United States Department of Agriculture

OFFICE OF INSPECTOR GENERAL

Farm Service Agency Microloan Program

03601-0003-22

September 2015

Farm Service Agency Microloan Program

Audit Report 03601-0003-22

What Were OIG's Objectives

The overall audit objectives were to evaluate the internal controls for FSA's administration of application processing, eligibility, servicing, and security requirements for the Microloan Program, and to document the strategies and actions taken to determine if the Microloan Program is expanding access to credit to a variety of producers.

What OIG Reviewed

We visited the FSA national office and field offices in Florida, Georgia, and Wisconsin, where we reviewed loans from fiscal years 2013-14 and records of outreach activities. We interviewed staff that issue microloans, producers with microloans, and the national outreach director and field staff.

What OIG Recommends

FSA needs to develop and implement controls and guidance to achieve consistent administration of microloans, periodically evaluate outreach activities to ensure effective marketing to target groups, and develop an accurate measurement of success for its outreach program.

OIG reviewed FSA's controls for marketing and administering Microloans in order to make credit available to eligible producers.

What OIG Found

OIG evaluated FSA's controls for administering the Microloan Program. Although our review concluded that FSA's controls appear adequate to achieve the program's goals, opportunities exist to improve operations in areas where FSA required excessive security for loans, inconsistently filed security liens, and inconsistently established microloan repayment terms. This happened because Farm Loan Programs field staff found it challenging to apply the microloan requirements that differed from the traditional Direct Operating Loan Program provisions and needed additional guidance for administering microloans. Because of the inconsistent application of the new Microloan Program requirements, FSA may place unnecessary burdens and cause financial strain on microloan borrowers, and may create the appearance of inequitable treatment.

We also found that FSA could not demonstrate that it had successfully reached out to some target audiences; this was due to limited budgets and staffing, and because FSA's methodology for determining those reached does not provide accurate measures. As a result, FSA may not fully achieve its objective of providing support to current and prospective producers, including underserved groups and veterans. If the agency does not market its programs effectively to all producers, including underserved groups, then some producers may not receive the information and assistance they need to succeed, and those producers may perceive that FSA is treating them inequitably.

FSA generally agreed with our findings and we accepted management decision on six of the seven recommendations.

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

DATE: September 23, 2015

AUDIT NUMBER: 03601-0003-22

TO: Val Dolcini
Administrator
Farm Service Agency

ATTN: Perry Thompson
Director
Operations Review and Analysis Staff

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Farm Service Agency Microloan Program

This report presents the results of the subject audit. Your written response, dated September 10, 2015, is included in its entirety at the end of the report. Excerpts from your response and the Office of Inspector General's (OIG) position are incorporated in the relevant sections of the report. Based on your September 10, 2015, response, we were able to accept management decision on Recommendations 1, 2, 3, 4, 6, and 7 in the report. Management decision has not been reached on Recommendation 5. To reach management decision on this recommendation, please see the relevant OIG Position section in the audit report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendation for which management decisions has not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publically available information and will be posted in its entirety to our website (http://www.usda.gov/oig) in the near future.

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Background and Objectives

Background

The Department of Agriculture's (USDA) Farm Service Agency's (FSA) mission is to equitably serve all producers and agricultural partners by delivering effective, efficient agricultural programs to all Americans. FSA administers the Farm Loan Programs (FLP), which makes direct farm ownership and operating loans to producers to purchase farmland and finance agricultural production. FLP helps producers who are temporarily unable to obtain private commercial credit. The goal of FLP is to graduate its borrowers to commercial credit. Once a producer can obtain credit from the commercial lending sector, the program has completed its goal, helping American producers towards financial stability.

FSA makes direct operating loans so that borrowers can purchase livestock, feed, farm equipment, farm chemicals, insurance, and fund other operating costs, including family living expenses. Borrowers may also use direct operating loans to pay for farm reorganization and refinancing of farm-related debt. A borrower must meet general eligibility requirements before receiving a direct loan from FSA. For example, a borrower must demonstrate sufficient managerial ability to assure reasonable prospects of loan repayment. An eligible borrower may obtain direct loans for up to a maximum indebtedness of $300,000.

FSA developed the Microloan Program to better serve the unique financing needs of beginning, niche, and the smallest of family farm operations, including socially disadvantaged farmers and ranchers, by modifying its original direct operating loan application, eligibility, and security requirements. The Microloan Program offers flexible access to credit and serves as an attractive loan alternative for smaller farm operations, including nontraditional farm operations, which often face limited financing options.

To accomplish this, FSA simplified the application process by reducing the amount of required documentation. It provided microloan applicants with alternative options for meeting managerial experience requirements by proving past participation with an agriculture-related organization,[1] or documenting a combination of prior experience in farm work or small business management and a written description of a self-directed apprenticeship.[2] Also, FSA reduced the security requirements for microloans. Prior to implementing the Microloan Program, FSA required that all direct loans be secured by a first lien on farm property or on agricultural products that result in a security value of at least 100 percent of the loan amount, and also required additional security up to 150 percent of the loan value, when available.[3] However, for microloans, FSA stated that the additional security up to 150 percent should only be required for microloans made

[1] Agriculture-related organizations may include but are not limited to the following: 4-H Clubs, Future Farmers of America, Beginning Farmers and Ranchers Development Program, or Community Based Organizations, that demonstrate experience in a related agriculture enterprise.
[2] Federal Register 3828; Vol. 78, No. 12; January 17, 2013.
[3] Title 7 CFR Part 764.103 requires, "(b) All loans must be secured by assets having a security value of at least 100 percent of the loan amount, (c) An additional amount of security up to 150 percent of the loan amount will be taken when available, (d) The Agency will choose the best security available when there are several alternatives that meet the Agency's security requirements."

for annual operating expenses (annual loans). Microloans made for purposes other than annual operating expenses (term loans) are not subject to the additional security requirement, and are considered to be adequately secured at 100 percent. FSA also clarified that for microloans the additional security should be limited to farm assets, and not include the personal residence, which is allowed for regular direct operating loans.

Eligible borrowers may obtain a microloan for up to $50,000.[4] Microloans can be used for the same approved operating expenses as those authorized for FSA regular operating loans, such as initial start-up expenses, annual expenses (including seed, fertilizer, utilities, land rent, family living expenses, purchase of livestock, equipment, and other materials essential to farm operations), or other farming expenses. The repayment terms may vary, but will not exceed 7 years. Annual operating loans should be repaid within 12 months or when the agricultural commodities produced are sold, while all other microloans are to be repaid within terms up to 7 years. Interest rates are based on the loan rates in effect for FSA's regular operating loans at the time of the microloan approval or microloan closing, whichever is less.[5]

FSA began making microloans in January 2013, using its existing authority for the Direct Operating Loan Program.[6] The Agricultural Act of 2014[7] created a permanent authorization for the Microloan Program, and made additional changes, such as exempting beginning and military veteran producers from term limits and providing these producers with an optional lower interest rate (applicable in years when regular interest rates are higher).

FSA oversees the Microloan Program within its existing Direct Operating Loan Program framework and control structure. FLP uses the Farm Loan Program Risk Assessment (FLPRA) as its primary tool for ongoing reviews and oversight of field office operations. The primary objectives of FLPRAs are to evaluate the effectiveness of FLP delivery systems and ensure compliance with applicable laws and regulations. FLPRAs are conducted by both the national and State offices. Also, FSA district directors conduct quarterly reviews[8] to monitor FLP delivery in its service centers, to ensure adherence to appropriate laws, regulations, policies, and procedures.

Funding for microloans comes from the existing Direct Operating Loan Program, whose funding levels for the entire loan program are established in the annual appropriations process. In fiscal year (FY) 2013, FSA obligated $1.0 billion for the Direct Operating Loan Program. Of this amount, $62.9 million funded 3,404 microloan obligations. In FY 2014, FSA microloan activity grew, with $97.9 million funding 4,979 microloan obligations. This amounted to 17.6 percent of all FSA direct loan activity in FY 2014. Since the creation of the Microloan Program, FSA has made microloans to borrowers in all 50 States, Puerto Rico, the U.S. Virgin Islands, and the

[4] On November 7, 2014, FSA increased the maximum amount for a microloan from $35,000 to $50,000. This was authorized by the Agricultural Act of 2014, Public Law 113-79, dated February 7, 2014.
[5] Interest rates for operating loans will not exceed 5 percent.
[6] The Consolidated Farm and Rural Development Act of 1972, Public Law 92-419, dated August 30, 1972, as amended, authorized FSA's Direct Operating Loan Program.
[7] Public Law 113-79, dated February 7, 2014.
[8] District Director Oversight Reviews are the official records documenting the results of the district director quarterly reviews.

Western Pacific.[9] As of September 30, 2014, there were 6,803 active microloans. Of those, 5,418 loans are on schedule for repayment, 1,160 loans are ahead of schedule for repayment, and 225 loans, or 3.3 percent, totaling $1.7 million, are behind on repayment.

The Microloan Program helps USDA address part of its FY 2014 departmental priority goal: the creation of new economic opportunities through farming. USDA's strategy for achieving this goal included improvement of outreach efforts to new and beginning farmers and ranchers; local and regional food producers; minorities; women; and veterans. USDA has successfully made progress towards this goal. The Microloan Program, building off the successes of FY 2013, continues to reach producers across the country, with at least one microloan obligated in each State in FY 2014.

The Secretary of Agriculture is required to provide outreach and technical assistance to encourage socially disadvantaged farmers and ranchers to own and operate farms and to participate in the full range of agricultural programs offered by the Department.[10] Outreach within FSA is described as planned activities that raise awareness of FSA programs, which are initiated by FSA at the national, State, or service center level and conducted beyond the normal course of business. Traditional outreach methods can include publishing articles in newsletters and local newspapers; making announcements through local radio and television stations; attending public meetings, fairs, or other farm-related events; and working with other agricultural agencies and partners to organize public meetings, including community-based and non-governmental organizations, as well as land-grant colleges and universities and other USDA agencies.[11]

FSA's targeted program outreach provides and expands technical assistance and training, and markets FSA programs and services to an ever-growing and diverse customer base. This includes groups that are identified as "traditionally underserved," such as: beginning farmers and ranchers; African-American producers; Alaska Native producers; Asian American/Pacific Islander producers; Hispanic American producers; Native American producers; women producers; farm workers; limited resource producers; persons under the poverty level; disabled producers; veterans; and youth. The mission of program outreach is to use innovative FSA marketing methods that reach these groups and (1) educate the public about FSA programs and/or services, (2) eliminate participation barriers, and (3) increase program participation.

To be considered an outreach event, which may or may not include traditional outreach methods, the activities or events must reach more than one person, unless that one person is representing a large body or group. An outreach activity must also include socially disadvantaged farmers and ranchers or agriculture groups that may have limited or no past exposure to FSA programs. To

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[9] Western Pacific includes American Samoa, Guam, Commonwealth of the Northern Mariana Islands, Republics of the Marshall Islands and Palau, and Federated States of Micronesia.

[11] Land-grant colleges or universities are institutions designated by a State legislature or Congress to receive benefits of the Morrill Acts of 1862 and 1890. A principal mission of these institutions, set forth in the first Morrill Act (Land-Grant Act), was to teach agriculture and the mechanical arts. This law gave each State a grant of Federal land to be sold to provide an endowment for at least one land-grant institution. Land-grant colleges or universities that resulted from provisions of the second Morrill Act prohibited racial discrimination in these institutions, and the second Act gave States the option of creating separate institutions to serve African-American students.

be considered a targeted outreach activity/event, over 60 percent of the audience participating in the targeted outreach activity or event should reflect a demographic makeup that includes minorities, women, veterans, or disabled individuals, as defined by the Federal civil rights or Americans with Disabilities legislation.[12]

FSA's FLP operates from Washington, D.C., with field offices located across the country. FSA has a State office in all 50 States and Puerto Rico, which oversees activities at service centers located in each State. Direct operating loan applications, including those for microloans, are processed through the service centers. The agency has established a national outreach program, with a director and staff located in Washington, D.C. Actual outreach activities are conducted by field staff primarily from State offices and service centers.

Objectives

The overall audit objectives were to evaluate the internal controls for FSA's administration of application processing, eligibility, servicing, and security requirements for the Microloan Program, and to document the strategies and actions taken to determine if the Microloan Program is expanding access to credit to a variety of producers.

[12] *FSA Handbook 22-AO*, Amendment 1, Outreach for FSA Programs and Services, dated November 6, 2012.

Section 1: Microloan Program Controls Need Improvement

Finding 1: FSA Needs to Strengthen Controls to Ensure that Program Requirements are Consistently Applied

OIG found that FSA did not consistently apply the requirements for administering the Microloan Program. FSA national office staff acknowledged that these inconsistencies exist because some FLP field staff found it challenging to apply the microloan requirements that differ from the traditional direct operating loan requirements. Because of the inconsistent application of the new Microloan Program requirements, FSA may be placing an unnecessary burden on borrowers and consequently cannot ensure that the Microloan Program is administered in accordance with its intended purpose, which is to better serve the unique operating needs of small farm operations through more flexible application, eligibility, and security requirements. This may also put financial strain on the borrowers, create the appearance of inequitable treatment, and subject the agency to complaints and possible litigation.

Office of Management and Budget (OMB) Circular A-123 provides that agency management is responsible for developing and maintaining effective internal control.[13] Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner.

We evaluated FSA's internal controls for administering and overseeing the Microloan Program. Based on our evaluation, we concluded that FSA's controls for microloan application processing, eligibility, and loan servicing are reasonably effective towards achieving program goals. From the program's implementation in January 2013 through FY 2014, FSA has made 8,383 microloans, totaling $160.8 million; many new and small farm operations have received the financial help they need to be successful. However, FSA can improve its operations because we found instances in which FSA (1) required excessive security for microloans, (2) inconsistently filed security liens, and (3) inconsistently established microloan repayment terms.

FSA Loan Officials Obtained Excessive Security for Microloans

We found that FSA officials in Florida, Georgia, and Wisconsin required security in excess of program requirements for 12 of the 53 approved microloans we reviewed. This occurred because FLP staff applied the security requirements for regular operating loans to microloans; field staff believe that the additional security is needed to protect the interests of the Government and to discourage defaults. As a result, FSA creates an unnecessary burden for borrowers, a condition that contradicts the intent of the Microloan Program.

To secure annual operating microloans, FSA requires a first lien on farm property or products having a security value of at least 100 percent of the loan amount, or up to 150 percent, when available. FSA also clarified that the additional security up to 150 percent for annual

[13] *Revisions to OMB Circular A-123, Management's Responsibility for Internal Control*, dated December 21, 2004.

microloans should be limited to farm assets and is not to include the personal residence.[14] For term microloans,[15] FSA requires security of 100 percent of the loan value.[16]

We reviewed 53 approved loan files made to 44 borrowers and found that FLP staff in these service centers obtained excessive security for 12 of the loans (see Exhibit A).[17] We found that 4 of the 12 microloans were secured at more than 300 percent of the loan value, while another microloan was secured at more than 900 percent of the loan value and included the borrower's personal residence. In one example, a borrower obtained a $35,000 term microloan for the purpose of buying a tractor and cattle. To secure the microloan, FSA placed a lien on the livestock and equipment purchased, as well as livestock and equipment already owned by the borrower. In addition, FSA obtained a second lien on the borrower's personal residence. FSA calculated the total value of security as $323,681, which is equal to about 925 percent of the loan value. However, because this was a term microloan, the security value should have been $35,000, equal to 100 percent of the original loan value of $35,000.

When evaluating new loans, FSA performs a collateral analysis within its Farm Business Plan System.[18] This analysis assesses the adequacy of security pledged for a loan. Currently, the system is used to determine if the minimum security requirements are met. However, the system does not determine whether excessive security is pledged for a microloan. As a result, the loan officer is not required to justify the additional security. This shortcoming in the system undermines FSA assurance that the security requirements for microloans are consistently and correctly applied, and are not excessive amounts that overburden the borrower.

When we discussed these loans with service center FLP staff, they told us that the additional security protects the interests of the Government and discourages defaults. Staff said that, for regular operating loans, they have been trained to obtain the additional security when it is available, and they have continued to operate according to those instructions. Officials at the FSA national office told us that the reduced security requirements for microloans require a cultural shift for the agency; the new provisions contradict the way they have always made loans, so it will take some time for everyone to adjust. They believe that future training and discussions will help staff adjust to the new program.

While OIG completed fieldwork for this audit, the FSA national office conducted its own review of the Microloan Program[19] and reached a similar conclusion, in that some loans had excessive security without adequate justification.[20] FSA's review concluded that some State

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[14] Federal Register 3828; Vol. 78, No. 12; January 17, 2013.
[15] Term microloans are microloans made for purposes other than annual operations.
[16] Federal Register 3836; Vol. 78, No. 12; January 17, 2013.
[17] These 12 loans were made to 11 borrowers.
[18] The Farm Business Plan system is an electronic system FSA uses to perform financial planning, analysis, loan origination and servicing functions, and manage the FLP loan portfolio.
[19] The objectives of FSA's review were to (1) evaluate the effectiveness of training and guidance published in Agency handbooks, (2) gain insight on future training needs, and (3) provide national office management with an overview of nationwide administration of the program.
[20] Evaluation of FSA's Microloan Program – An Internal Review; dated November 5, 2014.

offices have adopted a policy that treats microloans as regular operating loans. The report from FSA's national office cited a continuing need to emphasize adequate, but not excessive, security for microloans,[21] as excessive security for microloans will impact customer service and the borrower's ability to obtain other credit and make financial progress. FSA's own recommendations included instituting training and file reviews that focus on microloan security requirements. The FSA national office plans to conduct another review of the Microloan Program during 2015 to assess whether these corrective actions have been effective in reducing the frequency of deficiencies identified.

We acknowledge the national office's initiative in performing these reviews and believe that they may help correct the issues we found. However, we do not believe that insufficient training alone caused the conditions, because the FLP staff we interviewed indicated awareness of the new Microloan Program requirements. As such, additional training may not go far enough. We believe that additional controls should be implemented to ensure that the State-level FSA offices consistently administer the Microloan Program as intended.

Because of the challenges associated with this cultural shift, we believe that FSA needs to implement additional controls to ensure that the microloan requirements are applied consistently throughout the agency. Currently, district directors perform quarterly reviews at each service center to ensure adherence to appropriate laws, policies, and procedures. The guide used by district directors for this review describes procedures to evaluate loan making and servicing, but does not include procedures to evaluate the specific requirements for microloans.[22] We believe this review could be made more useful by including steps to determine whether security for microloans exceeded the maximum levels established by FSA.

FSA Did Not Consistently Complete Required Lien Documents

To secure the microloans, FSA files Uniform Commercial Code (UCC) Financing Statements with the appropriate agency within each State to record its interest in the loan collateral provided by a borrower. We found that for some of the microloans we reviewed, FLP staff in Florida, Georgia, and Wisconsin were still using a generic statement for microloans, rather than describing the specific items on the UCC Financing Statement. Specifically, we reviewed the UCC forms for 40 borrowers and found that only 2 listed just the specific items, whereas 32 included only the generic statements, and 6 included both the specific items and the generic statement. To find out why this happened, we reviewed the FSA handbooks for each State in question (Florida, Georgia, and Wisconsin), and discovered distinct differences in each State office's guidance for filling out these statements. Each FSA State office develops State-specific guidance regarding requirements for filing liens. For regular operating loans, the FSA State offices under review issued instructions to use a generic

[21] FSA stated in its report that there were 3,155 microloans obligated in FY 2014 through May 5, 2014; 5 percent of all microloans were chosen for review, including at least 1 microloan from each State; and a total of 171 microloans were chosen at random for review.
[22] Form FSA 2101, "DD FLP Oversight Report Guide," is used by FSA to document district directors' FLP quarterly oversight reviews.

statement for blanket security interest on the UCC Financing Statement.[23] Following implementation of the Microloan Program, the FSA national office supplied State offices and service centers with guidance regarding how these statements should be amended for microloans. This guidance provided that, when filing the UCC Financing Statement for a microloan, the generic statement should not be used; instead, financing statements should specifically describe the security. Providing these specific descriptions in the financing statement avoids excessive financial burden on the borrower. This would allow borrowers to pursue other lines of credit, should they need it, because not all of their assets will be assigned to a single loan.

Our review of State supplements to FSA's handbook revealed that Georgia and Wisconsin State FSA officials had updated their handbook supplements to include the FSA national office's guidance, but that the Florida State FSA office had not. When asked about this omission, the Florida State FSA office indicated that it believes the generic statement is more appropriate than listing the specific items because it keeps the language consistent between the UCC form and the security agreement. Reasons given for this deviation were varied. FLP staff told us that using this blanket statement negated the need to refile UCC Financing Statements for future loans or changes to operations. One FSA State official told us that the use of the blanket statement in the UCC Financing Statement is in accordance with the language used in the security agreements, and that once the UCC Financing Statement is recorded, future debt restructuring or a subsequent loan will be covered under the same lien without affecting FSA's lien position. A farm loan manager told us that it makes sense to describe the specific items for term loans, but it was unclear how this should be implemented when making loans for annual operating expenses when the crop is the primary security.

We discussed the inconsistent UCC Financing Statements with the FSA national office, which explained that the intent of listing only the specific security for microloans was to avoid over encumbering the borrowers with excessive loan requirements. One official told us that over the course of a loan's life, the borrower may not be able to obtain additional financing because of the blanket statement on the UCC form. The FSA national office said that every FSA State office should be able to adopt the new microloan requirements.

While we understand that the requirements for filing a lien may vary by State, we believe that the use of these blanket liens is a potential barrier for new borrowers. The FSA national office should clarify its intent regarding the use of the specific items versus the blanket statement. This clarification should also include guidance relative to the language needed for term loans and for annual operating loans.

We also noted that the security agreements used by FSA for the microloans contain similar blanket language for security.[24] For example, when taking equipment as security, the agreement provides a place to enter the specific items, but also stipulates that the security

[23] The language states that the security is "all crops, livestock, farm products, equipment, certificates of titles, goods, supplies, inventory accounts, deposit accounts, supporting obligations, payment intangibles, investment property, crop insurance indemnity payments, and all entitlements, benefits, and payments from all State and Federal farm programs."
[24] Form FSA-2028, "Security Agreement."

includes, but is not limited to, the items described. FSA officials told us that they originally developed an updated security agreement for microloans, but felt that the new product was too similar to the original agreement, and would result in confusion if implemented. We believe that, along with the more specific language preferred for the UCC forms, FSA should develop and implement a new security agreement for microloans that does not include the blanket language. This would ensure that the UCC form and security agreements are consistent and facilitate opportunities for producers to secure financial support from outside sources.

FSA Did Not Always Allow Microloan Borrowers Maximum Flexibility with Repayment Terms

During our review of the Florida FSA service centers, we found that FSA set microloan repayment terms for cattle operations in Florida that were generally shorter and not consistent with repayment terms set in Georgia and Wisconsin for similarly-situated borrowers. Also, the documentation for these loans did not clearly supply information about calculation methods or reasons for the variances. This occurred because FSA does not provide clear guidance for calculating repayment terms, leaving the decision to the individual loan officials. Because of this, microloan borrowers with similar operations have different repayment terms. Without clear documentation to support the variances, this creates the perception of inequity among borrowers, which could discourage participation in the program. This could also limit borrowers' reinvestment opportunities for expanding their farming operations, and their ability to manage unexpected events.

According to program regulations, the repayment terms for operating loans should be based on the applicant's ability to repay the loan and the useful life of the security.[25] Additionally, the regulations require a feasible farm operating plan that includes repayment of the proposed loan.[26] To demonstrate the feasibility of a plan or projection for a term loan, the margin-after-debt service (MADS)[27] and ending cash-on-hand must be positive.[28]

In Florida, 9 of 16 borrowers obtained microloans to either start or expand cattle farming operations.[29] FSA scheduled repayment terms of 5 years for 7 of these microloans and 7 years for the remaining 2 microloans. When reviewing FSA's evaluation of the borrowers' farm operating plans, we could not determine the basis for either the 5- or 7-year repayment terms.

Florida FLP staff told us that loan terms are based on the life cycle of the security being purchased and the borrower's ability to repay the loan. An FLP official at one service center

[25] Title 7 CFR Part 764.254 (b)(1)(ii)(2), January 1, 2013.
[26] Title 7 CFR Part 764.401 (a)(1), January 1, 2013.
[27] MADS is equal to operating income [minus] purchases for resale [minus] operating expenses including interest and depreciation [plus] nonfarm income [minus] owner withdrawals [minus] nonfarm expense [minus] income taxes [minus] term principal payments [plus] depreciation.
[28] FSA's Handbook 1-FLP, "General Program Administration," Exhibit 15, December 31, 2007.
[29] Four microloan borrowers' files with cattle operations were reviewed in the Alachua Service Center and five microloan borrowers' files were reviewed in the Madison Service Center.

stated that 5 years is the maximum allowed for cows, while an FLP official at another service center stated that he/she tries to do a maximum of 5 years on older cows.

Conversely, our review of five microloans for cattle farming operations in Georgia and Wisconsin showed that repayment terms were set at 7 years for all five loans, regardless of the age of the cows. We did not identify any significant differences between the proposed operating plans, MADS and ending cash-on-hand for these borrowers were similar to those in Florida. A Wisconsin FLP official stated that the term will often be based on cash flow and ability to repay, as well as the judgment of the loan officer.

We discussed the inconsistent loan terms with the FSA national office. One official said that, since the cattle operation should be self-sustaining, he would expect FSA to offer the maximum loan term of 7 years to the borrower. We agree; differences in microloan terms, for similar loans and borrowers, without adequate documentation can create the appearance of inequity or unfairness, and may subject the agency to complaints and possible litigation. Currently, the District Director FLP Oversight Report Guide does not list specific requirements for determining whether repayment terms comply with microloan guidance, or require adequate documentation for any exceptions. We believe the agency should clearly define and document the basis of its determination on microloan repayment terms when those terms are less than the 7-year maximum.

Recommendation 1

Expand the District Director FLP Oversight Report Guide to require the district directors to evaluate the amount of security and the repayment terms for microloans and indicate an exception when they identify a deviation from the microloan guidance or requirements that are not adequately justified in the loan file.

Agency Response

In its September 10, 2015, response, FSA stated:

FSA agrees that an additional control would improve compliance. FSA has evaluated the recommendation and believes that reliance on [District Director Oversight Reporting System] reviews is not the best approach to improve compliance with the handbook requirements. As an alternative, FSA will incorporate an edit check process in the Direct Loan System (DLS). DLS performs actions required to make and service loans, linking to the direct loan making and direct loan servicing processes.

The alternative solution would consist of:

- A required data field that the loan officer would complete, indicating the percentage of security taken on a microloan, based on the security analysis section of the Farm Business Plan;
- An alert to the loan officer when the security for a microloan exceeds the Microloan Program requirements;

- A requirement that the loan officer enter a justification consistent with handbook requirements for any additional security taken;
- Reports that identify loans exceeding the security percentage threshold; and
- Quarterly reviews of the reports to identify potential cases for further review and evaluation for program compliance.

FSA expects the corrective action to be fully implemented by June 30, 2016.

OIG Position

We accept management decision.

Recommendation 2

Incorporate enhanced controls, which include an automatic edit check, into the Farm Business Plan System that will alert the loan officer when the security for a microloan exceeds the Microloan Program requirements and require the loan officer to enter a justification for any additional security taken.

Agency Response

In its September 10, 2015, response, FSA stated:

> FSA has reviewed Exhibit A [to the OIG report] and agrees that an additional control would improve compliance. FSA contacted Web Equity Solutions, the Farm Business Plan vendor, regarding the recommended software change. Their response indicates that they will be unable to make this change. However, FSA believes that the edit check implemented to address Recommendation 1 will have the same effect as that intended by Recommendation 2.

FSA expects the corrective action to be fully implemented by June 30, 2016.

OIG Position

We accept management decision.

Recommendation 3

Issue guidance to the State and county FLP staff clarifying the intent of listing only the specific items on the Uniform Commercial Code (UCC) Financing Statement and requiring State offices to update their handbook supplements accordingly.

Agency Response

In its September 10, 2015, response, FSA stated:

> FSA agrees that additional guidance would improve compliance. FSA is developing additional guidance on the completion of security instruments for microloans and will issue a field directive in the form of an FSA notice no later than October 31, 2015. Additionally, FSA will conduct mandatory training for every FLP field employee addressing the microloan issues identified in this audit. The training will be completed by December 31, 2015.

OIG Position

We accept management decision.

Recommendation 4

Develop and implement an updated Security Agreement for microloans that removes the blanket language and is consistent with the guidance issued for completing the UCC Financing Statements.

Agency Response

In its September 10, 2015, response, FSA stated:

> FSA agrees that additional guidance would improve compliance. FSA is presently developing an updated Security Agreement that will provide an option of checking a box indicating whether the agreement is for a blanket lien, or only specific items. Subject to approval and clearance by the Office of [the] General Counsel, FSA will implement the revised form by December 31, 2015.

OIG Position

We accept management decision.

Recommendation 5

Provide further guidance to State and county FLP staff to use in establishing microloan repayment terms for borrowers with term loans. Require FLP field staff to document the justification when repayment terms deviate from guidance.

Agency Response

In its September 10, 2015, response, FSA stated:

> FSA agrees that additional guidance would improve compliance. FSA is developing guidance on the determination of repayment terms for microloans and will issue a field directive in the form of an FSA notice no later than November 30, 2015. Additionally, FSA will conduct mandatory training for every FLP field employee addressing the microloan issues identified in this audit. The training will be completed by December 31, 2015.

OIG Position

We cannot accept management decision for this recommendation. We concur with FSA's plan to issue the additional guidance. However, the agency response did not address our recommendation to require field staff to document the justification when repayment terms deviate from the guidance. To reach management decision, please provide FSA's plans to ensure that justifications are required for loan terms that deviate from the established guidance.

Section 2: FSA Outreach Activities Need Improvement

Finding 2: FSA Does Not Amply Market Agency Programs to Targeted Groups or Measure Outreach Program Effectiveness

We reviewed FSA's outreach activities in five States to identify the actions taken by the agency to market its programs to targeted audiences. We found that FSA has conducted program outreach to some extent. However, FSA could not demonstrate that it successfully reached out to some targeted audiences, such as specific underserved groups and veterans. This happened because FSA's outreach effort has been hampered by limited staffing, limited financial resources, and limited emphasis on conducting outreach activities geared towards targeted groups. This has hindered FSA's efforts to carry out and monitor outreach activities. Additionally, FSA's methodology for determining numbers associated with outreach to current and prospective producers is sometimes based on estimates and not actual figures. As a result, FSA may not fully achieve its outreach objective of providing support to current and prospective producers, including underserved groups and veterans. If the agency is not marketing its programs to all targeted groups, then some producers may not receive the information and assistance they need to succeed, and the agency could be criticized for inequity resulting in potential litigation. To avoid this, FSA needs to improve its outreach efforts to (1) ensure State and field offices proactively direct and carry out activities with targeted underserved groups and veterans, and (2) better measure the effectiveness of its outreach actions and outcomes.[30]

One of USDA's FY 2014 departmental priority goals is the creation of new economic opportunities through farming, and the creation of new markets for agricultural products.[31] As part of the strategy for achieving this goal, USDA wants to improve outreach to new and beginning farmers and ranchers, local and regional food producers, minorities, women, and veterans.[32] To support this goal, FSA created strategies to seek, encourage, and facilitate full participation of all producers in its available programs through outreach efforts, and to improve outreach efforts to socially disadvantaged farmers and ranchers.[33]

FSA's national office maintains that it has made outreach an integral part of the overall delivery of its programs and services to current and potential customers. FSA developed outreach guidance and direction for its employees who interact with the public and target audiences on the national, State, and service center levels. The agency also established an outreach program office in Washington, D.C.[34]

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[30] Targeted underserved groups are youth, women, beginning, African-American, Native American, Alaska Native, Hispanic American, Asian or Pacific Islander, farm workers, limited-resource, persons under the poverty level, veterans, and disabled farmers and ranchers.
[31] USDA FY 2014 Annual Performance Report.
[32] Performance.gov, July 17, 2014.
[33] FSA Strategic Plan, FY 2012 – 2016.
[34] FSA Handbook 22-AO, Amendment 1, Outreach for FSA Programs and Services, dated November 6, 2012.

FSA Needs to Increase Its Outreach Activities with Targeted Underserved Groups

FSA's State offices and local service centers track outreach activities through the Outreach Tracking and Information System (OTIS). The agency uses the information contained in OTIS, in part, to demonstrate its outreach accomplishments. During our fieldwork at FSA State offices, we reviewed OTIS reports from FYs 2013 and 2014. We found that the Florida, Georgia, and South Carolina FSA State offices did limited or no outreach activities for certain targeted groups. For example, Florida FSA offices did not perform any outreach activities targeting veterans or related organizations during FYs 2013 and 2014. Even though Georgia State FSA officials participated in nine outreach activities, according to its OTIS report for FY 2014, none of the activities specifically mentioned veterans or related organizations. None of the outreach activities reported by South Carolina FSA State officials appeared to target veterans or related organizations for FYs 2013 and 2014. However, USDA has identified veterans as a target group for the Microloan Program.[35]

A statistical breakdown of farm operators and microloan borrowers illustrates the reach of the Microloan Program, specifically to veterans and underserved groups. Overall, the national average for making microloans to veterans was 7 percent for both FYs 2013 and 2014. Of the five States reviewed in this audit, the percentage of microloans made to veterans varied during FY 2014, with Florida at 11 percent, Georgia at 10 percent, Kentucky at 4 percent, South Carolina at 6 percent, and Wisconsin at 4 percent. Three of the five States (Florida, Kentucky, and Wisconsin) were below the national average for making microloans to veterans in FY 2013, as well. The lack of outreach activities directed to this group means that some veteran producers may miss out on opportunities for microloans, causing USDA to miss its stated priority goal to improve outreach to this group.

Overall, FSA made 203 microloans in Wisconsin during 2014. Census of Agriculture (COA) data from 2012 identified 70 black operators and 26 Pacific Islander operators in Wisconsin. No one from either group had a microloan during FY 2014.[36] COA data showed that Wisconsin had 342 Asian American operators and FSA made 5 microloans to this group during FY 2014. Additionally, 2012 COA data showed 618 Native American and 1,310 Asian American farm operators in Florida.[37] Yet, we found only 6 of the 83 microloans made in Florida during FY 2014 went to Native and Asian American borrowers. Of 49 microloans made by Florida FSA State officials during FY 2013, no microloans were made to Asian Americans and 4 microloans were made to Native Americans.

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[35] Emphasis for loan making to veterans has been included as part of the USDA's FY 2014 departmental priority goals and the "Strikeforce for Rural Growth and Opportunity" (Strikeforce) which aims to improve economic opportunity and quality of life in persistent impoverished counties in rural America, and now operates in over 800 rural counties, parishes, boroughs, tribal reservations, and Colonias, within 20 States. Part of the Strikeforce initiative is to increase total direct loan applications in Strikeforce areas, including those of veterans.

[36] Each group's average farm size was less than 100 acres.

[37] Demographics of targeted groups can vary within and across States nationwide. FSA's Office of Outreach acknowledged using COA data as a source to evaluate outreach activities. The Director of Outreach also acknowledged other potential data sources, including State office and county office outreach coordinators, the Minority Registry, Office of Advocacy and Outreach, and stakeholders/partnerships with colleges, other government agencies, States Agriculture Departments, and underserved groups.

While COA data concerning numbers of farm operators across the country does not directly correlate to FSA direct loans (including microloans), the national director of FSA's outreach staff said that COA data is used to evaluate outreach activities. With that in mind, the low percentage of participation in the Microloan Program by some targeted groups suggests FSA needs to increase its outreach to those respective underserved groups.

While conducting fieldwork at local service centers, we asked loan program staff if they participated in outreach events. Staff from Florida's Alachua and Madison Service Centers informed us they had not participated in any outreach activities. They acknowledged that other county office officials may have participated in events. When asked, Florida State FSA office staff said that they had not had an outreach budget for several years, which has impacted their attendance and participation in outreach events.

When we visited 23 Microloan Program applicants in Florida, Georgia, and Wisconsin, we asked them how they learned about the program. None of the applicants reported hearing about the Microloan Program through an outreach event where an FSA employee participated face-to-face. Some reported hearing about it from other people in their agricultural community.

FSA Does Not Effectively Track Outreach Through Program Participation Data

We evaluated FSA's methodology for collecting and evaluating data concerning outreach activities by reviewing agency records (forms and statistics). We found that the agency cannot measure the impact of its outreach efforts based on participation in its programs, including the Microloan Program, because FSA does not collect this information in conjunction with outreach activities or through the application process. Also, the agency sometimes relies on estimates to determine outreach participation data. This methodology does not provide accurate numbers for measuring demographics, making it difficult to evaluate the impact of outreach activities on program participation. Without accurate data, outreach staff may miss opportunities to develop outreach initiatives that effectively reach their targeted audiences, which in turn could impact program participation for those underserved.

For example, Form FSA-2330, "Application for Microloan Assistance," does not capture any information concerning outreach or even how the applicant learned about the program. The same is true for other loan application documents. FSA does collect some ethnicity and race demographics through the microloan application process through either applicant self-reporting or FSA observation. However, FSA officials explained that applicants' ethnicity and race demographics are not recorded in OTIS. We determined that FSA had not integrated OTIS activities with its application and loan processes.

FSA State or local officials estimate attendance (including race and ethnicity) at some outreach activities by visual observation; the attendance figure on file is not always based on actual numbers. For example, a FY 2014 OTIS report from Florida said that FSA conducted outreach at a county fair, with a reported 10,000 people in attendance at the fair. The report recorded the 10,000 people in attendance as 10,000 people reached through the outreach

activity. FSA estimated the demographic breakdown of whites (75 percent), blacks (20 percent), Asians (4 percent), women (50 percent), American Indian (1 percent), Hispanic (40 percent), youth (20 percent), Pacific Islander (0 percent), veterans (2 percent), disabled (1 percent), and beginning farmers and ranchers (10 percent).[38]

We also found that FSA does not compile a formal report that summarizes its outreach activities across the agency. On its website, FSA reported that outreach activities reached over 4 million people in FY 2012.[39] But the website did not provide a breakdown of the types of outreach activities conducted, the groups reached, or the effect of those activities on program participation. The national outreach director cited OTIS as the source for this information.

FSA national office officials informed us that they have recently added five new employees to the national office outreach staff. They stated that they are working on strategies for targeting specific groups, including working with the Department on veterans outreach, and designing a method to record actual outreach activity with program participation. Additionally, FSA national office officials informed us that since FY 2014 they have added an outreach component performance measure to all field employees' evaluations, allotted outreach funding to States, increased funding to States to cover outreach related travel expenses, and reports its outreach efforts to the Administrator quarterly. One national office official added that the agency lost outreach funding during very difficult budget times, but is confident that the commitment is there and hopes there will be some outreach funding restored in the future. While we acknowledge these advances in FSA's outreach efforts, we think the agency needs to consider additional controls to ensure program success. To enhance transparency, we believe FSA's outreach staff should formally evaluate and report the outcome of States' outreach activities to its Administrator. We also believe FSA's Outreach Program should be integrated into its program administrative processes, to better capture information and maximize resources for measuring the impact of outreach activities on program participation.

Recommendation 6

Require the Director of FSA's Outreach Program to formally evaluate States' outreach activities, on a periodic basis, and report evaluation results, including making recommendations to the Administrator, to address weaknesses, when necessary.

Agency Response

In its September 10, 2015, response, FSA concurred with this recommendation and provided actions already taken or in process during FY 2015, including the following.

- FSA increased the Outreach Staff from 1 to 7. Each new staffer has jurisdiction over the following Outreach areas to support field training, provide educational materials, and track outreach activities:

[38] FSA Florida State Office Ad Hoc Report, Outreach, FY 2014
[39] www.fsa.usda.gov, May 20, 2015.

- African-American, Hispanic, COC Election Outreach
- Native American, Women's, Strikeforce, and Farm Program Outreach
- Veterans, New/Beginning Farmers, Asian American Outreach
- Local/Regional, Organic, Know Your Farmer, Urban Farming, Farm Loan Outreach
- Bridges to Opportunity and Special Projects

- FSA initiated a software enhancement to OTIS to improve specific program and targeted underserved tracking. (Estimated completion October 31, 2015)

- FSA currently provides an annual accomplishments report to the Administrator. FSA will supplement the report to include State deficiencies.

In addition, FSA will review State reports monthly in OTIS and provide quarterly progress reviews to the Administrator and State Executive Directors.

OIG Position

We accept management decision.

Recommendation 7

Develop a method to effectively measure and integrate program participation with outreach activities.

Agency Response

In its September 10, 2015, response, FSA concurred with this recommendation and provided actions already taken or in process during FY 2015 and continuing in FY 2016, including the following.

- FSA will pull cyclical reports to supplement its annual outreach reports following completion of the OTIS enhancement. (Estimated completion by October 2015)

- FSA will oversee Bridges to Opportunity Expansion, which includes a software platform allowing for improved customer resource management and improved Outreach tracking to target underserved and non-targeted underserved customers and stakeholder organizations. (Estimated completion by November 2015)

- FSA will coordinate modification of applications to include multi-select question(s) pertaining to Outreach and how the applicant learned of USDA programs. (Estimated completion by June 2016)

- FSA will increase the Outreach Staff from 7 to 8, and the additional employee will support management of OTIS Stakeholders, USDA Connect, Bridges to Opportunity

Expansion, and other Outreach programming support needs. (Estimated completion by November 2015)

FSA will obtain and monitor program participation reports to identify targeted outreach campaign needs. (Estimated completion by October 2015)

OIG Position

We accept management decision.

Scope and Methodology

We conducted the audit to evaluate FSA's internal controls for administration of the Microloan Program, including application processing, eligibility, servicing, and security requirements. We also documented FSA's strategies and actions taken to determine if the Microloan Program is expanding access to credit to a variety of producers.

Our audit focused on Microloan Program activities for FYs 2013 and 2014. During FY 2013, FSA made 3,404 microloans, totaling $62,901,933. During FY 2014, FSA made 4,979 microloans, totaling $97,967,307. We performed survey fieldwork at the FSA national office located in Washington, D.C., FSA's Kentucky and South Carolina State offices, and four service centers within those two States. We selected these States because Kentucky had the second largest number of approved microloan applications and the second largest number of closed microloans, nationwide, in FY 2013 through March 31, 2014, while South Carolina had among the lowest number of approved microloans across the southeastern States for this same period. We limited our survey fieldwork to developing an understanding of FSA's delivery (loan making and servicing aspects) and oversight of the Microloan Program, as well as its program outreach. Subsequently, we conducted audit testing at the FSA State office level for three non-statistically selected States: Florida, Georgia, and Wisconsin. The States were selected based on various factors, including the total number of approved microloans and rejected and withdrawn microloan applications for FYs 2013 and 2014 (through March 31, 2014), geographical location, and results from the Farm Loan Program Risk Assessment reviews for FY 2013. Specifically:

- **Florida -** Florida ranked 27th nationwide in the number of microloans made at the time of our review and 9th out of 10 among southeastern States.[40] Also, the FY 2013 Farm Loan Program Risk Assessment (FLPRA) for Florida indicated high risk in some aspects of its direct loan making and servicing.
- **Georgia -** Georgia had the highest number of rejected microloan applications nationwide (21 more than the second highest State) at the time of our review. We also selected Georgia due to its close proximity to the audit staff.
- **Wisconsin -** Wisconsin ranked fourth in the number of microloans made nationwide and third in the number of rejected microloan applications nationwide.

Additionally, we conducted fieldwork at two non-statistically selected service centers within Georgia and Florida, and three non-statistically selected service centers in Wisconsin, where we further tested internal controls for Microloan Program loan making and servicing, program oversight, and outreach.[41] Specifically, service centers were selected based on the numbers of approved microloans and rejected and withdrawn applications, results of FSA management reviews (including the FLPRA), geographical locations of the service centers, and recommendations from State office staff (see Exhibit B for FSA offices reviewed during the audit). In conjunction with audit testing at the service center level, we reviewed a non-statistical

[40] Including Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia.

[41] Because one Farm Loan Manager in Wisconsin was responsible for two service centers, we selected microloan files from both, resulting in coverage of three service centers in that State.

sample of 71 microloan files (29 files in Florida and 21 files in both Georgia and Wisconsin). These 71 files included 53 approved loans made to 44 borrowers, 11 rejected applications, and 7 withdrawn applications. We selected these based on microloan amounts, type of borrower (beginning farmer or rancher, socially disadvantaged farmer or rancher, non-socially disadvantaged farmer or rancher), borrower demographic, application category (approved, denied, or withdrawn), and account repayment status (on-schedule or delinquent). Florida, Georgia, and Wisconsin had 155, 339, and 457 total microloan applications, respectively, in FY 2013 through March 31, 2014. We also visited farms and conducted interviews with a non-statistical sample of borrowers, selected from our microloan sample set. All fieldwork was conducted from April 2014 through May 2015.

To accomplish our objectives, we:

- Reviewed laws, regulations, policies, procedures, FSA directives, handbooks, and other published guidance;
- Reviewed FSA's performance measures, established delivery of the Microloan Program, and outreach efforts;
- Reviewed FSA's Federal Managers' Financial Integrity Act report, the Agency Financial Report, USDA's Annual Performance Report, and prior OIG reports to determine if there are any issues that impact microloans;
- Reviewed FSA's documented structure for administering microloans;
- Interviewed FSA national, State, and local office officials;
- Reviewed and analyzed microloan data;
- Reviewed COA data;
- Reviewed FSA's internal controls for administering and overseeing microloans, including the FLPRA, in accordance with implementing regulations;
- Reviewed a non-statistical sample of loan files at the service centers; and
- Visited farming operations and interviewed microloan borrowers.

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

We did not assess the overall reliability of the data systems used by FSA to carry out the Microloan Program activities.

Abbreviations

CFR .....Code of Federal Regulations
COA .....Census of Agriculture
DLS .....Direct Loan System
FLP.....Farm Loan Programs
FLPRA .....Farm Loan Program Risk Assessment
FSA .....Farm Service Agency
FY .....Fiscal Year
MAD .....Margin-After-Debt Service
OIG .....Office of Inspector General
OTIS.....Outreach Tracking and Information System
U.S.C.....United States Code
UCC .....Uniform Commercial Code
USDA.....U.S. Department of Agriculture

Exhibit A: Microloans with Excess Security

The table below represents information about the microloans we found to be over-secured, including State, loan amount, type of loan, value of security, and security-to-loan percentage.

State	Loan Amount	Loan Type	Value of Security	Security-to-Loan Percentage
Georgia	$22,000	Annual	$50,752	231 percent
Georgia	$35,000	Term	$323,681	925 percent
Georgia	$34,000	Term	$41,000	121 percent
Georgia	$35,000	Term	$219,700	628 percent
Georgia	$26,700	Annual	$71,600	268 percent
Georgia	$7,000	Annual	$24,106	344 percent
Wisconsin	$30,000	Term	$105,916	303 percent[42]
Wisconsin	$30,000	Term	$48,300	161 percent
Wisconsin	$5,200	Annual	$44,262	443 percent[43]
Florida	$18,900	Term	$52,900	280 percent
Florida	$20,000	Annual	$96,900	277 percent[44]
Florida	$15,000	Term	$96,900	277 percent

[42] The borrower also obtained a $5,000 microloan in conjunction with the $30,000 microloan. The security for both loans was grouped together and valued at $105,916. The security-to-loan percentage is based on the total security value and the combined value of the two loans of $35,000.

[43] The borrower also obtained a $4,800 microloan in conjunction with the $5,200 microloan. The security for both loans was grouped together and valued at $44,262. The security-to-loan percentage is based on the total security value and the combined value of the two loans totaling $10,000.

[44] The last two loans listed were made to the same borrower. The security for both loans was grouped together and valued at $96,900. The security-to-loan percentage is based on the total security value and the combined value of the two loans totaling $35,000.

Exhibit B: FSA Offices Visited

The table shows FSA offices and locations visited during fieldwork.

Office	Location
FSA National Office	Washington, D.C.
Kentucky State Office	Lexington, Kentucky
Flemingsburg Service Center	Flemingsburg, Kentucky
Cynthiana Service Center	Cynthiana, Kentucky
South Carolina State Office	Columbia, South Carolina
Orangeburg Service Center	Orangeburg, South Carolina
Spartanburg Service Center	Spartanburg, South Carolina
Georgia State Office	Athens, Georgia
Jackson County Service Center	Commerce, Georgia
Bulloch County Service Center	Statesboro, Georgia
Florida State Office	Gainesville, Florida
Alachua County Service Center	Gainesville, Florida
Madison County Service Center	Madison, Florida
Wisconsin State Office	Madison, Wisconsin
Lafayette County Service Center	Darlington, Wisconsin
Grant County Service Center	Lancaster, Wisconsin
Green County Service Center	Monroe, Wisconsin

USDA'S
FARM SERVICE AGENCY'S
RESPONSE TO AUDIT REPORT

USDA

Farm and Foreign Agricultural Services

Farm Service Agency

Operations Review and Analysis Staff
1400 Independence Ave, S.W., Stop 0540
Washington, DC 20250

Voice: 202-690-2532
Fax: 202-690-3354

DATE: September 10, 2015

TO: Gil Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Perry Thompson, Director **/s/**
Operations Review and Analysis Staff

SUBJECT: Response to OIG Official Draft Report – Farm Service Agency Microloan Program, Audit 03601-0003-22

The Office of Inspector General (OIG) reviewed the Farm Service Agency's (FSA) controls for administering the Microloan Program and its efforts to market the Microloan program and make credit available to eligible applicants. OIG evaluated FSA's controls for administering the Microloan Program. OIG also evaluated FSA's ability to market the Agency's program to targeted groups or to measure outreach program effectiveness.

FSA's responses to the seven recommendations for the subject audit are provided as follows:

Recommendation 1:

Expand the District Director Farm Loan Programs (FLP) Oversight Report Guide to require the district directors to evaluate the amount of security and the repayment terms for microloans and indicate an exception when they identify a deviation from the microloan guidance or requirements that is not adequately justified in the loan file.

FSA Response:

FSA agrees that an additional control would improve compliance. FSA has evaluated the recommendation and believes that reliance on DDOORS reviews is not the best approach to improve compliance with the handbook requirements. As an alternative, FSA will incorporate an edit check process in the Direct Loan System (DLS). DLS performs actions required to make and service loans, linking to the direct loan making and direct loan servicing processes.

The alternative solution would consist of:

- A required data field that the loan officer would complete, indicating the percentage of security taken on a microloan, based on the security analysis section of the Farm Business Plan;
- An alert to the loan officer when the security for a microloan exceeds the Microloan Program requirements;
- A requirement that the loan officer enter a justification consistent with handbook requirements for any additional security taken;
- Reports that identify loans exceeding the security percentage threshold; and
- Quarterly reviews of the reports to identify potential cases for further review and evaluation for program compliance.

FSA expects this enhancement to be fully implemented by June 30, 2016.

Recommendation 2:

Incorporate enhanced controls that include an automatic edit check, into the Farm Business Plan System that will alert the loan officer when the security for a microloan exceeds the Microloan Program requirements and require the loan officer to enter a justification for any additional security taken.

FSA Response:

FSA has reviewed Exhibit A and agrees that an additional control would improve compliance. FSA contacted Web Equity Solutions, the Farm Business Plan vendor, regarding the recommended software change. Their response indicates that they will be unable to make this change. However, FSA believes that the edit check implemented to address Recommendation 1 will have the same effect as that intended by Recommendation 2.

Recommendation 3:

Issue guidance to the State and county FLP staff clarifying the intent of listing only the specific items on the Uniform Commercial Code (UCC) Financing Statement and requiring State offices to update their handbook supplements accordingly.

FSA Response:

FSA agrees that additional guidance would improve compliance. FSA is developing additional guidance on the completion of security instruments for microloans and will issue a field directive in the form of an FSA notice no later than October 31, 2015.

Additionally, FSA will conduct mandatory training for every FLP field employee addressing the microloan issues identified in this audit. The training will be completed by December 31, 2015.

Recommendation 4:

Develop and implement an updated Security Agreement for microloans that removes the blanket language and is consistent with the guidance issued for completing the UCC Financing Statements.

FSA Response:

FSA agrees that additional guidance would improve compliance. FSA is presently developing an updated Security Agreement that will provide an option of checking a box indicating whether the agreement is for a blanket lien, or only specific items . Subject to approval and clearance by the Office of General Counsel, FSA will implement the revised form by December 31, 2015.

Recommendation 5:

Provide further guidance to State and county FLP staff to use in establishing microloan repayment terms for borrowers with term loans. Require FLP field staff to document the justification when repayment terms deviate from guidance.

FSA Response:

FSA agrees that additional guidance would improve compliance. FSA is developing guidance on the determination of repayment terms for microloans and will issue a field directive in the form of an FSA notice no later than November 30, 2015. Additionally, FSA will conduct mandatory training for every FLP field employee addressing the microloan issues identified in this audit. The training will be completed by December 31, 2015.

Recommendation 6:

Require the Director of FSA's Outreach Program to formally evaluate States' outreach activities, on a periodic basis, and report evaluation results, including making recommendations to the Administrator, to address weaknesses, when necessary.

FSA Response:

FSA concurs with this recommendation. Actions already taken in FY 2015:

1. The Deputy Administrator for Field Operations (DAFO) Outreach Director increased the Outreach Staff from 1 to 7.
    a. Each new staffer has jurisdiction over the following Outreach areas to support field training, provide educational materials, and track outreach activities:
        - African American, Hispanic, COC Election Outreach
        - Native American, Women's, Strikeforce, Farm Program, RFS Outreach
        - Veterans, New/Beginning Farmers, Asian American Outreach
        - Local/Regional, Organic, Know Your Farmer, Urban Farming, Farm Loan Outreach
        - Bridges to Opportunity and Special Projects

2. DAFO Outreach initiated a software enhancement to the Outreach Tracking and Information System (OTIS) to improve specific program and targeted underserved tracking. Estimated completion by October 31, 2015.
    a. Enhancements are submitted to software engineers
    b. DAFO is awaiting finalization before developing training for the updated OTIS System.

3. DAFO Outreach Staff is enhancing the e-learning environment through SharePoint by developing targeted underserved tool-kits, trainings, and materials for Outreach use.
    a. Notice AO-1625 "Outreach to Support Local, Regional, and Organic Food Systems" – The notice emphasizes targeted Outreach to producer segments but also includes educational trainings to support their required Outreach activities.

4. DAFO Outreach continues to include outreach participation as a requirement within field staff performance elements.

5. DAFO Outreach developed FY 2016 Strategic Action Plan.
    a. Notice AO-1627, "Sharing Success Stories" – The notice is one component of the SAP for FY 2016 and beyond. The notice provides our field officials a structured protocol for identifying, gathering information, and submitting stories to facilitate our social media promotion of FSA programs. The notice also provides a quarterly schedule so officials can know what programs to focus outreach efforts on during any given season.

6. DAFO Outreach currently provides an annual accomplishments report to the Administrator. Will supplement report to include State deficiencies.

7. DAFO Outreach improved field preparedness for field officials dealing with Limited English Proficiency applicants through Notice AO-1631.
    a. Notice AO-1631, "Limited English Proficiency (LEP) Assistance Procedures and Responsibilities" – The notice provides field employees information to assist in the goal of communications with LEP individuals by providing field guidance.

Additional steps are underway to address recommendation:

1. Will review State reports monthly in OTIS and provide quarterly progress reviews to the Administrator and State Executive Directors.

Recommendation 7:

Develop a method to effectively measure and integrate program participation with outreach activities.

FSA Response:

FSA concurs with this recommendation. Actions in Progress and Continuing – FY 2015 and FY 2016:

1. DAFO to pull cyclical reports to supplement its annual outreach reports following completion of OTIS enhancement. Estimated completion by October 2015 and thereafter.
    a. National notice and training will be developed to support OTIS enhancements.

2. DAFO Outreach overseeing Bridges to Opportunity Expansion, which includes a software platform allowing for improved customer resource management and improved Outreach tracking to target underserved and non-targeted underserved customers and stakeholder organizations. Estimated completion by November 2015.

3. DAFO to coordinate modification of applications to include multi-select question(s) pertaining to Outreach and how the applicant learned of USDA programs. Ongoing, estimated completion by June 2016.

   a. Coordination with FSA's Economic and Policy Analysis Staff officials in process. (Ongoing)

4. DAFO Outreach and Education Director to increase the Outreach Staff from 7 to 8. Estimated completion by November 2015.
   a. New Employee to support management of OTIS Stakeholders, USDA Connect, Bridges to Opportunity Expansion, other Outreach programming support needs.

5. DAFO Outreach will continue leading Outreach Strategies team comprised of all program divisions to identify and plan outreach strategies for each program rollout. (Ongoing)

6. DAFO Outreach will obtain and monitor program participation reports to identify targeted outreach campaign needs. Estimated completion by October 2015 and thereafter.

To learn more about OIG, visit our website at
www.usda.gov/oig/index.htm

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