UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

STATEMENT OF PHYLLIS K. FONG

INSPECTOR GENERAL

Before the

HOUSE APPROPRIATIONS SUBCOMMITTEE
ON
AGRICULTURE, RURAL DEVELOPMENT, FOOD AND DRUG ADMINISTRATION,
AND
RELATED AGENCIES

March 3, 2004

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Committee on Appropriations

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Of
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INTRODUCTION AND OVERVIEW

Good morning, Mr. Chairman and members of the Committee. I appreciate the opportunity to testify before you today to discuss the activities of the Office of Inspector General (OIG) and to provide you information on our audits and investigations of the programs and operations of the U.S. Department of Agriculture (USDA).

Before I begin, I would like to introduce the members of my staff who are here with me today: Joyce Fleischman, Deputy Inspector General; Robert Young, Assistant Inspector General for Audit; Jon Novak, Deputy Assistant Inspector General for Investigations; and Delmas Thornsbury, Director of our Resources Management Division.

I want to thank the Committee for its support during the past year since my appointment as Inspector General at Agriculture. We have tried to work closely with you, and I hope we have been able to address some of your concerns. You, the Congress, are key OIG clients, and I look forward to continuing to work with each of you to address your areas of interest.

It has been a challenging year at USDA. In my testimony today, I will address some of the most significant management challenges facing USDA's programs and operations. Three of the most critical are the safety of our Nation's food supply, Homeland Security, and security of the Department's information technology (IT) systems. My testimony will also address farm programs, rural development, research integrity and financial management, as well as the President's fiscal year (FY) 2005 budget request for OIG.

FOOD SAFETY

Threats to public health and safety are the most important matters that OIG reviews and investigates. Ensuring a safe, wholesome, and properly labeled meat and poultry supply, whether domestically produced or imported, is one of USDA's primary missions and presents a management challenge OIG has identified and reported. Recalls of contaminated meat and poultry and the recent discovery of *Bovine Spongiform Encephalopathy* (BSE) in a cow in Washington state highlight the vulnerabilities and challenges USDA and the meat and poultry industry face.

Bovine Spongiform Encephalopathy

OIG is currently investigating allegations surrounding the actual state of the diseased cow before its slaughter. We initiated our inquiry based on allegations that were reported in the media in early February concerning possible alteration of official records. This is an active and open case. In addition, we have initiated an audit to review various aspects of USDA's response to the discovery of BSE, including the BSE response and surveillance plans. We are also monitoring the implementation of changes to slaughter and inspection operations. Our goal is to work with USDA to identify areas where USDA can strengthen its controls and processes to provide continuing assurance that the U.S. meat supply is safe, wholesome, and properly labeled.

Recalls of Meat

Last year I discussed work OIG had underway in the Food Safety and Inspection Service's (FSIS) recall operations. The reviews focused on the recall of 19 million pounds of ground beef produced at the ConAgra plant in Greeley, Colorado, because of adulteration with *Escherchia coli (E. coli)* O157:H7, and the recall of 27 million pounds of ready-to-eat poultry products at a Pennsylvania plant because of adulteration with a *Listeria* strain.

Our audit of the ConAgra plant found that neither ConAgra nor FSIS effectively fulfilled their responsibilities under the Hazard Analysis and Critical Control Point (HACCP) system. ConAgra did not design or assess its food safety system to ensure it operated in

compliance with Standard Sanitary Operating Procedures and HACCP requirements. Data were available to both ConAgra and FSIS in the period prior to the recall that indicated *E. coli* O157:H7 was becoming a continuous problem at the Colorado plant. FSIS inspectors did not recognize or respond to these indicators. Instead, they followed FSIS policies that effectively limited the documents the inspectors could review and the enforcement actions they were allowed to take. FSIS policies impeded the inspectors' ability to trace a contaminant from the grinder's establishment back to the supplier, in this case ConAgra. FSIS inspectors needed concurrence from FSIS technical officials before traceback samples could be tested. This required approval action contributed to a 7-day delay in initiating the recall. Under its normal operation, ConAgra could have produced up to 3.75 million pounds of recalled beef during this 7-day delay.

We made 31 recommendations to address these weaknesses. During the recall and audit, FSIS took a number of actions to strengthen its inspection procedures, including informing establishments producing raw beef products of the need to reassess their HACCP plans based on the assumption that *E. coli* O157:H7 is a hazard reasonably likely to occur at all stages of the process. FSIS has also begun a comprehensive food safety assessment to evaluate the adequacy of HACCP plans and food safety systems. We have not yet, however, received detailed replies for 21 of the recommendations specifying the corrective actions taken or planned, or implementation timeframes.

We continue to review the recall of ready-to-eat poultry products produced at a Pennsylvania plant and adulterated with a deadly strain of the bacteria *Listeria monocytogenes*. We have expanded our review to include other plants in the

Northeastern United States that had recalls due to contamination with a strain of *Listeria monocytogenes* which was indistinguishable from the strain associated with the outbreak from the Pennsylvania plant. In total, between January 1, 2002, and January 3, 2003, 15 plants recalled about 32.2 million pounds of ready-to-eat poultry products. Our work is focusing on two of these plants that accounted for about 98 percent of the recalled product. We also have an ongoing investigation involving the Pennsylvania plant which we are coordinating with the U.S. Attorney's office.

Food Safety Investigations

OIG investigations involve many phases of food production and distribution to help ensure the safety and wholesomeness of the Nation's food supply. We investigate smuggling and other activities that can result in the introduction of harmful foreign pests that could devastate production agriculture in this country. We also look at the distribution of contaminated meat and poultry products into the food supply and intentional tampering with food products in grocery stores and restaurants. In FY 2003, OIG investigative results in food safety yielded 18 indictments, 15 convictions, and $4.5 million in recoveries.

For instance, in last year's testimony, I mentioned the arrest of a former meatcutter in a Michigan food store. The investigation was conducted jointly by OIG, the Federal Bureau of Investigation (FBI), and local health authorities after approximately 130 consumers returned product or complained of sickness after eating ground beef purchased from the store. Ninety-two people who ate the hamburger reported acute symptoms

including burning in the mouth and lips, lightheadedness, dizziness, nausea, and vomiting. Preliminary laboratory results indicated the contaminant was nicotine, and meat tampering was suspected. Further investigation disclosed that an employee of the grocery store contaminated approximately 250 pounds of ground beef with Black Leaf 40, a pesticide containing nicotine. He contaminated the meat because of ongoing disagreements with coworkers in the meat department of the store. He said he had hoped his action would result in his coworkers being disciplined or fired. He pled guilty to poisoning meat using an insecticide and poisoning meat to seriously injure a business, and was sentenced in Federal court to 9 years in prison, followed by 3 years of supervised release, and ordered to pay $12,161 in restitution.

Another investigation, conducted jointly with FSIS Compliance, disclosed that a Los Angeles corporation, which was engaged in the business of purchasing, storing, and selling meat and poultry products to retail customers, had a history of selling adulterated meat and poultry products that had been gnawed and contaminated by rodents. When evidence of rodent infestation was again uncovered, FSIS detained approximately 8,600 pounds of various meat products, of which approximately 5,000 pounds were subsequently destroyed. The company, its president, and its warehouse manager were placed on probation and fined more than $105,000 after they pled guilty to selling and offering to sell adulterated meat food products for human consumption.

We began a joint investigation with the California Department of Food and Agriculture after being notified that an importer of Asian fruit imported approximately 44,000 pounds of prohibited fresh longans into the Port of Long Beach. The longans were infested with

eight different species of insect pests, including the Oriental fruit fly. The importer made a false statement on the manifest that the longans had been frozen and, therefore, could legally be imported into the United States from Thailand. The importer bought the fresh longans for $9.13 per container and sold them for as much as $57.50 per container. At the time, frozen longans were selling for an average price of $17.60 per container in the Los Angeles market. The importer pled guilty to a Federal felony smuggling charge and was sentenced to serve 3 years of probation and fined $23,251.

Exotic Newcastle Disease

In support of the Department's goal of protecting the health of poultry flocks used for food production, we have conducted investigations of bird fighting to address the illegal movement of infected birds. These investigations are particularly significant because they found that infected fighting cocks were moved to various counties in southern California and other Southwestern States, contributing greatly to the spread of Exotic Newcastle Disease (END) in late 2002. END is a highly contagious viral disease that is deadly to birds and poultry. In one joint law enforcement operation in northern California, officers seized more than 4,700 fighting cocks during searches. State criminal charges were filed against 24 individuals for "owning, keeping, or training animals for fighting." Seven of the individuals have been sentenced, 2 are fugitives, and the remaining 15 are awaiting trial. During the searches, our agents also seized several firearms and a large quantity of cockfighting paraphernalia. Most of the fighting birds have been destroyed. This law enforcement operation was conducted jointly with sheriff's deputies and animal control officers from several California counties.

In another case, in January and April 2003, OIG special agents and law enforcement officers of the New York City Police Department jointly raided cockfighting operations in progress in the Bronx, New York. In these raids, 221 people were either arrested or summoned and ordered to pay fines for a State misdemeanor offense, and 182 fighting cocks were seized. These animals were tested for END with negative results and euthanized.

Avian Influenza

During an investigation of a biological laboratory in Winslow, Maine, OIG learned that the laboratory had agreed to produce an avian influenza vaccine for a customer in Saudi Arabia. In order for the laboratory to do so, an isolate containing the virus was smuggled into the United States. The production manager of the firm knew smuggling the virus into the U.S. was unlawful. After a vice president of the laboratory learned that a letter had been written to the Government advising that the laboratory was producing the vaccine, the production manager – along with the four vice presidents of the laboratory and several employees – loaded the vaccine into a truck and drove it to the house of one of the vice presidents. During an interview with 1 vice president, we learned that he had possession of over 40 vials and 1 plastic 250-milliliter container of liquid material, and one vial of powder, all of which OIG seized. Testing conducted by APHIS' National Veterinary Services Laboratory revealed that the powder was a Newcastle disease virus. The liquid material tested positive for avian influenza. Based on testimony of several subjects and witnesses, the material was probably active when first imported into the

United States. However, since it was not properly stored, the material deteriorated and was no longer active or a threat.

In November 2003, the production manager pled guilty to being an accessory after the fact for smuggling an avian virus into the country. At the same time, the customer service manager pled guilty to aiding and abetting in violation of the Virus-Serum Toxin Act. Sentencing is pending on both individuals. Additionally, in December 2003, three of the vice presidents were indicted on charges of conspiracy, accessory after the fact of smuggling, and mail fraud. They have all pled innocent and are awaiting trial.

HOMELAND SECURITY

OIG continues to place a high priority on assisting the Department in strengthening its defenses against activities that threaten the Nation's food supply, production agriculture, and Government facilities. To address the vulnerabilities identified by OIG, the Department has had to refocus some of its goals and approaches: shifting from safety goals to both safety and security goals in each of its mission areas, fostering effective coordination and communication across mission areas, and increasing Departmental oversight and agency accountability. We are happy to report that the Department has taken significant steps to incorporate these approaches in restructuring some of its mission operations, not only across the Department but also across Government. We emphasized this theme in our reporting of major management challenges facing USDA.

The Homeland Security Act of 2002 mandated the transfer from USDA to the Department of Homeland Security (DHS) agricultural import and entry inspection activities and the Plum Island Animal Disease Center. To ensure effective oversight of those activities transferred to DHS, we met with officials from DHS' OIG to facilitate coordination and exchange of appropriate information, particularly with respect to followup on our prior audit findings and recommendations concerning effectiveness of agricultural import and entry inspections. This year, we plan to review and monitor the memoranda of understanding between USDA and DHS. We also plan to evaluate the progress made by USDA and its affected agencies to coordinate with the Food and Drug Administration (FDA), the Environmental Protection Agency (EPA), and other governmental entities to timely and effectively implement the provisions of the Public Health Security and Bioterrorism Preparedness and Response Act of 2002, particularly those to ensure security and safety of the food supply.

Reviews of Security at Laboratories

Last year, we reported that OIG had begun a review of laboratories funded by USDA agencies, as part of our effort to assist the Department in strengthening Homeland Security. OIG reviewed non-Federal institutions that receive USDA funding to conduct research into human, animal, and plant diseases. In our review, we evaluated the controls these institutions exercise over biological agents and toxins, as well as chemicals and radioactive materials. We visited 104 laboratories at 11 USDA-funded institutions and found deficiencies in inventory controls over biological agents, physical security at the laboratories, and personnel access to these laboratories. Since these institutions received

funding from multiple Government sources, our recommendations addressed the need for standards that are Governmentwide in nature. We, therefore, recommended that the issues be elevated to DHS and to the Executive Office of the President's Homeland Security Council, and that Federal Governmentwide security standards be established. In its response, the Department agreed that a consolidated set of security standards needed to be implemented and has stated that it has begun discussion of these issues with the President's Homeland Security Council.

We conducted a followup review of oversight and controls of biological agents at USDA laboratories to determine whether USDA laboratories and agencies had addressed security, inventory, and access deficiencies reported in our prior report, and to examine the implementation of the new policies and procedures regulating inventories and biosecurity controls. We visited 16 laboratories included in our earlier review. In general, we found that the agencies had made great strides in implementing biosecurity policies and procedures, and laboratories had strengthened their controls governing physical inventory, materials access, and materials accountability. We will be issuing our report in the near future.

We have a number of reviews ongoing to identify potential vulnerabilities in USDA facilities. We also plan to review the adequacy of USDA controls to prevent the release of sensitive technology. For instance, the Agricultural Research Service (ARS) issues agreements for sharing potentially sensitive technology with partners that could include foreign entities. Our review will focus on whether ARS has complied with the export

license requirements issued by the U.S. Department of Commerce for the transfer of potentially sensitive technology to foreign entities.

Forest Service

The Forest Service (FS) has inventories of significant amounts of explosives and is also responsible for military artillery and munitions issued to ski resort operators for avalanche control. We determined that FS did not have an overall management program that effectively secured these assets and that accountability and physical security of these items needed to be improved. Some magazines contained expired and deteriorating supplies of explosives and munitions. Permittees who maintained military artillery and munitions needed to conduct background investigations for employees who had access to these items. FS concurred with our recommendations to correct these problems.

In FY 2003 we followed up on our previous audit work to improve security over FS aircraft and aircraft facilities and found that while FS had made progress in implementing our recommendations, it needed to address additional issues. FS had not implemented adequate controls to account for aircraft transferred to States under the Federal Excess Personal Property (FEPP) program FS administers. We identified 52 of these aircraft that had tanks capable of dispersing biological or chemical weapons. We also found that FS had not required States with FEPP aircraft to conduct security assessments of their facilities and to implement minimum security standards. In addition, we found that the FS Washington office was not reviewing and approving security plans developed for air tanker bases. FS agreed with our recommendations to address each of these issues.

FS is responsible for management of Federal lands that include approximately 1,000 miles of international borders. Our audit determined that significant challenges exist to secure these borders. The Border Patrol has overall responsibility for security of these borders but has limited resources to cover national forest lands. The FS has insufficient officers assigned to the seven national forests that are contiguous to these international borders. In addition, FS law enforcement personnel lack authority over illegal entry into the United States and may not arrest persons crossing the border unless they commit a crime over which FS has jurisdiction. FS agreed with our recommendation to formally notify DHS of the issues raised in our report and agreed to actively participate with other agencies to develop a cohesive, multiagency strategy for securing U.S. borders.

Animal and Plant Health Inspection Service

Last year I referenced our ongoing review of the Animal and Plant Health Inspection Service's (APHIS) permit systems for the importation and domestic transfer of specified plant and animal pathogens and other restricted materials. The permits are issued to colleges, universities, public and private laboratories, and other users by APHIS' Plant Protection and Quarantine (PPQ), and Veterinary Services divisions. At the time of our review neither division (1) routinely performed inspections of all new applicants for import permits, (2) performed followup inspections to ensure that regulated materials imported under permit were properly disposed of when the permit expired, or (3) required accountable documentation to accompany shipments of permitted materials. In addition, APHIS allowed incoming passengers, including foreign nationals, to hand-carry permit

packages. PPQ's computerized system for tracking the status of active and pending permits did not automatically flag permits that had expired or were about to expire. APHIS generally agreed with our report's conclusions and our recommendations to address the control problems. We have reached resolution on 7 of the 11 recommendations we made.

The Agricultural Bioterrorism Protection Act of 2002 regulates certain biological agents and toxins researched by USDA and other Federal agencies. APHIS issued regulations in December 2002 to implement the law's Title II provisions governing the possession, use, and transfer of biological agents and toxins. We are beginning phase I of our review to: (1) assess the accuracy and completeness of APHIS' registration records, (2) determine what steps APHIS has taken to ensure adequate coordination with the Centers for Disease Control and Prevention, and (3) examine APHIS' assessment of laboratory security plans to determine whether the approvals of the plans were supported and consistent. During phase II, we will perform field visits to selected locations where listed agents and toxins are used or stored to determine whether controls are functioning and adequate to safeguard the biological agents and toxins from accidental or clandestine release.

Commodity Credit Corporation

As part of our overall effort to assist the Department in strengthening Homeland Security, we reviewed the strategy and controls applicable to food security, specifically over USDA-owned or controlled commodity inventories. These commodity inventories are acquired by the Commodity Credit Corporation (CCC) under its mandated goal to

stabilize, support, and protect farm income and prices. CCC is authorized to procure, transport, store, process, and dispose of various agricultural commodities and their products. These inventories include not only unprocessed commodities, such as bulk food grains, oilseeds, rice, and sugar, but also processed commodities such as cheese, nonfat dry milk, and butter. CCC's storage agreements sometimes include temporary storage for processed food distributed through various assistance programs administered by the Food and Nutrition Service (FNS) and the Agricultural Marketing Service. These CCC programs and operations are managed and administered by the Farm Service Agency (FSA).

Our review determined that FSA needs to: (1) conduct vulnerability and risk assessments to determine appropriate levels of protection needed to secure USDA-owned agricultural commodities; (2) address the prospect of intentional and widespread contamination regarding handling, transportation, storage, and distribution of such commodities, including developing clear safety and security policies and procedures to ensure that these commodities are adequately protected and safeguarded; and (3) upgrade its commodity inventory management information systems so that such commodities can be promptly located and tracked during crises. We recommended that FSA in collaboration with the Department develop food safety and security strategies and conduct risk assessments over its agricultural commodity operations and related programs. After those first steps have been accomplished, we recommended that FSA collaborate with FDA and USDA agencies to implement appropriate security measures to manage and protect USDA commodities. In its response, FSA generally concurred with our recommendations and stated that it had begun coordination and communication with

DHS to develop the appropriate corrective actions. FSA has agreed to conduct risk assessments under the supervision of, and using methodologies recommended by, DHS. FSA also agreed to start the process to upgrade its commodity inventory management information systems, if funds are available.

Employee and Research Integrity Involving Homeland Security

A former senior agricultural economist for the USDA Economic Research Service pled guilty to charges of conspiracy to commit visa fraud and has agreed, as part of the plea agreement, to remit to the Government approximately $82,000 that he obtained as a result of his role in the scheme. This economist, working with others, arranged for Chinese nationals to fraudulently obtain visas to illegally enter and remain in the United States. Although they were not agricultural specialists, the Chinese nationals received letters of invitation on USDA letterhead to enter the United States as part of a Government delegation of agricultural specialists. Each immigrant paid $10,000 for costs associated with obtaining the visas. As a result of the scheme, 99 Chinese immigrants improperly entered and remained in the United States from late 1999. The U.S. Embassy in Beijing, China, denied approximately 150 other applicants' visas when the scheme was discovered. Two co-conspirators have also been criminally charged and have entered guilty pleas. The other individual was sentenced to 1 year of probation and a $5,000 fine. This was a joint investigation with the State Department.

In another investigation, we investigated a threatening letter mailed to a Natural Resources Conservation Service (NRCS) District Conservationist in Deland, Florida,

allegedly infected with anthrax. The county sent a hazardous response team to the office when the anthrax threat was discovered. The letter contained a white powder, which was tested and found not to be contaminated with anthrax. A Florida man confessed to OIG agents that he wrote the threatening letter, put a commercial headache powder in the envelope, and mailed it to NRCS because he was upset that NRCS denied his request for financial assistance to dig a pond. The individual pled guilty, and in June 2003, a Federal judge sentenced the man to 3 years of probation, 150 hours of community service, mental health treatment, and ordered him to pay $824 in restitution.

Last year I reported on our investigation into an accidental shooting of an APHIS maintenance employee in Utah that had expanded into an investigation of theft of Government property, sexual assault, and murder on USDA property. The employee had been sentenced for theft of Government funds and had also entered a guilty plea for the murder of a 15-year-old girl. He subsequently withdrew his plea, and was convicted by a jury trial in January 2004 for capital murder, felony kidnapping, and desecration of a human body. He was sentenced to life in prison without possibility of parole.

I also mentioned last year, our investigation of a staged break-in at the Michigan State University (MSU) laboratory by a former graduate student. This investigation had begun as a Homeland Security investigation, but evolved into a research integrity case. The graduate student was attempting to conceal that he had fabricated *Actinobacillus pleuropneumoniae* (APP) research findings over the previous 5 years. APP causes pneumonia in swine. The news media reported that samples of a highly virulent, genetically altered strain of APP had been stolen during the apparent break-in.

Investigation by OIG, the Federal Bureau of Investigation, and MSU police found that no theft occurred. The graduate student admitted during an interview with agents, and again during an FBI-administered polygraph examination, that he never mutated the trkH gene in APP bacteria. Therefore, all the laboratory's research on the mutation was rendered fraudulent. He also stated that he did not remove any APP samples from the laboratory. A Federal district judge recently sentenced the former graduate student to 10 months of incarceration, followed by 3 years of supervised release, 120 hours of community service, and ordered him to pay $69,937 in restitution, which represents salary paid to the individual during the period he worked on the Cooperative State Research, Education and Extension Service (CSREES)-funded research at MSU to develop a vaccine against APP. CSREES continues to freeze funding for the current APP grant until an ethics/misconduct investigation by MSU officials can be completed. Because approximately $750,000 of CSREES' grant monies had already been paid to MSU for the research, we recommended CSREES recover these funds.

FARM PROGRAMS

Assistance to Farmers

USDA faces major challenges in implementing the 2002 Farm Bill and 2003 disaster assistance legislation, and in ensuring the integrity of the crop insurance programs. To more effectively implement the farm and crop insurance programs, USDA agencies must enhance their ability to work across organizational lines and to identify data discrepancies

in the programs. The agencies, especially FSA and the Risk Management Agency (RMA), must make it a priority to ensure that data is shared, data discrepancies are resolved, and problems found in both internal and external reviews are coordinated and analyzed for their impact on program payments in each affected agency.

Early on, we participated with FSA in discussions on implementation of a variety of farm programs for FYs 2002 through 2007 authorized by the 2002 Farm Bill. We have since reviewed the newly enacted Peanut Quota Buyout Program (PQBP) and Direct and Countercyclical Programs (DCP), as well as FSA's calculations and application of countercyclical payment rates and adjustments to commodity loan rates. Under PQBP, payments of nearly $1.3 billion were issued to eligible quota holders. Under DCP, over $3.4 billion was disbursed to eligible producers for the 2002 crop year, and nearly $5.6 billion for the 2003 crop year. Generally, we determined management controls were adequate to prevent or detect errors and irregularities. However, because of the magnitude of the payments involved, we have planned additional substantive audit testing to determine whether bases and yields under DCP were properly established.

Currently, we are reviewing payments to producers under the Milk Income Loss Contract Program, which was authorized under the 2002 Farm Bill. Over $1.8 billion in payments have been disbursed to date under this Program. Additionally, we have initiated reviews of programs authorized by the Agricultural Assistance Act of 2003. These include the 2001/2002 Crop Disaster Program, with nearly $2.5 billion in payments; the Livestock Compensation Program, which so far has disbursed $1.1 billion in payments; and sugar beet disaster assistance to producers, which totals $48 million to date.

Our investigative program has also been heavily involved in farm program cases. For instance, OIG investigated allegations that a farmer in North Carolina removed and sold CCC collateral for his personal use. The producer admitted to removing and selling 373,064 bushels of soybeans held by CCC as collateral for two loans totaling $2 million and converting the proceeds for his personal use in order to operate his farm. On October 1, 2003, the producer signed a Civil Settlement Agreement and Consent Order agreeing to repay FSA $2.7 million plus interest.

In another investigation, OIG joined with the FBI to investigate a cattle broker who falsified Grain Inspection, Packers and Stockyards Administration documents in furtherance of a scheme to defraud investors, business associates, and financial institutions. Essentially, the scheme involved the broker's misrepresentation to his clients – private investors and financial institutions – of the financial status of his business entity and of the numbers of cattle available at the time investments were made. Investors relied upon untrue, misleading, deceptive, and inaccurate information when making their investments. When the scheme unraveled, the broker was in control of only 5 percent of the cattle for which he was obligated to his investors. During the 2½-year investigation, over 100 victims were identified and interviewed by OIG agents in 4 midwestern states with losses totaling $166 million. The broker and his bookkeeper pled guilty to 5 counts each of mail fraud, wire fraud, false entries, and criminal forfeiture. They are awaiting sentencing.

Crop Insurance

The Federal crop insurance programs are billed as the American producers' primary "safety net." Despite the growth of these programs over the years – in crop year 2003, crop insurance covered 217 million acres with a total Government insurance liability of over $40 billion – RMA has not been able to determine the level of improper or erroneous payments.

The Agricultural Risk Protection Act of 2000 (ARPA) mandated that USDA develop and implement additional methods of ensuring Federal crop insurance program integrity, including a plan for FSA to assist RMA in monitoring the crop insurance programs. RMA must continue to improve and strengthen its policyholders' database by effectively implementing all of the provisions under ARPA and improving its Data Acceptance System (DAS), which is intended to perform validity checks on information submitted by the insurance companies before it is incorporated into RMA's Policyholder Database.

Our audits have shown that information contained in the database and used to drive RMA's accounting system may not be reliable and/or compliant with the Office of Management and Budget (OMB) core and Federal financial system requirements. Further, RMA has not yet fully implemented the ARPA-required reconciliation of FSA data and RMA data. In an effort to determine the full financial impact of the weaknesses noted in DAS, we plan to verify information recorded in RMA's databases and audit additional DAS edits, including controls over Zero Acreage Reporting. We also have planned audit work to fully evaluate RMA's implementation of other ARPA mandates,

such as data mining, utilization of the FSA State and county committees in program review, and contracting requirements.

In June 2003, we initiated a review to evaluate the circumstances leading to the financial insolvency of the American Growers Insurance Company (AGIC), formerly a reinsured company under RMA's Federal crop insurance program. Our objectives include evaluating whether RMA's financial management controls over the reinsured companies were sufficient to ensure their compliance with the financial requirements of the standard reinsurance agreement (SRA). We also want to evaluate whether such management controls are adequate to prevent and/or detect insolvency of other reinsured companies. We are currently summarizing the results of our work and plan to issue a report by late summer.

The issues identified during our review at AGIC have formed the basis for many of our comments to RMA officials for their consideration in revising the SRA. Adoption of our comments would, we believe, result in improved financial information being provided to RMA management that could be used to prevent future insolvencies of reinsured companies or, at least, minimize the impact of such insolvencies. We will continue to monitor the current SRA renegotiation process and provide RMA feedback on this process, as appropriate.

OIG investigations have resulted in significant prosecutions for crop insurance fraud. In Minnesota, the manager of a grain elevator conspired with producers to defraud both RMA and FSA. Our investigation found that, in October 1999, the manager instructed

his employees to misgrade durum wheat by inflating the damage and lowering the test weight for all loads delivered to the elevator. The elevator then resold the wheat at a substantial profit. The producers submitted the fraudulent scale tickets to their insurance companies and collected more than $1 million in crop insurance and $350,000 in disaster payments from FSA to which they were not entitled. Four producers pled guilty in this case, were placed on probation, and ordered to pay a combined total of $32,000 in restitution. The manager was recently sentenced to serve 46 months in prison and ordered to pay restitution of over $750,000.

An investigation in Wichita Falls, Texas, involved a crop insurance agent who lied about his 1999 cotton, wheat, and grain sorghum crops. He said the crops were planted and failed, but OIG's investigation showed the crops were never planted. He defrauded RMA and FSA out of about $740,000. The case resulted in a total of 25 counts of conspiracy, false claims, and false statements. On February 26, 2004, a Federal jury returned a guilty verdict against the crop insurance agent. An adjuster has also pled guilty and admitted that he fraudulently approved the appraisals of the crops. Sentencing is pending for both individuals.

RURAL DEVELOPMENT

Rural Business-Cooperative Service

The Business and Industry (B&I) guaranteed loan program is intended to create and maintain employment and improve the economic climate in rural communities. We

recently completed a comprehensive review of this program in which we summarized the results of our audits in 16 States. We examined 38 guaranteed loans totaling $125 million and questioned $58 million of these loans. The Rural Business-Cooperative Service (RBS) had approved questionable loans, failed to identify lender negligence in servicing loans, and honored guarantees when lenders failed to fulfill their responsibilities. We recommended that RBS improve the appraisal process for collateral, require that lenders use audited financial statements to perform financial analyses of borrowers, enforce lender compliance with critical agency oversight controls, and define what nonmonetary deficiencies would result in loan acceleration. RBS did not disagree with the conditions identified in our reports. However, it did not agree with our recommendations for corrective actions. We are working with the agency to develop an action plan that will correct the conditions noted in our report.

In FY 2003, we also completed an audit of the process RBS used to liquidate defaulted B&I loans. We found no material weaknesses in the controls over this process. We did find that RBS could improve procedures to ensure lenders filed loss claims promptly. Improvements in these procedures would reduce interest payments the Government is required to pay on defaulted loans. RBS agreed with our findings and recommendations and is taking actions to resolve the reported problems.

Our investigations continue to address significant fraud in the B&I program. In one case a Texas businessman, who acted as a paid consultant for both the buyer and seller of a Mississippi catfish farm, conspired with an appraiser and others to falsely inflate the number and value of the live fish inventory that was security for a $9.5 million Rural

Development (RD) guaranteed loan. Ninety percent of the loan note was guaranteed through the B&I Guaranteed Loan Program. The businessman was sentenced in Federal District Court for the Northern District of Mississippi for fraud. He received 20 months in prison, 3 years of supervised release, and was further ordered to pay $5.9 million in restitution. The Mississippi appraiser was sentenced to 6 months of home confinement, 50 hours of community service, and ordered to pay a $10,000 fine for his role in the conspiracy. Investigation and prosecution continues concerning the buyer and seller of a Mississippi catfish farm and others, including a former USDA official, who were involved in the application and receipt of the $9.5 million RD guaranteed loan.

Rural Housing Service and Rural Utilities Service

In FY 2004, we continue to focus our efforts in RD on high priority, high-risk programs. We are performing followup work on our 1999 nationwide audit of Rural Housing Service's (RHS) Multi-Family Housing Program, which provides Rural Rental Housing (RRH) housing to low- to moderate-income rural residents. We will determine whether RHS has taken adequate corrective actions to prevent the theft of millions of dollars of RRH project funds by fraudulent management companies and borrowers. We have also initiated audit work on RHS' Rental Assistance Program. Our review in Florida disclosed $4.4 million of excessive rental assistance over a 2-year period.

We are reviewing RUS' implementation of the Broadband Program, which is intended to bring high-speed Internet access to rural communities. In FYs 2001 and 2002, funding was about $100 and $80 million, respectively. Funding rose to over $1.5 billion in

FY 2003 to accelerate the expansion of the Broadband Program to rural areas. We plan to determine whether project funding was awarded within program criteria and spent for authorized uses.

RESEARCH INTEGRITY

Under the Reports Consolidation Act of 2000, which requires OIG to identify and report annually the most serious management challenges facing the Department, we reported to the Secretary the issue of research integrity as one of three emerging management challenge issues. USDA plays a major role in U.S. research activities, providing around $1.9 billion, intramurally and extramurally, in fiscal year 2002. In our ongoing review, we found that the Department has still not implemented any coordinated Departmentwide policy or procedures on research misconduct even though the President's Office of Science and Technology Policy (OSTP) issued a Federal policy in December 2000. Furthermore, there is no coordinated Departmentwide oversight process to ensure that OSTP policies and procedures are consistently and effectively applied across the Department's agencies. We are currently summarizing the results of our review and anticipate issuing our report to the Department by summer.

FOOD AND CONSUMER SERVICES

FNS administers the Department's food assistance programs, which include the Food Stamp Program (FSP); Child Nutrition Programs; and the Special Supplemental Program

for Women, Infants, and Children. These three major entitlement programs account for about $42 billion in estimated expenditures in FY 2004.

OIG has a long history of working collaboratively with FNS to improve program integrity and to identify improvements in program administration, particularly as FNS moved forward to implement the delivery of food stamp benefits through electronic benefits transfer (EBT) systems. OIG has continued to audit EBT systems as issues emerge or when new State contracts with EBT processors are awarded. Our reviews of two States during FY 2003 – Texas and Nevada – disclosed no material issues. During FY 2004, we will monitor statewide implementation as it rolls out in California. In FY 2002, the last full fiscal year reported, California issued almost $1.7 billion of the $18 billion in total food stamp benefits nationwide and is the last large state that must come on-line.

We are also continuing to monitor FNS' actions to address a serious management challenge in the National School Lunch and Breakfast Programs. Eligibility determinations for free and reduced price meals are a challenge that must be addressed to reduce improper payments and ensure that benefits go to those eligible to receive them. This is a difficult issue and the Department is considering various options. We will monitor and provide feedback to FNS on its proposals to minimize this problem.

We also did a significant amount of investigative work in programs administered by FNS. We issued a total of 182 reports of investigation involving FNS programs in FY 2003, including 152 reports involving FSP. Our food stamp investigations resulted in

285 indictments, 264 convictions, and a total of $22.5 million in monetary results, including $13.7 million in restitution. Over 95 percent of all food stamp benefits are being issued through EBT cards, which are essentially debit cards for purchasing food. The wealth of electronic data available on EBT transactions is of enormous benefit in detecting and investigating suspicious patterns of activity and in compiling evidence that is being used to successfully prosecute corrupt retailers.

As an example of our work in food stamp trafficking, OIG special agents investigated a grocery store in Philadelphia that fraudulently redeemed over $1.3 million in paper food stamps and food stamp benefits issued via the EBT system. The owner and an associate have been convicted on charges of trafficking in food stamp benefits, money laundering and conspiracy. A third individual in the case is a fugitive believed to be in Jordan. The owner was sentenced to 46 months in prison and ordered to pay nearly $1.3 million in restitution, as well as a fine of $1,000. The associate was sentenced to probation and ordered to pay over $92,000 in restitution and a $500 fine.

OIG investigations also resulted in 5 indictments, 16 convictions, and over $570,000 in monetary results involving the Special Supplemental Food Program for Women, Infants, and Children, as well as 10 indictments, 9 convictions, and about $35,000 in monetary results in other FNS programs, including the National School Lunch Program and other nutrition assistance programs.

INFORMATION TECHNOLOGY

USDA depends on IT to efficiently and effectively deliver its many diverse programs. Reliance on IT poses new and significant dangers as hackers access these systems for their own personal gain. IT security is also critically important in relation to Homeland Security. Without adequate security, terrorists could hack our computer systems impacting operations and obtaining sensitive data which could disrupt agricultural operations. Through our audit efforts over the last 3 years, OIG has identified numerous security vulnerabilities in IT systems maintained by the Department and its respective agencies. Much of our IT security work has been performed pursuant to legislative requirements – first the Government Information Security Reform Act and now the Federal Information Security Management Act. We have concluded that USDA and its agencies have not yet complied with OMB and other Federal requirements. USDA agencies have not (1) prepared security plans for major IT applications, (2) conducted risk assessments, (3) established disaster recovery plans, and (4) implemented processes to authorize or certify their systems. USDA agencies also do not have strong physical and logical access controls and have not effectively used scanning software tools to identify and mitigate known system vulnerabilities.

We have developed a close working relationship with USDA's Office of the Chief Information Officer (OCIO) to foster security awareness. We have made numerous recommendations to correct the identified weaknesses and, in most cases, USDA and its respective agencies have agreed. OCIO has several initiatives in process or planned to address these issues. During the current fiscal year, OCIO issued 16 cyber policy and

guidance documents, awarded contracts for agencies to obtain security planning and risk advisory services, and initiated processes to implement disaster recovery planning and certification and accreditation programs. However, only after agency management involvement is assured and agencies have adopted and implemented the IT security requirements will the necessary controls be in place to reduce the risk to a very low level.

FINANCIAL MANAGEMENT

As in FY 2002, USDA and its standalone agencies – FS, CCC, RMA, RD, and the Rural Telephone Bank – received unqualified opinions on their FY 2003 financial statements. An unqualified opinion means the financial statements fairly present an entity's financial position. Prior to FY 2002, we issued disclaimers of opinion due to weaknesses in USDA's and some of the standalone agencies' financial systems and the Department's inability to provide auditable financial statements within the timeframes established by OMB.

The maintenance of an unqualified opinion, after years of disclaimers, represents a major accomplishment that reflects the Secretary's leadership and the efforts of the Chief Financial Officers of the Department, the agencies, and their respective staffs. Still, much work is needed. The unqualified opinion did not result from improvements in underlying financial management systems, but from "Herculean" efforts by agency staffs. The financial system weaknesses prevented early implementation of accelerated timeframes for FY 2003 financial reporting as planned by the USDA Chief Financial

Officer. Enhancements and improvements to USDA's financial systems are needed so that Department managers have access to timely financial information to allow them to make appropriate management decisions.

Another challenge USDA faces is implementation of the Improper Payments Information Act of 2002. The act requires agencies to identify programs and activities that have a high probability of generating improper payments. It also requires agencies to annually estimate the amount of improper payments and develop plans that would prevent and reduce them. Successful implementation and compliance with the act will require a strong management commitment, as well as the necessary resources, quality control processes, and information systems to measure improper payments. Successful implementation will help prevent payments to persons ineligible for USDA programs or services. OIG will continue to review USDA's compliance with the act. Our current audit efforts will determine if USDA agencies have adequate internal controls and financial systems to estimate their improper payments.

FY 2005 BUDGET REQUEST

We are very proud of the accomplishments of OIG and pleased to report that in FY 2003 we continued to more than pay our own way. In the investigations arena, OIG issued 461 investigative reports, obtained 491 indictments and 435 convictions, and made 877 arrests. These actions resulted in $68.5 million in fines, restitutions, other recoveries, and penalties during the year.

In the audit arena, we issued 71 audit reports and obtained management's agreement on 451 recommendations. Our audits resulted in questioned costs of $25.1 million. Of this, management agreed to recover $20.1 million. In addition, management agreed to put another $49 million to better use. Equally as important, implementation of our recommendations by USDA managers will result in more efficient and effective operations of USDA programs.

During the past year, we have continued to review and evaluate OIG's activities and made changes as needed to provide the most effective support to the Department's programs and operations. One of our most critical efforts has been in our IT arena. With the essential funding provided by this Committee in FY 2003, we were able to move forward to start rebuilding our crucial IT infrastructure. Specifically, the agency was able to replace all of its IT workstations with new state-of-the-art equipment for each OIG employee. In addition, a new network operating system greatly improved the efficiency and security of the agency's IT system. Additional printers and related equipment and software improved efficiencies. All of this equipment has been received and installed nationwide for our staff's use.

We are already beginning to see results through improvement in our audit processes and our investigative forensic efforts. The new equipment and specialized software has helped OIG complete its audits faster and target its analyses to the highest USDA risk areas. For instance, OIG recently used an automated audit software package to extract, sort, summarize, classify, and analyze 800,000 individual USDA employee transactions from the Government-issued travel card over a 6-month period. From this analysis, OIG

concluded there was extensive misuse of the travel card and found that over $5.8 million, or 8 percent, of the $78.5 million in charges incurred over the audit period were for other than travel-related purposes. Acting on our audit recommendations, the Department took action to significantly strengthen the travel card program. The audit cost an estimated $75,000 to perform. In an exclusively manual environment, the audit might have cost 10 times that amount without any assurance of comparable results. This state-of-the-art equipment and software allow OIG auditors to review transactions in a matter of days versus weeks or months, and with fewer staff. The reduced staff time allows OIG to review additional high-risk or vulnerable programs and operations.

On the investigation side, the purchase of new software and hardware for our Computer Forensics Unit (CFU) has allowed this unit to process cases utilizing the most up-to-date forensic hardware and software tools. For instance, in an investigation involving a company that is allegedly assisting producers in establishing sham farms for the purpose of obtaining USDA program benefits, our investigation determined that numerous producers may have received millions of dollars in USDA benefits to which they were not entitled. OIG recently served a search warrant on this company with the assistance of the CFU, which determined that 17 file servers housed electronic information pertaining to the investigation. The CFU utilized its knowledge and training to image the servers in such a manner that will allow the servers to be recreated in the forensic lab, allowing a more thorough investigation. These forensic tools are specifically designed to process electronic data in a manner that maintains the integrity of the data so that they can be used in a court of law. These forensic tools must be regularly upgraded and replaced in

order to keep pace with the ever-changing IT hardware and software standards and investigative needs.

Again, I want to especially thank the Committee for its support in this area.

The President's FY 2005 request of $78.4 million for OIG provides for an increase of $1.6 million for mandatory pay costs only. No other increases are being requested. I recognize there is fierce competition for the Government's limited resources. However, I believe adequate funding for our OIG activities makes good sense. OIG audits and investigations save money for the taxpayers, help ensure the safety and wholesomeness of the Nation's food supply, promote USDA Homeland Security efforts, and ensure the integrity of USDA programs. As such, I support the President's budget request for OIG.

This concludes my statement, Mr. Chairman. I appreciate the opportunity to appear before you today and would be pleased to respond to any questions you and the Committee may have at this time.

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