amended, dated January 23, 2004.

<sup>2</sup> See Scope and Methodology for a complete explanation of how we arrived at this sample.

<sup>3</sup> Audit Report 03601-28-Te, 1996 Farm Bill Provisions Affecting FLP Direct Loan Servicing, dated May 17, 1999.

always complete; therefore, applicable information was not always being considered when loan officials determined applicants' eligibility. Currently, FSA is in the process of replacing MAC with the Farm Loan Program Information Delivery System (FLPIDS). The first phase of FLPIDS to be implemented will include debt history information and is scheduled to be complete by the summer of 2006.

- Agency procedures also did not require FLP loan officials to use all resources available to assess applicants' eligibility. Although applicants' histories with direct and guaranteed FLP loans are stored in different databases, procedures require that loan officials verify applicant eligibility only in the Automated Discrepancy Processing System (ADPS) —this database contains information only on direct loans. As a result, important information relating to applicants' credit history with guaranteed loans [stored on the Guaranteed Loan System (GLS)] could be overlooked during the loan approval process. During the audit, FSA issued a temporary directive (notice) to require FSA personnel to use both ADPS and GLS to determine an applicant's prior debt history.

We conclude that FSA should improve its controls for ensuring that applicants whose previous debts have been forgiven per the CONACT are judged ineligible for additional FLP loans. These improvements should include instituting an independent review to verify eligibility determinations, and correcting weaknesses in the automated management tools FLP loan officials rely on to make these determinations.

## **Recommendations In Brief**

To strengthen controls over FLP eligibility requirements, we recommend that FSA:

- Initiate appropriate servicing and collection actions for the \$9 million in unauthorized FLP assistance.
- Revise its FLP procedures to require an independent review of loan officials' eligibility determinations when the applicant has been forgiven a previous FLP debt.
- Ensure that complete debt forgiveness history (guaranteed and direct) is accessible to FLPIDS.
- Develop and implement an automated cross-check to flag potentially ineligible borrowers (who have received prior FLP debt forgiveness).
- Until FLPIDS is operational and an automated cross-check is implemented, FSA should revise its handbook(s) (permanent directives) to ensure FLP personnel use both ADPS and GLS to determine the eligibility of FLP applicants.

## **Agency Response**

In its February 15, 2006, response and subsequent information provided on March 8, and March 13, 2006, FSA reported that all 127 loans questioned in this report have been serviced, and collection proceedings have been initiated for ineligible loans. Based on its servicing, FSA deemed 14 loans totaling \$1,511,860 eligible, while 113 loans totaling \$7,541,144 remained ineligible. Of the 113 ineligible loans, 30 loans have been paid in full, 4 were liquidated, and the loss for 3 loans was repaid. The recipient of one loan was convicted of fraud, while the recipient of another loan has offered a compromise accelerated repayment agreement. For the 74 remaining ineligible loans, FSA considers these accounts fully serviced and will collect the accounts that remain through standard collection procedures. Also, FLPIDS is scheduled to be operational in July 2006, and complete debt forgiveness history for both guaranteed and direct loans will be accessible to the system. Until FLPIDS is operational, FSA has issued a notice giving specific guidance on procedures to ensure agency officials check all applicable systems (guaranteed and direct) to determine whether an applicant has received prior debt forgiveness. FSA will keep the notice effective until FLPIDS is operational.

## **OIG Position**

Based on the information provided and actions taken by FSA, we have reached management decisions for all recommendations in the report. We commend FSA for its prompt servicing actions on these loans. Under each recommendation, we have outlined those actions necessary to complete final action on the recommendation.

## ***Abbreviations Used in This Report***

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ADPS	Automated Discrepancy Processing System
CONACT	Consolidated Farm and Rural Development Act
DLS	Direct Loan System
FLP	Farm Loan Programs
FLPIDS	Farm Loan Program Information Delivery System
FSA	Farm Service Agency
GLS	Guaranteed Loan System
MAC	Management of Agricultural Credit System
OCFO/PAD	Office of the Chief Financial Officer, Director, Planning and Accountability Division
OIG	Office of Inspector General
PLAS	Program Loan Accounting System

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# ***Background and Objectives***

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## **Background**

The Farm Service Agency's (FSA) Farm Loan Programs (FLP) provide financial assistance to farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System institution, or other lender. In 2004, FSA approved 2,685 FLP loans with a total obligation of \$323 million for borrowers across the United States and surrounding territories. However, when a borrower causes the agency a loss by defaulting on a direct or guaranteed FLP loan, FSA is required to follow the Consolidated Farm and Rural Development Act (CONACT), which generally prohibits loans for borrowers whose prior FLP debts have been forgiven.

The CONACT, as amended, currently serves as the authorizing statute for FSA's FLP. FSA regulations and the CONACT establish specific guidelines for applicant eligibility for FLP loans.

According to the CONACT, a guaranteed loan cannot be made to an applicant whose debt on any CONACT loan, including FLP loans,<sup>4</sup> was forgiven after April 4, 1996, or to an applicant whose debt was forgiven on more than three occasions on or before April 4, 1996. The CONACT does provide for some exceptions, however. A borrower whose debt was forgiven only once prior to April 5, 1996 (and not at all after April 4, 1996), can be considered for emergency loans. Borrowers whose debts were forgiven as a result of an administrative debt restructuring process, or who are current on payments under a confirmed bankruptcy reorganization plan, can be considered for either a direct or guaranteed operating loan for payment of their annual expenses.

FSA eligibility provisions also provide exceptions to the preceding guidelines. They state that otherwise-qualified applicants may receive a direct or guaranteed operating loan to pay annual farm and ranch operating and family living expenses, even if the applicant and anyone who will execute the promissory note: (1) received a writedown under section 353 of the CONACT; (2) is current on payments under a confirmed reorganization plan under Chapter 11, 12, or 13 of Title 11 of the United States Code; and (3) received debt forgiveness on not more than one occasion after April 4, 1996, resulting directly and primarily from a Presidentially designated emergency for a county or contiguous county in which the applicant operates.

Unless they fall within one of the exceptions mentioned above, direct FLP loans cannot be made to applicants whose prior debts have been forgiven; applicants are limited to one administrative "debt forgiveness" on a direct FSA loan, and the prohibition on making or guaranteeing loans to delinquent borrowers remains unchanged.

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<sup>4</sup> CONACT loans include a number of programs, of which FLP is one.

FLP personnel have three automated systems to use as resources to determine a borrower's past debt history. The county office Management of Agricultural Credit System (MAC) tracks and reports on the processing of loan applications from the receipt of an application through loan closing, including servicing options and time frames. FLP personnel can use MAC to view a borrower's past debt information. The national office uses uploaded MAC data in reports to Congress, to the USDA Office of Civil Rights, and to FSA upper management.

The two other systems are the Automated Discrepancy Processing System (ADPS) and the Guaranteed Loan System (GLS). ADPS provides borrowers' debt history for direct loans; GLS provides borrowers' debt history for guaranteed loans.

In 1999, the Office of Inspector General (OIG) issued an audit report that identified \$24.1 million in improper and questionable direct and guaranteed FLP loans.<sup>5</sup>

## **Objectives**

We initiated this review to determine whether FSA has implemented an effective system of internal controls to ensure that applicants who have received debt forgiveness on prior FLP loans do not receive additional FLP loans.

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<sup>5</sup> Audit Report 03601-28-Te, 1996 Farm Bill Provisions Affecting FLP Direct Loan Servicing, dated May 17, 1999.

# Findings and Recommendations

## Section 1. Improvements Needed in FSA's Controls Over Loan Making

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### Finding 1

#### **FSA Should Improve Its Process for Determining FLP Applicants' Eligibility**

Of the 239 borrowers with 358 FLP loans identified through our data mining efforts, 98 applicants should have been determined ineligible according to the provisions of the CONACT. This occurred because FSA's controls for ensuring that all applicants meet its eligibility requirements need strengthening. Specifically, controls need strengthening because (1) FLP loan officials did not follow established procedures to determine if applicants' prior debts to the Government had been forgiven; (2) FSA does not independently review loan officials' eligibility determinations to verify their accuracy; and (3) the automated management tools FLP loan officials rely on when determining applicants' eligibility were either lacking complete information or not being used. As a result, FSA issued 127 loans totaling more than \$9 million to the 98 ineligible applicants over the 6-year period of 1999 through 2004.

When applicants apply for a direct or guaranteed FLP loan, FLP employees are required to follow established general eligibility procedures.<sup>6</sup> To determine if an applicant is eligible, employees must verify that the applicant—and anyone who will execute the promissory note—has not caused the Government a loss by receiving debt forgiveness on all or a portion of any direct or guaranteed loan made under the authority of the CONACT.<sup>7</sup> Such “forgiveness” includes debt writedown or writeoff; compromise, adjustment, reduction, or chargeoff under the CONACT; a discharge in bankruptcy; and the payment of a guaranteed loss claim.

We found, however, that FSA could not ensure that loans were issued only to applicants meeting these standards of eligibility. In particular, we found that FLP loan officials sometimes failed to apply FSA's eligibility requirements, and that the automated management tools these officials rely on to determine eligibility could be improved.

#### **FLP Loan Officials Did Not Follow Eligibility Determination Procedures**

Although FSA had implemented procedures to exclude applicants whose debts had been forgiven, some FLP loan officials did not follow those procedures and issued loans, even though the applicant should have been

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<sup>6</sup> *Farmers Home Administration Instruction 1941-A*, sections 12(a)(8) and (b)(11), dated October 14, 1988; *Farmers Home Administration Instruction 1943-A*, sections 12(a)(8) and (b)(10), dated October 14, 1988; *FSA Handbook 2-FLP* (amendment 17), dated March 10, 2004; and *FSA Handbook 3-FLP* (amendment 2), dated May 7, 2002.

<sup>7</sup> See Background for a description of exceptions applicable to this statement.

judged ineligible. We reviewed 6 of the 239 borrowers identified as potentially ineligible. Our review found that FLP officials mistakenly approved three of the six borrowers as eligible when they were, in fact, ineligible. Specifically,

1. An FLP loan official approved an unauthorized direct operating loan for \$59,680, although FSA records indicate that the applicant's debt had been forgiven on several prior FLP loans. Due to debt forgiveness restrictions imposed by the Federal Agriculture Information and Reform Act of 1996, which stipulated that eligible applicants can only have their debt forgiven once on direct FLP loans, the applicant should have been judged ineligible for FLP assistance. When asked why he approved the loan, the loan official admitted he was confused about procedures differentiating a writedown from a writeoff;<sup>8</sup> after reviewing these procedures, he agreed that the loan should not have been made.
2. Another loan official approved two guaranteed operating loans totaling \$123,410 for an applicant who received debt forgiveness effective April 9, 1996—5 days after the effective date of the Federal Agriculture Information and Reform Act of 1996, which prohibited FSA from making FLP loans to applicants who received debt forgiveness on or after April 4, 1996. The employee stated that he approved the loan based on the date the applicant applied for the debt settlement instead of the actual date the applicant's debt was settled. The Texas State FSA farm loan officer confirmed that the employee should have used the date the debt was settled, not the date of the application. This applicant was, therefore, ineligible.
3. A third FLP loan official approved a direct operating loan for \$42,000 for an applicant, even though that applicant was ineligible for the loan due to a writedown received during an administrative debt restructuring process. The provisions of the CONACT prohibit FSA from making a term direct operating loan to an applicant that has received debt forgiveness through restructure with a writedown. The official stated that he approved the loan after a discussion with a State office specialist in which they concluded that the borrower was eligible since his debt was written down and rescheduled; however, after we questioned this loan, they later determined that their interpretation of FSA procedure was incorrect.

In sum, our review identified three borrowers who received FLP loans totaling \$225,090, even though they should have been judged ineligible.

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<sup>8</sup> A "writedown" is when the amount a borrower owes is reduced in order to permit the borrower to continue making payments; a "writeoff" is when the lender forgives the entire sum the borrower owes.

When we presented the results of our preliminary analysis and field verification to FSA, the agency directed its State and county offices to review all potentially ineligible borrowers we identified. FSA determined that 98, or 41 percent, of the 239 borrowers had received loans totaling more than \$9 million, even though they were ineligible because their prior debts had been forgiven. FSA concluded that these errors, like those in our detailed review, occurred because loan officials did not follow procedures. Also, because there was no independent review of loan officials' eligibility determinations, FSA did not identify and correct these errors prior to issuing the loans.

### **FSA's Automated Controls for Determining Applicants' Eligibility Need Improvement**

In our prior audit, we identified \$24.1 million in improper and questionable direct and guaranteed FLP loans. In its written response to the prior audit, FSA stated that it would modify MAC to cross-check new applicants against borrowers in default. Although FSA modified MAC, we found the cross-check was not effective because of incomplete downloaded information.

County office employees are required to use MAC to review FLP applicants' debt forgiveness history. However, we found, and FSA agreed, that the debt history data in MAC is incomplete, compared to data in FSA's national debt settlement and guaranteed loss claim databases. At one county office, we found that MAC did not contain the debt history information we had obtained from the national databases for our sample borrower. When informed of our finding, the FSA national senior loan officer contacted another FSA county office and checked other applicants from our universe of potentially ineligible borrowers. It was found that debt histories could not be located in MAC at that county as well. The senior loan officer stated that the missing data was caused by a download problem of the debt history information. We conclude that MAC is not currently an effective management tool for preventing ineligible applicants from receiving FLP loans.

FSA officials stated, however, that MAC is being phased out. They are in the process of developing the Farm Loan Program Information Delivery System (FLPIDS) that will link with other systems (GLS, ADPS, etc.) to provide FLP officials total debt history for applicants. FLPIDS is scheduled to be implemented in two phases. Phase I will cover loan making to include debt history information, and is scheduled to be completed in the summer of 2006. Phase II will include debt servicing and is scheduled to be completed 6 to 8 months after Phase I.

In addition to MAC, FSA employees are required to use ADPS as another control for identifying applicants whose debts have been forgiven; however, ADPS only reports information on direct loans. To determine whether FSA has forgiven debt on a prior FLP guaranteed loan, employees would have to access GLS, but FSA does not require its employees to access GLS as a regular part of the approval process. If used alone, FSA's debt inquiry screen in ADPS will not always provide all the information necessary for employees to make accurate loan eligibility decisions.

During the audit, FSA issued a notice providing guidance and instructions to aid county offices in researching and verifying if an applicant has received debt forgiveness. The notice, which expires December 1, 2006, requires loan approval officials to use both ADPS and GLS to determine an applicant's prior debt history.

## **Recommendation 1**

Initiate servicing and collection actions for the \$9 million in unauthorized FLP assistance.

### **Agency Response.**

In its February 15, 2006, written response, FSA stated that on March 7, 2005, a letter was sent directing all FSA State offices that had cases (127 loans) identified by this audit to begin reporting on the resolution of the cases identified. As of January 3, 2006, all loans have been serviced through some final resolution. FSA provided a summary (see exhibit B) of resolutions and a spreadsheet detailing the resolution of each account.<sup>9</sup>

On March 13, 2006, FSA sent a revised spreadsheet showing the servicing actions on all 127 loans totaling \$9,053,004. Based on the revised spreadsheet, FSA subsequently determined that 14 loans totaling \$1,511,860 were eligible. The other 113 loans totaling \$7,541,144 were determined to be ineligible. Of the 113 ineligible loans, 30 have been paid in full, 4 were liquidated, and the loss for 3 was repaid. The recipient of one loan was convicted of fraud, while the recipient of another loan was offered an accelerated repayment agreement. For the 74 remaining ineligible loans, FSA considers these accounts fully serviced and will collect the accounts through standard collection procedures.

### **OIG Position.**

We concur with the management decision for Recommendation 1 and commend FSA for its timely servicing of these loans. In our opinion, final action has occurred. For acceptance of final action, FSA should provide the

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<sup>9</sup> FSA's February 15, 2006, response did not account for all 127 loans identified by this audit. The summary addressed 117 loans, and an attached spreadsheet addressed 124 loans. At OIG's request, FSA then submitted a revised spreadsheet accounting for all 127 loans—this spreadsheet was received on March 13, 2006.

Office of the Chief Financial Officer, Director, Planning and Accountability Division (OCFO/PAD) documentation of the servicing and collection determinations for the 113 ineligible loans.

## **Recommendation 2**

Revise FLP loan eligibility procedures to require an independent review, prior to loan approval, for applications received when the applicant has received debt forgiveness on a prior FLP loan.

### **Agency Response.**

In its February 15, 2006, letter, FSA disagreed with this recommendation because it would be overly burdensome for field staff and would cause unwarranted delays in processing loan applications. Moreover, FSA stated that *Notice* FLP-408 will correct the problems identified in this audit. This notice gives specific guidance on procedures to be used to check all systems to determine whether an applicant has received prior debt forgiveness from the agency.<sup>10</sup> FSA does not see any significant benefit from an independent review if the procedures outlined in this notice are followed. Also, its new automated system (scheduled to be operational in July 2006) will show debt forgiveness data on all borrowers with both direct and guaranteed loans. (See agency response to Recommendation 5.)

On March 8, 2006, FSA sent a supplemental response stating that *Notice* FLP-408 will be reissued in December 2006 if the FLPIDS is not implemented by that time. This notice will remain in effect until FLPIDS is operational.

### **OIG Position.**

We concur with the management decision for Recommendation 2. We agree with the alternate action as provided by the guidance in *Notice* FLP-408, and the agency's assurance that the notice remain in effect until FLPIDS is operational. For final action, FSA needs to provide OCFO/PAD documentation showing that FLPIDS is operational, or documentation showing that it has extended *Notice* FLP-408 until FLPIDS is operational.

## **Recommendation 3**

Review, test, and update data completeness controls to ensure that complete debt forgiveness history (guaranteed and direct) is accessible to FLPIDS.

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<sup>10</sup> OIG expressed concern that *Notice* FLP-408 was not permanent and was scheduled to expire on December 1, 2006. In response to these concerns, FSA stated on March 8, 2006, that *Notice* FLP-408 would be reissued in December 2006 if FLPIDS had not yet become operational.

## **Agency Response.**

In its February 15, 2006, written response, FSA stated that, once FLPIDS becomes operation in July 2006, it will interface with the Program Loan Accounting System (PLAS) to obtain the debt forgiveness or loss data for both direct and guaranteed loan borrowers. In the loan making module of FLPIDS, known as the Direct Loan System (DLS), when a loan application is entered into the system, the customer profile screen will automatically appear. This screen will display any information on debt forgiveness associated with an applicant's social security number or taxpayer identification number. An FSA employee will not be able to enter an application into the system without seeing the applicant's debt forgiveness history. Under this system, applications cannot be funded unless they have been entered into the system, so employees will see the customer profile screen for every applicant whose loan is funded.<sup>11</sup>

FLPIDS' DLS will be tested by the programmers, FSA automation and accounting staff, FSA program staff, and field users. DLS with the customer profile information will be a pilot program in two States before it is released nationwide. The data on debt forgiveness (both direct and guaranteed loan information) will be updated daily from PLAS. Interface will be much easier with the web application than the current MAC on the AS400/A36 local automated system.

In a supplemental response on March 8, 2006, FSA further explained that the GLS system interfaces with PLAS. All guaranteed borrower loss information is maintained in PLAS, but can currently only be accessed through GLS. FLPIDS will only need to interface with PLAS to have loss information on both guaranteed and direct loans.

## **OIG Position.**

We concur with the management decision for Recommendation 3. For final action, provide OCFO/PAD documentation that FLPIDS is fully operational and that FSA employees have access to complete debt forgiveness histories for both direct and guaranteed loans.

## **Recommendation 4**

Develop and implement in FLPIDS an automated cross-check to flag potentially ineligible borrowers.

## **Agency Response.**

In its February 15, 2006 written response, FSA stated that FLPIDS will act as an automated cross-check to flag potentially ineligible borrowers by

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<sup>11</sup> Because OIG understood that GLS must be accessed to obtain guaranteed loan information, as required in *Notice FLP-408*, we requested that FSA explain more fully how PLAS would interface with GLS. FSA supplied that information on March 8, 2006.

interfacing with PLAS to obtain the debt forgiveness or loss data for both direct and guaranteed loan borrowers. This information will be automatically displayed on the customer profile screen. FSA employees processing loan applications will review this information prior to approving any borrowers.

In a supplemental response on March 8, 2006, FSA further explained that GLS interfaces with PLAS. All guaranteed borrower loss information is maintained in PLAS, but can currently only be accessed through GLS. FLPIDS will only need to interface with PLAS to have loss information on both guaranteed and direct loans.

### **OIG Position.**

We concur with the management decision for Recommendation 4, as FLPIDS will serve as an adequate cross-check for flagging potentially ineligible borrowers. For final action, FSA needs to provide OCFO/PAD documentation that FLPIDS is operational and automatically displays customer profile screens for both direct and guaranteed loans.

## **Recommendation 5**

Until such time that FLPIDS is operational and an automated cross-check is developed and implemented, FSA should revise its handbook to ensure that county offices use both ADPS and GLS to determine the eligibility of FLP applicants.

### **Agency Response.**

In its February 15, 2006, written response, FSA stated that FLPIDS' DLS, which includes the customer profile with debt forgiveness data on all borrowers, will be operational in July 2006. In the meantime, FSA has issued *Notice* FLP-408 detailing how to verify previous debt forgiveness for borrowers with direct and/or guaranteed loans.

On March 8, 2006, FSA sent a supplemental response stating that *Notice* FLP-408 will be reissued in December 2006 if FLPIDS is not implemented by that time.<sup>12</sup> This notice will continue to be in effect until FLPIDS is operational.

FSA had previously argued that a permanent revision to the handbook is not necessary, as once FLPIDS is operational such a revision would be redundant; until FLPIDS becomes operational, *Notice* FLP-408 will serve as an adequate control to ensure that county offices use both ADPS and GLS to determine FLP applicants' eligibility.

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<sup>12</sup> The notice is scheduled to expire on December 1, 2006.

**OIG Position.**

We concur with the management decision for Recommendation 5, as the revision to the handbook is not necessary given FSA's recent actions. For final action, FSA needs to provide OCFO/PAD documentation showing that FLPIDS is operational, or that *Notice* FLP-408 will be continued until such time as FLPIDS is operational.

# ***Scope and Methodology***

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We evaluated FSA's management controls for ensuring that FLP loans are not issued to applicants who are ineligible due to having prior debts forgiven, according to the terms of the CONACT. From December 2003 through June 2005, we performed audit work at the FSA National Office and at selected Texas FSA county offices. Using FSA's national databases, we developed automated routines to identify potentially ineligible borrowers who may have received additional FLP loans. We also reviewed FSA's automated loan making controls to determine whether an effective control system had been implemented to prevent ineligible applicants from receiving FLP loans.

We selected all active direct and guaranteed FLP loans FSA had made on or after October 21, 1998, the effective date of the Omnibus Consolidated and Emergency Supplementation Appropriations Act of 1999. As of October 1, 2004, FSA's database included 139,466 such loans.

Using data mining techniques on these total active loans, we identified 6,630 loans to 3,427 borrowers who had received prior debt forgiveness. From these borrowers, we identified 239 potentially ineligible borrowers receiving 358 loans. In order to determine the validity of our techniques, we then judgmentally selected for detailed review six borrowers, serviced by FSA offices located in Hamilton, Levelland, Lubbock, Littlefield, and Lamesa Counties, Texas, who received eight potentially unauthorized FLP loans.

Since 50 percent of our sampled loans (3 of 6) were issued to ineligible borrowers, we met with FSA and presented our findings. In response, the agency reviewed our list of potentially ineligible borrowers. From its review, FSA determined that 98 borrowers were, in fact, ineligible, and should not have received 127 loans totaling over \$9 million.

We also tested the reliability of FSA debt history and loss claim data downloaded to MAC by comparing information in MAC to data extracted from FSA's national debt settlement and guaranteed loss claim databases.

We then accessed and evaluated the automated management tools that FLP loan officials use for processing loan applications and verifying applicants' eligibility.

This audit was conducted in accordance with generally accepted Government auditing standards. Therefore, the audit included tests of program and accounting records considered necessary to meet the audit objectives.

# Exhibit A – Summary of Monetary Results

FINDING NUMBER	RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	1	FLP Loans Made To Applicants With Prior Debt Forgiveness	\$9,053,004	Questioned Cost - Recovery Recommended
<b>Total</b>			<b>\$9,053,004</b>	



United States  
Department of  
Agriculture

Farm and Foreign  
Agricultural  
Services

Farm Service  
Agency

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FEB 15 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:** Response to Audit 03016-2-TE, FSA Debt Forgiveness Restrictions on  
Borrower Eligibility for Farm Loan Programs

### Recommendation 1

On March 7, 2005, a letter was sent directing all Farm Service Agency (FSA) State Offices that had cases identified by this audit to begin reporting on the resolution of the cases identified. As of January 3, 2006, all loans have been serviced through some final resolution. The following is a summary of each resolution:

- 69 loans were processed through 1951-L and due to the borrowers' inability to pay the account in full or at an accelerated rate, FSA is continuing with the borrowers
- 30 loans were paid in full
- 9 loans were subsequently discovered eligible because the borrower had assumed loans that had write-down with the former borrower or the borrower's only write-down was previous to April 4, 1996
- 9 guaranteed loans had their lenders informed, by letter that their borrower was not eligible for any further assistance, including annual operating, until the unauthorized loan is paid in full
- 4 borrowers repaid the write-down they received to restore their eligibility
- 4 accounts were liquidated
- 2 borrowers were subsequently discovered to be part of the Consent Decree group of eligible borrowers
- 1 borrower offered a compromise accelerated repayment agreement
- 1 borrower was formally investigated and subsequently convicted of fraud for when he obtained the loan.

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A report detailing the resolution of each account is attached. FSA considers these accounts fully serviced and will collect the accounts that remain through standard collection procedures.

Recommendation 2

The Agency does not agree with this recommendation and has determined that it would be overly burdensome for field staff and would cause unwarranted delays in processing loan applications. The Agency guidance which was put in place with Notice FLP-408 (attached) will correct the problems identified in this audit. This notice gives specific guidance on procedures to be used to check all systems to determine whether an applicant has received prior debt forgiveness from the Agency. We do not see any significant benefit from an independent review if the procedures outlined in this notice are followed.

Recommendation 3

Farm Loan Programs Information Delivery System (FLPIDS) will interface with the Program Loan Accounting System (PLAS) to obtain the debt forgiveness or loss data for both direct and guaranteed loan borrowers. In the Loan Making module of FLPIDS, known as the Direct Loan System (DLS), when a loan application is entered into the system, the customer profile screen will automatically appear. This screen will display any information on debt forgiveness associated with an applicant's Social Security Number or Taxpayer Identification Number. An FSA employee will not be able to enter an application into the system without seeing the debt forgiveness information on an applicant. Under this system, applications cannot be funded unless they have been entered into the system so employees will see the customer profile screen for every applicant whose loan is funded. Attached is an example of the customer profile screen.

The FLPIDS DLS will be required to be tested by the programmers, FSA automation and accounting staff, FSA program staff and field users. DLS with the customer profile information will be a pilot program in two States before it is released nationwide. The data on debt forgiveness (both direct and guaranteed loan information) will be updated daily from PLAS. Interfaces will be much easier with the web application than the current Management Agricultural Credit System on the AS400/A36 local automated system.

Recommendation 4

FLIPIDS will interface with the PLAS to obtain the debt forgiveness or loss data for both direct and guaranteed loan borrowers. This information will be automatically displayed on the customer profile screen.

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Recommendation 5

FLIPIDS' DLS, which includes the customer profile with debt forgiveness data on all borrowers, will be in production in July 2006. In the meantime, FSA has issued Notice FLP-408 detailing how to verify previous debt forgiveness for borrowers with direct and/or guaranteed loans.