



U.S. Department of Agriculture



Office of Inspector General
Southeast Region

Audit Report

Tobacco Transition Payment Program Tobacco Assessments Against Tobacco Manufacturers and Importers

Report No. 03601-15-At
September 2008



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



September 4, 2008

REPLY TO

ATTN OF: 03601-15-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: Tobacco Transition Payment Program (TTPP) – Tobacco Assessments
Against Tobacco Manufacturers and Importers

This report presents the results of our audit of the Farm Service Agency's management of the TTPP assessments against tobacco manufacturers and importers. Your August 4, 2008, written response to the official draft report is included as exhibit A with excerpts and the Office of Inspector General's position incorporated into the relevant sections of the report.

Based on the information in your written response, we accept management decisions for Recommendations 1, 2, 3, and 4. Management decision has been reached on all recommendations. Please follow your internal agency procedure in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the courtesies and cooperation extended to us by members of your staff during the review.

Executive Summary

Tobacco Transition Payment Program/Tobacco Assessments (Audit Report No. 03601-15-At)

Results in Brief

The Fair and Equitable Tobacco Reform Act of 2004 (FETRA) established the Tobacco Transition Payment Program (TTPP), which provides for transitional payments to tobacco quota holders and producers of tobacco, and for the imposition of quarterly assessments during each of fiscal years (FY) 2005 through 2014 on each tobacco product manufacturer and tobacco product importer that sells tobacco products in domestic commerce in the United States during that fiscal year.¹ The assessments fund a 10-year transitional payment program to quota holders² and producers in exchange for the termination of tobacco marketing quotas and related price supports. Persons who owned a farm with an established basic tobacco marketing quota as of October 22, 2004, or produced tobacco in 2002-2004 were eligible to receive transitional payments. These transitional payments may not exceed \$10.14 billion.

This report presents the results of Phase II of a three-phase audit of TTPP. In the Phase I audit we assessed the adequacy of FSA's controls to ensure that TTPP payments were issued to eligible tobacco quota holders and found that generally the controls were adequate. The Phase II audit focuses on tobacco assessments against tobacco manufacturers and importers. The objective of the Phase II audit was to determine whether the Farm Service Agency (FSA) had established adequate controls to ensure that domestic tobacco manufacturers and importers of tobacco products are properly assessed and payments (assessments and penalties) are timely submitted to the Commodity Credit Corporation (CCC). FSA, acting on behalf of CCC, administers TTPP and calculates and collects the assessments based on tobacco data tobacco manufacturers and importers submit to FSA.³

Based on our review, we concluded that overall FSA had adequate controls to ensure that it levied and collected the vast majority of assessments from tobacco manufacturers and importers of tobacco products to pay quota holders and producers. However, a number of companies were delinquent in paying their assessments and have been referred to the Department of Justice (DOJ) for debt collection. In addition, FSA has been unable to use data it receives from the Department of the Treasury Alcohol and Tobacco Tax and Trade Bureau (TTB) to pursue collection of assessments against non-reporting entities because the Internal Revenue Code of 1986 (IRC) limits the use of tax data for such purposes. In summary:

¹ FETRA section 625(b)(1), October 22, 2004.

² Quota holders are persons who owned farms on October 22, 2004, for which tobacco quota was assigned for the 2004 marketing year.

³ All domestic manufacturers and importers of tobacco products must provide, on a monthly basis for each class of tobacco, the total amount of tobacco products removed into domestic commerce.

- A total of 90 entities filed the required reports with FSA but did not pay assessments owed. For these entities, CCC funded the payments to quota holders and producers. During FY 2005, FSA levied assessments against 215 tobacco manufactures and importers and against 330 in FY 2006. FSA collected assessments totaling over \$2.9 billion including late payment interest for FYs 2005 and 2006. However, these 90 manufacturers and importers failed to pay over \$58.3 million in assessments for various reasons such as disputes, bankruptcies, etc. FSA has entered into payment agreements with 57 entities and is following the provisions of the Debt Collection Improvement Act for the remaining 33 entities who owe approximately \$30 million of the \$58.3 million. To date, 22 of the 33 entities have been referred to DOJ for legal action to collect the assessments owed.
- Additionally, 62 manufacturers and importers had not reported their tobacco data to FSA; therefore, they may be subject to an assessment and any penalties associated with not filing the required reports. FSA has not, so far, been able to take action against these entities because IRC limits FSA's ability to use the tax data FSA receives from TTB to individually identify non-reporting entities and to levy and collect assessments and penalties that are due. Although FSA receives information from TTB, certain laws⁴ restrict the use of that data. An agreed-to draft memorandum of understanding (MOU), once signed, will allow FSA to use data provided by TTB to verify data manufacturers and importers report to FSA; however, even with the MOU, FSA lacks the authority to use TTB data to enforce collection of assessments and/or penalties against entities that have not filed reports with FSA.

Collecting these assessments is important to ensure that adequate funds are available to reimburse CCC for the payments it makes to quota holders and producers. FETRA requires that no later than January 1, 2015, the Tobacco Trust Fund shall be used to fully reimburse with interest all funds CCC expended for purposes of the Act; however without the necessary authority to enforce the TTPP requirements (e.g., authorizing FSA to use TTB data for enforcement purposes) and to review manufacturers' and importers' compliance with such requirements, CCC would not be reimbursed for payments to quota holders and producers. Without such authority, CCC would be left without a means to collect millions of dollars from tobacco manufacturers and importers.

We also found FSA had not documented its policies and procedures for the tobacco transition assessment process. FSA officials told us they hesitated to develop a directive or handbook because of concerns in revealing their

⁴ Internal Revenue Code, Title 26 U.S.C. § 6103.

internal operating procedures and because of the sensitive nature of the data used to calculate the tobacco assessments. According to the *Office of Management and Budget (OMB) Circular A-123*, agency management is required to have internal controls that include mechanisms such as proper segregation of duties, proper authorization, and appropriate documentation. Because the agency's operating procedures are not documented, FSA is not in compliance with *OMB Circular A-123* and the lack of written procedures could hinder its ongoing operations since one staff member is responsible for all the functions of calculating the tobacco assessments. Although our review of 29 quarterly assessments levied against 12 tobacco manufacturers and importers did not disclose any discrepancies, we maintain that FSA should revise its second-party review process to include a review of source documents to ensure tobacco assessments are consistently calculated each billing cycle and that the accuracy of assessments is validated.

FSA and the Office of the General Counsel (OGC) are working together to address legal issues related to the collection of assessments. FSA needs to consult with OGC in developing corrective actions and responding to the audit recommendations. The Office of Inspector General may accept alternative corrective actions put forth by FSA (in consultation with OGC), so long as such alternative actions would correct the causes of the conditions noted in the audit.

Recommendations in Brief

We recommend that FSA:

- Work with OGC to take legal action, as necessary, to enforce the collection of assessments and penalties from non-paying and non-reporting entities.
- Develop and implement regulations and compliance procedures and activities authorizing FSA personnel to conduct onsite compliance reviews of all entities required to report to FSA.
- Continue to work with TTB to achieve a MOU that will allow FSA to use TTB's data to identify tobacco permit holders and tax return data to calculate assessments owed.

- Develop written policies and procedures documenting the tobacco transition assessment process to ensure that the assessment process is performed consistently and documented instructions are available in case of employee turnover. The procedures should identify levels of review, authorizations, and other content pertinent to the requirements of the FETRA and Federal regulations.

Agency Response In its August 4, 2008, written response to our official draft report, FSA generally concurred with each recommendation. FSA's response is included in this report as exhibit A.

OIG Position Based on FSA's response, we accept management decision for all recommendations.

Abbreviations Used in This Report

CBP	Customs and Border Protection
CCC	Commodity Credit Corporation
DOJ	Department of Justice
FETRA	Fair and Equitable Tobacco Reform Act
FSA	Farm Service Agency
FY	Fiscal Year
MOU	Memorandum of Understanding
OGC	Office of the General Counsel
OMB	Office of Management and Budget
TTB	Alcohol and Tobacco Tax and Trade Bureau
TTPP	Tobacco Transition Payment Program
USDA	Department of Agriculture

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Background and Objectives

Background

The Fair and Equitable Tobacco Reform Act of 2004 (FETRA) established the Tobacco Transition Payment Program (TTPP), which provides for transitional payments to tobacco quota holders and producers of tobacco, and for the imposition of quarterly assessments during each of fiscal years (FY) 2005 through 2014 on each tobacco product manufacturer and tobacco product importer that sells tobacco products in domestic commerce in the United States during that fiscal year.⁵ The assessments fund a 10-year transitional payment program to quota holders⁶ and producers in exchange for the termination of tobacco marketing quotas and related price supports. Persons who owned a farm with an established basic tobacco marketing quota as of October 22, 2004, or produced tobacco in 2002-2004 were eligible to receive transitional payments. The Department of Agriculture's (USDA) Farm Service Agency (FSA), acting on behalf of the Commodity Credit Corporation (CCC), administers TTPP and calculates the assessments based on tobacco product information provided by the manufacturers and importers, as well as any other information provided or obtained by the Secretary. The total amount of assessments collected may not exceed \$10.14 billion.

FETRA designates six classes of tobacco products for assessment purposes; cigarettes, cigars, chewing, roll-your-own, pipe, and snuff. Assessments are levied against these six classes of tobacco products based on the share of gross domestic volume held by that class of tobacco product as determined under the statute. The assessments for each class of tobacco product are to be allocated on a pro rata basis among manufacturers and importers based on each manufacturer's or importer's share of domestic volume. The initial market shares for the six tobacco classes were provided in FETRA, while any subsequent allocations may be adjusted by the Secretary to reflect changes in the share of gross domestic volume held by that class of tobacco product. The law further provides that each tobacco manufacturer and importer of tobacco products shall submit to the Secretary a certified copy of the returns or forms that are required to be filed with the Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau (TTB), and the Department of Homeland Security, Customs and Border Protection (CBP). TTB and CBP share tobacco information with FSA but restrict the use of the information.

FSA, in conjunction with these Federal agencies, quarterly identifies tobacco product manufacturers and tobacco product importers holding permits and subject to the imposed assessments. FSA calculates each permitted tobacco manufacturer's and importer's share (market share) of tobacco within the six tobacco classes from tobacco removal and excise tax information submitted

⁵ FETRA section 625(b)(1), October 22, 2004.

⁶ Quota holders are persons who owned farms on October 22, 2004, for which tobacco quota was assigned for the 2004 marketing year.

by tobacco entities. The market share within the class, depending on the class, is based either on taxes paid or units for product that is moved into domestic commerce. Once a market share for each entity is established, FSA will compute the assessments for tobacco entities with a market share of .0001 percent (.000001) or greater. No manufacturer or importer shall be required to pay an assessment that is based on a share that is in excess of that manufacturer's or importer's share of domestic volume per tobacco class as determined under the statute.

To facilitate the billing and collection process, FSA entered into a 3-year contract with a consulting company. FSA transmits the assessment data to the contractor, which in turn electronically performs quality control checks on the data received from FSA to ensure FSA's calculations are mathematically correct and tobacco entities are properly matched to their customer number, entity name and address information. In addition, the contractor collects payments mailed to FSA's drop-box and makes deposits to the U.S. Treasury for FSA. The contractor is responsible for properly crediting payments to the tobacco entities' accounts. FSA's Financial Management Division in Kansas City manages the actual contract and reconciles the contractor's billing and collection activities with the official records FSA maintains.

Objectives

The objective of this audit is to determine whether FSA established adequate controls to ensure that domestic tobacco manufacturers and importers of tobacco products are properly assessed and payments (assessments and penalties) are timely submitted to CCC.

Findings and Recommendations

Section 1. Tobacco Assessments

Finding 1

Internal Revenue Code Limits FSA's Ability to Enforce Collection of Tobacco Assessments and Penalties

FSA is limited in its authority to enforce collection of assessments and penalties from non-paying and non-reporting tobacco manufacturers and importers. While the Internal Revenue Code of 1986 (IRC) has stipulations meant to protect the confidentiality of tax information, its strict guidelines limit FSA's ability to enforce collection of assessments and penalties from entities that do not comply with TTPP regulations. Specifically, CCC depends upon information supplied to it by TTB of the Department of the Treasury to verify information submitted by manufacturers and importers for the purpose of assessment calculations. However, TTB objects to FSA's direct use of the TTB data to pursue payments from non-paying and non-reporting entities. Collecting these assessments is important to ensure that adequate funds are available to reimburse CCC for payments made to tobacco quota holders and importers.

FETRA established TTPP to provide a 10-year transitional payment program for quota holders and producers in exchange for the termination of tobacco marketing quotas and related price support. The payments are funded from quarterly assessments imposed on tobacco manufacturers and importers that sell tobacco products in the United States' domestic market. These assessments are accounted for in the Tobacco Trust Fund. When the collected assessments are not sufficient to cover the total payments due to quota holders and producers, CCC uses government funds to make up the shortfall. These CCC funds were advanced with the expectation of reimbursement when the assessments are collected.

Each year CCC borrows money from the U.S. Treasury to make annual payments to quota holders and producers. FSA then imposes quarterly assessments on tobacco manufacturers and importers to reimburse CCC for the funds it has borrowed. Overall, we found that FSA collected a significant portion of the assessments owed from tobacco manufacturers and importers. Specifically, we determined that FSA has collected \$2.9 billion in assessments owed.

By early 2007, a number of manufacturers and importers had failed to pay their assessments to CCC, either in part or in full, or had failed to report to CCC information necessary to compute assessments. To date, CCC has not received reimbursement for about \$58.3 million of the assessments from

entities with delinquent payments. In addition, FSA may be owed assessments and interest, as well as penalties, from 62 non-reporting entities.

Delinquent (Non-Paying) Entities

Our analysis of FSA tobacco assessment records showed that a total of 90 entities reported their tobacco activities but did not pay the associated assessments for various reasons including disputes of the amounts assessed, bankruptcies, etc. These entities owe \$58.3 million in delinquent assessments, of which approximately \$30 million is attributed to 33 entities who have not made any arrangements with FSA to pay their assessments. Twenty-two of the 33 entities have been referred to the Department of Justice (DOJ) for civil action to collect the assessments owed. FSA officials explained that in accordance with provisions of the Debt Collection Improvement Act, they will refer delinquent entities owing at least \$5,000 to DOJ for civil action. Without collection of the assessments owed, the \$58.3 million of uncollected assessments remains unpaid and could potentially increase as the program progresses.

According to FSA procedures, followup letters to these delinquent entities were issued but when that approach failed, CCC determined its only remedy to enforce collection of its assessment was to enlist the assistance of DOJ. Assisted by the Office of the General Counsel (OGC), CCC made a formal request to DOJ to intervene on the behalf of CCC by initiating legal action against the delinquent entities. As part of its request, CCC supplied DOJ with the names of the delinquent entities and other data necessary to establish the amount of overdue assessments owed by each entity.

However, starting in early 2007 questions citing the legal prohibitions contained in section 6103(o) of the Internal Revenue Code (IRC) were raised concerning CCC's citation or use of TTB data to seek enforcement of collection against delinquent entities. Currently, it has been determined among the agencies that DOJ could proceed with the lawsuits against the delinquent entities based on information supplied by entities to CCC, rather than relying on the TTB-supplied tax data.

Collecting these assessments is important to ensure that adequate funds are available to reimburse CCC for the payments it makes to quota holders and producers. While the litigation issue is pending, the delinquent balances could potentially increase, as well as CCC's carrying cost for the funds it borrows to pay quota holders and producers.

Non-Reporting Entities

FSA has limited authority to enforce collection of assessments and penalties against non-reporters (i.e., those entities which did not report their data

directly to CCC). This situation exists because the IRC does not provide any exceptions for TTPP on issues related to the confidentiality and disclosure of tax information. In addition, FETRA does not provide a source from which FSA can identify tobacco manufacturers and importers who are required to report or another source to obtain the data needed to compute the assessments. FSA receives data from TTB and CBP and can identify non-reporting entities from it. FETRA provides FSA with the authority to levy assessments and penalties against the non-reporting entities' tobacco activity; however, the IRC's restrictions so far have impeded the effort to enforce collection of these assessments and penalties. Although FETRA requires that the entities submit their tobacco excise tax information to FSA for quarterly TTPP assessments, we found that in FYs 2005 and 2006 a total of 62 entities did not report as required.⁷

FSA has been negotiating a MOU with TTB, consistent with section 6103(o), but the MOU in its current state allows FSA to use data provided by TTB only to validate manufacturers' and importers' self-reported tobacco data and compute the national assessment. The IRC (and, therefore, the MOU) does not allow FSA to use TTB data (i.e., disclose to DOJ) to enforce the collection of assessments and penalties against non-reporting entities. FSA is considering the viability of an amendment to the IRC to gain access to, and litigation use of, the needed data to enforce assessments and penalties (via judicial process and levies) against entities who do not voluntarily report their tobacco activity.

Without a change in the IRC, CCC is restricted in its use of tax data to enforce the collection of assessments and penalties from non-reporting entities that potentially may involve many millions of dollars as the program progresses. FSA is working with OGC to determine if there is any other legal authority or to develop alternative actions to more effectively enforce the collection of assessments and penalties from non-reporting entities.

FSA should also check publicly available information released by State (or other local) revenue or regulatory agencies with which tobacco manufacturers and importers are required to register and/or report. Such public information may be available on websites established by these State or local revenue or regulatory agencies. Preliminary information obtained from such public sources should be followed up with onsite reviews at these entities to verify the information. (We noted that current TTPP regulations do not prescribe any compliance investigations or other monitoring reviews to ensure compliance with FETRA and TTPP reporting provisions.) At the same time, FSA needs to work expeditiously to get a signed MOU with TTB so that the role and responsibilities of each agency are clearly documented.

⁷ The Internal Revenue Code – 26 U.S.C. § 6103 – prevents the identification of the amounts of assessments and penalties associated with the 62 non-reporting entities because such amounts would disclose tax data information provided by TTB to FSA.

FSA and OGC are working together to address legal issues related to the collection of assessments. FSA needs to consult with OGC in developing corrective actions and responding to the audit recommendations. The Office of Inspector General may accept alternative corrective actions put forth by FSA (in consultation with OGC), so long as such alternative actions would correct the causes of the conditions noted in the audit.

Recommendation 1

Work with OGC to take legal action, as necessary, to enforce the collection of assessments and penalties from non-paying and non-reporting entities.

Agency Response. FSA stated in its August 4, 2008, response:

FSA has already referred non-paying entities to the Department of Justice (DOJ), and anticipates that the first complaint will be filed very soon. FSA will continue to refer non-paying entities to OGC for referral to DOJ for litigation.

FSA is working with OGC to resolve problems related to non-reporting entities, and to develop alternative courses of action within the nine months.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Develop and implement TTPP regulations and policies and procedures for compliance reviews under TTPP, to include authorizing FSA personnel to conduct onsite compliance reviews of all entities required to report to FSA.

Agency Response. FSA stated in its August 4, 2008, response:

FSA agrees to publish regulations to authorize FSA personnel to conduct onsite compliance reviews of all entities required to report to FSA within the next nine months. At the present time, FSA lacks the funding to conduct such onsite reviews but will endeavor to secure them.

OIG Position

We accept management decision for this recommendation.

Recommendation 3

Continue to work with TTB to achieve a MOU that will allow FSA to use TTB's data to identify tobacco permit holders and tax return data to calculate assessments owed.

Agency Response. FSA stated in its August 4, 2008, response:

FSA agrees to continue to work with TTB, OGC, and DOJ to seek a modification to the current MOU to resolve any obstacles inhibiting the FSA's use of TTB data to identify tobacco product manufacturers and importers and calculate assessments owed within the next nine months.

OIG Position

We accept management decision for this recommendation.

Section 2. Program Procedures

Finding 2

Program Operating Procedures Were Not Documented

FSA has not documented its policies and procedures for operating the tobacco transition assessment program. FSA officials told us they hesitated to develop a directive or handbook because of concerns in revealing their internal operating procedures and because of the sensitive nature of the data used to calculate the tobacco assessments. In addition, with only two to three personnel using the data, agency officials believed written procedures were not necessary to continue operating the tobacco assessment program. However, without documented procedures, FSA cannot ensure that (1) tobacco assessments are consistently calculated each billing cycle, (2) documented program instructions are available in case of employee turnover, and (3) assessment accuracy is validated through appropriate second party reviews.

According to the *Office of Management and Budget (OMB) Circular A-123*, management has a fundamental responsibility to develop and maintain effective internal controls. The circular defines internal control as organization, policies, and procedures to help managers safeguard the integrity of their programs. These controls include proper segregation of duties, proper authorization, and appropriate documentation.

The agency has not documented the procedures it follows when calculating the tobacco entities' market shares and subsequent assessments. Without documenting the method used to calculate the assessments, including how information from source documents is used during the process, FSA cannot ensure its staff uses the same calculation method each assessment billing cycle. Written policies and procedures for the tobacco assessment program would ensure there is a guide for consistently performing the assessment process.

FSA's lack of written instructions for the assessment program could hinder the agency's operations if the employee who performs the assessment calculation was to leave the agency. FSA has a very small staff for TTPP. Aside from management staff, only one employee is responsible for reviewing the source documents submitted by tobacco manufacturers and product importers, entering the tobacco product volume and tax information into a spreadsheet, calculating the tobacco entities' assessments and following up with the tobacco entities when necessary to obtain reports. This same employee also performs a yearly reconciliation to verify that each tobacco entity was properly assessed during the year and prepares a case file for administrative appeals. Essentially, this employee performed all the assessment calculation functions for this multi-billion dollar program.

With one employee performing all the assessment calculation functions, a second party review is an essential control feature that should be performed. The second party reviews that FSA performed were only a mathematical check of assessment calculations and did not include spot checks of the source documents submitted by tobacco manufacturers and importers. A second party review that includes spot checks of the source documents used to calculate the assessments can ensure the underlying data used to calculate the assessments is input correctly and was not manipulated due to human error or fraud. Having detailed written instructions for performing the reviews would provide needed guidelines for a sufficient review process.

When we discussed FSA's need for documented policies and procedures for the tobacco transition assessment program, agency officials told us that with only two to three employees using the data they did not consider written procedures as necessary. Besides, with the sensitive nature of the data used to calculate the assessments, they were hesitant in developing a handbook or directive because it would reveal the agency's internal process for calculating the tobacco assessments. We disagree that FSA's internal process would be compromised and maintain that written procedures are necessary to provide instructions in the event of employee turnover and to ensure consistency in the calculation process. In addition, written procedures would be needed to defend the assessment calculation process in the event of appeals or lawsuits. FSA needs to document procedures for calculating the assessments, including how source documents are used, and procedures for performing second party reviews.

Recommendation 4

Develop written policies and procedures documenting the tobacco transition assessment process to ensure that the assessment process is performed consistently and documented instructions are available in case of employee turnover. The procedures should identify levels of review, authorizations, and other content pertinent to the requirements of FETRA and of the Federal regulations.

Agency Response. FSA stated in its August 4, 2008, response:

FSA agrees to develop written policies and procedures documenting the tobacco transition assessment process within the next nine months. The directive will address segregation of duties, proper authorizations and methodology for second party reviews.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We reviewed FSA's procedures for levying tobacco transition assessments to determine if domestic tobacco manufacturers and importers of tobacco products are properly assessed and payments (assessments and penalties) were timely submitted to the CCC. The review covered FYs 2005 through 2007 and current operations at FSA Headquarters in Washington, D.C.

Fieldwork was performed from January 2007 through December 2007.

To accomplish our audit objectives, we performed the following procedures:

- From discussions with FSA officials, we documented procedures for calculating the tobacco assessments; collecting delinquent debt; and procedures for identifying and penalizing any non-reporting tobacco entities. We also reviewed USDA's administrative appeals process for disputing tobacco transition assessments to determine if all appeals were handled in a manner consistent with FSA's tobacco regulations and FETRA. Our review of the appeals indicated that FSA is conducting the administrative appeals process in accordance with FSA's tobacco regulations and FETRA.
- We identified the procedures FSA followed to calculate the tobacco transition assessments. We met with FSA's billing and collections contractor to determine when and how the assessments are billed and collected.
- We used FSA's data on manufacturers and importers as the universe for our sample selection. We narrowed the universe of tobacco manufacturers and importers to include entities that were billed an assessment in FY 2005. We judgmentally selected tobacco manufacturers and importers (within each class of tobacco) whose combined assessments were at least 10 percent of the assessments levied on each class of tobacco products during FY 2005. As a result, entities who owed larger assessments were sampled and those with large market shares of their tobacco class. Our sample included 12 tobacco manufacturers and product importers whose individual or combined assessments were at least 10 percent of their class' assessment. The sample included seven assessed entities from the cigarette class, one from the cigar class, two from the snuff class, one from the pipe class, one from the roll-your-own class, and one from the chewing class. We then randomly selected and reviewed 29 different quarterly assessments levied against the entities in our sample. We tested the accuracy of these entities' assessment calculations and whether their assessment payments were made timely and were paid in full.

- We reviewed FSA's FYs 2005 and 2006 tobacco assessment collection data and aged all accounts listed to determine when the assessments were collected. Payments are due 30 days after receiving the notification of assessment from FSA. These notices are sent quarterly on March 1, June 1, September 1, and December 1. Our analysis showed that for FY 2005, 99 of 215 (46 percent) entities paid by the due date and the remaining 116 entities are in various stages of collection for delinquent assessment and interest balances. For FY 2006, 220 of 330 (68 percent) entities paid by the due date and the remaining 110 entities are in various stages of collection for delinquent assessment and interest balances.
- We interviewed FSA staff from the Financial Management Division in Kansas City about FSA's policies and procedures for collecting delinquent assessments from tobacco entities. We reviewed their accounts receivable aging reports to determine if the assessments were paid in a timely manner. We inquired as to when the assessments were considered delinquent, how the delinquent entities were notified, if interest and penalties were assessed, and if any litigation was involved. We reviewed FSA's monthly payment detail showing the amount of payment received and the method of payment. In addition, we reviewed aged accounts receivable reports to identify approximately 90 entities with \$58.3 million in delinquent balances as of September 30, 2007.
- We interviewed FSA staff about penalties for non-reporting tobacco entities. We examined the agency's methodology for calculating non-reporting penalties and actions taken to levy these penalties. In FY 2005, 42 entities did not provide their excise tax information to FSA and 38 entities during FY 2006.
- We did not perform any audit procedures at FSA's billing contractor, FSA contracted an independent auditor, KPMG, Limited Liability Partnership, to perform a Statements on Auditing Standards 70 audit and report on the controls the contractor placed into operation and to perform tests on the contractor's operating effectiveness. The auditor's report covered October 1, 2006, through March 31, 2007. KPMG found the contractor's internal controls were suitably designed to provide assurance that all control objectives were met.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Exhibit A – Agency Response



United States
Department of
Agriculture

Farm and Foreign
Agricultural
Services

Farm Service
Agency

Operations Review
and Analysis Staff

1400 Independence
Ave, SW
Stop 0540
Washington, DC
20250-0501

AUG 4 2008

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

FROM: T. Mike McCann, Director
Operations Review and Analysis Staff

SUBJECT: Audit 03601-15-AT – Tobacco Transition Program (TTPP) - Tobacco Assessments

Attached is the Farm Service Agency's Deputy Administrator for Farm Programs response to the official draft of the subject audit.

The projected target date for completion of all actions cited in the response is May 4, 2009.

Please address any questions to Karren Fava 720-6152.

Attachment

A handwritten signature in black ink, appearing to read "T. Mike McCann", written over the word "Attachment".

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Exhibit A – Agency Response



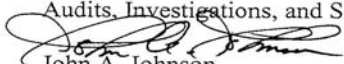
United States
Department of
Agriculture

Farm and Foreign
Agricultural
Services

Farm Service
Agency

1400
Independence
Avenue, SW
Stop 0508
Washington, DC
20250-0508

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

FROM: 
John A. Johnson
Deputy Administrator for Farm Programs

AUG 04 2008

SUBJECT: Tobacco Transition Payment Program – Assessments Against Tobacco
Manufacturers and Importers

Finding 1 – Internal Revenue Code Limits FSA’s Ability to Enforce Collection of
Tobacco Assessments and Penalties

Recommendation 1

Work with Office of General Counsel (OGC) to take legal action, as necessary, to enforce
the collection of assessments and penalties from non-paying and non-reporting entities.

Agency Response:

FSA has already referred non-paying entities to the Department of Justice (DOJ), and
anticipates that the first complaint will be filed very soon. FSA will continue to refer
non-paying entities to OGC for referral to DOJ for litigation.

FSA is working with OGC to resolve problems related to non-reporting entities, and to
develop alternative courses of action within the nine months.

Recommendation 2

Develop and implement TTPP regulations and policies and procedures for compliance
reviews under TTPP, to include authorizing FSA personnel to conduct onsite compliance
reviews of all entities required to report to FSA.

Agency Response:

FSA agrees to publish regulations to authorize FSA personnel to conduct onsite
compliance reviews of all entities required to report to FSA within the next nine months.
At the present time, FSA lacks the funding to conduct such onsite reviews but will
endeavor to secure them.

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Philip Sharp
Page 2

Recommendation 3

Continue to work with TTB to achieve a MOU that will allow FSA to use TTB's data to identify tobacco permit holders and tax return data to calculate assessments owed.

Agency Response:

FSA agrees to continue to work with TTB, OGC and DOJ to seek a modification to the current MOU to resolve any obstacles inhibiting the FSA's use of TTB data to identify tobacco product manufacturers and importers and calculate assessments owed within the next nine months.

Finding 2 – Program Operating Procedures Were Not Documented

Recommendation 4

Develop written policies and procedures documenting the tobacco transition assessment process to ensure that the assessment process is performed consistently and documented instructions are available in case of employee turnover. The procedures should identify levels of review, authorizations, and other content pertinent to the requirements of FETRA and of the Federal regulations.

Agency Response:

FSA agrees to develop written policies and procedures documenting the tobacco transition assessment process within the next nine months. The directive will address segregation of duties, proper authorizations and methodology for second party reviews.