



U.S. Department of Agriculture



Office of Inspector General  
Great Plains Region

# **Audit Report**

## **Farm Service Agency Analysis of Farm Service Agency/Commodity Credit Corporation Wheat Sales**

Report No. 03801-6-KC  
September 2004



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



DATE: SEP 30 2004

REPLY TO  
ATTN OF: 03801-6-KC

SUBJECT: Analysis of Farm Service Agency/Commodity Credit Corporation Wheat Sales

TO: James R. Little  
Administrator  
Farm Service Agency

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

This report presents the results of our audit of the Farm Service Agency/Commodity Credit Corporation wheat sales. Your September 21, 2004, written response to the official draft report is included as exhibit A with excerpts and the Office of Inspector General's (OIG) position incorporated into the Findings and Recommendations section of the report, where applicable.

The information contained in the response to the draft report was insufficient to reach management decisions for the five recommendations in the report. Management decisions for these recommendations can be reached when your agency provides the additional information outlined in the OIG Position sections of the report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned and the timeframes for implementing the corrective actions on the five recommendations for which management decisions have not yet been reached. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from the report issuance, and final action to be taken within 1 year of each management decision.

We appreciate the cooperation and assistance provided to our staff during the audit.

/s/

ROBERT W. YOUNG  
Assistant Inspector General  
for Audit

# ***Executive Summary***

## ***Farm Service Agency, Analysis of Farm Service Agency/Commodity Credit Corporation Wheat Sales***

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### **Results in Brief**

At the behest of a member of the U.S. House of Representatives, we performed an initial inquiry and a subsequent audit of selected Farm Service Agency (FSA)/Commodity Credit Corporation (CCC) wheat sales that occurred during calendar year 2002. We performed the audit to determine the impact of 2002 releases of CCC-owned wheat on (1) market prices and (2) warehouse operations.

Based on complaints received from his constituents, the Congressman expressed concern about the change in procedures used by the U.S. Department of Agriculture (USDA) to implement the June 2002 release of Bill Emerson Humanitarian Trust (BEHT) wheat (effected by Notice to the Trade Bulk Commodities Division (BCD) BCD-21, dated July 1, 2002). The Congressman stated that “CCC traditionally limited the percentage of its inventory offered for sale at any one time in an individual warehouse, so long as the storage rates charged to CCC by the warehouse were within a competitive range.” For the June 2002 release, however, “without due notice” USDA “abruptly changed policy and released the CCC wheat without guidelines or restrictions.” The Congressman was concerned that this change in policy “allow[ed] buyers to prey upon small companies,” that little companies “[were deprived] of all income from CCC storage,” and that “affected warehouse companies \*\*\* [were] thrust into extreme financial hardship.” The Congressman requested an investigation to determine whether any alleged wrongdoing occurred in connection with the change in policy.

In response to the Congressman’s concerns, we reviewed USDA’s change in policy and reported to him in our December 12, 2002, letter that nothing came to our attention to indicate USDA engaged in any wrongdoing in connection with the change in procedures for the June 2002 release of the BEHT wheat. While CCC does not guarantee storage revenue, we acknowledged the potential hardship the June 2002 release might have had on some of his constituents, as well as on warehouse operators in other States. We noted too that, in consideration of concerns raised over the handling of the June 2002 release, CCC imposed restrictions on later 2002 releases to include limitations on quantities and on numbers of warehouse locations on which bids could be submitted.

On December 13, 2002, we met with the Congressman and his staff to discuss the results of our review. At that meeting, the Congressman stated that USDA's failure to adhere to past practices had a negative impact on the industry—driving down prices \$0.40-\$0.55 per bushel (bu.) and putting warehousemen out of business. As a result of that meeting, we agreed to perform additional work to determine the effect of certain 2002 CCC-owned wheat sales on storing warehouses and on market prices. In consultation with the Congressman's staff, we established that our audit would cover the effects of CCC-owned wheat sales made under Notices to the Trade BCD-21, BCD-26, and BCD-31, dated July 1, September 3, and November 18, 2002, respectively ("the 2002 releases"). We agreed that our work would include interviews with warehousemen and reviews of the warehouses' financial statements.

In subsequent conversations, the Congressman's staff indicated to us that some of the restrictions applied by CCC on the later 2002 releases were not effective. Specifically, the staff had been informed that, in one case, a grain company used a middleman to submit bids to evade bidding limitations applied by CCC. Also, the staff had heard that some companies were intentionally removing their CCC wheat lots from consideration for sale by submitting offers and withdrawing them at the end of the sales period, thereby making their grain unavailable for sale. We agreed to expand the scope of our review to examine these allegations. Also, we agreed with the Congressman's staff that our work on the market price impact would be limited to the collection and review of any such existing economic analysis, and that we would not conduct our own economic analysis to determine any associated market price impacts.

In order to determine the financial impact that the CCC wheat sales had on individual warehouses, we attempted to ascertain the financial impact of the CCC wheat sales on a judgmental sample of 16 of 134 warehouses that were partially or completely depleted of CCC-owned wheat inventories by the releases. We estimate the 16 warehouses will sustain annual storage income losses of about \$2.13 million on the CCC-owned wheat sold in conjunction with the 2002 releases. This represents about 32 percent of the estimated \$6.73 million annual storage revenue losses that will be sustained on the total quantity of CCC-owned wheat sold from 134 warehouses nationwide. However, this loss may be mitigated by future storage of other CCC wheat quantities. At the time of our review, the eight sample warehouses at which the CCC-owned wheat was purchased by third parties had received revenues of about \$837,000 in the form of load-out fees and/or additional storage revenues that mitigated the loss of the CCC storage

income. For the remaining eight warehouses (which had purchased the wheat in-store), the warehouses generally were not able to quantify their net proceeds on the sales of the wheat that they purchased since the wheat was not identity-preserved. However, two of the warehouses were able to provide records showing that they realized net proceeds of about \$120,000 on the disposition of wheat that they purchased in-store.

Also, due to the absence of data showing a breakdown of market price trends by the causal economic factor(s), we were not able to reach a conclusion as to the impact of the 2002 releases on market prices. While the various cognizant USDA and industry officials we contacted in the course of our audit were generally aware of the 2002 releases, the officials advised us that they had not conducted any detailed studies or reviews to determine the specific impacts of the releases on National, regional, or local market prices. We did obtain, however, some general information on the local impact of the releases from the Washington State Wheat Commission. The information provided by the Commission primarily dealt with lost storage capacity and operational changes at two warehouses.

We noted from our review that FSA continued to modify its sales provisions as each succeeding wheat sale occurred during calendar year 2002. Through these evolving actions, it appears FSA attempted to lessen the economic impact on individual warehouses with each subsequent release. These actions included, but were not limited to, limiting the amount of wheat third parties could bid on in individual warehouses and specifying that inventories in some warehouses would not be made available so that some amount of the inventories in them would remain in storage.

During our review, we looked into allegations that one company was using a middleman party to purchase grain from a Pacific Northwest warehouse storing CCC wheat to avoid the bid limits established by CCC to minimize the impact of wheat sales on individual warehouses. We confirmed that the company in question did request another party to purchase wheat from the Pacific Northwest warehouse. As a result of this sale, the CCC-owned inventory at this Pacific Northwest warehouse dropped by 15 percent, from 2.9 million bu. to 2.5 million bu. Officials representing CCC were not aware that a middleman was being used to bypass bid limits for the November 2002 release. We are recommending that, in the future, CCC consider sanctions or other penalties for violations of bid limits.

We also looked into another allegation that warehouses were intentionally removing their lots from consideration for sale by submitting offers and withdrawing them at the end of the sales periods, thereby putting their lots into “unavailable” status during the sales period (by doing so, warehouses would prevent their inventories from being sold and continue to receive CCC storage fees). We were unable to confirm this allegation. CCC did not maintain data on the daily status of inventory lots; therefore, we could not determine the length of time lots were recorded as being in “unavailable” status. According to FSA personnel, the “unavailable” status for CCC-owned wheat should occur only for a short period (at most, several hours) until pending bids are canceled or accepted. However, we could not confirm this assertion. We are recommending that CCC utilize an existing automated capability or establish other compensating control to monitor whether this practice is occurring.

We also found that FSA did not retain a sufficient amount of supporting documentation on accepted and rejected offers. Without this information, FSA could not provide reasonable assurance that it received the fair market value for such wheat or that sales proceeds were actually maximized. Since CCC’s intent was to maximize 2002 wheat sales proceeds, the need for supporting sales documentation on both accepted and rejected offers was critical to show this objective was met.

## **Recommendations in Brief**

We recommend that the FSA Administrator:

- Develop and implement written policies and procedures that describe FSA’s process for administering the disposition of CCC-owned wheat stocks. Periodically notify the warehouse industry that procedures governing the disposition of CCC-owned commodities are subject to change, based on the type of release involved, and include a brief description of any significant differences from handling of previous sales.
- Strengthen existing automated system controls and develop management reports to monitor the placement of CCC-owned inventory lots into an “unavailable” status during periods of sales activity.
- Strengthen existing sales procedures to include appropriate program sanctions or consequences against offenders for any violations found.

- Direct Kansas City Commodity Office (KCCO) personnel to retain documentation supporting the determination of acceptable sale price levels in conjunction with future releases.

## **FSA Response**

In its September 21, 2004, written response to the official draft report, FSA concurred with the findings and recommendations presented therein. We have incorporated applicable portions of FSA's response, along with our position, in the Findings and Recommendations section of this report. The agency response is included in its entirety as exhibit A.

## **OIG Position**

Based on the information contained in the agency's response to the official draft report, we concur with FSA's proposed corrective actions. However, FSA did not provide the estimated timeframes for implementing its planned corrective actions for Recommendations Nos. 1, 2, 3, 4, and 5. Therefore, we were unable to accept the management decision for these recommendations.

### ***Abbreviations Used in This Report***

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|              |   |
|--------------|---|
| The 1998 Act | Africa Seeds of Hope Act of 1998              |
| BEHT         | Bill Emerson Humanitarian Trust               |
| BU.          | Bushel  |
| BCD          | Bulk Commodities Division                     |
| CCC          | Commodity Credit Corporation                  |
| CDT          | Central Daylight Time                         |
| CST          | Central Standard Time                         |
| DACO         | Deputy Administrator for Commodity Operations |
| FAS          | Foreign Agricultural Service                  |
| FOIA         | Freedom of Information Act                    |
| FSA          | Farm Service Agency                           |
| GIMS         | Grain Inventory Management System             |
| KCCO         | Kansas City Commodity Office                  |
| MT           | Metric Ton                                    |
| OGC          | Office of the General Counsel                 |
| OIG          | Office of Inspector General                   |
| PCP          | Posted County Price                           |
| P.L. 480     | Public Law 83-480                             |
| USAID        | U.S. Agency for International Development     |
| USDA         | U.S. Department of Agriculture                |



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# Background and Objectives

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## Background

Title III of the Agricultural Act of 1980 authorized the establishment of a 4 million metric ton (MT)<sup>1</sup> wheat reserve. The Federal Agriculture Improvement and Reform Act of 1996 expanded commodities authorized for the reserve to include corn, grain sorghum, and rice. The Africa Seeds of Hope Act of 1998 (the 1998 Act) replaced the Food Security Commodity Reserve and its predecessor, the Food Security Wheat Reserve, with the Bill Emerson Humanitarian Trust (BEHT). The purpose of the BEHT is to meet emergency humanitarian food needs in developing countries. The 1998 Act also re-delegated release authority from the President to the Secretary of Agriculture and authorized the Secretary to “swap” eligible commodities for any U.S. commodity of equal value. It also authorized the Commodity Credit Corporation (CCC) to hold funds as well as commodities in the reserve. The Farm Security and Rural Investment Act of 2002 extended the BEHT through fiscal year 2007.

No specific CCC-owned wheat bushels (bu.) are designated as BEHT stocks. However, CCC maintains a wheat inventory at least equal to the quantity required to meet BEHT obligations. Generally, CCC stocks not designated as BEHT stocks are “free” stocks (i.e., not designated for a special or restricted use).

BEHT commodities may be released in two situations. Generally:

1. Commodities may be released from the trust for emergency assistance - that is, when commodities needed to meet *unanticipated needs* under Title II, of Public Law 83-480 (P.L. 480), cannot be made available in a timely manner under the normal means of obtaining commodities.
2. Commodities may be released from the trust for emergency food assistance – that is, when *domestic supplies are insufficient* to meet the availability criteria of P.L. 480.

In releasing the commodities, the Secretary may exchange BEHT commodities for another United States commodity of equal value, including powdered milk, pulses (dry peas, lentils, and chickpeas), and vegetable oil. The 1998 Act also required the Secretary to use usual and customary channels, facilities, arrangements, and practices of trade and

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<sup>1</sup> One (1) MT = 2,204.6 pounds in the English system of measurements. Based on a standard wheat test weight of 60 pounds per bu., a MT of wheat would approximate 37 bu.

commerce to carry out the release of BEHT commodities to the maximum extent practicable. However, other restrictions applicable to the acquisition, storage, or disposition of eligible commodities owned or controlled by CCC do not apply to the BEHT. Examples of such restrictions include sales for export, commodity use, and country of import. Restricted sales are to be made at the highest prices determined to be obtainable after considering the quantity and condition of the commodity to be sold, the method of sale, and any associated restrictions imposed by CCC.

The three 2002 wheat releases included in our review resulted in the sale of about 26.7 million bu. (727,400 MT) of wheat for which CCC received gross sales proceeds of about \$101 million. CCC had approximately 101.5 million bu. of wheat in inventory prior to the first wheat release. A summary of each release and resulting sale during 2002 follows.

#### **June 2002 BEHT Release**

On June 4, 2002, the U.S. Agency for International Development (USAID) requested the Foreign Agricultural Service (FAS) to release 275,000 MT of the BEHT wheat to help respond to the food security crisis in Southern Africa. As previously noted, USAID also requested that the wheat released from the BEHT be exchanged for an equal value of corn, beans, and vegetable oil - commodities more typically consumed by the poor in Southern Africa - to be used under the Title II, P.L. 480 program. USAID's request followed a recommendation from the Food Assistance Policy Council that immediate action should be taken to address the food security crisis in Southern Africa. The request was justified because sufficient food commodities could not be procured under normal procedures due to the unanticipated scale of the emergency.

On June 7, 2002, Secretary Veneman authorized the release of 275,000 MT, or about 10.1 million bu., of wheat from the BEHT for use in Title II, P.L. 480 programs. Secretary Veneman announced the action at the World Food Summit in Rome, Italy, on June 10, 2002. CCC-owned wheat stocks were to have been sold by CCC and the requested commodities (corn, beans, and vegetable oil) purchased commercially. CCC planned to sell wheat through negotiated sales and, if necessary, catalog sales to finance the purchase of the requested commodities. All wheat stocks owned by CCC were made available for sale through the Farm Service Agency (FSA) Kansas City Commodity Office (KCCO), located in Kansas City, Missouri.

On July 1, 2002, FSA issued a Notice to the Trade (BCD-21) announcing the release and the manner in which BEHT stocks would be sold. The notice generally provided that CCC would sell the wheat through negotiated sales and, if necessary, catalog sales to finance the purchase of the requested commodities. The notice also showed that all wheat stocks owned by CCC would be available for sale through the KCCO. It also showed that all wheat stocks graded U.S. No. 1 or U.S. No. 2 sold after June 14, 2002, would be considered BEHT stocks for purposes of determining when the authorized release level (275,000 MT) was reached. Ultimately, CCC accounted for wheat that graded U.S. No. 1 or U.S. No. 2 sold during the period June 14 to July 17, 2002, as BEHT wheat.

### **Summary of the June 2002 BEHT Release Sales**

For the June 2002 BEHT release, sales occurred during June 14, 2002, to July 17, 2002, and included sales of forfeited wheat to storing warehouses that were applied to the BEHT, even though a storage start date did not apply (form 691 sales).<sup>2</sup> The BEHT wheat sales took place at 36 warehouses in 14 States and generated total sales proceeds of about \$32 million. Third-party negotiated sales totaled about 5.2 million bu. and sales to storing warehouse operators totaled about 4.8 million bu. Purchases of forfeited wheat to receiving warehouses (form 691 sales) totaled over 104,000 bu.

### **August 2002 BEHT Release**

On August 28, 2002, the U.S. Department of Agriculture (USDA) announced that it was further responding to the emergency food situation in drought-ravaged Southern Africa through the use of BEHT stocks. The announcement showed, in part, that the United States would release up to an additional 300,000 MT, or about 11 million bu., of the BEHT wheat in administering Title II, P.L. 480.

On September 3, 2002, FSA issued Notice to the Trade (BCD-26), which contained the sales provisions applicable to the second BEHT release. The provisions in that notice deviated from those applicable to the initial release. For example, the notice showed, in part, that storing warehouses would have the exclusive right to purchase stocks stored in their warehouses through 4:30 PM Central Daylight Time (CDT) on September 11, 2002. The notice also provided that no additional sales

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<sup>2</sup> These sales covered wheat forfeited by producers at the time of loan maturity and immediately purchased by a warehouse. The forfeited quantity was recorded as CCC-owned inventory and sold before the date that CCC was obligated to begin paying storage.

would take place for a period of 2 days in cases where such sales exceeded 450,000 bu. from a storing warehouse.

### **Summary of the August 2002 BEHT Release Sales**

CCC was able to meet all current needs from the sales of about 9.1 million bu. of BEHT wheat to storing warehouse operators as of September 11, 2002. As a result, the remaining quantity of about 1.9 million bu. (about 52,000 MT) of BEHT wheat was not made available for release.

The second BEHT release consisted of CCC-owned wheat sales that occurred during August 28, 2002, to September 11, 2002. The BEHT wheat sales took place at 69 warehouses in 13 States and generated total sales proceeds of about \$40 million. All of these sales were made to the warehouses where the CCC-owned wheat was stored at the time of the sale.

### **November 2002 Release**

In its Notice to the Trade (BCD-31), dated November 18, 2002, CCC announced an intention to sell an additional 7.5 million bu. of CCC-owned wheat. That figure represented the difference between the existing CCC-owned wheat inventory (81.6 million bu.) and the quantity available for release under the BEHT provisions (74.1 million bu.). The notice also showed that storing warehouses would have the first opportunity to purchase their stocks of CCC-owned wheat from 9:00 AM Central Standard Time (CST) on November 25, 2002, to 4:30 PM CST on November 29, 2002. In addition, it showed that CCC would sell the wheat to any interested party beginning at 9:00 AM CST on December 2, 2002.

The bid provisions for the November 2002 release were generally the same as those for the August 2002 release except for (1) a change in the maximum number of bids that a third party could make, and (2) a requirement for submitting bids on entire lots. For the November 2002 release, USDA again granted storing warehouse operators the exclusive right to purchase their existing CCC-owned wheat inventories on an in-store basis prior to accepting offers from any other interested parties.

### **Summary of the November 2002 Release Sales**

The final 2002 release consisted of uncommitted CCC-owned wheat stocks that were sold during November 25, 2002, to December 10, 2002. The uncommitted wheat stock sales took place at 42 warehouses in

14 States and generated total sales proceeds of about \$29 million. Third-party negotiated sales totaled 6.1 million bu. and sales to storing warehouse operators totaled 1.4 million bu.

Under the November 2002 sale of uncommitted wheat stocks, six entities (third parties) purchased the entire CCC inventory of 10 storing warehouses. In addition, negotiated third-party sales resulted in the partial depletion of CCC-owned wheat inventories from 12 additional warehouses.

### **Congressional Request for OIG Review**

In a July 24, 2002, letter, a member of the U.S. House of Representatives expressed concern about the change in procedures used by USDA to implement the June release of 275,000 MT of wheat from the BEHT. The Congressional representative requested that the Office of Inspector General (OIG) conduct an investigation into the reason for USDA's change in policy that "allowed buyers to prey upon small companies."

To determine whether USDA engaged in wrongful conduct in the release of wheat from BEHT, we reviewed the authorizing statute and the procedures used by CCC to sell the wheat. We interviewed USDA officials, including personnel from FSA/CCC and the Office of the General Counsel (OGC). We examined documentation and analyses collected or prepared by FSA and CCC in response to various complaints about the handling of the June release of the BEHT wheat.

We provided a written response, dated December 12, 2002, on the Congressional Representative's concerns and reported nothing came to our attention to indicate USDA engaged in any wrongdoing in connection with the change in procedures adopted for the June 2002 release of the BEHT wheat. According to USDA officials, the sale process used for the June release was a policy call to maximize the returns to CCC, allowing more commodities to be purchased to meet humanitarian needs. We could not validate whether, in fact, returns were maximized, because CCC used a negotiated sales process and did not maintain records of unsuccessful bids.

Upon further conversations with the Congressman and his staff, we agreed to do an additional review of all of the calendar year 2002 wheat sales that pertained to Notices to the Trade BCD-21, BCD-26 and BCD-31.

## **Objectives**

The primary objectives of this audit were to determine and quantify the financial impact of the CCC-owned wheat sales on selected warehouse operations and to determine if any economic assessments had been made of the impact of CCC-owned wheat sales had on National and local market prices. We also evaluated the FSA process for notifying warehouses of planned sales. In addition, we assessed the reasonableness of controls at the FSA KCCO to (1) monitor the placing of CCC-owned inventory lots into an “unavailable” status while offers were being negotiated, (2) preclude the removal of excessive CCC-owned inventory quantities from individual warehouses through third-party sales, and (3) provide reasonable assurance that negotiated sale prices reflected fair market values.



# ***Findings and Recommendations***

## ***Section 1. Written Procedures for Commodity Sales Operations Are Needed***

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### **Finding 1**

#### **Critical Change in Commodity Sales Policy Not Effectively Communicated to Industry Stakeholders**

FSA did not effectively communicate the changes in sales terms and conditions prior to the announcement of the June 2002 BEHT release or in the formal notification to industry stakeholders, especially to those warehouses storing CCC-owned wheat. FSA followed its traditional stakeholder notification process to announce that it would sell wheat through negotiated sales for the initial 2002 BEHT sales announced by the Secretary of Agriculture on June 10, 2002. Although the initial Notice to the Trade specified to stakeholders that all wheat stocks owned by CCC were available for sale, it did not describe that this was a departure from previous policies on the eligibility of lots for offers. We noted that FSA did not have written procedures in place showing how Notices to the Trade were to be prepared and what sales provisions needed to be described within them. As a result, criticism of the Department and FSA was experienced. In addition, various storing warehouses advised us that they did not have a reasonable opportunity to anticipate the financial impact of such changes, obtain needed financing arrangements to purchase the grain, or develop associated contingency plans regarding the sales of wheat they were storing.

We found that FSA's internal and formal written policies, procedures, and handbooks did not provide the KCCO staff with sufficient details on how inventory sales were to be announced to the industry or what information needed to be included in the announcements. FSA personnel informed us that they use the Notice to the Trade to inform the industry of impending sales and the sales terms that are applicable. The inventory lots that are available for sale are posted on its web site. FSA had written procedures in its Grain Inventory Management System (GIMS) handbooks for preparing sales contracts, storage invoicing, and performing other functions, such as transportation activities. In addition, the Bulk Grain Division in KCCO has a procedural manual for contract activity, market research, and grain movement. However, there were no specific policies, procedures, or handbooks identified to us that described the roles, responsibilities, and procedures for FSA KCCO staff in administering the disposition of CCC-owned wheat, including the policies and procedures to be followed in preparing notices to industry stakeholders of sales provisions or changes to existing practices.

FSA personnel followed their existing notification process to implement the wheat sales, even though the wheat inventories made available for the June 2002 wheat sale varied considerably from previous sales in that all CCC-owned inventories were offered for sale—the sale was not restricted to quantities at the warehouses charging CCC the highest storage fees. Our review disclosed that CCC had traditionally sold its commodities from those warehouse locations with the highest storage costs in an effort to minimize the overall cost of storing such commodities. The inventory in warehouses with the lowest storage rates were generally not made available for offers to purchase by third parties. However, that policy changed in conjunction with the initial BEHT wheat release in 2002. On June 10, 2002, the Secretary announced the release of 275,000 MT of wheat to be exchanged for an equal value of corn, beans, and vegetable oil through the BEHT. The associated Notice to the Trade BCD-21, dated July 1, 2002, provided, in part, that CCC had the authority to exchange BEHT stocks for other eligible commodities of equal value. The notice also showed that the request from USAID would likely involve the need for commodities other than wheat. For that reason, the notice showed that revenues from the sale of existing CCC-owned wheat stocks would be used to purchase the needed commodities. However, the notice did not specify the terms and conditions of the proposed sales.

With the issuance of the initial Notice to the Trade, FSA placed emphasis on maximizing revenues from the sale of BEHT wheat rather than the historical policy of minimizing storage costs. There was no other explanation or description included in the notice to alert stakeholders of this change in CCC sales objectives. Rather, the notice simply stated, in part, “all wheat stocks owned by CCC are available for sale through the Kansas City Commodity Office.” This resulted in making wheat available from all storage locations. As a result, the CCC-owned wheat in warehouses with the lowest storage rates was no longer precluded from sale under the BEHT releases.

The unanticipated departure from the traditional sales policy apparently surprised many of the storing warehouses, especially those in the Pacific Northwest, and resulted in criticism of the Department by the warehouse stakeholders. For example, our initial review disclosed the existence of numerous Congressional and industry letters expressing concern over the changes in sales procedures applicable to the initial BEHT release.

Our audit disclosed the existence of additional similar concerns. For example, a warehouse official in the State of Washington questioned the rationale for removing CCC-owned wheat from warehouses with the lowest storage rates. Our subsequent review of supporting program records confirmed that the lowest storage rates were generally offered by warehouses located in the Pacific Northwest. (See exhibit F for map containing data on the average storage rates in counties with warehouses where CCC-owned wheat was sold in conjunction with the 2002 releases.)

Other warehouse officials advised us that they were not aware the initial BEHT release had even been announced until they began receiving telephone calls from KCCO merchandisers during the early part of July 2002. The purpose of those calls was to provide warehouse personnel with an opportunity to purchase their existing CCC-owned wheat inventories on an in-store basis (i.e., right of first refusal) in cases where a third-party buyer (that is, a buyer other than CCC or the storing warehouse) had made an offer on the CCC-owned wheat. We did not find any evidence to indicate that such calls were made prior to the issuance of Notice to the Trade BCD-21. We were not able to determine whether all of the sample warehouses timely received or read the contents of Notice to the Trade BCD-21, dated July 1, 2002. KCCO personnel could not tell us a firm date of when the notice was actually mailed. However, we were provided a copy of the Notice to the Trade and the associated envelope at one warehouse, which showed that the Notice was post marked on July 9, 2002, and received by the warehouse on July 11, 2002.

After the Notice to the Trade was issued and the change in the sales policy became public, the National Grain and Feed Association expressed their concerns to FSA in a memo dated July 8, 2002. In a July 10, 2002, response to the Association, FSA explained in more detail why CCC made the decision to include all available wheat stocks for sale. FSA's memo also stated that the KCCO merchandisers had been instructed to minimize adverse effects on any single warehouse, when practical. However, due to a miscommunication within FSA, the notification to minimize the effect on individual warehouses was not communicated to the KCCO merchandisers during this sales period.

FSA officials contended that making all of its wheat stocks available for sale to any interested party under the June 2002 release allowed the market to dictate which stocks would be sold. This differed from the traditional policy of removing CCC-owned commodities from those locations with the highest storage costs. FSA personnel also emphasized that storing warehouse operators were given up to

two business days to counter such third-party offers (right of first refusal). However, one warehouse official advised us that the 48-hour time period was not adequate to secure the financing needed to make an offer to purchase the CCC-owned wheat on an in-store basis. We did note that the short response time might have been prompted by an OGC determination that the sale of BEHT wheat needed to occur not later than two weeks following the purchase of the commodity for USAID.<sup>3</sup> We also concluded that the financing issue was not significant to warehouses in the Pacific Northwest with CCC-owned wheat. This was due to the fact that the primary goal of such warehouses was to retain the revenue associated with storing CCC-owned commodities.

We do recognize that the commodity exchange provisions applicable to the BEHT releases prompted CCC to modify its traditional sales policy. However, our initial review disclosed the need for FSA to develop formal guidelines for handling future inventory sales. This was due to the fact that written procedures related to the sale of CCC-owned commodities were limited to the provisions contained in the individual Notices to the Trade. That concern was addressed in a memorandum to the FSA Administrator dated December 13, 2002. The FSA response, dated January 30, 2003, showed, in part, that FSA did not anticipate any changes to the existing policy of publicizing the sales procedures applicable to each release in the associated Notice to the Trade.

Although we recognize FSA's need to retain flexibility over the sales procedures governing the disposition of CCC-owned stocks, we also believe that any unexplained deviations from normal and customary sales procedures can carry an inherent risk of criticism by industry and other interested parties if these notifications are left to interpretation solely within the affected sales announcements. This is especially true since such sales have historically been conducted on a bushel-for-bushel rather than a commodity exchange basis. For that reason, we concluded that periodic warehouse industry reminders addressing the advance notice of sales policy changes could serve a significant purpose. The dissemination of such information, together with a brief explanation of significant differences, would ensure that warehousemen are provided adequate notification of the applicable sales policy. We also noted that including such an advance notice within future Notices to the Trade could serve this purpose.

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<sup>3</sup> OGC initially provided guidance that sales must take place concurrently with purchases, but FSA/CCC requested a 30-day turnaround. OGC and FSA eventually agreed to a 2-week timeframe.

## **Recommendation No. 1**

Develop and implement written policies and procedures that describe the process for administering the disposition of CCC-owned wheat stocks, including KCCO staff roles and responsibility.

### **FSA Response.**

FSA concurs with this recommendation. The Deputy Administrator for Commodity Operations (DACO) will establish broad policies and procedures that may be used when CCC owned wheat stocks, including BEHT stocks, are to be sold. These policies and procedures will be flexible in order to take into account market conditions and program requirements at the time of the sale, and to ensure that the commodity is marketed in a manner that maximizes returns to CCC. Future sales may take the form of negotiated sales, swaps, competitive sealed bids, or electronic on-line sales. While all methods result in the sale of wheat stocks, the policy may differ for each method. KCCO staff will be responsible for implementing the policies and procedures.

### **OIG Position.**

We concur with FSA's planned corrective actions. However, we will need to be provided with the estimated timeframe for implementing its actions in order to reach management decision.

## **Recommendation No. 2**

Periodically remind warehouse stakeholders that existing sales procedures are subject to change, based on the type of release involved, and include a description of any significant differences from the handling of previous sales. Include the supporting rationale and explain the need for such changes, where appropriate.

### **FSA Response.**

FSA concurs with this recommendation. FSA will periodically notify warehouse operators of CCC's rights with respect to selling its inventories. Additionally, FSA will continue to issue Notices to the Trade as soon as possible after the Secretary authorizes a release of BEHT stocks. Several Notices to the Trade were issued in 2003 to announce the release of the wheat stocks and the processes involved. A notice was also issued to notify the industry of postponed BEHT sales, and subsequently to announce changed sales procedures for BEHT stocks. During this time period, FSA officials worked with National

and regional industry/trade associations and briefed congressional staffers on BEHT issues. These lines of communications will continue with future releases of BEHT stocks.

**OIG Position.**

We concur with FSA's planned corrective actions. However, for management decision, we need the estimated timeframe for initially notifying warehouse operators of CCC's rights with respect to selling its inventories and clarification on the frequency of these notifications (that is, whether these notifications will be monthly, quarterly, semiannually, annually, etc.).

## **Section 2. Additional Controls Over Inventory Availability Are Needed**

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### **Finding 2**

#### **Existing Grain Inventory Management System Capabilities Should Be Utilized to Detect Abuse**

FSA has not effectively used existing GIMS capabilities to prevent or detect the placement of available CCC-owned inventory lots into an “unavailable” status during specified sales periods. One warehouseman in our sample alleged that any warehouses that were currently storing CCC-owned wheat could intentionally remove their lots from consideration for sale by submitting bogus offers and withdrawing them at the end of the sales period. This could occur because KCCO places warehouse inventories in an “unavailable” status while the offers are being considered. Even though the GIMS has a record of the status (available or unavailable) of each inventory lot, KCCO personnel advised us that the need for such controls would be extremely limited since inventory lots placed in an “unavailable” status should only be maintained for short time periods. However, since KCCO has not developed a record that would show the status of inventory lots on a daily basis, FSA does not have reasonable assurance that this process is not being abused and such lots always are being promptly returned to an “available” status when they are not sold or otherwise disposed of.

Our review disclosed that inventory data on CCC-owned commodities is available for public inspection on the FSA web site. The data is updated on a weekly basis and includes information such as warehouse name, storage location, lot number, commodity, grades, class, and quantity. Potential bidders, including storing warehouses, use this data to make associated purchase offers during announced sales periods. During the review, the officials at one sample warehouse expressed a concern about the potential for warehouses to remove their inventory lots from the weekly inventory listings through a protective bidding practice. The officials indicated that submitting offers on such lots and then withdrawing them just before the end of the release period would prevent the lots from being shown as available and, thereby, ensure that those lots would not be sold. Therefore, the storage income on those lots would continue to accrue to the warehouse.

FSA officials confirmed that the status of inventory lots associated with pending offers would be changed from “available” to “unavailable” until a decision was made to accept or reject such offers. FSA officials also confirmed that inventory lots associated with such offers would be removed from the inventory listings until such time that the offers were

disposed of by being cancelled or contracts being prepared for partial sale. However, the officials emphasized that they had not seen the need to identify the existence of this condition since decisions on pending offers were generally made within the hour.

During our review, we attempted to determine the scope and nature of controls used by FSA personnel to preclude the occurrence of and/or to detect this condition. FSA officials were able to provide us with copies of various GIMS reports showing data on the current status of inventory lots. FSA officials also advised us that the GIMS files are archived on a daily basis. However, FSA officials also advised us that obtaining information on the daily status of each inventory lot (i.e., available, locked, allocated to a loading order, etc.) would necessitate creation of a master database file containing the data from each archived file. Although this would be cumbersome to implement, the database file could provide FSA with the capability to determine which inventory lots are in an “unavailable” status on a daily basis. With this capability, FSA officials could ensure that existing inventory lots did not remain in an “unavailable” status during specified sales periods or beyond the period of time necessary to accept or reject the offer.

The absence of readily available data on the daily status of existing inventory lots prevented us from evaluating the length of time that any lots were in an “unavailable” status or whether this procedure was being abused. We also noted that the FSA position was predicated on the assumption that pending offers should be disposed of in a short time. However, that position did not address the possibility of inventory lots being accidentally being placed in an “unavailable” status and going undetected for an extended period of time.

Without historical data on the daily status of each inventory lot or other compensating controls, we concluded that existing management controls do not provide FSA with reasonable assurance that existing inventory lots will not unnecessarily remain in an “unavailable” status during periods of sales activity.

### **Recommendation No. 3**

Utilize existing automated system capabilities or establish other compensating controls to prevent the placement of existing inventory lots into an “unavailable status” during periods of sales activity from being abused.



### **FSA Response.**

FSA concurs with this recommendation. Effective immediately, FSA will discontinue removing lots from the listing of available stocks when offers have been received, but neither accepted or rejected. Accordingly, the listings will show all available lots, until they are sold. In addition, FSA will develop controls to ensure that a lot is not sold more than once.

### **OIG Position.**

We concur with FSA's planned corrective actions. However, we will need to be provided the estimated timeframe for implementing the planned controls to prevent duplicated lot sales.

---

## **Finding 3**

### **Sanctions Needed Over Offer Limits Violations**

The FSA sales procedures designed to limit the number of offers and total quantities of wheat that could be purchased by one buyer during the November 2002 wheat release were not entirely effective. Also, the sales procedures did not provide any sanctions or consequences against offerers and/or buyers who violated the established limits. This occurred because FSA personnel were unable to identify bidders who used third-party intermediaries to circumvent the established limits: FSA only manually monitored logs for potential buyers who made at least one offer and did not use other available information to detect parties that circumvented the established bid limits. As a result, we determined that buyers could circumvent the established bid limits by using third-party intermediaries to make the offer without detection.

Our review disclosed that CCC modified the sales procedures applicable to the August and November 2002 wheat releases. The modifications included an effort to address the concern expressed as a result of the initial BEHT release that complete inventories of CCC wheat were depleted from individual warehouses. Following the initial BEHT release, FSA established bid limits to minimize the impact of wheat sales on individual warehouses. For example, Notice to the Trade BCD-26, dated September 3, 2002, showed, in part, that the maximum a bidder could submit until CCC either accepted or rejected such offers, was:

- nine bids;
- three separate warehouse locations; and
- total bid quantity for all locations of 1,350,000 bu.

For an individual warehouse location:

- bids had to be submitted in, at a minimum, increments of 100,000 bu., except in those cases where warehouses stored less than 100,000 bu.;
- bids could not exceed 150,000 bu., except where a lot quantity exceeded 150,000 bu., then the entire lot had to be included in the bid; and
- up to three bids could be submitted at a time, but the total quantity for any warehouse location could not exceed 450,000 bu.

Similar provisions were in effect for the general release in November 2002.

Program records showed that CCC was able to fulfill its obligations for the August release through in-store sales (i.e., sales to the storing warehouse). Since the bid limits only applied to third-party sales, they were not applicable to any offers accepted under this release.

For the November 2002 release, KCCO maintained a separate log containing data on the offers made by each bidder to monitor compliance with the established limits. The use of the log was an effective control to prevent a single bidder from exceeding the imposed bid limits. We noted no instances where a bidder (1) attempted to exceed the nine bid limit, (2) attempted to bid at more than three separate warehouse locations, or (3) exceeded the total bid quantity of 1,350,000 bu. However, we did note that a buyer could circumvent the bid limits by contracting with another entity to bid on additional quantities. For example, the log for an entity in North Dakota showed that it submitted offers on a total of 1,343,081.85 bu. of CCC-owned wheat stored at three warehouses in the State of Washington. Program records also showed that it was the successful bidder for 449,932.85 bu. of wheat stored at one of the three warehouses. However, entity officials advised us that its offers were made at the request of corporate officials in a different State. We also noted that the corporation had other existing bid offers during the same timeframe and, therefore, would not have been able to make any additional offers until the pending offers were disposed of. Corporate officials confirmed that they had solicited the cited entity's assistance. However, they stated that the solicitation represented an effort to comply with the subject limits as written. When we visited the warehouse that submitted the offers, we found that the company had a joint business venture with the corporation that requested them to submit the offers.

Although FSA was not aware of the use of a third-party buyer to bypass the bidding limits, FSA also did not have any established sanctions in place to penalize the parties violating the established bid limits. When we informed FSA of the occurrence of these events, we were informed that they had no way of knowing that this had occurred and did not know what actions could be taken against the entity. We concluded that FSA needs to establish sanctions for violating any established bid limits as a tool to promote compliance with such requirements.

According to FSA personnel, the intent of the bid limit in the Notice to the Trade was to prevent one buyer from bidding on more than 450,000 bu. of grain at three separate warehouses at one time. They also believed the control was effective even though it was not intended to determine if major purchasers were using third parties to bid for them.

We did note that in subsequent Notices to the Trade in Year 2003, CCC did attempt to further limit the impact on individual warehouses by revising the limits. For example, Notice to the Trade BCD-43, dated March 21, 2003, further limited the quantity that could be removed from an individual warehouse location by third parties to a total of 450,000 bu. for the entire release period. Later, Notice to the Trade BCD-50, dated June 2, 2003, reduced the quantity of CCC-owned wheat that would be made available for third-party sales from 450,000 to 300,000 bu. for each individual warehouse location. That notice further provided that the CCC-owned wheat stored in warehouse locations with less than 300,000 bu. would not be made available for sale to third parties. Although these revisions would limit the impact on an individual warehouse, there is still no provision to prevent larger warehouses from using third-party intermediaries to purchase grain for them.

#### **Recommendation No. 4**

Strengthen existing sales procedures to include appropriate sanctions for violations of any future quantity and/or offer limits. Develop and implement procedures to ensure that sanctions are applied when such violations come to the attention of CCC. Also, periodically remind KCCO merchandisers to be alert for potential violations of such limits.

#### **FSA Response.**

FSA concurs with this recommendation. Commodity markets are designed to allow commodities to be traded numerous times before they reach the end-user or exporter. Accordingly, it would be difficult to determine whether the sale of wheat from one entity to another was

conducted in normal trade practices or was designed to circumvent CCC-established bid limits. For future sales of BEHT stocks, FSA will notify the trade that, if it is determined that attempts are being made to circumvent bid limits through prearranged third party sales, both parties involved in the suspected transaction will be referred to the OIG for investigation. In addition, FSA will consult with the OGC in pursuing civil penalties in cases for which a fraudulent activity determination is made. Pending OGC advice, FSA may also revise sales contracts to incorporate a statement regarding fraudulent activity. As future sales of BEHT stocks take place, KCCO merchandisers will be reminded to be alert for potential violations of established limits.

**OIG Position.**

We concur with FSA's planned actions. However, we will need to be provided with the estimated timeframes for consulting with OGC and revising the sales contracts to reach management decision.

### **Section 3. Basic Documentation Requirements Could Be Improved**

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#### **Finding 4**

#### **Acceptable Sale Price Determinations Not Adequately Documented**

FSA did not require the merchandisers to retain supporting documentation on how acceptable sales price levels were determined. FSA officials advised us that they had reservations about maintaining such documentation because of its market-sensitive nature and its potential for release under the Freedom of Information Act (FOIA) provisions. However, the absence of such documentation did not provide OIG with reasonable assurance that FSA received the fair market value for CCC-owned stocks that it sold.

KCCO merchandisers are primarily responsible for the marketing of CCC-owned commodities. This involves the establishment of acceptable sale price levels in conjunction with offers received from storing warehouses or third parties. The merchandisers use a variety of different sources to establish acceptable price levels. These include online trading data, daily listings of local market prices provided by the Data Transmission Network, and posted county price (PCP) data. Prior supervisory approval of acceptable offers is also required before the sales can be completed.

During our review, we attempted to determine whether CCC received a fair market value for CCC-owned wheat sold from the 16 sample warehouses included in our review. However, we generally found that the merchandisers had not retained documentation showing how the acceptable price levels were determined. Each sale generally required a supplemental oral explanation by the responsible merchandiser as to how the acceptable price level was determined. In that regard, FSA officials advised us that regional pricing differences would hinder standardization of the current sales process. However, the absence of such documentation prevented us from reconstructing the sales negotiation conducted by FSA. Therefore, we were unable to reach a conclusion as to whether CCC received a fair market value for such wheat on the date and location where it was sold.

During the audit, we did calculate the average PCPs in effect at the time of the subject wheat releases for those counties with CCC-owned wheat. (See exhibits G through I for copies of maps showing the average PCPs for those counties with CCC-owned wheat during each of the release periods reviewed.) The PCPs are used by FSA to establish the amount of any loan deficiency payment or marketing loan

benefits available on any given day. The daily PCPs are intended to reflect average market prices at the county level. However, PCPs for any given business day represent the previous business day's terminal market prices, adjusted for the associated transportation differentials. This is based on FSA's objective of having the PCPs reflect, rather than set, the market prices. As such, the PCPs do not necessarily reflect the actual daily bid amount at a particular warehouse location. Consequently, we noted differences during our comparison of the sales' contract prices with the PCPs in effect on the sale dates for the 16 selected warehouse locations. We noted that the sales' contract prices ranged between 24 cents below the PCP to 24 cents above the PCP for the sample warehouses visited (see exhibit J for details on the results of the subject comparison).

We did note that CCC-owned wheat sold in conjunction with the subject releases generally came from those counties with the highest average PCPs. However, the absence of rejected bid data and supporting documentation on the determination of acceptable offer price levels prevented us from determining whether a fair market price was obtained for the grain and/or whether any other improprieties may have occurred.

## **Recommendation No. 5**

Direct KCCO to retain all supporting documentation on acceptable price levels determined in conjunction with each future sale of CCC-owned commodities or develop a suitable alternative process whereby the accepted sales price negotiation process for each sale can be accurately reconstructed.

### **FSA Response.**

FSA concurs with this recommendation. KCCO will be directed to retain supporting documentation that was used to determine whether to accept bids, to the extent it is available. In instances where market data is not available or may not accurately reflect market conditions, KCCO will be permitted to determine that the bid received reflects the best market attainable for the commodity.

### **OIG Position.**

We concur with FSA's planned corrective actions. However, we will need to be provided with the estimated timeframe for completing its actions in order to reach management decision.

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**Finding 5****Documentation Not Retained for Rejected Offers**

FSA did not retain documentation of rejected offer data for either of the BEHT wheat releases that occurred in 2002. FSA personnel stated they did not recognize the importance of retaining such documentation. This did not provide FSA with reasonable assurance that it maximized associated sales revenues.

As noted in Finding 1, the need to maximize revenues prompted the change in sales procedures applicable to the BEHT wheat releases. However, FSA did not begin retaining rejected offer data until the general release that occurred in November 2002. The absence of such data prevented FSA from determining the extent to which it met the stated objective of maximizing revenues from the sale of BEHT wheat.

The need for such documentation was cited in our December 13, 2002, memorandum to the FSA Administrator. The FSA response, dated January 30, 2003, showed, in part, that KCCO merchandisers had been instructed to begin logging all price-specific inquiries, even when such inquiries did not lead to consummated sales. The response also showed that the written log would include data on the storing warehouse location, lot number, and the price and date received for a minimum period of three years.

Based on the nature of actions taken to address the cited condition during the November 2002 wheat release, we are not making any additional recommendations at this time.

## ***Scope and Methodology***

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Our review was initiated at the request of a Congressman to assess the financial impact of three CCC wheat sales that occurred in calendar year 2002. The announcements of the CCC wheat sales were made under Notices to the Trade BCD-21, BCD-26, and BCD-31, dated July 1, September 3, and November 18, 2002, respectively. In order to determine the financial impact that the three CCC wheat sales had on individual warehouses, we conducted visits to a judgmental sample of 16 storage warehouses that were partially or fully depleted of CCC-owned wheat through the subject releases. We also contacted three buyers of CCC-owned wheat. A Congressional staffer suggested two of the three sample wheat buyers for visit. At these locations, we interviewed company officials to determine how they learned about the CCC wheat sales and what factors influenced their decisions to buy CCC-owned wheat at selected locations.

To determine if any analysis had been performed on how the three wheat sales had impacted the market value of wheat at the National, State and local levels, we also performed fieldwork at 10 USDA entities, including the FSA National office and KCCO (see exhibit B for list of entity contacts). In addition, we contacted officials at six wheat industry/trade associations (see exhibit C for list of industry/trade association contacts). We conducted the review by reviewing applicable laws, regulations, and guidance pertaining to the BEHT and CCC commodity sales. We also reviewed FSA policies, procedures, and management controls applicable to the BEHT and CCC commodity sales. In addition, we interviewed agency officials, made physical observations, and reviewed supporting KCCO and warehouse records.

Our review disclosed that a total of about 101 million bu. of CCC-owned wheat was stored at a total of 294 warehouses located in 197 counties (25 States) prior to the initial BEHT release in June 2002 (see exhibit D for map showing county breakdown of CCC-owned inventories prior to the initial BEHT release in June 2002). Program records showed total sales and revenues of approximately 26.7 million bu. and about \$101 million, respectively, in conjunction with the three 2002 wheat releases. However, the BEHT quantities included about 104,000 bu. of forfeited-loan wheat that were acquired by the storing warehouses before the date that CCC was obligated to begin paying storage.



We selected a judgmental sample of 16 of the 134 storing warehouses that were partially or fully depleted of CCC-owned wheat inventories in conjunction with the subject releases. The selection criteria for 13 of the warehouses was based on an analysis of factors, such as warehouse location, release period(s) involved, type of sale (in-store vs. third-party), and quantity of percentage of CCC-owned wheat lost. We selected three warehouses for visits because concerns were expressed by the staff assistant to the Congressman about how the CCC-owned wheat sales were managed by CCC and how the CCC-owned wheat sales economically impacted smaller warehouses. At the individual warehouses that we visited, we interviewed the warehouse operators and reviewed their financial records to determine how the CCC wheat sales affected their operations.

Program records showed that the sample warehouses lost a total of about 10.3 million bu. of CCC-owned wheat in conjunction with subject releases. This represented about 10 percent of the total CCC-owned wheat inventory (101.5 million bu.) prior to the initial BEHT release in June 2002 (see exhibit E for map showing county breakdown of CCC-owned inventories after November 2002 release).

The fieldwork was conducted during the period February 2003 through March 2004. We conducted this audit in accordance with Government Auditing Standards.

# Exhibit A – FSA/CCC Response to the Draft Report

Exhibit A – Page 1 of 4



United States  
Department of  
Agriculture

Farm and Foreign  
Agricultural  
Services

Farm Service  
Agency

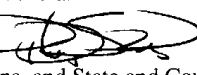
Operations Review  
and Analysis Staff

Audits,  
Investigations and  
State and County  
Review Branch

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

SEP 21 2004

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

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

**SUBJECT:** Response to Request for Information: 03801-6-KC – Analysis of Farm  
Service Agency/Commodity Credit Corporation Wheat Sales

Enclosed is a copy of a memorandum from the Farm Service Agency's Deputy  
Administrator for Commodity Operations responding to your August 30 request for a  
response to the subject audit report.

Please address any questions to Karren Fava 720-6152.

Enclosure

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# Exhibit A – FSA/CCC Response to the Draft Report

Exhibit A – Page 2 of 4



United States  
Department of  
Agriculture

Farm and Foreign  
Agricultural  
Services

Farm Service  
Agency

1400 Independence  
Avenue, SW  
Stop 0551  
Washington, DC  
20250-0551

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

**FROM:** Bert Farnish *BAF*  
Deputy Administrator for Commodity Operations

**SUBJECT:** Office of Inspector General's Draft Audit Report 03801-6-KC,  
Analysis of Farm Service Agency/Commodity Credit Corporation  
Wheat Sales

*SM* *17th*  
*9-21-04*  
SEP 20 2004

We have reviewed the subject audit report and are providing the following responses to the recommendations.

**FINDING 1: Critical change in commodity sales policy not effectively communicated to industry stakeholders.**

**Recommendation 1:** Develop and implement written policies and procedures that describe the process for administering the disposition of CCC-owned wheat stocks, including KCCO staff roles and responsibilities.

**FSA Response:** FSA concurs with this recommendation. The Deputy Administrator for Commodity Operations (DACO) will establish broad policies and procedures that may be used when Commodity Credit Corporation (CCC)-owned wheat stocks, including Bill Emerson Humanitarian Trust (BEHT) stocks, are to be sold. These policies and procedures will be flexible in order to take into account market conditions and program requirements at the time of the sale, and to ensure that the commodity is marketed in a manner that maximizes returns to CCC. Future sales may take the form of negotiated sales, swaps, competitive sealed bids, or electronic on-line sales. While all methods result in the sale of wheat stocks, the policy may differ for each method. Kansas City Commodity Office (KCCO) staff will be responsible for implementing the policies and procedures.

**Recommendation 2:** Periodically remind warehouse stakeholders that existing sales procedures are subject to change, based on the type of release involved, and include a description of any significant differences from the handling of previous sales. Include the supporting rationale and explain the need for such changes, where appropriate.

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# **Exhibit A – FSA/CCC Response to the Draft Report**

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Exhibit A – Page 3 of 4

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Director, Operations and Review Analysis Staff  
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**FSA Response:** FSA concurs with this recommendation. FSA will periodically notify warehouse operators of CCC's rights with respect to selling its inventories. Additionally, FSA will continue to issue Notices to the Trade as soon as possible after the Secretary authorizes a release of BEHT stocks. Several Notices to the Trade were issued in 2003 to announce the release of the wheat stocks and the processes involved. A notice was also issued to notify the industry of postponed BEHT sales, and subsequently to announce changed sales procedures for BEHT stocks. During this time period FSA officials worked with National and regional industry/trade associations and briefed congressional staffers on BEHT issues. These lines of communications will continue with future releases of BEHT stocks.

**FINDING 2: Existing Grain Inventory Management System capabilities should be utilized to detect abuse.**

**Recommendation 3:** Utilize existing automated system capabilities or establish other compensating controls to prevent the placement of existing inventory lots into an "unavailable" status during periods of sales activity from being abused.

**FSA Response:** FSA concurs with this recommendation. Effective immediately, FSA will discontinue removing lots from the listing of available stocks when offers have been received, but neither accepted or rejected. Accordingly, the listings will show all available lots until they are sold. In addition, FSA will develop controls to ensure that a lot is not sold more than once.

**FINDING 3: Controls over offer limits need improvements.**

**Recommendation 4:** Strengthen existing sales procedures to include appropriate sanctions for violations of any future quantity and/or offer limits. Develop and implement procedures to ensure the sanctions are applied when such violations come to the attention of CCC. Also, periodically remind KCCO merchandisers to be alert for potential violations of such limits.

**FSA Response:** FSA concurs with this recommendation. Commodity markets are designed to allow commodities to be traded numerous times before they reach the end-user or exporter. Accordingly, it would be difficult to determine whether the sale of wheat from one entity to another was conducted in normal trade practices or was designed to circumvent CCC-established bid limits. For future sales of BEHT stocks, FSA will notify the trade that, if it is determined that attempts are being made to circumvent bid limits through prearranged third party sales, both parties

T. Mike McCann  
Director, Operations and Review Analysis Staff  
Page 3

involved in the suspected transaction will be referred to the Office of Inspector General for investigation. In addition, FSA will consult with the Office of General Counsel (OGC) in pursuing civil penalties in cases for which a fraudulent activity determination is made. Pending OGC advice, FSA may also revise sales contracts to incorporate a statement regarding fraudulent activity. As future sales of BEHT stocks take place, KCCO merchandisers will be reminded to be alert for potential violations of established limits.

**FINDING 4: Acceptable sales price determinations not adequately documented.**

**Recommendation 5:** Direct KCCO to retain all supporting documentation on acceptable price levels determined in conjunction with each future sale of CCC-owned commodities or develop a suitable alternative process whereby the accepted sales price negotiation process for each sale can be accurately reconstructed.

**FSA Response:** FSA concurs with this recommendation. KCCO will be directed to retain supporting documentation that was used to determine whether to accept bids, to the extent it is available. In instances where market data is not available or may not accurately reflect market conditions, KCCO will be permitted to determine that the bid received reflects the best market attainable for the commodity.

## ***Exhibit B – Entities Contacted in Conjunction With the Subject Audit***

Exhibit B – Page 1 of 1

| Entity                                   | Location(s)      |
|--|------------------|
| Agricultural Marketing Service           | Washington, D.C. |
| Economic Research Service                | Washington, D.C. |
| Farm Service Agency                      | Washington, D.C. |
| Foreign Agricultural Service             | Washington, D.C. |
| Kansas City Commodity Office             | Kansas City, MO  |
| National Agricultural Statistics Service | Washington, D.C. |
| Office of Budget and Program Analysis    | Washington, D.C. |
| Office of the Chief Economist 1/         | Washington, D.C. |
| Office of the General Counsel            | Washington, D.C. |

1/ Includes the World Agricultural Outlook Board located in Washington, D.C.

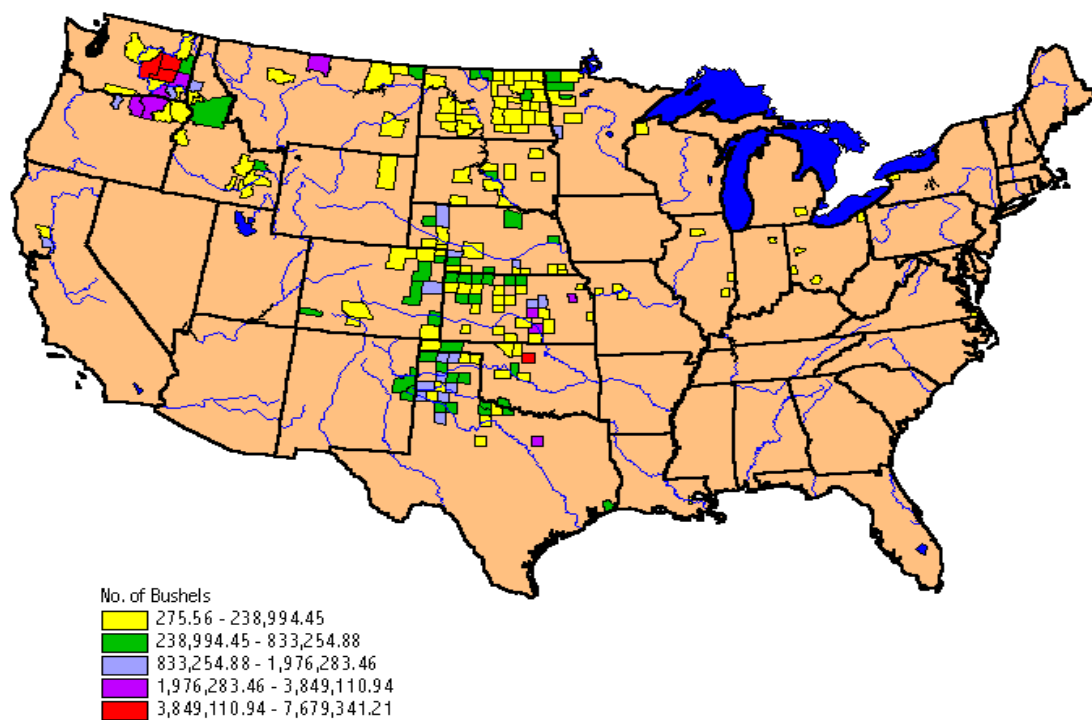
## ***Exhibit C – Wheat Industry/Trade Association Contacts***

Exhibit C – Page 1 of 1

| Entity                                       | Location         |
|--|------------------|
| National Grain and Feed Association          | Washington, D.C. |
| Pacific Northwest Grain and Feed Association | Portland, OR     |
| North American Export Grain Association      | Washington, D.C. |
| U.S. Wheat Associates                        | Washington, D.C. |
| Washington Wheat Commission                  | Spokane, WA      |
| Grain Elevator and Processing Society        | Minneapolis, MN  |

## ***Exhibit D – County Breakdown of CCC-Owned Wheat Inventories Prior to Initial Release in June 2002***

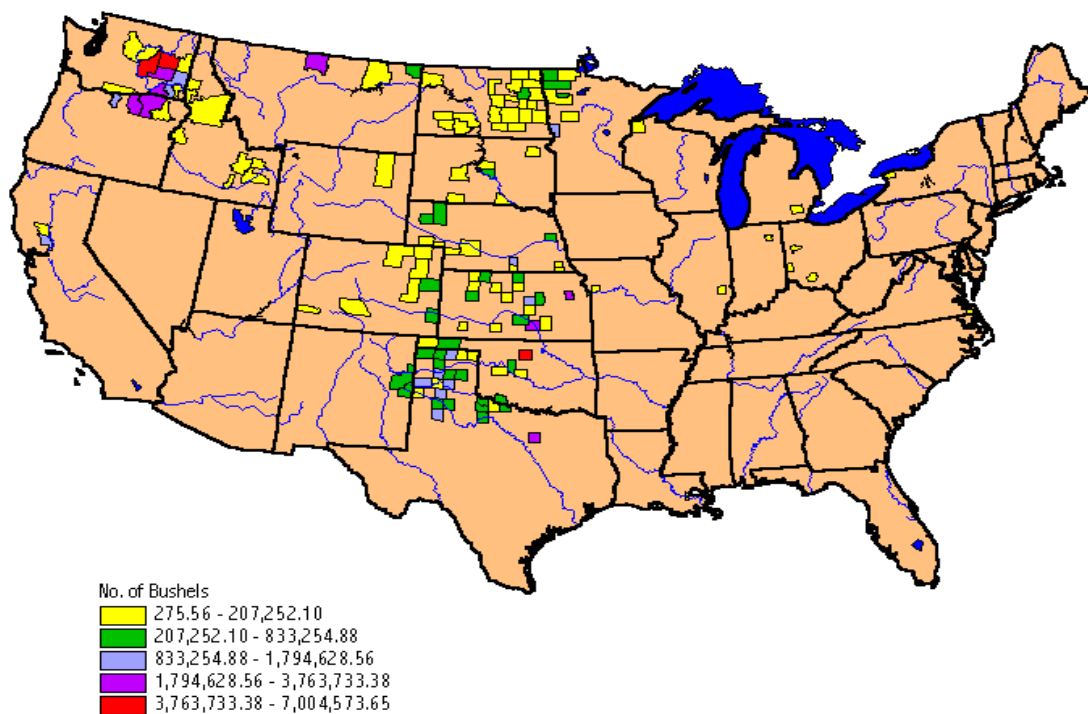
Exhibit D – Page 1 of 1





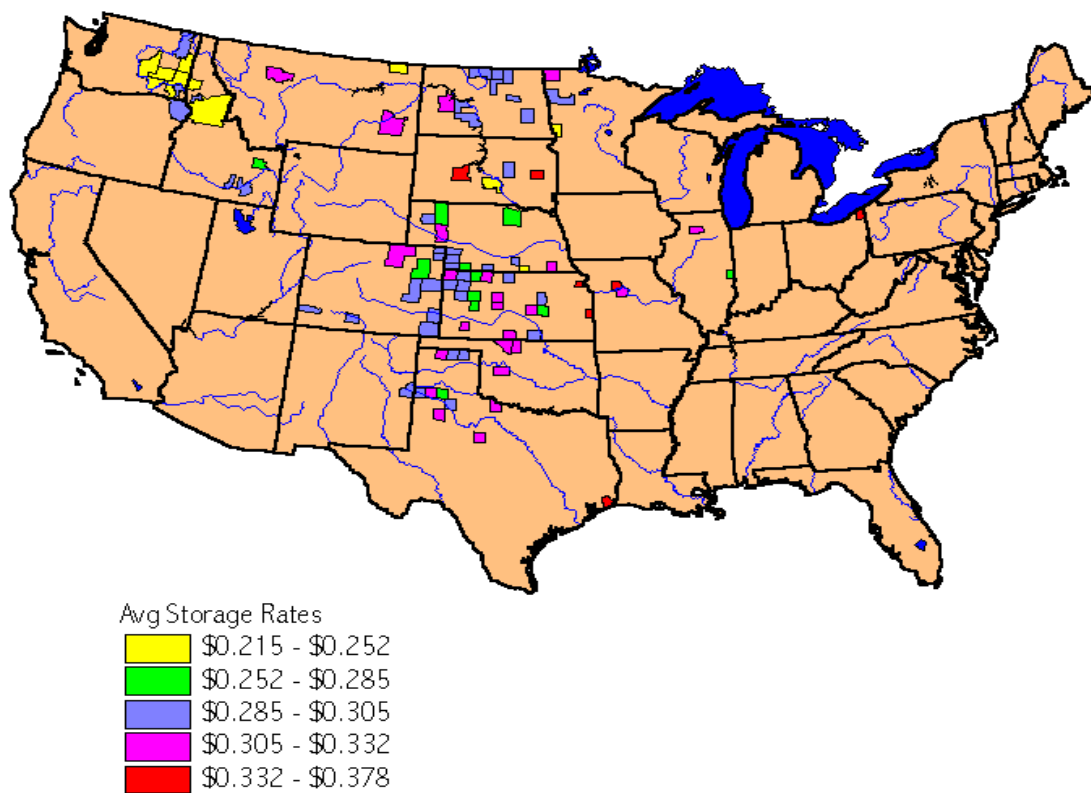
## ***Exhibit E – County Breakdown of CCC-Owned Wheat Inventories After November 2002 Release***

Exhibit E – Page 1 of 1



## ***Exhibit F – Average Storage Rates for Counties With Warehouses Where CCC-Owned Wheat Was Sold in Conjunction With the 2002 Releases***

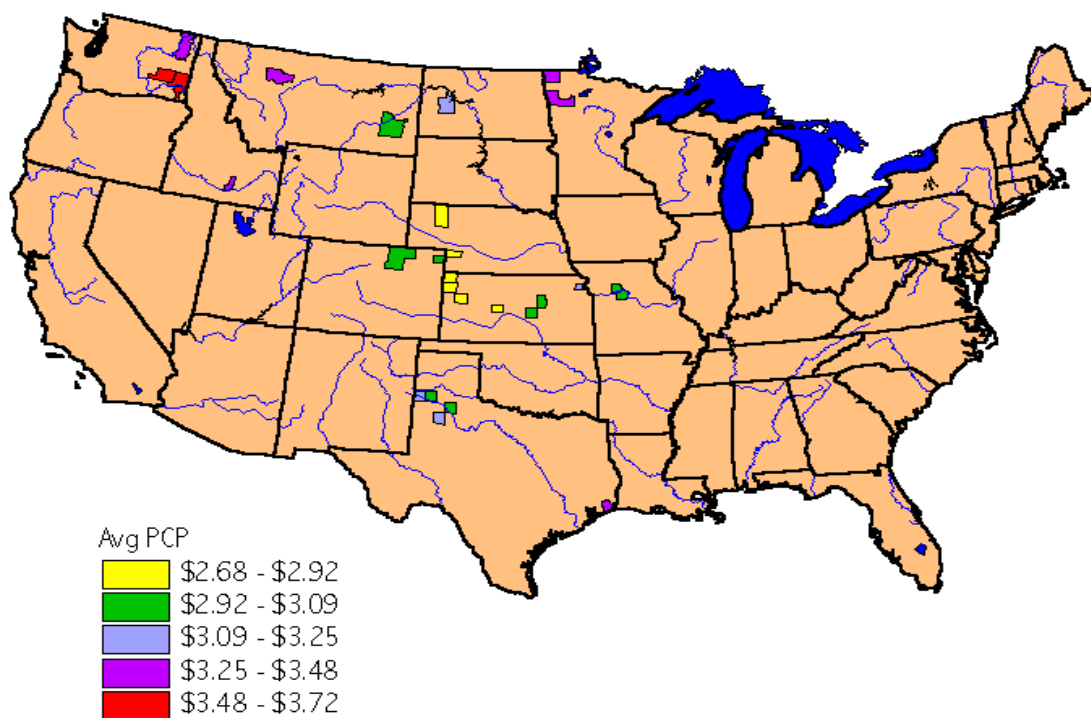
Exhibit F – Page 1 of 1



**Exhibit G** – Average Posted County Prices in Counties With Warehouses  
Where CCC-Owned Wheat Was Sold During the June 2002 Release  
(06/14/02 - 07/17/02)

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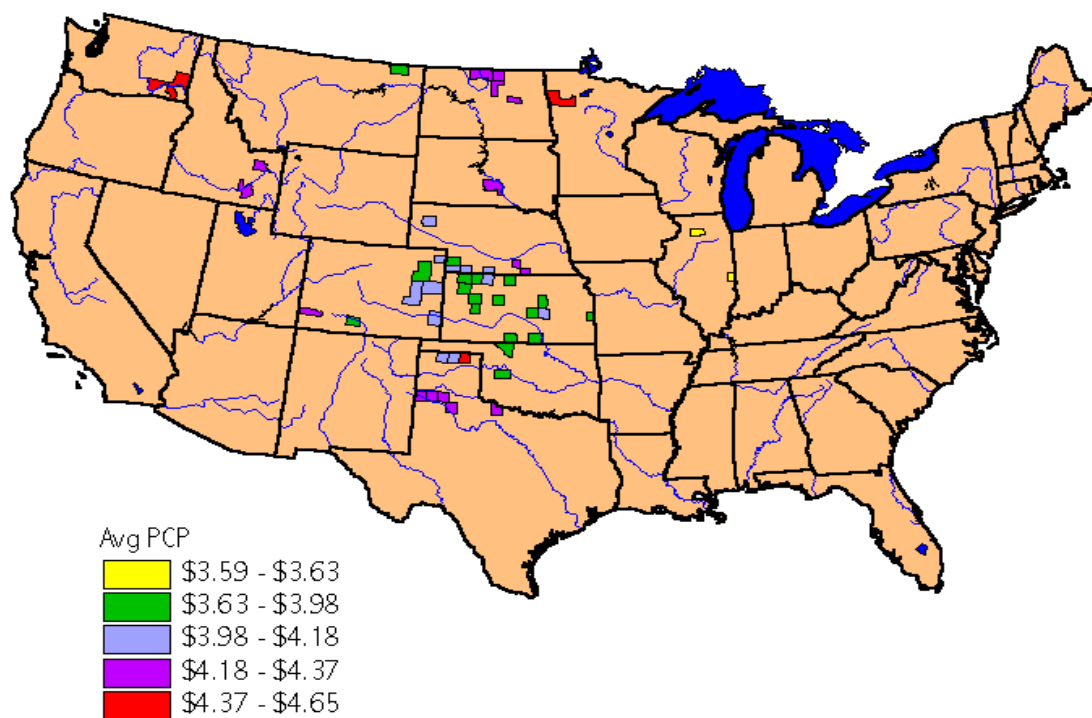
Exhibit G – Page 1 of 1



***Exhibit H – Average Posted County Prices in Counties With Warehouses  
Where CCC-Owned Wheat Was Sold During August 2002 Release  
(08/28/02 - 09/11/02)***

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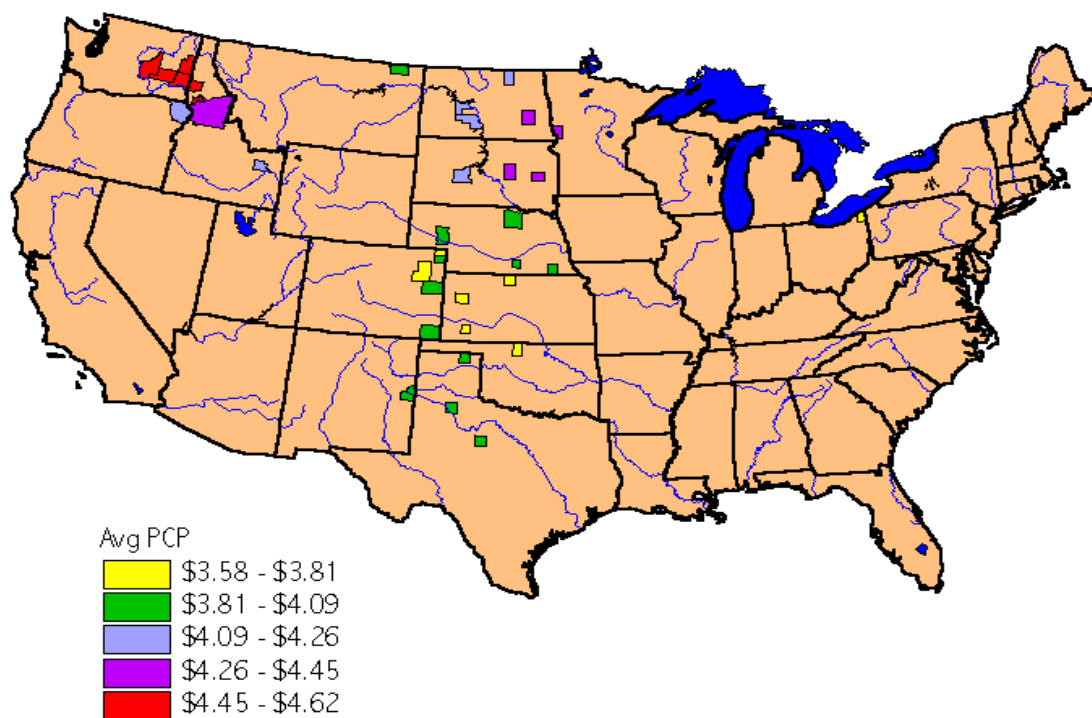
Exhibit H – Page 1 of 1



***Exhibit I – Average Posted County Prices in Counties With Warehouses  
Where CCC-Owned Wheat Was Sold During November 2002 Release  
(11/25/02 - 12/10/02)***

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Exhibit I – Page 1 of 1



# ***Exhibit J – Comparison of Contract Sale and Posted County Prices for 2002 Wheat Sales at the 16 Sample Warehouse Locations***

Exhibit J – Page 1 of 1

| Warehouse Name | Class of Wheat   | Contract Price | PCP    | Diff.      |
|----------------|------------------|----------------|--------|------------|
| A              | Soft White Wheat | \$3.2525       | \$3.23 | (\$0.0225) |
| A              | Soft White Wheat | \$3.83         | \$3.89 | \$0.06     |
| A              | Soft White Wheat | \$3.75         | \$3.83 | \$0.08     |
| B              | Soft White Wheat | \$3.20         | \$3.20 | \$0.00     |
| C              | Soft White Wheat | \$3.98         | \$3.97 | (\$0.01)   |
| D              | Hard Red Winter  | \$3.20         | \$3.12 | (\$0.08)   |
| E              | Hard Red Winter  | \$2.95         | \$2.98 | \$0.03     |
| E              | Hard Red Winter  | \$4.52         | \$4.70 | \$0.18     |
| F              | Hard Red Winter  | \$3.24         | \$3.14 | (\$0.10)   |
| G              | Hard Red Winter  | \$3.14         | \$3.05 | (\$0.09)   |
| H              | Hard Red Winter  | \$4.69         | \$4.81 | \$0.12     |
| H              | Hard Red Winter  | \$4.735        | \$4.81 | \$0.075    |
| H              | Hard Red Winter  | \$4.715        | \$4.81 | \$0.095    |
| H              | Hard Red Winter  | \$4.63         | \$4.70 | \$0.07     |
| I              | Hard Red Winter  | \$4.16         | \$4.13 | (\$0.03)   |
| J              | Hard Red Spring  | \$4.00         | \$4.24 | \$0.24     |
| K              | Hard Red Winter  | \$3.27         | \$3.03 | (\$0.24)   |
| L              | Hard Red Winter  | \$4.0475       | \$4.08 | \$0.0325   |
| M              | Soft White Wheat | \$3.7667       | \$3.89 | \$0.1233   |
| N              | Soft White Wheat | \$3.75         | \$3.74 | (\$0.01)   |
| N              | Soft White Wheat | \$3.95         | \$3.99 | \$0.04     |
| N              | Soft White Wheat | \$3.95         | \$3.99 | \$0.04     |
| N              | Soft White Wheat | \$3.99         | \$3.99 | \$0.00     |
| O              | Soft White Wheat | \$2.95         | \$3.13 | \$0.18     |
| P              | Soft White Wheat | \$3.31         | \$3.23 | (\$0.08)   |

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