



# **PERFORMANCE AUDIT REPORT**

**Department of Agriculture:  
Reviewing the Grain Warehouse Inspection Program**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
August 2004**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

**THE LEGISLATIVE POST** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$10 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

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August 16, 2004

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Department of Agriculture: Reviewing the Grain Warehouse Inspection Program*.

The report includes several recommendations for the Legislature, including raising bonding rates and minimums, authorizing the Department to impose fines, specifying the use of sampling to test grain quality, and requiring the Department to take additional steps for warehouses with quality problems.

We also recommend the Legislative Post Audit Committee request an interim study regarding future funding for the Program and protections for farmers who sell grain on contract rather than just store grain.

Finally, we recommend the Department of Agriculture develop and use a risk-assessment tool, require its staff to record all violations found during examinations, increase its oversight of field staff, and implement some form of rotation among field staff.

We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor

## Get the Big Picture

Read these Sections and Features:

1. **Executive Summary** - an overview of the questions we asked and the answers we found.
2. **Conclusion and Recommendations** - are referenced in the Executive Summary and appear in a box after each question in the report.
3. **Agency Response** - also referenced in the Executive Summary and is the last Appendix.

## *Helpful Tools for Getting to the Detail*

- In most cases, an “**At a Glance**” description of the agency or department appears within the first few pages of the main report.
- **Side Headings** point out key issues and findings.
- **Charts/Tables** may be found throughout the report, and help provide a picture of what we found.
- **Narrative text boxes** can highlight interesting information, or provide detailed examples of problems we found.
- **Appendices** may include additional supporting documentation, along with the audit **Scope Statement** and **Agency Response(s)**.

# EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

## Overview of Grain Warehouse Regulation in Kansas

*The State's program for regulating public grain warehouses was transferred from the Grain Inspection Department to the Department of Agriculture in 1997. The purpose of the Grain Warehouse Inspection Program is to ensure that Kansas farmers have solvent warehouses where they can safely store their wheat, corn, oats, soybeans, and other grains. The Program licenses and examines warehouses to ensure the warehouse is financially sound, the measured quantity of grain matches warehouse records, proper records are maintained, and the facilities provide a safe environment for the storage of grain. The Program covers only State-licensed warehouses that store grain for others; it doesn't cover federally licensed warehouses or those that hold only the warehouse owner's grain. Several recent warehouse failures have raised concerns about whether the Program and the laws it enforces are adequately protecting Kansas farmers who store their grain in State-licensed facilities.*

## Does Kansas Have an Adequate Program for Protecting Farmers Who Have Grain Stored in Public Warehouses?

**Kansas' Program follows a number of good practices, but some major weaknesses impair its ability to protect farmers. The Kansas Program should ensure that warehouses meet financial requirements, facilities are maintained to protect the quality of grain, the right amount of grain is there, and when problems are found they're addressed in a timely and sufficient manner.**

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*Our review of the Program identified several good practices staff were following: ensuring that warehouses met the financial requirements, conducting examinations annually as required by law, using a standardized checklist for examinations, and conducting unannounced examinations. To help in our assessment of the Kansas Program, we compared it to grain warehouse programs in Iowa, Nebraska, Oklahoma, and Illinois and to the federal program. After making those comparisons, reviewing licenses and examination files, and analyzing recent warehouse failures, we identified several weaknesses which have resulted in inadequate protection for Kansas farmers, as described below.*

### PROBLEMS RELATED TO LICENSING

**Some licensing requirements for grain warehouses in Kansas aren't as stringent as other states. As part of its annual licensing**

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requirements, the Program requires Kansas warehouses to post a bond which would help mitigate any losses due to mismanagement or fraud. Kansas' bonding requirements are lower than those of other states which use bonding for financial assurance. Also, Kansas law allows warehouses to submit "reviewed" (not audited) financial statements. Audited financial statements provide greater assurance that the figures presented are complete, accurate, and follow generally accepted accounting practices. Illinois' grain warehouse program requires audited financial statements, and Nebraska's requires additional bonding if "reviewed" financial statements are submitted.

**Program staff don't use all the financial information they receive to help identify and expand requirements for warehouses that may be at a higher risk of failure.** Program staff use information from the financial statements only to determine whether the warehouse meets the minimum financial requirements for licensure set out in law; namely, that its current assets are equal to or greater than current liabilities, and that its net worth is at least 25¢ per bushel of licensed capacity. Calculating other ratios and reviewing additional information contained in the financial statements could help Program officials identify warehouses which are financially "risky" and need more monitoring or increased bonding requirements.

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Program staff told us their review is limited because they think they have to grant a license if a warehouse meets the two minimum financial requirements set out in law. We think that interpretation is too narrow; State law says the Secretary may issue a license if the financial criteria are met.

## **PROBLEMS RELATED TO MONITORING**

**We found several serious weaknesses that hurt the effectiveness of the grain warehouse program.** Program staff perform very limited evaluations of the quality of grain stored in licensed warehouses. Their review is limited to observations of the conditions of the facility (open windows, water leaks, birds) and to a small sample of grain usually taken from the top of the storage bin (looking for insects, animal droppings, odor, etc.). By not taking samples further down to the sides or bottom—especially for flat-storage facilities—Program examiners may not discover problems with the quality of grain, or be able to tell whether previously identified problems have been fixed.

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Department staff don't think the Program has the authority to take samples of grain, require warehouses to test the quality of grain when Program staff observe problems with it, or deny a license based on grain quality problems. They don't think current State law is specific enough, and said even if it were, the Program doesn't have the equipment, money, or time to do further sampling and testing of grain quality. We don't think the law limits the Program's regulatory authority related to the quality of grain, because maintaining grain quality is referred to several times in the statutes. Further, the Program has a responsibility to take whatever reasonable actions are

*needed to assess whether warehouses are meeting statutory requirements relating to maintaining the quality of stored grain.*

*Program examiners aren't writing up—or aren't consistently writing up—all the problems they identify during examinations at licensed warehouses. That means Program officials have no way of knowing the real types or number of problems being found at warehouses. For example, one warehouse went out of business after USDA officials discovered it had nearly 400,000 bushels of poor-quality grain. State examiners said they'd known about grain-quality problems at this facility, but none had been reported since 2001. Before August 2002, the Program also had no formal policy regarding following up on grain quality or shortage problems identified during on-site examinations.*

*Finally, the Program's oversight of its examiners is inadequate to ensure that they are carrying out laws, regulations, and policies appropriately and consistently. The seven examiners are spread across the State, work alone most of the time, have no field supervision, and aren't routinely rotated to different regions.*

#### **PROBLEMS RELATED TO ENFORCEMENT**

**The Program doesn't have the statutory authority to fine warehouses that violate laws and Program regulations.** *The other states we reviewed and the federal program all have fining authority. Without the authority to issue fines, the Kansas Program has little recourse against warehouses that repeatedly violate grain quality and quantity requirements. Because Program officials don't think they have the authority to suspend or revoke a license based on quality problems, the actions they've taken have been very limited.*

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**Program officials have taken no enforcement actions against warehouses, even when such actions appeared to be warranted.** *Neither Program nor Department officials took any enforcement actions against one warehouse after the examiner reported serious uncorrected grain quality problems. The Program didn't take any enforcement action against another warehouse, despite evidence the facility repeatedly had serious quality problems that remained uncorrected for a full year. Again, Program officials don't think they have the statutory authority to take more aggressive actions against warehouses that have grain quality problems. They haven't sought additional statutory guidance or authority.*

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#### **PROBLEMS RELATED TO SCOPE AND FUNDING**

**Farmers who participate in sale contracts aren't protected under Kansas' warehouse law.** *The law only covers farmers who store their grain in a licensed warehouse, not those who sell their grain. Increasingly, farmers are selling grain using a form of contract sales in which ownership of the grain is transferred but the payment or price for that grain is deferred until a later date. In such cases, if the warehouse fails*

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*before the farmer is paid, the farmer is not covered under the Program and can't make a claim under the warehouse's bond.*

*Most other grain-producing states regulate grain dealers, which helps protect farmers who sell their grain to a dealer, which may be a warehouse. Nebraska, Iowa, and Illinois regulate grain dealers, and provide financial protection through a grain dealer bond or indemnity fund. The Kansas Legislature considered licensing grain dealers several times before 1985, but each time the proposed legislation failed. The use of sale contracts wasn't as common at that time.*

**Kansas' Program is expected to run out of money in 2005.** *The Program is funded through fees and a reserve fund. Since 1997, when the Program was transferred to the Department of Agriculture, it has been relying on reserve funds to meet expenditures. That reserve fund is expected to be depleted in March 2005. According to Department officials, Kansas is one of only three states that receives no general fund assistance for its grain warehouse program. Options the Department has considered range from requesting additional General Fund support to discontinuing the Program.* ..... page 21

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**APPENDIX B: Fee Increases for State-Licensed Warehouses** ..... page 29

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# Department of Agriculture: Reviewing the Grain Warehouse Inspection Program

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The Grain Warehouse Inspection Program in the Kansas Department of Agriculture administers and enforces the Kansas Grain Warehouse Law. The Program is designed to ensure that Kansas grain producers have safe, solvent warehouses to store their grain. The law requires any entity that stores grain for the public to be licensed by the State. Facilities that are licensed under the Federal Warehouse Act are not subject to Kansas law.

Recently, several grain warehouse failures occurred in Kansas, and grain producers incurred losses. These failures raised questions in legislators' minds about whether the Grain Warehouse Inspection Program and the laws it enforces appear to be adequate to protect grain producers who store grain in public warehouses. This audit answers the following question:

## **Does Kansas have an adequate program for protecting farmers who have grain stored in public warehouses?**

To answer this question, we interviewed officials of the Department of Agriculture, the U.S. Department of Agriculture (USDA), the Association of American Warehouse Control Officials, and agriculture departments in Nebraska, Oklahoma, Illinois, and Iowa. We also interviewed warehouse operators and grain producers affected by the recent bankruptcies.

We reviewed Program and legal files at the Department of Agriculture to determine whether Program staff were following established procedures and requirements during licensing and during examinations and other monitoring activities. Our review of 20 warehouses is too small a sample to project results to the entire population. We also accompanied an examiner on a two-day examination. Finally, we reviewed and compared related statutes and regulations for Kansas, Nebraska, Oklahoma, Illinois, and Iowa, as well as federal grain warehouse laws.

For reporting purposes, we collapsed the two questions from the scope statement (see Appendix A) into one broader question.

In conducting this audit, we followed the applicable government auditing standards set forth by the U.S. Government Accountability Office. Our findings begin on page 9, after a brief overview.

## Overview of Grain Warehouse Regulation in Kansas

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The purpose of the Grain Warehouse Inspection Program is to ensure that Kansas farmers have solvent warehouses where they can safely store their wheat, oats, corn, soybeans, and other grains. The State enacted the Public Grain Warehouse Law in 1907, and assigned the duty to enforce it to the Grain Inspection Department. Although the law has been updated to reflect changing practices and to include additional protections over the years, its basic purpose hasn't changed.

To carry out this purpose, the Program annually licenses and inspects each State-licensed public warehouse. These licensing and examination processes are designed to help ensure the warehouse is financially sound, the measured quantity of grain matches the amount in warehouse records, proper records are maintained, and the facilities provide a safe environment for the grain being stored.

This Program helps protect the financial well-being of Kansas farmers. Kansas is the nation's leading wheat producer: about one-fifth of all wheat grown in the United States is grown in Kansas—a total of 480 million bushels in 2003, according to the USDA. Kansas' total production of wheat, corn, grain sorghum, soybeans, oats, and barley totaled more than 972 million bushels that year.

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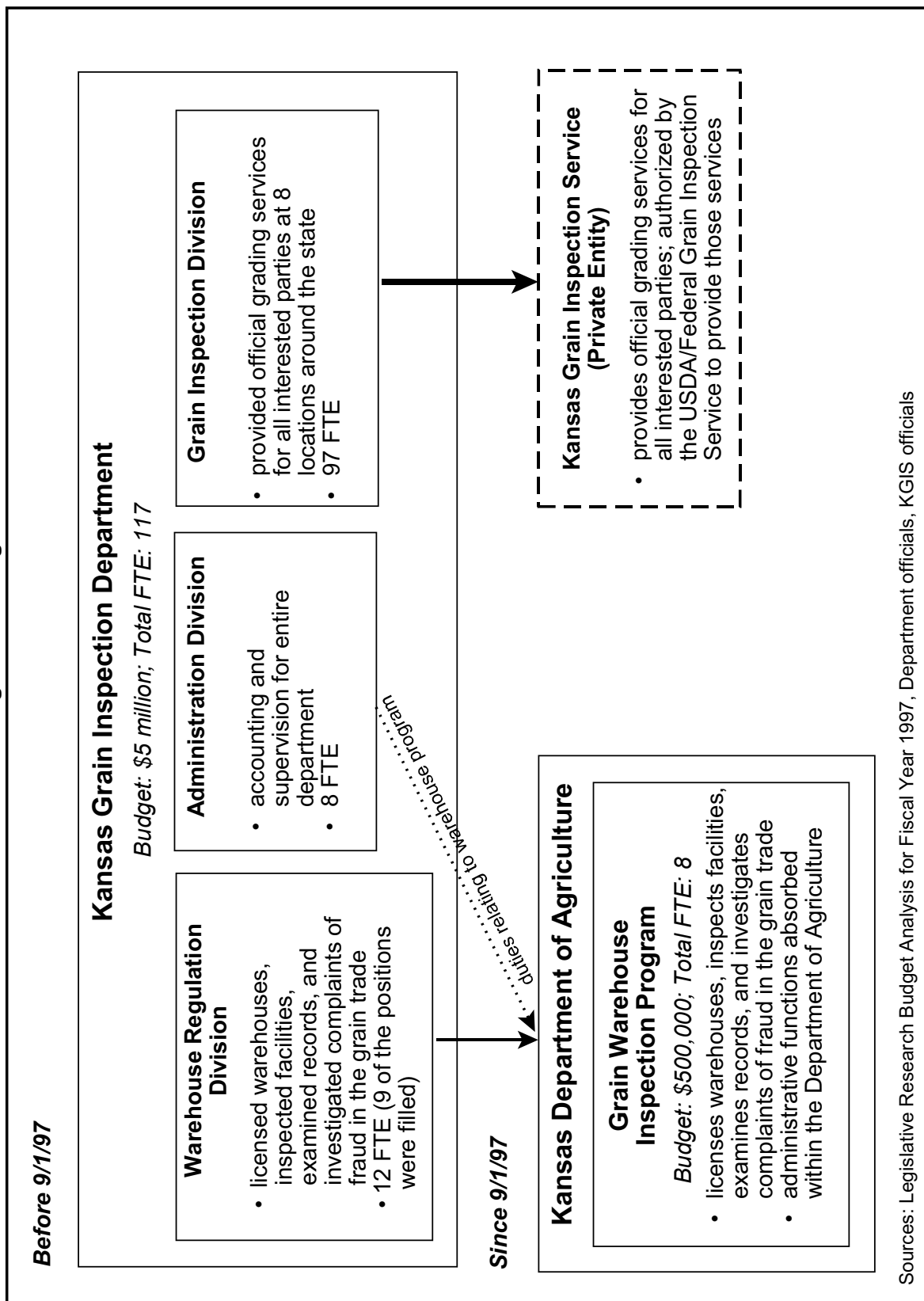
***In 1997, Responsibility for Regulating Public Grain Warehouses Was Transferred From the Grain Inspection Department To the Department of Agriculture***

The Grain Inspection Department was abolished in 1997. Its two main duties were divided, as follows:

- responsibility for carrying out the provisions of the State's Public Grain Warehouse Law was given to the Kansas Department of Agriculture
- responsibility for providing official grain "grading" services was privatized. Getting grain graded is now voluntary; the State's requirement for official grading of grain upon delivery for storage in Kansas warehouses was eliminated in 1990.

*Graphic OV-1* shows how the structure of the Program changed in 1997.

**Graphic OV-1**  
**Structural Change of the Program**



Sources: Legislative Research Budget Analysis for Fiscal Year 1997, Department officials, KGIS officials

***The State's Grain Warehouse Program Covers Only State-Licensed Warehouses That Store Grain Owned by Others***

Like all major grain-producing states, Kansas regulates the storage of grain at public warehouses. Not all grain storage falls under the State's warehouse law. *Table OV-1* shows which facilities and grain are covered under the law, and which aren't.

Table OV-1 Coverage Provided by the Kansas Grain Warehouse Inspection Program	
<u>The Program covers ...</u>	<u>But it doesn't cover ...</u>
... warehouses that store grain for the public	... warehouses that hold only the warehouse owner's grain
... State-licensed warehouses	... federally licensed warehouses
... farmer-owned grain stored at the warehouse	... grain owned by the warehouse, whether outright or being purchased on contract

**The USDA offers a parallel warehouse program, with separate but similar licensing and examination requirements.** All public warehouses must be licensed, but a warehouse might choose to get a federal license rather than a State license. For example, a warehouse with facilities in multiple states might become federally licensed so it must meet only a single set of requirements.

Although federal and State requirements are substantially the same, there are a few important differences. Kansas requires a warehouse that stores others' grain to be licensed, but federal licensing is optional. Unlike Kansas, the federal program doesn't require warehouses to be inspected annually. We also noted that, although it's not required or specifically authorized by law, federal warehouse examiners do more testing of grain quality during their inspections than Kansas examiners do.

Table OV-2 Grain Warehouse Programs in Kansas – 2004				
	State-Licensed	Federal-Licensed	Total	% of total for State-Licensed Facilities
# of licenses issued	146	83	229	64%
# of facilities examined (a license can cover more than one facility)	420	366	786	53%
Capacity of licensed facilities (in bushels)	340 million	482 million	822 million	41%
Average capacity per facility	810,000	1.3 million	1.0 million	
Source: Grain Warehouse Inspection Program staff				

*Table OV-2 compares the numbers and capacity of State-licensed and federally licensed grain warehouses in Kansas.*

***State-Licensed Grain Warehouses Must Meet a Number of Requirements To Operate in Kansas***

As part of the Program's annual licensing process, a warehouse must provide proof that it meets a number of financial requirements. Those requirements are designed to help ensure the warehouse has sufficient resources to operate, is insured against catastrophic damage to the structure, and can mitigate any losses that are caused by the warehouse's

mismanagement or fraud, for farmers who store their grain. These requirements are listed in *Table OV-3*:

<b>Table OV-3</b> <b>Financial-Related Requirements That Warehouses Must Meet Each Year for Licensure</b>	
<b>Financial Requirements</b> - to ensure sufficient resources to operate	<ul style="list-style-type: none"> <li>current assets must be equal to or greater than current liabilities</li> <li>net worth must be 25¢ /bushel of licensed capacity, with a minimum of \$25,000</li> <li>financial statements must be reviewed or audited by an accountant</li> </ul>
<b>Insurance Requirements</b> - to protect grain owners from catastrophe	<ul style="list-style-type: none"> <li>must have fire, explosion, lightning, and tornado insurance for the grain's full market value, with a deductible of not more than \$10,000</li> </ul>
<b>Bonding Requirements</b> - to mitigate any losses due to mismanagement or fraud	<ul style="list-style-type: none"> <li>ranges from 10¢ to 20¢ per bushel of licensed capacity (depending on the capacity), but must be a minimum of \$10,000 (maximum \$500,000)</li> </ul>
<i>Sources: K.S.A. 34-228(c)(1); K.S.A. 34-228(b)(1)(A); K.S.A. 34-229(a); K.S.A. 34-236; KAR 4-25-12</i>	

In addition, the warehouse is examined on-site each year. These examinations help ensure that the correct amount of grain is on hand, the warehouse's bookkeeping is in order, and the facilities for storing grain are adequate and provide a safe environment for stored grain. Examinations are further described in the profile below.

#### What Happens During a Warehouse Examination

We accompanied an experienced examiner on a two-day examination. (On average, each examination takes six days; this was a smaller warehouse.) Here are some of the main steps we observed, which he told us were usual during an examination:

- **Check record-keeping**
  - Check samples of inbound scale tickets to verify storage or payment and warehouse receipts to ensure they've been used and recorded properly.
  - Check whether the amount of the insurance policy is adequate to cover the value of the grain.
- **Check quantity**
  - Measure each bin and calculate the amount of grain in the warehouse.
  - Compare the measured amounts of grain to the amounts the warehouse's records show.
- **Check for quality**
  - Check the physical facility to determine whether it properly protects the grain's quality, e.g., whether it allows water to enter.
  - Check the quality of the grain on the surface by observation (e.g., excessive split kernels in a small sample, sprouting grain, or a bad smell likely would indicate deterioration in quality).
- **Provide feedback**
  - Discuss any problems found with the warehouseman; leave a copy of the examination report.
  - After the warehouseman reports corrections made, the examiner will determine whether the response is adequate and may return to the warehouse to check.

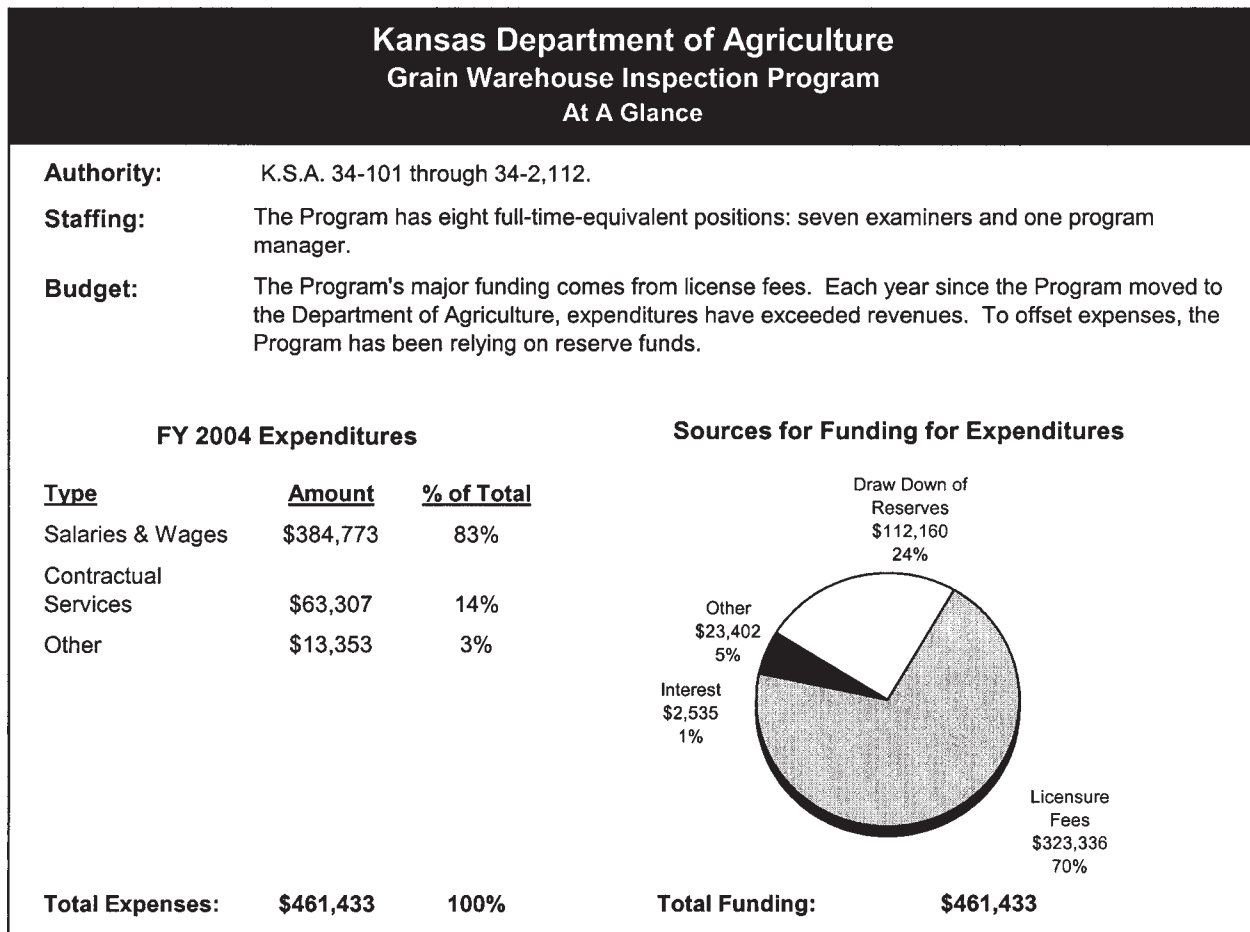
At the examination we observed, the examiner found problems with the adequacy of the facility. Windows at the top of the elevator were broken, which allowed birds to enter. Bird droppings on top of some of the bins dropped in when the bin was opened to measure the grain. In another of the warehouse's facilities, the dust was excessively deep and the man-lift didn't operate properly. This warehouse was placed on the Department's accelerated examination schedule for closer monitoring.

Overall, the Program's requirements are designed to provide reasonable protections to farmers who store grain in public grain warehouses.

***The Program Is Funded by Fees and Reserves***

The Program's main source of revenue is annual licensing fees paid by warehouses. A significant portion of funding (24% in 2004) also comes from reserves that were created in fiscal year 1998 when the State Grain Inspection Department was eliminated. When the regulation of grain warehouses was transferred to the Department of Agriculture, about \$1 million from the State Grain Inspection Fee Fund was transferred to the newly created Grain Warehouse Fee Fund. The Program has been using this money to offset expenses each year.

The At-a-Glance box in this section summarizes fiscal year 2004 Program revenues and expenditures.



Source: Division of the Budget forms DA 404 and DA 406, FY 2004, received from Department of Agriculture.

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***Part of the Impetus for  
This Audit Was the Recent  
Failure of Several Grain  
Warehouses***

Three State-licensed warehouses failed recently: two in April 2002, and one in August 2003. Two involved allegations of fraudulent activity or criminal wrong-doing; the third was due to mis-management.

Two other grain warehouses also recently lost their State licenses: one in October 2003 and the other in April 2004. These facilities operated in the grain business, but they had to buy the grain outright or on a contract and could no longer store grain for farmers. As a result, farmers who had grain stored there either had to sell it or move it to another State-licensed facility or to on-farm storage. Each has since been purchased or leased by another licensed warehouse.

These problems have raised questions about whether the Grain Warehouse Inspection Program is adequately protecting grain producers who store their grain in State-licensed facilities. Program officials told us that bankruptcies tend to be cyclical and follow drought patterns. Before 2002, they said, the most-recent State-licensed warehouse bankruptcy was in 1985.

Although bankruptcy proceedings aren't completed for the two former licensees, recent figures show about 500 farmers with grain stored in these facilities lost an estimated \$400,000. Other parties not protected by the Act may have suffered significant financial losses as well, including farmers who had sold wheat to these warehouses on contract and other creditors. The Department doesn't have information on these claims. More information about these three facilities is presented on the next page, and in Question 1.



## **State-Licensed Grain Warehouses That Recently Failed**

### **Brady Grain Inc. (Norton and Phillips County, Kansas)**

The warehouseman's attorney notified the Department in August 2003 that this warehouse had ceased to operate, and that the warehouseman wanted the Department to take control of the premises and records. The warehouse owner subsequently filed for bankruptcy. After the stored grain was sold and bond proceeds of \$263,500 were distributed, farmers with stored grain still lost about \$200,000. The USDA's Commodity Credit Corporation—which had had 300,000 bushels of grain stored there for about a decade—made an additional claim for \$205,000, which wasn't paid in the settlement.

Although State examinations over the preceding several years had noted some problems with the warehouse not holding a sufficient quantity of grain to cover its obligations, grain quality, not quantity, was the problem when the warehouse closed. Acting on a tip, USDA officials inspected the warehouse in May 2003, and found nearly 400,000 bushels of low quality grain. The overall quality of the stored grain had deteriorated so badly that the grain couldn't be used to cover warehouse obligations. State examiners said they'd known about grain quality problems, but none had been reported since 2001. (More details are on page 19.)

### **Miller Grain, Inc. (Saline County, Kansas)**

In November 2001, the bond company notified the Department that this warehouse's bond coverage was being cancelled effective April 30, 2002. The warehouse apparently tried to get new bond coverage but wasn't able to; without a bond, a warehouse can't be licensed. The Department took control of the facility on April 29 and didn't allow any further grain movement. Examination results from 1999 through 2002 had shown some periodic problems with both grain quality and quantity; one exam found the warehouse had sold as much as 100,000 more bushels than it owned. After the Department took over, examiners again found grain quality problems, as well as a shortage of 200,000 bushels of wheat and 17,000 bushels of milo.

The courts granted the Department receivership on May 7, and the Department liquidated the grain. After the grain was sold and \$750,000 in bond proceeds were distributed, the Department estimates that farmers with stored grain lost \$220,000. According to Department officials, the warehouse often didn't issue scale tickets or warehouse receipts for grain to farmers; instead, it issued them to the trucking company (which the warehouseman also owned) that picked the grain up from farmers and brought it to the warehouse. As a result, many farmers had undocumented claims. Department officials told us, that after the warehouse went out of business, law enforcement officials were called in to investigate its activities. This warehouseman also was licensed as a grain dealer and did business in Nebraska. Officials there estimated Nebraska farmers recovered about 15¢ of every dollar owed.

### **Marietta Farms, Inc. (Oberlin Milling Company) (Decatur County, Kansas)**

This warehouseman filed for Chapter 11 bankruptcy on April 30, 2002. State exams preceding the bankruptcy filing had identified various problems, such as crusted and insect-infested grain, bookkeeping problems, storing grain in unlicensed space, and the warehouse selling more grain than it owned. The examination conducted immediately after the bankruptcy showed that, in addition to continued grain quality problems, the warehouse had a shortage of 113,500 bushels of corn and 30,000 bushels of milo. Department staff told us the warehouse had issued receipts pledging grain but didn't have the grain to back-up those receipts. It also appeared the warehouse overstated the amount of grain it owned on the books by not making appropriate entries.

The Department ordered the warehouse to buy grain to cover these latest shortages on May 3, and took over the warehouse when it was unable to comply. After the grain was sold and bond proceeds of \$163,400 distributed, the Department estimates farmers with stored grain lost \$20,000.

## Does Kansas Have an Adequate Program for Protecting Farmers Who Have Grain Stored in Public Warehouses?

### ***ANSWER IN BRIEF***

The Program follows a number of good practices in licensing and monitoring warehouses and enforcing the Warehouse Act, but other weaknesses impair its ability to adequately protect farmers. Some licensing requirements aren't as stringent as those of other states or the federal government, and some states do more analysis of warehouses' financial solvency with the information they receive. Program staff allowed at least two warehouses' grain quality and shortage problems to continue without taking appropriate actions. New and supposedly stronger monitoring and enforcement policies haven't ensured that all problems are being reported or addressed to ensure that they are corrected.

Part of the problem stems from the Department's belief that Program staff don't have the authority to force warehouses to correct problems with grain that is infested or otherwise in poor condition. In addition, the protections built into the Grain Warehouse Law apply only to stored grain, which leaves many farmers unprotected because the law doesn't address the increasing trend in contract sales. Finally, the reserve funds that have helped support the Program each year will be exhausted in fiscal year 2005, requiring the Legislature to adopt a different funding structure if the Program is to continue.

### ***Kansas' Program Follows a Number of Good Practices, but Some Major Weaknesses Impair Its Ability To Protect Farmers***

As with any regulatory program, the Grain Warehouse Inspection Program should be designed and carried out in a way that would adequately protect the public (in this case, farmers who have stored grain) from harm. To provide that protection, the Grain Warehouse Program should ensure that:

- warehouses meet financial requirements designed to identify financial viability and to safeguard farmers' stored assets
- facilities are maintained to adequately protect the quality of the grain stored there
- the amount of grain in the warehouse matches the amount shown in warehouse records
- when problems are found, they're addressed in a timely and sufficient manner, and appropriate monitoring and enforcement actions are taken to bring warehouses into compliance or not allow them to operate.

Our review of Department documents including the files for 20 warehouses for 2003 and 2004 identified a number of good practices, including the following:

- All required records had been submitted for licensure, Program staff reviewed these materials, and all 20 warehouses met the minimum financial-related requirements set out in law.
- The 20 warehouses in our sample were examined on-site at least annually, as required by law. The Program also follows best practices in a number of other areas, including using a standardized checklist, requiring examinations be unannounced, developing a manual to provide guidance to examiners in conducting examinations, and requiring warehouse operators and the Program manager to sign or initial examination forms, including any corrective action reports.
- When examination reports showed that warehouses had problems, follow-up examinations were conducted as required by current policy, and warehouses whose identified problems were considered to be serious were placed on an accelerated examination schedule.

However, we also identified some major weaknesses that have resulted in inadequate protection for Kansas farmers. Our findings are presented in the sections that follow.

## **PROBLEMS RELATED TO LICENSING GRAIN WAREHOUSES**

### ***Some Licensing Requirements for Grain Warehouses in Kansas Aren't as Stringent as Other States***

We noted that Kansas' requirements were less stringent in the following areas:

- **Kansas bonding requirements are lower than some other states'.** Bonds and indemnity funds are the most common tools states use to provide reimbursement to farmers when warehouses fail. Of the programs we looked at, Kansas, the federal program, and Nebraska use only bonds, Iowa and Illinois use only indemnity funds, and Oklahoma uses both bonds and an indemnity fund. Their requirements are summarized in Table I-1 on the next page.  
  
Kansas legislators considered an indemnity fund several times in the 1980s, most recently in 1985. Officials in Iowa and Oklahoma said their financial assurances had been able to cover all claims from recent warehouse failures. However, the Illinois fund wasn't enough to cover all claims from a single bankruptcy in 2001. In that case, farmers and lenders lost about \$14 million.
- **Kansas law allows warehouses to submit "reviewed" (not audited) financial statements.** Audited financial statements can provide greater assurance that the figures presented are complete, accurate, and presented according to accepted accounting rules. Further, audited financial statements contain opinions by the accountant about the overall soundness and financial health of the entity. As a requirement for licensure in Illinois, grain warehouses are required to submit audited financial statements. Nebraska allows warehouses to submit reviewed financial statements, but those warehouses must also post an additional bond of 2¢ per bushel of licensed capacity. Kansas doesn't have any such requirements.

<b>Table I-1</b> <b>Financial Assurance Mechanisms Used To Reimburse Producers for Losses</b>						
<b>Mechanism</b>	<b>Kansas</b>	<b>federal</b>	<b>Nebraska</b>	<b>Oklahoma</b>	<b>Iowa</b>	<b>Illinois</b>
<b>Warehouse bonds <sup>(a)</sup></b> -amt. per bu. -minimum -maximum	10¢-20¢ /bu \$10,000 \$500,000	10¢-20¢ /bu \$20,000 \$500,000	20¢-40¢ /bu \$25,000 \$500,000	25¢/bu \$50,000 \$500,000	n/a	n/a
<b>Indemnity funds</b> -fund minimum -entity assessed	n/a	n/a	n/a	\$6 million  farmers, for commodities delivered to warehouses	\$6 million  warehouses	\$6 million  warehouses, 1 <sup>st</sup> sellers of grain to dealers <sup>(b)</sup> , lenders
(a) "bonds" refers to bonds and related financial instruments, such as irrevocable letters of credit; programs vary in the types of financial instruments they allow (b) Illinois regulates grain warehouses and grain dealers under the same laws and regulations. It also has an additional \$2 million in a reserve fund should the indemnity fund be exhausted.						
Sources: State and federal laws and regulations						

***Program Staff Don't Use All the Financial Information They Receive To Help Identify and Expand Requirements for Warehouses That May Be at a Higher Risk of Failure***

When they apply for annual licensure, warehouses are required to submit certain financial information—including an income statement, retained earnings, and changes in financial position. Such information could help Program officials identify which warehouses are financially “riskier.” For example, our review of cash flows from operations showed that two of the three warehouses that recently failed had negative cash flows from operations for two years in a row— one was hundreds of thousands of dollars.

These analyses also could help Program staff identify which warehouses need more rigorous monitoring or more stringent reporting or bonding requirements. The Department has the statutory authority to increase bonding requirements if the Secretary determines the bond is insufficient security against losses that might occur. Such actions could help ensure Kansas farmers are adequately protected if a warehouse goes out of business.

Program staff told us they don't use information from financial statements to help identify warehouses that might be at greater risk of financial failure. Rather, they use it only to determine whether the warehouse meets the minimum financial requirements for licensure set out in law; namely, that its current assets are equal to or greater than current liabilities, and that its net worth is at least 25¢ per bushel of licensed capacity, with a minimum of \$25,000.

Program staff told us their review was limited because they thought they had to grant a license to a warehouse that met the minimum financial requirements and was able to obtain a bond, regardless of the problems found on prior examinations or other financial concerns. We think that interpretation is too narrow; State law says the Department Secretary may issue a license if the financial criteria are met.

In contrast, Iowa uses the financial statement information it receives to help determine a warehouse's probability of failure, using a statistical model. Those warehouses with a higher risk of failure are subject to more frequent inspections, and warehouses whose financial position has deteriorated must submit more frequent financial statements. Illinois law also requires its program staff to analyze a warehouse's debt to equity, which can show how much a business is leveraged by comparing what is owed to what is owned.

## **PROBLEMS RELATED TO GRAIN WAREHOUSE EXAMINATIONS**

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### ***We Found Several Serious Weaknesses That Hurt the Effectiveness of the Grain Warehouse Program***

The problems we identified are summarized in the sections that follow.

**Program staff perform very limited evaluations of the quality of grain stored in licensed warehouses.** Most state warehouse inspection programs tend to focus on the quantity of grain and whether it matches warehouse records. Laws for each program we looked at require the warehouse operator to maintain quality. To check that, examiners in Kansas usually look at the storage facilities for evidence of such things as water leaks, open windows and birds, and look at a sample of grain for evidence of problems such as insects, crustiness, animal droppings, wetness, and odors. Federal and Illinois examiners go an extra step and determine whether stored grain likely meets grade standards.

During most examinations Program staff only observe samples of grain from the top of the storage facility or wherever their vantage point is; they don't probe further down to the sides or bottom. That's especially problematic for flat storage facilities (as opposed to vertical bins) which are prone to quality issues because it's very difficult and labor intensive for the operator to "move" grain from the sides and bottom.

As a result, Program examiners may not discover problems with the quality of the grain that they can't see. Further, if new grain is added on top of old grain, they may not be able to see whether quality problems they've identified in the past have been fixed.

Finally, we noted that the Program doesn't require warehouse operators to test the quality of the grain they are storing when examiners identify serious or repeated grain quality problems in their facilities.

**Department staff don't think the Program has the authority to require warehouses to test the quality of grain when Program staff observe problems with it, or to deny a license based on grain quality.** The Department's attorney told us, without that authority, he thought Department examiners could be charged with theft if the examiner took a sample of grain off the premises. He also said he didn't think State law was specific enough to allow Program staff to remove samples of grain that appears to be "out of condition" based on visual observation, to require warehousemen to have qualified companies obtain and test samples, or to deny a license based on problems with grain quality. Even if it were allowed, he said, the Program doesn't have the specialized equipment, money, or time to conduct such tests. The Department bases this position on the fact that other regulatory programs within the Department, such as the dairy program, have specific statutory authority to take samples.

While this is true, we think there are differences between the two programs and differences in the product being sampled and the nature of the testing. For example, the Pasteurized Milk Ordinance, which Kansas has adopted, requires frequent samples of milk to be tested for the presence of antibiotics and bacteria. In contrast, we're suggesting that examiners simply expand their current "observation" of grain by taking more and varied samples. Although not specifically addressed in the law, we don't think the law limits the Program's regulatory authority related to the quality of grain. Among other things, the Kansas Grain Warehouse Act:

- states that the policy of the State is to promote storage and handling practices which will assist in the maintenance of grain quality
- refers to a reasonable care standard, to the warehouse operator's obligation to maintain the quality of the grain, and to the operator's responsibility to provide notice to the Department and the grain owner if grain becomes out of condition
- states that diminished quality of grain is a basis to make a claim on the bond
- allows for any examination deemed necessary by the Secretary in cases where it appears the warehouse doesn't have sufficient commodities to cover the outstanding receipts (emphasis added). Diminished quality grain would contribute to "insufficient commodities."
- states that the law is to be liberally interpreted

In our opinion, the regulatory program has a responsibility to take whatever reasonable actions are needed to assess whether warehouses are meeting these statutory requirements and, if not, to ensure that they come into compliance or that appropriate actions are taken to ensure that farmers' stored grain is adequately protected and the quality



maintained. As a starting point, examiners could take more and varied samples of grain to base their observations on. If serious problems with the grain are evident (sprouting, wet), then we think the Program has authority to require further testing—in other words, any examination deemed necessary.

**Until August 2002, the Program had no formal policy regarding follow-up on grain quality or shortage problems identified during on-site examinations.** When problems were found that couldn't be corrected while the examiner was on-site, the warehouse was supposed to report back within 15 days on the steps being taken to fix the problem. However, there was no formal policy to follow-up in a timely manner to make sure problems had been corrected, even if the warehouse operator had failed to report as required. Based on the files we reviewed, it appeared the examiner would wait until the next regularly scheduled examination—which could be 12 or more months later—to determine whether the problem had been fixed.

Finally, although the Program requires warehouses to provide detailed information regarding grain that's been purchased to make up for shortages identified during exams, it doesn't require them to send in copies of the cancelled checks to provide greater assurance that those shortages have, in fact, been made up.

Partly in response to the warehouse failures described in the Overview, the Program adopted stronger policies in August 2002. Under those new policies:

- Warehouse officials must tell the Department what they've done to correct problems found during exams in written, signed responses.
- Examiners decide whether the answer is acceptable and whether they will go back to the warehouse to check.
- The Program sends a letter to the warehouse telling it to expect a follow-up exam.
- Examiners recommend to the Program manager whether the warehouse should be inspected more than once a year.
- Warehouses are to be charged for the 2<sup>nd</sup> follow-up exam if problems weren't corrected by the time of the first follow-up

**Program examiners aren't writing up—or aren't consistently writing up—all the problems they identify during examinations at licensed warehouses.** Program policies require examiners to report an “exception” (a violation of the Grain Warehouse Act) when the warehouse doesn't have enough grain to cover its obligations, but are vague on when examiners should report other types of problems.



For example, policies make no reference to housekeeping issues, and only a vague reference to quality problems. Further, the policies state that if grain is purchased during the exam to correct a shortage, no exception report is needed.

We found several problems with this approach:

- **It gives examiners too much discretion in deciding what gets written up.** Two examiners we spoke with said they wouldn't necessarily write up a problem if they thought the operator would fix it in the near future. (In one case we reviewed, an examiner didn't write up serious and significant grain quality problems he had identified—even though they hadn't been corrected while he was there—because the operator indicated those problems would be corrected at a future date. They weren't.) One examiner also told us he would write up an exception the second time he saw a minor problem, but probably not the first time.
- **Program and Department officials have no way of knowing the real types or number of problems being found at warehouses.** Under this policy, management sees only the problems the examiner has documented. Other Kansas regulatory programs usually instruct their inspectors to document every violation, and note whether or not it was fixed on the spot. When all violations are noted, management has a much better indication of the situation that actually existed at each warehouse at the time of the examination, and can ensure that appropriate follow-up or enforcement actions are being taken to adequately protect farmers.

**The Program's oversight of its examiners is inadequate to ensure that they are carrying out laws, regulations, and policies appropriately and consistently.** The Program has seven examiners, all of whom have been in their positions for many years. Although annual discussions are held on examination issues, and examiners are required to agree on their findings when more than one examiner looks at a given warehouse, these examiners still are spread across the State and work alone most of the time.

Given the Program's lack of guidance on when examiners should report many types of problems, there's an increased risk that examiners will develop different ways of carrying out exams. Such differences may not be apparent just by looking at completed examination reports.

Although the Program manager rides along with each examiner once a year to touch base with his examiners and learn more about examinations, he isn't assessing how well or how consistently examiners are carrying out their jobs, or whether problems are being reported appropriately.

We also noted that inspectors aren't rotated from region to region. All the other states we reviewed and the federal government rotate their inspectors so that no examiner goes to the same warehouse more than once (Nebraska, Oklahoma), twice (Illinois, Iowa), or three times (federal) in a row. This is considered to be a best practice for a regulatory program.

**As designed, the Program doesn't require warehouses to submit more frequent financial statements when problems are identified during examinations.** By statute, Iowa may require a warehouse to do this if it has a shortage of grain, bounces a check, or violates record-keeping requirements, or if there's other evidence the licensee's financial position has deteriorated. Kansas has no such statute. Such information can help regulators decide whether to increase bonding, or whether to conduct more frequent inspections to help ensure that the warehouse is sound and that farmers' stored grain is adequately protected.

## ***PROBLEMS RELATED TO ENFORCEMENT ACTIONS AGAINST WAREHOUSES THAT DON'T VOLUNTARILY COME INTO COMPLIANCE WITH THE LAW***

When warehouses won't voluntarily come into compliance with State laws, regulations, or requirements, the Program has a responsibility to take appropriate enforcement actions to compel them to comply or to stop operating. Some of the hallmarks of a good enforcement process:

- having a graduated system of sanctions that gets more severe at each stage if licensees don't come into compliance (for example, starting with a letter of non-compliance, issuing a fine, suspending a license, and finally revoking a license)
- setting the sanctions sufficiently high to compel the entity to comply
- taking appropriate, consistent, and timely enforcement actions that address the violations cited

In this area, we looked at the Program's enforcement authority in general, and at whether appropriate enforcement actions were taken for the three failures we reviewed, plus the 20 warehouses whose files we reviewed for 2003 and 2004.

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### ***The Program Doesn't Have the Statutory Authority To Fine Warehouses That Violate Laws and Program Requirements***

Kansas' Program has a number of enforcement notifications or actions available to take against warehouses that don't voluntarily come into compliance with the law. These include:

- charging a warehouse the costs for the 2nd follow-up visit if the warehouse hasn't fixed the problem by the 1<sup>st</sup> follow up
- requesting injunctions to stop warehouses from violating or continuing to violate the act

- applying to the courts to take possession of the warehouse (receivership)
- suspending a license
- revoking a license
- referring violations of the warehouse law to a county or district attorney for criminal investigation and prosecution

<b>Table I-2</b> <b>Fines Programs Have Available To Penalize Warehouses That Won't Come Into Compliance with the Law</b>					
Kansas	federal	Nebraska	Oklahoma	Iowa	Illinois
none	up to \$25,000 per violation if agricultural product is not involved, or 100% of the value of the agricultural product	up to \$10,000 per day per violation (limit of \$2 million per year)	\$100 - \$10,000 per day per violation	up to \$1,500 per day per violation	up to \$20,000 for grain quantity and quality violations; also may require the warehouse to post collateral of up to the larger of \$40,000 or an amount based on the deficiency
Sources: State and federal laws and regulations					

However, Kansas doesn't have statutory authority to fine warehouses, something that's common in most regulatory programs. As *Table I-2* shows, the other states we reviewed and the federal government all have fining authority.

Although we couldn't always get information on the extent to which others use fines, we were told that Illinois issues and collects fines for every violation noted. Iowa has imposed fines 20 times in the 4 years it's had this authority.

Without the authority to issue fines, the Kansas Program has little recourse against warehouses that repeatedly violate grain quality and quantity requirements. It's important to remember that Program officials don't think they have the authority to suspend or revoke a license because of grain quality problems, and because of that, enforcement options are limited.

***Program Officials Have Taken No Enforcement Actions Against Warehouses, Even When Such Actions Appeared To Be Warranted***

We noted problems in this area with two of the three grain warehouses that had failed recently:

- **Neither Program nor Department officials took any enforcement actions against Brady Grain after the examiner reported serious uncorrected grain quality problems.** Although the examiner didn't write up any quality problems after his December 2002 exam and January 2003 follow up exam of Brady Grain, he told the Program manager later in January 2003 about the "serious grain quality problems" he had continued to observe during both exams, and asked what should be done about it. Enforcement actions should have been initiated against this warehouse, which had had grain quality problems in the past. The Program manager told the examiner he would bring the issue up with Department officials, but he didn't until May 2003. That's when federal officials conducted their own inspection and identified significant grain quality problems. More details about this case can be found in the box on page 19.

- **The Program didn't take any enforcement action against Oberlin Milling despite evidence the facility repeatedly had serious quality problems that remained uncorrected for a full year.** A March 2001 exam reported that this facility had crusted grain. The warehouse owner reported in June 2001 that the quality problems were being addressed. A November 2001 exam showed the same quality problems at this location (the problem apparently had never been addressed). Although we found no evidence that the warehouse provided a corrective action plan in response to this report, the Program took no action for five months until April 2002. At that time, the examiner noted that none of the quality problems identified in the original March 2001 exam had been fixed.

Even though it was now clear the quality problems had not been corrected for a full year, the examiner only recommended that the warehouse be inspected again in 30 days, at the warehouse's cost. The Program manager was intending to re-license this facility around this same time period; however, the warehouse filed for bankruptcy.

**Program officials don't think they have the statutory authority to take more aggressive regulatory actions against warehouses that have grain quality problems.** As noted earlier, they think the law isn't specific enough to allow them to do anything regarding quality issues. Although Department officials consider their hands to be tied in this area, to-date they haven't sought any additional statutory guidance or authority.

As spelled out on page 13, we don't agree with the Department's interpretation. Based on our reading of the Grain Warehouse Act, we think the Department has the authority it needs to take appropriate enforcement actions against warehouses that aren't operating in compliance with the law to ensure that farmers' stored grain is adequately protected and the quality maintained.

Finally, although our review of the files for a sample of warehouses for 2003 and 2004 showed that no enforcement actions appeared to be needed, there's no way for us or Program officials to know whether all violations had been reported or were being fixed. As a result, there's no way to know for certain whether enforcement actions were needed in any of these cases.

**Most of the Problems We Saw with Grain Warehouse Examinations  
Can Be Seen in the Program's Handling of Brady Grain,  
One of the Warehouses That Went Bankrupt**

Brady Grain, Inc., had a licensed capacity to store about 1.4 million bushels of grain in its storage facilities. About 300,000 bushels were being stored for the federal Commodity Credit Program, for perhaps as long as a decade. When we reviewed the files for this warehouse, we saw the following:

*Program staff didn't follow-up in a timely manner on serious grain quality and shortage problems identified during the July 2001 on-site examination.* Problems written up in 2001 included insect-infested and "crusted" grain, and grain shortages. According to the files, the warehouse didn't report back within 15 days on the steps being taken to fix the problem, and the examiner took no follow-up actions before the next examination. The Department didn't have a policy regarding timely follow-up at this time.

*Program staff didn't verify that the warehouse had purchased enough grain to cover the shortage of grain identified during the April 2002 examination.* The warehouse sent in a listing of grain purchases to cover the shortage, with information on names, dates, and amounts. The Department didn't have a policy regarding timely follow-up at this time, and accepted this documentation.

*The examiner didn't write an exception report on the grain quality problems he observed during his December 2002 examination and the January 2003 follow-up.* The examiner told us he hadn't written up what he saw because the warehouse operator indicated he would address the quality problems, and because the examiner knew he'd be back out for a follow-up exam. In this case, the examiner said, the warehouse operator had grain-cleaning equipment on-site in December and had indicated he was going to use it. The operator apparently still hadn't used it by the time of the January 2003 follow-up.

*Program and Department officials didn't take timely action to address the grain quality problems at Brady Grain after the examiner subsequently reported them.* Later in January 2003, the examiner told the Program director about the "serious grain quality problems" he had continued to observe during both the December 2002 exam and the January 2003 follow up. The Program director reportedly told the examiner he would discuss the problem with Department officials. Apparently, he didn't do so until mid-May. No action was taken by the Program to try to bring Brady Grain into compliance. In fact, the warehouse was taken off the accelerated examination schedule.

*Federal examiners found significant quality problems when they inspected the warehouse.* In May 2003, federal officials responding to a tip found broken windows and birds inside the storage facility, less grain in the bins than indicated on the records, live insects in the grain, crusting of the grain, and bookkeeping problems. Their tests also found 400,000 bushels of lower-quality wheat than indicated in warehouse records. Those results were much worse than the Kansas Program had ever identified.

In August 2003, after federal officials already withdrew about half of their 300,000 bushels of wheat, the warehouse operator turned control of the warehouse over to the Department of Agriculture, and subsequently filed for bankruptcy.

## PROBLEMS RELATED TO THE SCOPE AND FUNDING OF KANSAS' REGULATORY PROGRAM

### *Farmers Who Participate in Sale Contracts Aren't Protected Under Kansas' Warehouse Law*

When the Warehouse Act was passed, farmers who took grain to a warehouse either stored the grain there and paid the warehouse a storage fee, or sold the grain outright to the warehouse for cash. The Act was intended to protect farmers who stored their grain, not those who sold their grain.

Over the past 15 years or so, however, farmers have increasingly participated in a form of contract sales. Under these contracts, farmers agree to defer payment until a later date, to set the sale price at a later date, or both; in essence, the grain is considered to be sold. As a result, if the warehouse fails before the farmer is paid, the farmer is not entitled under the Kansas Warehouse Act to receive any of the moneys recovered from the warehouse's bond or letter of credit, because those financial assurances only cover stored grain, not sold grain.

**Most grain-producing states regulate grain dealers, which helps protect farmers who sell their grain to a dealer, which may be a warehouse.** Although a majority of grain-producing states regulate dealers, Kansas does not. For comparative purposes, we reviewed detailed information from the federal program and the programs in Nebraska, Oklahoma, Iowa, and Illinois. *Table I-3* shows the results of our comparison.

Table I-3 Protections Other Programs Have for Grain Sold on Contract						
	KS	federal	NE	OK	IA	IL
financial protection is provided under a grain <u>dealer</u> law	no	no	yes	no	yes	yes
farmer may make claim for losses against the...			...grain dealer bond		...grain dealer bond	...indemnity fund
Sources: State and federal laws and regulations						

States that allow claims against the dealer's bond or the indemnity fund allow only a limited amount of time to file those claims—90-160 days after the contract is signed.

The Kansas Legislature has considered licensing of grain dealers in 1927, 1953, 1974, and 1985, but each time the proposed legislation failed. Most recently, proponents of licensing have cited the need for



farmers to have some assurance that the grain dealer is publicly accountable, through a State-issued license with financial backing such as a bond. Opponents cited a reluctance to restrict that type of commerce.

**No one tracks the number of these contract sales in Kansas, nor the amount that holders of such contracts have lost when a warehouse failed.** However, in conversations with farmers about the recent failure of three State-licensed warehouses, one farmer told us his neighbor lost \$300,000 on this type of sale contract.

It's not clear how much these individuals will receive when the bankruptcies are finalized, but their contracts make them unsecured creditors, low on the payout list. These losses are in stark contrast to the losses of farmers who had grain stored in the warehouses that went bankrupt. According to figures provided by the Department, their losses typically averaged less than \$1,000.

***Kansas' Program Is Expected To Run Out of Money in 2005***

As mentioned in this report, the Program has some weaknesses that need to be addressed, which will likely take more resources. The Program's current funding level is already inadequate. The Grain Warehouse Program has been funded primarily through annual licensing fees paid by warehouses and drawing down reserves which were created when the Program was transferred from the Grain Inspection Department to the Department of Agriculture in 1997.

<b>Table I-4 Difference Between Program Revenues and Expenditures, Fiscal Years 2002 – 2005</b>			
	<b>Revenues</b>	<b>Expenditures</b>	<b>Difference</b>
FY 2002	\$338,266	\$564,256	-\$225,990
FY 2003	\$448,210 <sup>(a)</sup>	\$580,126	-\$131,916
FY 2004	\$349,273	\$461,433	-\$112,160
FY 2005 (est.)	\$362,569	\$484,429	-\$121,860
<sup>(a)</sup> includes \$134,409 in recovered expenses from Miller Grain bankruptcy Source: Unverified data from Department of Agriculture budget reports			

As *Table I-4* shows, the Program's expenditures have exceeded revenues substantially over the last several years.

Department of Agriculture officials told us that they expect the reserve moneys to be depleted by March 2005, and that they'll have a \$171,000 shortfall to fund fiscal year 2006

at current Program levels. To address this shortfall, Department officials identified the following options:

- **Requesting additional funding from the State General Fund.**  
Department officials have told us Kansas is one of only three states in the nation that receive no general fund assistance for its grain warehouse program.



- **Raising fees.** Fees were raised to the maximum allowed by law (for large elevators) effective January 2004. This increase is expected to generate an additional \$46,000 for both fiscal years 2004 and 2005. Fees would need to increase an additional 42% to balance with the Program's current expenditures. Appendix B has more information about the fee increases.
- **Cutting staff.** The Department would have to cut 5 of the Program's 8 employees to bring expenditures in-line with current revenues. That would leave two field examiners and one manager to cover the State (see the map on the next page). At this level of staffing, however, the Program would be unable to meet the legal requirement for an examination of each warehouse each year, and travel expenses could increase significantly.
- **Contracting with the federal program to operate a joint program.** Department staff have indicated the likelihood of this is slim. The Department knows of no other state where a joint program is operating. See the profile below on additional concerns related to the federal program.
- **Discontinuing the Program, and allowing grain producers to store their grain in federally licensed facilities.** Because of capacity and location issues, this option would be feasible only if a significant number of facilities currently licensed by the State would become federally licensed. However, federal licensure is optional, so there's no certainty that currently State-licensed warehouses would switch. As a result, farmers would either have fewer options for storing their grain, or less protection.

The Legislature will need to consider these and potentially other options during the 2005 legislative session to address the Grain Inspection Warehouse Program's funding shortfall for fiscal year 2005 and beyond. Other state staffing and funding information can be found in Appendix C.

#### **Federal Grain Warehouse Regulation Is in a State of Flux**

Federal warehouse laws were extensively rewritten in 2000. New regulations, issued in 2002, took the former specific regulations for the various commodities and put them into a single set of regulations. Those new regulations take specific requirements for net worth, bond, and so forth out of the regulations and give the USDA's Farm Service Agency authority to include them in its licensing agreements with the various types of warehouses.

States strongly objected to a provision in the new regulations that says federally licensed warehouses need not comply with state laws relating to warehousing, grading, weighing, storing, merchandising, or other similar activities. Some states, including Kansas, objected, saying the language preempts grain dealer laws and some State warehouse laws.

As a result of the objections, in 2003 Congress passed a joint resolution requiring the USDA to stop work on the new regulations for 180 days. USDA has voluntarily continued this prohibition, and a USDA official said it's likely no additional work will be done on the new requirements until after the next presidential election.

[illegible]

**Conclusion** Because grain is such an important industry in this State, it's critical to ensure that farmers have safe, solvent warehouses to store their grain. As discussed in this report, several aspects of the Department of Agriculture's Grain Warehouse Inspection Program hamper its effectiveness at providing that protection. An issue that underlies many of the problems we identified is that Department officials don't think State law gives them the specific authority to address grain-quality issues or to act against State-licensed warehouses with a history of financial or quality problems. We think the statute is general enough to give them this authority.

Resolving this issue has to be among the Legislature's and the Department's highest priorities for this Program. Some of the other weaknesses we've identified can be addressed in the short-term; others may take additional study. Finally, because of the Program's current funding problems, some action also will be needed during the 2005 session to determine how and whether to continue the Program. Strengthening it will take additional resources and effort, and will require a commitment from both the Department and the Legislature to operate this Program at a level that provides both adequate and cost-effective protections for Kansas farmers.

**Recommendations      Recommendations for the Legislature**

1. To help provide adequate protection for Kansas grain farmers, the House and Senate Agriculture Committees should amend the Kansas Grain Warehouse Act to do the following:
  - a. increase Kansas' bond rates and minimum bond requirements to be more in line with the other grain-producing states cited in this audit.
  - b. require warehouses to provide audited financial statements as part of the annual licensing process, or to post additional bond if "reviewed" (rather than audited) financial information is provided. For example, if a Nebraska warehouse submits reviewed financial statements, that states' program requires an additional bond of 2¢ per bushel of licensed capacity.
  - c. authorize the Department to impose fines for violations of the grain warehouse laws, at levels commensurate to those allowed by other grain-producing states.

- d. require the Department to consider grain quality in operating the Program, and specifically authorize the use of sampling to observe or test the quality of grain being stored in State-licensed warehouses. As part of other changes relating to quality, legislation should require the Department to do the following:
  - i) consider a warehouse's history of serious quality or shortage problems before reissuing a license, and use this information to decide whether a license should be denied, the warehouse's bond raised, or other measures taken
  - ii) take additional samples of grain from sides and bottoms of certain grain storage facilities to look for evidence of problems. This need not be a representative sample of all grain; it could involve random samples from different places and depths to provide a better idea of the existence of grain-quality problems or the extent to which cited problems have been fixed.
  - iii) when observations identify problems with grain quality, perform testing of grain at its own expense, or if problems are significant or repeated, require the warehouse to pay those costs, at the Department's discretion
  - iv) take appropriate enforcement actions if warehouses don't voluntarily come into compliance with Act in terms of quantity or quality problems identified during exams within the required time
- 2. To consider issues surrounding the long-term future of the Grain Warehouse Inspection Program, the Legislative Post Audit Committee should request an interim study in 2005 to explore and make recommendations regarding:
  - a. sustainable funding for the Program
  - b. statutory protection for farmers who sell grain on contract, through some type of grain dealer licensing

To aid in its discussion, the interim study should explore whether federal program requirements have been finalized and adopted. This information might be helpful in any deliberations about what the focus of the Kansas program should be.

### **Recommendations for the Department of Agriculture**

1. To better identify State-licensed warehouses that may be at a higher risk of failure, the Department should develop a risk-assessment tool. It should use the results of that assessment to increase protections for farmers who store grain in those warehouses (for example, requiring more frequent examinations or by increasing bonding requirements for those facilities). An assessment tool should include measures of financial stability in addition to those currently required for licensing, trends in a warehouse's financial data, whether examiners have found any quality problems, whether the warehouse has repeated violations of grain warehouse laws, and the warehouse's physical facilities. To help monitor the status of warehouses, the Department also should require that additional financial information be submitted when more serious quantity or quality problems are identified during examinations, which may require seeking statutory or regulatory authority.
2. To help ensure that Program and Department officials have complete information about the problems being identified at State-licensed grain warehouses, the Department should require examiners to write up all problems found during examinations that relate to compliance with the Grain Warehouse Act, regardless of whether those problems are corrected before the examiner leaves, or whether the examiner expects the warehouseman to fix the problem in the future.
3. To help ensure that examiners are conducting examinations and citing violations of the Act consistently and in accordance with law and policy, the Department should increase its oversight of the Program's field staff.
4. To help ensure that examiners maintain an independent attitude toward the warehouses they inspect, the Department should require some level of examiner rotation; for example, requiring every 3<sup>rd</sup> examination to be done by a different person.

## APPENDIX A

### Scope Statement

This appendix contains the scope statement approved by the Legislative Post Audit Committee for this audit on February 25, 2004. The audit was requested by Senator Stan Clark.

#### **Department of Agriculture: Reviewing the Adequacy of Inspections of Grain Elevators**

The Department of Agriculture has a Grain Warehouse Inspection program which administers and enforces the Kansas Public Warehouse Law. It requires that any entity that stores grain for the public to be licensed. Facilities that are duly licensed under the Federal Warehouse Act, are not subject to the Kansas law.

The program is designed to ensure that Kansas grain producers have safe, solvent, warehouses where they may store their commodities. Licensed facilities are to be inspected at least once each year. According to the Department's website, the examinations are designed to eliminate fraud in the grain industry, ensure the quantity and quality of stored commodities in Kansas-licensed warehouses, and maintain the percentage of loss to producers at zero.

Recently, several grain elevator bankruptcies have occurred in Kansas in which grain producers have incurred losses. In one particular case, it is estimated that 450,000 to 475,000 bushels of the grain stored in the facility was "out-of-condition" which means its value is significantly diminished and it isn't suitable for either animal or human consumption.

These bankruptcies have raised questions in legislators' minds about whether the Grain Warehouse Inspection Program is doing all that needs to be done to ensure the quality of grain stored in licensed storage facilities. Those legislators also are interested in knowing how Kansas' bonding requirements for licensed warehouse facilities compare with other states' and federal requirements and whether they appear to be adequate to protect grain producers who have grain stored in facilities.

A performance audit of this topic would answer the following questions:

- 1. Does the Department of Agriculture have and follow appropriate inspection practices to ensure that both the quantity and quality of grain shown on records at grain elevators is accurate?** To answer this question, we would review the statutes relating to the Grain Warehouse Inspection Program. We would interview department inspection staff and review documents as needed to determine what they are supposed to look at in the course of an inspection to ensure both the quantity and quality of grain. We would compare those inspection practices to what is required by law, to the inspection practices of nearby states and the federal program, and to good inspection practices in general. We would select a sample of inspections to determine whether Department staff were doing the things their procedures call for. In addition, we would accompany inspectors on a sample of inspections to observe the process. Finally, we would determine whether program officials took appropriate steps to ensure that violations were appropriately dealt with.

2. **How does Kansas's program for inspecting and regulating grain elevators compare with other states' and federal programs, and has it been adequate to protect farmers who have grain stored in elevators?** To answer this question, we would review Kansas law related to inspections, bonding, or other security measures designed to protect those who store grain in grain elevators. We would contact officials in a sample of other grain-producing states to determine what their inspection, bonding or other requirements are, and how they compare with Kansas' requirements. We also would determine whether they license grain dealers, and who is required to have dealer's license. In addition, we would compare their staffing and funding resources to Kansas. As part of this review, we would determine what flexibility states have to focus inspection resources on elevators that are perceived to have problems. We also would look to see whether inspections in Kansas are prioritized to deal with elevators that have exhibited problems. Finally, we would review a sample of recent grain elevator bankruptcies to determine whether the bond was enough to cover the losses and if not, by how much it fell short. We would conduct additional work as needed.

**Estimated time to complete:** 10-12 weeks



## APPENDIX B

### Fee Increases for State-Licensed Warehouses

Effective January 1, 2004, the Department increased its licensing fees for most grain warehouses to the maximum allowed by State law. As noted on page 22, the Department estimated these changes would raise an additional \$46,000 in fiscal years 2004 and 2005, combined.

capacity in bushels	rate in FY03	rate after 1/1/04	% change	number of warehouses in 2003 potentially affected	maximum allowed by current law
1 to 100,000	\$400	\$400	no change	6	\$500
100,001 to 150,000	\$430	\$430	no change	6	\$525
150,001 to 250,000	\$460	\$460	no change	9	\$550
250,001 to 300,000	\$490	\$490	no change	1	\$600
300,001 to 350,000	\$520	\$520	no change	6	\$625
350,001 to 400,000	\$550	\$550	no change	5	\$650
400,001 to 450,000	\$575	\$575	no change	3	\$700
450,001 to 500,000	\$605	\$605	no change	6	\$725
500,001 to 600,000	\$630	\$630	no change	10	\$775
600,001 to 700,000	\$660	\$660	no change	2	\$800
700,001 to 800,000	\$690	\$850	23.2%	3	\$850
800,001 to 900,000	\$720	\$875	21.5%	4	\$875
900,001 to 1,000,000	\$750	\$900	20.0%	4	\$900
1,000,001 to 1,750,000	\$1,010	\$1,225	21.3%	34	\$1,225
1,750,001 to 2,500,000	\$1,150	\$1,400	21.7%	18	\$1,400
2,500,001 to 5,000,000	\$1,440	\$1,750	21.5%	39	\$1,750
5,000,001 to 7,500,000	\$1,725	\$2,100	21.7%	3	\$2,100
7,500,001 to 10,000,000	\$1,955	\$2,375	21.5%	2	\$2,375
10,000,001 to 12,500,000	\$2,130	\$2,600	22.1%	2	\$2,600
12,500,001 to 15,000,000	\$2,300	\$2,800	21.7%	2	\$2,800
15,000,001 to 17,500,000	\$2,475	\$3,000	21.2%	1	\$3,000
17,500,001 to 20,000,000	\$2,645	\$3,225	21.9%	1	\$3,225
fee for each additional 2,500,000 over 20,000,000	\$290	\$350	20.7%	1	\$350

Sources: K.S.A. 34-228, K.A.R. 4-25-16, Department licensing records

## APPENDIX C

### Comparisons Among States

During this audit, we contacted grain warehouse oversight officials from Kansas, Oklahoma, Nebraska, Iowa, and Illinois. The table below summarizes some of the basic statistics about grain warehouses and dealers and their regulation in those states.

	Kansas	Oklahoma	Nebraska	Iowa	Illinois
number of state-licensed grain warehouses <sup>(a)(d)</sup>	146	57	135	243	333
total warehouse capacity (millions of bushels)	340	79	446	442	1,155
number of state-licensed grain dealers <sup>(a)</sup>	n/a	n/a	150	477	387
number of examiners	7	4	4	16	27
total program staff	8	6	7	21	33
program budget, FY04	\$474,000	\$255,000	\$727,000 <sup>(b)</sup>	\$1,460,000 <sup>(b)</sup>	\$2,464,000 <sup>(b)</sup>
number of licensed warehouses per examiner <sup>(a)(c)(d)</sup>	21	14	34	15	12
warehouse capacity per examiner (in bushels) <sup>(c)</sup>	49 million	20 million	112 million	28 million	43 million
program budget per staff	\$59,000	\$43,000	\$104,000	\$70,000	\$75,000
Sources: grain warehouse oversight officials from the listed states					

<sup>(a)</sup> many grain warehouse licensees also are licensed grain dealers

<sup>(b)</sup> program budget includes expenses related to both grain warehouses and grain dealers

<sup>(c)</sup> examiners may spend time working with warehouses, dealers, or both

<sup>(d)</sup> one license can cover several warehouse facilities

## **APPENDIX D**

### **Agency Response**

On August 4, 2004 we provided copies of the draft audit report to the Kansas Department of Agriculture, and its response is included in this Appendix. The agency generally concurred with our recommendations. We made some minor corrections and clarifications to the draft audit report that didn't affect any of our findings or conclusions.

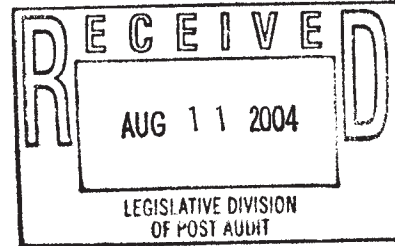
# KANSAS

DEPARTMENT OF AGRICULTURE  
ADRIAN J. POLANSKY, SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

August 11, 2004

Barbara J. Hinton  
Legislative Post Auditor  
800 SW Jackson  
Suite 1200  
Topeka, KS 66612-2212



Dear Ms. Hinton:

Thank you for the opportunity to respond to the Legislative Division of Post Audit's report reviewing the Kansas Department of Agriculture's Grain Warehouse Inspection program. The audit will provide valuable information about funding and other issues affecting the inspection program, Kansas farmers, and the grain warehouse industry in Kansas.

The warehouse inspection program was transferred to the Kansas Department of Agriculture in 1997 when the former Grain Warehouse Department was abolished, with responsibility for grain grading privatized and the warehouse audit program continued as a state program.

The warehouse program licenses the houses, ensures they meet financial, insurance and bonding requirements, and performs inspections to protect the depositors of grain in public warehouses.

Since the program was transferred to the Department of Agriculture, it has been drawing down reserve funds that were transferred with it. Our awareness that expenditures consistently are higher than revenues from fees has caused us to initiate discussions with program stakeholders, look at internal efficiencies, and seek other sources of revenue. In January 2004, program fees were increased to the maximum allowed under current law for all but the smaller grain elevators.

Many of the audit observations and recommendations will be helpful to us as we consider what needs to be done to make this an efficient, effective and solvent regulatory program. We appreciate the efforts of the professional auditors and their contributions to this effort.

A particular item of discussion during the audit was our agreement with LPA that there should be an effective way to monitor grain quality problems during the examination process at

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Legislative Post Auditor  
August 11, 2004  
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licensed facilities, and our disagreement with them about whether appropriate statutory language currently exists within the Grain Warehouse Act.

We believe the question of authority should be dealt with through a change to the statute that would provide the grain examiner with clear authority to obtain representative samples whenever suspicions of grain quality problems arise during an inspection and the authority to assess those samples. The statute then should provide clear authority for the secretary of agriculture to require the warehouse to have suspect grain thoroughly sampled and graded by the Kansas Grain Inspection Service, with results reported to the secretary. If the facility does not comply with the required sampling, the secretary would have authority to order it done at the facility's expense. This will be a legislative initiative and priority of the department in the 2005 session.

The audit has also made it clear to us that we need to continue to seek a cooperative and established working relationship with USDA inspectors, and to identify and monitor all federal CCC-owned grain in state facilities.

Responses to specific audit recommendations for the Department of Agriculture follow.

#### Recommendation 1

LPA recommended that the department develop a risk-assessment tool to identify those warehouses that may be at high risk of failure.

We agree that there may be mechanisms that can help provide a better early-warning system for warehouses that are experiencing difficulties. We will be working to develop these systems, but at the same time, do not want to increase financial demands on already-stressed businesses. We have contacted the Iowa Department of Agriculture for more information about a risk assessment model used in their state, and plan to use this or other methods to identify conditions that may require additional financial information or inspections.

#### Recommendation 2 and Recommendation 3

LPA recommended that communications between field examiners and program administrators be improved, and that all problems in the field be communicated in writing to the Topeka office, whether or not the examiner receives assurances from the warehouseman that they will be corrected. It recommended that oversight over field staff be increased.

The audit made it clear that program processes and communication can be improved. We have begun a thorough review of all forms used in the program to ensure that they collect only useful, unambiguous and quantifiable data that will benefit the examiner and program

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management. All examiners have been reminded to notify Topeka staff by telephone and electronically when questionable practices or problems are observed. We believe improved reporting and communications will provide for prompt response to potential enforcement situations, and help ensure equitable regulation and interpretation of the grain warehouse statute in warehouses across the state.

An updated procedures manual is undergoing review in the field at the current time. Our goal is to have the procedures manual and updated forms in use this fall.

The audit also contributed to our decision to restructure the management of the program. The goal of all these changes is effective, efficient and equitable regulation.

#### Recommendation 4

LPA recommended that we look at some method of rotating the examiners so they retain an independent attitude toward the warehouses they inspect.

Many aspects of the state's grain warehouse program are in flux at the current time. New federal regulations can either bring more warehouses into the program or make a state warehouse program unnecessary. The budget and the economy make it necessary to search for further efficiencies in this already tightly stretched program. We will consider some system of rotation as we review grain warehouse processes and consider reforming assignments and territories. We would note, however, that about a third of the inspections every year are performed by randomly assigned teams of inspectors. We believe the team approach assists with consistency and equitable regulation.

Again, we are grateful to the Legislative Post Auditors for their research and analysis. We look forward to working with the Kansas Legislature to clarify the statute to provide the best regulatory protections for the Kansas grain industry and clarify our authorities in the area of grain quality.

Sincerely,



Adrian J. Polansky  
Secretary of Agriculture

Attachment:  
Detailed comments, corrections and clarifications

## Detailed Comments/Corrections/Clarifications to Grain Warehouse Audit

- 1] Page 1, paragraph 2- It would be more accurate to state: three grain warehouse insolvencies or failures have occurred in Kansas since May 2002, and to either use the term failure or insolvency throughout the document.
- 2] Page 4, paragraph 3 Although not required, does federal law clearly authorize and establish the procedure for sampling and evaluating grain quality?
- 3] Page 7, paragraph 1 Technically only Marietta Grain declared bankruptcy (chapter 11) Miller Grain was a chapter 7, involuntary filed by creditors, and Brady Grain was a receivership. Bankruptcies are the jurisdiction of the federal bankruptcy court; receivership is a process of the state court that involves only the grain assets.
- 4] Page 7, paragraph 2 The two facilities referred to were not “failures;” in fact, they were successes for the program in the fact that the department was able to guide the facilities through the process of satisfying all of their obligations to their grain customers when the warehouse was on the brink of insolvency. No grain depositor lost money and neither the grain customer nor the elevator had to endure the costly and lengthy process of a receivership or a bankruptcy.
- 5] Page 7, paragraph 4, It should be clarified that the “others” are not within the statutory scheme of the warehouse act.
- 6] Page 8, paragraph 1, The only claim process related to the grain inventory of Brady Grain was conducted by the Norton County District Court via the receivership. USDA conducted KDA legal by telephone in May or June of 2004 and was so informed.
- 7] Page 8, paragraph 2 The USDA inspection of the Brady facility may have been precipitated by a call from the KDA program manager to USDA in the early spring of 2003 regarding suspected quality problems and the possibility of conducting joint examinations to utilize the USDA examiner’s ability to sample and evaluate quality. The KDA program manager does not recall that Brady grain was specifically mentioned or the exact date of the call.
- 8] Page 9, paragraph 1&2  
KDA is in absolute agreement that a meaningful and effective mechanism to monitor grain quality problems needs to be a part of the regulatory and examination process at the licensed facilities. We disagree that the statutory language to facilitate that is currently in the grain warehouse act. The “appropriate action” if a quality problem is suspected would be to determine if the suspicion of the examiner is based upon fact. To establish the facts related to the condition of the grain a sample or samples based on an established protocol would have to be obtained and evaluated in a manner that was a representative indication of the quality of the grain involved. Presently there is no authority or reference to examiners obtaining samples or making a quality assessment during the examination. KDA will propose a legislative change that would clearly provide the examiner with the authority to obtain representative samples in any case where his or her observations indicate a suspicion of a quality problem in grain contained in a licensed warehouse and to assess the samples obtained to determine if the suspicions are confirmed by the



samples obtained. In any instance where the examiner's assessment indicates quality problems, the Secretary would have the authority to require the warehouse to have any grain suspected of quality problems thoroughly sampled and graded by the Kansas Grain Inspection service with the results reported to the Secretary. If the facility fails to have the required sampling and grading performed, the Secretary would have the authority to arrange for it to be done at the expense of the facility. [In addition to the statutory change, additional training of examiners, sampling equipment and the development of sampling protocol would have to be developed.]

9] Page 12, paragraph 1 KSA 34-230 does provide the secretary the discretion afforded by the word "may" in issuance of the license. It is not accurate to state that meeting the minimum financial requirements obligates the secretary to issue a license. The statute also provides that a determination of a violation of the act is also a basis to deny a license.

The discretion afforded the secretary in the statute does not allow him or her to arbitrarily impose additional financial requirements or deny a license to a facility that meets the statutory minimum without having a credible and established basis to do so. If a license is denied to someone who satisfies the statutory requirements the burden would be on the Secretary to provide a credible basis for the denial that is uniformly applied to all applicants. Currently there is no such mechanism or system to provide that basis. The mechanism available to increase the bond at the secretary's discretion is utilized and was responsible for the elevated bond required of Miller Grain.

10] Page 13, paragraph 1, Page 13, paragraph 3, Page 17, paragraph 3  
There are recurring statements reflecting the issue of whether the current statutory language contains the authority and mechanism for KDA to quantify a quality problem accurately enough to establish a violation of the warehouse act. Another series of statements indicate the inability of the agency to take enforcement action because of grain quality or shortage problems. These statements are confusing because they treat two issues as though they are one .

There is no question that a warehouse license may be revoked or suspended by the secretary for a deficit in the commodities present. Due to the bailment nature of the warehouse operation the provisions of 34-2,104 provide for the mechanism that must accompany the termination of a license. When a warehouse is not authorized to operate the commodities, the control of the commodities must immediately be transferred to the custody of the secretary. The process of assuming physical control of the inventory and premises and ultimately liquidating the inventory is a very involved and costly process. We have the means to accurately determine deficits in quantity to provide the basis for the secretary to confidently determine a deficit and act accordingly. The significance of any of those actions requires a completely reliable level of proof that the deficit in the commodities is a fact. The impact of that action by the secretary involves a significant loss to the grain producers and the warehouse in addition in addition to the loss in commodity value or quantity that may have already taken place. The point is, that action of the secretary cannot be based on suspicion or a hunch that quality problems may exist that might involve sufficient value decreases to create a deficit in the value of the commodities present. Our present ability to make the quality assessment necessary is as undeveloped as our quantity assessment is reliably developed. There simply is no currently the means to make a

reliable assessment. If those tools were available, the department could apply the same enforcement to quality problems that it does to quantity problems.

11] Page 13, paragraph 1 The actual statement made by the department was “Without the clear authority for KDA examiners to obtain samples they could arguably be charged with theft if they leave the premises with a quantity of grain”. The statement, if included, should be included in its entirety.

12] Page 16, paragraph 1 The rotation of examiners is a concept that we will try to implement as much as travel and budget constraints allow. Of the 145 licensed facilities, 45 of those currently involve multi-examiner teams that are randomly assembled, which diminishes the concern of repetitive examinations by the same individuals.

13] Page 16, paragraph 2 Requiring the submission of financial information on an accelerated basis has not been previously utilized, but is a concept that will be considered under the appropriate circumstances. Accelerated examinations are the current response mechanism when problems are identified.

14] Page 16 paragraphs 4,5,6 Amending the warehouse act to include civil penalties would be supported by KDA.

15] Page 17 paragraph 5 See No. 8

16] Page 18 paragraph 3 Until presented with the unusual circumstances of the Brady Grain case, the lack of specific quality authority had not been a problem. The Brady receivership commenced in the fall of 2003 and the legislative session was nearly concluded before the extent of the problems at Brady were known.

17] Page 19 paragraph 7 See No. 8 and 16 The last sentence implies that KDA had the ability and had conducted quality assessment. It would be meaningful to include the frequency of USDA quality assessments. In the Brady profile, it would be important to note that the wheat in question had been apparently been mismanaged in storage for 10 years or longer due to CCC ownership?