

**TENNESSEE COMMODITY PRODUCER INDEMNITY BOARD**  
**TENNESSEE GRAIN INDEMNITY FUND**  
**AUGUST 1996**

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August 1, 1996

The Honorable John S. Wilder  
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Speaker of the House of Representatives  
The Honorable Joe Haynes, Chair  
Senate Committee on Government Operations  
The Honorable Mike Kernell, Chair  
House Committee on Government Operations  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Commodity Producer Indemnity Board and the Tennessee Grain Indemnity Fund. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the fund and the board should be continued, abolished, or restructured.

Very truly yours,

W. R. Snodgrass  
Comptroller of the Treasury

WRS/tp  
96-028

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit  
**Tennessee Commodity Producer Indemnity Board**  
**Tennessee Grain Indemnity Fund**  
August 1996

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## AUDIT OBJECTIVES

Grain producers of the state were authorized by Chapter 232 of the 1989 Public Acts to levy an assessment on themselves and establish a fund to protect grain producers in the event of the financial failure of a commodity dealer or warehouseman. The Tennessee Commodity Producer Indemnity Corporation was created after a statewide referendum of producers, and assessments began in September 1990. The fund's balance in March 1996 was \$2.5 million.

The objectives of the audit were to review the legislative mandate of the board and the Department of Agriculture concerning the indemnity fund, evaluate the extent to which the board and department have fulfilled their mandated responsibilities efficiently and effectively and complied with applicable laws and regulations, and make recommendations that might result in more efficient and more effective operation of the board and the fund.

## FINDINGS

### **Indemnity Fund Unsuccessful in Recovering Funds for Claims Paid**

The indemnity fund has paid 71 claims for a total of \$442,230 but has recovered only \$60,000 (for one surety bond) of that amount. Bond amounts may be too low; producer claims from each of the three failed warehouses exceeded the \$100,000 maximum bond authorized by department rule, which is inconsistent with the statutory maximum of \$500,000. In addition, the fund has the position of unsecured creditor and, as a result, has been unable to recover any money in the bankruptcy proceedings of the three failed warehouses (page 5).

### **Administrative Costs Not Charged to the Fund\***

The Department of Agriculture has absorbed the costs of administering the indemnity fund, although statute allows these costs to be charged to the fund. Administrative costs directly related to the fund include the auditing of dealers' financial records and the receipt, recording,

\* This issue was also discussed in the 1991 Sunrise review of the fund and board.

and refund of assessments. Because the fund was established to benefit grain producers, it seems reasonable that the fund should cover not only the claims but also the cost of administration (page 8).

### **Inefficient Process for Refunding Assessments**

Although grain producers who receive a refund forfeit the protection of the fund for any future sales, they must request a refund of assessments after each grain sale. Review of a sample of monthly refund reports showed that many refunds were small (some less than \$10) and that some producers received several refunds in a month. This process is inconvenient for the producers and generates significant paperwork for department staff; a less frequent refund schedule could improve efficiency (page 9).

### **No Written Procedures for Fund Operations**

The board has not adopted bylaws or procedures to govern the operations of the board and the fund and has not met in more than two years. In addition, the Commissioner of Agriculture has not promulgated rules or formalized procedures for administering the fund. Draft procedures were discussed after a Department of Finance and Administration review in 1991 but have not been finalized. The board did not meet in 1992, 1994, or 1995, although statute requires all nonprofit corporations to meet at least once a year (page 11).

## **ISSUES FOR LEGISLATIVE CONSIDERATION**

The General Assembly may wish to consider amending *Tennessee Code Annotated* to create a statutory lien for the indemnity fund in bankruptcy proceedings, allow less frequent refunds of assessments, provide a process for producers to terminate the fund if they wish, and require the board to meet at least annually (page 14).

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"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit  
1500 James K. Polk Building, Nashville, TN 37243-0264  
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PERFORMANCE AUDIT  
TENNESSEE COMMODITY PRODUCER INDEMNITY BOARD  
TENNESSEE GRAIN INDEMNITY FUND

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PERFORMANCE AUDIT  
TENNESSEE COMMODITY PRODUCER INDEMNITY BOARD  
TENNESSEE GRAIN INDEMNITY FUND

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INTRODUCTION

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**PURPOSE AND AUTHORITY FOR THE AUDIT**

This performance audit of the Tennessee Commodity Producer Indemnity Board and the Tennessee Grain Indemnity Fund, which the board administers, was conducted pursuant to the Tennessee Government Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-218, the board is scheduled to terminate June 30, 1997. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the board and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the board and the fund should be abolished, continued, or restructured.

**OBJECTIVES OF THE AUDIT**

The objectives of the audit were

1. to determine the authority and responsibility mandated to the board and the Department of Agriculture;
2. to evaluate the extent to which these responsibilities have been performed; and
3. to develop recommendations, as needed, for administrative or legislative action which might result in more efficient and/or more effective operation of the board and the fund.

**SCOPE AND METHODOLOGY OF THE AUDIT**

The operations and activities of the Tennessee Commodity Producer Indemnity Board and the Tennessee Grain Indemnity Fund were reviewed for the year ended June 30, 1995, and updated to May 1996. The audit was conducted in accordance with generally accepted government auditing standards and included

- review of applicable legislation and rules and regulations;
- interviews with members of the board, staff of the Department of Agriculture, and staff of the Office of the Attorney General; and

- examination of board meeting minutes and an analysis of assessments, refunds, and claim payouts.

## **ORGANIZATION AND RESPONSIBILITIES**

The Tennessee Grain Indemnity Fund was authorized by Chapter 232 of the Public Acts of 1989, codified as Section 43-32-101 et seq., *Tennessee Code Annotated*, “to promote the state’s welfare by improving the economic stability of agriculture.” Producers of grain were permitted to levy an assessment upon themselves and establish a fund to protect grain producers in the event of the financial failure of a commodity dealer or warehouseman. [*Grain* is defined in Section 43-32-102(11) as corn, wheat, oats, rye, soybeans, rape seed, canola and grain sorghums.] Before an assessment could be levied, it had to be approved by a majority vote of grain producers on a statewide referendum under procedures outlined in Section 43-32-203. The Tennessee Commodity Producer Indemnity Corporation was created upon passage of this referendum in July 1990. Assessments began September 15, 1990.

The governing powers of the indemnity corporation are vested in the board of directors composed of the Commissioner of Agriculture, who serves as the president; the chief fiscal officer of the Department of Agriculture, who serves as the secretary; the Commissioner of Commerce and Insurance; the State Treasurer or the Treasurer’s designee; and the Comptroller of the Treasury or the Comptroller’s designee. Under Section 43-32-204, the board has the authority to

- adopt, alter, and repeal bylaws for regulation and conduct of its affairs and business;
- receive assessments collected by the Department of Agriculture;
- administer the indemnity fund by investing the funds not needed for its corporate purposes; and
- make payment from the indemnity fund to the department when payment is needed to compensate claimants.

Under Section 43-32-212, the Department of Agriculture performs the following tasks for the Tennessee Grain Indemnity Fund:

- Collects and deposits all fees and assessments into the indemnity fund for investment by the corporation.
- Transfers moneys from the department to the indemnity fund for investment.
- Assigns all rights, title, and interest in any judgment from the claimant to the department.
- Initiates any action necessary to compel the commodity dealer or warehouseman whose financial failure led to a claim to repay the indemnity fund.

- Initiates any action necessary to compel the claimant, whose claim arose because of a failure, to participate in any legal proceeding in relation to the claim.

## **PROCESS, REVENUES, AND EXPENDITURES**

### Assessments

After the assessment was approved by the referendum in July 1990, the Commissioner of Agriculture notified persons engaged in the business of purchasing commodities from producers to deduct the assessment (one cent per bushel on soybeans and one-half cent per bushel on all other grain) before paying the producer. On or before the 20th day of the month following the purchase, the purchaser is to remit the assessments to the department along with a report of the amount of grain purchased from Tennessee producers and participating out-of-state producers during the previous month.

All assessments collected by the department are to be held in trust in the indemnity fund under the control of the corporation. The corporation may invest the funds and deposit the resulting interest into the fund. The fund is to be used for the payment of claims and administration of the fund. Section 43-32-207 authorizes the Commissioner of Agriculture to suspend assessments temporarily when the fund reaches \$3 million and to reinstate assessments when the fund balance falls below \$3 million.

### Refunds and Reinstatement

Under Section 43-32-206, any producer against whom the assessment is levied and collected can receive a refund of the assessments from the Tennessee Grain Indemnity Fund. The request must be filed within 90 days of the date the assessment was deducted from sale proceeds. By receiving the refund, the producer forfeits any protection or compensation from the fund in the future. Such producers may be reinstated to the program by repaying all previously refunded assessments plus interest, with the approval of the board.

### Claims and Payments

Section 43-32-211, *Tennessee Code Annotated*, requires the Commissioner of Agriculture, when he has determined that a commodity dealer or warehouseman has failed or defaulted on payment, to

- present claims to the board for validation and determination of the amount of the claims to be paid to claimants for financial losses incurred because of the failure of the commodity dealer or warehouseman;
- request transfer of money from the indemnity fund for payment of valid claims;

- hold in trust any assets of a failed commodity dealer or warehouseman for repayment of the indemnity fund money used to pay claimants; and
- pay valid claims based on a pro rata share of available funds, if the indemnity fund is insufficient to pay all valid claims.

The department is required by Section 43-32-210 to provide compensation within 90 days of an approved claim. A participating grain producer who has incurred a financial loss because a commodity dealer did not pay for the purchase of grain is to be compensated for 85 percent of a valid claim, up to \$100,000, with money from the indemnity fund. The remaining balance of such a claim is to be paid by the department from the assets and other security of the failed dealer, to the extent funds are available. A participating claimant who has incurred a financial loss because of a warehouseman's failure and who still owns the grain, as evidenced by a warehouse receipt, will be compensated for 100 percent of a valid claim.

If the indemnity fund is insufficient to pay approved claims, the corporation's board is authorized by Section 43-32-209 to borrow up to \$1.5 million from the state's revenue fluctuation reserve to satisfy the unpaid claims. The approval of the Commissioner of Finance and Administration and the appropriate standing committees of the General Assembly is required for the loan. When the fund has been replenished by assessments on the appropriate commodity, the board must reimburse the state with interest. If, in the opinion of the Commissioner of Agriculture, current assessments are insufficient to repay the funds borrowed from the revenue fluctuation reserve, the commissioner may institute a supplementary assessment, which shall stay in effect until the funds are repaid. The board requested permission to borrow \$65,000 from the state's revenue fluctuation reserve fund in 1991, but the request was denied.

### Fund Balance

Assessments collected from September 15, 1990, through March 31, 1996, totaled \$2,887,303; refunds totaled \$190,567. Additional sources of revenue included \$226,716 interest and \$60,000 bond proceeds. The board had paid 71 claims totaling \$442,230, arising from the failure of three commodity dealers or warehouses, as of March 31, 1996, and the fund balance was \$2,541,222.

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## FINDINGS AND RECOMMENDATIONS

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### INDEMNITY FUND WAS UNSUCCESSFUL IN RECOVERING FUNDS FOR CLAIMS PAID

1. FINDING:

The Tennessee Grain Indemnity Fund has paid 71 claims for a total of \$442,230 but has recovered only \$60,000 (for one surety bond) of that amount. Under Section 43-32-212, *Tennessee Code Annotated*, the Department of Agriculture has the duty to “initiate any action it may deem necessary to compel the commodity dealer or warehouseman against whom an awarded claim arose to repay the Tennessee Grain In-demnity Fund.” To repay the fund, the Commissioner of Agriculture can require the commodity dealer or warehouseman who has defaulted on payment for grain to surrender the surety bond required by Section 43-32-106 and can file a claim against the assets of a dealer or warehouseman in bankruptcy. These methods for recovery have had only limited success for several reasons.

#### Inadequate Surety Bonds

Bond amounts may be too low. As of March 31, 1996, claims resulting from the financial failure of three dealers or warehouses had been paid from the indemnity fund. These claims totaled \$183,203 (Lexington Feed and Grain), \$156,972 (Merchants Grains), and \$102,055 (Delap Brothers). The producers’ losses resulting from each bankruptcy exceeded the department’s maximum surety requirement of \$100,000. Only Delap Brothers had a bond posted with the department; its \$60,000 proceeds were deposited to the fund but did not cover the claims resulting from Delap’s failure. Section 43-32-106 states, “The surety bond should provide a reasonable level of protection for those persons storing commodities in the warehouse or selling commodities to a dealer in the event of bankruptcy, fraud, or other occurrence which would deprive the person storing or selling commodities from recovering its value.”

According to department staff, Merchants and Lexington, which failed in 1991, did not have bonds on file with the department. Department staff said that Lexington was operating without the license and bond required by state law and that Merchants held a federal license. Warehouses licensed under the United States Warehouse Act (Title 7, Chapter 10, *U.S. Code*) post a bond with the U.S. Secretary of Agriculture, who sets the amount of bond and distributes bond proceeds in case of default. Although Tennessee producers might have had claims paid from federal bond proceeds, the fund would not have received any of the proceeds. The Tennessee Department of Agriculture also has no jurisdiction over the amount of bonds for federally licensed warehouses. Under Section 43-32-103, a federally licensed commodity warehouse that meets the minimum requirements of the federal act is deemed to be in compliance with state requirements.

Section 43-32-106 requires every person licensed as a commodity dealer or warehouseman by the state of Tennessee to have a surety bond in an amount set by the Commissioner of Agriculture between \$20,000 and \$500,000. Rules promulgated by the Department of Agriculture (Rules 0080-5-13-.04 and 0080-5-14-.02) specify that the principal amount of the surety bond will be based on the aggregate amount the dealer paid to grain producers during the last fiscal year and the capacity of the warehouses. Grain dealers and warehousemen may satisfy the bond requirement by filing with the department a certificate of deposit payable to the Commissioner of Agriculture as trustee or an irrevocable letter of credit from a bank.

Consistent with Section 43-32-106, the department's rules allow the Commissioner of Agriculture to waive all but the minimum bond for any commodity dealer or warehouseman who documents satisfactory financial ability and resources. The rules are also consistent with the statute by requiring a minimum surety of \$20,000, but the rules differ from the statute by setting the maximum surety at \$100,000 instead of \$500,000.

Department staff said the bond amounts are reviewed each year when dealers and warehousemen apply for license renewal. The department does not maintain a list of grain dealers and warehousemen, bonds required, and bonds on file; that information can be obtained only by reviewing approximately 200 individual files. Department staff provided a list of grain dealers and warehousemen and their bonds on file with the department, but one could not determine from the list whether the businesses had obtained bonds in the proper amounts. According to staff, the list included (but did not distinguish) warehouses with federal licenses not required to post a bond with the department and multiple locations of businesses bonded under one license. Apparently, bond amounts were not listed for businesses that had obtained a letter of credit or certificate of deposit instead of a surety bond. To properly monitor the bond amounts, the department needs information readily available that would allow staff to compare the amount of surety obtained with the amount required. In addition, the principal amount of equivalent instruments should be listed; Rule 0080-5-13-.04 treats the letter of credit and certificate of deposit like bonds and requires them to be in the same amount that would be required for a bond.

### Unsecured Position in Bankruptcy Court

The indemnity fund's interest in a bankruptcy proceeding is created when the board pays claims to producers and requires them to sign a subrogation agreement. The agreement gives the board the right to pursue recovery in a bankruptcy proceeding in an amount and manner equal to those the producer could have pursued. However, the fund inherits the position of an unsecured creditor, placing it near the bottom of the list for recovery. As a result, the fund has been unable to recover any money in the bankruptcy proceedings of the three failed warehouses.

Section 43-32-211 authorizes the Commissioner of Agriculture to hold the assets of a failed commodity dealer or warehouseman for the purpose of reimbursing the Tennessee Grain Indemnity Fund for payments to claimants, but this authority would be

difficult to exercise. The commissioner may be reluctant to exercise this control over assets until the business' financial condition has worsened, and the commissioner does not have authority to control those assets once the dealer or warehouseman files for bankruptcy.

Legal staff of the department, working with the board, have discussed with a representative of the Attorney General's Office the issue of improving the fund's position in a bankruptcy claim, but staff have been uncertain about what action to take. The board could seek a statutory amendment to create a statutory lien for the fund and to specify when that lien would take effect. For instance, the lien could take effect when the dealer's payment for grain was due and not paid or it could take effect when the fund reimbursed a producer for money not paid by a dealer.

Without a statutory lien, the board may not be able to recover funds from bankrupt dealers or warehouses. By granting the lien, the state would be giving one business (grain producers) an advantage over other businesses in recovering losses in certain situations. However, Section 43-32-202 indicates that creating the Tennessee Grain Indemnity Fund was for the state's welfare ("to improve the economic stability of agriculture") as well as the benefit of grain producers. Granting a statutory lien to the fund would give the fund secured creditor status, putting it ahead of producers who do not participate in the fund and are unsecured creditors. On the other hand, a lien might be granted to all grain producers, both participants and nonparticipants in the fund; the fund would then inherit this secured position.

#### RECOMMENDATION:

Department management should review the criteria (in department rules) for computing the principal amounts of surety bonds (and equivalent instruments) and the manner in which the criteria are applied and decide whether current bond levels are adequate. A supervisor should review a sample of bond amounts to ensure that staff required, and the dealer and warehouseman filed, the proper principal amount. In addition, the department should revise its rules to raise the maximum amount of surety to \$500,000 to be consistent with Section 43-32-106, *Tennessee Code Annotated*.

Department staff should develop a data system capable of providing ready access to information related to the licensure of grain dealers and warehousemen, including the principal amount of bonds required and the amount and type of surety on file with the department. The data system could be maintained on a personal computer to facilitate access and updating.

The board should consider, in consultation with the Office of the Attorney General, if and how statutes could be amended to improve the fund's position in bankruptcy proceedings and propose legislation as needed. The General Assembly may wish to consider the statutory amendments proposed by the board to improve the fund's position in bankruptcy proceedings.

MANAGEMENT'S COMMENT:

We concur. Concerning surety bonds, an internal review of all TDA's statutes and rules is underway. We will recommend changes to make code and rules consistent. Surety bond amounts are reviewed for adequacy at the time of license renewals. Criteria to review principal amounts of surety bonds and the manner in which criteria are applied are adequate. The problem lies in the inconsistency between the statute and the 1993 amended rule.

The grain warehouse staff will work with department systems personnel to create a personal computer-maintained data base to provide needed information about the licensure status, surety requirements, etc., of grain dealers and warehousemen.

We will submit a proposal to the board to address TDA's creditor position in bankruptcy proceedings.

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ADMINISTRATIVE COSTS ARE NOT CHARGED TO THE FUND

2. FINDING:

The Department of Agriculture has been absorbing the costs of administering the indemnity fund, although Section 43-32-208, *Tennessee Code Annotated*, allows these costs to be charged to the fund. Because the fund was established to benefit grain producers, it seems reasonable that the fund should cover not only the claims but also the cost of administration. Administrative tasks directly related to the fund include the auditing of dealers' financial records necessary under Section 43-32-206 and the receipt, recording, and refund of assessments. Since the department does not allocate the administrative cost, the exact burden on the department and state appropriations was not determined.

The need to charge administrative costs to the fund was first cited by the Division of State Audit in its 1991 Sunrise review of the fund. The department has been reluctant to charge administrative costs to the fund until the fund reached its target balance of \$3 million, set by Section 43-32-207. Staff said a proposal to begin charging administrative fees to the fund will be presented to the board at its next meeting because the fund is expected to reach \$3 million around December 1996.

RECOMMENDATION:

The Department of Agriculture should begin recording and charging to the Tennessee Grain Indemnity Fund the costs of administering the fund. These costs should be charged to the fund regardless of whether the fund reaches the \$3 million balance.

MANAGEMENT'S COMMENT:

We concur. The budget for fiscal year 1996-97 reflects administrative charges to the fund.

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REFUNDING ASSESSMENTS AFTER EACH GRAIN SALE IS INEFFICIENT

3. FINDING:

Tennessee grain producers who choose not to participate in the Tennessee Grain Indemnity Fund are not exempt from assessments. Instead, although grain producers who receive a refund forfeit the protection of the fund for any future sales, they must request a refund of assessments after each grain sale. This process of charging and re-funding assessments after each transaction, set up under Section 43-32-206, *Tennessee Code Annotated*, is inconvenient for the producer and generates significant paperwork for department staff. Review of a sample of monthly refund reports showed that many refunds were small and some were less than \$10. For example, in March 1995, there were 60 refunds totaling \$8,577; in April 1995, there were 24 refunds totaling \$2,160. In addition, some producers received several refunds in a month.

Under Section 43-32-207, the corporation may enter into a reciprocal agreement with a contiguous state having a similar program, affording out-of-state grain producers the same protection as in-state producers. However, out-of-state producers can be exempted from assessments, and forego protection, if they do not wish to participate. To be exempted, the out-of-state producer completes an exemption form provided by the Tennessee Department of Agriculture and gives a copy of this form to the commodity dealer, so an assessment will not be deducted from the purchase proceeds.

Department staff said that they were reluctant to adopt such an exemption process for in-state producers, although the program is voluntary, because more producers might drop out of the fund. Also, according to staff, allowing such exemptions could decrease the money flowing into the fund because some producers do not bother to request a refund even though they once received a refund and are not protected by the fund. If more producers drop out of the fund, the fund's ability to achieve its purpose of promoting the economic stability of agriculture could be weakened.

To improve the efficiency of the refund process, the board could consider paying refunds only once or twice a year, to coincide with the harvest-sales cycle. Staff said most assessments are submitted and refunds are paid from October through January because they follow the sales after harvest. On a semiannual schedule, refunds might be paid in February for assessments received August through January and in August for assessments received February through July. If paid only once a year, refunds could be paid in

February, so most assessments of nonparticipating producers would be paid soon after the harvest-sales season. Allowing dealers to remit assessments and producers to request refunds on a semiannual or annual schedule (synchronized with the refund pay-ment cycle) could also be considered.

The department adopted, in October 1995, a policy requiring out-of-state producers to establish the producer's intent by declaring, when the grain is delivered to the dealer or warehouse, whether that grain will be exempt from assessments. Staff said that this was done to keep the out-of-state producer from enjoying the protection of the fund during storage and sale of the grain and then requesting a refund of assessments when the protection was no longer needed. That same concern would also seem to apply to in-state producers because the assessments are paid when the sales transaction is completed. Early declaration of intent could be especially important if requests for refunds are not made after each sale because the fund could be at risk for all the producer's grain sales in the season, not just the sale for which the producer requested re-fund of assessments.

Staff estimated that 5 to 10 percent of Tennessee producers have received refunds and, therefore, are not protected by the fund. The exact percent was not readily available because the department does not know the number of grain producers in the state. However, in order to estimate the extent to which grain storage and sales are protected by the fund, one could compare the amount of refunds to the amount of assessments in a sales period. For example, in November 1995, when the highest monthly assessments and refunds of that year were recorded, the \$5,637 refunds paid represented 5 percent of the \$116,192 assessments collected. Although some assessments on unprotected grain sales may have been left in the fund, one could conclude that approximately 95 percent of the grain sales were protected by the fund.

#### RECOMMENDATION:

The department should develop, and the board should consider adopting, a schedule for paying refunds once or twice a year at the end of the harvest-sales seasons, not after each transaction, to make the refund process more efficient. The department or board should then propose this change as a statutory amendment. If such policy and statute are changed, producers should be required to declare when the grain is delivered to the dealer or warehouse if the grain is not to be protected by the fund.

Alternatively, the board could consider providing an exemption from assessments for in-state producers who choose to withdraw from the coverage provided by the fund, perhaps through procedures modeled after those for exempting out-of-state producers.

The General Assembly may wish to consider statutory amendments as proposed by the board relating to the time for remittance of assessments and the request for and payment of refunds.

To evaluate the fund as a control to limit producers' losses, the board should require staff to periodically compute and report a seasonal or annual estimate of grain sales

protected by the fund and to compile these estimates for trend analysis. The estimate could be based on the percentage of assessments refunded for a season or year.

MANAGEMENT'S COMMENT:

We concur in part. A refund schedule will be proposed to the board. The department feels that (1) a monthly refund schedule, with special consideration given to large amounts (i.e., in excess of \$500), would be more feasible than a semiannual or annual refund schedule and (2) assessments should continue to be remitted on a monthly basis.

The department will submit to the board a proposal to allow in-state producers storing grain to declare their intent to participate in the fund. The board will instruct the grain warehouse staff to provide a semiannual report reflecting the estimated amount and value of grain stored and subject to protection under the fund.

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NO PROCEDURES HAVE BEEN ADOPTED FOR OPERATION OF THE FUND

4. FINDING:

As of May 1996, the board had not adopted bylaws or procedures to govern the operations of the board and fund, as authorized by Section 43-32-204, *Tennessee Code Annotated*, and had not met in more than two years. Also, the Commissioner of Agriculture had not promulgated rules or formalized procedures for administering the fund, as authorized by Section 43-32-213. A June 1991 review of the fund (performed by Department of Finance and Administration staff and transmitted by the Commissioner of Finance and Administration to the Commissioner of Agriculture) noted that no policies, procedures, or bylaws had been established for the fund, and stated:

Prudent business practices dictate that [policies, procedures, and bylaws] are in place prior to disbursement of funds to claimants and prior to other actions of the board. The statutes are not specific enough to direct when assessments should be raised, when to request funds from the reserve fund, or when to draw from the assets of the failed dealer.

Board members expressed similar concerns in a June 1991 memorandum and listed several issues to be addressed, including the priorities to be established when funds are insufficient to pay all claims and the need for a risk assessment to determine the annual assessment amounts necessary to ensure the fund is not completely depleted.

The Commissioner of Agriculture reported to the board in an April 1992 memorandum that department staff were reviewing draft procedures and would propose procedures to the board in the near future. In May 1996, department staff reported that draft procedures would be presented to the board at its next meeting.

One of the reasons for the lack of necessary procedures may be the relative inactivity of the board. Minutes documented three meetings in 1991, and an agenda for a September 1993 meeting was found. There was no documentation that a meeting was held in 1992, 1994, or 1995. Therefore, the board has not complied with Section 48-57-101, *Tennessee Code Annotated*, which requires all nonprofit corporations to meet at least once a year.

Although state law details the process for establishing the grain producer assessments and indemnity fund, the law does not indicate how the assessments and fund might be discontinued (except through the Sunset review process), and does not address the disposition of assets or payment of debts if the fund ceased. Providing in statute an opportunity for producers to petition the Commissioner of Agriculture for a referendum to discontinue the assessments and terminate the fund would seem to be reasonable and in keeping with the voluntary nature of the fund. Statute could also provide for the board to develop an orderly process for settling debts and disposing of assets within a year after a decision to terminate.

#### RECOMMENDATION:

The Commissioner of Agriculture should ensure that department staff develop and present to the board procedures for the operation of the Tennessee Grain Indemnity Fund. The board should review, revise as necessary, and adopt policies and procedures to guide board and fund operations. If delayed in finalizing procedures, the board should consider setting priorities for addressing issues that might arise during the upcoming harvest seasons.

The board may wish to propose, and the General Assembly may wish to adopt, an amendment to the board's authorizing statute to require an annual meeting. The board should also ensure that annual reporting and other duties required of nonprofit corporations are accomplished.

The board may wish to propose, and the General Assembly may wish to adopt, a statutory amendment to provide for a process by which producers could decide by referendum to discontinue the assessments. Statutes could also provide a wind-down period and require the board to develop and implement an orderly process for settling the fund's debts and disposing of the fund's assets, upon a decision for termination.

#### MANAGEMENT'S COMMENT:

We concur. Proposed rules for the board have been drafted, but not finalized. A tentative September meeting of the board is scheduled to address the items in this recommendation.

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## RECOMMENDATIONS

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### LEGISLATIVE

1. The General Assembly may wish to consider statutory amendments proposed by the board to create a statutory lien to improve the fund's position in bankruptcy proceedings.
2. The General Assembly may wish to consider statutory amendments proposed by the board relating to the time for remittance of assessments and the request for and payment of refunds.
3. The General Assembly may wish to consider amending the board's authorizing statute to require the board to meet at least once a year.
4. The General Assembly may wish to consider statutory amendments proposed by the board to prescribe a process whereby producers could decide to discontinue the assessments and the indemnity fund. Statutes could also provide a wind-down period and require the board to develop and implement an orderly process for settling the fund's debts and disposing of the fund's assets, upon a decision for termination.

### ADMINISTRATIVE

1. Department management should review the criteria (in department rules) for computing the principal amounts of surety bonds (and equivalent instruments) and the manner in which the criteria are applied and decide whether current bond levels are adequate. A supervisor should review a sample of bond amounts to ensure that staff required, and the dealer and warehouseman filed, the proper principal amount.
2. The department should revise its rules to raise the maximum amount of surety to \$500,000 to be consistent with Section 43-32-106, *Tennessee Code Annotated*.
3. Department staff should develop a data system capable of providing ready access to information related to the licensure of grain dealers and warehousemen, including the principal amount of bonds required and the amount and type of surety on file with the department. The data system could be maintained on a personal computer to facilitate access and updating.
4. The board should consider, in consultation with the Office of the Attorney General, if and how statutes could be amended to improve the fund's position in bankruptcy proceedings and propose legislation as needed.

5. The Department of Agriculture should begin recording and charging to the Tennessee Grain Indemnity Fund the costs of administering the fund. These costs should be charged to the fund regardless of whether the fund reaches the \$3 million balance.
6. The department should develop, and the board should consider adopting, a schedule for paying refunds once or twice a year at the end of the harvest-sales seasons, not after each transaction, to make the refund process more efficient and should propose the change as a statutory amendment. Alternatively, the board could consider providing an exemption from assessments for in-state producers who choose to withdraw from the coverage provided by the fund, perhaps through procedures modeled after those for exempting out-of-state producers.
7. If policy and statute are changed to allow dealers to remit assessments and producers to request refunds less frequently, producers should be required to declare when the grain is delivered to the dealer or warehouse if the grain is not to be protected by the fund.
8. To evaluate the fund as a control to limit producers' losses, the board should require staff to periodically compute and report a seasonal or annual estimate of grain sales protected by the fund and to compile these estimates for trend analysis. The estimate could be based on the percentage of assessments refunded for a season or year.
9. The Commissioner of Agriculture should ensure that department staff develop and present to the board procedures for the operation of the Tennessee Grain Indemnity Fund. The board should review, revise as necessary, and adopt policies and procedures to guide board and fund operations. If delayed in finalizing procedures, the board should consider setting priorities for addressing issues that might arise during the upcoming harvest seasons.
10. The board may wish to propose an amendment to the board's authorizing statute to require an annual meeting. The board should also ensure that annual reporting and other duties required of nonprofit corporations are accomplished.
11. The board may wish to propose a statutory amendment to prescribe a process whereby producers could decide to discontinue the assessments. Statutes could also provide a wind-down period and require the board to develop and implement an orderly process for settling the fund's debts and disposing of the fund's assets, upon a decision for termination.