U.S. Department of Agriculture
Office of Inspector General
Southwest Region
Audit Report

Farm Service Agency
Recapture Under Shared Appreciation Agreements

Report No.
03601-37-Te
AUGUST 2000

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: August 7, 2000

REPLY TO
ATTN OF: 03601-37-Te

SUBJECT: Recapture Under Shared Appreciation Agreements

TO: Keith Kelly
Administrator
Farm Service Agency

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

We have completed an audit survey of Farm Service Agency's (FSA) recapture under shared appreciation agreements (SAA). We found that shared appreciation amounts due upon settlement of SAA's or the sale of real estate were computed correctly and being collected. However, the survey did find that the computer database for SAA's contained erroneous information.

BACKGROUND

SAA's were initiated in fiscal year (FY) 1989 as an exhibit to 7 CFR 1951, subpart S, in accordance with the Agricultural Credit Act of 1987. SAA's allow the FSA to recapture a portion of the Government debt written down for farm program loans. As of March 7, 2000, the SAA database included over 9,200 SAA's for debt writedowns of real estate totaling $1.2 billion.

Regulations for Primary Loan Service Programs are found in FmHA Instruction 1951-S, dated March 14, 1997. Paragraph 1951.914(c)(3) states that shared appreciation will be due if there is a positive difference between the market value of the security property at the time of calculation upon expiration and the market value of the security property as of the date the SAA was signed. The maximum appreciation requested is not to be more than the total amount written down. The amount of shared appreciation will be 75 percent within 4 years of the SAA or 50 percent after 4 years from the date of the SAA, including when the SAA expires at the end of the 10-year period. Paragraph 1951.914(h) states that borrowers whose SAA's mature prior to December 31, 2000, may request partial or complete suspension of the shared appreciation recapture repayment annually up to three times.

OBJECTIVES

Our objectives were to evaluate FSA's servicing of SAA's and to determine whether actions taken on SAA's were proper when agreements expired, real estate security sold or conveyed, loans were repaid or accelerated, or borrowers ceased farming.

SCOPE AND METHODOLOGY

Policies and procedures for servicing SAA's were reviewed at the FSA national office and Texas State office. We judgmentally selected Texas for review based on the large volume of reported SAA activity (about 6 percent of the Nation) shown on the FSA Farm Loan Programs Monthly Management Report for February 1999. We judgmentally selected six county offices in Texas (Childress, Hamilton, Marlin, Paducah, Stephenville, and Vernon) based on SAA activity and discussions with State office officials and reviewed the case files for borrowers with SAA's. Borrowers with expired agreements, payments of recapture of appreciation due, and large dollars subject to recapture were judgmentally selected for review. We reviewed the actions taken by the six county office staffs for the 19 SAA's that expired or for which the real estate had been sold.

In addition, we obtained a copy of the FSA SAA computer database as of March 7, 2000, and generated reports for review using FOCUS computer software. We reviewed nationwide data by State and compared beginning and ending market values, writedown amounts, and shared appreciation due and paid. We judgmentally selected Arkansas, Oklahoma, and Texas for further review based on the large amount of SAA activity in these Southwestern States. The database for these 3 States showed total SAA's of 1,316 (14 percent of the 9,260 SAA's) and that 429 (13 percent of the 3,283) of these SAA's were settled cases involving real estate loan writedowns. Of these 429 settled SAA's, we reviewed the 258 SAA's that were settled with appreciation and computed the amount of shared appreciation due. We contacted the respective State and county offices via telephone to discuss any discrepancies noted and to gather additional information. We also contacted St. Louis Finance Office officials regarding the database information. We performed this review during the period October 1999 through March 2000.

The survey included reviews of administrative and financial records and regulations, policies, and procedures that apply to SAA's. Administrative records were reviewed and interviews conducted to satisfy the survey objectives. We verified the market values used in computing recapture to the independent appraisals received for both the market values at the time the SAA was executed and at the time of sale. We accepted the market values reflected in the appraisals.

The March 7, 2000, database also showed that 5,977 SAA's on real estate writedowns totaling $797.6 million had not been settled (i.e., active SAA's). The Finance Office notifies the applicable county office in advance when SAA's will expire, and the county office staff initiates action to notify the borrowers, obtain real estate appraisals, and determine the amounts of any recapture owed. We did not evaluate the database information regarding these unsettled SAA's.

This audit survey was performed in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objectives.

FINDINGS AND RECOMMENDATIONS

1. Shared Appreciation Database Contains Erroneous Information

We found that FSA's actions taken on SAA's were proper when agreements expired, real estate security sold, loans repaid, or borrowers ceased farming. However, we noted that the FSA shared appreciation database did not accurately reflect shared appreciation data. The database included chattel-only writedowns, was not designed to handle partial sales of security property, did not track suspended SAA's, and did not have sufficient edit checks in place to ensure data accuracy. As a result, the database contained errors that resulted in inaccurate management reports and could result in inaccurate recapture amounts.

Information provided by FSA showed about 11,900 SAA's had been executed on debt writedowns of over $1.7 billion, and that approximately 6,500 of these agreements were currently in effect. However, our analysis of the SAA database revealed that as of March 7, 2000, there were 9,260 SAA's on real estate debt writedowns totaling $1.2 billion. This difference of over 2,600 agreements was primarily a result of including writedowns for non-real estate loans (chattel) in the SAA database and in the management reports generated from the database. SAA's do not apply to non-real estate loans. Therefore, any management information obtained from the SAA database would likely be inaccurate and misleading. Other problems with the database are identified below.

As of March 7, 2000, the SAA database showed that 3,283 SAA's had been settled on real estate writedowns totaling $432.4 million with recapture paid of $48.8 million. Of the settled SAA's, 1,656 showed no appreciation and 1,627 showed the farms had appreciated in value. Of the 1,656 SAA's showing no appreciation, 272 SAA's showed recapture amounts totaling over $5 million; therefore, these 272 SAA's contained incorrect data because of no data entry and/or incorrect data entry for the market values. Of the 1,627 SAA's where the real estate appreciated, the database showed 1,216 farms had been sold (includes 57 SAA's shown as sold but without a settlement code) and 468 farms had appreciated in value and had not been sold (i.e., farms still active).

We computed the amount of shared appreciation due for the 258 SAA's reviewed in Arkansas, Oklahoma, and Texas. Of the 258 settled SAA's reviewed, we noted 29 discrepancies (instances where we computed different amounts of appreciation due than those shown in the report or were unable to compute the appreciation due because one of the market values was shown as zero) in the database information for these States that required additional explanation (11 in Arkansas, 11 in Oklahoma, and 7 in Texas). We contacted the applicable FSA State and county office staffs to obtain explanations for these 29 discrepancies and found the following.

- Fourteen data entry errors. For example, one borrower's ending market value was recorded as $48,000,000 rather than $48,000; the ending market value for another borrower showed zero because the market value was not entered into the system; and incorrect amounts were entered for other SAA's.
- Four partial sales. The database is not designed to properly handle partial sales of real estate. For example, the database showed one borrower in Oklahoma with a beginning market value of $196,210 and an ending market value and amount of appreciation due and paid of $28,233. Discussions with the county office staff revealed that a partial sale occurred in which the beginning and ending market value of the property sold was $129,000 and $136,252, respectively. The actual appreciation due (and paid) was $5,439. Therefore, the SAA database was incorrect.
- Three net recovery buyouts. Net recovery buyouts cancel the SAA.
- One voluntary conveyance. Voluntary conveyances cancel the SAA.
- One debt settlement. Debt settlements cancel the SAA.
- One second lien. One borrower's loan had the Federal Land Bank as first lienholder and FSA as second lienholder. The database showed the property was sold, had appreciated in value, and no appreciation collected.

- Two misapplications of funds. FSA applied the funds to the borrower's debt before applying the funds to the SAA as required.
- Three discrepancies were not resolved because the borrower files were not available.

Three of the above 29 discrepancies affected SAA dollars. Payments for shared appreciation and loans made for two borrowers were incorrect because the county office staff did not apply sales proceeds to the SAA before applying the proceeds to the debt. FmHA Instruction 1951-S, paragraph 1951.914(f), requires that proceeds collected from the sale of security property be applied first to any shared appreciation due and the balance to the outstanding loans. All proceeds were applied to the loan of one borrower and nothing was applied to the SAA. In the second case, sale proceeds were applied to the loan, and the remaining proceeds were applied to the SAA. As a result, loan balances were improperly reduced and shared appreciation amounts were understated $9,726 for these two borrowers. The database for a third borrower showed that the borrower paid shared appreciation of $2,300 even though the borrower actually paid $10,100. This occurred due to an input error by the county office staff. As a result, shared appreciation shown as paid for the borrower was understated $7,800. Thus, the balance of shared appreciation collections was understated a total of $17,526 for these three borrowers.

Based on the above (non-real estate loans included in the SAA database, SAA's showing no appreciation also showing recapture amounts, and data entry errors), the database contained significant erroneous data that could affect management information. The database would be more accurate by making system changes and including edit checks to reduce the number of data entry errors.

Also, suspended SAA's are not tracked within the SAA database. When a borrower's shared appreciation due is approved for suspension by the county office, the suspension information is forwarded to the Finance Office Loan Operations Division in St. Louis, Missouri. FSA National Office and Finance Office officials stated that SAA suspension agreements are recorded and tracked manually at the Finance Office; i.e., suspended SAA's are not identified as such in the database. As of May 1, 2000, there were about 1,023 suspended SAA's totaling about $45.5 million per the FSA Finance Office. The SAA database should have the capability to identify and monitor suspended SAA's.

Recommendation No. 1

Make system changes to the shared appreciation database to remove chattel-only debt writedowns from the SAA database, allow for proper input of partial sales, and capture and track borrowers with suspensions. Also, include edit checks which require entries greater than zero in the beginning and ending market values for settled SAA's and generate an exception report when the ratio of these two values is improbable (e.g., $48,000 vs. $48,000,000).

Agency Response

The Deputy Administrator for Farm Programs' July 17, 2000, written response to the draft report, a copy of which is included as attachment A to this memorandum, stated that a Request for Automation had been submitted to record suspended SAA's in the Program Loan Accounting System (PLAS). Suspended SAA's will be monitored through a database spreadsheet until the revision is fully implemented. In addition, the Deputy Administrator stated that by June 30, 2001, the Finance Office would coordinate with the Farm Credit Applications Division to remove chattel-only debt writedowns from the PLAS. The Deputy Administrator also stated that the Loan Operations Division is reviewing the issue of allowing proper input of partial sales and including edit checks to prevent data entry errors. The PLAS changes to implement these changes will be documented and provided to the Office of the Chief Financial Officer (OCFO).

OIG Position

We accept FSA's management decision for Recommendation No. 1.

Recommendation No. 2

Remind all State and county office staffs that net sale proceeds are to be applied first to the SAA and then to the outstanding debt.

Agency Response

The Deputy Administrator's written response to the draft report stated that Notice FLP-139, Applying Proceeds on Accounts With Shared Appreciation, dated July 1, 2000, reminded all State and county office staffs that net sale proceeds are to be applied first to the SAA and then to the outstanding debt.

OIG Position
We accept FSA's management decision for Recommendation No. 2.

Please follow your internal agency procedures in forwarding final action correspondence to OCFO.

s/ Richard D. Long
for
JAMES R. EBBITT
Assistant Inspector General
for Audit

ATTACHMENT 1 – FSA's WRITTEN RESPONSE TO THE DRAFT REPORT

USDA

United States Department of Agriculture

Farm and Foreign Agricultural Services

Farm Service Agency

1400 Independence Avenue, SW
Stop 0523
Washington, DC 20250-0523

JUL 17

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

FROM: Carolyn B. Cooksie
Deputy Administrator for Farm Loan Programs

Carolyn B. Cooksie

SUBJECT: OIG Audit Report No. 03601-37-TE
Recapture Under Shared Appreciation Agreements

I am writing in response to the Office of Inspector General's recommendations on the subject audit.

Recommendation 1: Make system changes to the shared appreciation database to remove chattel-only debt writedowns from the SAA database, allow for proper input of partial sales, and capture and track borrowers with suspensions. Also include edit checks which require entries greater than zero in the beginning and ending market values for settled SAAs, and generate an exception report when the ratio of these two values is improbable.

Response: The requirement to record suspended SAAs has been addressed in RFA E-7704 (copy attached). These revisions to the Program Loan Accounting Systems (PLAS) are being implemented as time and funding permit. Until the RFA is fully implemented, suspended SAAs are monitored through a database spreadsheet (copy attached). Since a "Request for Automation" (RFA) is already in place for this requirement and since SAAs are being tracted by spreadsheet until the RFA is fully implemented, I ask that recommendation 1 be amended to remove this requirement.

By June 30, 2001:

- The Finance Office will coordinate with the Farm Credit Applications Division to remove chattel-only debt writedown from the PLAS. To show closure, Farm Loan Programs will provide the Office of the Chief Financial Officer with a memorandum from the Chief, Loan Operations Division certifying that all chattel-only debt writedowns have been removed from PLAS.

- The Loan Operations Division is reviewing the issue of allowing proper input of partial sales and including edit checks to prevent data entry errors. To show closure, Farm Loan Programs will provide the Office of the Chief Financial Officer with a copy of the RFA implementing the PLAS changes to address these issues. If these issues can be addressed without an RFA, Farm Loan Programs will provide the Office of the Chief Financial Officer with a memo and supporting documentation from the Director of the Loan Operations Division, explaining how these issues have been corrected outside of an RFA.

Recommendation 2: Remind all State and county office staffs that net sale proceeds are to be applied first to the SAA and then to the outstanding debt.

Response: Attached is a copy of Notice FLP-139, "Applying Proceeds on Accounts with Shared Appreciation," which meets the above requirement. Accordingly, the management decision for recommendation 2 should be approved by the Office of Inspector General. Recommendation 2 should also be closed by the Office of the Chief Financial Officer.

If you have questions, please call Bruce Mair, Loan Servicing and Property Management Division, at 690-4009.

Attachments