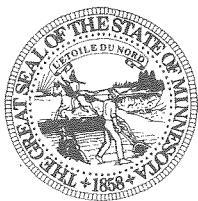


**DEPARTMENT OF AGRICULTURE  
MANAGEMENT LETTER  
FOR THE YEAR ENDED JUNE 30, 1988**

**DECEMBER 1988**





STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Mr. Jim Nichols, Commissioner  
Department of Agriculture  
90 West Plato Blvd.  
St. Paul, Minnesota 55107

Dear Commissioner Nichols:

We have reviewed certain accounting procedures and controls for your department as part of our statewide audit of Minnesota's fiscal year 1988 financial statements and federal programs. The scope of our work was limited to:

- the family farm security loan program handled in the General Fund, Special Revenue Fund, and the Debt Service Fund; and
- the status of prior audit recommendations included in our management letter for the year ended June 30, 1987.

We emphasize that this has not been a complete financial and compliance audit of all programs within your department. Even though no auditing of federal programs was done in your department during our fiscal year 1988 audit, the statewide single audit coverage still satisfies the federal government's current financial and compliance audit requirements for all federal programs administered by your department in fiscal year 1988.

We reviewed the status of recommendations included in our management letter for the year ended June 30, 1987. We concur with the corrective actions you have taken for resolving finding #1 and consider it implemented. We withdraw the recommendation for finding #2, because the Family Farm Advisory Council did not meet during fiscal year 1988. However, minutes should be kept for all future loan committee meetings.

The current recommendations included in this letter are presented to assist you in improving accounting procedures and controls. Progress on resolving the findings will be reviewed during our audit next year.

1. Internal controls are inadequate to properly account for interest payment adjustment loans.

The family farm security loan program was established in 1976 to assist beginning farmers in purchasing farm real estate. The program offered two forms of assistance: loan guarantees and interest adjustment loans. Interest adjustment loans are required to be repaid in one lump-sum at a future date. Unfavorable economic conditions and a significant decrease in agricultural land values has resulted in a high default rate for program participants. During fiscal year 1988, the department had to pay \$6,848,324 to lenders on behalf of defaulted participants. In an effort to fund the guarantee obligations, the state established a special bond account for the program. Pursuant to Minn. Stat. Section 41.56, Subd. 4B,

proceeds from the sale of farms obtained with bond proceeds shall be returned to the bond fund to the extent that funds were issued. The remaining balance, if any, is to be used to reduce any outstanding interest payment adjustment balance. There has never been a situation in which proceeds from a farm sale have been sufficient to replenish the bond account, much less reduce any outstanding interest payment adjustment balance.

Two sections of the Department of Agriculture administer the program. The family farm security (FFS) section authorizes interest adjustment payments and maintains individual participant records. The accounting section makes all payments and maintains a loans receivable control account. The control account balance is certified to the Department of Finance at year-end for inclusion in the state's comprehensive annual financial report. The certified loans receivable balance was not in conformance with generally accepted accounting principles (GAAP) due to inadequate accounting controls and write-off procedures.

At the close of fiscal year 1988, the accounting section certified an outstanding interest adjustment loans receivable balance of \$14,754,430. However, the outstanding loan balance based on participant files in the FFS section was only \$10,549,300. The department was unaware of the difference, since the loans receivable control account in the accounting section was not reconciled to the individual participant files in the FFS section. We were able to account for \$3,992,274 of the \$4,205,130 variance as follows:

- \$3,046,714 was attributable to interest adjustment payments for participants who subsequently defaulted. Upon a participant's default, the FFS section authorizes payment of the loan guarantee to the lender. After the guarantee is paid, the FFS section removes the participant from the outstanding interest payment adjustment records and classifies the farm as inventory held for resale. However, the accounting section does not remove the interest adjustment payments from the loans receivable control account until the farm is actually sold, a period which takes years for some property. This timing difference results in the same assets being accounted for as both inventory and loans receivable in the state's financial statements. The accounting section argued that until the property is sold, the state is a valid lienholder for the amount of the outstanding interest payment adjustments. In an effort to promote conservatism in financial reporting, GAAP require the immediate recognition of all probable and measurable losses. As a result of the significant decline in land values and the statutory requirements to return sale proceeds to the bond account first, we believe that the entire \$3,046,714 represents uncollectible accounts and should not be included in the loans receivable balance for financial reporting purposes. Since they are still receivables from a legal standpoint, a subaccount for doubtful loans could be established within the control account until the liens are released to sell the property.

- \$726,151 was for loans forgiven during mandatory mediation and removed from FFS records. Mandatory mediation is a process in which lenders and debtors meet with an independent mediator to reach a compromise. The Department of Administration, management analysis division, was delegated the authority to enter into mediation compromises on behalf of the state. In most mandatory mediation compromises, the state agreed to sell back the property to the defaulted participant for cash and forgave the outstanding interest adjustment loans. After the mediation, the FFS section removed the participant from the outstanding loans receivable records. However, the accounting section has not deleted the forgiven interest adjustment loans from the loans receivable control account.
- \$171,570 was for loans approved for write-off by the Executive Council and removed from FFS records. These loans were not removed from the control account because the FFS section failed to inform the accounting section of the write-off approval.
- \$47,839 was a loan included in the loans receivable control account awaiting Executive Council write-off approval. The lien was released when the property was sold to provide the buyer with clean title, and the sale proceeds received were insufficient to replenish the bond account. This loan is no longer a valid receivable from either a legal or financial reporting standpoint.

In programs with shared accounting responsibilities such as the family farm security loan program, internal accounting controls are weakened when control accounts in one section are not reconciled to subsidiary records maintained in the other. Without a reconciliation, there is no way to assure that transactions approved by one section are being correctly processed, or even processed at all, by the other.

#### RECOMMENDATIONS

- *The loans receivable control account maintained in the accounting section should be reconciled to the participant records in the FFS section. The sections should investigate differences and adjust records as appropriate.*
- *Interest adjustment loans to participants who have defaulted and where guarantees have been paid should not be included in the loans receivable balance for financial reporting purposes.*
- *Procedures should be implemented for removing interest payment adjustments forgiven during mediation compromises and approved for write-off by the Executive Council from the loans receivable control account in the accounting section.*

2. Processing procedures for special assistance loan repayments need to be improved.

Participants of the family farm security loan program facing cash flow problems may apply for special payment assistance to meet their current loan obligations. Applicants approved for special assistance are required to sign promissory notes before the state will make scheduled loan payments on their behalf. Special assistance repayment dates are outlined in the promissory notes, with interest accruing at an annual percentage rate four percent below federal land bank rates. Due to fluctuating interest rates, the family farm security (FFS) section bills participants when repayments are due. Participants send loan repayments directly to the FFS section, which records them on individual loan cards. The accounting section deposits the receipts and maintains an outstanding balance for all loans issued. On an annual basis, the accounting section certifies the outstanding loan balance to the Department of Finance for inclusion in the state's comprehensive annual financial report. The outstanding loan balance of \$395,211 certified for fiscal year 1988 was \$76,385 more than the balance computed under generally accepted accounting principles (GAAP).

In one situation, a deposit coding error caused the total outstanding loan balance to be reduced by \$1,000 too much. This error was not detected by personnel from either the FFS or accounting section. The failure to reconcile the total outstanding loan balance to the individual loan records is a material weakness in the system of internal accounting control because it allows simple coding errors such as this to go undetected. To improve internal accounting controls and provide a mechanism to detect errors, the total outstanding loan balance must be reconciled to the subsidiary loan records.

The FFS section does not collect special assistance payments in a timely manner due to an inefficient billing process. In all cases reviewed, requests for payment were sent to participants on or after payment due dates outlined in the promissory notes. The resulting late payments caused the state to forgo interest income which could have been earned on the money. Since participants are unable to calculate payment amounts on their own, it is critical to bill them early enough so that payments can be received by the scheduled due dates.

Finally, the total outstanding loan balance certified to the Department of Finance included four loans where uncollectability was probable. Each of these loans were made on behalf of participants who subsequently defaulted. Upon default, the state paid the participant's lender the loan guarantee amount and obtained title to the property. For financial reporting purposes, special assistance loans made on behalf of participants who have defaulted are not to be included in the outstanding loan balance, as discussed in finding #1.

RECOMMENDATIONS

- *The total outstanding special assistance loan balance maintained in the accounting section should be reconciled to subsidiary records in the family farm security section.*
- *Special assistance requests for payment should be sent to participants early enough for them to make payments by the scheduled due dates.*
- *Special assistance loans where uncollectability is probable should not be included in the total outstanding loan balance for financial reporting purposes.*

3. Family farm security loan program receipts are not deposited on a timely basis.

During fiscal year 1988, the family farm security loan program deposits totaled \$2,022,364, mainly for farm sale proceeds and rentals. In most situations, receipts are delivered directly to the family farm security section, where they are posted to participant files. After posting, the receipts are sent to the accounting section for deposit. Both the FFS and accounting sections contributed to the delays in depositing receipts.

In five of seven farm sales reviewed, proceeds were not deposited in a timely manner, ranging from 6 to 21 days. In one situation, two checks totaling \$47,500 were in the accounting section for 20 days before deposit. In two of five farm rentals reviewed, checks were not deposited timely. In the first case, a \$7,105 money order was in the FFS section for six days before it was sent to the accounting section for deposit. In the second case, the accounting section did not deposit a \$3,712 check for eight days.

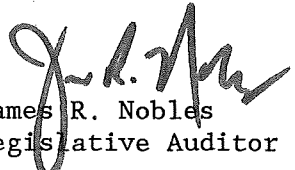
Internal controls over receipts are weakened whenever receipts are not deposited in a timely manner. Minn. Stat. Section 16A.275 requires all agencies to deposit receipts totaling \$250 or more in the state treasury on a daily basis. To strengthen internal controls over receipts and reduce the risk of loss or theft, all program receipts must be deposited on a daily basis.

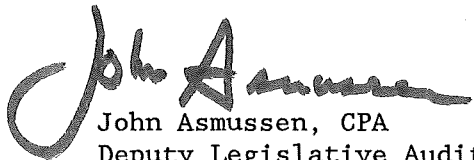
RECOMMENDATION

- *All program receipts should be deposited daily in conformance with Minn. Stat. Section 16A.275.*

Thank you for the cooperation extended to our staff during this audit.

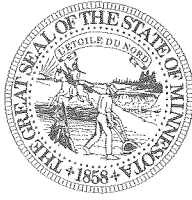
Sincerely,

  
James R. Nobles  
Legislative Auditor

  
John Asmussen, CPA  
Deputy Legislative Auditor

November 28, 1988





LAND OF QUALITY FOODS

90 W. PLATO BOULEVARD  
SAINT PAUL, MN 55107

**STATE OF MINNESOTA**  
DEPARTMENT OF AGRICULTURE

November 28, 1988

Mr. James R. Nobles, Legislative Auditor  
Office of the Legislative Auditor  
Veteran's Service Building  
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

We have reviewed your recommendations and provide the following responses concerning your audit of the Family Farm Security Loan Program of this agency for the fiscal year ended June 30, 1988.

**1. Internal controls are inadequate to properly account for interest payment adjustment loans.**

**RECOMMENDATIONS**

- The loans receivable control account maintained in the Accounting Section should be reconciled to the participant records in the Family Farm Security Section. The sections should investigate differences and adjust records as appropriate.

**RESPONSE:** The current procedures were set in place as recommended by the Legislative Auditor in prior years. The intent was to reconcile with the Department of Finance the outstanding loans receivable from interest payment adjustments so that the Department of Finance could express assurance that all such payment adjustments had been properly recorded as loans receivable. There exists a timing difference between the Statewide Accounting System (SWA), and the Family Farm Security computer system since payment dates must be achieved, and the time it takes to have a payment processed through SWA. In other words, a payment due on December 1, 1988 must be paid prior to that date or in November to reach the payee in time. This is reflected in Statewide Accounting as a November expenditure and loan receivable, and in Family Farm Security as a December amount.

Because of this problem, Family Farm Security is not reconciled, and as an alternative, the individual files are reviewed each year for assurance that all payments have been included in the master file as contained in the accounting payment file. The major concern of the Accounting Division and previous audits has been to ensure that all interest payment adjustments have been properly recorded in the Statewide Accounting System.



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Because of changes in the program and the many defaults and farm mediations, this has caused problems for the Family Farm Security Program Director to reconcile to the statewide accounting figures. Sufficient staff is not available to complete this reconciliation at the present time. The balancing, in order for it to be meaningful, should be done on a monthly or quarterly basis. The agency agrees that Family Farm Security should be reconciled with the Statewide Accounting System and with the assistance of the Legislative Auditor, desires to work out a method to accomplish this. It is requested that the staff of the Legislative Auditor work closely with the Administrator of the Family Farm Security Program to develop appropriate procedures that will meet the requirements of this recommendation within current personnel resources available.

- Interest adjustment loans to participants who have defaulted and where guarantees have been paid should not be included in the loans receivable balance for financial reporting purposes.

**RESPONSE:** While we concur with this recommendation for financial reporting purposes, care must be exerted so that these amounts are still recorded for the purposes of Minnesota Statutes (1986), Sections 10.12 and 10.15. The assistance of the Legislative Auditor is requested to help define procedures for the Administrator of the Family Farm Security Program to accomplish and satisfy this recommendation. This will enable him to advise the auditors at the close of each fiscal year of the amounts in question based upon this jointly developed procedure.

To meet the initial part of this recommendation, I have asked the Administrator of the Family Farm Security Program to prepare a program (LOTUS123) listing the following information:

- a. The name of the Family Farm Security Participant.
- b. The name of the loan/agreement holder to whom interest payment adjustments are being paid.
- c. The date of default.
- d. The date the guarantee was paid.
- e. The amount of interest payment adjustments paid to date.
- f. Date of write-off to the Executive Council.

This report will be done monthly for the current fiscal year which will include all such defaults since the program started. Copies of this report will be furnished to the Accounting Division of this agency and the Department of Finance.

- Procedures should be implemented for removing interest payment adjustments forgiven during mediation compromises and approved for write-off by the Executive Council from the loans receivable control account in the Accounting Section.

**RESPONSE:** We concur with this recommendation. Family Farm Security will notify the Department of Finance when interest payment adjustments are approved for write-off by the Executive Council and also forward a copy of this notification to the Accounting Division of this agency. This can then be verified against the monthly report noted in the previous recommendation.

**2. Processing procedures for special assistance loan repayments need to be improved.**

**RECOMMENDATIONS**

- The total outstanding special assistance loan balance maintained in the Accounting Section should be reconciled to subsidiary records in the Family Farm Security Section.

**RESPONSE:** The current procedure is for the Accounting Division of this agency to balance the statewide accounting expenditures for this purpose with the Department of Finance to ensure all such payments are properly recorded. The further balancing of these amounts to the records of the Family Farm Security Program are the responsibility of the Family Farm Security Program Administrator. Previous procedures were thought to be adequate in this area. This recommendation is difficult for the agency to implement since additional staff is currently not available to be placed into this activity. In order for the agency to meet this recommendation, it requests the assistance of the Legislative Auditor to help develop procedures to their satisfaction and also allow for the program to operate in an efficient manner.

- Special assistance requests for payment should be sent to participants early enough for them to make payments by the scheduled due dates.

**RESPONSE:** The agency concurs with this recommendation and will implement it immediately.

- Special assistance loans where uncollectibility is probable should not be included in the total outstanding loan balance for financial reporting purposes.

**RESPONSE:** While we concur with this recommendation for financial reporting purposes, care must be exerted to comply with Minnesota Statutes (1986), Sections 10.12 and 10.15. The Family Farm Security Program Administrator will develop, with the assistance of the Legislative Auditor, a simple personal computer program (LOTUS123) where the Program Administrator will add to the file any such special assistance loans where a determination has been made that the payments are uncollectible in the opinion of the agency. This report will be produced as of June 30 of each year. The information contained on this report will be similar to the other report mentioned in a previous recommendation.

Mr. James R. Nobles, Legislative Auditor  
November 28, 1988  
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**3. Family farm security loan program receipts are not deposited on a timely basis.**

**RECOMMENDATION**

- All program receipts should be deposited daily in conformance with Minnesota Statutes 16A.275.

**RESPONSE:** This recommendation was implemented immediately.

Your assistance to this agency through this audit is appreciated.

Sincerely,

MINNESOTA DEPARTMENT OF AGRICULTURE

A handwritten signature in cursive script that reads "Jim Nichols".

Jim Nichols  
Commissioner

cc: Joseph Komro  
Wayne Marzolf