United States Department of Agriculture

Office of Inspector General

Economic Adjustment Assistance to Users of Upland Cotton



03601-0002-22

July 2014

Economic Adjustment Assistance to Users of Upland Cotton

Audit Report 03601-0002-22

What Were OIG's Objectives

To review FSA's implementation of EAAP and its effectiveness in stimulating investment to maintain a globally-competitive textile industry.

What OIG Reviewed

We reviewed EAAP program activity for cotton marketing years 2009 to 2011. We judgmentally selected nine current and former users and reviewed a sample of capital expenditures, valued at approximately $34.6 million, to determine whether the expenditures were allowable uses of EAAP funds.

What OIG Recommends

FSA needs to develop outcome-based performance measures for EAAP and evaluate its effectiveness. FSA should amend its guidance and user agreement to require closeout reviews, prohibit expenditures for personal use, prohibit the transfer or sale of EAAP assets based on one user's consumption to another entity, and require pre-approval for capital expenditures over a designated threshold. Finally, FSA should recover the $1.5 million in EAAP payments made to the Seller.

OIG reviewed FSA's oversight of the Economic Adjustment Assistance to Users of Upland Cotton Program (EAAP) to determine its effectiveness.

What OIG Found

The EAAP, which is administered by FSA, authorizes economic assistance to domestic users of upland cotton, such as textile mills, in order to maintain a globally-competitive United States textile industry. We found that in implementing the program, FSA did not put effective management controls in place to ensure the EAAP is meeting its program intent and sufficiently ensure that funds expended are not a waste or abuse of Government funds. Specifically, we found that FSA has not (1) established a purpose for EAAP consistent with its regulations, (2) conducted a program evaluation, or (3) established performance measures to determine the impact of payments to domestic users of upland cotton. Even though the agency anticipated payments would limit market losses, plant closures, and employment declines, FSA has not developed a way to measure this impact.

We also found that management controls were insufficient to prevent one upland cotton user from transferring $1.5 million of $12.1 million in payments to another user. The user who received $12.1 million (the Seller) sold its cotton spinning operations to another EAAP user (the Buyer) and used $10.6 million in EAAP payments to buy equipment to be installed at one of the Buyer's plants. The Seller used the remaining $1.5 million of its funds to supplement the Buyer's own equipment purchase—effectively serving as a discount to the Buyer. Additionally, we identified $900,000 in expenditures that were wasteful or for personal use. Altogether, we questioned 75 expenditures, totaling over $2.4 million. This occurred because FSA has not implemented effective internal controls to determine which capital expenditures are eligible uses of EAAP funds.

Without necessary controls in place, FSA cannot ensure that EAAP properly supports its intended purpose—to stimulate investments that make the United States textile industry more competitive. We were able to reach management decision on three of the eight recommendations.

United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250

DATE: July 31, 2014

AUDIT NUMBER: 03601-0002-22

TO: Juan M. Garcia
Administrator
Farm Service Agency

ATTN: Philip Sharp
Director
Operations Review and Analysis Staff

FROM: Gil H. Harden
Assistant Inspector General for Audit

Gil H. Harden

SUBJECT: Economic Adjustment Assistance to Users of Upland Cotton

This report presents the results of the subject audit. Your written response, dated July 21, 2014, is included in its entirety at the end of the report. Excerpts from your response and the Office of Inspector General's (OIG) position are incorporated in the relevant sections of the report. Based on your written response, we accept management decision on Recommendations 1, 2, and 6. We are unable to accept management decision on Recommendations 3, 4, 5, 7, and 8. The documentation or action needed to reach management decision for these recommendations are described under the relevant OIG Position sections.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendations for which management decisions have not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publically available information and will be posted in its entirety to our website (http://www.usda.gov/oig) in the near future.

Table of Contents

Background and Objectives

Background

First authorized by Section 1207 of the Food, Conservation, and Energy Act of 2008 (commonly referred to as the 2008 Farm Bill), the Economic Adjustment Assistance to Users of Upland Cotton[1] Program (EAAP) is a program designed to maintain a globally-competitive United States textile industry by limiting further market losses, plant closures, and employment declines. EAAP, which is administered by the Farm Service Agency (FSA), authorizes economic assistance to domestic users of upland cotton, such as textile mills, that invest in capital improvements to their operations.[2,3]

Domestic users received 4 cents for each pound of upland cotton used from August 1, 2008, to July 31, 2012, and 3 cents thereafter. The payments must be used to acquire new property, plant, and equipment or upgrade the existing capital facilities, and equipment, and the user agrees upon accepting program payments to open its records to audits by the Department of Agriculture (USDA). Payments may only be used for capital investments to acquire, construct, install, modernize, develop, convert, or expand land, plant, equipment, facilities or machinery. The capital expenditures must be completed within 18 months after the close of the cotton marketing year when the cotton was consumed, which runs from August 1 of one year to July 31 of the following year.[4] Since the onset of EAAP in August 2008 until July 2013, program payments have amounted to approximately $337 million.

The 2008 Farm Bill authority ended in September 2012, without a new Farm Bill being enacted. However, Congress extended programs and payments at the 2008 Farm Bill levels until September 30, 2013.[5] The Agricultural Act of 2014, also known as the 2014 Farm Bill, was signed on February 7, 2014, which extends EAAP through September 30, 2018. The 2014 Farm Bill provides EAAP payment assistance at a rate of 3 cents per pound of eligible cotton consumed.

Users must first apply to FSA for authorization to participate in EAAP through the Upland Cotton Domestic User Agreement. Prior to entering into an agreement, FSA officials conduct a telephone interview and/or physical inspection of the user's facility. After the user is approved, the user provides a monthly application for payment, certifying the amount of eligible upland

[1] Upland Cotton is a type of cotton that is considered "short staple," as the staple length is shorter than Extra Long Staple or Pima cotton. In the United States, cotton is considered upland if its staple length is less than three-eighths of an inch.
[2] For EAAP purposes, "cotton" refers to baled lint, loose samples that have been re-baled, baled semi-processed motes, or baled re-ginned motes.
[3] Eligible domestic users are those who are regularly engaged in the business of opening bales of eligible upland cotton for eligible purposes and who have entered into a user agreement to participate in the program. To be eligible, cotton bales, regardless of origin, must be opened by an eligible domestic user. Eligible purposes include the spinning, papermaking, or processing of non-woven cotton products in the United States. Typically, spinning is the process of transforming cotton into yarn, which is further processed into products such as clothing.
[4] For example, August 1, 2012, to July 31, 2013, would be marketing year 2012.
[5] The American Taxpayer Relief Act of 2012 (Public Law 112-240), dated January 2, 2013, provided a 1-year extension of agricultural programs.

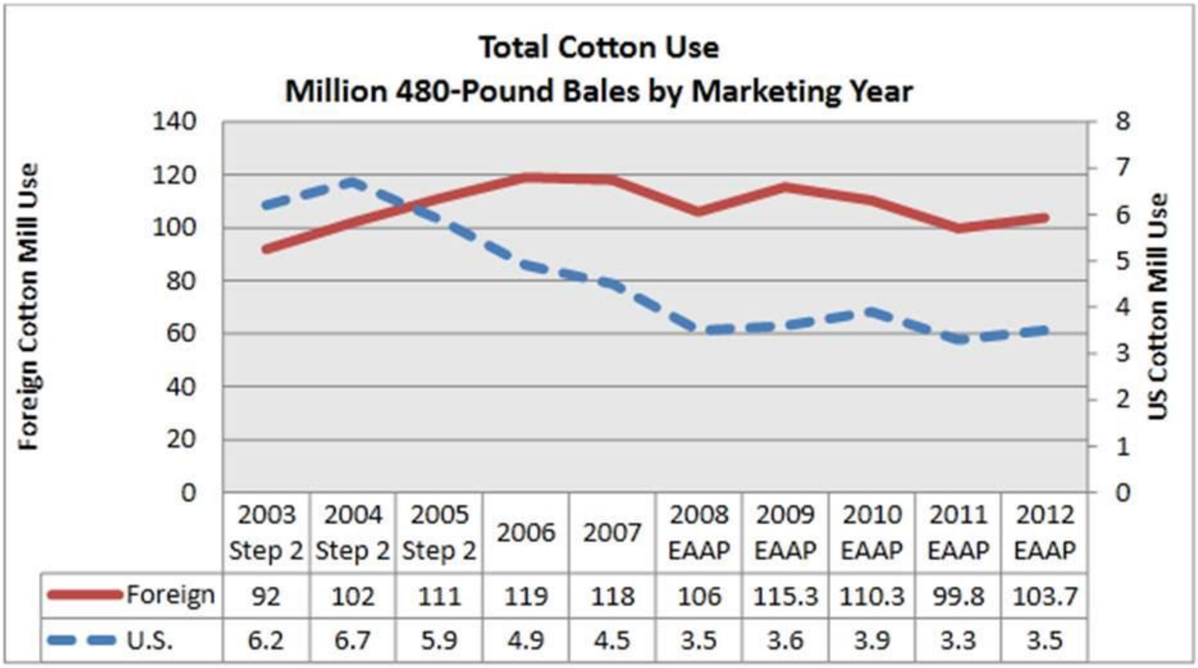
cotton used and requesting payment. Monthly payments to eligible users are made through the Commodity Credit Corporation (CCC). As CCC has no operating personnel, its activities are carried out primarily through FSA's personnel.

EAAP was preceded in 1990 by the Upland Cotton User Marketing Certificate Program, commonly referred to as the Step 2 Program. However, there are two key differences between EAAP and Step 2. EAAP has a set payment rate for consumed upland cotton, regardless of origin. On the other hand, Step 2 used a variable rate to compensate exporters and domestic mill users for purchasing United States upland cotton, which tends to be priced higher than the world cotton market price. In addition, Step 2 payments did not have any restricted uses; the user could use the payments for any purpose. Economic adjustment assistance under EAAP is made available to domestic users of upland cotton that certify that the assistance shall be used only to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery.[6] In 2002, Brazil initiated a World Trade Organization (WTO) dispute case against specific provisions of the United States' cotton programs. As a result of the WTO ruling, USDA eliminated "prohibited subsidies" and stopped Step 2 payments on August 1, 2006.

The United States' use of cotton had steadily decreased before EAAP. In cotton marketing year 1997, domestic use was over 11.3 million 480-pound bales. By 2007, domestic use was down to almost 4.6 million 480-pound bales. After EAAP was authorized in the 2008 Farm Bill, average domestic use has held relatively steady at approximately 3.5 million 480-pound bales annually. As illustrated in the chart below, United States cotton consumption was dropping even during the Step 2 Program and continued to do so through the first year of EAAP payments. Since EAAP's second year began, the United States' use has not dramatically increased or decreased, but held relatively steady, as has world cotton use.

[6] Section 1207(c)(3) of the Food, Conservation, and Energy Act of 2008 (Public Law 110-246, commonly referred to as the 2008 Farm Bill), dated June 18, 2008.

Figure 1: Cotton Consumed During Marketing Years 2003 - 2012[7]



	2003 Step 2	2004 Step 2	2005 Step 2	2006	2007	2008 EAAP	2009 EAAP	2010 EAAP	2011 EAAP	2012 EAAP
Foreign	92	102	111	119	118	106	115.3	110.3	99.8	103.7
U.S.	6.2	6.7	5.9	4.9	4.5	3.5	3.6	3.9	3.3	3.5

The preceding table demonstrates increases and decreases in annual foreign and U.S. Cotton use between 2003 and 2012. Between 2008 and 2012, U.S. and foreign cotton use increase or decrease together except in 2010 when foreign consumption decreases while U.S. consumption increases.

The 2008 and 2014 Farm Bills authorize the Secretary of Agriculture to audit or review a user's records to determine if it is in compliance with program rules. To accomplish this oversight responsibility, field examiners from FSA's Kansas City Commodity Office periodically conduct on-site examination reviews of users in EAAP, in order to ensure users comply with their user agreement and applicable Federal regulations (i.e., 7 *Code of Federal Regulations* (CFR) Part 1427). These reviews determine if the cotton consumed by a user is eligible by examining purchasing and shipping invoices. The review also verifies that program payments are spent for authorized purposes. If examiners determine that a user did not comply with program regulations, the user can be liable to repay the assistance and be disqualified from the program for 1 year.

As of February 2013, FSA examiners reviewed all users at least once, performing approximately 129 reviews. Also as of February 2013, FSA's reviews of EAAP users have resulted in over $3.2 million in refund requests. A majority of the refund requests are due to users claiming inflated weights for the cotton consumed.

Objectives

The overall audit objective was to review the implementation and the effectiveness of EAAP in stimulating investment to maintain a globally-competitive United States textile industry.

Section 1: EAAP Lacks Established Goals or Measures to Demonstrate Program Effectiveness

Finding 1: FSA Has Not Implemented Effective Management Controls to Evaluate the Impact of $337 Million in EAAP Payments to Program Users

FSA has not (1) established a purpose or goal for EAAP consistent with its regulations, (2) conducted a program evaluation, or (3) established performance measures to determine the impact of economic assistance payments to domestic users of upland cotton. Even though the agency anticipated payments would limit market losses, plant closures, and employment declines,[7] FSA has not developed a way to measure this impact. Instead, the agency views paying users in a timely manner and assuring that the users spend the money within required timeframes to be its only purpose in administering the program. Therefore, FSA did not develop an assessment of program impact beyond making payments and performing examination reviews. Without established goals and related outcome measures, FSA cannot demonstrate that the $337 million spent between August 2008 and July 2013 has stimulated the United States textile industry, or determine to what extent the assistance actually improved the condition of users as they compete in a global market.

The Government Performance and Results Act (GPRA) requires agencies to establish goals and measure program performance.[8] After establishing goals, GPRA requires agencies to use performance indicators—including outcome measures—to measure or assess progress toward established goals. The Office of Management and Budget (OMB) issued guidance for agencies to place more emphasis on program evaluations to determine if programs are performing as intended, and the Government Accountability Office has reported that these goals can serve as leading practices at the program level.

Prior to the passage of the 2008 Farm Bill, the United States textile industry's consumption of upland cotton steadily declined to less than half the use a decade earlier.[9] EAAP was designed as a "short term economic assistance program for a struggling domestic textile industry"[10] when originally enacted in the 2008 Farm Bill. The program assists users in making capital improvements to their operations by funding expenditures that acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery.[11]

We found that FSA has not developed an overall goal for EAAP, conducted a program evaluation, or developed performance measures to determine the effectiveness of the program in assisting the domestic textile industry. Instead, FSA views its only requirement under the 2008 Farm Bill to be ensuring users are timely paid for the cotton they consume. FSA stated it

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[7] 73 Federal Register 65718, dated November 5, 2008.
[8] GPRA of 1993, Public Law 103-62, amended by the GPRA Modernization Act of 2010, Public Law 111-352, dated January 4, 2011.
[9] In cotton marketing year 1997/1998 domestic use was over 11.3 million 480-pound bales; by 2007/2008 domestic use was down to almost 4.6 million 480-pound bales.
[10] Committee Report, 110th Congress, Senate Report No. 110-220, dated November 7, 2007.
[11] Section 1207(c) of the Food, Conservation, and Energy Act of 2008 (Public Law 110-246, commonly referred to as the 2008 Farm Bill), dated June 18, 2008.

had not performed an analysis of EAAP due to the simplicity of the program, and the intent was to get the money out quickly to assist the struggling textile industry. FSA officials further stated that establishing a goal is difficult because the legislation did not state any objectives. FSA officials believe they are administering the program as required by the Farm Bill and by the Department, since they timely pay users and conduct examination reviews of nearly all users on a routine basis. While EAAP has a goal to stimulate investment in order to maintain global competitiveness, FSA officials told us this goal is more a definition to assist the public in understanding the program; it is not their goal in administering the program.

While we acknowledge timely payments are important, since EAAP was originally designated a short-term program, FSA needs to determine whether the program has made a real impact in assisting the textile industry. Doing so will inform FSA whether changes are needed to increase the effectiveness of the program. With the passage of the 2014 Farm Bill, which extends the program, it is increasingly important to assess whether taxpayer dollars in future years are effectively yielding measurable results.[12]

The domestic textile mills we visited explained that EAAP funds have allowed them to purchase new equipment, thereby increasing their efficiency and competitiveness. We also visited trade associations representing the cotton and textile industries, who informed us that their members benefited from EAAP by creating or saving jobs, increasing efficiency, and allowing investments in plant and equipment. However, FSA does not know what impact the program has had in assisting the textile industry in maintaining jobs, efficiency, or investments. After spending over $337 million since the program was enacted in the 2008 Farm Bill,[13] FSA has not collected information, such as mill closings, job creation, market share, or other data, to determine the impact on the textile industry. Although anecdotal evidence from users and industry representatives indicates the program has been successful, it appears actual cotton consumption, number of plants that use cotton, and plant employment in the United States has remained level during EAAP. With the exception of 1 year, EAAP era year-to-year changes in United States and non-United States cotton consumption have risen or fallen together.[14] Due to the absence of an analysis by FSA to explain the correlation between the United States and foreign cotton use, the Office of Inspector General (OIG) was led to question whether changes have been due to EAAP (see figure 2).

[12] Agricultural Act of 2014 (Public Law 113-79, commonly referred to as the 2014 Farm Bill), February 7, 2014.
[13] Through July 31, 2013.
[14] "The EAAP era" is the period of time when EAAP is operating, beginning on August 1, 2008.

Figure 2: The United States and Foreign Cotton Consumption Before and During the EAAP Era[15]

Year	2007	2008	2009	2010	2011	2012
United States Use (Change From Prior Year)	4.6	3.5 (-24%)	3.6 (+3%)	3.9 (+8%)	3.3 (-15%)	3.5 (+6%)
Foreign Use (Change From Prior Year)	119.0	106.5 (-10%)	115.3 (+8%)	110.3 (-4%)	99.8 (-10%)	103.8 (+4%)

Figure 2 above displays United States and Foreign cotton consumption, including percentage changes from the prior year, for the period 2007-2012.

Without a more definite goal to measure against, FSA has not explored this or other available data to appraise the program's effectiveness. Without a program evaluation or established performance measures, FSA does not know whether the program has assisted the textile industry in the short term or needs to continue for a longer period. Additionally, without an evaluation of the program, FSA will not know if the 3 cents per pound rate paid to users is adequate or excessive.[16]

Recommendation 1

Develop a goal or goals along with outcome-based performance measures for EAAP to determine the impact the program has on the United States textile industry.

Agency Response

FSA agreed with this recommendation and stated that it will use guidance issued by the Office of Management and Budget to establish goal(s) with outcome-based performance measures in order to comply with the Government Performance and Results Act. Furthermore, FSA stated it will statistically estimate and quantify the competitiveness-enhancing strength of EAAP, based on its performance in encouraging capital investment and limiting market losses, plant closures, and employment declines among domestic users of upland cotton. FSA expects to complete the analysis by December 31, 2014.

OIG Position

We accept management decision for this recommendation.

Recommendation 2

Perform a program evaluation to determine if EAAP is performing as intended.

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[15] Expressed in millions of 480-pound bales.
[16] From August 1, 2008, to July 31, 2012, the payment rate was 4 cents.

Agency Response

FSA agreed with this recommendation. FSA stated that it will conduct a program evaluation of EAAP in order to determine/measure the impact of economic assistance payments to domestic users of upland cotton. Measures of potential impacts, according to FSA, may include limits on market losses, a decrease in plant closures, increased employment levels, and the extent that the economic assistance improved the condition of the program participants competing in a global market. FSA stated that it will thereafter maintain and update analyses for use by policy officials in future assessments of EAAP program performance. FSA will present the findings no later than January 31, 2015.

OIG Position

We accept management decision for this recommendation.

Section 2: EAAP Lacks Adequate Policies and Controls to Prevent Improper Spending

Finding 2: Lack of Effective Program Oversight and Close-out Review of One EAAP User Placed $1.5 Million in Program Payments at Risk

We found that one upland cotton user received $12.1 million in EAAP payments for consuming cotton, but did not use the funds to invest in its operations, as it originally told FSA it would. Instead, it (the Seller) transferred those funds, both directly and indirectly, to another user (the Buyer). The Seller directly used $10.6 million of the $12.1 million to acquire equipment that was installed into the Buyer's plant and then indirectly transferred $1.5 million to the Buyer to be used in acquiring additional equipment. These transactions were approved by FSA because the agency's officials reasoned that investments made by any user of upland cotton met the purpose of the program—to make payments to users of upland cotton— and did not perform a close-out review that examined the transaction. However, we determined that, even though the $10.6 million equipment purchase met the purpose of the program, the $1.5 million transfer did not meet that purpose, because it was transferred, rather than used to acquire equipment for the Seller. The entity that earned the payment, the Seller, neither used the money for qualified purchases nor returned it to the Government as required under EAAP. Therefore, FSA should recover $1.5 million from the Seller.

EAAP payments are based on the amount of cotton consumed by the user and "all payments received by the agreement holder [user] must be used for purposes as specified in the…2008 Farm Bill."[17] Transfer of funds to another user is not listed as an authorized purpose. Each EAAP user agrees to the terms of the program contained in its user agreement with FSA. According to this Upland Cotton Domestic User Agreement, users have 18 months after the close of the marketing year (July 31) to either spend consumption earnings on capital investments or return them to FSA. For example, payments earned for cotton consumed between August 1, 2008, and July 31, 2009, must be used or returned by January 31, 2011.

The 2008 Farm Bill authorizes the Department to conduct audits and reviews.[18] FSA has stated it maintains an informal policy to inspect each user at least once a year, except in rare cases where it is not cost effective to do so, and to conduct a close-out inspection for users who leave the program.[19] These examination reviews are intended to confirm that reported consumption is accurate, that qualified expenditures are actually paid for and can be verified, and that agreement holders made capital expenditures equal to or greater than any amounts paid by FSA, based on the users' own "documented use" [consumption] of upland cotton.

The Seller participated in EAAP for 15 months—from August 2008 until October 2009—when it sold its cotton spinning operations to the Buyer.[20] Originally, the Seller planned, and FSA

[17] 7 CFR 1427.105(e), dated November 5, 2008.
[18] Section 1207(c)(4) of the Food, Conservation, and Energy Act of 2008 (Public Law 110-246, commonly referred to as the 2008 Farm Bill), dated June 18, 2008.
[19] Section 1207(c) of the Food, Conservation, and Energy Act of 2008 (Public Law 110-246), dated June 18, 2008.
[20] The Seller's user agreement was signed in December 2008, but retroactively applied to cotton consumption starting in August 2008.

approved, use of its EAAP funds to modernize one of its plants, stating that it might then sell the plant to another company. The modernization plan included the purchase of 13 pieces of spinning equipment in the Seller's plant. In September 2009, a month before selling its cotton spinning operations, the Seller issued a purchase order for approximately $12.1 million to buy 13 spinning machines. The Seller then sold its cotton spinning operations, including U.S. plants, to the Buyer, but changed its plan, instead installing the machinery in one of the Buyer's facilities that was never owned by the Seller.

In what was presented to FSA as a separate transaction, the Buyer purchased 17 pieces of the same model of spinning equipment from the same equipment manufacturer. All 30 pieces of equipment were installed in the Buyer's plant as part of the same project, even though it was represented by the Seller and Buyer respectively as two separate purchases: (1) the 13 pieces of equipment (originally costing $12.1 million) bought from the Seller and (2) 17 pieces of equipment bought directly from the manufacturer for $12.3 million. The manner of this transaction is problematic on two levels. First, it provided an incentive for the Seller to spend EAAP funds on equipment that it did not and could not use in its own operations, which, although allowable, does not fulfil the purposes of EAAP. Second, it allowed the Buyer to receive a $1.5 million improper discount for the separate purchase of 17 machines indirectly from the Seller.

Equipment Purchases Based on the Seller's Consumption Were Not Used in Its Operations

The Seller paid $12.1 million for 13 pieces of equipment and had them installed in the Buyer's plant during the summer and fall of 2010. The sale of equipment was not related to the purchase of the Seller's cotton spinning operations and corresponding plants, but, rather, was a facet of an agreement in which the Seller would buy yarn[21] from the Buyer for use in its clothing manufacturing operations, located in four foreign countries. Since the Seller would have to return any unused funds to FSA within 18 months of the close of the marketing year, it had an incentive to spend as much of the $12.1 million it had received as possible—even if the funds were for equipment it had no intention of using—in order to sell that equipment for cash. As a result, we found that the Seller was able to use EAAP funds to eventually receive a cash payment from the Buyer and use that for operations that convert yarn to clothing—expenditures not eligible for EAAP.[22] Although allowed under the program, the transaction did not assist the Seller in remaining in business. If FSA were to require users to return the remaining value (net book value) of sold equipment, users would no longer have this incentive to waste EAAP funds on expenditures that did not directly benefit the user's operations.

Buyer Effectively Used $1.5 Million of Seller's EAAP Payments to Fund Its Own Purchases

We also determined that, although the purchase of 30 pieces of equipment was being treated as two transactions, the price was, in fact, negotiated as a single transaction.[23] Representing one

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[21] Yarn is the resulting product from spinning cotton.

[22] The cash payment was in the form of a discount by the Buyer to the amount owed it by the Seller for managing the Seller's inventory of yarn purchased under the agreement.

[23] The Seller initially refused to cooperate with OIG's review and, as a result, we conducted additional fieldwork with the Buyer and the equipment manufacturer in order to fully evaluate this transaction. Seven months after our

transaction as two allowed the Seller and the Buyer to shift EAAP funds between them—which is not listed as an allowed purpose according to program regulations, because EAAP payments are calculated based on each individual user's consumption.

The Seller originally negotiated with the equipment manufacturer and paid approximately $12.1 million for 13 pieces of equipment. However, the Buyer had previously negotiated a lower price for 30 pieces of the same equipment, but had not executed the sale. When the Buyer later decided to purchase 17 pieces of equipment itself, the equipment manufacturer agreed to combine that purchase with the purchase of 13 pieces that the Seller had contracted for (and then sold to the Buyer,) into one 30 machine transaction at a price of $24.4 million, even though the Seller had already agreed to pay $12.1 million for only 13 pieces of equipment. The pricing to the Buyer was as follows:

Figure 3: Manufacturer and Buyer Pricing Agreement For 17 Pieces Of Equipment

Price for 30 pieces of equipment	$24.4 Million
Less: Seller's purchase of 13 pieces	($12.1 Million)
Amount due from Buyer for remaining 17 pieces	**$12.3 Million**

Figure 3 demonstrates how the Buyer's price for 17 pieces of equipment was arrived at by using a set price for 30 pieces less the Seller's payment for 13 pieces.

Had the Buyer only paid for its 17 pieces of equipment at its negotiated per machine price, rather than combined the two purchases into one, its cost would have been $13.9 million.[24] Instead, this retroactive price allocation resulted in an even lower price of $12.3 million for 17 machines for the Buyer, which resulted in an overall $1.5 million discount from what the Buyer would have paid if the deal had been strictly between it and the equipment manufacturer. Under this single transaction price structure, the Seller paid $10.6 million for 13 pieces of equipment, effectively transferring the additional $1.5 million to the manufacturer, receiving no equipment in return. The manufacturer then transferred the $1.5 million to the Buyer by discounting the price of its 17 pieces of equipment. Therefore, while the Seller paid $1,518,068 more than the Buyer's originally proposed price, the Buyer paid exactly $1,518,068 less. The effect was an indirect payment from the Buyer to the Seller of approximately $1.5 million (see figure 4).[25]

original inquiry, the Seller did provide documentation proving that it did pay $12.1 million to the equipment manufacturer for the 13 pieces of equipment, but did not cooperate further.

[24] The Buyer had a pre-existing price agreement with the equipment manufacturer which, after adjustments, resulted in a per machine price of $814,839. At this price, the Buyer would have paid $13.9 million for the 17 pieces of equipment.

[25] Since the equipment is manufactured by a company based in the European Union, prices are established and payments were made in euros, and over an 11-month period. For simplicity, we used the Seller's average exchange rate of $1.3582 per euro.

Figure 4: Comparison of Amounts Under Agreement and Actually Paid (dollars in millions)

Company	Seller	Buyer	Seller/Buyer Combined
Number of Equipment pieces purchased	13	17	30
Actual Price Paid	$12.1	$12.3	$24.4
Price under agreement between Buyer and manufacturer	$10.6	$13.9	$24.4
Overpayment:	**$1.5**		

Figure 4 above demonstrates how OIG calculated the Seller's overpayment by breaking down transaction as it actually occurred and comparing it to the transaction if every identical piece of equipment had been priced equally.

Program regulations require that all funds expended on allowable capital expenditures be equal to, or greater than, any amounts paid by FSA, based on the user's consumption of upland cotton. The $1.5 million in question was transferred from the Seller to the Buyer, using the equipment manufacturer as an intermediary, which is not an allowable expenditure. Therefore, the $1.5 million that was not expended on the Seller's purchases should be returned to the Government.

Both of these issues were allowed to occur because FSA was unaware of the particulars of the *de facto* transfer or the agreement between the Buyer and Seller. Although FSA did conduct what it considered to be a close-out examination of the Seller in February 2010, we found that this examination was not an effective close-out review because it did not include an examination of the equipment paid for. At the time of that review, FSA was not aware that the equipment would be placed somewhere other than the Seller's plants, having been told that the equipment would be installed in the Seller's plant and would transfer to a Buyer as part of the sale of that plant. It was in April 2010 that the Seller informed FSA that the equipment would be installed in one of the Buyer's plants unrelated to the sale. FSA remained unaware that the transfer of the equipment was not part of the sale of cotton spinning operations and plants until informed by OIG.

Had an effective close-out examination been conducted, including an evaluation of the nature and appropriateness of any transfer of payments to the Buyer, FSA examiners should have become aware of the negotiated price and Seller's inflated payment, compared to the Buyer's discounted payment. Because it did not analyze the transaction in depth, FSA did not evaluate whether the Buyer should be able to benefit from EAAP-purchased assets based on the Seller's consumption. Additionally, when we spoke to agency officials, they explained that, even if they had been aware of the equipment transfer, they would have approved the transaction, since they believe the program was designed to put assistance in the hands of cotton users, such as the Buyer. However, OIG notes that allowing EAAP purchases to be transferred between users undermines the 2008 Farm Bill's stipulations that payments be based upon a user's individual consumption, rather than the industry as a whole. Because benefits are based on individual users' consumption, the investments should also be made for that user. Without sufficient controls addressing transfers of EAAP purchased equipment, particularly during close-out examinations, EAAP funds remain vulnerable to being used in ways that do not fulfil the goals of the program for the individual users.

Recommendation 3

Amend the EAAP user agreement to prohibit the transfer or sale of EAAP assets based on one user's consumption to another entity, unless the depreciated (net book) value of the asset is returned to FSA.

Agency Response

FSA did not agree with the recommendation to prohibit the transfer or sale of EAAP assets based on one user's consumption to another entity unless the depreciated (net book) values of the assets were returned. FSA's disagreement was due, in part, to its belief that the agency does not have the authority to approve or prohibit the transfer or sale of legitimately purchased land, plant, buildings, equipment, facilities, or machinery. Additionally, FSA believes that involving the agency in micro-management of agreement holders' everyday accounting and business decisions after EAAP funds were legitimately used to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery would be excessively restrictive to agreement holders and beyond the scope of FSA's authority.

OIG Position

We are unable to reach management decision for this recommendation. EAAP has an objective to stimulate investment in order to maintain global competitiveness, and OMB Circular A-123, *Management Responsibility for Internal Control,* requires agencies to ensure that Federal resources are used efficiently and effectively to achieve desired program objectives. When assets are transferred, the expenditure to acquire that asset no longer serves as an investment for that company in a globally competitive industry. To reach management decision, FSA should seek an opinion from the Office of the General Counsel (OGC) to determine if FSA has the authority to limit the sale or transfer of EAAP purchased assets once they are acquired. If OGC determines the agency does have the authority in administering EAAP to limit transfers, FSA needs to develop internal controls, with a date of implementation that sufficiently addresses transfers of EAAP purchased equipment, particularly during close-out examinations, sufficient to ensure EAAP funds are protected from being used in ways that do not fulfil the goals of the program.

Recommendation 4

Recover the $1,518,068 in EAAP payments made to Seller.

Agency Response

FSA did not agree with this recommendation. FSA states that the Seller made a purchase of equipment in excess of EAAP funds (paid to the Seller), in accordance with established guidelines in place at that time. FSA further states that it does not have the authority to be involved in second-guessing agreement holder accounting and business decisions after EAAP funds have been used to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery in accordance with the terms of the statute.

OIG Position

We are unable to reach management decision for this recommendation. Under the Upland Cotton Domestic User Agreement, in the event where a user receives funds in excess of the entitled payment under the agreement, CCC may require a refund of those funds. Only $10.6 million of the $12.1 million payment was used by the Seller to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery; the remaining $1.5 million was indirectly transferred to the Buyer. As such, OIG believes FSA would be within its authority to recover payment from the Seller. Since the Buyer additionally refunded a portion of the Seller's payment under the agreement to manage inventory, offsetting future payments to the Buyer of $1.5 million would serve the same purpose as the recovery. To reach management decision, FSA needs to provide an OGC opinion stating whether FSA does or does not have the authority under statute to recover the $1.5 million in funds that were transferred to the Buyer. If FSA does have the authority, FSA will also have to provide a copy of the bill for collection to the Seller for amounts owed to the Government and documentary support that the amounts have been entered as a receivable on the agency's accounting records, provide sufficient documentary evidence that the costs by the Seller were allowable, or reduce the Buyer's amount of EAAP funds available for future purchases by $1,518,068.

Recommendation 5

Amend the EAAP user agreement to require any user exiting the program to undergo a closeout examination after all transactions have been completed, including a review to determine if any payments transferred to another user are proper.

Agency Response

FSA agreed to conduct a close-out examination of an agreement holder after all transactions are completed, but did not agree to include a review to determine if transferred payments were proper. FSA noted that it has conducted close-out reviews since the inception of the program, with its available resources, but that program participants will be notified, in writing, of the existing policy and the Upland Cotton Domestic User Agreement (CCC-1045DOM) will be updated to reflect the policy by November 2014.

FSA stated that it does not have the available resources to conduct an exhaustive review and audit of each agreement holder and business transactions related to EAAP. FSA's position is that reviewing corporate documents, analyzing depreciation schedules, questioning equipment manufacturers, and spending over 12 months to review and audit 9 of 45 program participants is beyond the level of available resources.

OIG Position

We agree with the actions taken and proposed future actions by FSA for the first part of this recommendation. However, we are unable to reach management decision for this recommendation as FSA needs to further address the second part of this recommendation. FSA does not agree that close-out examinations need to include a review to determine if any payments transferred to another user are proper.

Section 1207(c)(3) of the Food, Conservation, and Energy Act of 2008 requires that EAAP payments be used in the acquisition, construction, installation, modernization, development, conversion, or expansion of land, plant, buildings, equipment, facilities, or machinery. Transfer of payments to another entity, which may or may not be used for these purposes, is not authorized in the Act. Additionally, the Act stipulates that payments are based by the individual user's consumption, not the consumption of the entire textile industry, and thus OIG maintains that acquisitions must also be made by the user who consumed the cotton. Without sufficient controls in place, such as a review conducted during a close-out examination, to identify transferred EAAP payments, the program remains vulnerable to being used in ways that do not fulfil the goals of the program for the individual users. However, OIG recognizes that the level of resources used must be calculated based on the relative risk to the program. To reach management decision, FSA needs to develop internal controls that include a detailed risk assessment designed to identify which entities are vulnerable to improper transfer of EAAP payments and, for those entities, close-out review procedures to allow FSA to determine if any payments transferred to another user are proper.

Finding 3: FSA Lacks Effective Controls to Ensure EAAP Funds Support the Intent of the Program

During our fieldwork we identified 75 expenditures, totaling over $2.4 million, which were questionable uses of program funds. This occurred because FSA, in implementing EAAP, had not established effective internal controls, such as definitive guidance and a consistent process to determine which capital expenditures are eligible uses of EAAP funds. Instead, FSA relies on an ad hoc decision making process to evaluate whether a user's program funds are spent on valid capital expenditures that meet the requirements and intent of EAAP. Without guidance in place clearly stating what is and is not an allowable capital expenditure, FSA cannot prevent users from making purchases that do not directly meet the intent of the program, thereby protecting EAAP funds against potential fraud, waste, and abuse.

OMB requires agencies to develop and maintain effective internal controls. Agencies must ensure that Federal resources are used efficiently and effectively to achieve desired program objectives. Specifically, programs must operate and resources must be used consistently with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.[26] For EAAP, users must spend the payments they receive for authorized capital expenditures, which include the acquisition, construction, installation, modernization, development, conversion, or expansion of land, plant, buildings, equipment, facilities, or machinery.[27] Users must certify that such capital expenditures are directly attributable to manufacturing upland cotton into eligible cotton products in the United States.[28]

[26] OMB Circular A-123, *Management's Responsibility for Internal Control*, Section I, dated December 21, 2004.
[27] Section 1207(c) of the Food, Conservation, and Energy Act of 2008 (Public Law 110-246, commonly referred to as the 2008 Farm Bill) and 7 CFR 1427.105(e), dated November 5, 2008.
[28] 7 CFR 1427.105(e), dated November 5, 2008.

During the implementation of EAAP, FSA interpreted an allowable asset that qualified under the terms of EAAP as "capital expenditures," which are the funds expended by a business for modernization or acquisitions of property, fixtures, or machinery that will improve the productivity and/or efficiency of the business.[29] FSA noted these expenditures are usually significant in nature, depreciable, and attributable to the manufacturing, storage, and distribution of upland cotton or eligible cotton products. Conversely, FSA noted that items that are best classified as "operating expenditures" do not qualify under EAAP's terms. FSA defined operating expenditures as funds expended by a business in its normal day-to-day activities, including, but not limited to, rent, salaries, supplies, utilities, and routine or scheduled maintenance.

When it first implemented EAAP, FSA developed a table[30] listing some expenditures that were eligible and ineligible for EAAP purposes; however, the list was for internal, illustrative purposes only. We found that because this list is a general, informal document, FSA does not have requirements that are sufficiently specific to be routinely used in the evaluation process when determining whether capital expenditures directly support the United States' manufacturing of upland cotton products. We conclude that, until FSA has formal and specific requirements in place, its approval and review processes will not sufficiently protect taxpayers' dollars from potential fraud, waste, and abuse.

As noted in FSA's EAAP review guidelines, the agency contends that the 2008 Farm Bill description of an authorized expenditure gives a great deal of latitude for interpretation, and FSA has implemented its approval process accordingly. For example, while the EAAP regulations[31] state that expenditures must be "directly attributable" to manufacturing upland cotton, FSA has interpreted the term "attributable" in the regulations to include all aspects of the textile manufacturing process. Thus, FSA considers expenditures for assets used both directly and indirectly in purchasing and selling cotton as eligible. Consequently, FSA seldom denies any of the capital expenditures purchased by users with the EAAP funds they earned.

Additionally, FSA contends that, since it has not developed written guidance prohibiting particular expenditures, any asset purchases that FSA chooses to deny will be appealed by users to the National Appeals Division and ultimately determined allowable. However, we believe this demonstrates why FSA must develop controls for identifying whether capital expenditures are eligible for EAAP purposes.

With little restrictions as to what is and is not a valid expenditure, FSA has allowed capital expenditure purchases that compromised EAAP's effectiveness in improving the United States textile industry. For example, in our review of 9 users, we sampled 332 capital expenditures, totaling approximately $34.6 million in EAAP payments.[32] We identified issues with six of the nine users: of the 332 expenditures, 75 (or 23 percent) were questionable, based on the program

[29] FSA memorandum "Upland Cotton Economic Adjustment Assistance Program" from the Acting Deputy Administrator for Commodity Operations to the Director of the Kansas City Commodity Office, dated April 3, 2009.
[30] The table was developed in April 2009 and revised by FSA in September 2009.
[31] 7 CFR Part 1427.105(e), dated November 5, 2008.
[32] OIG judgmentally selected nine users for fieldwork (five current users and four former users) and questioned some of the capital expenditures made with EAAP funds by three of the current users and by three of the former users.

regulations. These 75 questionable expenditures totaled over $2.4 million in EAAP payments. These questionable expenditures included purchases (1) used for personal reasons; (2) not readily put into service for the manufacturing of upland cotton into saleable product (i.e., unused equipment, replacement parts, and items not related to cotton manufacturing operations); and (3) which were transferred or disposed of prior to the end of their useful life (i.e., sold or scrapped equipment). OIG concluded that these types of expenditures, which were allowed by FSA, represent waste and abuse of EAAP funds, as they do not have direct applicability to the manufacturing of upland cotton into eligible cotton products by the user that made them.

Capital Expenditure Purchases for Personal Use

OIG found over $45,500 was expended for two automobiles used mainly for personal use and over $6,500 to decorate executive offices with carpet and artwork. One former EAAP user purchased two Ford Explorers with its EAAP funds. One of the Explorers was purchased for $30,435 and was traded in 11 months later on a new vehicle. The difference between the second vehicle price and the trade-in value was also paid with EAAP funds. In addition, the new vehicle was purchased by the user the day before FSA's imposed deadline for the user to spend its EAAP funds or return the unused funds back to FSA. The owner of the participating company said the vehicles were used primarily for his personal use. Another user spent EAAP funds on decor, such as artwork and an elephant lamp for the Chief Executive Officer's office and for carpet at one of its operating plants for the managers' offices.

Capital Expenditure Purchases Not Readily Put Into Service

We found over $58,000 was spent for unused equipment that was sitting idle and over $675,000 was used to purchase replacement parts that did not modernize the user's operations. One user's only expenditure made with EAAP funds consisted of machinery that was not in use during our fieldwork and was covered in dust and cobwebs. Another user had equipment sitting in its warehouse that was purchased almost 2 years prior to our fieldwork. This equipment had never been installed in the plant or used in cotton operations. This user no longer participates in EAAP. Although these participants acquired the unused equipment as required by the 2008 Farm Bill, not putting them into production demonstrates that these expenditures were unnecessary and represents a waste of EAAP funds. By implementing stronger requirements for purchases, FSA can provide stronger assurance that EAAP expenditures meet the goals of the program.

In addition, we found examples of capital expenditures that were not actually assets and others that were not related to cotton operations. For example, over $7,000 in EAAP funds were spent on service warranties for two vehicles, a service contract for a computer, and internal labor. Twenty-one of the questionable expenditures OIG identified, totaling over $93,000, were not directly related to cotton production operations. Examples of these include lawn mowers, a hearing booth, a portable sound system, a TV monitor for a guard station, computers and other IT equipment for corporate offices, grass seed, and road repairs.

Capital Expenditure Purchases Disposed of Prior to the End of Their Useful Life

As noted in Finding 2, we found $10.6 million in machinery that was immediately resold. Unlike the equipment that stayed in the textile industry, we found that another user scrapped or sold over $14,000 in equipment to another entity outside the textile industry. As a result, this $14,000 did not go towards improving the Nation's cotton textile industry.

FSA agreed with OIG that replacement parts and maintenance do not fit the authorized purposes of program regulations and are not a qualified use of EAAP funds. However, overall, FSA contends the questionable expenditures identified by OIG are authorized because FSA opted not to utilize what it calls a "myopic approach to the program." Instead, FSA stated it adopted an approach that met the "spirit of the program," which is to get the payments out to users as quickly as possible. One FSA official stated that more was involved in cotton manufacturing than opening a bale. Thus, FSA took the position that all assets used in the activities attributable to cotton consumption and sales—including computers, vehicles (that may be used for just one sales call), and artwork—are allowed under EAAP. An FSA official also noted that it was a user's choice to use equipment purchased with EAAP funds, and disuse of that equipment has no bearing on the legitimacy of the purchase as a qualified expenditure. This official also noted there are no provisions prohibiting users from disposing of assets.

OIG maintains that the regulations require expenditures made with EAAP funds to be "directly attributable" to the manufacturing of upland cotton and to stimulate investments that make the United States textile industry more competitive. However, the expenses cited above do not accomplish this. Without developing sufficient program guidance, FSA lacked the management control structure necessary to reduce the risk of allowing users to make expenditures that are an abuse and waste of Government funds. Overall, OIG recommends that FSA develop effective controls to facilitate the day-to-day administration of EAAP in accordance with the goals of the program.

Recommendation 6

Establish a dollar threshold and require program users to gain pre-approval of their planned capital expenditures above that threshold from FSA prior to the purchase.

Agency Response

FSA agreed with this recommendation and stated it will establish a dollar threshold, which will be reasonably related to the purpose of the program. FSA further stated that program users will be required to gain pre-approval of their planned capital expenditures above that threshold, and this will be clearly addressed, and program participants notified, in an update to the form CCC-1045DOM to reflect the new policy by November 2014.

OIG Position

We accept management decision for this recommendation.

Recommendation 7

Establish program guidance requiring eligible purchases with EAAP funding include only those expenditures that can be readily put into service by the user for the manufacturing of upland cotton into saleable product and provide specifics as to what items qualify under that definition.

Agency Response

FSA did not agree with the recommendation. FSA stated that it did not have the authority or the business acumen to the make a business decisions to disallow expenditures that fall outside of a subjective descriptor, such as "readily put into service." FSA maintains that in any case that the plain language of the Food, Conservation, and Energy Act of 2008 and the Agricultural Act of 2014 neither limits allowable purposes to "expenditures that can be readily put into service" nor does it compel that expenditures be made for such purpose. FSA also notes that both laws state, "Economic adjustment assistance under this subsection shall be made available only to domestic users of upland cotton that certify that assistance shall be used only to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery."

OIG Position

We are unable to reach management decision for this recommendation. While OIG acknowledges that neither of the Farm Bills limit allowable purposes to "expenditures that can be readily put into service," we also note that FSA's EAAP review guidelines state that the 2008 Farm Bill description of an authorized expenditure gives a great deal of latitude for interpretation. FSA has used this latitude in the past to determine which expenditures are and are not consistent with the purposes of EAAP. The 2014 Farm Bill does not significantly change the rules governing EAAP. One of the purposes of EAAP is to stimulate investment to maintain a globally competitive United States textile industry. OIG maintains that equipment that sits idle or that is purchased without a plan to use in the production of saleable product does not aid in maintaining global competitiveness.

Under this recommendation, FSA would be responsible for using its program knowledge to determine what specifically qualifies as an expenditure that "can be readily put into service," and to provide specifics as to what items qualify as such. To reach management decision, FSA should seek an opinion from OGC to determine if FSA has the authority to limit eligible purchases to those that can be readily put into service as an investment in a globally competitive textile industry. If OGC determines that FSA has the appropriate authority to do so, FSA needs to develop and issue guidance, including a definition and specific examples, requiring items purchased under EAAP to be readily available to put into service by the user for the manufacturing of upland cotton into saleable product.

Recommendation 8

Disallow expenditures that are wholly or partially for personal use by executives and employees of the user.

Agency Response

FSA agrees to continue to disallow expenditures where it becomes aware that the asset is wholly for personal use, but does not agree that items partially for personal use should be disallowed. FSA states that if it can be established an asset is being used jointly for business and personal uses, then FSA will prorate the expenditure and allow the business use portion to be an allowable expenditure. FSA states that in the case of the two vehicles purchased with EAAP funds, FSA requested justification and the agreement holder verified that the vehicles were to be used for official use. FSA further states that OIG's exhaustive investigation determined that the actual use of the vehicles by the agreement holder was in contrast to the information presented to FSA. Finally, FSA notes that agreement holders will be notified, in writing, of the existing policy by September 2014.

OIG Position

We are unable to reach management decision for this recommendation. The provisions governing EAAP set forth in 7 CFR 1427.105(e), state that each users must certify that all expenditures of EAAP funds are "directly attributable" to manufacturing upland cotton into eligible cotton products. OIG maintains that personal use items, such as the office decorations we identified, do not qualify as directly attributable to the manufacturing process and should be ineligible for payment under EAAP as an item wholly for personal use. Items similar to the automobiles OIG identified should be considered directly attributable only for that portion of their use where they are used for non-personal purposes. Any EAAP payment for items used both for personal and non-personal reasons should be prorated, so long as FSA has established adequate controls to allow FSA to reasonably determine the ratio of personal to non-personal use. To reach management decision, FSA would need to (1) develop and implement controls, including an implementation plan and date, to identify purchases that are wholly or partially used for activities not directly attributable to manufacturing upland cotton into cotton products, as well as controls to reasonably identify the ratio of personal to non-personal use of the items purchased, and (2) disallow future expenditures, or prorated portion of expenditures, that are for the personal use of executives and employees of the user.

Scope and Methodology

We conducted this audit to evaluate the effectiveness of FSA's controls over the administration of EAAP and to evaluate whether it has been effective in stimulating domestic investments to maintain a globally-competitive United States textile industry. We performed fieldwork from March 2013 through March 2014. To accomplish our objective, we conducted survey work at the FSA Kansas City Commodity Office, examining reviews conducted at 33 users to determine the results and identify significant findings and recommendations related to the operations of users, and accompanied FSA field examiners during their review of a current user. We also conducted audit fieldwork at the FSA national office in Washington, D.C., and cotton trade organizations in Washington, D.C., and Gastonia, North Carolina. We visited 14 plants of 9 current and former EAAP users,[33] as well as a textile equipment manufacturer, in North Carolina, South Carolina, Texas, Alabama, and Massachusetts.

The scope of the audit covered EAAP program activity for cotton marketing years 2009 to 2011 (i.e., August 1, 2009, through July 31, 2012). During this time, FSA issued $216 million in program payments to users. We judgmentally selected 9 of 65 current and former users, based on (1) the size of their operations (specifically choosing large and small entities); (2) the amount of EAAP payments received; (3) previously identified issues during FSA examinations, such as using inflated weights; and (4) the locations of their operating facilities. These nine users received approximately $86.3 million in EAAP payments. From these 9 users, we examined the cost and description of EAAP purchased items to judgmentally select a sample of 332 capital expenditures, valued at approximately $34.6 million, for review to determine whether the expenditures were allowable uses of EAAP funds.

We also examined whether and how FSA appraises success of the program, identified and assessed controls over program payments, and evaluated the effectiveness of on-site examination reviews. Specifically, we:

- Reviewed the agency's administration activities,[34] starting in August 2008 with the onset of EAAP through July 31, 2012.
- Reviewed trends in cotton consumption both in the United States and abroad between marketing years 2003 and 2013.
- Identified and reviewed Federal regulations, policies, procedures, and instructions used by FSA in the administration of EAAP. This included a review of the 2008 and 2014 Farm Bills to evaluate any program changes.
- Interviewed FSA management officials to determine their roles and responsibilities in the administration of EAAP.
- Evaluated management controls in place over EAAP administration. This included a determination of whether FSA established performance measures to evaluate the impact of EAAP.
- Reviewed EAAP review guidelines used by FSA examiners to conduct the examination reviews of users' cotton consumption and use of program funds.

[33] We visited one user during the survey phase; however, this user is not included in the number of users visited because we did not apply the audit procedures (i.e., verify use of program funds) at this user.
[34] As opposed to actual payments, which were examined during the period August 2009-July 2012.

- Reviewed the files maintained by FSA to document the users' participation in EAAP, including reports of consumption, examination review files, and correspondence between users and FSA.
- Interviewed officials from the National Council of Textile Organizations and the National Cotton Council in Washington, D.C., and Gastonia, North Carolina, to obtain their comments about the effectiveness of EAAP on the U.S. cotton textile industry.
- Visited current and former users to review their operations, the documentation maintained regarding their involvement in EAAP, the program payments they received, and the capital expenditures they made with EAAP funds. We also inquired into how EAAP has benefited these users and their operations.
- Visited a textile equipment manufacturer to obtain and review information about the sale of machinery to both a current and a former user.
- Developed and sent questionnaires to former users in the program and nonparticipant users in the program in order to determine why they stopped participating in EAAP or why they had not participated in EAAP, respectively.

We did not assess significant financial information or database systems used by FSA for EAAP to determine their overall reliability in relation to our audit objectives. Instead, during a fieldwork visit with a user in North Carolina, we assessed the effectiveness of FSA examinations' controls over payments to users and re-performed consumption calculations, finding no significant errors in payments.

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

Abbreviations

CCC............................Commodity Credit Corporation
CFR............................Code of Federal Regulations
EAAP..........................Economic Adjustment Assistance to Users of Upland Cotton Program
FSA............................Farm Service Agency
GPRA..........................Government Performance and Results Act
OGC............................Office of the General Counsel
OIG............................Office of Inspector General
OMB...........................Office of Management and Budget
USDA..........................Department of Agriculture
WTO...........................World Trade Organization

Exhibit A: Summary of Monetary Results

Finding	Recommendation	Description	Amount	Category
2	4	Payment by Seller to Discount Purchaser's Equipment	$1,518,068	Questioned Costs, Recovery Recommended
3	7	Expenditures Not Readily Put into Service or Disposed before End of Useful Life	$848,748	Questioned Costs, No Recovery
3	8	Personal Use Expenditures	$52,081	Questioned Costs, No Recovery
TOTAL			**$2,418,897**	

The table above identifies the finding number, description of error, program dollar amount impacted, and OIG management tracking classification associated with the monetary results from the report's findings.

USDA'S
FARM SERVICE AGENCY
RESPONSE TO AUDIT REPORT

Farm and Foreign Agricultural Services

Farm Service Agency

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DATE: July 21, 2014

TO: Gil Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Philip Sharp, Director
Operations Review and Analysis Staff

SUBJECT: Response to OIG Official Draft Report – Economic Adjustment Assistance to Users of Upland Cotton, 03601-0002-22

The Farm Service Agency (FSA) recognizes the need for further improvements in the administration of the Economic Adjustment Assistance Program (EAAP), but also would like to emphasize FSA's considerable accomplishments since this program was implemented in 2008. FSA created regulations for a new program, as well as new operating procedures, policies, and review procedures using available resources in order to provide agreement holders with the best possible service. EAAP replaced the Upland Cotton User Marketing Certificate Program, commonly known at the Step 2 Program, which did not have any restricted use of program funds.

FSA takes a serious view of the recommendations provided in the official draft report and continues working to ensure that the overall objectives of EAAP are carried out in the best interest of all stakeholders.

The eight OIG recommendations and FSA's responses are provided, as follows:

Recommendation 1:

Develop goal(s) along with outcome-based performance measures for EAAP to determine the impact the program has on the United States textile industry.

FSA Response:

FSA agrees with this recommendation. FSA will use guidance issued by the Office of Management and Budget to establish goal(s) with outcome-based performance measures in order to comply with the Government Performance and Results Act. FSA will statistically estimate and quantify the competitiveness-enhancing strength of EAAP, based on its performance in encouraging capital investment and limiting market losses, plant closures, and employment declines among domestic users of upland cotton. FSA expects to complete the analysis by December 31, 2014.

<u>Recommendation 2:</u>

Perform a program evaluation to determine if EAAP is performing as intended.

FSA Response:

FSA agrees with this recommendation. FSA will conduct a program evaluation of EAAP in order to determine/measure the impact of economic assistance payments to domestic users of upland. These potential impacts may include limits on market losses, a decrease in plant closures, increased employment levels, and the extent that the economic assistance improved the condition of the program participants competing in a global market. Afterwards, FSA will maintain and update analyses for use by policy officials in future assessments of EAAP program performance. FSA will present the findings no later than January 31, 2015.

FSA disagrees with the characterization of EAAP as a short-term program. The official draft report suggests that EAAP has an end date and that the short-term nature of the program necessitates performance measures in order to determine whether the program should continue. This is not the case. In the Food, Conservation, and Energy Act of 2008 and the Agricultural Act of 2014, Congress authorized EAAP with no mention of an end date. The authority for EAAP continues until such time as it is repealed. FSA is willing to evaluate the program but lacks the authority to use those results to continue, discontinue, or adjust program payment rates, as those are statutory.

<u>Recommendation 3:</u>

Amend the EAAP user agreement to prohibit the transfer or sale of EAAP assets based on one user's consumption to another entity, unless depreciated (net book) value of the asset is returned to FSA.

FSA Response:

FSA does not agree with the recommendation. Under the Food, Conservation, and Energy Act of 2008 and the Agricultural Act of 2014, FSA does not have the authority to approve or prohibit the transfer or sale of legitimately purchased land, plant, buildings, equipment, facilities, or machinery. Involving FSA in micro-management of agreement holders' everyday accounting and business decisions after EAAP funds were legitimately used to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery would be excessively restrictive to agreement holders and beyond the scope of FSA's authority.

A disagreement between FSA and the agreement holder on the depreciation schedule of legitimately purchased land, plant, buildings, equipment, facilities, or machinery could be viewed as beyond the scope of the statute.

Recommendation 4:

Recover $1,518,068 in EAAP payments made to Seller.

FSA Response:

FSA disagrees with this recommendation. The Seller made a purchase of equipment in excess of EAAP funds, in accordance with established guidelines in place at that time.

FSA does not have the authority to be involved in second-guessing agreement holder accounting and business decisions after EAAP funds have been used to acquire, construct, install, modernize, develop, convert, or expand land, plant, buildings, equipment, facilities, or machinery in accordance with the terms of the statute.

Recommendation 5:

Amend EAAP user agreement to require any user exiting the program to undergo a closeout examination after all transactions have been completed, including a review to determine if any payments transferred to another user are proper.

FSA Response:

FSA agrees to conduct a close-out examination of an agreement holder after all transactions are completed. FSA has done this since inception of the program, with its available resources. Program participants will be notified, in writing, of the existing policy and the Upland Cotton Domestic User Agreement (CCC-1045DOM) will be updated to reflect the policy by November 2014.

FSA requires that expenditures are recorded in a ledger form to include, but not limited to, description of the expenditures, acquisition dates, method of payment, date of payment and amount of payment. FSA also verifies the existence of the expanded land, plant, buildings, equipment, facilities, or machinery.

FSA does not have the available resources to conduct an exhaustive review and audit of each agreement holder and business transactions related to EAAP. Reviewing corporate documents, analyzing depreciation schedules, questioning equipment manufacturers, and spending over 12 months to review and audit nine of forty five program participants is beyond the level of available resources.

<u>Recommendation 6:</u>

Establish a dollar threshold and require program users to gain pre-approval of their planned capital expenditures above that threshold from FSA prior to the purchase.

FSA Response:

FSA agrees with this recommendation. FSA will establish a dollar threshold, which will be reasonably related to the purpose of the program. Program users will be required to gain pre-approval of their planned capital expenditures above that threshold. This will be clearly addressed in an update to the form CCC-1045DOM. Program participants will be notified, in writing, of the new policy and form CCC-1045 DOM will be updated to reflect the new policy by November 2014.

<u>Recommendation 7:</u>

Establish program guidance requiring eligible purchases with EAAP funding to include only those expenditures that can be readily put into service by the user for the manufacturing of upland cotton into saleable product and provide specifics as to what items qualify under that definition.

FSA Response:

FSA has had established program guidelines on eligible and non-eligible expenditures since the program's inception. FSA will attempt to clarify and update these guidelines. Agreement holders will be provided guidance, in writing, of eligible and non-eligible expenditures for program payments by November 2014.

FSA does not agree with the recommendation to disallow expenditures that fall outside of a subjective descriptor, such as "readily put into service." FSA does not have the authority or the business acumen to the make a business decision on behalf of every participant to determine the optimum installation timeline for each piece equipment or improvement in an individual manufacturing facility.

The plain language of the Food, Conservation, and Energy Act of 2008 and the Agricultural Act of 2014 neither limits allowable purposes to "expenditures that can be readily put into service" nor does it compel that expenditures be made for such purpose. Both laws state, "Economic adjustment assistance under this subsection shall be made available only to domestic users of upland cotton that certify that assistance shall be used only to acquire, construct, install, modernize, develop, convert, **or** expand land, plant, buildings, equipment, facilities, or machinery." (Emphasis added)

The descriptor "readily" is subjective, not required by the statute, and therefore would likely be difficult for FSA to defend.

Recommendation 8:

Disallow expenditures that are wholly or partially for personal use by executives and employees of the user.

FSA Response:

FSA does not agree with disallowing expenditures that are partially used for business by executives and employees of the user. FSA has disallowed expenditures that are wholly for personal use since inception of the program with the available resources. If it can be established an asset is being used jointly for business and personal uses FSA will prorate the expenditure and allow the business use to be an allowable expenditure. In the case of the two vehicles purchased with EAAP funds, FSA requested justification and the agreement holder verified that the vehicles were to be used for official use. OIG's exhaustive investigation determined that the actual use of the vehicles by the agreement holder was in contrast to the information presented to FSA. Agreement holders will be notified, in writing, of the existing policy by September 2014.

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