



UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20250



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REPLY TO

ATTN OF: 03703-1-Ch

TO: Douglas J. Caruso
Administrator
Farm Service Agency

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

FROM: Robert W. Young
Assistant Inspector General
for Audit

SUBJECT: Controls Over Aquaculture Grant Recovery Act Funds – Phase I

The American Recovery and Reinvestment Act of 2009 (Recovery Act) authorized not more than \$50 million to carry out the 2008 Aquaculture Grant Program (AGP) to assist aquaculture producers in recovering from losses associated with high feed costs during the 2008 calendar year. Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of the funds. On April 3, 2009, the Office of Management and Budget (OMB) published “Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009,” M-09-15. This is the second installment of detailed government-wide guidance for carrying out programs and activities enacted in the Recovery Act. This updated guidance supplements, amends, and clarifies the initial guidance issued by OMB on February 18 (“Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009,” M-09-10).

Funding for AGP is provided by the Commodity Credit Corporation (CCC), a Federal corporation within the Department of Agriculture. However, since CCC has no operating personnel, administration of its programs and activities is carried out primarily by the Farm Service Agency (FSA). Because the current AGP is a new program, and its governing provisions are spelled out by the Recovery Act itself, the Office of the General Counsel ruled that FSA can implement the program through a Notice of Funds Availability (NOFA) rather than through the normal rulemaking process.

On April 27, we held an entrance conference with members of your staff and briefed them on the objectives of our ongoing review. To accomplish our objectives, we are in the process of assessing the program's policies and procedures, as well as its internal controls. Although some of the agency's internal controls and processes have been carried forward from the previous aquaculture program, others are being newly developed and implemented based on the requirements and provisions of the Recovery Act. In order to better assist FSA officials in ensuring that AGP will fully comply with the oversight and accountability objectives of the Recovery Act, we are providing comments on procedures and requirements that are still under development.

On April 17, FSA provided to each of the 50 States a draft Memorandum of Agreement (MOA) for review and comment. Once the MOA is finalized, it will constitute the primary guidance to the States and outline the requirements to be followed when disbursing grant funds to eligible aquaculture producers. The MOA's provisions included: (a) eligibility of aquaculture producers to receive grant funds; (b) requirements for collection of calendar year (CY) 2007 feed delivery data to be used in allocations of funds among participating States; (c) payment limitations to aquaculture producers; and (d) reporting requirements for participating States under the Recovery Act.

Because the finalized MOA will largely take the place of program regulations for AGP, we believe it is critical that it include adequate provisions to ensure that participating States implement the program in a consistent and equitable manner nationwide (our emphasis). Further, the MOA needs to provide the States with sufficient guidance to ensure compliance with the requirements of OMB and of the Recovery Act.

On May 8, we provided FSA with our comments and suggested modifications to the April 17 draft MOA. On May 15, we received FSA's response to our comments; the response included a revised draft MOA incorporating our suggestions. Although FSA's changes largely addressed the concerns highlighted in our May 8 letter, we were subsequently informed by FSA officials that the MOA would be further revised to allow States the option of implementing their programs using a feed voucher system instead of making direct payments to aquaculture producers. A revised draft MOA provided to us on May 21 authorizes the States to provide assistance in the form of either (1) cash payments to eligible producers or (2) feed credits, vouchers, or similar instruments to be applied to future feed purchases. Under the second option (the voucher method), we understand from FSA that each participating producer would be required to identify the feed mill from which the producer would be purchasing feed, and assistance would be provided in the form of credits that each producer would redeem at the producer's designated feed mill. Each State would make the determination of the method of providing assistance for its own program but would then have to apply that method to all participating producers in the State.

We are concerned that the current draft of the MOA does not adequately address issues that could arise due to FSA's decision to allow States to use the voucher method of assistance. This letter, the second in a series that will report on our oversight activities during the initial phase of

this audit, relays our concerns in this regard and provides suggestions for changes to the MOA. In some instances, as described below, our primary purpose is to point out the need for FSA officials to be aware of possible ramifications to both the program and the Department during the process of finalizing the MOA. Our concerns are described in the following paragraphs.

Potential Exclusion of Certain Aquaculture Producers Under the Voucher Method

The use of feed credits, vouchers, or similar instruments to be applied to future feed purchases under items A2 and D2 of the MOA could potentially exclude any otherwise-eligible aquaculture producer who does not purchase feed from a feed mill. The officials we interviewed could not provide assurances that this possibility had been considered. We believe that, before finalizing the decision to allow assistance in the form of feed credits, vouchers, or similar instruments to be applied to future feed purchases, FSA needs to determine whether any State that implements the voucher method might, by doing so, unfairly disqualify any otherwise eligible producers from program participation.

Payment or Reimbursement of Designated Feed Mills Under the Voucher Method

As currently written, the MOA does not specify whether designated feed mills would receive funds up-front or would be reimbursed by submitting vouchers from participating producers. We believe that this needs to be clarified.

If FSA officials determine that the designated feed mills will receive their payments up-front, we question how either the States or FSA can be assured that these funds will be expended on credits to producers or refunded to the States within a timely manner as outlined by the Recovery Act.¹ If FSA chooses this payment option, we believe that the MOA should include requirements for each designated feed mill to report its status of AGP funds by a date specified by FSA, and to return any unused funds to the applicable States. Although the MOA requires the States to refund funds not distributed, there is no obligation on the part of the feed mills. Further, we believe that each State should be required to perform verification checks at each mill to confirm that any Recovery Act funds the mill received were used according to the requirements of the Act. We believe such controls would be necessary to prevent feed mills from improperly retaining Recovery Act funds that are not claimed by participating producers.

Potential Restrictions on Out-of-State Feed Mills Under the Voucher Method

Based on our discussions with representatives of two State Departments of Agriculture, many aquaculture producers currently purchase feed from out-of-State feed mills.

¹ The MOA, item G6, states that "[T]he State agrees to provide assistance to eligible aquaculture producers not later than 60 days after the date on which the states [sic] receives the grant funds from CCC, as required by Section 102(d)(2)(D)(ii) of the Recovery Act. The State shall refund to CCC funds provided under this Agreement that are not distributed by this deadline within 30 days with interest accruing from the initial date of disbursement from CCC."

However, FSA officials stated, on May 26, that producers might be required to use their feed vouchers at feed mills located only within their own States. We believe that either decision carries risks that need to be addressed in the MOA.

If FSA determines that producers may only redeem vouchers at feed mills within their own States, it could change the existing patterns of commerce between producers and feed mills in some areas. For example, a representative of the Arkansas Department of Agriculture stated that, of the 14 feed mills he/she contacted to determine CY 2007 feed deliveries in Arkansas, only 1 feed mill was actually located within the State. We believe that before making a decision to limit producers to dealing with in-State feed mills, FSA needs to fully consider the possible ramifications of such decision. While some feed mills could benefit financially, others could be negatively impacted. Such an outcome may not be in keeping with the purposes of the Recovery Act.

Another potential concern is that aquaculture producers in certain areas could be limited to dealing with a single in-State feed mill (for instance, where no other in-State competition exists within a reasonable distance). We are concerned that some mill owners could raise their prices to reflect both the increased demand on their products and the limited choices available to local aquaculture producers. If FSA chooses to limit producers to dealing with in-State feed mills, we believe the MOA should require States to provide sufficient oversight to prevent feed mills from abusing the program by making unwarranted price increases.

Oversight of Designated Feed Mills Servicing Producers in Multiple States Under the Voucher Method

If FSA allows participating aquaculture producers to continue using their normal out-of-State feed mills, FSA officials would need to determine how to provide oversight of mills that deal with producers in more than one State. In such cases, oversight would be complicated by the fact that a single mill could process vouchers from more than one State Department of Agriculture. If, for example, each participating State had sole oversight responsibility for those feed mills located within its own borders, each State would need to possess information on all of the participating producers, including producers located in other States, serviced by each of its mills. Unless protocols for exchanges of information between States were established up-front in the MOA, we question how any single State could accurately provide oversight of its feed mills in relation to the program. Moreover, a State that opted to not participate in the program might be called upon to provide oversight of its feed mills that participate in the program through another State.

Conversely, each State could be given responsibilities for providing oversight to each feed mill designated by its participating aquaculture producers, regardless of location. However, this would require coordination between participating States and could also raise issues regarding the authority of one State Department of Agriculture to monitor

and oversee a feed mill located in another State. Such issues would, we believe, need to be addressed up-front by FSA when agency officials finalize the MOA.

Random Internal Reviews Under the Voucher Method

Item F1 of the MOA requires each State to perform random internal reviews of 5 percent of the total applications it receives. As currently written, however, the MOA does not require that these reviews involve a cross-section of producers dealing with each of the State's feed mills that participate in the program. Without a specific provision in the MOA to address this, a State could potentially perform all of its reviews of producers dealing with a single feed mill, even if there are multiple feed mills that service its participating producers.

Reporting Requirements Under the Voucher Method

We believe the MOA needs to address reporting requirements for both the feed mills and for individual producers. Although item E5 of the MOA requires feed mills to obtain a Dun and Bradstreet Universal Numbering System (DUNS) number if they do not currently have one, it does not include a reporting requirement for the feed mills or individuals. Feed mills would be considered as "vendors" under this program. According to OMB Circular A-133, section 210,² "program compliance requirements normally do not pass through to vendors." As such, the MOA needs to address compliance requirements such as reporting for feed mills (vendors) and individuals. We suggest the MOA include language requiring feed mills (vendors) and individuals that receive funding under the Recovery Act to report vouchers processed.

The MOA should incorporate verbiage to ensure "false statements on certifications can be prosecuted," as mentioned in the "Guide to Grant Oversight and Best Practices for Combating Grand Fraud."³ This language should cover, at a minimum, producers and feed mills.

Equity of Payment Rate Calculations

The MOA specifies that the payment rate shall be equal to the producer's 2008 average feed price, minus the State's 5-year (2003-2007) average feed price. However, we believe that under item C5 of the MOA, FSA should consider calculating the payment rate as the difference between (1) the producer's 2008 average feed price and (2) the State's 2003-2007 average feed price times 1.25. This change would provide better equity in that all producers would be paid on only their increased feed costs over the eligibility threshold of 25 percent. Consequently, item D3b of the MOA would need to

² OMB Circular A-133, section 210, "Audits of States, Local Governments, and Non-Profit Organizations," dated June 24, 1997, revised to show changes published in the *Federal Register*, dated June 27, 2003.

³ "Guide to Grant Oversight and Best Practices for Combating Grant Fraud," National Procurement Fraud Task Force, Grant Fraud Committee, February 2009.

be revised to limit assistance to a producer that experienced greater than a 25 percent price increase of 2008 feed costs above the State's previous 5-year average.

Based on our review of the May 21 draft MOA, and our discussions with FSA officials, we are making the following suggestions:

1. Before approving any State's request to implement a feed mill voucher system in lieu of direct cash payments to producers, require the applicable State Department of Agriculture to submit a written determination that this will not cause any otherwise-eligible aquaculture producer to be excluded from program participation.
2. Specify, in the MOA, whether designated feed mills, under the voucher method, would receive payments up front or be required to apply for reimbursement following producer feed purchases.
3. If, under the voucher method, designated feed mills are provided with Recovery Act funds in advance of actual producer purchases, include a requirement in the MOA for each State to ascertain its designated feed mills' status of funds as of a date specified by FSA.
4. Require, in the MOA, that each State using the voucher method implement a process to verify information reported by designated feed mills.
5. If, under the voucher method, FSA determines that participating producers must redeem their feed credit vouchers at in-State feed mills, ensure that the possible economic ramifications to the affected feed mills are fully considered as part of the decision-making process. Also, include oversight provisions in the MOA to preclude unwarranted price increases by designated feed mills.
6. If, under the voucher method, FSA allows participating producers to use out-of-State feed mills, include provisions in the MOA to outline the States' oversight responsibilities in relation to the feed mills that service participating producers.
7. Amend item F1 of the MOA to ensure that, under the voucher method, the State internal reviews include all feed mills designated by participating producers.
8. Ensure that item E5 of the MOA addresses reporting requirements for both feed mills and producers for States that choose to implement the voucher method.
9. Incorporate verbiage in the MOA to require the States' agreements with feed mills, under the voucher method, and producers' applications state that false statements made on program certifications by feed mills or producers can be prosecuted.

10. Modify the payment calculation under item D3b of the MOA to provide better equity to all producers.

Please provide a written response to this letter within 5 days, outlining your proposed actions. If you have any questions, please contact me at 720-6945, or have a member of your staff contact Ernest M. Hayashi, Director, Farm and Foreign Agricultural Division, at 720-2887.



**United States
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Agriculture**

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DATE: June 15, 2009

TO: Robert W. Young
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for Audit

FROM: T. Mike McCann
Agency Liaison Officer
for the Farm Service Agency (FSA)

SUBJECT: Controls Over Aquaculture Grant Recovery Act Funds – Phase I
(03703-1-Ch) – Your June 3 Memorandum

Provided below are responses to your 10 suggestions on our May 21 draft Memorandum of Agreement (MOA).

Suggestion 1:

Before approving any State's request to implement a feed mill voucher system in lieu of direct cash payments to producers, require the applicable State Department of Agriculture to submit a written determination that this will not cause any otherwise-eligible aquaculture producer to be excluded from program participation.

Response to Suggestion 1:

Section A, Background and Purpose, of the MOA provides the following:

“The State may choose one of the following methods to provide assistance to eligible aquaculture producers in the State:

1. Provide cash payments directly to eligible aquaculture producers; or
2. Provide assistance in the form of feed credits, vouchers, or similar instruments to be applied to future aquaculture feed purchases.”

Each State is responsible for choosing the most beneficial method of providing assistance to eligible aquaculture producers in their State. A State's decision to implement the program one way or another may be based on other issues (not just eligible producers) relevant to the State's implementation of the program, i.e. administrative costs. If a State opts to implement the program in the form of feed credits, vouchers, or similar instruments to be applied to future aquaculture feed purchases, and the State is aware of a small amount of producers that do not buy their feed from a feed mill, the State would not be able to submit a written determination that it will not cause any otherwise-eligible aquaculture producer to be excluded from program participation.

Please remember, each State is required to submit a work plan to FSA that describes how the State intends to implement the program. If a large crawfish-producing State submits a work plan that indicates that the State intends to implement the program through feed credits, vouchers, or similar instruments, FSA will ensure that the State is aware that they are excluding otherwise-eligible aquaculture producers from program participation. But, ultimately, the final decision on the method of program implementation lies with the State.

Suggestion 2:

Specify, in the MOA, whether designated feed mills, under the voucher method, would receive payments upfront or be required to apply for reimbursement following producer feed purchases.

Response to Suggestion to 2:

FSA concurs with Suggestion 2 with respect to the MOA specifying whether feed mills would receive payments from the States upfront or on a reimbursable basis after the feed is delivered to the producer.

Item 3 of Section G, Terms of This Agreement, of the MOA was amended to add the following sentence:

“In no instance shall the State advance funds to any claimant or participant in the program prior to the time at which a valid, present claim has been established by, in the case of a payment to a producer, the filing by the producer of a completed application establishing the producer's eligibility for payment or, in the case of a feed mill, the feed mill requesting by a completed application reimbursement for feed already delivered.”

Suggestion 3:

If, under the voucher method, designated feed mills are provided with Recovery Act funds in advance of actual producer purchases, include a requirement in the MOA for each State to ascertain its designated feed mills' status of funds as of a date specified by FSA.

Response to Suggestion 3:

Suggestion 3 is no longer applicable, based on FSA's decision to prohibit States from advancing funds to feed mills or producers, as described in "Response to Suggestion 2".

Suggestion 4:

Require, in the MOA, that each State using the voucher method implement a process to verify information reported by designated feed mills.

Response to Suggestion 4:

FSA concurs with Suggestion 4 with respect to the MOA requiring the States that are implementing the program with feed credits, vouchers, or other similar instruments to implement a process to verify information reported by designated feed mills.

Item 5 of Section F, Transparency and Accountability, of the MOA was added to require States that choose to implement the program with feed credits, vouchers, or other similar instruments, to execute a legally-binding document with the feed mills. Part of item 5 reads as follows:

"...the State agrees to execute, with the applicable feed mills, a legally-binding document that:

- Is structured such that the feed mill is responsible for compliance with the applicable laws, regulations and provisions of the Agreement.
- Requires the feed mill to report to the State, by producer and aquaculture species, funds provided under this Agreement that are obligated and expended. States shall require the feed mill to file such report as needed to ensure the State's compliance with Recovery Act reporting requirements outlined in Section E of this Agreement.
- Requires the feed mill to return to the State any overpayment made to a feed mill and insure that all payments to the feed mill are completed by September 30, 2010. All refunds by Feed Mills to the State must include interest that accrues from the initial date of disbursement from the State for any time in which such funds were under the control of the feed mill."

Suggestion 5:

If, under the voucher method, FSA determines that participating producers must redeem their feed credit or vouchers at in-State feed mills, ensure that the possible economic ramifications to the affected feed mills are fully considered as part of the decision-making process. Also, include oversight provisions in the MOA to preclude unwarranted price increases by designated feed mills.

Response to Suggestion 5:

If a State implements the program using feed credits, vouchers or other similar instruments, FSA has determined that producers are not limited to redeeming their feed credits, vouchers or other similar instruments at in-State feed mills; therefore, Suggestion 5 is no longer applicable.

Suggestion 6:

If, under the voucher method, FSA allows participating producers to use out-of-State feed mills, include provisions in the MOA to outline the States' oversight responsibilities in relation to the feed mills that service participating producers.

Response to Suggestion 6:

FSA concurs with Suggestion 6 with respect to including provisions in the MOA that outline oversight responsibilities in relation to the feed mills that service participating producers.

Item 6 of Section G, Transparency and Accountability, of the MOA was added to read as follows:

“If an eligible aquaculture producer has an aquaculture operation in more than one State and/or purchases aquaculture feed from a feed mill located outside the State in which the aquaculture operation is located, the State agrees to coordinate with the applicable State Department(s) of Agriculture to ensure the eligible aquaculture producer does not exceed the payment limitation provided in Item C7. If an eligible aquaculture producer has aquaculture operations in more than one State, all States, in which the eligible aquaculture producer has an aquaculture operation, are responsible for oversight with respect to this issue. If an eligible aquaculture producer purchases feed outside the State in which the aquaculture operation is located, the State in which the aquaculture operation is located is responsible for oversight with respect to this issue.”

Suggestion 7:

Amend item F1 of the MOA to ensure that, under the voucher method, the State internal reviews include all feed mills designated by participating producers.

Response to Suggestion 7:

FSA concurs with Suggestion 7 with respect to amending the MOA to ensure that all participating feed mills are included in the State's internal review of the program.

Item 1 of Section F, Transparency and Accountability, of the MOA was amended to include the following:

“As part of the State's internal random reviews, the State agrees to review feed mill records, if applicable, to determine program compliance. The State agrees to conduct internal random reviews on 5 percent of the total applications the State receives from applicants. The 5 percent of applications shall be selected in a way that ensures all participating feed mills are included in the review, if applicable.”

Suggestion 8:

Ensure that item E5 of the MOA addresses reporting requirements for both feed mills and producers for States that choose to implement the voucher method.

Response to Suggestion 8:

FSA concurs with Suggestion 8 with respect to the MOA addressing reporting requirements for feed mills and producers for States that choose to implement the program through feed vouchers, credits, or other similar instruments.

In item 5 of Section E, Reporting Requirements, of the MOA the State agrees to “Ensure producers that are NOT individuals establish a DUNS number or update an existing DUNS record and register in the CCR database.” Producers that are not individuals are the only aquaculture entities that need to establish a DUNS number and register in the CCR database regardless of which method the State will use to implement the program. Also, in item 4 of Section E of the MOA, the State agrees to comply with the reporting and registration requirements of Section 1512 of the Recovery Act as provided in Appendix A and the award terms in 2 CFR Part 176. Furthermore, the Office of Management and Budget (OMB) has not provided agencies with final guidance with respect to reporting requirements; however, once final guidance is provided by OMB, FSA will provide the States with further guidance with respect to this issue.

Suggestion 9:

Incorporate verbiage in the MOA to require the States' agreements with feed mills, under the voucher method, and producers' applications state that false statements made on program certifications by feed mills or producers can be prosecuted.

Response to Suggestion 9:

FSA concurs with Suggestion 9 with respect to the MOA requiring the States' agreements with feed mills and program applications with producers to include provisions relating to false statements made on program certifications by feed mills or producers can be prosecuted.

Section D, Providing Assistance, of the MOA was amended to include item 6 that reads as follows:

“The State shall have producers and feed mills certify that the statements producers and feed mills make on the program application and any other program documents are true and correct and that they understand that any false statements made as part of the application, or any other program documents, can be the subject of substantial civil and/or criminal liability and sanctions. The State is responsible for enforcing diligently all program requirements applicable to participants in the program.”

In addition, Section G, Transparency and Accountability, of the MOA was amended to include item 5 that reads as follows:

“Requires the feed mill to certify that the statements it makes in such document are true and correct and that it understands that any false statements made as part of these certifications can be the subject of substantial civil and/or criminal liability and sanctions.”

Suggestion 10:

Modify the payment calculation under item D3b of the MOA to provide better equity to all producers.

Response to Suggestion 10:

Section 102(d)(2)(A) of the Recovery Act specifically provides:

“Of the funds of the Commodity Credit Corporation, the Secretary shall use not more than \$50,000,000, to remain available until September 30, 2010, to carry out a program of grants to States to assist eligible aquaculture producers for losses associated with high feed input costs during the 2008 calendar year.”

Mr. Robert Young

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The statute does not specifically provide a payment calculation for the program; therefore, FSA developed a payment calculation that is most beneficial to aquaculture producers, taking into account the limited amount of program funding, a \$100,000 payment limitation, and a \$2.5 million AGI provision. It has been projected that many aquaculture producers will not receive a program payment that is even relatively close to the losses suffered due to the high cost of feed in 2008.