



U.S. Department of Agriculture



Office of Inspector General
Great Plains Region

Audit Report

Farm Service Agency's Reliance on the National Agricultural Statistics Service's Published Peanut Prices

Report 50601-14-KC
March 2009



U.S. DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



DATE: March 31, 2009

REPLY TO
ATTN OF: 50601-14-KC

TO: Dennis Taitano
Acting Administrator
Farm Service Agency

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

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Farm Service Agency's Reliance on the National Agricultural Statistics Service's
Published Peanut Prices

Summary

From 2002 through 2007, the Farm Service Agency (FSA) provided over \$1 billion in financial assistance to peanut producers.¹ To determine how much assistance is needed, FSA relies on weekly average peanut prices published by the National Agricultural Statistics Service (NASS). Since FSA's assistance can be affected significantly by even small changes in peanut prices—an estimated \$33 million per \$0.01 difference for one type of assistance²—we undertook this audit to determine if NASS' peanut prices are based on reliable market data. Overall, we concluded that the peanut prices are not based on reliable market data because, in the absence of a public commodities market for peanuts,³ NASS solicits price data from peanut buyers (e.g., shellers) whose participation is voluntary and confidential by law.⁴ Moreover, NASS lacks authority to verify the price data reported by buyers that do participate. As a result, without mandatory and verifiable price reporting, FSA has no assurance that its program payment rates that depend or rely on NASS' published prices are based on reliable and supportable data.

To gauge the price of peanuts, NASS surveys peanut buyers each week.⁵ These buyers generally purchase peanuts through forward option contracts, which give them the option to accept

¹ The \$1 billion comprises \$934 million in counter-cyclical payments, \$71 million in marketing loan gains, \$26 million in loan deficiency payments, and does not include direct payments made to peanut producers. We explain these types of financial assistance in our "Background."

² According to our estimates, a \$0.01 difference in the average peanut price per pound, as determined by NASS, would have affected total counter-cyclical payments by an average of over \$33 million a year.

³ For the purposes of this report, "peanuts" refers only to in-shell (farmer-stock) peanuts.

⁴ Public Law 99-198: §1770 "Confidentiality of Information."

⁵ NASS solicits price data from peanut buyers instead of producers because this allows the agency to collect data about many sales transactions in

delivery of producers' peanuts, often months later, at the price quoted in the contracts. These contracts usually require that producers take out marketing assistance loans⁶ from FSA at a rate set by law (\$355 per ton),⁷ which provides them with interim financing. Typically, buyers agree to redeem producers' loans and to pay an additional option premium rate (e.g., \$60 per ton) above the loan repayment rate to the producer. An accurate reported price, then, should include the total amount that buyers paid for peanuts (e.g., \$415 per ton if the \$355 loan rate was not adjusted for premiums or discounts).

At our request, NASS contacted several buyers who participate in its price surveys and asked them to allow us access to their records. Of the buyers contacted, only two small buying point entities agreed to share their records with us. We found that these two buyers did not report the option payment rates on their NASS surveys. The omission may be partly attributable to the survey asking for the total weekly amount paid, but not explicitly stating that buyers should include option payments in the amounts they reported. After we discussed the issue with NASS officials, the agency added a statement to the survey reminding buyers to include option payments. NASS and FSA have since collaborated on additional changes to the survey. Beginning in January 2009, the weekly NASS' peanut price survey asks buyers to identify what the average option payment per pound was of the total dollars paid.

However, FSA still lacks assurance that buyers will report option payments in future survey responses. Since buyers' information is confidential by law, the data they report to NASS cannot be verified without their permission. And since only two buyers agreed to share their records with us, we could not determine the extent of incomplete reporting or calculate its impact on NASS' published peanut prices. The effect of underreporting on NASS' prices is also indeterminate because some buyers who agree to participate may not submit their purchase data in a given week. This inconsistent reporting means that NASS' prices are based on prices reported by the group of buyers who respond that week, and may not accurately reflect nationwide prices. In addition, NASS' survey asks for information about buyers' current payments, which include sales prices that were contractually established months earlier.

We concluded that NASS' weekly published prices are unreliable because they may not be complete (incomplete, inconsistent, and voluntary reporting) and cannot be verified (confidential records). In addition, the data does not reflect prevailing weekly market values because it incorporates previously established prices. Since FSA's financial assistance for peanut producers partly depends on these published prices, the agency lacks assurance that this assistance is based on reliable and supportable data unless all buyers are required to report complete, verifiable information.

To strengthen its confidence in weekly peanut prices, USDA should seek authority to establish mandatory price reporting for buyers as well as the authority to verify buyers' reported data. FSA should also have NASS use its weekly surveys to gather additional price data on buyers' current option contracts because peanuts do not have an open public market that provides this information.

a few surveys rather than canvassing a much larger group for the same information, i.e., each producer's individual sale.

⁶ A high percentage of the peanut crop moves through the loan program each year. For example, for the 2006 crop year about 98 percent of the crop was placed under loan while approximately 74 percent of the crop for the 2007 crop year was placed under loan.

⁷ Public Law 107-171.

FSA generally agreed with the two audit recommendations. However, we need additional information for both recommendations to reach management decision. FSA's February 26, 2009, response to the official draft report is included in its entirety as exhibit B, with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant sections of the report. The information needed to reach management decision is set forth after each recommendation in the Finding and Recommendations section of this report.

Background

Generally, peanut producers receive financial assistance from FSA through counter-cyclical payments, and through marketing loan gains or loan deficiency payments. Each of the programs' assistance rates are based, in part, on peanut market prices.

To provide a safety net for producers who have a history of farming peanuts, FSA offers annual counter-cyclical payments that make up the difference when prices fall below \$459 per ton.⁸ FSA determines the amount of assistance by the difference between \$459 per ton and the higher of either (1) the national loan rate (\$355 per ton), or (2) the national average market price.⁹ From 2002 to 2007, FSA made \$934 million in counter-cyclical payments.

Peanut marketing assistance loans are 9-month loans that use peanuts as collateral to provide interim financing to producers. The loan rate prescribed by law is \$355 per ton of peanuts pledged as collateral. Producers can repay their loans any time during the loan period, or designate agents such as buyers to do so for them.¹⁰ Through option contracts, buyers typically purchase producers' peanuts by agreeing to pay them an option premium payment (e.g., \$60 per ton) and to repay their loan if the option contract is exercised. From 2002 through 2007, FSA loaned peanut producers \$3.4 billion.

When producers or buyers repay marketing assistance loans, the loan may be repaid at the lesser of the loan rate plus interest and other charges, or the FSA-established weekly national posted price for peanuts in effect at the time. Unlike NASS' weekly published price for peanuts, FSA's weekly national posted price is not directly tied to peanut sales. Instead, FSA's Economic and Policy Analysis Staff meets each week to set the national price that best meets legislative requirements such as allowing peanut producers to compete in domestic and international markets.¹¹ In determining the national price, FSA's economic staff considers NASS' weekly published price (which reflects domestic peanut prices), European peanut prices, peanut product prices (e.g., peanut butter), and other market indicators such as peanut imports and exports. The staff does not use a fixed methodology, but instead fluidly evaluates varying market conditions to recommend a national posted price that best meets its legislative requirements. According to

⁸ This number is simplified for explanatory purposes. FSA makes \$36 per ton in direct payments to producers based on eligible historical peanut production. This amount is added to the higher of either \$355 per ton or the national average market price and that total is then subtracted from \$495, a target price set by law, to determine the counter-cyclical payment rate (Public Law 107-171: §1304 "Availability of Counter-Cyclical Payments for Peanuts"). For illustration purposes, we first subtracted \$36 per ton from the \$495 target price to arrive at \$459.

⁹ Price received by peanut producers during the 12 month marketing year, which is the season's average price for peanuts published by NASS.

¹⁰ Producers can also forfeit their loans, in which case the Government's Commodity Credit Corporation takes possession of their harvest to use for other purposes (e.g., foreign aid).

¹¹ According to Public Law 107-171, the national posted price should be set to (1) minimize potential loan forfeitures, (2) minimize the Federal Government's stock of peanuts, (3) minimize the Government's cost of storing peanuts, and (4) allow peanuts produced in the United States to be marketed freely and competitively, both domestically and internationally.

the economic staff, the national posted price ideally should represent the best price for moving peanuts into the market.

By setting the loan repayment rate,¹² FSA's national posted price can affect two types of benefits that are based on marketing assistance loan rates: marketing loan gains and loan deficiency payments.

- If the loan repayment rate has dropped below \$355 per ton by the time of loan redemption, buyers or producers pay FSA back at that price and keep the difference as a marketing loan gain. For example, if the repayment rate falls to \$345 per ton, buyers pay back that amount and keep the remaining \$10 per ton.
- Alternately, producers can bypass the loan and receive the difference directly as a loan deficiency payment when the repayment rate is below \$355. Using the previous example, producers would receive \$10 per ton from FSA without taking out a loan.

From 2002 to 2007, FSA provided peanut producers \$71 million in marketing assistance loan gains and \$26 million in loan deficiency payments.

Although NASS' published prices are not the only factor in determining the national posted price, they are used because peanuts do not have an open, public market like other commodities (e.g., soybeans). As a result, the data NASS gathers from buyers represents FSA's main source of information about peanut prices in setting the national posted price.

Objective

We undertook this audit to determine if the peanut price data reported by NASS and used by FSA to provide financial assistance to peanut producers is based on reliable market data.

Scope and Methodology

We performed our audit fieldwork from June 2007 to October 2008. To accomplish our objective during this period, we interviewed officials from FSA's Economic and Policy Analysis Staff, Price Support Division, and Commodity Office. We also interviewed officials from NASS and the Agricultural Marketing Service. In addition, we interviewed peanut industry representatives, peanut producers, and peanut handlers.

In general, we interviewed the above officials to ascertain: (1) how they gathered data and established peanut prices, (2) the methodology for establishing the loan repayment, loan deficiency payment, and counter-cyclical payment rates, and (3) the procedures for administering peanut marketing assistance loans. (See exhibit A for details of sites visited and purposes.) We also reviewed applicable Federal laws and regulations, FSA directives and procedures, and FSA and industry news releases.

¹² The loan repayment rate is the rate at which farmers are allowed to repay their loans when market prices are below the commodity loan rate. For peanuts, this lower repayment rate is based on FSA's weekly national posted price. Any accrued interest on the loan is waived.

Significant constraints were imposed on our audit approach by limitations on access to information needed to verify price data reported to NASS by peanut buyers. Initially, at our request, NASS contacted approximately 15 large volume buyers who refused to let us review their records. This lack of cooperation confined our evaluation to two smaller buyers that NASS contacted later. Further, each of these buyers only allowed us to review one week's NASS survey response.

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

Finding and Recommendations

FSA Needs Reliable Peanut Price Data from NASS

Weekly peanut pricing data used by FSA to determine the financial assistance available to peanut producers is not reliable because the price data is incomplete, outdated, and unverifiable. This occurred because the agency FSA relies on to gather peanut price data, NASS: (1) bases its weekly published price on buyers' confidential and voluntary survey responses, which cannot be verified, and (2) gathers information about prices that have been established often months in advance of the surveys. As a result, without mandatory and verifiable price reporting, FSA has no assurance that assistance payment rates that depend on NASS' weekly published peanut prices are based on reliable data that reflects current market values.

Before each peanut marketing year begins, NASS officials meet with buyers to ask them to take part in its weekly price surveys and to review reporting procedures with those who agree to participate. Buyers are not to report individual purchases, but instead the total amount paid that week (including option payments) and volume purchased. Buyers' participation is voluntary and the information they send to NASS is confidential so their reported data cannot be verified without their permission. After buyers send in their survey responses each week, NASS statisticians review the data to determine if their peanut prices are close to those reported by other buyers. If they are not, NASS personnel contact the outliers to confirm the information.

The two buyers that allowed us to review their records did not include option payment amounts, demonstrating the possibility for omissions and errors in NASS' weekly reports. Further, NASS' weekly prices do not reflect the prevailing market value of peanuts each reporting week because they are based on prices contractually established earlier, but they are not reported until the purchase contracts are settled. Below, we discuss these issues and their impact on FSA's financial assistance rates for peanut producers.

Incomplete and Unverifiable Prices

In order to review the data that buyers provide to NASS in its weekly surveys, we asked NASS to contact buyers to determine if they would be willing to allow us to review their records. NASS agreed and informed us they contacted those buyers who buy a large volume of peanuts and participate in the surveys. Those buyers all declined our request. However, NASS eventually identified two smaller buyers who each agreed to let us examine a weekly survey submitted in February 2008 so we could evaluate the reliability of their reported data. We found that neither buyer included option payments they paid to producers, but only the amount they paid to redeem the producers' marketing assistance loans. Since buyers' voluntary and confidential data cannot be verified, NASS could not identify the incomplete reporting.

We discussed the omissions with the buyers who said that they did not know that option payments should have been included in their weekly survey response. NASS officials stated that they had explained the reporting requirements when they met with the buyers before the year's surveys began. The confusion may be partly attributable to NASS' survey asking for the total weekly amount paid, but not explicitly stating that buyers should include option payments in the amounts they report.

After we discussed the issue with NASS officials, the agency added a statement to the survey reminding buyers to include option payments. NASS and FSA have since collaborated on additional revisions to the survey. Beginning in January 2009, NASS' peanut price survey will include a place for buyers to report the average option payment amount of the total payment reported. However, since buyers' responses are confidential, FSA still cannot be sure that the added option payment section will ensure buyers submit complete price information in future survey responses.

Because of buyers' reluctance to allow us to review their confidential data, we could not determine the extent of incomplete price reporting or calculate its overall impact on NASS' published peanut price. However, the two buyers' undetected submission of incomplete price data calls into question the accuracy of NASS' weekly published price. The effect of underreporting is also indeterminate because buyers may choose not to respond to surveys.

According to NASS, "since a complete report is not received each week from all buyers, the reported quantities purchased and total dollars paid . . . are expanded to account for non-response."¹³ This expanded result is then compared to historical data for reasonableness. While the historical comparison offers some safeguard against egregious results, voluntary reporting means that NASS' weekly published prices are based on the subset of buyers who choose to respond in a given week and, therefore, may not accurately reflect nationwide prices.

¹³ This statement was included in NASS' 2008 weekly peanut price reports.

Outdated Prices

We also concluded that NASS' survey does not value peanuts at their prevailing market price because NASS does not ask for this information. Peanut buyers typically purchase peanuts through forward option contracts, which let them acquire producers' peanuts, often months later, at the prices quoted in the contracts. Although prices are established when contracts are signed, NASS' survey asks for data about the purchases settled that week. NASS' published prices simply represent the total pounds purchased and prices paid by buyers in a given week, which is not necessarily that week's prevailing market value. For example, we reviewed one contract that was signed on February 28, 2007. The contract set a total price of \$415 per ton for a producer's peanuts when the option was executed. However, during that same week that the contract was signed, NASS' published price was \$340 per ton—a difference of \$75. Later in the year when the option contract was exercised and the settlement made with the producer (at \$415 per ton), the average weekly NASS published price was \$437 per ton during the redemption period.

FSA, however, uses NASS' published price as an indicator of the current value of peanuts when it determines the national posted price for peanuts. Since peanuts do not have an open, public market like other commodities (e.g., soybeans), the price data NASS gathers from buyers represents FSA's main source of information about the price of peanuts that week.

FSA's financial assistance for peanut producers depends on either (1) NASS' weekly published price or (2) FSA's national posted price. While counter-cyclical payments depend directly on NASS' weekly published price¹⁴, the NASS price data is one of several considerations FSA uses to establish the weekly national posted price used for determining marketing assistance loan gains and loan deficiency payments. For example, FSA's counter-cyclical payments to producers are determined by the difference between \$459 per ton and the higher of either \$355 per ton (loan rate), or the season's national average market price which is calculated from NASS' weekly peanut price. Financial assistance for producers related to marketing assistance loan gains or loan deficiency payments only occurs when FSA's national posted price falls below the peanut marketing assistance loan rate.

Although FSA and NASS have already coordinated on changes to NASS' weekly survey that will require buyers to separately include data on option payments and on the spot peanut sales, we believe that FSA's counter-cyclical payments will be vulnerable to errors and omissions by NASS survey respondents unless mandatory reporting and verification is instituted. The changes to NASS' weekly price survey are scheduled to go into effect January 12, 2009, and FSA's economic policy staff believes that they will assist them in determining the weekly national posted price because they will include information on peanuts acquired through transactions other than an option contract (e.g., spot sales). In addition, they apprised us that they periodically consult industry trade sources and publications to obtain information on the prevailing contract option rates being offered producers for their peanuts. We believe that because peanuts do not have an open public market like other commodities, FSA should consider having NASS gather

¹⁴ Public Law 107-171 allows the Secretary of Agriculture discretion in determining the counter-cyclical payment and FSA currently bases the payment rate on the NASS seasonal average price.

additional information on current option contracts during their weekly survey process. The NASS weekly survey process would provide FSA a consistent source for this information.

In total, from 2002 to 2007, FSA paid over \$1 billion in financial assistance to peanut producers, but, without mandatory, verifiable price reporting, the agency has no assurance that such payments are based on consistent, complete, and reliable market price data from NASS. To strengthen FSA's assurance, USDA should seek authority to establish mandatory price reporting requirements for buyers along with the authority to verify data these respondents report.

Recommendation 1:

Seek authority to establish mandatory price reporting of peanut purchases by buyers as well as the authority to verify buyers' reported data to NASS.

Agency Response:

FSA agrees to work with the new Administration to develop policy recommendations regarding mandatory price reporting for peanuts.

OIG Position:

We agree with FSA's planned actions. To achieve management decision, we need a proposed completion date for implementation of the corrective action, i.e., the date by which FSA and the new Administration will seek authority to establish mandatory price reporting of peanut purchases by buyers as well as the authority to verify buyers' reported data to NASS.

Recommendation 2:

Coordinate with NASS and request it collect buyers' contract price data for option contracts executed with producers during the week.

Agency Response:

FSA is continuing to work with NASS to collect option contracts price data and began coordinating with NASS to modify its peanut price survey on April 23, 2008. The new peanut price survey was submitted to the American Peanut Shellers Association in July 2008 for feedback and was approved by the Office of Management and Budget on October 7, 2008. The updated survey became effective January 12, 2009. This new survey captures both option contract prices and cash prices during the weekly survey period.

OIG Position:

Although we agree with the changes that NASS has made to the peanut price survey, the intent of our recommendation was to have NASS also collect contract price information on new peanut option contracts executed during each weekly survey period. We believe the NASS survey should include data on the prevailing option contract rates producers have negotiated each reporting period. In order to achieve management decision, we need an estimated completion

date by which FSA will request NASS gather peanut price information on new peanut option contracts being executed each reporting period. If FSA does not plan to request NASS collect buyers' contract price data for option contracts executed with producers during the week, we need justification for that position.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the requested information, including the timeframes for implementation of the corrective actions for both recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance. Final action on the management decisions for recommendations should be completed within 1 year of the date of the management decisions to preclude being listed in the Department's Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by your staff.

Exhibit A – Sites Visited and Purpose

Sites Visited	Purpose of Visit
Athens, Georgia <ul style="list-style-type: none"> • FSA’s Georgia State Office 	Interviewed officials to determine the impact of peanut marketing assistance loans and loan deficiency payments in Georgia.
Sylvester, Georgia <ul style="list-style-type: none"> • FSA’s Worth County Office 	Interviewed officials to obtain their understanding of the peanut marketing process and to identify available peanut pricing data. Interviewed three judgmentally selected peanut producers including the owner/manager of a peanut cooperative to (1) determine how producers market peanuts, and (2) obtain producers comments about FSA’s financial assistance programs, such as loan deficiency payments and marketing loan gains.
Albany, Georgia <ul style="list-style-type: none"> • Federal-State Shipping Point Inspection Service 	Interviewed officials for background information about the peanut industry and the availability of market price data.
Warwick, Georgia <ul style="list-style-type: none"> • Georgia Peanut Commission Director Tifton, Georgia <ul style="list-style-type: none"> • National Buying Points Association 	Interviewed industry representatives to learn how peanuts are marketed, and for their opinion about FSA’s financial assistance programs.
Ashburn, Georgia <ul style="list-style-type: none"> • The Peanut Cooperative Marketing Association • The Peanut Designated Marketing Association 	Interviewed officials to discuss how peanuts are marketed and to determine the availability of market price data. We also sought their opinions about whether peanut loan and loan repayment rates accurately reflect market prices.
Location A <ul style="list-style-type: none"> • Peanut Buyer (sheller) Location B <ul style="list-style-type: none"> • Peanut Buyer (sheller) 	We reviewed documentation supporting weekly pricing information reported to NASS. For one, we reviewed the sheller’s submission to NASS for the week ending February 2, 2008; for the other, we reviewed the weekly submission for the week ending February 16, 2008.

Exhibit A – Sites Visited and Purpose

Sites Visited	Purpose of Visit
Tifton, Georgia <ul style="list-style-type: none"><li data-bbox="240 359 553 390">• Peanut Buying Point Sylvester, Georgia <ul style="list-style-type: none"><li data-bbox="240 470 553 501">• Peanut Buying Point	Interviewed officials and toured the facilities to understand how peanuts are marketed.
Sylvester Georgia <ul style="list-style-type: none"><li data-bbox="240 617 469 648">• Shelling Plant	Toured the shelling plant to learn how peanuts are processed.



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FEB 26 2009

TO: Jon M. Holladay
Acting, Chief Financial Officer
Office of Chief Financial Officer

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



SUBJECT: Office of Inspector General Official Draft Audit Report – 50601-14-KC
– Farm Service Agency’s Reliance on the National Agricultural
Statistics Service’s Published Peanut Prices

This memorandum is in response to the subject official draft.

Recommendation #1: Seek authority to establish mandatory price reporting of peanut purchases by buyers as well as the authority to verify buyers’ reported data to NASS.

FSA agrees to work with the new Administration to develop policy recommendations regarding mandatory price reporting for peanuts. FSA discussed mandatory price reporting authority with Congressional staff during negotiations for the Food, Conservation, and Energy Act of 2008 (the 2008 Farm Bill). Mandatory price reporting authority for peanuts appeared in an early draft of the House legislation, but was removed due to resistance from the peanut industry.

Recommendation #2: Coordinate with NASS and request that it collect buyers’ contract price data for option contracts executed with producers during the week.

FSA is continuing to work with NASS to collect option contracts price data, where such contracts represent a transfer of beneficial interest. FSA began coordinating with NASS to modify its peanut price survey on April 23, 2008. The new peanut price survey was submitted to the American Peanut Shellers Association in July 2008 for feedback and was approved by the Office of Management and Budget on October 7, 2008. The updated survey became effective on January 12, 2009. This new survey captures both option contract prices and cash prices during the weekly survey period.

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Informational copies of this report have been distributed to:

Administrator, FSA

Attn: Agency Liaison Officer (3)

Government Accountability Office (1)

Office of Management and Budget (1)

Office of the Chief Financial Officer

Director, Planning and Accountability Division (1)