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Audit Report

Farm Service Agency
Review of the 2002 Farm Bill Commodity Loan and Payment Rates

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

DATE: December 22, 2003

REPLY TO
ATTN OF: 03601-20-KC

SUBJECT: Review of the 2002 Farm Bill Commodity Loan and Payment Rates

TO: James R. Little
Administrator
Farm Service Agency

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

SUMMARY:

We have completed an audit survey of the Farm Service Agency's (FSA) established management controls over formulation, calculation, and implementation of local county loan rates and counter-cyclical payment rates for crop years 2002 and 2003 to determine the need and areas for additional audit work. The overall survey objectives were to determine (1) the methodologies used and management controls over calculating loan county rates, establishing counter-cyclical payment rates, and designating eligible commodities, and (2) whether such controls were adequate to ensure that such rates were properly calculated and, in the case of counter-cyclical rates, were applied to properly designated eligible commodities. We also reviewed and tested a judgmental sample of payment rates and disbursements provided to producers of agricultural crops for proper support, accuracy, and propriety. The disbursements provided to these producers were in the form of marketing assistance loans, direct payments, counter-cyclical payments, and loan deficiency payments (LDP).

Overall, we determined that FSA had established reasonable controls regarding the formulation, calculation, dissemination, and implementation of local county loan rates, counter-cyclical rates (where applicable), and other payment rates[1] for crop years 2002 and 2003, and that such controls were working as intended. In addition, we determined that selected FSA State and county offices properly applied payment rates for the various agricultural crops for both crop years 2002 and 2003,[2] as appropriate, and that

[1] Direct payment rates, LDP rates, and marketing assistance loan payment rates.
[2] Local county loan rates, counter-cyclical payment rates, direct payment rates, LDP rates, and marketing assistance loan rates.

they computed the various disbursements we tested in accordance with program policies and procedures. We confirmed that the weighted average local county loan rates established by FSA equaled the national loan rates as set forth in the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill), Public Law (P.L.) 107-171, dated May 13, 2002. Nothing came to our attention to cause us to believe that the systems of management controls over these activities were not effective and operating as designed. As a result, we will not be initiating any further audit work.

<u>BACKGROUND</u>:

The Commodity Credit Corporation (CCC) is a wholly-owned Government corporation created in 1933 to stabilize, support, and protect farm income and prices; to help maintain balanced and adequate supplies of agricultural commodities, including products, foods, feeds, and fibers; and to help in the orderly distribution of these commodities. CCC was originally incorporated under a Delaware charter and was reincorporated June 30, 1948, as a Federal corporation within the U.S. Department of Agriculture (USDA) by the Commodity Credit Corporation Charter Act (15 U.S.C. 714). Since the CCC has no operating personnel, its price support, domestic acquisitions, production payments, and other commodity programs are carried out through the personnel and facilities of FSA.[3]

The 2002 Farm Bill was signed into law on May 13, 2002, and governs Federal farm programs for 6 years (2002 through 2007). Title I, subtitles A, B, and C of the 2002 Farm Bill provide for direct payments, counter-cyclical payments, marketing assistance loans, and loan deficiency payments on selected agricultural commodities, including wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, and other oilseeds and commodities. The 2002 Farm Bill replaced flexibility contract payments, which were authorized under the Federal Agricultural Improvement and Reform Act of 1996, with direct payments.

Subtitle A of Title I provides for direct and counter-cyclical payments to be made to eligible producers on farms enrolled for the 2002 through 2007 crop years for each covered commodity. Both direct and counter-cyclical payments are computed using the base acres and payment yields established for the farm. The amount of the direct payment to be made to the producer for a crop year shall be equal to the product of the direct payment rate multiplied by the payment acres (85 percent of the base acres) of the covered commodity on the farm multiplied by the payment yield. Counter-cyclical payments provide support counter to the cycle of market prices and are only to be made to producers on farms if the effective prices for the covered commodities are less than

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[3] FSA was established when USDA was reorganized in 1994, incorporating programs from several agencies, including the then Agricultural Stabilization and Conservation Service, Federal Crop Insurance Corporation, and Farmer's Home Administration. Although its name has changed over the years, the FSA's relationship with farmers/producers goes back to the 1930's. FSA's missions include stabilizing farm income, helping farmers conserve land and water resources, providing credit to new or disadvantaged farmers and ranchers, and helping farm operations recover from the effects of disaster.

their target prices. The target prices are fixed in the legislation. The counter-cyclical payment rate is the amount by which the target price of each commodity exceeds its effective price. The effective price for a covered commodity is equal to the sum of (1) the higher of the national average market price or national average loan rate and (2) the direct payment rate.

Subtitle B of Title I continues non-recourse marketing assistance loans and LDP provisions from previous legislation. The subtitle provides for non-recourse marketing assistance loans for loan commodities produced on the farm (i.e., a producer has the option of delivering to CCC the quantity of a commodity pledged as collateral for a loan as full payment for that loan at loan maturity). The national loan rates for 18 commodities are fixed in the legislation. For commodities other than upland cotton, rice, and extra-long staple cotton, producers are allowed to repay their marketing assistance loans at a rate that is the lesser of (1) the loan rate established for the commodity, plus accrued interest and other charges, or (2) the alternate loan rate CCC determines. For all loan eligible commodities (except upland cotton, extra-long staple cotton, and rice), the alternate loan repayment is the CCC-determined market price. For wheat, feed grains, and oilseeds, the CCC-determined local market price is often referred to as the posted county price. Posted county prices are established and available at each USDA county office. For peanuts, CCC determines national posted prices for four types of peanuts and announces them weekly. For wool and mohair, CCC determines weekly regional and national posted prices, respectively. For upland cotton and rice, the alternate repayment rate is the prevailing world market price of the commodity (adjusted to United States quality and location). For extra-long staple cotton, the repayment of the loan is the loan rate established for the commodity, plus accrued interest and other charges.

The Secretary may make LDP's available to producers who, although eligible to obtain a marketing assistance loan with respect to a loan commodity, agree to forego obtaining the loan for the commodity in return for LDP's.[4] The LDP payment rate shall be the amount by which the loan rate established for the loan commodity exceeds the rate at which a marketing assistance loan for the commodity may be repaid. An LDP for a loan commodity shall be computed by multiplying (1) the payment rate determined for the commodity by (2) the quantity of the commodity produced by the eligible producers, excluding any quantity for which the producers obtained a marketing assistance loan.

Section 1606, Adjustment of Loans, provides that the Secretary may adjust commodity loan rates for differences in grade, type, quality, location, and other factors. The adjustments are, to the maximum extent practicable, to be made in such manner that the average loan level for the commodity will, on the basis of the anticipated incidence of the factors, be equal to the level of support determined, as provided in Title I of the 2002 Farm Bill; i.e., the national loan rates. The Secretary may establish loan rates for a crop for producers in individual counties in a manner that results in the lowest such

[4] LDP's apply to all loan commodities, except extra-long staple cotton.

rate being 95 percent of the national average loan rate, except that such action shall not result in an increase in outlays. Adjustments are not to result in an increase in the national average loan rate for any year.

SURVEY OBJECTIVES:

The survey objectives were to determine (1) the methodologies used and management controls over calculating local county loan rates, establishing counter-cyclical payment rates, and designating eligible commodities, and (2) whether such controls were adequate to ensure that such rates were properly calculated and, in the case of counter-cyclical rates, were applied to properly designated eligible commodities.

SCOPE AND METHODOLOGY OF THE SURVEY:

The review was performed at the FSA National office in Washington, D.C., and the Kansas City Commodity Office (KCCO) located in Kansas City, Missouri. We also conducted work at the Missouri State FSA office and at two FSA county offices in Missouri. Since those two FSA county offices did not issue any payments for rice and cotton, we reviewed and tested producer information and payment for cotton and rice at a third FSA county office in Missouri. To accomplish our objectives, we reviewed applicable laws, regulations, and FSA procedures and instructions, and we interviewed the USDA Office of the Chief Economist and the USDA Office of the General Counsel in Washington, D.C. We conducted our review through interviews, reviews of FSA records, and observations.

At the FSA National office, we reviewed FSA's local county loan rate-making processes and analyzed detailed spreadsheets containing price and production data and loan rate calculation formulas for crop years 2002 and 2003. We tested data for 15 of 18 loan commodities contained in the spreadsheets to verify the data sources, uses, accuracy, and completeness. The 15 commodities reviewed included wheat, corn, grain sorghum, barley, oats, upland cotton, extra-long staple cotton, rice, soybeans, other oilseeds, graded wool, non-graded wool, mohair, peanuts, and honey. For all 15 agricultural crops that had an established loan rate, we identified and recomputed some of the specific formulas used by FSA to calculate the individual county loan rates to determine their completeness and accuracy. We tracked and recomputed FSA's posting of the 2-year period posted county prices by individual county offices to electronic worksheets and supporting documentation (1999 through 2000 and 2000 through 2001, respectively). For crop years 2002 and 2003, we also tracked and recomputed FSA's posting of a 5-year crop production history by individual county offices to electronic worksheets and supporting documentation (1996 through 2000 and 1997 through 2001, respectively). We traced and recomputed other data that made up the calculations of the local county loan rates, such as the final adjusted local county loan rate and each county's prorated share of the overall loan rate calculation. We further traced FSA's final calculations of the weighted average local county loan rates to the national loan rates (i.e., the weighted average local county loan rates for all counties must equal the established national loan rate by crop as set forth in the Farm Bill).

Counter-cyclical payments were only made on peanuts, rice, and upland cotton for crop year 2002 because the effective prices for the other commodities equaled or exceeded their target prices. We reviewed the methodology FSA followed in determining which commodities were or were not eligible for counter-cyclical payments. We verified that FSA used the correct target prices, direct payment rates, and national loan rates stipulated in the legislation as well as the proper marketing year average prices in arriving at each commodity's eligibility for payments. We further verified that FSA properly applied the higher national loan rate in determining the effective price used for establishing the counter-cyclical payment rates for peanuts, rice, and upland cotton.

We also documented and assessed the management and supervisory controls over these processes as well as the processes to monitor the loan rates to ensure that they were properly updated and applied. In addition, we compared the effect of the established local county loan rates on the projections and forecasts contained in the annual President's budget.

At the Missouri State FSA office, we reviewed and discussed pertinent information with officials concerning the processes used to implement the counter-cyclical payment rates, direct payment rates, LDP rates, and marketing assistance loans. We also reviewed and discussed management controls in place to ensure that the rates established at the FSA National office were correctly disseminated down to the FSA State and county office levels.

At two FSA county offices in Missouri, we judgmentally selected 29 direct payment files, 19 LDP files, and 13 commodity loan files for crop years 2002 and 2003 for wheat, corn, grain sorghum, soybeans, wool, and mohair from a universe of 5,869 producer files. Since those two FSA county offices did not issue any counter-cyclical payments for cotton and rice, we reviewed producer information from a cotton and rice counter-cyclical payment file in a third county in Missouri. We reviewed these producer payments to verify that the rates established by the FSA National office for these selected sites were, in fact, properly used by all three FSA county offices when issuing their direct payments, counter-cyclical payments, LDP's, and commodity loans, as applicable. We also recalculated the posted county prices for the three cited counties and confirmed whether the correct LDP rates were used when issuing LDP's to these selected producers.

The fieldwork was performed from January 2003 through February 2003. The audit survey was conducted in accordance with Government Auditing Standards.

SURVEY RESULTS:

We concluded that FSA had developed and implemented reasonable management controls in establishing and administering local county loan rates and counter-cyclical payment rates for crop years 2002 and 2003, and that such controls were working as intended. We also concluded that the market price and production data obtained from required sources, the methodologies and procedures used by FSA to complete the calculation spreadsheets and the formulas contained therein, and the quality assurance exercised over these activities and processes in establishing the various local county loan rates and counter-cyclical payment rates were applicable and adequately supported with appropriate documentation.

We noted that the local commodity loan rate calculations for the 15 commodities reviewed were consistently applied for both crop years 2002 and 2003. The specific formulation processes, formulas, and calculations required to establish local county loan rates for these commodities were complex and numerous. Although we determined that there were several levels of management and supervision exercised by FSA in establishing these rates, we did note an absence of documentation supporting these reviews; e.g., supervisory initials on spreadsheets or footings and/or tick marks, etc., evidencing the reviews. However, nothing came to our attention to cause us to believe that the system of management controls over establishment of local county loan rates and counter-cyclical payments rates were not effective and operating as intended. We verified that for each of the crop year local county loan rates reviewed, the established rates equaled the national loan rates, as set forth in the 2002 Farm Bill. In regard to the selected direct payments, LDP's, and commodity loan files reviewed at the two Missouri county offices visited, we noted no discrepancies.

Our review did not disclose any reportable conditions and we will not be initiating additional work regarding these areas. Therefore, we are not making any audit recommendations and a reply to this report is not required.

The cooperation and assistance extended by your staff are appreciated.

/s/ Richard D. Long

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