



U.S. Department of Agriculture

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Office of Inspector General  
Midwest Region

# Audit Report

## Farm Service Agency Milk Income Loss Contract (MILC) Program

Report No. 03601-10-Ch  
DECEMBER 2004

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



DATE:

REPLY TO

ATTN. OF: 03601-10-CH

SUBJECT: Farm Service Agency - Milk Income Loss Contract (MILC) Program

TO: James R. Little  
Administrator  
Farm Service Agency

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

Based on the memorandum from your office dated November 18, 2004, we accept management decision on Recommendation No. 1. A summary of management decision is attached. Please follow your agency's internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer.

If you have any questions, please have a member of your staff contact Ernest M. Hayashi, Director, Food and Marketing Division at 720-2887.

/s/

ROBERT W. YOUNG  
Assistant Inspector General  
for Audit

cc: Office of the Chief Financial Officer  
(w/attachment and a copy of  
above-mention memorandum)

# **Executive Summary**

## **Milk Income Loss Contract (MILC) Program Audit Report No. 03601-10-Ch**

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### **Results in Brief**

The Milk Income Loss Contract (MILC) Program provides producers on eligible dairy operations with monthly payments based on the quantity of eligible production marketed by the producer in a month when the domestic milk prices fall below a specified level. We performed this audit survey to evaluate whether (1) payments to producers were properly determined and were based on reliable evidence of production, and (2) FSA State and county offices correctly and consistently applied the definition of a “dairy operation” when determining the production cap for each dairy operation.

Since the MILC Program’s inception under the 2002 Farm Bill, FSA has disbursed over \$2 billion in program payments to dairy producers. We found that, although FSA’s controls over MILC program payments were generally effective, FSA county officials made several errors in determining eligibility and computing payments (see exhibit A). We concluded that these errors represented isolated instances, and the county offices agreed to follow up on them.

In addition, we found that the FSA State offices’ disparate definitions of a “dairy operation” (used to determine whether a producer should be allowed to participate in the program as a single or multiple dairy operation) resulted in inconsistent payments to producers in different States. FSA requested that we assess the impact of the States’ inconsistent definitions after attempting to develop a more specific definition in 2002.<sup>1</sup> Our review confirmed FSA’s concerns, documenting significant differences in the criteria used to define a dairy operation from State to State. Further, we identified at least three instances in which, because of the States’ varying criteria, producers with similar operations located in different States received disparate program payments. Although the MILC program is currently slated to end with the 2005 fiscal year (FY), proposed legislation could extend the program through FY 2007. We concluded, and agency officials agreed, that FSA should submit language for inclusion in the proposed legislation that would ensure a consistent, nationwide definition of a dairy operation.

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<sup>1</sup> The Office of the General Counsel (OGC) had advised FSA officials that the existing law prohibited them from applying different standards than those that were used under the predecessor Dairy Market Loss Assistance (DMLA) Program.

**Recommendations  
in Brief**

We recommend that FSA submit proposed language to the Department for inclusion in the amendment to the Farm Security and Rural Investment Act of 2002, which would permit FSA to establish a clear, consistent, nationwide definition of a dairy operation. In addition, we recommended that the agency verify that county offices either recover or provide documentation to justify the overpayments and unsupported costs questioned in the report, and disburse cited underpayments to producers.

**Agency  
Response**

In their November 18, 2004, response to the draft report, FSA officials generally agreed with the findings and recommendations as presented.

**OIG Position**

We agree with FSA's response, and have reached management decision on Recommendation No. 1. Management decision can be reached on Recommendation No. 2 once FSA has provided us with the information specified in the OIG Position section for Recommendation No. 2.

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# ***Background and Objectives***

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## **Background**

The MILC Program was authorized by section 1502 of the 2002 Farm Bill, the Farm Security and Rural Investment Act of 2002 (Public Law 107-171). The 2002 Farm Bill authorizes the Farm Service Agency (FSA) to provide the nation's dairy producers with economic assistance for market losses. Under the program's provisions, payments are issued on a monthly basis to eligible dairy operations based on the Boston Class I milk price. If the Boston Class I milk price falls below a pre-determined benchmark of \$16.94 per hundredweight, participating producers receive payments at the rate of 45 percent of the difference between the Boston Class I market price and the \$16.94 benchmark. For example, if the Boston Class I price were \$14.51, a participating producer would receive \$1.09 (45 percent of the \$2.43 difference between the Boston Class I price and the benchmark) for every hundredweight marketed up to a total of 2.4 million pounds per dairy operation.

To qualify for program payments, dairy producers must meet certain eligibility criteria and enter into a Milk Income Loss Contract (Form CCC-580) for each participating dairy operation. A producer may have either one or multiple dairy operations, each of which would have its own contract and be separately subject to the 2.4 million pound production cap. To receive payments, producers must provide evidence of dairy production, such as sales records, to the FSA county office.

Under the 2002 Farm Bill, the MILC Program generally covers eligible production marketed by the producers on a dairy farm during the period beginning December 1, 2001, and ending on September 30, 2005 (FY 2005). However, Congress has introduced legislation that could potentially extend the MILC Program through FY 2007. It was originally estimated that the MILC Program would cost approximately \$1.4 billion. However, payments through July 2004 already exceeded \$2 billion.

The 2002 Farm Bill contains a requirement that the same eligibility and other requirements that applied to the most recent of the three Dairy Market Loss Assistance (DMLA-III) Programs under section 805 of the 2001 Appropriations Act be carried over and incorporated into the MILC Program.

## **Objectives**

The objective of the audit was to evaluate whether program payments to producers were properly determined and were based on reliable evidence of production. In addition, we evaluated whether the State and county offices were correctly and consistently applying the definition of a "dairy operation" in applying the production cap.

# **Findings and Recommendations**

## **Section 1. MILC PROGRAM ELIGIBILITY AND PAYMENTS**

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Based on our audit work and information provided to us by FSA national officials, we determined that the FSA State offices were using varied and sometimes inconsistent criteria for determining whether dairy producers should be allowed to participate in the MILC Program as single or multiple dairy operations. Because of the inconsistent definitions of a dairy operation, producers with similar operations located in different States received disparate MILC Program payments.

In addition, our review of the three county offices in one State disclosed errors that resulted in overpayments and unsupported payments totaling about \$59,600, and underpayments of about \$4,500.

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### **Finding 1**

#### **DEFINITION OF A DAIRY OPERATION NEEDS TO BE CLARIFIED TO ENSURE CONSISTENT APPLICATION BY STATES**

The definition of a dairy operation, for the purpose of limiting eligible quantities of milk production under the MILC Program, was applied inconsistently from State to State, impacting the amount of program benefits received by producers with similar operations in different States. Although FSA officials recognized the disparities, the Office of the General Counsel (OGC) advised FSA that according to the law the definition of a dairy operation could not be changed. In four selected States, we found numerous discrepancies in the criteria applied by the State offices to determine whether producers had single or multiple operations. We also identified three instances where producers in two of these States received disparate program benefits amounting to \$174,721 in one State and \$70,325 in the other.

The DMLA Programs I, II, and III, established in 1999, provided financial assistance to dairy producers through fiscal year 2001. The MILC Program was established by the 2002 Farm Bill, and is generally similar to the DMLA Programs in that it provides for payments to dairy producers when the market price of milk per hundredweight falls below an established threshold. In addition, both the MILC and DMLA Programs included provisions to limit per dairy operation the amount of milk on which payments could be made. For the MILC Program, the production cap was 2.4 million pounds of milk per dairy operation per fiscal year.

The 2002 Farm Bill requires that “for purposes of determining whether producers are producers on separate dairy operations or a single dairy operation, the Secretary shall apply the same standards as were applied in implementing [DMLA III].” Under DMLA-III, FSA defined a dairy

operation as “any person or group of persons who as a single unit markets milk commercially and whose production and facilities are located in the U.S.” However, this regulatory definition did not clarify the term “single unit”<sup>2</sup> and the term remains open to interpretation. Currently, FSA State offices make determinations of what constitutes a “single unit” based on a variety of criteria that can vary widely from State to State.

In 2002, aware that the FSA State offices were not using consistent criteria in making their determinations, and in light of Congress’ enactment of the MILC Program, the FSA national office conducted a survey of the 13 States that had the largest DMLA payments to determine the extent of the disparity. The survey presented six different scenarios involving dairy operations that were potentially eligible to receive MILC payments and asked the States to determine whether they would consider the producer as having a single dairy operation or two operations. One scenario, for instance, described a situation where two producers owned herds located on a single farm, and shared the same milking parlor but maintained separate books and received separate milk checks. Of the 11 State offices that responded to the survey, 6 considered it a single operation while the other 5 concluded that two operations were involved. Overall, the States’ opinions diverged on three of the six survey scenarios.

Based on the survey results, the FSA national office concluded that it needed to clarify the definition of a dairy operation to prevent inconsistent interpretations that would in turn affect the amount of program payments a producer could receive under the production cap of 2.4 million pounds per dairy operation. In a 2002 draft memorandum to the Under Secretary, FSA summarized the results of its survey and proposed adding a definition of a “single unit” to the existing definition of a dairy operation. However, the OGC advised that FSA could not legally change the existing definition. Although OGC did not provide FSA with a written legal opinion, it told FSA officials that that the law instructs the Secretary to apply the same standards as were applied in implementing the DMLA Program. This provision, according to OGC, prevented FSA from applying a more detailed definition of a dairy operation than was in effect under DMLA.

At the beginning of our review FSA officials informed us of the States’ inconsistent application of the term “dairy operation” for participation in the MILC Program and requested that OIG review the situation further. We interviewed officials at the California, Michigan, Pennsylvania and Wisconsin State FSA Offices to document the criteria used by each State to determine whether a producer had one or multiple dairy operations. As shown in exhibit B, we found that the criteria used by the four States varied considerably. In some cases, all four States’ criteria were in agreement – for instance, all of the States stipulated that to have more than one dairy

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<sup>2</sup> Title 7 CFR 1430.203



operation, a producer had to have separate herds, separate milking barns and bulk tanks, and had to receive separate milk marketing statements for each separate operation. However, California had only those three requirements, while the other States required additional information to make their determinations. Pennsylvania officials reviewed 14 different criteria related to dairy herds, facilities, location, recordkeeping, management, filing of tax returns, and other items. The other two States each had 10 criteria they considered, but these differed from one another in several respects.

We also found that the States had differing policies regarding the documentation of their procedures. California had seven written procedures, but in practice only used three of these. Wisconsin and Pennsylvania had provided some documentation to the county offices, but supplemented these with verbal instructions. In Michigan, none of the criteria were in writing.

To determine whether these differences in definitions could result in disparate treatment of dairy producers in different States, and whether the States were consistently applying their own criteria, we (1) reviewed a judgmental sample of 20 dairy producers, 5 producers from each of the 4 sampled States (California, Michigan, Pennsylvania and Wisconsin), who had multiple dairy operations according to the MILC Program payment database; and (2) reviewed FSA State Committee minutes from each of the 4 States to identify instances where producers participating in the MILC Program had applied for changes in their dairy operations. Based on our review of the 20 producers selected from the database, we determined that each State's decisions to allow multiple units were consistent with their established criteria and that these were applied consistently within each State. However, in reviewing the State Committee minutes for Pennsylvania, and information obtained about a producer in California, we identified three instances in which determinations made by one State would not have been upheld by the other due to their different definitions of a dairy operation.

We found that in the Pennsylvania State FSA Committee minutes, one producer (Producer A) with two dairy operations was mentioned which appeared very similar to another producer (Producer B) who had applied for a change in California. Producer A in Pennsylvania was requesting reconsideration of the State Executive Director's determination that he qualified for only a single dairy operation and a single MILC contract instead of the two he believed he was entitled to. In another Pennsylvania case, a producer (Producer C) contended that he had three separate dairy operations but was determined by the State to have only one dairy operation for purposes of participation in the MILC Program.

In each case, we identified the facts used by the FSA State offices to make its determination. We then contacted the other State office to determine whether the same determination would have been made. Where necessary, we were required to contact the county office where a farm was located to obtain

information which one State required in order to make a determination but which the other State had not considered necessary.

In comparing Producer A in Pennsylvania to Producer B in California, we noted that each producer had two dairies with the following characteristics in common:

1. Dairy #1 was a single operation and participated in DMLA-III;
  2. Dairy #2 did not participate in DMLA-III;
  3. Each dairy operation is at a different location; and
  4. Each dairy operation has a separate milking barn, tank, and facility.
- For Producer A in Pennsylvania, the FSA State office disapproved the producer's request for two MILC contracts. According to the FSA State Committee, the dairy operation did not meet all of the requirements for two separate dairy operations because (1) one storage facility for supplemental feed was used for both operations; (2) there was one record keeping system, (3) there was one bank account, and (4) the dry cows from both facilities were kept at the same third facility and returned to the operation when freshened. However, according to a California State FSA official, the above issues would not have been factors in making their determination. The producer's dairy operations meet the California State FSA Office's three criteria (separate milk marketing statements, cows, facility) and would have been approved as two separate dairy operations. As a result, while in Pennsylvania the producer received only \$54,569 for a single dairy operation, in California the producer would have received \$110,679, a difference of \$56,110<sup>3</sup>.
  - For Producer B, the FSA county office in California determined that the two dairies qualified as separate operations and approved the producer's request for two MILC contracts. This determination was based on California's three criteria (separate milk marketing statements, separate cows, and separate facilities) that are required by the State office. However, when we described these circumstances to a program official in the Pennsylvania State FSA Office, we were told that this information was insufficient to make a determination. The Pennsylvania State FSA official stated that to make a determination under that State's criteria, they would need to know whether the "operations" under consideration had (1) separate management for the two operations, (2) separate facility locations and bulk tanks for each operation, (3) separate accounts for feed purchases, (4) separate sets of records, and (5) separate bills for each operation. The California State FSA Office did not have this information, but we obtained it through the applicable county office. When we provided this further information to the Pennsylvania State FSA Office, we were told that Producer B's operation did not meet the

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<sup>3</sup> The county office originally approved as two separate operations. The State Committee approved as one operation.

criteria related to “management” and thus would have been considered a single dairy operation rather than the two allowed by California. During FY 2002 and 2003 the producer in California received a total of \$127,300 in MILC payments, \$70,325 more than the \$56,975 he would have received in Pennsylvania.

- For another producer in Pennsylvania (Producer C), the FSA State Committee disapproved the producer’s contention that he had three separate dairy operations and his request for three MILC contracts. Based on a review of the State Committee minutes, we found the following information about the dairy facilities:
  1. Dairy Operation A participated in DMLA-III
  2. Dairy Operation B did not participate in DMLA-III, but was in operation at the time.
  3. Dairy Operation C was established after DMLA-III ended
  4. Each farm has its own dairy operation (milking barn and bulk tank)
  5. Each dairy received separate milk marketing statements

The Pennsylvania State FSA Office determined that the three facilities were not in fact separate, but a single dairy operation. This determination was based upon the following facts: (1) Feed was purchased and delivered to one feed center before distribution to the three facilities; (2) all three were run by the same management; (3) the three facilities shared a single bank account for their income and expenses; and (4) heifers from all three facilities were commingled and one employer identification number is used for all three facilities. However, when we described this scenario to an official at the California State FSA Office, he responded that the three facilities met California’s three criteria based on the following: (1) the three facilities received separate milk marketing statements; (2) each facility had its own milking barn and bulk tank; and (3) the milking cows were separate at each facility. The FSA State official stated that based on the information provided, this producer’s request for three dairy operations and three contracts would have been approved in California. In California, the producer would have received \$173,036 for 3 separate operations, while in Pennsylvania he actually received only \$54,425 as a single dairy operation. This resulted in a disparity of \$118,611 in MILC Program payments between the two States.

In our review of FSA’s MILC Program database, we noted an overall disparity between some States in the numbers of producers who had multiple dairy operations and multiple contracts (see exhibit A). For instance, of Pennsylvania’s 6,148 MILC contracts as of December 2003, only 34 (or 0.6 percent) were for multiple dairy operations. In contrast, of California’s 2,073 MILC contracts at that time, 455 (or 22 percent) were on multiple operations. Of Michigan’s 2,878 contracts, 1 percent was for multiple operations, while 2.5 percent of Wisconsin’s 20,965 contracts fell into this

category. FSA national officials believed that the much higher percentage of multiple contracts in California was attributable to both the relatively large size of dairy operations in that State and the different criteria used to distinguish single from multiple dairy operations owned by a particular producer.

We concluded that the different criteria used by various States to define a dairy operation did in fact result in disparate treatment of some producers and that a more specific definition was needed to address the problem. FSA national officials agreed with this assessment, but an OGC official confirmed that existing legislation prohibits FSA from changing the current definition. However, the OGC official also stated that FSA is not restricted from submitting proposed legislation to accomplish this if the MILC Program is extended beyond the end of FY 2005. On July 6, 2004, a bill to amend the Farm Security and Rural Investment Act of 2002 was introduced into Congress that would, if approved, extend the program through FY 2007. This provides FSA with the opportunity to submit proposed language, for inclusion in the pending legislation, to allow for a clear and consistent definition of a dairy operation that could be applied to all dairy producers nationwide.

## **Recommendation No. 1**

Since the program may be extended, submit proposed language to the Department, for inclusion in the amendment to the Farm Security and Rural Investment Act of 2002, which would permit FSA to apply a consistent, nationwide definition of a “dairy operation” to all producers participating in the MILC Program.

### **Agency Response**

FSA officials agreed with the recommendation. They stated that FSA has submitted an Options Memorandum to the Secretary requesting that consideration be given to submitting to Congress proposed language for inclusion in any pending legislation that would amend the MILC program by allowing the Secretary to establish consistent criteria for determining single dairy operations from multiple dairy operations nationwide. In subsequent conversations with an FSA official, FSA stated that the memorandum would be submitted to the Secretary by December 31, 2004.

### **OIG Position**

We accept FSA’s management decision.

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## Finding 2

### ELIGIBILITY AND PAYMENT ERRORS RESULTED IN UNSUPPORTED COSTS AND UNDERPAYMENTS TO PRODUCERS

We reviewed 63 out of approximately 495 MILC contracts approved by three FSA county offices in Michigan. While we found that the three offices were generally accurate when making eligibility determinations and in calculating program payments, we did identify errors that resulted in ineligible payments of \$18,860, unsupported payments of about \$40,800, and underpayments of about \$4,500 (see exhibit A). The conditions we noted were the result of eligibility errors and misinterpretation of payment rules. During our audit, the county offices initiated and in some cases completed corrective actions.

#### Eligibility Errors

- Conservation Certification Not Obtained

To be eligible to receive MILC payments, a dairy operation must certify compliance using form AD-1026.<sup>4</sup> However, in one county office, two producers were approved for participation even though the county office did not have these forms on file. A county office official stated that employees often assumed that the certifications were in place because this had also been a requirement of the DMLA Program. By incorrectly confirming the producer's compliance, the county office made unsupported payments totaling \$39,862.

- DMLA Records Not Reviewed

Dairy operations must be organized under MILC the same way they were organized under DMLA. We found that one county office mistakenly approved three MILC contracts for one dairy operation, which resulted in an overpayment of \$14,484.31. Under DMLA, the three producers were partners in one dairy. They then applied separately for the MILC Program, and the county office approved all three applications without first checking the DMLA application. During our audit, the county office had already identified this error and was calculating the overpayment for recovery.

In the same county office, we found one producer applied for and received 100 percent of a dairy operation's MILC payments even though it was a 50/50 partnership under DMLA. Because of this error the county overpaid one partner by \$4,374 and underpaid the second partner by the same amount. The county executive director (CED) did not review the dairy's DMLA application to see how the operation was organized until the producer had received three MILC payments. The CED then modified the contract to make all future payments on a 50/50 basis.

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<sup>4</sup> Notice LD-524, announcing the MILC Program, part 4C requires producers to submit form AD-1026 to certify compliance.

- Addendum Not Signed

Notice LD-530, dated December 17, 2002, states that either the CED or a county committee member must sign and date the Addendum for Modification to the MILC contract after the producer completes it. For all of its contracts, one county did not sign the addenda which update the MILC contracts to include modifications to program requirements that went into effect after the original contracts were signed. The CED did not realize that the addenda had not been signed.

#### Payment Errors

Dairy operations are to receive MILC payments no later than 60 days after the production evidence (used to calculate monthly MILC payments) and all supporting documents for the applicable month are received. Producers who receive late payments are entitled to prompt payment interest as allowed by the law. For nine MILC contracts in two county offices, the county offices made payments more than 60 days after they received the producers' production evidence. The county offices did not calculate and pay the required late payment penalties, which would have totaled \$159.

Each month, eligible dairy operations must provide documentation to verify that the dairy operation produced and marketed milk that month. The county office must make a copy, date stamp the copy, attach the copy to the MILC contract as proof of production, and return the original documentation to the producer.<sup>5</sup> One county office did not have production evidence on file to support a monthly program payment of \$902.

#### **Recommendation No. 2**

Verify that the FSA county offices have collected the cited overpayments of \$18,858, as well as any portion of the unsupported costs of \$40,764 for which the county offices cannot obtain the necessary eligibility documentation. In addition, verify that the county offices have disbursed the cited \$4,533 in underpayments to producers.

#### **Agency Response**

FSA officials agreed with the recommendation. They stated that as of November 10, 2004, the required eligibility documentation was obtained from the appropriate producers to substantiate the \$40,764 in payments issued to dairy operations who had not provided appropriate production evidence or certified compliance with highly erodible land conservation and wetland conservation provisions.

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<sup>5</sup> LD-524, announcing the MILC Program, part 8C.

In addition, the appropriate county FSA offices in Michigan have initiated actions for recovery by establishing receivables for the outstanding payments and plan to have the underpayments of \$4,533 and over payments of \$18,858 resolved by December 15, 2004.

**OIG Position**

To achieve management decision, we need evidence that the cited \$18,858 in overpayments have been collected or are in the process of being collected. FSA's November 18, 2004, response included copies of outstanding receivables reports and cash receipts history reports. In addition, on November 30, 2004, FSA provided to us copies of demand letters related to MILC overpayments. However, we have been unable to reconcile to the overpayment amounts cited in the audit either (1) the receivables/cash receipts amounts or (2) the demand letter amounts. We continue to work with your agency to account for the cited overpayments.

## Scope and Methodology

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We performed an audit of MILC payments at the FSA national office in Washington, D.C.; at the Michigan State FSA Office in East Lansing, Michigan; and at three selected Michigan county offices. We also obtained information from the California, Pennsylvania, and Wisconsin FSA State and county offices and from the MILC Program Payment Database. Our fieldwork was performed between September 2003 and July 2004.

To determine whether dairy producer payments were properly determined, we judgmentally selected 63 of 495 MILC contracts in Michigan from the Allegan, Huron, and Sanilac County FSA Offices. We selected Michigan for our State office visits because it was one of the larger States both in terms of program payments and numbers of program participants. In addition, we selected the three counties with the largest number of MILC contracts. The sampled producers received over \$1.8 million of the estimated \$12 million in payments issued in the three counties during fiscal years 2002 and 2003. Overall, Michigan has paid participants over \$84 million in MILC Program benefits payments during this same period. We reviewed the dairy producer files to determine whether producers provided the required documentation and production evidence, whether transition payments and subsequent monthly payments were properly computed, and whether payments to any producer were made on production exceeding the 2.4 million pound cap.

Using ACL data-mining software, we analyzed the MILC Program Payment Database for California, Michigan, Pennsylvania, and Wisconsin. As of July 2004 these States have issued over \$824 million of the \$2 billion in total MILC payments made since the inception of the MILC Program in 2002. We identified producers with two or more contracts with the same tax identification numbers in order to determine whether the dairy operations were separate and distinct entities. We also determined whether restructuring of the dairy operations were completed in accordance with program requirements.

Based on our analysis of the FSA MILC database, we selected 5 producers from each of the 4 States for a total of 20 producers for further review. For these producers, we reviewed 53 of 1,063 MILC contracts. We also contacted the FSA State offices in California, Michigan, Pennsylvania, and Wisconsin to determine the criteria they used when defining a dairy operation.

The audit was conducted in accordance with Generally Accepted Government Auditing Standards.



To accomplish our objectives we:

- Reviewed notices, policies and procedures governing the MILC Program, including the Code of Federal Regulations, title 7;
- Reviewed policies and procedures governing the DMLA Program, including the Code of Federal Regulations, title 7;
- Interviewed FSA national officials as well as State office and county level officials in four States to determine what controls were used to monitor MILC Program payments;
- Reviewed county office files which consisted of MILC applications, DMLA applications, payment data, and conservation certification records;
- Visited the Michigan Milk Producers Association to determine the reliability of producer production evidence;
- Reviewed the County Operation Review Report to identify any reported deficiencies that could affect program payments;
- Reviewed the State committee minutes to determine the basis for the approval or disapproval of MILC applications when the producer requested a change in operation such as splitting an existing operation or purchasing a new operation;
- Analyzed the FSA MILC Program Payment Database to identify producers with multiple dairy operations to determine whether the dairy operations were separate and distinct entities; and
- Held discussions with OGC to discuss the courses of action open to FSA in applying a more specific definition of a dairy operation nationwide.

# Exhibit A

## Summary of Monetary Results

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	<i>Description</i>	<i>Amount</i>	<i>Category</i>
Finding 2	MILC Payments Issued Without Supporting Documentation	\$40,764	Unsupported Costs, Recovery Recommended
Finding 2	Eligibility and Payment Errors	\$ 4,533	Other: Underpayments and Overcollections
Finding 2	Incorrect Determination of Dairy Operations	\$18,858	Questioned Costs, Recovery Recommended
<b>Total</b>		<b>\$64,155</b>	

## **Exhibit B**

### **Disparity Between Sampled States In The Number of Producers With Multiple Dairy Operations And Multiple Contracts**

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<b>STATE</b>	<b>TOTAL NUMBER OF MILC CONTRACTS</b>	<b>TOTAL NUMBER OF PRODUCERS WITH MULTIPLE DAIRY OPERATIONS</b>	<b>TOTAL NUMBER OF MILC CONTRACTS PER PRODUCERS WITH MULTIPLE DAIRY OPERATIONS</b>
<b>California</b>	<b>2,073</b>	<b>202</b>	<b>455</b>
<b>Michigan</b>	<b>2,878</b>	<b>14</b>	<b>29</b>
<b>Pennsylvania</b>	<b>6,148</b>	<b>17</b>	<b>34</b>
<b>Wisconsin</b>	<b>20,965</b>	<b>250</b>	<b>545</b>
<b>Totals</b>	<b>32,091</b>	<b>483</b>	<b>1,063</b>

# Exhibit C

## STATE CRITERIA

The Farm Security and Rural Investment Act of 2002 requires FSA to apply the same standards that were applied in implementing DMLA-III. In DMLA-III, a dairy operation was defined as any person or group of persons, who, as a single unit as determined by CCC, produce and market milk commercially produced from cows, and whose production and facilities are located in the United States. Each State and county office shall strictly adhere to and apply this definition to the MILC Program in the **exact** same manner applied for the DMLA-III program in your State with no variation.

<b>STATE OFFICE CRITERIA FOR DETERMINING SEPARATE DAIRY OPERATIONS</b>				
Criteria:	California <sup>1</sup>	Michigan <sup>2</sup>	Pennsylvania <sup>3</sup>	Wisconsin <sup>4</sup>
Separate Cows	X	X	X	X
Separate Facility Locations				
Includes milking barn and bulk tank	X	X	X	X
Separate Records				
Includes Milk Checks		X	X	X
Includes Milk Marketing Statements	X	X	X	X
Includes Accounting Records			X	
Includes Bank Accounts		X	X	X
Includes Bills (Each dairy is responsible)			X	
Includes Accounts for Storage			X	
Includes Accounts for Feed Purchases			X	X
Includes Accounts for Breeding Expenses				X
Includes Credit/Financing			X	X
Includes Veterinary Bills				X
Separate Feed Receipts		X <sup>5</sup>		
Separate Management		X	X	
Separate Labor		X		
Separate SSN or EIN for each operation			X	
Separate Capital		X		
If leasing, who pays for lease?		X		
How are income tax returns filed?			X	X
Whose contributions are significant and at risk?			X	

<sup>1</sup> The three criteria used to determine a separate dairy operation.

<sup>2</sup> All criteria are reviewed; however, the State looks more at the financial aspect of an operation.

<sup>3</sup> All criteria are reviewed; however, the criteria are reviewed for their separateness.

<sup>4</sup> All criteria are reviewed; however, all criteria do not have to be separate. There is some judgment.

<sup>5</sup> Producer needs to provide information to show the operation paid for the feed.

# Exhibit D

## FSA'S RESPONSE TO DRAFT REPORT

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United States  
Department of  
Agriculture

Farm and Foreign  
Agricultural  
Services

Farm Service  
Agency


Operations Review  
and Analysis Staff

Audits,  
Investigations, and  
State and County  
Review Branch

1400 Independence  
Avenue, SW  
Stop 0540  
Washington, DC  
20250-0540

NOV 18 2004

**TO:** Director, Farm and Foreign Agriculture Division  
Office of Inspector General

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

**SUBJECT:** Response to Audit 03601-0010-CH, Milk Income Loss Contract Program

Enclosed is a copy of a memorandum dated November 15 from the Farm Service Agency's Deputy Administrator for Farm Programs, which responds to your September 21 request for information to the official draft of the subject audit.

Direct any questions to Karren Fava at 720-6152.

Enclosure

USDA is an Equal Opportunity Employer

# Exhibit D

## FSA'S RESPONSE TO DRAFT REPORT



United States  
Department of  
Agriculture

Farm and Foreign  
Agricultural  
Services

Farm Service  
Agency

1400 Independence  
Avenue, SW  
Stop 0512  
Washington, DC  
20250-0512

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

**THROUGH:** John A. Johnson  
Deputy Administrator for Farm Programs

**FROM:** Grady Bilberry  
Director, Price Support Division

**SUBJECT:** Response to Official Draft Audit Report 03601-10-CH, Milk Income Loss Contract (MILC) Program

JW PHS  
11-16-04

We have reviewed the official draft report prepared by Office of Inspector General (OIG) regarding the audit survey results for the MILC program. The results of the survey revealed that the inconsistent use of the dairy operation definition used by States to determine single or multiple dairy operations was causing disparate treatment to producers with similar operations in different States (Finding 1). Another finding revealed eligibility and payment errors that resulted in unsupported costs and underpayments to producers (Finding 2).

As a result of the findings from the MILC audit survey, OIG has recommended for Finding 1 that FSA should submit language to the Department for inclusion in proposed legislation that would amend the Farm Security and Rural Investment Act of 2002, to allow the Secretary to establish a clear, consistent nationwide definition of a dairy operation, provided the program is extended beyond September 2005. As for Finding 2, OIG has recommended that FSA collect overpayments to dairy producers in the amount of \$18,858, issue underpayments in the amount of \$4,533, and collect any portion of unsupported costs in the amount of \$40,764, for which the county offices cannot obtain the necessary eligibility documentation.

We agree with the OIG audit survey findings and recommendations. In response to Finding 1, FSA has submitted an Options Memorandum for the Secretary (copy enclosed) requesting consideration be given to submitting to Congress proposed language for inclusion in any pending legislation that would amend the MILC program by allowing the Secretary to establish consistent criteria for determining single dairy operations from multiple dairy operations nationwide. The Options Memorandum was drafted as a corrective action taken by FSA to achieve management decision on the OIG recommendation. However, the decision as to whether the proposed legislative language is actually supported by the Department and forwarded to Congress is ultimately at the sole discretion of the Secretary. As of the date of this memorandum, a response to the Options Memorandum from the Secretary's office has not been received by FSA.

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# **Exhibit D**

## **FSA'S RESPONSE TO DRAFT REPORT**

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**Phillip Sharp**  
**Page 2**

With respect to Finding 2 involving eligibility and payment errors, the appropriate county FSA offices in Michigan have been instructed to take corrective actions to resolve any unsupported costs and underpayments to producers that were discovered by OIG during their MILC audit investigation. As of November 10, 2004, the required eligibility documentation was obtained from the appropriate producers to substantiate the \$40,764 in payments issued to dairy operations whom had not provided appropriate production evidence or certified compliance with highly erodible land conservation and wetland conservation provisions. In addition, all CCC-580 Addendum-1's that were discovered in Huron County FSA Office with no signature have now been signed by a county office Representative as required by procedure in Handbook 11-LD.

As of the date of this memorandum, the underpayments discovered by the OIG audit survey in the amount of \$4,533 have not yet been disbursed. Also, the overpayments identified in the amount of \$18,858 have yet to be collected. However, the appropriate county FSA offices in Michigan have initiated actions for recovery by establishing receivables for the outstanding payments and plan to have underpayments and overpayments resolved by December 15, 2004.

Enclosed we have provided evidence to support actions taken by FSA in response to the OIG recommendations. If you have any questions regarding this case or require anything further, please contact Danielle Cooke in PSD at (202) 720-1919.

Enclosures

Information copies of this report have been distributed to:

Administrator	4
Attn: Agency Liaison Officer	
General Accounting Office	1
Office of the Chief Financial Officer	
Director, Planning and Accountability Division	1