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

DATE: February 3, 2011

AUDIT NUMBER: 03601-28-KC (2)

TO: Jonathan Coppess
Administrator
Farm Service Agency

ATTN: Philip Sharp
Acting Director
Operations Review and Analysis Staff

FROM: Gil H. Harden /s/
Assistant Inspector General
for Audit

SUBJECT: Recommendations for Preventing or Detecting Schemes or Devices
Biomass Crop Assistance Program Controls over Collection, Harvest, Storage, and Transportation Matching Payments Program

Summary

The Biomass Crop Assistance Program (BCAP) was authorized by the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) to support the establishment and production of eligible crops of renewable biomass.[1] Bioenergy production plays a key role in the Administration's efforts to achieve homegrown sustainable energy options.[2] One portion of BCAP involves matching payments to assist agricultural and forest landowners and operators with the cost of collection, harvest, storage, and transportation (CHST) of eligible material for use in a qualified biomass conversion facility. This provides an incentive for collecting underutilized biomass, such as crop residue and wood waste, for energy production.[3] Funding for this portion of BCAP begun under the authority of a Notice of Funding Availability (NOFA) that occurred before the issuance of the final regulation that implemented the full program. Before the NOFA was terminated,[4] a total of over $243 million was spent on the CHST portion in calendar years 2009 and 2010.[5]

---

[1] Biomass is organic material that can be converted into heat, power, bio-based products, or advanced biofuels.
[2] "Memorandum on Biofuels and Rural Economic Development," Daily Compilation of Presidential Documents, dated May 5, 2009.
[3] Farm Service Agency, "Fact Sheet: The Biomass Crop Assistance Program," dated June 2010. Congressional Research Service, "Biomass Crop Assistance Program: Status and Issues," dated August 13, 2010.
[4] With the final rule announcement on October 27, 2010, the CHST program has been reauthorized.
[5] Farm Service Agency, "BCAP CHST Summary Report," dated October 20, 2010.

BCAP is a new program unlike any other that Farm Service Agency (FSA) has historically delivered. Additionally, the CHST portion of BCAP resulted in very high FSA county office workload in many areas minimally staffed because of limited production agriculture activities, and participation by a producer base not normally accustomed to doing business with FSA. At the request of FSA, the Office of Inspector General (OIG) reviewed the CHST portion of BCAP upon its commencement, focusing on the efficacy of processes and controls used in implementing the NOFA, and to issue recommendations that can assist FSA when implementing the full BCAP upon publication of the final regulation. Based on our review of 12 county office operations in 4 States, we found 3 cases where potential schemes or devices were carried out by material suppliers or biomass conversion facilities. The arrangements and transactions in these three cases appear to have been conducted with the aim of circumventing the intent of CHST program agreement terms and guidelines. These cases involved the following: a biomass conversion facility that may have sought "kick-backs" from matching payments received for deliveries to its facility; a biomass conversion facility that sold its material through a broker and indirectly received matching payments it was not eligible for; and an arrangement in which one participating material supplier allowed three other participating material suppliers to make deliveries at a particular biomass conversion facility using its name and account, and thus receive matching payments they were not eligible for. (We referred the three cases to OIG Investigations. OIG Investigations is discussing these three cases with the Civil Division of the U.S. Attorney's Office.)

Though questionable cases such as these sometimes emerge in a program such as CHST,[6] the confusion created by a lack of prohibited practices or activities in the agreement terms and guidance provided little notice or deterrence to participants. In an effort to quickly implement the program to comply with a Presidential Directive, FSA left its field personnel without adequate guidance and oversight controls to detect, identify, and take action against potential schemes or devices.

We recommend that FSA evaluate the three cases and determine whether they constitute a scheme or device. To prevent reoccurrence, we recommend that FSA issue new agreement terms and/or guidance that address schemes or devices more comprehensively and specifically prohibit arrangements and transactions of this nature. FSA should also develop and implement new controls and review processes for detection and prevention. Before implementing any corrective actions, FSA should coordinate with OIG Investigations. These issues are being provided in a Fast Report format to aid FSA as it moves forward with re-implementation of the CHST program. This Fast Report provides only a few examples of the problems and deficiencies found by OIG; a full draft report with greater scope and detail will be provided at the completion of our fieldwork.

[6] In Notice BCAP-8, dated April 1, 2010, FSA said it had received reports of possible abuses, and instructed county offices to report possible fraud, waste, or abuse by biomass conversion facilities.

Background

The 2008 Farm Bill authorized such sums as are necessary to carry out BCAP, and in 2009, BCAP received $25 million in funding. The 2010 Supplemental Appropriations Act[7] capped BCAP funding at $552 million in fiscal year 2010. BCAP supports two sets of activities. First, it provides funding for "matching payments" for certain eligible material sold to qualified biomass conversion facilities. CHST matching payments are made at a rate of $1 for each $1 per dry ton[8] paid by a qualified biomass conversion facility, in an amount up to $45 per dry ton. Second, BCAP provides funding for producers to establish and maintain renewable biomass crops in specified project areas. This second part of the program had not yet been implemented at the time of our review.

On May 5, 2009, the President issued a directive calling for the acceleration of investment in and production of biofuels.[9] In particular, the directive called for the issuance of guidance and support related to the collection, harvest, storage, and transportation of eligible materials for use in biomass conversion facilities within 30 days. In order to comply with this directive, on June 11, 2009, the Commodity Credit Corporation (CCC) published a BCAP notice of funds availability (NOFA) in the Federal Register for the collection, harvest, storage, and transportation of eligible materials. FSA administers this program on behalf of the CCC. The NOFA was terminated after the proposed rule was issued on February 3, 2010. Deliveries were allowed to continue through April 30, 2010.

We initially selected Missouri for our review because it allowed us to test our audit program and it was in close proximity to our office conducting the field work. We then selected offices in Alabama, California, and Maine because they distributed the largest amounts of matching payments to program participants. They also represented a diverse range of biomass industries and varying geographical regions. County offices were selected primarily based on payment volume. The national office was reviewed to gain perspective on overall program administration.

Results

During our review, OIG identified two cases in California and one case in Maine where potential schemes or devices were carried out by participating material suppliers, and/or biomass conversion facilities. The arrangements and transactions carried out in the three cases appear to have been created with the aim of participants circumventing the intent of CHST program agreement terms and guidelines.

Case A involved a tiered-pricing structure developed by a biomass conversion facility in which material suppliers participating in the CHST program were paid lower per ton rates than those who were not part of the program, in anticipation that the participants would later receive

---

[7] Public Law 111-212.

[8] The final rule states that, "One dry ton is the amount of renewable biomass that would weigh one U.S. ton at zero percent moisture content."

[9] Published in the Federal Register (FR) on May 7, 2009 (74 FR 21531-21532).

matching payments. The lower rates could, in effect, be viewed as a "kick-back" as described in program guidance. Case B involved a qualified biomass conversion facility, which also sold biomass material, that was selling its material to a participating material supplier. The supplier then received matching payments for this material and indirectly shared them with the facility. The facility was not a program-registered material supplier, and was also commingling material it purchased from suppliers—creating a situation where loads of material may have received two matching payments. Case C consisted of an arrangement in which one participating material supplier allowed three other participating material suppliers to use his unfilled, obligated CHST delivery allocation payment funds at a certain biomass conversion facility, in exchange for a fee. The other three suppliers had either used up the bulk of their CHST obligations, or were not approved to receive matching payments for deliveries to the facility in question.

The expedited timeline in which FSA implemented the CHST program left field personnel without clear guidance on how to detect, identify, and investigate questionable practices such as these three cases. The general definition of scheme or device in the terms of the agreement between USDA and program participants[10]—coupled with the inadequate BCAP Notice guidance that was subsequently released—did not provide FSA personnel with adequate tools to accurately determine which business practices are acceptable and which could be aimed at circumventing the program's intent.

In contrast to FSA's normal practice of issuing handbooks to aid the day-to-day administration of a large program, no handbook was issued for the CHST program under the NOFA. Instead, FSA relied on a series of notices and question and answer sheets, which provided limited program guidance. Also, FSA did not create adequate proactive controls to help county personnel identify possible schemes or devices. In fact, only one control was created specifically for the CHST program.[11]

Questionable cases like these sometimes emerge in a program and a lack of adequate prohibitions, guidance, and controls did not help to deter actions by participants to manipulate the program. As a result, our review found that FSA distributed over $83,880 in payments for biomass material that may not have been eligible for the payments. In two of the three cases that OIG identified, county offices were not aware of the situations and, therefore, did not question participants or block payments. In Case B, the county office did deny some matching payments for ineligible biomass material, but did not investigate further to determine if the case would constitute a scheme or device. In the context of our broad review, many county office officials claimed that the volume of paperwork required as documentation made a thorough eligibility review impractical, and that they lacked resources to effectively administer the NOFA.

---

[10] The NOFA, dated June 11, 2009, defines scheme or device as (but not limited to) "coercion, fraud, misrepresentation, depriving any other person of a payment, or obtaining a payment that otherwise would be payable." This is a general definition often used in order to allow for further guidance and interpretations by the administering agency. Penalties detailed in the NOFA include refunding any program payments paid with interest, and loss of program eligibility.

[11] County offices are required to conduct an in-person review of a biomass conversion facility before releasing a payment over $50,000. No procedures on how to conduct or document this review were issued. FSA has other, more general controls (such as recommending second-party review of payment calculations) for programs it administers.

The final rule, issued on October 27, 2010, contains the same scheme or device definition as the original agreement terms, with one addition requiring more detailed disclosures when land ownership changes. However, the specific situations in the three cases OIG identified have not been addressed, with the possible exception of Case A. The final rule does specify that qualified biomass conversion facilities must "pay fair market value for eligible material regardless of whether the seller has applied for or receives a matching payment authorized by this subpart."[12] Also, the responses to comments included with the final rule do provide some more detailed examples of situations that would constitute a scheme or device. Penalty and appeal actions, based on standard FSA language, are the same as those described in the NOFA.

While the final rule makes some limited progress towards addressing uncertainties regarding the definition of scheme or device, FSA must continue to strengthen CHST program agreement terms, guidance, and oversight controls.[13] If more comprehensive agreement terms and guidance are not issued before the CHST program is re-implemented, FSA runs the risk of such situations continuing unchecked and improper payments being made. Further, given the volume of documentation required for the CHST program, personnel may be handicapped in their ability to detect questionable practices if FSA does not create specific, proactive controls to guide them.

Case A

This case involved a participating material supplier in California that allegedly denied its program participation status to a biomass conversion facility in order to receive a higher price per ton, as the facility was paying a lower price per ton to CHST program participants. This situation emerged during our interview with representatives from the facility, who complained about the supplier's behavior. Upon hearing of the situation, OIG found contracts in a FSA county office that showed the facility had agreed to pay the supplier a price per ton of $20 for a certain period of time. However, since the supplier never confirmed its participation in the program, it was actually paid the higher rate of $28 per ton for this period and received matching payments based on that amount. The facility's representatives then sought to recoup the losses they felt the facility had incurred. They informed the supplier that they would deduct the difference in payment rates, totaling approximately $11,700, from future per ton payments on deliveries from the provider. As of the date of our review, no deductions had been made, as the facility said it planned to incorporate the offsets into its next contract with the supplier.

This case could be viewed as a "kick-back," as described in Notice BCAP-8, which prohibited a biomass conversion facility from requiring participating material suppliers to "return any portion of their matching payments to [a] BCF for any reason." The lower per ton payments for program participants—and the concept that the extra money received by the participating material supplier needed to be repaid—both imply that the facility sought to indirectly receive matching payment funds.[14]

[12] Biomass Crop Assistance Program Final Rule, 7 CFR Part 1450, October 27, 2010.
[13] OIG has other concerns about the final rule that are not addressed in this Fast Report, but will be included in our forthcoming full report.
[14] The potential "kick-back" is the immediate concern of this Fast Report. However, we believe the supplier's alleged

County office officials said that they were not aware of the facility's tiered-payment structure, or the contract payment discrepancy in their files. After learning the details of the case, they commented that even if they had noticed the discrepancy, they would not have been likely to question it, as the payment was not close to the $45 per ton CHST payment limit.

Case B

In this case, a CHST program-qualified biomass conversion facility (BCF 1) owned land with walnut trees and harvested walnut shells as biomass material. Instead of registering as a material supplier in order to receive matching payments,[15] BCF 1 sold material to a broker that was a participating material supplier. BCF 1 received $42 per ton from the broker; the broker then sold the material to another biomass conversion facility (BCF 2) for $24 per ton. The arrangement was profitable only after matching payments were received (for a per ton total of $48, with a $6 per ton profit for the broker). Therefore, BCF 1 was indirectly receiving matching payments it was not eligible for.

This situation was further complicated by the fact that BCF 1 bought walnut shell biomass material from the broker to create fuel products for sale to the public. The broker received matching payments for these loads (as BCF 1 was a program-qualified facility). While representatives of BCF 1 claimed that the walnut biomass purchased from the broker was distinct from the walnut biomass sold to the broker, they admitted that all walnut biomass—either its own or from outside suppliers—was commingled when it reached the facility. So, the biomass material that had already received matching payments (bought by BCF 1 from the broker) could have then been sold to BCF 2 for a second matching payment.[16]

The county office questioned the source of the materials when it calculated program payments and moved quickly to seek clarification. In a letter to the broker, it asked for documentation to show that the material sold to BCF 2 was separate from the material sold by the broker to BCF 1. The letter cited Notice BCAP-2, Section 2 D, which states that "eligible material for which a payment has already been applied… is ineligible for CHST matching payments." No documentation was provided, so the county office moved to block $9,393 in matching payments. Due to human error, country office personnel still issued over $5,060 in matching payments for material purchased from BCF 1.

While FSA was correct in denying matching payments for these loads, it did not investigate further to determine whether the situation would constitute a scheme or

---

misrepresentation also merits further investigation by FSA.

[15] BCF 1 could have been qualified to receive matching payments had it elected to participate as a biomass material supplier with ownership over eligible material that was not processed at its facility and was sold at arm's length to an unrelated facility.

[16] OIG found no evidence that such duplicate payments occurred.

device. If FSA had investigated this case, it could have discovered—among other possible circumventions of agreement terms and guidance—that matching payments were being shared with a biomass conversion facility that was not eligible to receive them.

Case C

In Maine, two participating material suppliers were prevented from delivering eligible biomass material to the biomass conversion facility (BCF 3) where they held CHST program fund obligations, as the facility had reached its capacity and had reduced its acceptance of deliveries. A third participating material supplier had nearly completed delivery of the entire quantity of material that was approved for his program fund obligation at a second facility (BCF 4).[17] Two of the three suppliers filed requests for relief seeking approval to either deliver their approved quantities of material to other facilities, or to increase the quantity of material approved for matching payments. Upon learning that similar requests for relief were denied, one withdrew his request; the other request remained filed but was never acted upon.

Through mutual contacts, all three suppliers entered into arrangements with a fourth participating material supplier who had an unfulfilled matching payment obligation at BCF 4 (which was still accepting deliveries). The fourth supplier agreed to let the others deliver material to BCF 4 using its name and account. The fourth supplier passed on all per ton payments received from the facility—and all matching payments—to the three suppliers responsible for delivery of the material, minus a $3 per ton fee retained by the fourth supplier as compensation. Because of this questionable arrangement, FSA should not have issued $78,820 in matching payments for material attributable to these suppliers, who were not eligible to receive such payments for this facility. OIG determined that BCF 4 was aware of these arrangements and provided delivery documentation that clearly attributed loads delivered by the other three suppliers under the fourth supplier's account.

County office officials had copies of the agreements between the four suppliers and the delivery documentation submitted by the fourth supplier in their files. They stated that they were not aware of the potential program impact of these arrangements, and did not realize the situation was potentially improper.

Because of their possible legal improprieties, OIG referred the three cases to OIG Investigations. OIG Investigations is discussing these three cases with the Civil Division of the U.S. Attorney's Office. As such, please coordinate with OIG Investigations before proceeding with any corrective actions on the three cases.

Given the problems we found, we are recommending that FSA take the following steps before any future implementation of the BCAP CHST program:

[17] BCF 3 and BCF 4 are separate facilities owned by the same parent company. They share a material procurement manager.

(1) Evaluate the circumstances of all three cases to determine whether such situations constitute a scheme or device. (Before proceeding with corrective actions on any of the three cases, please coordinate with OIG Investigations.)

(2) Create new terms of agreement and/or guidance that address scheme or device more comprehensively, and specifically prohibit schemes or devices of this nature. As part of issuing a program handbook, include guidance that details procedures for investigations, enforcement actions, penalties, and appeals related to scheme or device determinations.

(3) Create controls and compliance review procedures at the county office level designed to detect and identify potential schemes or devices.

Please provide a written response within 5 days outlining your proposed corrective action for this issue. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact, Ernest Hayashi, Director, Farm and Foreign Agricultural Division, at (202) 720-2887.

USDA'S

FARM SERVICE AGENCY'S

RESPONSE TO AUDIT REPORT

United States Department of Agriculture

Farm and Foreign Agricultural Services

Farm Service Agency

Operations Review and Analysis Staff

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

February 22, 2011

TO: Gil H. Harden
Assistant Inspector General
for Audit

FROM: Philip Sharp, Acting Director
Operations Review and Analysis Staff

SUBJECT: Audit 03601-28-KC (2): Recommendations for Preventing or Detecting Schemes or Devices Biomass Crop Assistance Program (BCAP) Controls over Collection, Harvest, Storage, and Transportation Matching Payments Program

This is the Farm Service Agency's (FSA) response to your February 4 memorandum requesting comments on the fast report of the subject audit.

FSA invited the Office of Inspector General (OIG), at the Beginning of Notice of Funding Availability (NOFA) activities, to join with FSA in monitoring BCAP expenditures, to focus on identifying questionable actions among program participants, and to provide recommendations to FSA in advance of issuing the final BCAP regulation.

FSA appreciates the responsiveness of OIG to FSA's request.

In contrast to the conventional practices of other agencies (where independent examinations are conducted often after programs are put into service and operational for some time), FSA sought OIG involvement early in BCAP so that unintended results could be identified in advance and addressed before continuation of the full program.

The Presidential Directive required the BCAP NOFA to be implemented on an expedited basis, in contrast to FSA's normal and standard procedures. Upon approval of the Office of Management and Budget in 2009, FSA issued the BCAP NOFA. Recognizing BCAP was a new program, and anticipating that identifying controls to detect practices not yet in existence would be a challenge that could result in limited program guidance to staff, FSA determined new types of controls may be necessary, and that OIG review and recommendations should be sought to provide valuable input when formalizing applicable safeguards for the full program.

Therefore, FSA has instituted OIG recommendations in the circumstances outlined in this report, and pledges to expand upon these safeguards to concur with the issuance of the final OIG report.

USDA is an equal opportunity provider and employer.

Recommendation 1

Evaluate the circumstances of all three cases to determine whether such situations constitute a scheme or device. (Before proceeding with corrective action actions on any of the three cases, please coordinate with OIG Investigations.)

Agency Response

The State and County offices in Maine and California involved in the cases identified in this report are closely examining the circumstances of each case to determine if the actions of these BCAP participants constitute a scheme or device. FSA has received notice that OIG Investigations has declined to open an investigation on the subject cases in California. However, as recommended, the State and County committees will consult with OIG investigations before taking any corrective actions in Maine.

Recommendation 2

Create new terms of agreement and/or guidance that address scheme or device more comprehensively, and specifically prohibit schemes or devices of this nature. As part of issuing a program handbook, include guidance that details procedures for investigations, enforcement actions, penalties, and appeals related to scheme or device determinations.

Agency Response

The final rule for BCAP explicitly prohibits a number of practices described in this report as potential schemes or devices and these practices are specifically defined as program violations. As recommended, these changes are incorporated in the terms of the facility agreement and will be further detailed in program policy documents.

In the facility agreement, new terms have been added to the qualified biomass conversion facility elements (paragraph V of the agreement) so that the facility agrees to:

F. Purchase eligible material at a fair market price that is consistent for similar products regardless of whether the seller participates in BCAP or if the seller and purchaser are related entities.

O. Issue no settlement sheets for the purchase of eligible material that is commingled with ineligible materials.

P. Receive no payments or reimbursements from eligible material owners that are related to the eligible material matching payment, including any requirement that the eligible material owner re-pay a portion of the BCAP matching payment as a kickback, value-share, or similar payment, or charge the eligible material owner any administrative or similar fee.

Each provision above addresses an area of concern in the report, particularly those regarding tiered pricing structures and a variety of kickback schemes.

In addition, FSA will issue before the end of the month handbook 1-BCAP to provide program guidance consistent with the BCAP final rule. The handbook includes more comprehensive policy on investigations, enforcement actions, penalties, and appeals related to scheme and device determinations.

Recommendation 3

Create controls and compliance reviews procedures at the county office level designed to detect and identify potential schemes or devices.

Agency Response

Handbook 1-BCAP will include enhanced guidance for compliance reviews of qualified biomass conversion facilities and eligible material owners.

BCAP policy will also incorporate additional controls to ensure that fair market pricing is being paid, including enhanced data collection from facilities by FSA as part of the funding allocation process.

Further, FSA is developing a number of automated controls in BCAP matching payment software to ensure the County Offices have proper documentation from eligible material owners before approving applications and payment requests.