



U.S. Department of Agriculture

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Office of Inspector General  
Southeast Region

## **Audit Report**

### **Farm Service Agency Efforts to Identify and Recover Overpayments in the Direct and Counter-Cyclical Program**

Report No. 03008-1-At  
December 2006

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



December 12, 2006

REPLY TO

ATTN OF: 03008-1-At

TO: Teresa C. Lasseter  
Administrator  
Farm Service Agency

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

FROM: Robert W. Young /s/  
Assistant Inspector General  
for Audit

SUBJECT: Advance Counter-Cyclical Overpayments and Recovery

The Farm Service Agency's (FSA) Direct and Counter-Cyclical Program (DCP) protects agricultural producers from low market prices by issuing counter-cyclical payments—often in advance—up to the commodity's target price<sup>1</sup> in a given crop year (CY). If a commodity's effective price<sup>2</sup> for a given year is less than its target price, producers keep the difference known as a counter-cyclical payment. If a commodity's effective price is greater than the target price, then producers must return any difference received previously as an advance of the estimated counter-cyclical payment for the CY. For CYs 2003 and 2004, FSA made counter-cyclical payments totaling about \$1 billion and \$4.4 billion respectively, including overpaying in advance \$477.4 and \$174.2 million, respectively.<sup>3</sup> Of the \$652 million in advance overpayments made for CYs 2003 and 2004, \$651 million (99.9 percent) was recovered as of July 10, 2006. The Office

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<sup>1</sup> Target price is the price per bushel (or other appropriate unit in the case of upland cotton, rice, and peanuts) of a covered commodity used to determine the payment rate for counter-cyclical payments. The target price is a benchmark price established by statute.

<sup>2</sup> Effective price is the sum of the higher of the national average market price or national average crop loan rate, plus the direct fixed payment rate.

<sup>3</sup> See exhibit A.

We found that FSA has adequate controls in place to minimize and recover advance counter-cyclical overpayments. Accordingly, we are making no recommendations and plan no further work on advance counter-cyclical overpayments.

**BACKGROUND:**

DCP is authorized under Title I of the Farm Security and Rural Investment Act of 2002 (2002 Act), and administered by FSA. Title I provides that, for each of the 2002 through 2007 CYs, counter-cyclical payments will be made to producers on farms for which base acres and yields are established for eligible commodities if the effective price for the commodity is less than the target price established for the commodity in the law. The law also authorizes direct fixed payments based on the individual producer's established base acres and crop yields. Direct payments are issued regardless of market prices.

The 15 commodities eligible for counter-cyclical payments are: corn, sorghum, wheat, oats, soybeans, barley, rice, upland cotton, peanuts, and other oilseeds (sunflower seed, rapeseed, canola, safflower, flaxseed, and mustard seed). During the initial implementation of DCP, management considered several options for determining advance counter-cyclical payment rates and decided that producers would receive advance counter-cyclical payments based on projected average market prices.

To determine the advance counter-cyclical payment rate for a given commodity, FSA compares the commodity's target price (set by the 2002 Act) with its effective price. Since the national average market price for a CY is a projection and the only unknown variable in the comparison, FSA relies primarily on official price estimates reported monthly by the Department of Agriculture (Department) in *World Agricultural Supply and Demand Estimates (WASDE)*. The estimated counter-cyclical payment rate is equal to the target price, less the direct payment rate (set by the 2002 Act), and less the higher of the national average loan rate or the midpoint of the *WASDE's* estimated price range. Since a counter-cyclical payment is dependent on market prices, there is no guarantee that a payment will be made for any eligible commodity.

Producers may elect to receive two advance partial payments of the total counter-cyclical payment estimated by FSA for the eligible commodity and CY. For each eligible commodity, a first partial payment may be made not earlier than October 1, and to the extent practical, not later than October 31 of the calendar year in which the crop is harvested. Also, the first partial payment shall not exceed 35 percent of the estimated total payment. A second partial payment may be made no earlier than February 1 of the next calendar year not to exceed the difference between 70 percent of the estimated total payment and the first partial payment.

The National Agricultural Statistics Service (NASS) in the Department has a mission to provide timely, accurate, and useful statistics on agriculture, including market prices of commodities. NASS conducts surveys of the prices paid for farm commodities by individual buyers and cooperatives, and then provides estimates of prices received in the monthly publication, *Agricultural Prices*. This price data is a factor in determining projected prices for commodities,

as reported in the *WASDE* and then used in FSA's methodology to calculate advance counter-cyclical rates. One further use of this price data is for determining the final actual national average market price of individual commodities as of the end of the CY.

#### **OBJECTIVE:**

The objective of our audit was to determine if FSA's management controls were adequate to minimize and recover advance counter-cyclical overpayments. Specifically, we evaluated the (1) methodology to calculate advance counter-cyclical payment rates, including use of market pricing data and (2) adequacy of procedures to recover advance counter-cyclical overpayments. Our audit was not designed to validate the accuracy of payments or recoveries. Also, we did not evaluate NASS' process for estimating commodity market prices or validate NASS' commodity market price data.

#### **SCOPE AND METHODOLOGY:**

We reviewed internal controls for the methodology to calculate advance counter-cyclical payment rates, and for recovery of overpayments. To accomplish the review, we (1) examined applicable laws, FSA regulations and instructional handbooks; (2) interviewed FSA officials and staff; (3) reviewed data on counter-cyclical payments and recoveries for CYs 2003 and 2004; (4) reviewed spreadsheet formulas and advance counter-cyclical rate calculations for rice covering CYs 2003 and 2004; and (5) confirmed estimated and final average market prices used in the methodology agreed with official price data reported in *WASDE* or *Agricultural Prices* for commodities having advance counter-cyclical overpayments for CYs 2003 or 2004 (rice, wheat, corn, sorghum, soybeans, and oats).

We selected rice for our review of rate calculations because (1) FSA made counter-cyclical overpayments of \$106 million on rice for CY 2003 and (2) NASS disclosed its rice price survey data was not updated timely. Although our scope did not include assessing the reliability of NASS' price estimates for any commodity, we did review NASS' new procedure to obtain updated price data for rice. We interviewed NASS officials, and reviewed written instructions issued to NASS State offices and a draft report to Congress on how rice price surveys are conducted.

The audit was performed from March to July 2006 with work completed at the FSA and NASS national offices in Washington, D.C.

We conducted our audit in accordance with generally accepted government auditing standards.

#### **SUMMARY OF WORK PERFORMED:**

We found that FSA has adequate controls in place to minimize and recover advance counter-cyclical overpayments. During CY 2003, there were large advance counter-cyclical overpayments for rice. Rice prices fluctuated rapidly during the market year and NASS' price reporting procedures did not require the monthly estimates reported by rice buyers and

cooperatives to be timely updated to reflect such rapid changes in market prices. When this problem was identified, NASS took immediate action to revise its price reporting procedures for CY 2004, thereby allowing FSA to minimize future overpayments.

### **Methodology to Minimize Overpayments**

We found that FSA's methodology for calculating advance counter-cyclical payment rates has adequate controls to minimize overpayments. This methodology utilizes spreadsheet calculations based on parameters set by the 2002 Act and by FSA's *WASDE* midpoint price policy. An FSA employee, using an electronic spreadsheet that automatically computes advance counter-cyclical payment rates, enters the midpoint of the estimated price range (as published in the *WASDE*) for a particular commodity for that CY. This computation process is performed twice during the CY—in October for the first advance and February for the second. Department officials considered the use of the midpoint price in the methodology as preferable to other policies (e.g., use of a high point from the estimated price range) it could have adopted to minimize potential overpayments because it represents a simple average of the high point and low point in the officially-projected price range.

A second employee performs a quality control review of the calculation by independently tracing the price data back to the *WASDE*, re-computing the payment rate, and comparing the results to those previously determined. A senior agency official performs a final review of the payment rate before it is released to the public.

The October and February estimated CY price ranges are used in the methodology because they represent the latest months for which official price estimates are available prior to determining advance counter-cyclical payments. According to the 2002 Act, a first advance should be paid no earlier than October 1, and a second advance no earlier than February 1.

Because estimation of future commodity prices involves uncertainty, there is risk that any advance counter-cyclical payment rate will result in overpayments of varying degrees to producers depending on the crop, production level, and degree of market price fluctuation.

### **Recovery of Overpayments**

We found that FSA has adequate controls in place to recover overpayments. To be eligible for counter-cyclical payments, producers are required to sign contracts stating that if overpayment occurs, they must repay the overpayment through future program benefit offsets, including automatic reductions to future DCP payments. FSA officials expressed confidence about recovering overpayments because most collections would be accomplished by automatic reductions.

Summary data provided by FSA<sup>4</sup> for CYs 2003 and 2004 disclosed that FSA recovered at least 99.9 percent of advance counter-cyclical overpayments as of July 2006, primarily by automatic reductions.

- For CY 2003, FSA overpaid \$477.4 million but recovered all but \$31,073.
- For CY 2004, FSA overpaid \$174.2 million but recovered all but \$202,486.

Given the high rate of recovery and the actions taken by NASS to improve its price reporting procedures for rice, we discontinued further audit work.

### **Estimated Market Prices for Rice**

Although the scope of this audit did not include a review of the reliability of NASS' commodity price estimates, we learned that NASS' procedures for obtaining price data for rice were not designed to account for rapid changes in market prices. FSA used the official price ranges published by WASDE to calculate CY 2003 advance counter-cyclical payment rates for rice, which totaled \$0.63 per cwt<sup>5</sup> or 900 percent greater than the final rate of \$0.07 per cwt. As a result, rice producers were overpaid \$106.9 million in advance counter-cyclical payments for CY 2003, of which all except \$26,920 was recovered as of July 10, 2006.

The Appropriations Committee of the United States House of Representatives was concerned about the impact on producers and instructed the Secretary of Agriculture to study the benefits and cost of mandatory price reporting for rice. Accordingly, in its draft report to Congress entitled *Mandatory Price Reporting for Rice Crops*, NASS explained the circumstances surrounding the rapid rise in prices for CY 2003 and its subsequent policy changes to improve price reporting for rice.

According to NASS, this problem was caused by an unprecedented spike in rice prices, as the commodity's price increased \$1.73 per cwt from the midpoint of the price range estimated as of October 2003. Rice cooperatives and marketing pools—whose rice price data are used by NASS to report monthly price estimates and establish the commodity's preliminary and actual final average market prices—could not accurately estimate final prices to be paid growers while prices were fluctuating so rapidly. Although low prices were reported to NASS early during the rice marketing year,<sup>6</sup> they were revised later in the year to the new, much higher prices, which explains the large fluctuation between the midpoint price (\$6.35), based on the October 2003 estimated price range, and the final actual average market price (\$8.08) published in January 2005. Since FSA had paid producers advance counter-cyclical payments according to the low, early price, it had thus made overpayments once the end of the year final average price was determined.

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<sup>4</sup> FSA Budget Division and Kansas City Finance Office.

<sup>5</sup> Cwt – abbreviation for hundredweight.

<sup>6</sup> Marketing year is the 12-month period beginning in the calendar year when the crop is normally harvested; for rice, August 1 through July 31.

NASS, however, responded quickly to this reporting problem. Beginning with CY 2004, NASS allowed rice buyers to update previously reported price data twice after market year-end. Under the old policy, data could be updated just once prior to NASS determining the actual final average price. The CY 2004's preliminary final average price published in the August 2005 *Agricultural Prices* report was the same as the CY 2004's actual final average price for rice published in January 2006. FSA made no counter-cyclical overpayments on CY 2004 rice.

Given NASS' new policy to obtain updated price data, we concluded that future variations between preliminary and actual final average market prices reported for rice should continue to be minimized. Since this data is a basis for the projected average price of rice as published in *WASDE* and used by FSA to compute advance counter-cyclical rates, we also concluded advance rates should be more reliable under the new policy.

We determined that further audit work is not warranted because FSA's methodology for determining advance counter-cyclical payment rates appears to be generally sound and consistent with applicable laws and regulations. Since we have no audit findings or recommendations, a reply to this report is not required.

We appreciate the assistance you and your staff provided us during this review.

**Exhibit A – Summary of Counter-Cyclical Payments**

<b>Counter-Cyclical Payments</b> (Thousands of Dollars) As of February 6, 2006				
<b>Crop</b>	<b>Total Payments For CY 2003</b>	<b>Overpayments Based on Advances For CY 2003</b>	<b>Total Payments For CY 2004</b>	<b>Overpayments Based on Advances For CY 2004</b>
Wheat	\$27,897	\$27,897	\$27,536	\$27,536
Oats	-	-	341	341
Corn	338,726	338,726	2,444,643	-
Sorghum	3,885	3,885	158,882	-
Soybeans	-	-	146,317	146,317
Rice	119,505	106,873	159,343	-
Upland Cotton	391,791	-	1,263,767	-
Peanuts	139,266	-	145,879	-
Barley	-	-	51,551	-
<b>TOTALS</b>	<b>\$1,021,070</b>	<b>\$477,381</b>	<b>\$4,398,259</b>	<b>\$174,194</b>
Source: FSA Budget Division				



Informational copies of this report have been distributed to:

Administrator, FSA, **Attn:** Agency Liaison Officer (10)

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