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United States
Department of
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Office of
Inspector
General

Semiannual Report Office of Inspector General

April 1, 1980 - September 30, 1980

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MANAGEMENT OPERATIONS STAFF

PREFACE

This is the fourth semiannual report of the Office of Inspector General in the U.S. Department of Agriculture. The report covers the period from April 1, 1980 through September 30, 1980. We issued 238 audit reports and 949 investigative reports during the reporting period. These audits and investigations identified approximately \$250 million in recoveries, savings, erroneous payments, management improvements, incorrect loan amounts, penalties, claims, fines and judgments. The work also resulted in 345 indictments during the 6-month period. Our audit and investigative work in the Department's 300 programs continues to be focused on those which have the greatest vulnerability to fraud and abuse, those which have the potential for wasting the greatest amount of Government money, and those which pose the greatest risk to employee integrity. It is important to note that this report does not describe all of the problems and recommended corrective action brought out by our audits and investigations, but only those which are significant.

OIG RESOURCES

In terms of our internal operations, perhaps the most significant development during the reporting period has been the assumption of various additional responsibilities. Both Congress and the Office of Management and Budget have become more aware of the Inspectors General as the first line of defense in the efforts to prevent fraud, abuse, and waste in Government programs. We are increasingly being called upon to provide reports and testimony on the

effectiveness and deficiencies of the Department's programs and internal systems of administration. In addition, the deployment of our audit and investigative resources are, to a greater extent, being directed by legislation and regulations. For example, the Senate Committee on Appropriations, in its recent report on the Supplemental Appropriations and Recission Bill of 1980, included requests that the Office of Inspector General report on actions taken by the Department to improve debt collection and to include in our semiannual report a summary of the total amounts due the Department, as well as amounts overdue and amounts written off as uncollectible during the reporting period; determine compliance with Treasury Circular 1075 by auditing a sufficient number of recipient accounts to determine whether they are filing accurate reports of cash on hand; and submit to Congress an evaluation of the Department's progress in instituting effective management controls and improving accuracy and completeness of the data provided to the Federal Procurement Data System. In a report of the Senate Subcommittee on Oversight of Government Management of the Committee on Governmental Affairs, we were requested to make periodic reports on the efficacy of the Department's "procurement agenda" in improving competition for Government procurement dollars; and to conduct for the next two fiscal years thorough and vigorous audits of year-end contract obligations to determine not only technical compliance with law and regulations but whether such expenditures were made as a result of sufficient competition and for bona-fide needs of the Government. In addition to these responsibilities the Office of Management and Budget has also made various requests of the Offices of Inspector General. For example, it also requires the Inspector General to

review, evaluate, and report on the Department's plans for management control systems of procurement practices, their implementation, and their effectiveness in insuring ethical practices and integrity in the procurement process.

The recent regulation which has the most impact on the work of this Office is Attachment P to OMB Circular A-102. This regulation requires State and local governments that receive Federal grant assistance funds to arrange for a single organizationwide financial and compliance audit at least once every 2 years. Since we have direct oversight responsibility for a significant number of such audits and will be reviewing all other audits of entities which receive any funds from the Department, the potential effect on our operations of OMB Circular A-102 cannot be overestimated. We anticipate that the implementation of that circular will become one of our highest audit priorities in 1981 and 1982. All of these requirements address significant areas of fraud, abuse, and waste. They do, however, have a major effect on the use of OIG resources and the desired flexibility of our audit planning and priority setting.

ADEQUACY OF RESOURCES

Currently our office is 65 persons below authorized ceiling as a result of the employment freeze. While clearly the objective of the freeze, that of saving money, is one we also share, our ability to conduct audits and investigations designed to make the Department's programs more efficient and less susceptible to fraud and abuse is limited by the number of personnel we have. Our effectiveness has also been hampered by restrictions on travel.

We have been asked to cut significantly the total amount of money we spend on travel at a time when airline costs are going up, per diem rates are increasing, and the mileage allowance is increasing. Travel is essential to audit and investigative activity. The programs of the Department are widely dispersed geographically, and our auditors and investigators cannot audit and investigate effectively while sitting at their desks.

CHANGES IN AUDITS AND INVESTIGATIONS

During the reporting period we have continued an evolutionary change in the way our audits and investigations are undertaken. On the audit side we have deemphasized significantly the amount of "cycle audits" we conduct, that is, those audits where every 2 to 3 years on a given cycle we would audit an entity such as a Farmers Home Administration county office or an Agricultural Stabilization and Conservation Service county office. Instead, we have diverted more of our resources to special impact audits; that is, we will audit an entire program nationwide using statistical sampling techniques. We have recently conducted such audits of the Rural Rental Housing and Business and Industrial Loan Programs and the Supplemental Food Program for Women, Infants and Children. We are convinced that these kinds of audits are far more beneficial to the Congress, the Secretary, and the program managers in telling them how well the overall programs are operating and pinpointing specific problems. This has meant that our audit coverage at the small entity level for some agencies has decreased. We are working with those agencies to devise new methods to provide this type of coverage. For example, we have worked closely with the Farmers Home Administration during

this last reporting period in designing an internal control system for those reviews which we believe should be done but are more appropriate for the agency to do than the Office of Inspector General.

On the investigative side we have continued to devote our resources to major cases such as food stamp trafficking or fraud in the loan programs, and corruption, bribery, or serious misconduct involving employees of the Department. However, this too has left a void in some less major cases we had previously handled which now must be handled by the agencies. We are also working closely with the agencies to try to address this problem.

SINGLE AUDIT CONCEPT

We are continuing our implementation efforts for the single audit approach as promulgated by OMB Circular A-102, Attachment P. While we are committed to this new concept and have planned considerable resources for its implementation, we believe it will take several years to test the concept thoroughly and to operate it effectively. We recently conducted a study to collect data in eight States and to compile the data in order to find out the impediments to successful implementation of A-102. The report shows that in fiscal year 1979, the Food and Nutrition Service granted a total of over \$2.5 billion to 5,518 entities in the eight States. Under current program regulations, 5,359 of these entities were required to be audited on a biennial basis, but only 3,200 of the entities had actually been audited during the 1979 and 1980 period. The great preponderance of these audits,

moreover, covered only Department of Agriculture funds, not funds of other Federal agencies. The report identifies 26 non-Federal audit groups who performed the audits, and points out that only six met the GAO standards for auditor independence. In view of the complexities involved, this new single-audit approach must be carefully developed in order to assure its ultimate success. In this regard we have some concerns with pending "single audit" legislation. We believe, as a first step, it is important to test the single-audit concept under the current OMB regulations and to identify and carefully develop solutions to the many complexities that are involved as we move forward in the implementation of single audit coverage of Federal grant funds.

CORRECTIVE ACTION

One of our continuing concerns has been to get corrective action on our audit and investigative reports. If we are only able to detect the problems but have little success in correcting them, then we are not doing our full job. We, therefore, have continued to devote considerable resources during the period to getting corrective action by the agencies. Our audit review committees have been continued for the Food and Nutrition Service, the Farmers Home Administration, and the Agricultural Stabilization and Conservation Service. We have initiated a new audit review committee in the area of Departmental Administration. These committees, which include the Inspector General, the Assistant Secretary concerned, and program personnel, deal with those long-standing problems that have not received sufficient

attention by the agency. We are also concerned with holding program managers accountable for corrective action, and are working with the Office of Personnel in the Department to see that such requirements are made a part of employee performance standards.

This report addresses significant problems, abuses, and deficiencies in the Department's programs together with recommendations for corrective action. It is important to note that we have continued to receive excellent cooperation from Secretary Bergland and Deputy Secretary Williams in dealing with these problems and wish to thank the Under and Assistant Secretaries and program administrators and staff who have worked with us so effectively in implementing many of the corrective actions required.

THOMAS F. McBRIDE
Inspector General

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SECTION I

SIGNIFICANT PROBLEMS, ABUSES OR DEFICIENCIES AND RECOMMENDATIONS FOR CORRECTIVE ACTION

RURAL DEVELOPMENT PROGRAMS OF THE FARMERS HOME ADMINISTRATION

In past reports we have expressed our concerns regarding the rapid growth in the number of programs and the dollar volume of the programs administered by FmHA, and the stress this growth has placed on the agency's capacity to manage these programs.

Illustrative of this growth is the fact that since FmHA began as the Resettlement Administration in 1935 through the end of fiscal year 1979, the agency has advanced or obligated, through loans and grants, a total of \$73.2 billion. More than \$58 billion (80 percent) of the total has been obligated between 1969 and the end of fiscal year 1979. Thirty-eight billion dollars (45 percent) of the total has been obligated between fiscal year 1976 and the end of fiscal year 1979. FmHA services the accounts of approximately 1.25 million borrowers with a principal indebtedness of over \$40 billion. In fiscal year 1979 almost \$5 billion was collected by approximately 2,000 field offices.

This growth has occurred while employment has increased very little. Recent trends show the number of full-time FmHA employees has increased from 8,057 at the end of fiscal year 1972 to 8,456 in April 1980. Part-time employment during the same period has increased from 1,491 to 1,674.

The result is that the number of staff years available for loan-making and servicing functions per \$1 million in program money has decreased from 1.0 in fiscal year 1969 to 0.21 in fiscal year 1979. Conversely, the average value of the loan portfolio per employee has increased from \$960,000 in fiscal year 1969 to \$4.7 million in fiscal year 1979.

Effective management of the FmHA loan programs, however, does not depend totally on the adequacy of FmHA resources. An equally large part of the problem lies in FmHA management priorities, which emphasize getting the loan made, often at the expense of careful review of the loan application, financial statements, availability of commercial credit and loan servicing.

Our investigations and audits have shown long-standing and serious problems in these areas. We have investigated numerous instances involving alleged fraud or false statements by borrowers only to find that faulty FmHA procedures or practices were an obstacle to successful prosecution. While additional staff resources are necessary to help deal with these problems, a

fundamental reorientation of FmHA management attitudes is likewise essential. Recently there have been some indications that such a

reorientation is occurring. For example, the Administrator of FmHA has recently sent an administrative notice to the field offices emphasizing the need for improved loan servicing.

The rapid growth in programs, combined with the inability to hire additional personnel; the emphasis on loan-making at the expense of loan-servicing; the failure to develop the Unified Management Information System (UMIS); and new programs such as the Economic Emergency Loan program and the Synthetic Fuel program place new demands on employee skills and seriously strain FmHA management capacity.

Intradepartmental Review

In early 1979, we conducted a review of past audits of FmHA programs and found that many of them reported the same general problems--for example inadequate review of loan applications, inadequate servicing of loans and delinquent accounts, and inadequate review of borrowers to determine if they should be graduated to commercial sources of credit. Many of the problems were attributed to the imbalance between the size and complexity of FmHA programs and the size and skills of its staff.

This review led to the creation of an intradepartmental group (the Deputy Secretary, Assistant Secretary for Rural Development, Inspector General, and FmHA Administrator) which was charged by the Secretary with the responsibility of developing recommendations to improve FmHA's management controls and lessen the susceptibility of the Rural Rental Housing, Business and Industrial Development, and Emergency Loan programs to fraud, abuse, and waste. The group developed over 60 recommendations which FmHA has implemented or is in the process of implementing. In addition FmHA requested audit and investigative assistance in those program areas.

Internal Review Capacity

At the request of FmHA, the Office of Inspector General analyzed the need for FmHA to establish an internal review capacity. The analysis was predicated on the fact that FmHA has evolved from a small lender of last resort for family farmers to one of the largest financial institutions in the world. In the past decade FmHA's loan volume has increased from \$800 million to over

\$14 billion annually. The typical county office (there are over 1,800) is often the largest lending institution in the county, having the responsibility for servicing a case load of 591 loans with an outstanding balance of \$19.6 million, making loans and grants of \$7.5 million per year; and making cash collections of \$2 million per year. This workload is usually handled by a staff of three: county supervisor, assistant county supervisor, and county office assistant.

FmHA has traditionally relied upon OIG to provide the resources necessary to test and monitor the internal controls in their programs and financial operations, and, to a lesser extent, has itself performed internal reviews on an ad hoc basis. However, the tremendous growth in FmHA programs and the amount of dollars loaned, plus the fact that the loan programs are becoming increasingly complex, require the Office of Inspector General to focus its resources on those program areas most susceptible to fraud, abuse and waste. Therefore, the checking of internal controls at the State or county offices on a standardized cycle cannot be accomplished within available OIG resources. While we believe that our new audit approaches have substantially reduced the need for cycle audits of State and county offices, we recognize the need to perform control checks at those levels, and we have therefore recommended that a permanent internal review staff be established within FmHA. This staff would not assume any OIG functions. Rather it would augment the FmHA Administrator's ability to detect and respond immediately to problem areas. The internal review staff would also enable the Administrator

to ensure that corrective actions for problems identified in audits, investigations, and reviews are, in fact, implemented. This latter function should help resolve the primary concern of OIG that effective corrective action is taken.

Specifically, we have recommended the establishment of an internal review staff of between 50 and 75 persons within FmHA which would be responsible for the following functions:

- o perform post-closing credit analysis of large dollar loans and review the independent public accountant reports required by various FmHA programs;
- o perform trend analysis on FmHA programs and operations and monitor the activities of the Finance Office--that is, make confirmations of borrower accounts; and
- o perform additional internal reviews of areas most susceptible to problems, and follow up on actions taken to correct deficiencies disclosed in prior OIG audits and internal reviews.

FmHA has recently developed a plan for creating an internal review staff, but has not yet assigned personnel to this function.

Special Impact Audits

Although we continue to devote a significant portion of our resources to programs administered by FmHA, we have also concentrated on improving the effectiveness of our audit effort by placing greater emphasis on special

impact audits designed to focus on problems in an entire program, as opposed to problems in the particular office administering the program as was done under the cycle audit concept. We have found that the special impact audit results in more comprehensive correction of endemic problems.

The following audits, conducted during this reporting period are examples of our special impact audits.

BUSINESS AND INDUSTRIAL LOAN PROGRAM

The Business and Industrial Loan Program was authorized by the Rural Development Act of 1972. The purpose of the program is to stimulate the rural industrial economy by providing loan funds to acquire, construct, reorganize, or expand rural businesses providing new employment opportunities. It is primarily a guaranteed loan program. That is, FmHA can guarantee up to 90 percent of a loan which is usually made by a commercial bank. Business and industrial loans made through the program through fiscal year 1980 totaled approximately \$4.4 billion.

During this reporting period we completed a review of 40 business and industrial loans. This review resulted from concerns voiced about the business and industrial loan guarantee decisionmaking process by persons within FmHA, the Office of Inspector General, and the Secretariat, and from outside the Department. We were concerned not only with the issue of whether or not external pressures were leading to the approval of business and industrial loan guarantees for reasons unrelated to the financial and economic feasibility and impact, but also with the appearance that external

loan guarantees were present and/or there was evidence of meetings or consideration only those instances where strong letters of support for the staff, White House staff, or State and local elected officials. We took into for example, Office of the Secretary, members of Congress, congressional loans reviewed there was evidence of support for the loan by outside parties; We determined through interviews and record examinations that in 21 of the 40 Committee).

also rejected at least once by the State Office or National Loan Review primarily because of the large dollar amount of the loans (4 of the 18 were (totaling almost \$223 million) were selected from fiscal year 1979 operations the National Loan Review Committee, or loan review officers. Fifteen loans "discouraged;" that is, not recommended for approval by the State office or \$88 million) were selected primarily because loan approvals initially were Of 40 loans in excess of \$1 million selected for review, 22 loans (totaling to all business and industrial loan guarantee decisionmaking.

loans were not randomly selected, we cannot project the results of the survey for reasons other than financial and economic considerations. Since these the fact that there is an appearance that these loans could have been made mean all loans reviewed were not worthy of being approved, it does highlight in the loan-making process. While it is important to note that this does not the loans reviewed, there was a considerable amount of external involvement political or other pressures were factors in the approval of such loans. For

personal contacts between FmHA officials and outside interested parties concerning the loan applications. Routine congressional or other inquiries on the status of loan applications were disregarded.

Six of the 40 loans in our sample were approved outside the normal application review and evaluation process at both the State and national office levels. While the regulations provide that the State director has ultimate responsibility for final loan approval, in practice that system is not always followed. In three cases, State officials either did not recommend approval of the loan or were not given an opportunity to review and evaluate fully the application before the loan application was reviewed by the National Office. A national office loan review officer was assigned to evaluate the six applications, but the applications were either not fully evaluated by the officer or were not subsequently recommended for approval by the national office loan review committee. Two of the loan applications were approved but never reviewed by the loan committee as required by FmHA procedures. The remaining four applications were discouraged by the committee but were subsequently approved. According to interviews and record examinations, the assigned loan review officers had recommended or were going to recommend against guaranteeing loans to these applicants because of their poor financial condition, the high risk involved, or the lack of credit worthiness.

Of the 40 loans reviewed, 26 were discouraged at least once by the national office prior to being approved. There were nine cases where the loan guarantee applications were discouraged two to four times preceding final

approval. From our reviews of the loan docket and our interviews, it appeared that considerable support from members of Congress or the Secretariat was given for final approval of 14 of the 26 loan applications previously discouraged.

In many of the cases where there was outside support for loan approval, the documentation of the processing and the factors on which approval of the applications was based were inadequate.

In addition, the loan review summaries prepared by the assigned loan review officers for presentation to the loan review committee were not retained when applications were discouraged or rejected. Only the letters to the State offices discouraging the projects were in the loan files. However, when the applications were resubmitted and ultimately approved, the loan review summaries prepared at that time were retained. Therefore, the loan review committee in its deliberations did not have the benefit of the prior review and reasoning for discouraging the loan guarantee application.

Recommendations

We made the following recommendations to the Secretary to improve business and industrial loan decisionmaking. These recommendations were based on our belief that we must insure the integrity of the Business and Industrial Loan Program and that we should take steps necessary to assure that all loans are made on their merit and in accordance with statutory requirements.

1. All "outside" contacts, that is, from other than FmHA employees or the applicant and his/her representative, should be documented. A

written record of such communications, calls or inquiries setting forth the nature of the inquiry and the response should be transmitted to a designated official of FmHA who will make sure such records of contacts are placed in the loan docket.

2. The Administrator of FmHA should have full delegation of responsibility for business and industrial loan approvals and disapprovals. While such a delegation presently exists, our review showed noncompliance with this regulation in a number of instances.
3. The Administrator of FmHA may delegate approval authority to subordinate levels within FmHA with clear guidelines specifying the dollar size or specific nature of the business and industrial loans subject to such delegation.
4. Each business and industrial reviewing level within FmHA (State or national office) should fully document their recommendations for approval or disapproval and the specific factors on which such recommendations are based.
5. All loans of \$1 million and over should be reviewed by a national loan review committee.
6. The loan committee should make a documented committee recommendation of approval or disapproval setting forth the specific reasons and analyses in support of that recommendation.

7. There should be an appeal process to the FmHA administrator for those loans finally disapproved at the State level. For those for which the national office has approval/denial authority, there should be no appeal.

8. The Administrator of FmHA should immediately implement internal review systems to deal with the following aspects to assure that the business and industrial loan applications are thoroughly reviewed in depth and in detail:
 - a. Economic feasibility of the venture, including review and verification of current financial data, sales and profit projections, employment projections, adequacy of borrower equity, management capability, and any specific feasibility studies submitted in connection with the applications.
 - b. Negotiation of an appropriate level of guarantee commensurate with the degree of risk and FmHA financial exposure.
 - c. Adequacy of loan security, particularly personal guarantees.

The agency is implementing those recommendations, with one modification. The Under Secretary for Rural Development will retain final review authority for loans over \$2.5 million which have been approved by the FmHA administrator.

We are continuing our audits of the overall administration of the Business and Industrial Loan Program and are currently performing a review of a statistically selected sample of 30 business and industrial loan guarantees in 20 States.

RURAL HOUSING CONSTRUCTION AND REPAIR LOANS: INTEREST CREDIT AGREEMENTS

The Housing Act of 1968 gave FmHA authority to subsidize interest on loans approved for low-income borrowers. Under this authority FmHA can charge a low-income borrower as little as 1 percent interest on the loan, with FmHA paying the difference between the subsidized interest rate and the true interest cost to FmHA, currently 11 percent.

Since 1968, FmHA has granted approximately \$1.7 billion in interest credit assistance. The interest credit program has grown from \$1 million in 1969 to \$442 million in 1979. The average effective interest rate paid on loans by borrowers who receive interest credit is approximately 2.8 percent.

The interest credit agreements are for a 2-year period and are reviewed biennially to determine the need for continued interest credit assistance. The FmHA county supervisor has the authority to increase the benefits if there is a reduction in income prior to the normal review date. However, there is no requirement to reduce benefits unless the borrower is found ineligible for the program; nor are there requirements for the borrower to report changes in income nor for the county supervisor to monitor changes in income.

We conducted an audit of the interest credit program in 1976 and found that 34 percent of the 150 interest credit agreements sampled were incorrect at the time they were approved by the county supervisor.

The amount of interest credit was incorrect in an additional 39 percent of the sample agreements because of changes in borrower income or other

circumstances occurring after the loan was made. The prior audit projected \$50.3 million in excessive interest credits being granted to borrowers during the term of the 181,262 agreements that were in effect at the time of the audit.

Our current audit, based on a statistical sample of 200 loans selected from 310,778 loans in effect as of October 1, 1979, was to determine what changes had occurred in the program since our previous audit and to determine the effect of such changes. We found that: (1) FmHA had not adopted many of our recommendations, and (2) the magnitude of the problems had increased significantly. We found there had been a 72-percent increase in the number of interest credit agreements and a 157-percent increase in the value of these agreements since 1976. The error rate in interest credit computations resulting in overissuance of benefits increased from 64.7 percent of the agreements sampled in the prior audit to 76.5 percent in the current audit; while the error rate resulting in an underissuance of benefits increased from 8.6 percent to 10.5 percent.

The dollar impact of these errors increased from \$50.3 million in 1976 to about \$190.7 million in 1979. Generally, the same types of problems disclosed in our previous audit were found in the current audit. For example:

- o Because FmHA procedures do not require borrowers to report changes in their income or other circumstances to the county office, we found 19 percent of the 200 borrowers sampled would have been ineligible for interest credit because of increases in income. An additional 48

percent, while still eligible for interest credit, had income increases which would have resulted in an increase in the interest charged them on the loan.

The audit also identified certain inequities in the granting of interest credit to rural housing borrowers. An analysis of the loan data for the period October 1, 1978, to December 31, 1979, showed that lower income interest credit borrowers on a nationwide average were purchasing higher priced homes than are higher income borrowers who were not eligible for interest credit. The analysis also showed that some rural housing applicants not eligible for interest credit probably could not afford to purchase a home because they would pay a higher percentage of their income for housing than do the interest credit borrowers.

Recommendations

- (1) Interest credit agreements should be reviewed on an annual basis and upon termination or renewal and, if appropriate, retroactive adjustments made for improper interest credit benefits. Appropriate changes should be made when a change in borrower circumstances offsets the interest credit by more than \$15.00 per month. In addition FmHA should provide for penalties to borrowers' accounts to cover the expense of performing retroactive adjustments if the borrowers do not report changes.

- (2) The forms used to obtain and verify an applicant's family income should be revised to include scheduled increases in salary, expected overtime, and any other data necessary to evaluate and compute adjusted family income. County office personnel should be required to document adequately their computations of adjusted family income and interest credit.
- (3) The period for reverifying income if the verification of employment is more than 90 days prior to the date of loan approval, the date of loan closing, or the date the interest credit agreement is approved should be maintained. FmHA is proposing to extend that period to 120 days. We believe that FmHA will have greater assurance that borrower income data is correct if the 90-day period is maintained.
- (4) The interest credit agreement should be revised to alert borrowers to the fact that when they sign the agreement, they are certifying to the accuracy and completeness of the financial and household data.
- (5) The national office should emphasize to county office personnel the need for accurately identifying and verifying all household income for persons applying for interest credit. They should be instructed to include income from temporary employment and overtime. In addition, county office personnel should be requested to interview borrowers applying for renewal of interest credit agreements to

determine if income or family status has changed since execution of the interest credit agreement.

FmHA officials were in agreement with some of the audit findings; however, they stated they did not have the staff to review interest credit agreements upon termination or renewal nor to make retroactive adjustments for excessive interest credit. While we agree the recommended reviews would be an administrative burden, such corrective action is both desirable and cost beneficial when more than \$190 million in ineligible subsidy payments is involved. The agency is establishing a task force to review the program to determine the cost effectiveness of implementing the recommendations.

If the recommendations contained in the prior audit had been acted upon by FmHA, a substantial portion of the projected \$190.7 million in excess interest credit would have been saved.

ECONOMIC EMERGENCY LOAN PROGRAM

The purpose of the Economic Emergency Loan Program, enacted in 1978, is to make financial assistance available to eligible farmers and ranchers to enable them to maintain a viable agricultural operation during times of economic stress. Loans can be made only to applicants who receive 50 percent or more of their gross income from agricultural production or expend more than 50 percent of their time operating the farm or ranch. Originally the loans could be used for (1) refinancing outstanding indebtedness on farm or

home real estate and for other essential farm and home debts; (2) reorganization of the agricultural operation; (3) purchase of water rights, supplies and irrigation facilities; (4) purchase of livestock and farm equipment; (5) purchase of feed, seed, fertilizer, insecticides and other farm supplies; (6) financing land and water development; (7) family subsistence; and (8) loan closing costs.

Legislation enacted in 1980 prohibits the refinancing of outstanding indebtedness on farm or home real estate unless such real estate was purchased by the applicant at least one year prior to the date of the loan application.

The interest rate charged for these loans is "the cost of money to the Government," currently 11 percent for real estate loans and 11.5 percent for operating loans. For insured loans and guaranteed loans the interest rate is negotiated between the borrower and the lender. Insured loans are those loans made by FmHA directly to the borrower. Guaranteed loans are made to the borrower by commercial lenders and FmHA guarantees repayment of a portion, usually 90 percent, of the loan.

The purpose of the loan reviews conducted by this office was to determine whether the economic emergency loans were made to eligible applicants for authorized purposes, and whether there were reasonable efforts to consider making guaranteed loans before consideration was given to making insured loans.

Our review of 276 loans disclosed the following problems:

Extended Loan Amortization Periods

Economic emergency loans were made to refinance borrowers' operating debts over periods as long as 40 years without determining the borrowers' ability to repay the loans over shorter periods of time. FmHA procedures provide that loans for operating debts shall be repaid in 7 years. A 20-year repayment period can be approved, however, if certain provisions are met. Some FmHA county office personnel were of the opinion that if real estate was used as loan security, the repayment period could be scheduled for periods up to 40 years. As a result, 42 of the 276 loans reviewed were made to finance operating debts (totaling \$3.9 million) for periods of up to 40 years.

The effect of this practice is to increase substantially the interest cost to the borrower and to hinder the graduation of these loans to private sources of credit, because commercial lenders usually limit the repayment schedule for operating debts to much shorter periods even when the debt is secured by real estate.

Insured Loans Versus Other Sources of Credit

Although FmHA established a policy of making insured loans only when loan guarantees were not available through local agricultural lenders, as of December 1979 only 4 percent of the \$3 billion in outstanding economic emergency loans represented guaranteed loans. While FmHA personnel attributed this to the higher interest rates charged by commercial lenders, a projection based on a statistically selected sample of 30 of 377 economic emergency loans in 11 county offices in Indiana showed

that as many as 146 of the 377 loans were probably made without adequate FmHA determination of whether borrowers could obtain credit from commercial lenders either through commercial loans or FmHA loan guarantees.

Ineligible Borrowers and Unauthorized Loan Purposes

Of the 276 loans included in the review, 31 loans totaling \$3 million were made to borrowers who were ineligible, or the loans were made for purposes not authorized by the program. Many of the improper loans occurred because FmHA personnel approved substitution of economic emergency loans for farm ownership and operating loans when applicants did not meet the economic emergency loan eligibility requirements, or the loans were for purposes not authorized by the program.

Our survey disclosed that 12 loans totaling \$1.9 million were made to borrowers who were ineligible because they did not meet the FmHA criteria of deriving more than 50 percent of gross income from agricultural production or contributing over 50 percent of their time to operate the farm. Nineteen of the loans reviewed were made for unauthorized purpose, such as the expansion of farming operations; purchasing, repairing or constructing personal dwellings; and financing real estate debt.

In addition to conducting the audit, we reviewed the data base of the St. Louis Finance Office and determined that over 4,000 borrowers with loans totaling \$199 million reported receiving less than 50 percent of their

income from agricultural production. Field verification of this information revealed that 7 of 27 borrowers in two counties were not primarily and directly engaged in agricultural production as is required by the statute.

Recommendations

1. The procedures for approval of loans for refinancing operating indebtedness should be revised to place more emphasis on the applicant's repayment ability, as a condition for loan approval, rather than relying solely on the assets used as security for the loan; and to further define what other debts can be included in real estate loans.
2. In order to carry out the stated policy of making guaranteed loans in preference to insured loans, the FmHA or Congress should consider establishing interest rates keyed to the mortgage market and establishing separate fund limitations for insured and guaranteed loans. Subsequent to the audit, the Economic Emergency Loan Program was extended by Congress. In extending the program, several amendments were made, one of which requires that before approving an insured loan of more than \$300,000, FmHA determine that the applicant is unable to secure a loan commitment from a commercial lender that could be guaranteed by FmHA. This requirement should improve the balance between insured and guaranteed loans.

3. The FmHA national office should rewrite and clarify the intent of operating instructions pertaining to the applicant's eligibility, authorized loan purposes, and repayment terms. In addition, the national office should monitor more closely critical problem areas.

The 1980 amendments also included a requirement that the FmHA conduct a comprehensive study of the operation and effectiveness of the Economic Emergency Loan Program and the need for extension of the program beyond September 30, 1981. Other provisions of the study include: (1) the effect of the loans on the overall financial condition of the borrowers and their ability to maintain viable agricultural operations, (2) the effect of the credit elsewhere test, (3) the loan delinquency rate and the percentage of borrowers subsequently graduated, (4) the use of loan guarantees compared with insured loans, (5) the purposes for which the loans are obtained compared to the purposes specified in the act, (6) the methods of servicing loans and encouraging repayment, and (7) program alternatives, including merging the program with the farm ownership and operating loan programs or the combination of all programs into a single program.

The agency is revising the Economic Emergency Loan Program instructions to incorporate the provisions of the amendments and to provide the clarification necessary to assure loans are made only to eligible applicants and that such loans are used for authorized purposes.

UNIFIED MANAGEMENT INFORMATION SYSTEM

In November 1979, we pointed out that FmHA had experienced serious problems and cost escalation in its efforts to develop the Unified Management Information System. Since that time the following events have occurred.

- o In January 1980, a departmental task force was formed, under the direction of the Assistant Secretary for Administration, to evaluate the status of the Unified Management Information System, to determine what portions of the project could be salvaged.
- o In July 1980, the House Subcommittee on Legislation and National Security of the Committee on Government Operations held hearings to examine the cause of the failure of the project and to determine what corrective actions are needed to ensure that FmHA will develop a modern and efficient management information system.
- o In September 1980, the subcommittee issued a report entitled Management Failures in Developing the Farmers Home Administration's Unified Management Information System. The report contains several recommendations, including: (1) the Secretary should direct that all UMIS development efforts be halted; (2) the Assistant Secretary of Administration should develop a project plan to design and develop a new Management Information System; and (3) the Assistant Secretary for Administration should assume overall management control for the development of FmHA's management information system.

It is essential that FmHA have a viable management information system and we will continue to monitor its development.

DOMESTIC FOOD ASSISTANCE PROGRAMS

The domestic food assistance programs of this Department such as the Food Stamp Program; National School Lunch Program; and the Supplemental Food Program for Women, Infants, and Children receive more OIG resources than any other program area. They involve large amounts of Federal expenditures, complex delivery systems and are vulnerable to fraud, waste and abuse. Before discussing our most recent work in this area, it is appropriate to note the major efforts of the Department program officials and of the Congress during the last 2 years to develop a more effective strategy for dealing with chronic deficiencies. The first step is the establishment of enforceable performance standards for the States and local entities that administer the program. Next, adequate compliance monitoring systems must be developed. Finally, incentives and sanctions must be applied as appropriate. Considerable strides have been made to accomplish these objectives in the Food Stamp Program and current legislative and administrative initiatives in the Child Nutrition Programs show great promise. As a result, there is an opportunity to make significant improvements in program management during the next few years.

The most recent of these efforts the Assessment, Improvement, and Monitoring System, which covers the school feeding programs, becomes effective January 1, 1981. It establishes five performance standards which are related to the determination of Federal payments. We think this is a positive step toward requiring States to deal with a number of chronic problems. We plan to review the system after it is implemented to evaluate its effectiveness.

While we believe there is an opportunity to make significant improvements in program management during the next few years we should also note that in our review of the Food Stamp, Child Nutrition and WIC Programs we have consistently found that there is insufficient technical assistance provided to State and local administering agencies, inadequate monitoring of program operations, and ineffective correction of the deficiencies that are uncovered. As a consequence, our recommendations are usually that the program agency either initiate some practice or increase its activities in an area found wanting. Effective program administration requires adequate staff resources. The present personnel hiring limitations faced by the Food and Nutrition Service may well preclude building up the agency's capacity to provide technical assistance and conduct monitoring in the areas of financial management and computer systems. We have consistently noted State and local agency weaknesses in these two functions, most recently in the WIC Program. As we have stated in all our previous reports, we are also concerned that the agency's staff capability continues to be diluted by States abandoning the Summer Feeding and Child Care Food Programs forcing direct Federal administration.

FOOD STAMP PROGRAM

There have been a number of recent legislative and administrative initiatives aimed at deterring error and punishing fraud and abuse in the Food Stamp Program. As noted in the House Agriculture Committee report on the Food

Stamp Act Amendments of 1980, " * * * the most significant portions of the bill, not merely from the point of view of bulk (22 separate amendments covering nearly three-fourths of the lines) but primarily from the perspective of long-term impact upon the shape of the Food Stamp Program, are the 15 basically bipartisan measures that deal with reducing error, fraud, and abuse. * * * Taken as a whole, they clearly constitute part of a continuing massive effort to save program money for the use of those who need it most by denying it to the unentitled." The Food Stamp Act of 1977 and the Food Stamp Act Amendments of 1979, also show a clear congressional concern with providing the necessary authorities to improve the program. We would like to comment on some of these provisions.

Federal Funding of Investigative and Prosecutive Activities

The Food Stamp Act of 1977 provides for 75 percent Federal funding of investigative and prosecutive activities. The basic rate of Federal matching for most other State administrative costs is 50 percent. The Food and Nutrition Service issued an interim rule to implement this provision on August 10, 1979, with funding retroactive to October 1, 1978. To be eligible for the increased funding, the State welfare agency must include a description of the investigative unit and its relationship with prosecutors in its budget submission. If an agency outside the State welfare agency, such as a prosecutor's office, is to be funded, it must have an agreement with the State welfare agency and be added to the agency's budget.

To date only 15 States are receiving enhanced funding. In these States it is not yet possible to tell if the funding is making a substantial difference in the level of investigative and prosecutive activities. In the other States the reasons most often given for not making use of the opportunity are the lack of a working relationship between the State welfare agencies, through which funding is channeled, and the prosecution authorities; the paperwork and guidelines attendant to the use of Federal funds; a lack of knowledge on the part of investigators and prosecutors that the funding is available; and the low priority some States place on food stamp fraud given the other demands on their resources. FNS in cooperation with OIG is sponsoring a review of investigations and prosecutions of food stamp fraud. It will evaluate the activities of six States that have been active in this area and survey the work done by the other States. This should provide information on methods States and localities can use to detect and prosecute food stamp fraud and how they can effectively utilize 75 percent Federal funding for such efforts.

FNS and OIG have been contacting State and local investigators and prosecutors to interest them in food stamp investigations. OIG agents met with investigators and prosecutors in 32 States, the District of Columbia, and Puerto Rico during the course of a combined audit/investigation survey on the implementation of the 1977 Food Stamp Act. Copies of the 75-percent funding regulations were sent to all persons contacted. FNS has designated one person in its national office and in each regional office to promote

State utilization of this funding. OIG has conducted training sessions for investigators and prosecutors in many States. OIG and FNS have made presentations on the Food Stamp Program at training conferences of organizations involved in combatting fraud such as the National Welfare Fraud Association.

Administrative Fraud Hearings

The Food Stamp Act of 1977 provided for State administrative fraud hearings as an alternative to criminal prosecutions. Initially, the only penalty that could be imposed as a result of such hearings was suspension from the program for three months for the individual who had committed fraud but not for the entire household. Subsequent legislation has made restitution of the Government's losses resulting from such fraud a condition for reentry to the program. The restitution can be made as a lump sum payment or a monthly offset against benefits. States are also permitted to retain half of any recoveries. These last two provisions also apply to State criminal prosecutions.

In our review of the Food Stamp Program in individual States we found minimal use of administrative fraud hearings. The reasons given for the failure to use this tool more effectively are the same as the reasons given in many States for not undertaking criminal prosecution of food stamp fraud. While fraud is undeniably a major problem in some geographical areas when considered in the aggregate, most States feel that the effort and cost that must go into pursuing an administrative fraud hearing for any individual is

excessive given the penalty that can be imposed in relation to the amount of the fraudulent overissuance, and the fact that fraudulently obtained food stamp benefits are a loss to the Federal rather than the State treasury.

Until more States have actually conducted administrative fraud hearings it will not be possible to determine the cost in personnel and funds necessary to operate them. Since an important goal of these hearings is to deter others from committing fraud, not just the imposition of punishment in a specific case, OIG and FNS are pressing several States to take action on at least some cases. In recent legislation which clarified the States' option of attacking fraud through criminal prosecution or administrative fraud hearings, the Congress made it clear that it expects the States to make a good faith effort to pursue recipient fraud through one means or another. In our reviews of individual State Food Stamp Programs we will continue to monitor what the States are doing to punish recipient fraud.

Wholesalers

The original reason for wholesaler participation in the Food Stamp Program was to make it easier for retailers in isolated or rural areas to redeem their food stamps. This was during a period when increased retailer participation was critical for program expansion. In our last report we noted that the participation of wholesalers in the Food Stamp Program is now an area of particular concern. Wholesalers can easily enter large quantities of illegally obtained food stamps into redemption channels by altering the redemption certificates of their legitimate retailer customers. For example:

- o Sixteen individuals and one corporation in New York City participated in a scheme to traffic food stamps which involved wholesalers, retailers, bank tellers, and check cashers. The corporation, an authorized retailer/wholesaler, purchased food stamps at a discount from retailers who purchased stolen authorization cards and exchanged them for food stamps with the help of a bank teller and check cashers. The manager of a branch bank was paid by the corporation's owners to approve phony checks used to cover their massive food stamp trafficking and excessive redemptions. Over a period of 2 years at least \$2.5 million in illegally obtained food stamps were redeemed as part of the overall scheme.

- o An authorized wholesaler sold bakery products to retail stores using route deliverymen, and received food stamps and redemption certificates in payment. During a 2-month period in 1977 approximately \$23,259 in illegally obtained food stamps were redeemed through the wholesaler's account. These illegally obtained food stamps were covered by altering the numbers on the redemption certificates received from retail stores.

We believe that continued participation by most wholesalers is unnecessary at the present time. Some States with isolated locations such as Montana have no authorized wholesalers at all. In the past two years, FNS has withdrawn authorizations for nearly half the wholesalers that have been participating in the program. However, a substantial number of the remaining wholesalers

are located in the Northeastern States--an area where many of the kinds of illegal activities cited above have been uncovered. At the time of our last semiannual report, we noted that the agency had drafted a regulation which would eliminate most remaining wholesalers. That regulation is scheduled for issuance early in November.

Food Stamp Issuance System

In our last report we expressed concern about the problem of lost or stolen food stamp authorization cards in certain parts of the country. In the Authorization to Participate (ATP) card issuance system, a State or local food stamp office mails an authorization card to a recipient who then takes it to an issuance agent, usually a bank, post office or check casher, and exchanges it for food stamps. This system is vulnerable to mail theft and to recipients falsely claiming that their card was stolen or lost in the mail, receiving a replacement and redeeming both cards for food stamps.

There are two approaches to correcting this problem. The first limits access to authorization cards making them more difficult to steal or falsely report stolen. This would include mailing cards by certified mail or requiring a recipient to come to a specified distribution point to pick up their cards. Recent efforts in New York City and in Pennsylvania to improve ATP delivery systems are set forth later in this report.

In May, legislation was enacted which facilitates a second approach to the problem of high rates of lost or stolen authorization cards -- limiting the ability of anyone other than the recipient or the recipient's authorized

representative to redeem the card by tightening the identification requirement. Specifically, the Secretary of Agriculture is authorized to require the use of photographic identification cards in those areas where it is necessary to protect the program's integrity. Regulations to implement this provision are now being drafted. We are optimistic that photo ID's will add a strong safeguard to the authorization card issuance system. The critical element is, of course, that they must actually be used in the transaction of authorization cards. To accomplish this, it will be necessary to impose some liability on the States if there are program losses because the photo ID's are not used. This in turn may require modification of the State agencies' contracts with issuance agents to impose liability on the issuers if they permit the transaction of authorization cards by anyone other than the recipient or the authorized representative of the recipient. This is similar to the way public assistance checks are often handled where a bank is liable for cashing a stolen check with a forged endorsement.

NEW YORK CITY FOOD STAMP PROGRAM

Multiple Redemptions

In our last two reports we cited the New York City situation where about 25,000 replacement Authorization to Participate cards are issued each month because recipients reported that their cards were lost or stolen. About 60 percent of the original authorization cards were redeemed along with the replacement cards representing a \$7.2 million loss to the program for the first 6 months of 1980. While mail theft is a serious problem in New York

City, the main cause of the problem appears to be recipient fraud. Using manual procedures, local officials were able to establish over 10,000 cases where, in their judgment, the same individual signed both the original authorization card which was redeemed and the affidavit stating that the card had never been received.

The city's fraud unit has been using 30 to 40 employees to sort through the 25,000 cases of reported lost or stolen authorization cards each month. Manual processing was necessary because the city's Office of Data Processing had not developed a computer program to identify the households for which both an original and replacement authorization card were issued and redeemed. During our audit, we developed such a program and provided the results to the city over the 9 month period October 1979 through June 1980. This will enable the city to establish priorities for referring cases to postal authorities if the recipient appears to be the victim of mail theft and to criminal prosecution or administrative fraud hearings in other cases. Even with the computer assistance, a substantial problem is left to deal with. For example, there are over 15,000 households for which an original and a replacement card were redeemed for at least two of the nine months from October 1979 through June 1980. There are about 250 households where this occurred every month during the period. While the sheer volume will make it difficult to take action on every single household, at least some action should be taken quickly on the more flagrant cases of fraud and high mail loss situations. To date no administrative fraud hearings or State

prosecutions have been held. However, the city expects to begin holding some fraud hearings during November 1980. We were able to get cooperation from the Office of the U.S. Attorney for the Southern District of New York in initiating prosecutions. Several food stamp recipients were indicted for falsely claiming that their authorization cards were lost or stolen.

Several changes have already been implemented to deal with the multiple redemption problem. In August 1980, the city began requiring recipients to pick up replacement authorizations directly from five designated locations throughout the city. This has eliminated a part of the problem. In addition, in October 1980 the city began implementation of a rapid access reconciliation system. Rapid access will require the issuance of a replacement authorization only upon verification that the participant has not already transacted the original authorization. This can be done because this system gives the city access to redeemed authorization cards within 5 days after redemption. This, combined with an 8-day expiration date for the authorization card will allow the city to delay issuing a replacement card until the original has expired or been located if it was redeemed. If the original was redeemed, a replacement can be issued to the household after a prompt investigation has been made to determine whether mail theft or recipient fraud was involved. The 8-day validity period for authorization cards will be in place on December 1, 1980. Two additional steps are planned which should cause a further reduction in the program losses. First, all households reporting the loss of their authorization cards 2 months in

succession will be required to pick their card up directly at the issuance office. Computer analyses will be continued so that any households that still frequently report a lost or stolen authorization card, for example, every other month, can be added to the list. The second step will be the initiation of criminal or administrative fraud proceedings against those recipients who have falsely claimed that their original card was lost or stolen.

Duplicate Issuances

We found that there were insufficient safeguards in the New York City program to prevent issuance of more than one authorization card to a recipient. As a result, we estimate that at least \$2 million in unauthorized duplicate food stamp benefits were issued between October 1979 and June 1980. At the time of our review, the city was already aware of some of the problems and had either corrected them or was taking action to do so. The most common duplicate issuances occurred for two reasons.

First, there was no computer check to prevent caseworkers from unknowingly opening up more than one case for the same household. This usually occurred because a household transferred its case to an office other than the one in which it was initially certified. The new office would open up a case but the old office would not close its case. There were also instances where an eligibility worker mistakenly prepared a computer input document to open up a case for a recipient who already had an active food stamp case in the office.

Second, although there were safeguards against issuing authorization cards to the same household through more than one of the three issuance systems, they were not always effective. New York city uses three systems to issue food stamp authorizations. As a generalization, one system takes care of issuing monthly authorization cards to recipients in an active recurring status. The second system takes care of issuing the first card for recipients who have just come into the program. The third deals with expedited issuance of cards to destitute recipients and replacement cards to those who have reported that their original card was lost or stolen. The city has recently improved the data communication capability among its issuance systems which should substantially reduce this part of the problem.

Mailing Authorization Cards to Recipients No Longer Eligible

During the period of our review, New York City closed an average of 24,000 cases each month. One to two weeks before the end of the month, the data base is frozen and authorization cards are prepared for mailing the following month. Thus cases that are closed after the freeze date receive an additional authorization card to which the household is not entitled. In the case of public assistance grants, the data base is frozen later in the month and checks for households whose cases have been closed after that date are pulled manually from the prepared mailings. If a similar system were used for food stamps we estimate that 3,000 to 5,000 authorization cards could be retrieved with a savings of \$200,000 to \$350,000 per month to the program.

We have already mentioned that recipients receive excessive benefits by redeeming extra authorization cards obtained through errors in the city's issuance system or by falsely claiming that a card was lost or stolen. In addition, the quality control system identifies cases of overissuance due to errors in certification and benefit determination resulting from mistakes by caseworkers and incorrect information supplied by households.

Claims are required against households when overissuances exceed \$35. For the period January 1978 through July 1980, the city had only established 180 claims. Of these, 10 cases were paid in full. During the period covered by our audit, the establishment and collection of claims was the part time responsibility of one employee. In June 1980, the city began to send out claim letters to recipients who transacted both their original and replacement authorization cards during December 1979. No action is planned on the cases that occurred before that date. In the case of duplicate authorization cards resulting from problems within the city's issuance system no claims action at all is planned. The city feels that there are only sufficient resources to identify the duplicate issuances, determine why they resulted, close cases as warranted, and develop controls to prevent the situation from recurring.

Further Review

The New York City program is quite large, representing almost 6 percent of the value of food stamps issued nationally. For that reason we are concerned about the serious nature of the problem uncovered so far. While we are satisfied that the city is making serious efforts to correct many of these deficiencies we plan to continue to monitor the effectiveness of their changes as we continue to review other aspects of program administration.

PUERTO RICO FOOD STAMP PROGRAM

In our last semiannual report we discussed a number of problems in the administration of the Food Stamp Program in Puerto Rico. We noted that when we used all available information to reconcile cash collections and coupon issuances, shortages of \$12.1 million in cash and \$3.7 million in coupons were indicated. These shortages were incurred during the period from July 1974 through December 1978. The Food and Nutrition Service has billed the Commonwealth of Puerto Rico for the full amount of the shortage. The actual amount to be collected will not be determined until some time in the future while the Commonwealth continues to search for documentation or reconstruct past transactions to account for the shortages. To date about \$2.4 million of the cash shortage has been explained, but practically none of the coupon shortage.

The Commonwealth has developed a corrective action plan to deal with the other problems that we pointed out. That plan is now being reviewed by the Food and Nutrition Service. Work has already begun on the correction of some deficiencies.

Last May, Public Law 96-249, which requires a special financial audit review by OIG of any "State" where participation in the Food Stamp Program exceeds 60 percent of the population, was enacted. In effect, this provision applies to Puerto Rico only since no other State is close to a 60-percent participation level. We maintain audit and investigative staffs in Puerto Rico and have monitored the program almost continuously since it began. We will continue to review program operations on a frequent basis even if the 60-percent threshold is not reached because of the size of the program in Puerto Rico and the history of problems in administration.

PENNSYLVANIA FOOD STAMP PROGRAM

In our last semiannual report, we noted that in October 1979, Philadelphia County had 2,800 cases where both the original and replacement authorization cards were redeemed resulting in program losses of \$210,000.

In September, Pennsylvania began a demonstration project in three districts in Philadelphia and one in Pittsburgh that should eliminate the problem in those districts. The project involves a direct delivery system in which certain recipients are not mailed their authorization cards. Instead they go to a specific issuance agent to pick up and negotiate their authorization cards. This eliminates the possibility of mail theft or of recipients fraudulently claiming the nonreceipt of their authorization card and receiving a replacement.

The project is planned to last 6 months during which its effectiveness will be evaluated. After the first month of operation, preliminary results appear favorable.

We audited the operation of the Food Stamp Program in the State of Michigan as of July 1979. We conducted our review because previous reviews dating back to 1974 had noted serious problems in program operations, especially in Wayne County. We wanted to determine whether the situation had improved. Our work concentrated on the certification error rate, fraud referrals and claims administration.

We found that the certification error rate was high in Wayne County. In our sample of 200 cases, 24 percent contained errors. The corresponding dollar error rate was 10.2 percent. These findings represent a reduction from the 34 percent case error rate found in our previous audit. Two factors must be considered in assessing this reduction. First, the Food Stamp Act of 1977 eliminated many itemized deductions from income and replaced them with a standard deduction. Since a significant portion of the certification errors shown nationally in food stamp quality control reports were caused by

improper handling of deductions, some improvement in the case error rate was expected. On the other hand, our review took place immediately after the State had converted its entire caseload to the new eligibility requirements, a time when error rates could be expected to be higher than normal.

Considering both factors, the Department decided that improvement had been sufficient so that sanctions against the State were not warranted.

We also reviewed the handling of cases of authorization cards reported lost or stolen. We found many instances where a replacement card had been issued

to the household but the file had no affidavit that the original authorization card was lost or stolen. There was also little effort to retrieve copies of the redeemed original authorization cards to compare the signature with that on the affidavit as a first step in determining if the case should be settled by a collection action, referred for an administrative fraud hearing or investigation, or referred to the Postal Service.

We found there was little effective State supervision over the claims establishment and collection activities of local county offices. In several offices, including Wayne County, we found confusion about claims procedures, insufficient collection action and incomplete or inadequate recordkeeping related to claims.

Since our audit was completed, the Food and Nutrition Service has conducted reviews of the Michigan situation. They informed us that the State agency has strengthened procedures for followup on duplicate redemption of authorization cards, established signature checks for redeemed replacements, and increased emphasis on fraud referrals and the establishment of recipient claims.

CURRENT POLICY ON RECIPIENT CLAIMS

The failure to establish and collect recipient claims is one of the most frequently noted deficiencies in State and local Food Stamp Program administration. It is often viewed as a paper shuffling exercise that is not worth the effort and consequently given a low priority. This is particularly the case with nonfraud claims where current policy takes into consideration

that the undeserved benefit to the recipient was often the fault of the State agency and that any diminution of current benefits to repay the Government could put a real strain on the resources of a poor household. The demand letter that is sent to nonfraud households seeking repayment of excessive benefits asks the recipient to make a cash payment or agree to repay in installments and states in part, "The amount of food stamps you are eligible to receive will not be affected if you can't pay or if you fall behind in your installment payments." States occasionally cite this language as virtually inviting the recipient not to pay the claim. Anecdotal comments from State officials and our own reviews tend to indicate that very few recoveries result from claims activities in most States and in some cases the costs of handling claims exceed the recoveries.

The Food and Nutrition Service will shortly propose regulations designed to increase claims collections. The regulations would delete the language cited above from the demand letter, and would allow recipients to repay claims with food stamps as well as with cash. In an effort to make claims collection more cost effective, the regulations also would raise the dollar threshold above which States are required to pursue claims from \$35 to \$100. We will monitor the impact of these changes to determine whether there is any significant increase in collection activity by the States.

COUNTERFEITING OF FOOD STAMPS

There have been relatively few cases of food stamp counterfeiting uncovered during the history of the program. When the Food Stamp Program first began, coupon books were serially numbered but the coupons were not. As a result, there were some early instances of counterfeiting. To combat the problem, food stamps were serialized and quality and security standards were imposed. The Federal Reserve Banks examine a sample of the coupons as they come through the redemption system to check for counterfeiting. In recent years there have been very few counterfeits discovered. This is probably due in part to the fact that large amounts of counterfeit stamps could not be converted to cash very easily. The cooperation of a number of retailers and wholesalers would be required or a network of street dealers established to sell small amounts to individuals at discount.

Recently, two serious food stamp counterfeiting operations were discovered. First, in August, the U.S. Secret Service arrested three persons in New York and New Jersey who had printed approximately \$300,000 in counterfeit food stamps. In September, two persons were arrested in Chicago in an operation involving OIG and the Secret Service, and over \$1 million in counterfeit stamps were seized. The coupons were of good quality and could have passed a cursory review. The Federal Reserve Banks have been advised of the problem and have increased their monitoring of redeemed stamps. To minimize the problem, it is necessary to combine close scrutiny by the Federal Reserve Banks with high quality coupon paper and printing techniques.

The Special Supplemental Food Program for Women, Infants, and Children (WIC) provides specific supplemental foods high in protein and iron to persons at "nutritional risk," that is, pregnant, post-partum and lactating women, infants and children under the age of five. The program was originally authorized on an experimental basis for 2 years by the Child Nutrition Amendments of 1972. The original legislation authorized appropriations of \$20 million for each of fiscal years 1973 and 1974. The program was subsequently expanded, with funding increased to \$250 million for each of fiscal years 1976, 1977 and 1978. The Child Nutrition Amendments of 1978 again extended the program. The fiscal year 1980 appropriation is \$734.2 million. For fiscal year 1981, \$900 million has been authorized. From the original pilot sites begun in 1973 and 1974, the program has rapidly expanded to include 50 States and 30 other "State" agencies, primarily Indian tribes. Administration of the programs by the Food and Nutrition Service has been geared to encouraging and facilitating speedy adoption and implementation of the program. Now, the program is operating in every State.

We have just completed a special impact audit of the program, which demonstrates that this rapid expansion was not accompanied by the enforcement of commensurate management controls. This audit included reviewing the program in the 10 States with the largest allocations for fiscal year 1980 (approximately 40 percent of the total appropriations). The audit results

pinpoint various areas in which the Food and Nutrition Service can provide greater guidance to its regional offices and can provide better instructions and monitoring to the State and local agencies involved with the program. In particular these areas include automated data processing (ADP) systems, financial management, contracts, procedures, and monitoring of food vendors and participants.

Our general findings were the following:

- o States' systems for monitoring food vendors, usually retail grocers, were in need of improvement. As a way to test the integrity of the system, our staff conducted purchases at some participating grocery stores for which there was evidence of potential abuse of the voucher system. While our samples were not representative of all vendors in each State, they were representative of those vendors which the States had the capability to identify as potential abusers. The results revealed that vendors had (1) redeemed the food vouchers for foods not actually purchased, (2) overcharged the program for foods sold, (3) sold ineligible foods, (4) sold larger quantities of foods than were prescribed and claimed reimbursement for all the food sold, (5) accepted and redeemed vouchers which were no longer good because the recipient had not used them in the month following issuance, and (6) redeemed expired food vouchers that retailers had obtained

without providing any food. In four of the 10 States we reviewed, there was no documentation that compliance visits to grocers had been made.

- o Our review identified several deficiencies in the ADP systems which FNS has financed in the 10 audited States, including: inability to identify potential vendor abuse; ineffective procedures to identify potential duplicate redemptions by participants; no system documentation and/or unusable user's manuals; lack of security procedures to protect software and data files; inadequate data input, edit checks, and output; and inability to fully reconcile redeemed financial instruments with manually issued vouchers. Costs for automatic data processing systems are not specifically identified within State administrative expenses as reported to the Food and Nutrition Service. Eight of these systems were not properly reviewed and approved by the Food and Nutrition Service regional offices. Sole-source procurement was often used in purchasing machinery and automatic data processing services.

- o In our review, we looked at States' systems for identifying program participants who potentially received dual benefits under the program. We found that seven State agencies did not have effective and efficient procedures to determine whether a participant has received benefits from more than one program clinic. Analysis of the actual extent of dual benefits was not within the scope of our audit.

- o In the three States which had home delivery as opposed to retail store purchases, procedures did not provide for sufficient accountability of the food vouchers used to obtain eligible foods or for assurances that the food was received by program recipients.
- o Some State and local agencies have negotiated contracts for ADP, banking, or retail services that did not contain such standard contract requirements as retention of records for at least 3 years, provision for access to the records by Federal Government personnel, remedies in instances where contract terms are breached or violated, or an expiration date.

We made the following recommendations to the Food and Nutrition Service:

- o Make a more consistent and coordinated effort to assure that headquarters units, regional offices, and State agencies carry out their responsibilities efficiently and effectively.
- o Provide guidance and assistance to State Agencies on how to conduct effective food vendor and participant monitoring and assure that procedures are implemented that will identify and resolve abuse.
- o Implement fully and require compliance with current instructions, guidelines, and regulations for ADP systems. Further, provide the technical assistance and supervision necessary to assure that costs are allowed only for ADP systems which are in compliance with Federal regulations.

- o Require State agencies to reconcile the number of food vouchers issued with the number redeemed to assure accurate financial status reports and to assist in identifying fraudulent transactions.
- o Require State agencies to utilize food voucher redemption listings to detect dual or excessive participation.
- o Require contractors providing bulk food, equipment, and supplies to adhere to Federal regulations and sound contract procedures.

The Food and Nutrition Service has agreed with our recommendation and has already begun corrective action.

Our 10 State audit followed an earlier audit of the WIC food delivery system in California. As we reported 1 year ago, we found deficiencies in California's program, with a high proportion of vouchers redeemed at the maximum price. Since release of our audit, California and FNS have worked to improve the program. The State implemented a computerized edit check system to monitor negotiated vouchers, added staff to oversee vendor and bank operations and has investigated vendors and suspended some from the program. The FNS regional office has increased its assistance and monitoring. The agency has informed us that a significant reduction in vouchers cashed at maximum value has resulted.

DEPARTMENTAL ADMINISTRATION

During the past year, we have increased our audit coverage of the administrative systems and operations of the Department. We completed audits in the areas of claims collection policies and procedures. Of particular interest in the procurement field were our audits of consultant services and of property management, with emphasis on furniture purchases and year-end buying.

CONSULTANT SERVICES

In May 1980, we initiated an audit survey of the overall procurement/contract administration throughout the Department. We undertook a comprehensive review of the procurement procedures and practices being followed in several large agencies, with initial emphasis on consultant contracts.

In July 1980, the Office of Management and Budget issued a directive requiring executive departments and agencies to develop a management control system for procurement practices to assure ethical practices and integrity in the procurement process. The control system was to emphasize those procurements involving consulting services.

We worked closely with the Office of the Assistant Secretary for Administration in developing a plan, which was approved by OMB, for the control of consulting services and the improvement of procurement practices within the Department. We are currently monitoring implementation of the management control system and continue to work closely with the Assistant Secretary for Administration to identify needed revisions to help assure an effective system.

Our review of consulting services focused on procurement in six departmental agencies in the Washington metropolitan area. Its objectives were to determine whether (1) the services were needed, (2) reasonable and competitive prices were obtained, (3) the services were properly approved and monitored, (4) the end result was useful, and (5) the procurements of the services were free of any conflicts of interest.

Included in the scope of our review were all procurements of what appeared to be consultant/management-type services. We stratified and analyzed data from the Federal Procurement Reporting System, which contains procurements of over \$10,000 by (1) those "product service codes" which we felt contained consulting/management-type services; (2) type of procurement, emphasizing negotiated, noncompetitive (sole source) awards; and (3) awards near the end of the fiscal year. We also obtained a listing of former employees (GS-13 or above) to see whether they had been awarded such contracts. In addition, we reviewed financial disclosure statements of top Departmental and agency officials, in those agencies covered in the review, for potential conflicts of interest. Finally, since procurements of \$10,000 and under are not captured by the reporting system, we manually reviewed purchase orders to identify consulting/management services.

From this review, we identified 163 contracts and 428 purchase orders with a total value of over \$25 million, involving consultant/management services by the six agencies. Looking for potential problem procurements, we selectively chose 31 contracts and 73 purchase orders for review. In addition we reviewed four personnel actions involving consultants.

We found the following types of problems, with 93 of the 104 procurement and 4 personnel actions selectively reviewed:

- o Of 79 sole-source procurements reviewed, none of the justifications on file adequately explained why a sole-source action was needed and there was no evidence that attempts had been made to procure the services competitively.
- o There were 28 procurements with former employees generally awarded sole source, with no evidence that attempts were made to obtain the services competitively. In most cases, the services were contracted for shortly after the employees retired and, in some instances, were for duties similar to those they performed prior to retirement. The lack of adequate planning to provide for continuity of service by in-house personnel contributed to this condition. Had these former employees been brought back as rehired annuitants, savings could have been realized.
- o In 27 instances there was no evidence that a study or other evaluation was made to determine the agency's ability to provide the needed contract services with in-house staff.
- o We found irregularities with 18 procurements which were made near the close of fiscal year 1979. In some instances, the procurements had not been planned or provided for in the budget. Three contracts were awarded near the end of the fiscal year, but the work did not begin until several months after the 1980 fiscal year began.

- o We identified 34 other instances, including four personnel appointments, which involved improper or questionable procurement practices, such as services performed which were outside the scope of the contract, services provided prior to the official procurement action, repeated use of the same contractor, the cost of the service split among two or more purchases through purchase orders to avoid the use of contracts, improper use of personnel appointments and purchase orders to obtain services, consultants used to perform functions of a policy/decisionmaking nature, and failure to determine properly the basis for price negotiation.

We attributed these problems to a mutual failure of program management to consult and involve procurement personnel in planning and conducting the project and of procurement personnel to administer the contract effectively through oversight by the contracting officer's representative. While responsibility for corrective action in this area rests primarily on procurement management, it cannot be effective without the active support of program management.

We have recommended that the Department establish a sole-source review board(s) to review all noncompetitive awards or at least expand the duties of the existing contract review boards to include an evaluation of the sole-source justification. We also recommended that the Department set forth more precisely the criteria for determining whether or not a procurement may be made noncompetitively, the justification documentation that is required,

and the review approval requirements that are necessary. Further, we recommended that the Department inform all administrators of the general findings and recommendations contained in our report, emphasizing to program officials that justifications showing that in-house capabilities are not available must be reasonable, proper, fully supported, and adequately documented; and that procurements, especially those made during the last quarter, must have documented justifiable need and be awarded in accordance with prescribed procurement regulations. The matters have been discussed with the Assistant Secretary for Administration and an appropriate alternative has been worked out. We are continuing our audit efforts in the procurement area, and subsequent reviews will emphasize year-end spending practices.

PROPERTY MANAGEMENT

In our March 1980 Semiannual Report, we reported on our audit covering the acquisition, management, and disposition of furniture, equipment, and supplies at the Department's Washington, D.C. building complex. Two major actions were taken to correct some of the problems described in the audit.

- o The Office of Operations and Finance initiated "Operation Clean Sweep" in September 1979 to rid all hallways and offices in the Washington, D.C. building complex of excess furniture and equipment and transfer it to the Departmental pool.
- o On December 18, 1979, the Assistant Secretary for Administration ordered a freeze on all furniture procurements within the Department except for emergencies.

We have followed up to determine whether agencies were complying with these directives. We found some noncompliance. Based on these findings, the Office of Operations and Finance took two additional actions during April 1980:

- o On April 7, 1980, the Office of Operations and Finance notified the General Services Administration and the Federal Prison Industries to cancel all unfilled orders from the Department.
- o On April 11, 1980, the Office of Operations and Finance issued a notice establishing a total moratorium on the procurement or rental of all furniture in seven Federal supply classes. The notice further directed agencies to cancel immediately all current but unfilled orders for items in these seven classes regardless of source.

Throughout this period, we continued to monitor the overall area of property management, especially the performance of USDA agencies under the purchasing moratorium. On September 23, 1980, we released a followup report which contained the following findings:

- o In spite of ongoing instructions from the Assistant Secretary for Administration and the Office of Operations and Finance, 14 agencies ordered more than \$250,000 in prohibited furniture and equipment items on "FEDSTRIPS" alone during the period January through April 1980. One field location ordered and received \$50,000 in prohibited items on purchase orders issued since the imposition of the moratorium.

- o Although USDA agencies did cancel a total of \$1.7 million in unfilled furniture orders, the General Services Administration has continued to deliver, and agencies have accepted delivery of furniture and related items covered by the moratorium. The General Services Administration received a total of \$277,469 in payments during May (\$223,370) and July (\$54,099) for FEDSTRIP shipments of prohibited items to USDA agencies.
- o Three agencies ordered about \$606,000 in systems furniture even though adequate cost-benefit justifications were not prepared, and the equipment to be replaced did not appear to need replacement. As the result of our reviews, these orders were cancelled.
- o The control and distribution of excess furniture at the Department's Washington, D.C. building complex still need improvement. In spite of instructions to the contrary, agencies have persisted in storing excess and unused items in building hallways.
- o Justification for one agency's purchase of \$829,414 in laboratory equipment was questionable. The agency purchased the equipment prior to obtaining firm commitments from the General Services Administration for needed laboratory space; did not consider utilizing available excess items in lieu of purchasing new equipment; and submitted the purchase orders and obligated funds only 3 days prior to the end of the fiscal year. Although agency officials are

currently attempting to obtain needed space for a laboratory, over \$200,000 of this equipment has remained in rented storage (\$300 per month) since its delivery on December 8, 1978.

In order to ensure that furniture deliveries are stopped, and that USDA agencies comply with the moratorium, we have:

- o Coordinated our efforts with the Office of Operations and Finance, which is working with the General Services Administration to stop furniture deliveries to USDA agencies.
- o Recommended that the Office of Operations and Finance notify the Assistant Secretaries of all moratorium violations so that agency administrators may be directed to take appropriate administrative action against the responsible parties. We have further recommended that the Office of Operations and Finance monitor this process and advise us of all actions taken.

In view of the persistent nature of the problem, we are continuing audit coverage in the property management areas by:

- o Periodically reviewing National Finance Center computer-generated reports of open FEDSTRIP orders to ensure that currently unfilled orders are, in fact, cancelled and that no new orders for prohibited items are placed.
- o Monitoring known furniture vendor accounts of the Department to determine whether any purchases and/or shipments of furniture prohibited under the moratorium have occurred or are pending.

We have also completed our survey of the property management information system currently being implemented by the Department, and we will be providing additional audit coverage in this area.

ESTABLISHMENT AND COLLECTION OF CLAIMS

For some time we have been concerned with getting corrective action on audit findings which recommend the establishment and collection of a claim. The Secretary, in August 1979, issued a memorandum which set forth the procedures to be followed and the time within which the resolution of audit exceptions was to be achieved. In order to test the effect of this memorandum and determine the degree of compliance with its requirements, we undertook an audit of the Department's Food and Nutrition Service's policies and procedures in this area.

We evaluated the Food and Nutrition Service's system to establish and collect claims for program losses (that is, overpayments, and the like) reported by audits and investigations. We measured the system against the requirements promulgated by the Department, OMB, and the Federal Claims Collection Act of 1966. In general, these requirements are that a claim determination be made within 6 months for any losses cited in OIG reports, and that prompt action be taken to collect or otherwise resolve established claims.

At the time of our review, the Food and Nutrition Service's records listed 357 OIG reports (of which 87 were released prior to 1977) containing potential claims totaling about \$60 million for which a claim determination had not been made, or if made, the amount determined due had not been collected or properly resolved. Our review of 66 of these cases found that:

- In 21 cases, collection action was delayed because the amount of the claim was not decided from 1 to 5 years after our report was issued.
- In 35 cases where claims were established, collection action was not pursued as required by the GAO Claims Collection Standards.

We attributed the problem in claims collection in the Food and Nutrition Service to:

- the absence of agencywide claims handling procedures.
- the lack of a central unit to monitor the resolution of potential claims and collection actions.
- the need for legal opinions on authorities that can be used to pursue claims.
- the compromise of some claims without the required legal concurrence.
- inadequate accounting for claims due and collected from sub-state entities.

FNS has agreed to implement our recommendation and we are currently working with the agency to expedite its resolution process of OIG reports on which a claim determination has not been reached. Analysis will be done to determine what additional procedures are needed to improve the claims resolution process.

INTERNATIONAL AND COMMODITY OPERATIONS

The Commodity Credit Corporation has as its major activities the support of agricultural commodities through loans, purchases, and payments; and the procurement of surplus agricultural commodities for sale or donation to other domestic government agencies, foreign governments, and domestic, foreign, and international relief or rehabilitation programs.

The CCC acquires commodities through purchase or by taking possession of those pledged as collateral for price support loans. Loans to producers are "nonrecourse" in that producers are not obliged to repay their loans. Instead, a producer may forfeit the collateral on the loan to the CCC. Producers generally forfeit the collateral on their loans when market prices for the commodities are below the amount of the loan.

The CCC disposes of its inventories in various ways. Some commodities are sold for domestic use, others are exported. Both domestic and export sales can be for restricted or unrestricted use. In addition, commodities are donated to Federal, State, and private agencies for use in child nutrition and other food assistance programs.

The Commodity Credit Corporation is managed by a board of directors subject to the general supervision and direction of the Secretary, who is an ex-officio director and chairperson of the board. The CCC utilizes the personnel and facilities of several USDA agencies, the principal one being the Agricultural Stabilization and Conservation Service (ASCS). The Kansas City Commodity Office (KCCO) of ASCS has management responsibilities for the acquisition, handling, storage, and disposition of CCC commodities.

The following is a summary of the more significant audit work conducted during the reporting period:

MONITORING OF GRAIN SUSPENSION

In January 1980, when the President announced the suspension of future grain deliveries to the Soviet Union, we immediately established an audit task force to monitor and test compliance with the suspension. The task force worked continuously and closely with the CCC in implementing the various phases of the suspension. Our continuing effort has included an active role in preparing the CCC-Exporter Agreement, reviewing the assumed exporter contracts, selling the contract rights, and reviewing offsetting purchases.

Under the grain suspension, the Commodity Credit Corporation purchased contracts valued at \$2.5 billion from grain exporters. Since early February we have been issuing periodic memoranda to the Commodity Credit Corporation and other Departmental officials on our findings. In almost all cases, corrective action has been taken or is underway. Some of the areas covered in these memoranda include:

- o Relatively minor errors in contract pricing, which resulted in overstating some CCC liabilities by about \$170,000 and understating others by about \$70,000. The errors were immediately corrected by CCC.
- o Discrepancies between the amount of grain which the exporters had sold to affiliates for shipment to the Soviet Union and the actual amount contracted for by the Soviet Union buying Agency. This was found to result from quantities of grain to be shipped to the Soviet Union being sold by the U.S. exporter in long tons rather than in metric tons as specified in the Soviet contracts. The CCC reduced the tonnage it assumed by 7,760 metric tons, thereby decreasing its net liability by about \$200,000.

During this reporting period, we also audited the effectiveness of the procedures used by the ASCS to manage inventories of CCC-owned commodities. The times during which commodities can be acquired are dictated by market conditions and the provisions of applicable price support programs. As a result, the CCC has limited authority to control increases in its inventories. Inventory management is therefore of major importance.

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE'S
MANAGEMENT OF COMMODITY CREDIT CORPORATION INVENTORIES

Department's efforts have been carried out in an effective manner. We will be continuing our cooperative efforts with the CCC in implementing the grain suspension, giving particular attention to the sale of assumed contracts and final settlements negotiated with the exporters. Audits will include reviews of the exporters' profit and loss statements and position reporting prior to final settlement.

In view of the considerable effort involved in implementing the contract assumption and liquidation and the complexity of the process, we feel the Department's efforts have been carried out in an effective manner. Exporter shipments being applied against contracts other than those having the highest prices and the earliest delivery dates. The net liability assumed by the CCC could have been several million dollars less had CCC rigidly insisted on this provision. CCC permitted exporters to apply shipments to other than the earliest contracts because exporters claimed unusual circumstances surrounding certain shipments in conjunction with the negotiation of other contract terms and conditions. Our review in this area continues.

0 Overpayment by the Commodity Credit Corporation to an exporter resulting from several errors in the calculation of a contract settlement. This overpayment, initially reported by GAO in the amount of \$606,000, was subsequently determined by OIG to be \$850,000. CCC recalculated the settlement and recovered \$929,800, which included interest from the date of overpayment.

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In our last semiannual report, we noted that although the CCC Board of Directors and the Secretary had adopted a policy of self-insurance in December 1976, in response to a GAO recommendation, the policy had not been fully implemented. Warehouses had been paid approximately \$942,840 between

INSURANCE RATES FOR CCC-OWNED COMMODITIES

We have therefore recommended that a comprehensive annual inventory management plan be developed for each price-supported commodity to help ensure that the CCC sales policy is more reflective of the board of directors' collective judgment. The report was discussed with members of the board of directors; the board, has not yet acted on the recommendations.

We found that CCC operations are managed without detailed criteria relating to when commodities will be available for sale, on what basis prices should be set, and the method of sale. Many decisions seem to be made in reaction to a particular market situation rather than within the framework of an overall Department plan. Although these decisions are made by commodity experts and are usually approved by an officer(s) of the CCC Board, documentation is not always formal and little information is available regarding alternatives and other data which were considered. We believe an overall Department inventory management plan is needed because of (1) the scope, complexity, and economic impact of CCC sales on consumers, industry, and world prices, and (2) audit determinations that certain management or sales decisions resulted in lost sales proceeds or increased storage costs totaling millions of dollars.

July 1, 1978, and June 30, 1979, for insuring CCC-owned grain and rice. Had the CCC fully implemented a policy of self-insurance during this period, losses on damaged inventories would have totaled only \$71,932. Given that a policy of self insurance would have been more cost beneficial, we recommended that the CCC Board fully implement such a policy. Although ASCS initially concurred with our recommendation, that position was subsequently reversed. The decision not to implement self-insurance was approved by two CCC Board members but was never presented for full board consideration. The CCC has about 400 million bushels of grain currently in storage; and, we estimate that insurance rates will cost the CCC \$4 - 5 million in the 1980-81 storage year.

Since the USDA General Counsel ruled that the CCC charter grants broad authorities to manage its business and that the Comptroller General opinions on self-insurance that apply to other Government agencies do not apply to the CCC, we have requested an opinion from the Comptroller General on the propriety of the CCC payments for hazard insurance on commodities stored in commercial warehouses. The CCC has agreed to use the ruling as a guide in arriving at a final decision.

PARTICIPATION OF COOPERATIVE MARKETING ASSOCIATIONS IN THE
PRICE SUPPORT PROGRAM

During this reporting period, we also audited three cooperative marketing associations which participated in the Department's price support programs. The audit was conducted to determine whether the cooperatives were (1)

placing only eligible quantities of commodities under price support loans, (2) distributing proceeds from commodity sales to producers according to the quantity and quality of their contribution, and (3) maintaining their eligibility to participate in the program in accordance with applicable ASCS regulations.

Cooperative marketing associations may participate in price support programs on behalf of their members if approved by ASCS. To participate, a

cooperative must establish, among other things, that (1) it is owned and

controlled by producers who have actively conducted business with it for 3 or

more years, (2) more than 50 percent of its equities are owned by active

members, and (3) at least 80 percent of its grain inventories are acquired

from members. An approved cooperative must submit a list of its active

members to the ASCS county office to receive a price support loan on a

particular commodity. The ASCS county office, in turn, determines which

members are eligible for price support and forwards certification of member

eligibility to the cooperative, where it remains on file. Price support

loans are approved for only eligible active members.

The audit disclosed a potentially significant problem at one regional wheat

cooperative. The cooperative sold about 725,000 bushels of wheat under loan

with a value of \$1.7 million. The loan was not repaid to CCC until 30 - 150

days after the collateral was sold. Provisions of the loan agreement,

however, specifically stated that the loan was to be repaid before the

collateral was sold.

The ASCS peanut oil sales program was initiated in November 1976 in an effort to reduce large stocks of CCC peanuts which had accumulated as a result of a 1974 policy decision to sell government stocks at not less than the support level. Peanuts in CCC inventories were subsequently crushed into prime crude peanut oil and refined for use in domestic and foreign food assistance programs. In our March 1979 semiannual report, we reported that our audit of 1975-76 crop peanuts and peanut oil disclosed that at least 17.5 million pounds of peanut oil designated for domestic use had been exported. We attributed this occurrence to the lack of an effective system to monitor and enforce domestic use restrictions. Since that time, regulations have been implemented that require contractors who purchase CCC peanut oil restricted for domestic use to document that it has been used domestically. We recently conducted another audit which covered the sale of 1977 and 1978 crop year peanuts. Peanuts not exported for edible use were sold for domestic crushing into oil for restricted use sales. The provisions of the CCC announcement governing restricted use sales specify that (a) restricted use oil be sold for domestic use only, and (b) a "certification chain" be maintained to document that the oil is used domestically. Time periods

RESTRICTED USE OF PEANUT OIL

The audit also disclosed ineligible or questionable price support loans totaling about \$11 million to two of the three cooperatives audited. ASCS has agreed to the recommendations made in our audit report and has initiated corrective action.

within which peanut oil must be sold are also specified. Liquidated damages may be assessed on violations of the announcement. To date, we have audited the records of two companies that had purchased domestic restricted use peanuts and/or peanut oil from 1977 and 1978 CCC stocks. In both instances, we found that large amounts of restricted use oil had been resold without requiring certification that it would be used domestically. We concluded that ASCS could assess liquidated damages of about \$3.1 million.

One contractor sold and exported to a foreign subsidiary approximately 1.6 million pounds of oil restricted to domestic use. This contractor also purchased about 8.4 million pounds of restricted use oil from other companies, and on the same day, sold an identical quantity of oil back to them without the appropriate stipulation that it be used domestically. The now unrestricted use peanut oil was resold at prices ranging from 2 to 11 cents more per pound than the price paid under the restricted use transaction. Officials told us that peanut oil from the company's own stocks was substituted for the lots of restricted use oil that was exported or sold without the restricted use provision. Neither the supervising peanut association nor the CCC were advised of the substitutions. ASCS could assess liquidated damages of about \$1.7 million against this contractor for violating the restricted use provision if the contractor is unable to produce documentation proving that the oil, or an equivalent quantity of oil, has been used domestically.

The other contractor, a refiner, retained liability for the peanut oil's domestic use because a restricted use clause endorsement was not included in the written sales contracts. This decision, in effect, broke the chain of accountability in tracing the domestic use of the peanut oil sold in bulk quantities. Approximately 9.3 million pounds of refined restricted use peanut oil were subsequently resold as non-restricted use peanut oil which could have been resold for export. ASCS could assess liquidated damages of about \$1.4 million for violations of the restricted use provision. The refiner also violated the terms of the CCC announcement with respect to time limitations for disposition. If liquidated damages for violations of the restricted use provisions were not already due on some of the same oil, the refiner would be subject to liquidated damages of about \$244,360 for violations of the time restrictions. The Department is currently reviewing additional documentation provided by these two contractors to determine the amount of the liquidated damages, if any.

In the last semiannual report, we mentioned the meat grading study which we had undertaken with the Meat Science and Research Laboratory of the Science and Education Administration. The purpose of the study was to evaluate the accuracy and uniformity of beef grading by Food Safety and Quality Service (FSQS) graders in the various plants and main stations across the country. A three-member grading panel evaluated 5,582 beef carcasses from 56 plants and 11 main stations to provide data for the estimate of percentage error in quality grades and yield grades. The study focused on two types of grading--quality grades and yield grades. The "quality" grade is that familiar to consumers, for example, prime, choice, good, and so on. The "yield" grade is the estimate of the amounts of lean meat, fat, and bone in a beef carcass.

The panel included grading experts recruited from various universities. The overall study team also had representatives from the Food Safety and Quality Service, the Science and Education Administration, and the Office of Inspector General. Contract funds of the Office of Inspector General were used to support the study.

The study found that the overall percentage error for quality grades was 7.3 and for yield grades was 11.6. The percentage error among main stations was not statistically different for quality or yield grades. Due to the consistency of the quality grading error (7.3) in relation to the overall grading panel error (5.5), there is little reason to believe that much

improvement in the accuracy of quality grading can be achieved under the present grading system. In contrast, the overall yield grading error (11.6) was considerably larger than the overall grading panel error (7.0). This indicates that efforts to reduce the errors in yield grading might be productive.

In 7 of the 11 main stations, the percentage error in quality grading was significantly in favor of the plant. On a national basis, 4.7 percent of the error was in favor of the plant, while 2.6 percent was in favor of the public.

The study recommended that the Meat Quality Division of the Food Safety and Quality Service should: (1) continue to support USDA's efforts to develop tools (marbling photographs and instruments) to assist graders in evaluating certain grade factors, (2) concentrate their efforts on reducing yield grading errors on a national basis (This may involve a re-evaluation of the factors in the present yield grade standards with the possibility that certain factors; such as, carcass weight and percentage of kidney, pelvic and heart fat, might no longer be used for yield grading.), (3) conduct or support studies conducted under controlled conditions to evaluate the effect of environmental conditions (grading speed, light intensity, time after ribbing, etc.) on grading error, and (4) utilize the data collected to formulate minimum job performance standards for GS-7 and GS-9 graders. The agency, in response to the study, agreed with the results and recommendations and concluded that it shows a generally high quality of grading service in

the United States. The agency also stated that it will continue to develop objective tools to assist graders. Such tools should be ready by June 1981. It will also initiate a training program designed to reduce yield grade errors.

INVESTIGATIVE ACTIVITIES RELATED TO THE FOOD SAFETY AND QUALITY SERVICE

During fiscal year 1980, we continued to devote substantial investigative resources to the inspection and grading activities of the Food Safety and Quality Service. This has resulted in twenty indictments. Violations included bribery of Federal inspectors, adulteration of products and the use of counterfeit grading devices. The investigations involving the counterfeit devices, as well as investigations into problems associated with certificates used in the importation/exportation of meat products, disclosed the need for better administrative controls to make these items less susceptible to counterfeiting or other abuse. Of particular concern is the problem of insufficient controls in the issuance and security of the genuine items and the ease with which they can be obtained from local manufacturers. A joint FSQS/OIG study is being initiated to determine the extent of this problem and to formulate appropriate technical, legislative and administrative recommendations.

SECTION II

SUMMARY OF INVESTIGATIVE AND AUDIT ACTIVITIES

INVESTIGATIONS

Between April 1 and September 30, 1980, we completed 949 investigations including 712 which involved possible criminal violations. We referred 324 cases to the Department of Justice.

During this six-month period, there were 345 indictments and 292 convictions based on our investigations. Since the period of time to get court action on indictments varies widely, the 292 convictions are not necessarily related directly to the 345 indictments. Our overall conviction rate is about 90 percent. Fines, recoveries, and collections resulting from our investigations during this same period totaled about \$2 million and claims were established for approximately \$1 million. The following is a breakdown by agency of indictments and convictions for the period:

| <u>Agency</u> | <u>APRIL-SEPTEMBER 1980</u> | | <u>TOTAL FOR FY 1980</u> | |
|--|---------------------------------|--------------------------|------------------------------|--------------------------|
| | <u>Indict- ments</u> | <u>Convic- tions</u> | <u>Indict- ments</u> | <u>Convic- tions</u> |
| Agricultural Marketing Service | 1 | 2 | 3 | 4 |
| Agricultural Stabilization and Conservation Service | 42 | 32 | 83 | 68 |
| Farmers Home Administration | 47 | 25 | 78 | 39 |
| Forest Service | 0 | 0 | 1 | 2 |
| Rural Electrification Administration | 0 | 0 | 0 | 1 |
| Soil Conservation Service | 0 | 0 | 2 | 2 |
| Food and Nutrition Service | 231 | 209 | 443 | 344 |
| Animal and Plant Health Inspection Service | 14 | 11 | 14 | 11 |
| Food Safety and Quality Service | 3 | 9 | 20 | 15 |
| Federal Grain Inspection Service | 0 | 0 | 1 | 2 |

| <u>Agency</u> | <u>APRIL-SEPTEMBER 1980</u> | | <u>TOTAL FOR FY 1980</u> | |
|--|---------------------------------|--------------------------|------------------------------|--------------------------|
| | <u>Indict- ments</u> | <u>Convic- tions</u> | <u>Indict- ments</u> | <u>Convic- tions</u> |
| Office of the General Sales Manager | 0 | 0 | 0 | 1 |
| Multiple Agencies (two or more USDA Agencies) | 3 | 3 | 3 | 3 |
| Commodity Futures Trading Commission | 0 | 0 | 0 | 7 |
| Science and Education Administration | 3 | 0 | 3 | 0 |
| Miscellaneous (e.g.; mailroom thefts) | 1 | 1 | 1 | 1 |
| Totals | <u>345</u> | <u>292</u> | <u>652</u> | <u>500</u> |

Examples of investigations follow:

FARMERS HOME ADMINISTRATION

- o An investigation into multiple fraud schemes involving a realtor, a former Farmers Home Administration county supervisor, and attorneys and contractors, resulted in indictments and convictions. The fraud schemes involved a conspiracy to defraud the United States Government through a series of land transactions involving houses financed through the FmHA. The two principals were subsequently tried and convicted. The realtor was convicted of one count of conspiracy and four counts of defrauding the Government. He was sentenced to 5 years imprisonment on each count, the sentences to run concurrently. (United States v. Karl S. Bowers, District of South Carolina.) The former county supervisor was also convicted of one count of conspiracy and sentenced to 5 years in prison. (United States v. Henry F. Glover, Jr., District of South Carolina.)

- o The vice president and manager of a sound and communications firm was indicted for furnishing false documents and information to the Farmers Home Administration in connection with an application for a \$1.5 million dollar business and industrial loan which was guaranteed by FmHA. He was tried, convicted and sentenced to serve 2 years imprisonment. (United States v. Thomas Boyd Kellum, Sr., Eastern District of Arkansas).
- o A Farmers Home Administration county office clerk was convicted for attempting to defraud the FmHA by converting monies paid by FmHA borrowers on their FmHA debts, to her own use. She was placed on supervised probation for a period of 5 years and ordered to make restitution to FmHA. (United States v. Rutha Lee Jones, Western District of Louisiana.)
- o A contractor offered a bribe of \$1,000 to a Farmers Home Administration county supervisor for each house the contractor would be permitted to build under FmHA contract. The contractor was convicted and sentenced to 2 years imprisonment. (United States v. William Lee Holt, Jr., Northern District of Georgia.)
- o A farmer offered a bribe of \$5,000 to a Farmers Home Administration county supervisor if the county supervisor would approve a loan of between \$125,000 and \$150,000. The farmer was convicted of offering a bribe. The farmer was sentenced to 2 years probation and to

0 A Federal Grand Jury returned a 20-count indictment against the pastor of a church in Starkeville, Mississippi, for violations involving the Summer Food Service Program. The defendant submitted claims for reimbursement totalling over \$3,000 for food and milk that were not purchased. The defendant also submitted inflated meal

FOOD AND NUTRITION SERVICE

0 The supervisor, Billing and Collecting Department, Craighead Electric Cooperative, Jonesboro, Arkansas, was convicted of embezzling over \$67,000 from the firm. The embezzlements were spread over a 3-year period, and the supervisor covered the shortages by falsifying bookkeeping entries. He was sentenced to 5 years confinement and fined \$5,000. (State of Arkansas v. Danny Faulk, Second Judicial District of Arkansas.)

RURAL ELECTRIFICATION ADMINISTRATION

0 A farmer sold livestock and farm equipment, mortgaged to the Farmers Home Administration, without FmHA's knowledge or consent and failed to apply the proceeds of the sales to his FmHA indebtedness. The farmer was convicted and sentenced to 1 year of probation. He was further ordered by the court to make restitution to FmHA of over \$29,000. (United States v. Terry L. Williams, Middle District of Pennsylvania.)

Reinhard, Northern District of Indiana.) perform 100 hours of community service. (United States v. Richard

counts resulting in claims for reimbursement for approximately 17,000 meals that were not served. In addition, checks totalling more than \$1,800 were issued from the program's account for purposes other than costs incurred in the program. Trial is pending. (United States v. Louis H. Bell, Northern District of Mississippi.)

- o Two brothers who operated a child day care center in Pigeon Forge, Tennessee, were indicted on six counts for violations related to the Child Care Food Program. In support of their operational expenses, the brothers furnished false invoices for a 6-month period and, when asked, they maintained that all supporting documents had been destroyed by fire. To facilitate the scheme, they purchased blank invoice forms and had rubber stamps of three fictitious vendors prepared. The brothers also altered the dates on invoices from existing vendors. During this 6-month period, in excess of \$18,000 in false invoices were identified, which resulted in overclaims for program expenses in excess of \$29,000. Trial is pending. (United States v. David G. and Bobby J. Culp, Eastern District of Tennessee.)
- o The owner of a tool and air-conditioning supply company was indicted for making systematic payoffs to a supervisor in the maintenance division of the Fort Worth Independent School District. The supervisor, who also was indicted, was paid over of \$4,000 during a 19-month period for requesting and obtaining purchases of equipment

from the firm. The equipment was used in the maintenance and food service division of the district and involved, in part, the expenditure of National School Lunch Program funds. In another unrelated instance, a maintenance division plumber of the school district was indicted for perjury for claiming that kickbacks from an equipment company were legitimate payments to him for off-duty services as a painter when, in fact, the payments were made as a result of equipment purchased from the firm for use in school cafeterias. Trial is pending. (State of Texas v. Harry V. Gates and J. W. Swackhamer; and State of Texas v. Jerry Tate, Tarrant County Criminal District Court Number Four, Fort Worth.)

- o A Summer Food Service Program sponsor in Canton, Mississippi, was indicted by a Federal grand jury for submitting a false and fraudulent affidavit and invoices totalling more than \$9,000 for food supplies. He was convicted and sentenced to 1 year. (United States v. James Westly Wiggins, Southern District of Mississippi.)
- o A department supervisor of a Wayne County Department of Social Services District Office and seven others were arrested for conspiring to obtain food stamps through false statements. The supervisor and another employee set up at least 37 food stamp files for nonexistent persons. The "Authorization to Participate" cards were sent to a drop address owned by co-conspirators. Five hundred forty-two cards with a bonus value of over \$143,000 were redeemed. In addition, 39 emergency cards were stolen and 26 of these were

redeemed. We worked with the Office of Inspector General, Michigan Department of Social Services, on this investigation. Trials are pending. (People of the State of Michigan v. Magnolia Bates, et al, Detroit Recorder's Court.)

- o A retailer authorized to accept food stamps in Lajas, Puerto Rico, was arrested and indicted for purchasing over \$13,000 in food stamps for cash from an OIG undercover agent. Trial is pending. (United States v. Domingo F. Martinez, District of Puerto Rico.)
- o A Washington State mailroom employee and two confederates pled guilty to conspiracy to steal and traffic food stamps. The employee used his knowledge of the State's mail system to intercept food stamps returned as undeliverable. His confederates sold the food stamps obtained for cash. The defendant estimated he stole between \$30,000 and \$50,000 in food stamps in a 6-month period. He was sentenced to 5 years in jail. As a result of this investigation by OIG and the Postal Inspection Service, the State agency changed its return mail system to provide better controls against unauthorized access. (United States v. Mark E. Nicolich, et al, Western District of Washington.)
- o The mayor of a Tennessee town pled guilty to failing to properly register the sale of a weapon and to purchasing food stamps for cash. The mayor was also the owner of a retail store authorized to participate in the Food Stamp Program and a licensed firearms dealer.

The assistant fire chief of Gary, Indiana, was convicted of selling food stamps for cash. He had offered to sell food stamps to an authorized retailer, who alerted the Food and Nutrition Service. He subsequently sold almost \$11,000 in food stamps for \$7,000 cash to an

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The owner and an employee of a truck and equipment sales outlet in Greenville, South Carolina, were arrested and indicted for selling major nonfood items for food stamps and for firearms and narcotics violations. They sold 51 items, including 5 motor vehicles, 32 firearms, 2 pounds of marijuana, and other items for food stamps to undercover agents. Some of the food stamps were redeemed through two retail stores belonging to the wife of one of the subjects. The Bureau of Alcohol, Tobacco, and Firearms, and the Drug Enforcement Administration worked with OIG on this investigation. Four other persons were indicted on similar charges at the same time. Trial is pending. (United States v. Daniel Burrell Cox and Charles Ellis Willis, District of South Carolina.)

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A Food and Nutrition Service Compliance Review identified him as purchasing food stamps for cash. He subsequently purchased \$670 in food stamps for cash. The mayor was sentenced to serve six months, 3 years' suspended sentence on supervised probation, and received a \$5,000 fine. (United States v. William F. Kemmer, District of Tennessee, Nashville Division.)

OIG undercover agent. He claimed that the food stamps had been obtained by his brother-in-law, who had recently died. His brother-in-law had owned a retail outlet which had been disqualified from participation in the Food Stamp Program. Sentencing is pending. (United States v. Percy Jones, Northern District of Indiana.)

- o A investigation of food stamp trafficking in eastern Oklahoma resulted in 18 indictments in Tulsa and 17 indictments in Muskogee. Employees of 7 authorized retailers, 2 unauthorized retailers, and 21 individuals unconnected to retail stores purchased over \$65,000 in food stamps for \$23,000 in cash and a stereo set. Almost \$18,000 in food stamps was recovered during arrests. (United States v. Leonard Jackson, et al, Eastern District of Oklahoma; United States v. Paul Joseph, et al, Northern District of Oklahoma.)

FOOD SAFETY AND QUALITY SERVICE

- o A wholesale meat broker in Detroit, Michigan, was indicted on four counts of violating the Federal Meat Inspection Act. The violations involved a scheme in which the broker would alter weight data previously stamped on cartons of beef by a computerized weighing machine. The broker purchased cuts of beef from a meat packing firm which packaged and weighed the meat prior to shipment to the broker. Prior to reselling the meat to retailers, the broker would alter the

weights in some instances by as much as eight pounds. Trial is pending. (United States v. J. A. Tremonti, Inc., Eastern District of Michigan.)

ANIMAL AND PLANT HEALTH INSPECTION SERVICE

- o An investigation into the U. S. Screwworm Eradication Program facility at Moore Air Base, Mission, Texas, led to the indictment of six Animal and Plant Health Inspection Service employees at the facility and one non-Government employee. The defendants were charged with various offenses including conspiracy and the stealing of Government property such as tires, tools, auto accessories, a lawn mower, office furniture, an automotive transmission, and a four-cylinder engine. Six individuals have pled guilty to one misdemeanor count, and sentences ranged from 1 year to 3 years. (United States v. Cowan, et al, Southern District of Texas, Brownsville.)

- o An investigation was jointly conducted by special agents of the Office of Management Integrity, United States Customs Service, Houston, Texas; the Drug Enforcement Administration; and the Office of Inspector General, USDA. As a result of the investigation, a Plant Protection and Quarantine inspector of the Animal and Plant Health Inspection Service and her husband were arrested for bribery. The inspector allowed drugs to pass undetected from Mexico through her inspection point, Laredo International Bridge, Texas, for a price of \$500 to \$1,500. The inspector and her husband were indicted on

five felony counts--three for bribery; one for conspiracy to commit bribery and one for conspiracy to import a controlled substance. The individuals pled guilty to one count of bribery and aiding and abetting and were sentenced to six years imprisonment. (United States v. Gorder, Southern District of Texas, Laredo Division.)

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE

- o As a result of an investigation conducted jointly with the Federal Bureau of Investigation, the principals of a large grain warehouse in Indiana were charged in a 12-count conspiracy indictment. Charges included defrauding a bank by securing loans with worthless warehouse receipts, making false statements to the Government about the status of grain at the warehouse, selling grain mortgaged to the Commodity Credit Corporation, and "bugging" a room at the warehouse office building. Trial is pending. (United States v. Arthur Don Waddell and William H. Waddell, Southern District of Indiana.)

- o The owner of a grain warehouse in Nebraska was indicted for eight counts of making false statements to the Government about the status of grain at his warehouse, selling grain mortgaged to the Commodity Credit Corporation, and withholding records from warehouse examiners. He pled guilty to five misdemeanor counts and was placed on probation for 2 years. He is also required to make restitution of \$74,500. (United States v. Richard J. Hanson, District of Nebraska.)

0 A Brooklyn, New York, construction firm, its president, and a former employee were indicted for conspiring to overstate costs of revisions on a \$10.7 million contract for construction of laboratory and storage space at the Plum Island Animal Disease Center, Science and Education Administration, Plum Island, New York. Additional counts

SCIENCE AND EDUCATION ADMINISTRATION

0 An Agricultural Stabilization and Conservation Service county executive director from Tennessee obtained \$110,000 in low-interest farm disaster loans from the Farmers Home Administration and the Small Business Administration by exaggerating cotton crop losses and withholding ASCS loss indemnity payment information from loan officials. The county executive director was indicted on three counts of making false statements to the lending agencies. He was found guilty at trial, sentenced to confinement for a year and a day, and fined \$15,000. (United States v. Earl Wayne Avery, Sr., Western District of Tennessee.)

0 Four Colorado grain bin vendors furnished inflated invoices to the Agricultural Stabilization and Conservation Service to support some 23 bin loan applications. These inflated prices resulted in \$46,500 in excessive loans. The vendors were indicted for making false statements. Three pled guilty to misdemeanor charges and were placed on probation. The fourth was acquitted. (United States v. Jerry L. Gibson, et al., District of Colorado.)

An investigation conducted into alleged sexual misconduct and improper personnel practices in the Federal Crop Insurance Corporation resulted in the removal of the three top managers of the Corporation. FIC employees had alleged that the manager and the deputy manager engaged in personal relationships with subordinate FIC female employees who were later given favored treatment in promotion and assignment opportunities, that these officials utilized Government travel to pursue personal relationships with these female employees, and that other FIC employees were improperly reassigned or promoted during several reorganization actions which the manager undertook after assuming office in 1977. The investigation was carried out jointly by special agents of the Office of Inspector General and representatives of the Department's Office of Personnel, whose special expertise was needed because of the substantial number of questioned personnel actions which were identified in the complaints. One highly publicized aspect in the complaints was the alleged creation of a so-called "bone pile" at the National Service Office of FIC in Kansas City, Missouri, where employees were allegedly reassigned and given no duties to perform with the expectation that they would resign or retire. The investigation disclosed a number of improper personnel management actions under either

FEDERAL CROP INSURANCE CORPORATION

cited the subjects for obstructing justice by concealing or destroying records being sought by the grand jury. Trial is pending. (United States v. Joseph Morton Company, Inc., Joseph Battaglia and Samuel Sembler, Eastern District of New York.)

the joint or independent direction of the Manager, Deputy Manager or Associate Manager for Administration but did not establish the current existence of a bone pile in Kansas City despite evidence of the existence of such circumstances until 1977 or 1978. The investigation did not establish proof of improper travel or utilization of travel funds by the Corporation's top staff. The trips that were examined all appeared to be related to ongoing official regional or district activities of the Corporation where the presence of top management was not unusual.

The investigation established that the deputy manager developed a personal relationship with a female employee of the Spokane, Washington, Regional Office and thereafter that several improper personnel actions were undertaken related to that employee. In connection with this same matter, testimony established that the deputy manager ordered subordinates to destroy official records which indicated that the appropriate selection official had declined to select this female employee for the position under consideration and thereafter ordered the selection official to select the employee in question. Since these circumstances indicated a possible violation of Federal criminal statutes, the relevant testimony was referred to the Department of Justice for consideration of criminal prosecution, but prosecution was declined. The investigation then continued in order to establish whether there was a basis for administrative actions. There were no other situations developed during this investigation indicative of a

possible violation of Federal criminal statutes. The investigation also established that the three top managers at one time or another engaged in after-hours social activity with subordinate female employees of FCIC field installations in circumstances creating the appearance of an improper association. Some subordinate FCIC female field employees testified that they were coerced into social circumstances with the top managers and some described sexual overtures. While the extensive interviews of FCIC employees and examination of official records did not establish proof of other specific improper actions with regard to these officials in their contacts with female employees of the organization, the Office of Personnel review cited well-documented patterns of both improper personnel practices and bad management practices. The report observed that merit system abuses which had been disclosed affected the confidence and morale of employees and the public confidence in the willingness and the ability of the organization to carry out its mission. The report described the FCIC personnel management program as being characterized by highly personalized decisions tainted with favoritism, that there was evidence of incompetence, poor training, and lack of leadership in the Personnel Branch at FCIC headquarters, with a related failure of the personnel officer to carry out effectively his advisory and control responsibilities to preclude the personnel problems disclosed. On the basis of information disclosed by OIG investigation and the special personnel review, the Department initiated action to correct deficiencies and abuses that had been discovered, and initiated action which ultimately

resulted in the removal of the three top officials and the reassignment at a lower grade to another agency of the former FIC headquarters personnel officer. The Corporation Manager applied for a medical disability retirement but this application was disapproved by the Office of Personnel Management. The Corporation's deputy manager has applied for disability medical retirement with action pending at this point. The Associate Manager for Administration exercised his right to retire from active service on the basis of age and years of service.

AUDITS

During the period April 1 to September 30, 1980, the Office of Inspector General issued 238 audit reports. One hundred and forty-one of these reports had monetary values associated with them as follows:

| | |
|--|------------------------------|
| Questioned Costs | \$124,338,000 |
| Savings and Management Improvements | 91,228,000 |
| Improper Loan Payments and Guarantees | <u>30,920,000</u> |
| | <u><u>\$246,486,000*</u></u> |

* This includes a monetary finding of over \$163 million in an audit of the interest credit agreements of the Rural Housing Construction and Repair Loan Program.

During the same period, we closed 268 reports, 152 of which contained monetary findings. At the time of issuance, the monetary value associated with these reports amounted to \$2,743,000 for questioned costs; \$1,927,000 for savings and management improvements and \$2,415,000 for improper loan payments and guarantees.

Adjustments during the audit resolution process changed these amounts, resulting in the following monetary values at time the reports were closed: questioned costs (Disallowances) \$1,924,000, savings and management improvements \$3,356,000, and improper loan payments and guarantees \$1,312,000.

Claims which were established on the basis of the above disallowances were disposed of as follows: collected \$1,066,000, in process of collection of \$295,000, and collection waived under authority of existing legislation or the provisions of the Federal Claims Collection Act of \$563,000.

On September 30, 1980, we had a total of 642 open audits. One hundred ninety-four of them had been issued within the last months, 194 were from 6 to 12 months old, 175 from 1 to 2 years, and 79 were over 2 years old.

The monetary values associated with these reports at the time of their issuance amounted to over \$517 million. Even though all these reports are still open, many of their findings have been resolved, reducing the monetary value of the unresolved portions of these reports to \$412 million.

A representative selection of our audits is highlighted below. In many cases corrective action has already been taken or is in progress.

FARMERS HOME ADMINISTRATION PROGRAMS

Low Income Housing Repair Grant Program

This FmHA program provides home improvement grant funds to elderly homeowners who cannot be assisted through other FmHA loan programs because their incomes are so limited they could not make the required loan payments. Grant funds, which may not exceed \$7,500, are used for repairs to make the dwelling safe and sanitary or remove health hazards. The funds may not be used for cosmetic purposes or to improve the convenience of the dwelling. In fiscal year 1979, 6,842 grants totaling \$19.0 million were made. In fiscal year 1980 FmHA awarded 8,589 grants amounting to \$24 million.

We conducted an audit of the grant program in two counties in New Mexico because there had been complaints from grant recipients regarding the quality of the work performed on their homes. We reviewed 21 FmHA grants totaling \$90,000 and 12 related State grants totaling almost \$29,000.

The audit disclosed problems of poor and incomplete construction, repairs which did not accomplish the objective of removing health and safety hazards, and dwellings which were too deteriorated to justify repairs.

Specific examples of the audit findings are as follows:

- o Two applicants received grants to renovate houses in which they did not live. One lived in a nearby mobile home and the other lived in another town.
- o Inspection reports in general were incomplete and in many cases inaccurate. The reports did not relate to the plans for the work or to repair work actually performed. In addition, the reports rarely mentioned specific deficiencies and occasionally showed satisfactory completion when the work was not completed or was not satisfactory.
- o Partial and final payments were made for repair work without adequate supporting documentation. In many cases contracts for the repair work were not executed by the borrower or grantee and the contractors did not provide surety bonds. Also, many partial and final payments were made prior to the satisfactory completion of the work.

- o Most of the repair work was of poor quality; that is, interior walls were not finished or painted, roof joists were not properly spaced, roof repairs were not made or in some cases they were made but the roof continued to leak, bathroom fixtures were not installed, doors and windows were not cased or insulated, kitchen cabinets lacked drawers, in one case there was a 10 x 24-inch hole between the roof connection of a new addition and the old structure, exterior doors had been replaced with hollow core doors, holes for plumbing and electrical wiring had not been sealed, and some work had to be redone at additional cost while other work had been paid for twice.

In summary, of the 20 grants (totaling \$90,000) reviewed, we found 9 cases in which grant funds of more than \$30,000 had been either misused or ineffectively used because of poor and unsupervised repair work.

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE
COMMODITY CREDIT CORPORATION

Loans For Farm Storage Drying Equipment

We recently initiated a nationwide review of the Farm Storage and Drying Equipment Loan Program because of the increase in loan activity. The value of new loans made during fiscal year 1979 was nearly \$680 million. The balance of outstanding loans rose from about \$800 million as of September 30, 1978 to about \$1.3 billion as of September 30, 1979.

In one audit, we selected a random sample of 187 loans of the 2,181 loans disbursed in a single State between January 1978 and September 1979. Detailed record reviews and field inspections were performed for 34 multipurpose structures in our sample. Loans totaling over \$323,000 for 21 multipurpose structures (about 62 percent) did not entirely meet program provisions. For example, structures were not properly maintained so they could be used for storage purposes. Twenty of 34 structures examined did not have the necessary liners, bulkheads, or applicable grain kits. A borrower remodeled a structure and used a portion of it for a machine shop and a portion as a commercial fertilizer store. Eight of the 34 multipurpose structures were not inspected before loan disbursement, which resulted in loans being made for four ineligible structures. We recommended corrective actions for each deficiency noted.

Warehouse Examinations

Traditionally, warehouse examinations are made to determine whether sufficient inventory is on hand to satisfy storage obligations. Also, warehouse examiners usually attempt to determine the condition of the grain and whether there is sufficient insurance coverage on the inventory. We checked on the adequacy of examinations in 29 grain warehouses in 9 States. While procedures for these traditional functions were considered satisfactory, we noted two specific areas that need increased emphasis during future inspections. Current procedures do not require examiners to review

records to determine whether rates charged CCC for storage were no more than those charged other warehouse customers. Also, CCC was not always advised when overobligated positions were noted during warehouse examinations. In some cases, CCC was not advised that adverse conditions were repeatedly found at the same warehouse. Our reports recommended specific corrective actions for each deficiency noted.

Fiscal Closing Operations - Kansas City Commodity Office

In one of the first audits to be conducted by a local certified public accounting firm under a contract with us, several weaknesses were reported in the cash receipts control and fiscal year closing operations. Many of the problems were similar to those cited in OIG audit for the years ending September 30, 1978 and 1977. For example, we found deficiencies with respect to transportation accruals for both processed and bulk grain commodities, overall responsibility for closing operations not being assigned to a single coordinator, unrecorded claims for freight bills which could total as much as \$350,000, lack of a systematic selection process for promptly identifying largest potential dollar recoveries in the post audit of freight bills, position inventory quantities not being reconciled with financial quantities, and checks not being immediately restrictively endorsed and deposited. The CPA firm included 14 recommendations to correct the noted deficiencies.

Alabama State ASCS Office - Administrative Operations

Various administrative operations were reviewed during the audit of State and county office operations. We found that numerous overpayments, duplicate, and/or inappropriate payments were made for equipment, supplies, and telephone usage. Our limited review disclosed weaknesses in procedures which resulted in improper payments of over \$2,000. Budgeting and staffing activities were not coordinated, and counties were directed to deposit their remaining fiscal year allocation in the county checking account. We estimated the interest cost to the Federal Government for money exceeding the sum authorized by instructions, which was deposited in local county checking accounts, at about \$5,000. Procurement requirements for office equipment were not followed. During fiscal year 1979, the State office advised counties to cancel existing machine maintenance contracts, and to contract with one firm selected by the State office. The new contracts were more expensive, based on services provided, than the previous contracts. Some counties obtained contracts on some machines that were still under manufacturer's warranty. Our audit disclosed that in seven of eight counties, one or more typewriters were purchased in each county even though they were not needed. The State office purchased 36 programmable calculators. The proposed annual savings from the use of these machines appeared overstated and most did not appear necessary. We estimated unnecessary purchases of this and other equipment in fiscal year 1978 and 1979 exceeded \$100,000. Our report contained 14 recommendations for corrective actions.

FOREIGN AGRICULTURAL SERVICE

National Renderers Association

We reviewed the operations of the National Renderers Association (NRA), a cooperator who entered into agreements with the Foreign Agricultural Service (FAS), for foreign market development projects on a shared (industry-Federal) funding basis. The Federal contributions are about \$850,000 annually. We found a need for increased NRA headquarters monitoring, supervision, delegation of authority, and control of the Association's field operations in order to improve management and thus to assure better control over the expenditure of funds. We concluded that administrative and management problems have had an adverse effect on program operations. We recommended organizational, administrative, and management actions. The Association and FAS have responded positively to the disclosures and are undertaking corrective actions.

OFFICE OF OPERATIONS AND FINANCE

Automatic Data Processing Security

The Department's Office of Operations and Finance (O&F) operates five major computer centers located throughout the United States. The Department's ADP security guidelines state that users have a responsibility to access or attempt to access only data they are authorized to use. Agencies are also responsible for safeguarding any sensitive data maintained on the computers and data protected under the Privacy Act by using the various restrictive devices offered by the centers. The centers are responsible for providing

the means for the user agencies to protect fully their sensitive data as well as providing physical security for the center. The increasing technology and the proliferation of ADP equipment has resulted in a wider range of computer applications and a greater commitment of the Department's resources to ADP operations. This increased dependence and use of ADP has brought about a corresponding vulnerability to theft, modification, or destruction of ADP assets, and to disruption of processing. Our audit effort in these areas has therefore been increased. Our recent audits have disclosed the following.

Washington Computer Center

Our 1978 audit of the Washington Computer Center (WCC), cited in our March 31, 1979 Semiannual Report, disclosed numerous unauthorized accesses to computer files. We also reported that user agencies were not adequately protecting sensitive data and data covered by the Privacy Act.

We attributed these problems to (1) an insufficient concern and emphasis by management on computer security, (2) poor computer security procedures and practices by user agencies, and (3) noncompliance with the Department's existing security standards and guidelines. Further, there was no central management organization with the day-to-day responsibility and authority for monitoring and enforcing USDA computer security procedures and standards among the agencies.

Many problems similar to those found at WCC were also found during our 1980 audit of the Fort Collins Computer Center (FCCC). In this audit we reported that (1) user agencies were not complying with existing ADP security standards, resulting in inadequate protection of sensitive files and files covered by the Privacy Act, (2) user agencies had neither formally appointed security officers nor defined specific ADP security responsibilities, (3) user agencies had not developed contingency plans to identify critical application programs and data files in case of a major disaster at the FCCC, and (4) user agencies were not making full use of the disaster site facility to backup their critical data files.

Fort Collins Computer Center

Our 1980 followup audit found that the WCC's security standards and procedures had improved considerably. WCC had installed a security package which proved to be an effective control over unauthorized access to the system and had strengthened its procedures. However, some of the actions required by O&F's directives which were designed to correct deficiencies were not implemented at the user agency level. For example, agency security officers were (1) not keeping abreast of attempted accesses rejected by WCC's security package, (2) not providing security training for their agency's ADP users, (3) not obtaining required security clearances for personnel who handled sensitive data, and (4) not providing security briefings to new and departing personnel.

We also reported that the center's ADP security procedures and controls were not adequate to meet the standards required by the Privacy Act, that unauthorized users were not limited in their attempts to access the system, and that system access keys were not adequately protected. As in the WCC audits, we attributed these security weaknesses to agency and center management not placing a high enough priority on ADP security. The Office of Operations and Finance has been receptive to our recommendations for an improved program. A key problem in our opinion is the need for independent monitoring to insure all levels of ADP users understand and consistently implement existing regulations. We are currently working with O&F to search for ways that agency can strengthen its oversight role.

In our continuing effort to review activities relating to ADP security, we are starting an audit of USDA's implementation of the requirements of OMB Circular A-71, Security of Federal Automated Information Systems, issued in July, 1978.

SECTION III

MONEY OWED TO THE DEPARTMENT OF AGRICULTURE

In accordance with a request in the report of the Senate Committee on Appropriations on the Supplemental Appropriation and Rescission Bill of 1980, the following are estimates provided by the agencies of the Department of the amount of money owed, the amount of money overdue, and the amount written-off as uncollectible in fiscal year 1980.

| <u>Agencies</u> | (Millions) | | <u>Written-Off</u> |
|---|-------------------|------------------|--------------------|
| | <u>Money Owed</u> | <u>Overdue</u> | |
| Federal Crop Insurance Corporation | \$ 134.0 | \$ 6.0 | \$.2 |
| Science and Education Administration | .4 | -0- | -0- |
| Food and Nutrition Service | 9.6 | 6.7 | -0- |
| Soil Conservation Service | 5.2 | 1.4 | -0- |
| Animal and Plant Health Inspection Service | 5.4 | -0- | -0- |
| *National Finance Center | 22.0 | 8.4 | -0- |
| **Agricultural Stabilization and Conservation Service | 13,501.6 | 94.5 | .9 |
| ***Rural Electrification Administration | 21,841.0 | .4 | -0- |
| Forest Service | 57.0 | 24.3 | 2.9 |
| ***Farmers Home Administration | <u>43,487.0</u> | <u>917.0</u> | <u>14.0</u> |
| TOTAL DEPARTMENT | <u>\$79,063.2</u> | <u>\$1,058.7</u> | <u>\$18.0</u> |

* The National Finance Center keeps the accounts for the Food Safety and Quality Service, Federal Grain Inspection Service, Economics, Statistics and Cooperatives Service, Agricultural Marketing Service, and the Office of Transportation.

** Includes Commodity Credit Corporation

*** Includes Certificates of Beneficial Ownership sold to Federal Financing Bank but excludes Certificates of Beneficial Ownership and notes sold to other than the Government. (The latter figure was approximately \$3.8 billion for Farmers Home Administration and \$385 million for the Rural Electrification Administration in 1979.)

SECTION IV

EMPLOYEE COMPLAINTS (HOTLINE")

During fiscal year 1980, the Complaints Analysis and Investigation Staff (CAIS) established action files on 425 complaints received from USDA employees, the General Accounting Office, and the public. This represents an increase of 11 percent over the number of complaints received in the previous 12-month period. The majority of the complaints (65 percent) were received over the OIG toll-free hotline or through mail directed to the Inspector General.

Most complaints involved allegations of noncriminal matters such as general program mismanagement or waste (22 percent); minor misconduct or misuse of government equipment and supplies (9 percent); pay, promotion or other personnel irregularities (24 percent); and program abuse or violation (19 percent). After initial review by CAIS, these and other similar complaints not resolved or closed by the CAIS were forwarded to the appropriate agency within USDA for their inquiry and administrative resolution, if warranted. However, 95 complaints (22 percent) required preliminary OIG investigative or audit attention with 25 of those referred for preliminary inquiry being scheduled for further field investigation.

It is too early to assess the results of those complaints being actively investigated by OIG as most of those found to be substantiated are open investigations. To date, agency actions on those complaints of a non-criminal nature which were found to have substance have included letters of caution, program changes, increased supervision, repayments, removal from program participation, and restoration of back pay.

