

MINUTES OF THE SENATE COMMITTEE ON AGRICULTURE & SMALL BUSINESS

Held in Room OLD SUPREME COURT at the Statehouse at 10:15 a. m./~~1:15~~
on Wednesday, January 12, 1983, 19 .

All members were present except: Senator Dan Thiessen (Excused)

The next meeting of the Committee will be held at 10:00 a. m./~~1:00~~,
on Tuesday, January 18, 1983, 19 .

These minutes of the meeting held on Wednesday, January 12, 1983, 19 were
considered, corrected and approved.


Chairman 1/18/83

The conferees appearing before the Committee were:

Hal Johnson, auditor in charge of Post Audit report
of Kansas State Grain Inspection Dept.

Senator Fred Kerr called the meeting to order. Copies of the Audit Report of the Kansas State Grain Inspection Department by the Legislative Division of Post Audit had previously been distributed to committee members. (P.A. Report on file in their office and KSGID.) Senator Kerr called on Hal Johnson, the auditor in charge of this audit. Mr. Johnson read his remarks as contained in Attachment 1 to original minutes.

In answer to a question by Senator Warren, Mr. Johnson stated under the present law a warehouse is not required to send annual statements to grain depositors as to the amount deposited in the elevator, but mentioned there is a bill which has been introduced relative to this item.

Answering a question by Senator Gannon, Mr. Johnson stated a ticket is issued on inbound transactions and is considered by the Grain Inspection Division at the time of their inspection, but not an outbound ticket, but any disbursement is shown on the settlement sheet.

Answering Senator Kerr's question as to whether the Post Audit would do a follow-up on their report to see if progress had been made on suggestions made, Mr. Johnson stated they do not do any additional on site audit work, but once a year (around May) they request a statement from the audited agency.

Senator Kerr stated the committee would meet on Tuesday, January 18.

The meeting was adjourned.

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MR CHAIRMAN, MEMBERS OF THE COMMITTEE, MY NAME IS HAL JOHNSON, THE AUDITOR IN CHARGE OF THIS PERFORMANCE AUDIT.

GRAIN INSPECTION DEPARTMENT

BECAUSE OF CONCERN OVER THE DEPARTMENT'S PERFORMANCE IN PROTECTING THE FARMERS WHO STORE GRAIN IN PUBLIC WAREHOUSES, ON MAY 14, 1982 THE LEGISLATIVE POST AUDIT COMMITTEE DIRECTED THE LEGISLATIVE DIVISION OF POST AUDIT TO CONDUCT A PERFORMANCE AUDIT OF THE GRAIN INSPECTION DEPARTMENT'S WAREHOUSE DIVISION. WE RELEASED OUR REPORT ON NOVEMBER 22, 1982.

THE AUDIT ADDRESSED THREE MAIN QUESTIONS:

1. WHY HAVE GRAIN WAREHOUSES FAILED IN KANSAS IN RECENT YEARS?
2. ARE CURRENT STATE LAWS AND REGULATIONS ADEQUATE TO PREVENT FAILURES?
3. IS THE GRAIN INSPECTION DEPARTMENT ADMINISTERING CURRENT LAWS AND REGULATIONS ADEQUATELY?

THE AUDITORS REVIEWED THE FAILURES OF ALL 11 STATE-LICENSED GRAIN WAREHOUSES THAT HAVE GONE BANKRUPT SINCE 1967. IN ADDITION THEY ANALYZED THE GRAIN INSPECTIONS DEPARTMENT'S VARIOUS REGULATORY ACTIVITIES FOR A FIVE YEAR PERIOD FROM JULY 1977 TO JUNE 1982. THEIR TESTS AND ANALYSES INCLUDED SUCH ITEMS AS THE FOLLOWING:

..DETERMINING THE LEGISLATURE'S INTENT IN CREATING THE PROGRAM.

..REVIEWING THE DEPARTMENT'S REGULATORY PROCEDURES TO DETERMINE WHETHER THEY ARE BEING ADHERED TO.

..DETERMINING WHETHER THE DEPARTMENT'S REGULATORY ACTIVITIES ARE ADEQUATE TO PROTECT THE PUBLIC.

..COMPARING REGULATORY ACTIVITY IN KANSAS WITH THAT OF OTHER STATES AND WITH FEDERAL REGULATION.

..COMPARING THE MAGNITUDE OF GRAIN ELEVATOR PROBLEMS OR FAILURES IN KANSAS WITH THAT OF OTHER STATES.

TO CONDUCT THE AUDIT, THE AUDITORS REVIEWED KANSAS STATUTES AND ADMINISTRATIVE REGULATIONS, MAJOR NATIONAL STUDIES ALREADY CONDUCTED, AND LAWS AND REGULATIONS OF OTHER STATES AND THE FEDERAL GOVERNMENT. THEY EXAMINED DEPARTMENT RECORDS, EXAMINATION REPORTS, AND RECORDS DOCUMENTING WAREHOUSE BANKRUPTCIES. THEY CONDUCTED MANY INTERVIEWS AND ACCOMPANIED DEPARTMENT EMPLOYEES ON EXAMINATIONS OF GRAIN WAREHOUSES.

GRAIN
SINCE 1967 THERE HAVE BEEN 11 INSTANCES IN WHICH STATE LICENSED WAREHOUSES FAILED IN KANSAS. IN REVIEWING RECORDS AT THE GRAIN INSPECTION TO TRY TO DETERMINE WHY THESE WAREHOUSES FAILED, SEVERAL ADVERSE CONDITIONS WERE PRESENT. THEY WERE:

1. FINANCIAL STATEMENTS WERE POOR OR HAD NOT BEEN SUFFICIENTLY CHECKED BY DEPARTMENT PERSONNEL TO SPOT APPARENT FINANCIAL PROBLEMS.
2. WAREHOUSES HAD A HISTORY OF NOT HAVING ENOUGH GRAIN ON HAND TO COVER OBLIGATIONS TO FARMERS WHO HAD STORED GRAIN THERE.
3. WAREHOUSES DID NOT HAVE SUFFICIENT MONEY IN NET CURRENT ASSETS TO MEET MINIMUM REQUIREMENTS.
4. WAREHOUSES HAD PROBLEMS OBTAINING OR RENEWING BONDS.

Alch. 1

I WILL NOW IDENTIFY THOSE AREAS IN WHICH WE FEEL THERE ARE WEAKNESSES AND THEN I WILL COVER OUR RECOMMENDATIONS AND THE AGENCY'S RESPONSE.

IN THE LICENSING OF GRAIN WAREHOUSES THE AUDITORS FOUND THAT THE DEPARTMENT WAS MEETING THE REQUIREMENTS OF LAW. HOWEVER, THE DEPARTMENT'S PROCEDURES ARE NOT THOROUGH ENOUGH TO EFFECTIVELY IDENTIFY WAREHOUSES WITH POTENTIAL PROBLEMS. THE WEAKNESSES ARE AS FOLLOWS:

... ..FINANCIAL INFORMATION SUBMITTED WITH MANY LICENSE APPLICATIONS IS NOT ADEQUATE ENOUGH TO ALLOW A THOROUGH REVIEW.

.....THE DEPARTMENT DOES NOT MAKE FULL USE OF EVEN THE LIMITED INFORMATION IT RECEIVES TO EVALUATE THE FINANCIAL CONDITION OF WAREHOUSES.

.....TO CONDUCT MORE THOROUGH FINANCIAL REVIEWS OF WAREHOUSES, THE DEPARTMENT'S STAFF NEEDS TO BE BETTER TRAINED, AND ITS WORK NEEDS MORE THOROUGH REVIEW.

THE AUDITORS ALSO ANALYZED SEVERAL OPTIONS THAT COULD INCREASE THE AMOUNT OF FINANCIAL PROTECTION FOR FARMERS. ONE WOULD REQUIRE A MINIMUM NET WORTH REQUIREMENT FOR WAREHOUSES WHILE THE OTHER WOULD PROVIDE ADDITIONAL FINANCIAL PROTECTION AT RELATIVELY LITTLE COST IF BONDING REQUIREMENTS WERE INCREASED.

IN ENFORCING THE LAW THE DEPARTMENT IS CHARGED WITH EXAMINING WAREHOUSES PERIODICALLY AND THEN FOLLOWING UP TO MAKE SURE PROBLEMS ARE CORRECTED.

STATE LAW REQUIRES ONE INSPECTION A YEAR FOR EACH WAREHOUSE; ON THE AVERAGE, THE DEPARTMENT VISITS WAREHOUSES TWICE A YEAR. SEVERAL PROCEDURES DURING EXAMINATIONS, HOWEVER, CAN BE IMPROVED. THESE IMPROVEMENTS RELATE TO FURTHER REVIEW OF CERTAIN KINDS OF RECORDS AND FORMS--DAILY POSITION RECORDS, SCALE TICKETS, AND SETTLEMENT SHEETS.

THE DEPARTMENT'S ENFORCEMENT ACTIVITIES HAVE SEVERAL MAJOR WEAKNESSES:

.....THE DEPARTMENT DOES NOT RESPOND TO THE DISCOVERY OF SERIOUS PROBLEMS WITH THE INTENSITY THAT SOMETIMES APPEARS TO BE NECESSARY.

.....THE DEPARTMENT'S FOLLOWUP PROCEDURE IS INADEQUATE.

... ..MANY ENFORCEMENT TOOLS ARE SELDOM USED, DESPITE STRONG INDICATIONS THAT THEY SHOULD BE.

THE PROBLEM IS NOT THAT THE DEPARTMENT HAS INSUFFICIENT POWER OR AUTHORITY; THE DEPARTMENT SIMPLY DOES NOT USE THE RANGE OF POWERS AVAILABLE TO IT.

THE REPORT MADE RECOMMENDATIONS IN FOUR MAIN AREAS. *THE*
FIRST AREA OF RECOMMENDATIONS CONCERNED IMPROVING THE LICENSING PRO-
CEDURES:

.....THE DEPARTMENT SHOULD SEEK A CHANGE IN KANSAS ADMINISTRATIVE REGU LA-
TIONS TO REQUIRE FINAN CIAL STATEMENTS BE PREPARED IN ACCORDANCE WITH
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. A CHANGE SHOULD ALSO BE SOUGHT
TO REQUIRE THAT THE FINANCIAL STATEMENTS BE ACCOMPANIED BY AN AUDIT OR
REVIEW REPORT PREPARED BY AN INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT OR
INDEPENDENT PUBLIC ACCOUNTANT. THIS REPORT SHOULD BE PREPARED IN ACC-
ORDANCE WITH STANDARDS OF THE ACCOUNTING PROFESSION. A FINAL CHANGE TO
THE REGULATIONS SHOULD REQUIRE THAT LICENSE APPLICATIONS BE SUBMITTED WITHIN
90 DAYS OF THE END OF THE WAREHOUSE'S FISCAL YEAR..... THE DEPARTMENT
AGREED WITH THE RECOMMENDATION CONCERNING THE USE OF GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES IN THE PREPARATION OF FINANCIAL STATEMENTS AND ALSO
AGREED WITH THE SUBMISSION OF AN AUDIT OR REVIEW REPORT BUT WOULD ALSO
LIKE TO MAKE A COMPILATION REPORT ACCEPTABLE. THE DEPARTMENT DISAGREED
WITH THE RECOMMENDATION CONCERNING THE REQUIREMENT THAT THE LICENSE
APPLICATIONS BE SUBMITTED WITH 90 DAYS OF THE THE CLOSE OF THE FISCAL
YEAR. THEY APPARENTLY FELT THAT THIS WOULD BUNCH A LARGE AMOUNT OF
LICENSES AT THE BEGINNING OF THE YEAR.....

... THE AUDIT ALSO RECOMMENDED THAT TO ENSURE THAT THE FINANCIAL
INFORMATION SUBMITTED TO THE DEPARTMENT IS ANALYZED ADEQUATELY, THE
DEPARTMENT SHOULD DEVELOP SPECIFIC TEST AND ANALYSES TO BE CONDUCTED.
ADDITIONALLY THE DEPARTMENT SHOULD DEVELOP A PLAN FOR ENSURING THAT THE
STAFF HAS THE NECESSARY EXPERTISE TO ANALYZE THE INFORMATION AND THAT
THE ANALYSIS BE ADEQUATELY REVIEWED.....THE DEPARTMENT AGREED
WITH THE USE OF RATIOS AND ANALYSIS AND IS WORKING ON A DRAFT TO BE
USED...THEY ALSO INDICATED THEY WOULD CONSIDER DEVELOPING A PLAN
TO INSURE THE NEEDED EXPERTISE TO ANALYZE THE STATEMENTS BY THEIR STAFF.
A LAST RECOMMENDATION IN THE LICENSING AREA CONCERNED THE REVIEW OF
ADEQUACY OF INSURANCE COVERAGE IN SPECIFIED CASES PRIOR TO THE ISSUANCE
OF THE LICENSE, THE DEPARTMENT DISAGREED ~~STATING~~ THAT THEIR CURRENT
PROCEDURES WERE ADEQUATE.

THE SECOND AREA OF RECOMMENDATIONS WERE AIMED AT IMPROVING FINANCIAL
PROTECTION FOR GRAIN PRODUCERS....THE AUDIT RECOMMENDED THAT THE
DEPARTMENT SEEK A CHANGE IN THE KANSAS ADMINISTRATIVE REGULATIONS TO
REQUIRE A WAREHOUSE TO HAVE A MINIMUM NET WORTH....THE DEPARTMENT
AGREED WITH THIS RECOMMENDATION. THE REPORT ALSO RECOMMENDS THAT
THE LEGISLATURE SHOULD CONSIDER RAISING BOND REQUIREMENTS FOR GRAIN
ELEVATORS....THE DEPARTMENT DID NOT AGREE WITH THIS RECOMMENDATION
STATING THAT IT THOUGHT THERE WOULD BE A MASS EXPDUS FROM STATE
LICENSING TO FEDERAL LICENSING.

THE THIRD AREA OF RECOMMENDATIONS CONCERNED IMPROVEMENTS IN THE DEPARTMENT'S EXAMINATION PROCEDURES. THE AUDIT RECOMMENDS THAT THE DEPARTMENT DO MORE DETAILED CHECKING OF RECORDS AT THE WAREHOUSE. SPECIFIC AREAS MENTIONED WERE TESTING THE MATHEMATICAL ACCURACY OF INDIVIDUAL SETTLEMENT SHEETS; TRACING SELECTED SCALE TICKETS TO THE DAILY POSITION RECORDS AND TESTING THE NUMERICAL ACCOUNTING OF SCALE TICKETS; TESTING THE ACCURACY OF THE DAILY POSITION RECORDS AND TRACING TRANSACTIONS POSTED IN THE DAILY POSITION RECORDS TO SUPPORTING DOCUMENTS.; TESTING OUT BOUND AS WELL AS IN BOUND SCALE TICKETS; AND INCREASING THE NUMBER OF SCALE TICKETS AND SUMMARY SHEETS TESTED AT LARGER WAREHOUSES. THE DEPARTMENT BASICALLY AGREED WITH THE MAJORITY OF THESE RECOMMENDATIONS BUT DID POINT OUT THE ADDED TIME REQUIRED TO DO THIS MORE DETAILED CHECKING. THE DEPARTMENT DID NOT AGREE WITH THE NEED FOR CHECKING OUT BOUND SCALE TICKET STATING THAT IT WAS THE INBOUND TICKET THAT ESTABLISHED THE LIABILITY.

THE FOURTH AND FINAL AREA OF RECOMMENDATIONS ADDRESSED IMPROVEMENTS IN THE DEPARTMENT'S ENFORCEMENT ACTIVITIES. THE REPORT RECOMMENDS THE FOLLOWING CHANGES:

.....THE DEPARTMENT SHOULD BEGIN REQUIRING EXAMINERS TO DOCUMENT ON EXAMINATION FORMS ANY APPARENT VIOLATIONS ~~OF~~ THE PUBLIC WAREHOUSE LAW AND ANY FACTORS LEADING UP TO THOSE APPARENT VIOLATIONS. THE DEPARTMENT DISAGREED STATING THAT IT WAS NOT IN A POSITION TO MAKE LEGAL DECISIONS.

.....THE REPORT ALSO ADVOCATES MORE DOCUMENTATION BY EXAMINERS ON THEIR FOLLOW UP TO PRIOR DEFICIENCIES NOTED DURING EXAMINATIONS. THE DEPARTMENT SAID IT WOULD CONSIDER MORE DETAIL BUT DID NOT ELABORATE ANY FURTHER.

.....SPECIAL FOLLOW UP EXAMINATIONS WERE RECOMMENDED IF EXAMINATION REPORTS NOTED SEVERE OR RECURRING PROBLEMS. THE DEPARTMENT RESPONSE INDICATED THAT IT FELT IT WAS ALREADY DOING THIS.

.....THE REPORT ALSO CALLED FOR THE TAKING OF STRONGER ACTIONS, INCLUDING SUSPENSIONS, REVOCATIONS OF LICENSES; SPECIAL EXAMINATIONS; AND ASSESSMENT OF FINES AND PENALTIES. THE DEPARTMENT STATES IT IS ALREADY TAKING SUCH ACTIONS AS FINES AND PENALTIES BUT COULD NOT PRODUCE ANY DOCUMENTATION TO SUPPORT THIS CLAIM.

.....TO HELP ENSURE THAT EXAMINATIONS ARE COMPLETE, THOROUGH,

AND CONSISTENT, IT IS RECOMMENDED THAT THE DEPARTMENT BEGIN REVIEWING COMPLETED EXAMINATIONS MORE ~~THOROUGHLY~~ EXTENSIVELY AND SHOULD BEGIN ON SITE EVALUATIONS OF EXAMINERS. THE DEPARTMENT RESPONDED THAT IT WOULD CONSIDER MORE EXTENSIVE REVIEWS AND WOULD BEGIN EVALUATING EXAMINERS ON SITE.

.....THE FINAL RECOMMENDATION TO THE LEGISLATURE IS THAT TO ENSURE THAT ADEQUATE DETERRENENTS EXIST AGAINST MAINTAINING FALSE OR DUPLICATE RECORDS, THE LEGISLATURE SHOULD CONSIDER AMENDING THE WAREHOUSE ACT TO MAKE COMMITTING SUCH ACTS A FELONY AND TO PROVIDE APPROPRIATE PENALTIES. THE DEPARTMENT SUPPORTED THIS RECOMMENDATION.

IN SEVERAL INSTANCES, THE DEPARTMENT HAS SAID IT DISAGREES WITH THE AUDIT RECOMMENDATIONS OR CANNOT PUT THEM INTO EFFECT. ALTHOUGH THE DEPARTMENT AGREES WITH OTHER RECOMMENDATIONS, LEGISLATIVE POST AUDIT DOES NOT THINK THAT THE DEPARTMENT'S RESPONSE IS VERY PERSUASIVE IN DEMONSTRATING THAT IT PLANS TO DO VERY MUCH ABOUT SEVERAL OF THEM...

SEVERAL RECOMMENDATIONS ARE ADDRESSED DIRECTLY TO THE LEGISLATURE. ONE CALLS FOR CONSIDERATION OF A STATUTORY CHANGE TO MAKE IT A FELONY FOR A WAREHOUSEMAN TO MAINTAIN A SET OF FALSE OR DUPLICATE RECORDS. ANOTHER CALLS FOR CONSIDERATION OF STATUTORY CHANGE TO INCREASE THE BOND REQUIREMENTS FOR WAREHOUSES. OTHER RECOMMENDATIONS CALL FOR CHANGES IN KANSAS ADMINISTRATIVE REGULATIONS. THESE CHANGES CAN BE STARTED BY THE GRAIN INSPECTION DEPARTMENT BUT WILL ULTIMATELY REQUIRE REVIEW AND APPROVAL BY THE LEGISLATURE AS WELL.....

THIS CONCLUDES MY PRESENTATION I WILL BE HAPPY TO TRY AND ANSWER ANY QUESTIONS YOU MAY HAVE ON THIS AUDIT.