APPENDIX C – OIG MAJOR USDA MANAGEMENT CHALLENGES

(November 8, 2002)

USDA Homeland Security

1. Homeland Security Issues

The events of September 11, 2001, and the subsequent anthrax attacks on Government and media officials have alerted U.S. Department of Agriculture (USDA) at all levels to the need for increased vigilance and the strongest possible defenses. The Administration established the Office of Homeland Security to provide coordination and guidance across the Federal Government. As reflected in the Office of Homeland Security's priorities and the Administration's request for supplemental funding, homeland security comprises four missions: to support first responders to terrorist attacks, to defend against biological attacks, to secure our borders, and to share information about suspect activity. USDA's operations involve it in all four missions. The attacks also added a new dimension to the Department's priorities, particularly its mission to ensure the safety and abundance of the Nation's food supply, from the farm to the American people's table. However, based on our past and ongoing reviews, if the Department is to effectively respond to these new circumstances, it faces several challenges which it has not often confronted in the past: increased communication and coordination across the Department and its agencies, consistent departmental policies and procedures, and an emphasis on security (as opposed to safety) from potentially terrorist activities or other deliberate conspiracies.

The Office of Inspector General (OIG) experienced these challenges that the Department now faces in our recent efforts reviewing the USDA laboratory facilities. High on the list of potential weapons are the biological agents that USDA laboratories use for research on plant and animal diseases. OIG recently issued an audit report on the Department's controls over the security of its biological agents. The aim of the audit was to determine what pathogens the Department used and stored in over 300 laboratories around the country and what security those laboratories established to guard against break-ins. Our audit found that the responsibility for dealing with security was fragmented among the laboratory units. There were no policies or procedures in place to identify the type and location of the pathogens. Security in general at the laboratories needed improvement, but laboratory managers also needed to restrict access.

In response to the need for greater biosecurity in the wake of the September 11 attacks, the Secretary assigned a task force to develop policies and procedures for biosecurity within the Department. On August 30, 2002, the Secretary's Chief of Staff signed for the Secretary the decision memorandum adopting for USDA-wide implementation Departmental Memo 9610–1, entitled "USDA Security Policies and Procedures for Biosafety Level-3 Facilities." (The Department is also currently working on the draft policies and procedures for its other laboratories and technical facilities excluding Biosafety Level-3 facilities.) The affected USDA agencies have been developing corrective actions in response to our report and in response to the new Department policies and procedures on biosecurity. The recently-issued policies and procedures constitute the first major effort by the Department to issue departmentwide biosecurity policies and procedures. Furthermore, any effective implementation of these corrective actions will entail a major change in the approach by the agencies' staff. To ensure that the current impetus is carried forth effectively, we have planned follow-up reviews to evaluate and verify whether these facilities have properly implemented their corrective actions.

Inadequate security procedures even after September 11 were observed during OIG's review of the security provided by the Forest Service over aircraft, including air tankers used for aerial dispersal of flame retardant chemicals and other fire suppression activities, because of its potential use as a weapon. The Forest Service owns 44 aircraft and leases another 800 under contract. Our review found that the Forest Service had not assessed the risk of theft and misuse by terrorists of these aircraft, because prior to September 11, officials did not consider the threat significant. In response to our concerns, the Forest Service assembled a team of security experts to review their air bases. At each site visited, the team planned to conduct a threat assessment and analyze the countermeasures needed to mitigate that threat. We have been reviewing the Department's operation to prevent the entry of Foot and Mouth Disease and contaminated food products into the United States (see also sections on "Food Safety" and "Marketing and Regulatory Programs"). In an earlier review, we found that the two USDA agencies (that is, Animal and Plant Health Inspection Service (APHIS) and Food Safety and Inspection Service (FSIS)) responsible for preventing contaminated meat and poultry products from entering the Nation's food supply did not always coordinate their activities, giving importers an opportunity to bypass the inspection system. We are continuing our oversight of FSIS' inspection activities, particularly their systems to track, account for, and inspect all meat and poultry products arriving at U.S. ports of entry. If the Department is to ensure the safety of the American food supply, the Department and particularly the two affected agencies, APHIS and FSIS, must increase coordination and communication among themselves.

Currently, we have a number of ongoing reviews evaluating the spectrum of USDA agencies' homeland security initiatives and activities in response to the heightened alert resulting from September 11. These include a number of ongoing efforts looking at APHIS' role in monitoring America's vulnerable ports of entry; a review of APHIS' permit system involving the importation and domestic transshipment of biological agents (for example, animal and plant pests and pathogens), and a review of APHIS' agricultural imports inspection system, particularly on inspections of cargo and passengers at major ports of entry and border crossings to prevent entry of prohibited pests and diseases into the United States. We have initiated the second phase of our reviews of controls and oversight over biohazardous agents; in this phase, we are evaluating the biosecurity and biosafety controls and procedures at USDA-funded laboratories (that is, university and private laboratory facilities receiving USDA financial assistance). So far, we have found minimal or no departmental guidance involving biosecurity to these laboratories. We have also initiated a review of controls and procedures over chemicals and radioactive materials stored and used at USDA facilities. In our earlier audit several years ago, we had reported material accountability problems. The urgency for strengthened Department controls over these substances materialized with the recent "dirty bomb" alert.

Communications and information technology are among the Department's primary assets and have been a target of hackers in the past. OIG has been involved in strengthening the Department's security of this technology well before September 11. To date, we have reviewed or are in the process of reviewing nine separate information systems within the Department. Our reviews found several weaknesses in the security of information technology within the Department. Increased cyber security remains a priority for the Department. (See also section 15 on Information Resources Management.)

As the Department and its agencies have undertaken efforts to identify vulnerable assets and to perform vulnerability assessments of their facilities and programs, they have realized the need to secure sensitive information that could be subject to criminal misuse by potential terrorists or cause major harm to the agriculture sector of the economy. In response, the Department and some agencies initiated actions to remove some sensitive information from their websites. However, they are still faced with the required public disclosure of any document or information they have compiled or collected under the Freedom of Information Act since they do not have classification authority. Because of this vulnerability, the Department and agencies expressed concerns about compiling such information or issuing vulnerability reports. Recently, the Department was granted classification authority and is drafting regulations and procedures to implement this classification authority.

On January 10, 2002, President Bush signed the Defense Appropriations Act, which included $328 million for security upgrades and other activities in response to the terrorist attack. Emphasizing the protection of the Nation's food supply, the Act designates $119 million for APHIS, $113 million for the Agricultural Research Service, and $15 million for the Food Safety and Inspection Service. The remaining $80 million is designated for other USDA homeland security priorities. The Department faces a challenge in ensuring that these significant funds are expeditiously expended for the purposes specifically authorized by the act.

Farm and Foreign Agricultural Services

2. Federal Crop Insurance

Crop insurance has become USDA's farmer "safety net." The Federal Crop Insurance Reform Act of 1994 did away with the traditional crop loss disaster payments, and the Federal Agricultural Improvement and Reform (FAIR) Act of 1996 phased out the traditional crop deficiency payments. Between crop years 1996 and 2001, crop insurance coverage increased from 205 million acres to 212 million acres (or an increase of about 3.4 percent), and the Government's total insurance liability increased from $26.9 billion to $36.7 billion (an increase of about 36.4 percent), as of March 18, 2002. Although both the number of acres and total liability has increased, the total liability has had a substantially larger increase. This illustrates that the total liability per acre has increased, probably due to increases in specialty crop acreage, as well as, the increase in revenue coverage. This substantial increase in liability per acre also results in a probability for larger per acre indemnity payment. The total indemnity payments in 1996 were $1.5 billion compared to $2.8 billion in 2001 (or an increase of approximately 88 percent), as of March 18, 2002. For the 2001 calendar year (CY), the total annual premiums were about $3 billion; of which, $1.8 billion (or approximately 59 percent) was paid by the Government through the legislated subsidy. The Government's subsidy was $982,062,000, out of a total premium of $1,838,559,000 (or 53.4 percent) for CY 1996. This represents an 80.2 percent increase in total subsidy payments from the 1996 CY to the 2001 CY.

Areas within the Federal crop insurance program where we believe management controls need to be strengthened based on past audit reviews or that we believe pose high vulnerability based on our assessment include the following:

Implementation of ARPA

The Agricultural Risk Protection Act (ARPA), enacted in June 2000, required the Secretary to develop and implement additional methods of ensuring Federal crop insurance program compliance and integrity, including a plan for the Farm Service Agency (FSA) to assist the Risk Management Agency (RMA) in the ongoing monitoring of crop insurance programs. ARPA also increased the Government's support (subsidy) of the insurance premium. The subsidy ranges from 67 percent for additional coverage equal to or greater than 50 percent, but less than 55 percent, of the recorded or appraised average yield to 38 percent for additional coverage equal to or greater than 85 percent. In the case of additional coverage, all insurance other than catastrophic, the amount of the premium shall: 1) be sufficient to cover anticipated losses and a reasonable reserve, and 2) include an amount for operating and administrative expenses, as determined by the Federal Crop Insurance Corporation, on an industry-wide basis as a percentage of the amount of the premium used to define loss ratio. RMA has begun the process of modifying the basic policy provisions to incorporate the changes mandated by ARPA, particularly the program integrity provisions. For example, RMA believes that data mining has provided constructive feedback to the agency. We will continue to actively monitor and provide oversight as RMA continues to implement the multitude of provisions mandated by ARPA.

Oversight by Insurance Companies and RMA

To evaluate overall program integrity and compliance on the claims for loss filed by insured producers, RMA uses a quality control (QC) review system that consists largely of reinsurance company internal reviews and periodic agency verifications. This process of oversight and monitoring procedures by the reinsurance companies and by RMA needs to be strengthened. In our current audit of the oversight and monitoring procedures titled "Monitoring of RMA's Implementation of Manual 14 Reviews/Quality Control Review System," we raised the following concerns: 1) over the years, RMA has been unsuccessful at responding to recommendations regarding the establishment of an effective QC review made by both OIG and the General Accounting Office; 2) RMA abandoned its standard error rate review; 3) reinsurance company internal reviews implemented through the Manual 14 process were not reliable; 4) the QC process does not have regulatory authority; and 5) RMA's error rate does not count all errors. RMA's earlier stated commitment to QC has not answered basic policy questions. In our report, in addition to recommending the need to strengthen its QC review system, we also recommended that RMA identify and report the absence of a reliable QC review system as a material internal control weakness in its Federal Managers' Financial Integrity Act (FMFIA) report.

According to RMA, this QC review system is part of a more comprehensive package of oversight and monitoring activities over the insurance companies. RMA agrees that the QC review system as being conducted by insurance companies and its oversight of this process need to be strengthened and is working closely with OIG to that end. To address our recommendations, RMA is (1) updating its Manual 14 which prescribes the type and number of internal reviews to be performed by the insurance companies and (2) evaluating alternative methods to improve its oversight responsibilities which will be included in a new Manual 14. RMA has issued a statement of work seeking non-government services of performance management experts to develop a more effective QC review system. Furthermore, before implementing any changes, RMA believes that it may need to re-evaluate the best method for implementing these changes; for example, evaluating the pros and cons for seeking statutory versus regulatory changes. We will continue to monitor this process to ensure that an effective QC review system is implemented.

3. Farm Security and Rural Investment Act of 2002

The Farm Security and Rural Investment Act of 2002 (also referred to as the 2002 FSRIA) was signed by President Bush on May 13, 2002. The Act covers the plethora of programs administered by the Department—re-authorizing many existing programs, establishing new programs and initiatives, establishing significantly higher program caps and budget authority—from fiscal year (FY) 2002 through FY 2007. However, many of the provisions are effective for the current crop year (2002). In addition to strengthening the safety net for producers, the bill also provides a major commitment to and strengthening of the conservation programs, reinforces our international trade and export programs, improves nutrition programs, and continues strong support for developing rural communities and businesses. According to the Congressional Budget Office's recently released cost estimate, the 10-year cost of the bill is $82.8 billion. By some estimates, it is expected to cost about $190 billion over 10 years.

With enactment of the FAIR Act of 1996, OIG was actively involved with the Department and its agencies from the early stages of developing the then-mandated program procedures through the implementation of these programs. We believe that our initial, proactive approach as FAIR was being implemented was beneficial and efficient in ensuring that adequate management controls and procedures were timely implemented by the agencies. Based on the perceived vulnerabilities and risks in those programs, we continued to monitor and review many of those programs. Although the 2002 FSRIA reauthorized many of the programs from the FAIR Act of 1996, this new bill authorizes a number of new programs. Furthermore, the bill not only reauthorized many existing programs, but established significantly increased funding authority or increased program caps for many of these existing programs. Prior OIG audits have reported serious problems with some of these existing programs, particularly with respect to some smaller programs that were re- introduced. Therefore, as we previously did as FAIR was being implemented, we believe an upfront, proactive approach during the initial stages of implementing the 2002 FSRIA will be more cost effective to the agency and to the Department.

Examples of areas in the 2002 FSRIA where our resources need to be targeted follow.

Farm Programs

The bill continued and enhanced many of the provisions of the FAIR Act of 1996, which provided long-term planting flexibility contract payments to major program commodities plus marketing assistance loans and loan deficiency payments. To strengthen the safety net to producers against falling prices, the bill provides for new counter-cyclical payments based on established target prices. In addition to the crops authorized under the 1996 bill, the 2002 FSRIA expanded the scope of marketing assistance loans and loan deficiency payments to new crops—wool, mohair, honey, dry peas, lentils, and chickpeas. The bill terminated the marketing quota program for peanuts, which was basically a no-cost program, by authorizing a quota buyout program, a direct and counter-cyclical program, and marketing assistance loans and loan deficiency payments for peanuts. Although limitations on program payments were not significantly changed from current levels for ongoing programs, eligibility for payments are now subject to a $2.5 million adjusted gross income cap. Furthermore, the bill supplanted the existing regional dairy compacts by establishing a national safety-net program, Dairy Market Loss Payment Program, and continuing the Milk Price Support Program. Prior audits have reported ineligible producers resulting from comparable adjusted gross income caps in the disaster assistance programs, and have recommended discontinuing some special crop programs that have been reintroduced in the current bill. The net outlays on commodity programs in Title I of the bill alone are estimated to increase by $49.7 billion over the next 10 years.

Conservation Programs

The 2002 FSRIA represents the single most significant commitment of resources toward conservation on private lands in the Nation's history. The bill also establishes a balanced portfolio of tools, including technical assistance, cost-sharing, land retirement, and a new stewardship incentives program. The bill not only reauthorized the Environmental Quality Incentives Program through 2007, but also provided significant budget authority amounting to approximately $6 billion for the period. The bill established a new Conservation Security Program to assist producers in implementing conservation practices rewarding ongoing stewardship on working lands; the new program is intended to supplement the other ongoing conservation programs. The bill reauthorized a number of other conservation programs: Conservation Reserve Program (CRP), Wetlands Reserve Program (WRP), Wildlife Habitat Incentives Program (WHIP), and Farmland Protection Program (FPP). In the cases of CRP and WRP, the bill increased their overall acreage caps. And with respect to WHIP and FPP, the bill significantly increased the budget authority for these programs. Overall, the increased budget authority for all of these changes will amount to $17.1 billion over the 6-year time period of the bill (or additional net outlays over the 10-year time period of $13.2 billion). Monitoring the changes, particularly in light of substantially increased funding authority and increased acreage, for the reauthorized programs and monitoring the new initiatives will require substantial audit resources. Compliance reviews will play a key role in ensuring program integrity, and our past reviews indicate that the USDA agencies will need to strengthen their monitoring and oversight activities.

Food, Nutrition and Consumer Services

4. Food Stamp Program

The Food Stamp Program (FSP), administered by the Food and Nutrition Service (FNS), helps put food on the table of some 7.3 million households, about 17.3 million people. It provides low-income households with coupons or electronic benefits they can use like cash at participating grocery stores to access a healthy diet. Because of the size and vulnerability of the FSP, OIG has annually devoted a large number of staff days auditing and investigating the program.

Electronic Benefits Transfer (EBT) Systems Implementation

All States are mandated to implement EBT for food stamps by October 2002. As of July 2002, 48 States and the District of Columbia have operational systems with 45 being operational State or district wide. About 87 percent of food stamp benefits are now issued through EBT systems. OIG has audited controls over these systems as they were implemented and it will continue to audit the remaining systems as they are implemented.

Six State agencies will not meet the October 2002 deadline including California, Delaware, Guam, Iowa, Maine, and West Virginia. With the exception of Guam, all have negotiated a contract for a statewide EBT system and are in the development phase. While FNS has made great strides in getting EBT systems implemented, the remaining States will provide a challenge, in particular California with its county-centered organizational structure.

Improper Payments

FNS has had a quality control (QC) system in place for a number of years to measure the accuracy of States' certification of participants. Between FY's 1993 and 2001, the annual error rates have fluctuated between 10.81 percent and 8.7 percent, which include both overpayments and underpayments. In FY 2001, the latest year testing was completed, the total erroneous payments were $1.33 billion. At the time of OIG's audit in 1997 to review FNS' efforts to reduce the error rate through reinvestment of QC penalties, it was thought that the high error rate was attributable to large increases of participation without a corresponding increase in State certification personnel. However, between 1995 and 2001, there was a significant decline in the number of participants and program outlays (34 percent in program dollars). While there was a decline in certification errors, about eight percent for the same period, the decline in participation did not result in a corresponding drop in the certification errors. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony in March 2002, that while payment accuracy was at its highest level, 91.3 percent, this also meant that 8.7 percent of the payments were erroneous. His testimony indicated that FNS' budget proposes revamping the QC system and having it focus sanctions on States with the most serious problems and consistently high error rates.

Retailer Abuses

Curbing the incidence of unlawful transactions (trafficking) by authorized and unauthorized retailers remains an area of significant mutual concern for FNS and OIG. FNS' latest estimate is over $600 million annually. Over the past several years, OIG and FNS have explored and developed a series of corrective measures to address trafficking. Conversion to EBT systems has allowed for more timely information to identify possible violations. However, further reducing the amount of trafficking will remain a challenge.

5. National School Lunch and School Breakfast Programs

Eligibility Determinations for Free and Reduced-Price Meals

In its FY 2003 budget, FNS estimates that the National School Lunch Program (NSLP) outlays will be about $6 billion with the School Breakfast Program (SBP) approaching $1.7 billion. Both programs share common eligibility requirements for free and reduced-price meals. For FY 2001, the latest reporting year, almost 57 percent of lunches were served free or reduced-price, while 83 percent of breakfasts were served free or reduced-price. Eligibility is based on income with households submitting applications to school food authorities for eligibility determinations at the beginning of each school year. To ensure that households correctly report their income, school food authorities (SFA) are required to sample applications to verify the information. Two sampling methods are provided by regulations, and most SFAs select a random sampling method of the lesser of 3,000, or three percent of the applications.

In August 1997, OIG issued a report concerning Illinois' application verification process for the NSLP. While SFAs were generally following regulations, SFAs did not expand sampling when high error rates were found. Overall, Illinois had a 19 percent error rate of households underreporting income or failing to respond to verification requests. This meant that up to $31.2 million per year, 18.9 percent of $165.1 million Illinois received from FNS for free or reduced-price lunches, was potentially paid out for households that were not eligible. OIG recommended that FNS establish a threshold for the maximum percentage of errors allowable during the verification process and require additional sampling when that percentage is exceeded. OIG further recommended that States be required to monitor SFA verification efforts and take appropriate follow-up action.

FNS did not initially agree to make regulatory change based only on Illinois, but subsequently revised this position when information it gathered on additional States showed an average error rate of 26 percent. FNS will publish a proposed rule requiring State agencies to collect, analyze, and act on verification results of SFAs annually. FNS currently has pilot projects underway in 23 SFAs to assess 3 different options to address the verification process and the current high error rate. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony before the House Subcommittee on Agriculture, Rural Development, Food and Drug and Related Agencies, in March 2002, that the evidence is strong that more students are certified for free or reduced-price school meals than appear to be eligible with the most recent data showing it to be 27 percent. He also noted that the issue is complicated because certification data is used to distribute billions of dollars in education aid. FNS and OIG both agree that the eligibility determination and verification process is a management challenge that must be addressed.

Food Safety

6. Food Safety Issues

Food safety and quality issues have received considerable attention over the last few years, including the implementation of the Hazard Analysis and Critical Control Point (HACCP) inspection system. OIG issued four audits in FY 2000 on the Food Safety and Inspection Service's (FSIS) Implementation of the Hazard Analysis and Critical Control Point System; FSIS Laboratory Testing of Meat and Poultry Products; FSIS' Imported Meat and Poultry Inspection Process, Phase I; and FSIS' District Enforcement Operations Compliance Activities. FSIS generally agreed with our findings and recommendations with the exception of two recommendations in the Imported Meat and Poultry Inspection Process, Phase I. The two recommendations concerned reporting control weaknesses in the equivalency determination process as a material internal control weakness for FSIS and establishing a follow-up process to obtain annual certifications from foreign countries that failed to timely submit them.

OIG currently has two audits underway reviewing additional facets of FSIS' responsibilities for imported meat and poultry products. Countries may export meat and poultry products to the United States if their meat and poultry inspection systems are determined to be equivalent to the U.S. inspection system. Individual plants within a country may then be approved to export to the United States. Product entering the United States is subject to FSIS reinspection before entering U.S. commerce.

One audit is focusing on FSIS' reinspection process and whether it has effective procedures and controls to provide FSIS with a means of ensuring that only wholesome, unadulterated and properly labeled product enters U.S. commerce. The fieldwork has been completed and OIG has determined there are reportable conditions warranting FSIS' corrective action.

The second audit is also underway and concerns the equivalency determinations FSIS makes of foreign inspection systems. In the Phase I audit cited above, OIG reviewed equivalency determinations for

Sanitation Standard Operation Procedures (SSOP) and *E. coli* testing. At that time, the HACCP and *Salmonella* testing requirements were not in place. The audit is focusing on equivalency determinations for HACCP and *Salmonella*.

Marketing and Regulatory Programs

7. Animal and Plant Health Inspection Service (APHIS)

APHIS carries out inspections at U.S. ports-of-entry to prevent the introduction of foreign plant and animal pests and diseases which are harmful to our country's agriculture. It engages in cooperative programs to control pests of imminent concern to the United States and carries out surveys in cooperation with States to detect harmful plant and animal pests and diseases. The programs also help determine if there is a need to establish new pest or disease eradication programs. Through APHIS' Wildlife Services program, it protects agriculture from detrimental animal predators.

The importance of APHIS' mission and challenges has been highlighted over the past few years as Asian longhorn beetle, citrus canker, and Karnal bunt found their way into the United States and foot and mouth disease (FMD) broke out in the United Kingdom. The foreign terrorist attack on the U.S. mainland alerted USDA to the need for increased vigilance to protect U.S. agriculture from potential threats of terrorism to agriculture. OIG has reviews underway, some which began prior to September 11, 2001, to assess APHIS' activities to protect U.S. agriculture, as well as safeguarding APHIS' assets which could be used to further terrorist activities.

- In July 2001, OIG issued a report detailing a review of the Department's controls to ensure that the Nation was adequately protected against the increased threat of an FMD outbreak from abroad. We determined the Department needed more stringent controls to ensure meat products entering the United States were free of FMD. Communications between APHIS and FSIS were weak. Both agencies initiated action to address the weaknesses. OIG currently has a review underway focusing on APHIS' policies and procedures for (1) identifying and assessing risk among the various types of imported goods to prevent the entry of exotic pests and diseases; (2) conducting inspections at airports, seaports, and land-border crossings; (3) providing inspection coverage at all major ports-of-arrival of cargo and passengers, particularly during times of high volume traffic; and (4) ensuring that sealed transportation and exportation shipments entering the United States exit the country under seal as required. We have issued Management Alerts to APHIS on weaknesses that needed to be immediately addressed.
- In protecting agriculture from animal predators, APHIS' Wildlife Services uses pesticides, drugs, and other hazardous materials which in the wrong hands could be harmful to people and animals alike. In a review begun prior to September 11, 2001, OIG found APHIS could not account for 60 pounds of strychnine-treated bait and over 2,000 capsules containing sodium cyanide. Transfers of agents between locations were not documented. A second phase of this review is now underway with specific focus on pesticide and drug accountability. We will determine if the missing strychnine and cyanide have been accounted for, as well as 13 other restricted-use compounds.
- APHIS' Plant Protection and Quarantine and Veterinary Services divisions each have separate permit systems for the importation and domestic transfer of specified plant and animal pathogens and other restricted materials. Anthrax is one example of a pathogen which would fall under the permit requirements. OIG currently has a review underway to evaluate APHIS' controls over permits issued to colleges and universities, public and private laboratories, and other users. An adequate control structure is needed to ensure that the pathogens and restricted materials are not made available to terrorists or others intent on harming U.S. citizens or agriculture.

Natural Resources and Environment

8. Forest Service (FS) Management and Program Delivery Issues

Management issues within the FS have proven resistant to change. We attributed part of this to the agency's decentralized management structure. The agency delegates broad authority to its field units (regions, forests, and ranger districts) without having an adequate system of internal controls to ensure policies established by top management are followed. The use and accuracy of management performance information is severely limited. As a result, agency actions often run counter to the intent of top management. Following are some of the areas where recent audits and evaluations have identified significant issues.

- Our reviews of the agency’s administration of grants to State and nonprofit organizations have disclosed significant weaknesses in all aspects of management of the program. These weaknesses increase the likelihood that program objectives will not be achieved and Federal funds will be spent for unauthorized purposes.
- We identified serious weaknesses in the controls over the preparation and implementation of the environmental analyses required for timber sales. These weaknesses could result in environmental damage that could be either mitigated or avoided. In addition, weaknesses in the FS’ environmental analyses process have resulted in successful appeals of FS management decisions. This has halted or delayed FS efforts at ecosystem management. It has also resulted in successful lawsuits for monetary damages from the timber industry and exposed the FS to significant future damages.
- FS has not developed agency-wide policies for dealing with partnerships with private parties. As the agency moves to increase the use of partnerships with private groups to meet its mission requirements, direction will be needed to ensure these relationships comply with existing laws.
- FS’ Strategic and Annual Plans have lacked meaningful goals and objectives with relevant performance measures. Past performance measurement data has been irrelevant and lacks basic accuracy.

FS has reported initiating management action to address many of these challenges. However, at this time OIG has not verified the extent or effectiveness of these corrective actions.

9. Forest Service National Fire Plan

As a result of the devastating 2000 wildfire season the President and Congress directed and funded the “National Fire Plan” (NFP). The NFP included objectives to prepare to fight future forest fires, rehabilitate burned lands, actively reduce fuel loads in vulnerable areas, and assist local communities. In October 2000, Congress provided FS over $1.1 billion of additional funding. This increased funding has continued and is projected to continue for at least 10 years. This program has support from both State and local governments. The dramatic increase in funding has presented FS with challenges in effectively and efficiently implementing the NFP. Our initial survey identified issues regarding the agency’s ability to accurately project funding requirements and ensure funds were spent for only authorized purposes. Our survey work indicates that this area is vulnerable to waste and misuse of funds.

10. Grant and Agreement Administration

FS has not effectively managed grants agreements to ensure that funds appropriated by Congress were expended for their intended purposes and grantees complied with applicable financial management standards. Our reviews identified the following issues.

- Funds were used for purposes not authorized under the enabling legislation.
- Grantees were not matching Federal funds with required private funding.

- Unauthorized expenditures were paid with Federal funds.
- Accounting records were not adequate to allow for audits.
- Records were not adequate to determine if the grants achieved their intended purpose.
- FS created a new agreement “Participating agreements” that did not conform to the Federal Grants and Cooperative Agreements Act or to the Office of Management and Budget (OMB) and departmental regulations, to transfer funds without obtaining contractual assurance that the recipient will use the funds for intended purposes and without the provisions necessary for effective FS oversight.

FS officials have taken some actions to address these issues. Our future audits will address the adequacy of these actions.

Rural Development

11. Rural Rental Housing (RRH)

Portfolio Management

The Rural Housing Service (RHS) RRH program provides low-cost apartments to residents with low incomes in rural areas. The 2003 budget reflects a decision by the Administration to conduct a thorough review of alternatives for both making new loans and servicing the existing portfolio of over 17,000 RRH projects that contain about 460,000 housing units, with indebtedness of almost $12 billion. A substantial portion of this portfolio is over 20 years old. The FY 2003 proposed budget does not include funding for the direct loans for new RRH projects, although funding for RRH construction may be reinstated. However, it does include $60 million in direct loans for repair and rehabilitation of the current portfolio. RHS faces a major challenge to maintain its current portfolio in good repair so that it will provide safe, decent, and affordable housing for rural Americans.

Guaranteed RRH Program

We reported that during the first 4 years of the pilot program RHS reported to Congress, and included in their Government Performance and Results Act (GPRA) accomplishment report, the construction of over 6,000 apartment units. Our audit found that as of August 25, 2000, the pilot program had completed construction of only 222 units. RHS had reported apartment units that were obligated *to be built*, as being built. RHS restated the GPRA report to reflect the status of the units proposed for construction rather than built. We need to continue to monitor the program’s growth and success and whether RHS has implemented sufficient controls to ensure accurate reporting of units built.

Rental Assistance

The RRH rental assistance program was increased from $707 million in FY 2002 to $712 million in FY 2003. This assistance makes up the difference between what the tenant pays and the rent required for the project owner to meet debt servicing and other costs. Tenants receiving this assistance are mostly elderly and have very low incomes. Most recipients pay only a small portion of the average $300 monthly rent.

Currently, there are proposed regulatory changes that will require project owners to increase the balances in the RRH reserve accounts used to fund the increasing demands for repair and rehabilitation of aging projects. The increased reserves will be funded by increased rents. For those tenants on rental assistance, their basic rent will not increase. To match the increased rents, the amount of rental assistance needed to make up the difference between what the tenant pays, and the actual rent necessary for the project owner to meet expenses, will increase. Thus, the cost to the Government will increase because funding for rental assistance will need to increase. RHS needs to plan for these increased funding requirements.

RRH Projects Leaving the Program

As the RRH portfolio continues to mature, the possibility that project owners will want to pre-pay their loans will increase. Loans made between 1979 and 1989 can pre-pay their loans after 20 years. Projects obligated after 1989 cannot pre-pay. However, the majority of the over 17,000 projects in the portfolio are over 20 years old. The incentives for owners to pre-pay include increasing repair costs, loss of tax credits, and the possibility of higher rents from more affluent tenants.

RHS offers incentive payments for project owners to stay in the program. The payments are equal to the equity value in the property at the time pre-payment is planned. To be eligible for the incentive payment, owners must maintain the property in good physical condition and they must continue to serve lower income rural residents. RHS and OIG need to monitor the number of incentive payments and ensure that once made, project owners continue to meet the conditions of the incentive payment.

Unallowable and Excessive Expenses Charged to RRH Projects

RRH programs are vulnerable to program fraud and abuse because of the large cashflows involved. OIG has worked with RHS to detect fraud and abuse and remove from participation those who abuse the program. Our March 1999 report entitled “Uncovering Program Fraud and Threats to Tenant Health and Safety,” described the results of our team approach with RHS to identify and act on the worst offenders. We found 18 owners who misused over $4.2 million while neglecting the physical condition of the properties, some of which threatened the health and safety of tenants. Our audits continue to disclose unallowable and excessive expenses charged to RRH projects. Currently, RHS has proposed major regulatory revisions, which are intended to resolve 19 open recommendations from OIG audits that address improper RRH project expenses and program deficiencies. The proposed regulation is intended to bring consistency and better controls to the RRH program, as well as to resolve the open recommendations. We are working with RHS to ensure that the proposed regulation adequately addresses the open recommendations, or that appropriate alternative corrective actions, such as program handbooks to supplement the proposed regulation, are issued along with the regulation. Continued monitoring of the agency’s implementation of the new regulation is needed to ensure the desired results are achieved.

12. Rural Business-Cooperative Service (RBS)

Business and Industry (B&I) Loan-making and Servicing Procedures

RBS loan-making and servicing procedures in the B&I guaranteed loan program are not being properly administered by some State and field office program staff. In a few cases, States have had their loan-making and servicing authority rescinded by the National office, due to concerns pertaining to compliance with rules and regulations. We are in the process of conducting a Nationwide review of RBS’ B&I program and have, so far, issued 13 reports on the guaranteed B&I program with monetary findings of $32 million. Six more reports on the B&I program have yet to be issued, with two reports due on the direct B&I loan program. An additional $30 million in monetary findings is projected. We have found serious conditions with the B&I loans including borrowers with insufficient collateral to secure the loan, businesses that default within months after the loan is made, and loan proceeds used for unauthorized purposes. We are working with the RBS National office to implement corrective actions to these issues.

Waivers of Internal Controls

The previous Administrator of RBS endangered the integrity of the B&I Program by granting improper and undocumented waivers to B&I loan regulations. Based on these waivers many improper B&I loans were made which resulted in large dollar losses to the Government. RBS’ internal review programs and future OIG reviews should focus on any waivers to established regulations and instances where internal control mechanisms have been eliminated or bypassed. In an audit dated January 2001, we recommended the reestablishment of loan review controls which had been abolished by the previous Administrator. RBS agreed to re-establish the requirement that the National Office Executive Loan (NOEL) committee review proposed waivers for consistency with existing regulations. RBS also agreed to have the Under Secretary and the Office of the General Counsel resolve any inconsistencies between the findings of NOEL and the Administrator's reasons for the waiver. We need to continually monitor the use of waiver authority by RBS and Rural Development to ensure that waivers are fully documented and justified.

Administration

13. Civil Rights Complaints

The Director of the Office of Civil Rights (CR) has full responsibility for investigating, adjudicating and resolving complaints of discrimination arising out of USDA employment activities or in the context of federally assisted or federally conducted programs. This includes complaints made by USDA employees, applicants for employment and USDA program participants and customers. During fiscal years 1997 through 2000, OIG performed seven reviews of CR's operations relating to program and employment complaint processing at the requests of the Secretary and the Assistant Secretary for Administration.

Our reviews resulted in seven reports and one Confidential Memorandum with 94 recommendations to address the weaknesses reported. As of April 17, 2002, management decision had been reached on 84 recommendations, but 10 recommendations in four reports and the Confidential Memorandum remain without management decision. These recommendations involved things such as: 1) designing corrective actions to address civil rights review results in two counties; 2) finalizing operating procedures to ensure recipients of USDA financial assistance comply with civil rights laws and regulations; 3) vetting of settlements with OIG to ensure there are no outstanding fraud or criminal actions involving the complainant; 4) re-review of 70 civil rights cases to assess their proper disposition; and 5) review of employment-related case files to assess whether necessary documents are available and accounted for. Until action plans are drafted, and timeframes developed to implement the actions, CR activities will remain a management challenge at USDA.

Chief Financial Officer

14. Financial Management

Financial management in the Department is of major importance; USDA's balance sheet, for example, exceeds $127 billion. Financial management within the Department has not, however, been sufficient to provide assurances that its consolidated financial statements are reliable and presented in accordance with generally accepted accounting principles. For the past eight years our disclaimer of opinion means the Department does not know whether it correctly reported all collected monies, the cost of its operations, or other meaningful measures of financial performance.

The Office of Chief Financial Officer (OCFO) has taken extraordinary strides, however, in the past year to resolve these longstanding issues. According to the Chief Financial Officer, among the initiatives consummated or in process are the following.

- Providing effective leadership and talent from OCFO to USDA's agencies and the National Finance Center (NFC) to capture break-through rather than incremental value from extensive changes in financial management accountability and accounting operations.
- Implementing effective operational accounting processes within the branches of then NFC, problem agencies, and OCFO while transferring knowledge through documentation and training.
- Successfully completing the implementation of a standard accounting system at USDA.
- Renovating related corporate administrative systems during FY 2002 with focused, disciplined effective projects.

- Resolving Credit Reform deficiencies and maintaining improvements.
- Transforming the Forest Service into operating as an effective, sustainable, accountable, financial management function.
- Correcting real and personal property accounting and stewardship inadequacies.
- Developing cost accounting capabilities.
- Enhancing decision-making and cash management of USDA's Working Capital Fund.
- Providing guidance on USDA's lending function.
- Installing the leadership and management structure to support sustained excellence within USDA's financial management and accounting operations.

Although many of these have been completed, others await audit verification, which we will focus upon in our upcoming audit of the FY 2002 Departmentwide financial statements.[*]

Chief Information Officer

15. Information Resources Management

As the Department continues to expand its use of information technology (IT) for program and service delivery, this component of USDA's infrastructure has become a key element for operational integrity and control. The Department has numerous information assets, which include market-sensitive data on the agricultural economy and its commodities, signup and participation data for programs, personal information on customers and employees, agricultural research, and Federal inspection information ensuring the safety of the food supply, as well as accounting data.

Public confidence in the security and confidentiality of the Department's information and technology is essential. Our audit of USDA Information Technology, required by the Government Information Security Reform Act, found that USDA had initiated actions to strengthen information security in the Department. The Department, through its Chief Information Officer (CIO) has established a Department-wide security program, implemented a departmental security incident response program, and strengthened its oversight function through review of USDA agencies' security programs. In this report we stated that the Department and its agencies had other IT security weaknesses that included:

- The Department is not fully compliant with several requirements of OMB Circular A–130 and Presidential Decision Directive (PDD) 63 that require all Federal departments and agencies (1) prepare and test contingency and business continuity plans, (2) have certified the security controls in place on their systems, and (3) assess the risks to their systems and establish plans to mitigate those risks.
- Inadequate physical and logical access controls to ensure that only authorized users can access critical agency data.
- Nine of 11 USDA agencies had not assessed the risks of their systems and initiated a plan to eliminate or mitigate those risks.
- Inadequate oversight to ensure that contractors have the proper security clearances and background checks and they are sufficiently trained in Federal Security Requirements.

OCIO has reported that many of these items have been mitigated but more needs to be done.

[*] Note from the Office of the Chief Financial Officer, USDA: On January 7, 2003, USDA obtained a clean audit opinion on the FY 2002 Financial Statements.