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Report to the Chairman, Committee on Agriculture, House of Representatives

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AGRICULTURAL TRADE

Cooperator Conflict of Interest Regulation Needs Strengthening

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National Security and
International Affairs Division

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May 22, 1991

The Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives

Dear Mr. Chairman:

As you requested, we reviewed the U.S. Department of Agriculture's (USDA) conflict of interest regulation for the Cooperator Foreign Market Development Program. As we reported to you in October 1987,[1] USDA regulations and guidelines were needed to prohibit or preclude alleged activities of certain dairy livestock breeder organizations that operated private for-profit export subsidiaries while participating in government-funded market development activities abroad.

This report follows up on our 1987 study by reviewing whether USDA's September 1989 conflict of interest regulation and the restructuring of the Purebred Dairy Cattle Association's International Market Development Council (IMDC) (see app. I) have effectively addressed two concerns. These concerns are (1) individual livestock exporters' potential for involvement in conflict of interest situations and (2) these exporters' potential for promoting their self-interests and conducting private business while participating in approved program activities abroad.

Background

The USDA's Cooperator program aims to develop new markets and expand and maintain existing markets for U.S. agricultural commodities. The program is administered by USDA's Foreign Agricultural Service (FAS). Activities under the program usually fall into three categories: (1) consumer promotion, (2) technical assistance, and (3) trade servicing. These activities are developed and carried out by nonprofit agricultural organizations, known as Cooperators, who share with FAS in funding the programs.

In response to increased complaints from livestock exporters, concerns expressed by other Cooperators, and inquiries from Congress about conflict of interest problems, FAS reviewed its livestock Cooperator program. In August 1986 it reported to the House Committee on Agriculture that three dairy cattle breeder Cooperator organizations—the American

[1] International Trade: FAS Management of Livestock Cooperator Program (GAO/NSIAD-88-24, Oct. 26, 1987).

Jersey Cattle Club, the Brown Swiss Cattle Breeders Association, and the Holstein-Friesian Association of America—had the potential for involvement in conflicts of interest. They were participating in approved market development activities abroad that were funded by USDA, while at the same time maintaining for-profit export subsidiaries. FAS proposed drafting a conflict of interest provision to address this problem.

In April 1988 FAS issued its proposed conflict of interest regulation for public comment and finalized it on September 13, 1989. The regulation included a statement that if Cooperators failed to adhere to the regulation, FAS could remove them from the program. In December 1988 FAS also included this same statement when it issued the program guidelines.

On January 30, 1989, before the conflict of interest regulation was finalized, FAS expelled the American Jersey Cattle Club, the Brown Swiss Cattle Breeders Association, and the Holstein-Friesian Association of America from the Cooperator program. FAS determined that the three organizations had refused, as individual Cooperators, to comply with the conflict of interest provision of the program guidelines.

One month after the conflict of interest regulation was finalized in September 1989, IMDC was established to serve as the dairy livestock Cooperator in the Cooperator program. Its mission is to achieve maximum development of international markets for U.S. dairy genetics (dairy cattle, semen, and embryos). It has 10 members, including the 3 former dairy cattle organizations that had been expelled from the program. IMDC is staffed only by its Administrator and a secretary. Therefore, it differs from other Cooperators that have larger, more self-contained staff in that it relies on representatives of its member organizations to develop and implement its foreign market development activities.

Results in Brief

Actions taken by FAS to finalize its conflict of interest regulation and to provide guidance to Cooperators regarding the promotional and export activities of the Cooperators are positive steps toward limiting the potential of Cooperators' involvement in conflict of interest situations.

The regulation provides that program benefits be broadly distributed throughout the relevant agricultural sector and that no program participant derive an unfair advantage or benefit from program activities. Toward this end, the regulation prohibits participants, i.e., Cooperators, from (1) exporting the agricultural commodities that they promote with project funds and (2) using program activities to promote private self-interests or conduct private business. The regulation establishes sanctions if any provision of the regulation is violated. However, the regulation applies only to the Cooperators and not their members.

FAS decided not to apply the export prohibition to individual members of Cooperators because such an action could weaken the program. FAS determined that most members of Cooperator organizations that export would decide not to participate in the program. We found no reason to question FAS' decision.

In order to minimize the potential for conflict of interest, the second prohibition is especially important for Cooperators such as IMDC. Because IMDC relies on staff of its members to carry out its foreign market development activities, the potential for IMDC members to promote their self-interests while, in effect, acting as Cooperator staff, still exists.

IMDC has taken steps to deal with this problem by developing a procedure manual that places restrictions on the activities of its members' staff who conduct overseas market development activities on behalf of IMDC. However, the potential still exists for conflict of interest.

FAS needs to revise the regulations to specifically provide that any firm, organization, or individual involved in approved Cooperator program activities shall not improperly use the activities to promote private self-interests or conduct private business. In addition, the regulation should also be changed to hold all Cooperators responsible for ensuring that individual members comply with this second prohibition.

Applicability of the Conflict of Interest Regulation

USDA's conflict of interest regulation contains various requirements and restrictions regulating the conduct of firms and individuals that participate in its Cooperator program. The pertinent restriction states as follows:

> (1) Neither program participants nor their affiliated organizations shall, during the term of the agreement, make export sales of agricultural commodities of the kind which are promoted, in whole or in part, with project funds.

According to the terms of the above provision, the prohibition is directed to "participants and their affiliated organizations." The regulations define the term "participant" as any entity entering into a market development project agreement (i.e., a Cooperator).

The term "affiliated organization" is defined as "any partnership, association, company, corporation, trust, or other legal entity in which the program participant has any investment other than an investment in any mutual fund." Because a member of a Cooperator does not fall within either of the above definitions, in our opinion the prohibition does not specifically apply to the export-related activities of members. The FAS Administrator recently expressed similar views in responding to the same questions raised by a dairy cattle exporter. In a January 1990 letter, the FAS Administrator stated as follows:

> The fact that a Cooperator has members that are actively engaged in export sales does not, in itself, contravene our regulations. The regulation precludes participation only if the Cooperator has investment in the exporting entity. In this way we attempted to ensure that no exporting firm would be in a position to take unfair advantage of opportunities developed through the market development efforts of the Cooperator.
>
> In drafting [the conflict of interest regulations], the Department was not trying to prevent Cooperator organizations from accepting as members private firms or other organizations which are involved in export trade. To have done so would have resulted in excluding several broad-based Cooperator program participants which draw support, contributions, and board members both from farm groups and agribusiness corporations. The active and informed participation of private sector entities has been a source of strength and balance for the Department's market development programs.

We found no reason to question FAS' decision.

FAS and the Cooperators that we interviewed believe that applying the restriction to members of Cooperators would weaken the overall Cooperator program. We asked FAS to determine how many of its Cooperators had members that export. FAS responded that of the 65 participating Cooperators that it included in its study, 48 had member organizations that export their particular commodities and products.

Cooperators told us that the loss of important members because of their export activities would severely affect their programs. For example, the President of the Feed Grains Council stated that the loss of an important member would result in a significant decrease in program funding; a loss of expertise in developing market development programs; a loss of skilled staff able to demonstrate the uses of the U.S. products overseas; and a need for additional funding for the Cooperator to hire experienced staff to perform Cooperators' activities, such as conducting educational seminars overseas.

The other restriction in the conflict of interest regulation that forbids the promotion of private self-interests or the conducting of private business on program-sponsored activities also, by its terms, applies only to program "participants," i.e., Cooperators, and not to members of the Cooperator. This provision of the regulation is important for Cooperators who do not have staff of their own and rely on their members to staff Cooperator market development activities. This is the case in the dairy livestock sector because IMDC's members plan, approve, and carry out the Cooperator's market development activities abroad. Hence, the potential for individual members to conduct private business or promote self-interests while carrying out Cooperator-approved activities in other countries remains.

In April 1991 an FAS official informed us that, on the basis of discussions with us about a draft of this report, the conflict of interest regulation would be changed. The regulation would be revised to extend to members of Cooperators the restriction on conducting private business or promoting self-interests. This official also stated that FAS plans to replace the Cooperator program guidelines with regulations.

Dairy Cooperator Program Arrangements and Oversight

IMDC was approved as a Cooperator on October 10, 1989. It has a budget ceiling of $500,000 for fiscal year 1991—IMDC's administrative budget for 1991 is about $60,000. As the Cooperator for U.S. dairy genetics, IMDC is directly responsible to FAS for implementing the program's promotional activities in accordance with the program guidelines. In response to FAS directives that the conflict of interest regulation must be complied with, IMDC has published a procedure manual for its members about how to prepare and document the various program activities.

Briefly, the manual states that when FAS funds are used abroad, members must follow these requirements:

- All promotional material must be IMDC material, with IMDC listed as the primary contact for requests for information. To avoid any appearance of conflict of interest, the return address, telephone number, etc., of the member cannot be used.
- Sales inquiries may be responded to by individual members, but members must direct all inquiries to IMDC. IMDC will provide the requester with information and lists of all relevant U.S. organizations that export U.S. dairy genetics.

The manual does not state what would happen if members do not comply with these requirements. In discussing this matter with the IMDC Administrator in April 1991, he stated that he was redrafting IMDC's bylaws. He said that he planned to add language specifying penalties when members do not comply with IMDC procedures. The bylaws are subject to approval by IMDC's members.

In addition, we found that the regulation provides for sanctions for Cooperators who do not comply with the conflict of interest prohibitions. These include nonreimbursement for expenses and termination from the Cooperator program. However, the regulation does not specifically mention the application of sanctions in instances of noncompliance by members of Cooperators. Nor does the regulation specifically provide that Cooperators are to establish appropriate internal controls to further ensure that members comply with the conflict of interest prohibitions.

Recommendations

In discussing these issues with FAS officials, we indicated the need to strengthen the conflict of interest prohibition by specifying that no firm, organization, or individual shall derive an unfair advantage or benefit while carrying out approved program activities funded by the government. FAS officials informed us that FAS is planning to make such a change.

We recommend that the Secretary of Agriculture direct the FAS Administrator, as part of the plans to strengthen the conflict of interest prohibition, to specifically provide that any firm, organization, or individual involved in approved Cooperator Foreign Market Development Program activities shall not improperly use the activities to promote private self-interests or conduct private business.

In addition, to ensure that Cooperators effectively implement this conflict of interest regulation, (since the current regulation does not specifically address sanctions for noncompliance by members), we further recommend that the Secretary of Agriculture direct the FAS Administrator to require that the Cooperators establish (1) appropriate internal controls to ensure that members of Cooperators comply with the regulation and (2) procedures specifying sanctions when members do not comply. These sanctions should include withholding member reimbursement for expenses and declaring members ineligible for continued participation in the program.

Scope and Methodology

To evaluate the implementation and adequacy of the USDA's new conflict of interest regulation and the structure of the new dairy cattle industry Cooperator with respect to promotional and marketing interests, we met in Washington, D.C., with the Agriculture Department's FAS Assistant Administrator, Commodity and Marketing Programs; various directors and staff of the Commodity Divisions; the Compliance Division; the Marketing Operation's staff; and the Office of General Counsel. In the private sector, we spoke with the IMDC Administrator, officials of the various dairy cattle breeder organizations, various dairy cattle exporters, and a number of other Cooperators.

We performed our audit work in accordance with generally accepted government auditing standards. As requested, we did not obtain written agency comments. During the course of the review, however, we discussed the matters addressed in this report with federal agency and private livestock organizations and have incorporated their comments where appropriate.

We are sending copies of this report to the Secretary of Agriculture. Copies will also be made available to others on request.

Please contact me on (202) 275-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix II.

Sincerely yours,

Allan I. Mendelowitz

Allan I. Mendelowitz, Director
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Contents

Abbreviations

FAS	Foreign Agricultural Service
IMDC	International Market Development Council of the Purebred Dairy Cattle Association
PDCA	Purebred Dairy Cattle Association
USDA	U.S. Department of Agriculture

Establishment of the International Market Development Council - The Dairy Livestock Industry Cooperator

On April 11, 1989, The Purebred Dairy Cattle Association (PDCA) applied for Cooperator status under the Foreign Agricultural Service's (FAS) Cooperator Foreign Market Development Program. PDCA, established in 1940, is a national, nonprofit agricultural association that represents the U.S. purebred dairy cattle industry. It conducts activities to increase acceptance of purebred dairy cattle and enhance the profitability of dairy cattle owners through improved management and marketing. At its spring 1989 meeting, PDCA members saw the need for an organization that represented all elements of U.S. dairy genetics—cattle, semen, and embryos—as well as the exporters of these genetics to achieve maximum development of international markets for U.S. dairy genetics.

PDCA is comprised of the three dairy cattle breeder organizations that were formerly Cooperators (the Holstein-Friesian Association of America, the Brown Swiss Cattle Breeders Association, and the American Jersey Cattle Club), plus three other organizations: The American Guernsey Association, the American Milking Shorthorn Society, and the Ayrshire Breeders Association.

According to FAS, the International Market Development Council (IMDC) was formed in PDCA after FAS terminated Cooperator agreements with the three original dairy cattle breeder organizations in January 1989. IMDC was to carry out the market development activities previously performed by these organizations. To enhance IMDC's proposal to represent the interests of the entire purebred dairy industry, the following organizations were added to its membership: the American Embryo Transfer Association, the Livestock Exporters Association, the National Association of Animal Breeders, and the Wisconsin Department of Agriculture. With these additions, the entire U.S. dairy livestock industry was included in a single foreign market development effort for the first time.

IMDC has a part-time Administrator and a secretary. The IMDC Administrator serves as chairman of the 10-member council. In working out the Cooperator market development plan, IMDC's members prepare and submit proposed activities to IMDC's council. The council reviews and approves the activities and develops the final IMDC marketing plan for submission to FAS.

The annual IMDC budget is submitted to the members by the Administrator. This budget includes administrative, capital, and market development income and expenditures and is funded by FAS along with in-kind and cash contributions from the members on a percentage basis determined by the members.

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