

**AGRICULTURAL MARKETING SERVICE
CONTROLS OVER PORK CHECKOFF FUNDS
WASHINGTON, D.C.
EVALUATION REPORT NO. 01801-1-KC**

MARCH 1999

**UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL - AUDIT
GREAT PLAINS REGION
P. O. BOX 293
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UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington D.C. 20250



DATE: March 31, 1999

REPLY TO
ATTN OF: 01801-1-KC

SUBJECT: Controls Over Pork Checkoff Funds

TO: Enrique Figueroa
Administrator
Agricultural Marketing Service

ATTN: David Lewis
Director
Compliance Staff

This report presents the results of our evaluation of the National Pork Board's (Board) controls over pork checkoff funds. Although our evaluation did not disclose material misuse of checkoff funds, it showed the Board needs to improve accountability for the funds and regain control over the National Pork Producers Association's (NPPC) influence on the Board's business. We identified significant weaknesses in the Board's management controls over checkoff funded NPPC subcontracts and cost accounting practices. We also found that the Board did not perform effective compliance testing at checkoff fund collection sites or during State association reviews. In addition, the Board did not ensure that pork producers are afforded a complete and equal access to national pork delegate elections.

Your March 9, 1999, written comments on the draft report are included as exhibit C, with excerpts and the Office of Inspector General's (OIG) position incorporated into relevant sections of the report. Your response provided sufficient information to reach a management decision on all findings and recommendations of the evaluation. Please follow your internal agency procedures and provide final action documentation to the Office of the Chief Financial Officer.

We appreciated the courtesies and cooperation extended to us by members of your staff, the National Pork Board, and the National Pork Producers Council.

JAMES R. EBBITT
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

CONTROLS OVER PORK CHECKOFF FUNDS AUDIT NO. 01801-0001-KC

PURPOSE

This evaluation was scheduled as part of the Office of Inspector General's annual plan and requested by Agricultural Marketing Service (AMS) officials. Our overall objective was to determine if the National Pork Board (Board) and AMS applied effective controls to ensure pork checkoff funds were collected, distributed, and expended in accordance with the Pork Promotion, Research and Consumer Information Act of 1985 (Act).

The Board was established by the Act to promote the pork industry through research and advertising. The Board is empowered to finance its activities by collecting assessments, called "checkoff funds," from all pork producers, based on the volume of their production. In 1997, the Board collected \$60 million in checkoff funds.

RESULTS IN BRIEF

Our evaluation showed that the Board basically used checkoff funds to finance pork promotion, research, and consumer education projects which generally benefited the pork industry, including small and disadvantaged producers. Our evaluation did not disclose material misuse or loss of checkoff funds, but it did find the Board has relinquished too much authority to its primary contractor, the National Pork Producers Council (NPPC), and has placed the NPPC in a position to exert undue influence over Board budgets and grant proposals. The Board has awarded all program grants to the NPPC since 1996.

The Board itself has not hired sufficient staff to administer and provide adequate oversight of the checkoff program. The Board employs only two persons (an Executive Vice President and an assistant), to oversee \$60 million in annual checkoff collections, distribution, and use. The Board's degree of dependence on the NPPC to administer subcontracts and carry out much of the Board's work resulted in a weakened accountability over contributed funds.

- Projects were begun without contracts or without appropriate signatures on contracts. NPPC agreed to ignore USDA contract requirements for veterans preferences, etc., when vendors objected to them.
- The Board did not require NPPC to implement accounting and management information systems to track and report on the checkoff funds expended for each project and subcontract.
- The Board was not involved in NPPC activities for subcontractor selections, setting contract terms, and accepting deliverables.
- The NPPC did not develop adequate written policies and procedures for administering checkoff-funded projects and subcontracts.

The absence of appropriate oversight by the Board resulted in subcontractors working without contracts, a \$900,000 unsecured prepayment to a subcontractor, varying and subjective rates for common contracting costs, nondisclosure of potential conflicts of interest, and noncompliance with USDA and NPPC's own requirements.

We also established that the Board's lack of oversight also had a negative impact on assuring accountability of funds for other activities. We found that neither the Board nor AMS tested NPPC's fixed cost allocations to determine if the allocations were fairly applied to checkoff activities. The Board also did not effectively test compliance at checkoff collection sites or at State pork associations. State associations receive and expend about \$10.5 million in national checkoff funds each year.

In addition, the Board did not provide State pork associations sufficient guidance on their national election practices. State associations restricted producer access to Board national delegate elections. As a result, the elections in some States were vulnerable to manipulation because all producers were not provided equal opportunity to participate.

KEY RECOMMENDATIONS

We recommended AMS work with the Board and its delegates to develop a plan to accomplish appropriate separation from the NPPC and assure accountability for checkoff expenditures. The plan should provide for sufficient staff to oversee key operational responsibilities for the Board. We also recommended actions for the Board to more effectively oversee their primary contractor's subcontracting practices and procedures; more closely monitor and test State association checkoff expenditures and collections and transfer of checkoff funds from collection sites; and improve access to Board delegate elections for all pork producers.

AGENCY POSITION

We discussed our draft findings, conclusions, and recommendations with responsible AMS officials on January 20, 1999. The officials generally concurred with our findings and recommendations.

However, preliminary discussions of our results with representatives of the Board and NPPC indicated that officials of both organizations disagreed with our conclusions concerning the working relationship of the Board and the NPPC, as well as certain NPPC subcontracting and accounting activities (see exhibit B for the Board's written comments on our preliminary results). The Board's Executive Vice President and NPPC's Chief Executive Officer stated their mutual belief that the NPPC's close working relationship with the Board has not weakened the contract relationship between the two entities and that the partnership has served the industry well by conserving personnel and overhead costs.

On March 9, 1999, AMS officials provided written comments on our draft report. The comments showed the officials generally concurred with our findings and accepted our recommendations. The comments also provided sufficient information about the agency's planned corrective actions to achieve a management decision on all findings and recommendations of the evaluation (see written comments attached as exhibit C). We incorporated relevant excerpts of the comments into the applicable sections of the report.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
<hr/>	
INTRODUCTION	1
BACKGROUND	1
OBJECTIVES	2
SCOPE	2
METHODOLOGY	2
<hr/>	
FINDINGS AND RECOMMENDATIONS	4
I. ACCOUNTABILITY OF CHECKOFF FUNDS SHOULD BE IMPROVED	4
BOARD'S DELEGATION OF AUTHORITY WEAKENED ITS CONTROLS AND ACCOUNTABILITY	4
Recommendation No. 1a	8
Recommendation No. 1b	9
SUBCONTRACTING PRACTICES NEED IMPROVEMENT	9
Recommendation No. 2a	15
Recommendation No. 2b	16
Recommendation No. 2c	16
COST ACCOUNTING REQUIREMENTS NEED STRENGTHENING	17
Recommendation No. 3a	19
Recommendation No. 3b	19

TABLE OF CONTENTS

REVIEWS OF STATE ASSOCIATIONS DID NOT TEST FOR COMPLIANCE	20
Recommendation No. 4a	21
COLLECTION SITE REVIEWS NEED BETTER CONTROLS	22
Recommendation No. 5a	23
II. NATIONAL PORK ELECTIONS SHOULD BE MORE INCLUSIVE	24
RESTRICTED VOTING OPPORTUNITIES INHIBIT PARTICIPATION	24
Recommendation No. 6a	25
Recommendation No. 6b	26

EXHIBITS

A - PROJECT ACCOUNT CLASSIFICATIONS	27
B - NATIONAL PORK BOARD COMMENTS ON OUR PRELIMINARY FINDINGS	30
C - AMS RESPONSE TO THE DRAFT REPORT	32

INTRODUCTION

BACKGROUND

In answer to increasing quantities of low-cost imports of foreign produced pork and pork products, Congress enacted the Pork Promotion, Research and Consumer Information Act of 1985 (Act). The purpose of the Act was to provide an orderly procedure for financing and carrying out an effective and coordinated program of promotion, research, and consumer information to strengthen the position of the pork industry in the marketplace and to maintain, develop, and expand markets for pork and pork products.

The Act established a 15-member National Pork Board (Board) to implement the Act, with oversight by the Secretary of the U.S. Department of Agriculture (USDA). The Agricultural Marketing Service (AMS), a USDA agency, fulfills the Department's oversight responsibilities through its Livestock and Seed Division. The Board employs two full-time employees to administer the collection, distribution, and use of the checkoff funds.

The Board began operating in 1986. Board members are nominated by pork producers (through the Pork Act Delegate Body) and shall consist of producers representing at least 12 States and importers appointed by the Secretary. Members may serve up to two consecutive 3-year terms and are not compensated for their service.

The Act also established an assessment to finance the Board's promotion, research, and consumer information activities. The assessments, commonly referred to as "checkoff," are collected from all importers and pork producers based upon the value of their imports and/or production. The assessments began in 1986 and have grown in value in recent years. The current assessment rate is .0045, or 45 cents per \$100 of the market price. Assessments totaled about \$41 million in 1995, but a recent increase in the rate raised about \$58 million in 1996 and \$60 million in 1997. The Board's 1998 budget provided for about \$56 million in revenues.

The Act acknowledged an existing nonprofit organization, the National Pork Producers Council (NPPC), as a venue for facilitating implementation of the Act. Thus, Congress authorized temporary disbursement of checkoff funds directly to the NPPC in 1986. Within a short time, the NPPC became the Board's primary contractor for implementing the Act. The Board presently contracts the NPPC to provide working space; routine personnel, administrative, and accounting services; and the technical and professional applications necessary to implement requirements of the Act. The NPPC employed 98 employees at the time of our evaluation, to take care of NPPC

business, to provide services to the Board, and to administer projects for the Board's eight industry program areas. The areas include (1) Consumer Advertising, (2) Retail Merchandising, (3) Pork Information, (4) Foodservice Promotion, (5) Foreign Market Development/World Trade, (6) Production Technology and Information, (7) New Products Development, and (8) Swine Health/Pork Quality/Pork Safety.

At the time of our evaluation, the pork industry, including the Board and the NPPC, was involved in public discussion on the state of the pork industry, including the impact of large, commercial hog confinement operations on small farmers and the environment. A number of pork producers and civil activist groups were also in the process of gathering signatures for a referendum on pork checkoff assessments and related issues. Our evaluation was planned and conducted to facilitate USDA's oversight responsibilities and was not performed to hinder or promote any opinions expressed in these public discussions or related proposals for a referendum.

OBJECTIVES

The objective of our evaluation was to determine if the Board and AMS applied effective control systems to ensure that pork checkoff funds are collected, distributed, and expended in accordance with applicable laws and regulations.

SCOPE

We performed our fieldwork at AMS offices in Washington, D.C., and at the co-located offices of the Board and the NPPC in Clive, Iowa. Our evaluation generally covered the Board and the NPPC expenditures and operations funded with checkoff dollars during 1997 and 1998, but included components of 1996 activities when warranted.

Specific matters reviewed included checkoff funded operations of the Board and the NPPC; controls over checkoff collections; distribution of checkoff funds to State associations; checkoff funded agreements, contracts, and subcontracts; Board and/or NPPC committees; oversight and compliance activities; and delegate body elections. We relied on audits conducted by an international certified public accounting firm on the Board's and the NPPC's financial statements for issues concerning financial operations.

Our evaluation was conducted in accordance with the Quality Standards for Inspections of the President's Council on Integrity and Efficiency.

METHODOLOGY

To accomplish our objectives, we performed a survey to identify issues and areas vulnerable to noncompliance with the Act. Based on the results of the survey, we developed and performed tests of program records, contracts, and subcontracts, as well as

financial and election documentation. We interviewed and obtained regulatory information from responsible AMS program officials. We also obtained the officials' comments and concerns on the administration of the Act.

Our evaluation included interviews with the Board's Executive Vice President; the NPPC's Chief Executive Officer (CEO) and other NPPC officials, staff, and subcontractors; and the certified public accountant engaged by the Board and the NPPC to perform periodic financial statement audits.

We visited the Iowa Pork Producers Association and reviewed the objectives of the association's 1997 checkoff funded projects. We also interviewed officials at five State pork producer associations to obtain information about their nomination practices and procedures, voting participation levels and accessibility for eligible producers. The five associations were judgmentally selected based on the amount of checkoff receipts distributed to each State in 1997.

We interviewed 36 producers to verify collection information and obtain their comments about the pork checkoff program. We also interviewed representatives and members of three civil activist groups which publicly voiced concerns about pork checkoff issues.

We reviewed the agreements between the Board and the NPPC, as well as subcontracts awarded by the NPPC for pork checkoff funded projects and activities. We could not establish the total number or dollar value of all subcontracts active during the period of our evaluation (see Finding Nos. 2 and 3). We judgmentally selected three vendors with 1997 NPPC subcontracts for detailed review, one of which did not have an active contract at the time of our review. The review included evaluation of the documentation and other support for all related checkoff disbursements, as well as tests to determine the adequacy of controls in place to prevent and detect waste, loss, and misuse of checkoff funds. All three vendors were selected primarily because NPPC documents indicated funds disbursed to the vendors exceeded the contracted amounts. Two of the vendors were also selected because the contracted deliverables included personal or consulting services. The third was selected because the vendor received over \$1 million under the contract. We also reviewed the files of 51 subcontracts with budgets that exceeded \$25,000 and were active during 1998.

FINDINGS AND RECOMMENDATIONS

I. ACCOUNTABILITY OF CHECKOFF FUNDS SHOULD BE IMPROVED

The Board has not assured an appropriate level of accountability for pork checkoff funds. Although we found no evidence that the Board or the primary contractor misused checkoff funds, we believe the Board should retain more direct control over program operations and funds in order to comply with the Act. Several factors weakened the Board's control over its operations and funds, including:

- * A scarcity of Board staff to administer the program and to oversee operations delegated to the Board's primary contractor;
- * the relationship between the Board and its primary contractor, including annual contract and service agreement renewals;
- * the primary contractor's inappropriate contracting and cost accounting practices; and
- * ineffective compliance reviews at collection sites and for State associations' use of checkoff funds.

BOARD'S DELEGATION OF AUTHORITY WEAKENED ITS CONTROLS AND ACCOUNTABILITY

FINDING NO. 1

level of NPPC influence that is unnecessary and inappropriate. We believe through the Board's reliance on the NPPC, the Board has relinquished the responsibilities and authorities it was given under the Act.

The Conference Report for "The Food, Agriculture, Conservation, and Trade Act of 1990" (October 22, 1990), includes provisions which prohibit commodity boards from allowing other organizations to influence their decisions. Subtitle I, Section 1999S(b) of the report states:

The Board delegated too much authority to its primary contractor, the NPPC, without establishing effective control systems to assure accountability of its contributed funds. The Board was not sufficiently staffed to administer the program, and it perpetually renewed its contract with the NPPC to carry out much of the Board's work without instituting adequate reporting systems and oversight. In our opinion, the Board's relationship with the NPPC and its degree of dependence on it have subjected checkoff funds to a

It is the sense of Congress that, to ensure the continued success of the federally-authorized checkoff programs, boards or councils that participate in the administration of the checkoff program should take care to faithfully and diligently perform the functions assigned to them under the authorizing legislation * * * [E]ach currently operational checkoff board or council should review its charter and activities to ensure that its responsibilities and duties have not been inappropriately delegated or otherwise relinquished to another organization.

Conditions disclosed during our evaluation show the Board became dependent upon the NPPC to such a degree that inappropriate influence was unavoidable and the Board relinquished key responsibilities to the NPPC. The details follow.

- a. Staffing. The Board employs only two full-time employees, an Executive Vice President and an assistant. These employees must oversee the collection, distribution, and expenditure of checkoff funds totaling about \$60 million annually. Section 1619 (b)(1)(G) of the Act states the Board shall employ a staff and conduct routine business. The provision does not describe a minimum staff nor prohibit the use of contracted services to accomplish the Board's business.

In our opinion, two employees cannot be expected to fulfill all the necessary administrative and oversight responsibilities and be reasonably expected to maintain the level of accountability necessary to ensure the integrity of checkoff funds. The effect of this weakness is compounded by the number and complexity of issues within the eight major grant areas, the number of checkoff-funded projects and contracts under authority of the Board, and the influencing factors of the NPPC.

- b. Committees and Task Forces. Checkoff dollars fund committees of both the Board and the NPPC that are used to develop annual proposals for the Board's eight major grant areas. The committees develop detailed projects, budgets, and subprojects within each grant area. Although the Board makes final decisions on significant issues, the issues themselves are often formed by, or based upon, the committees' work.

We examined the structure of 48 committees operating for the Board and/or the NPPC in March 1998. Thirty-three of these committees were funded entirely with checkoff dollars. Fifteen of these 33 were described once as separate committees for the Board, once as separate committees for the NPPC, and once again as joint Board/NPPC committees. Another eight committees operated with both checkoff and NPPC non-checkoff funds. We believe these and other conditions show funding, structure, and assigned tasks for the committees have obscured accountability for checkoff expenditures.

- Thirteen of the 33 committees that were funded entirely with checkoff dollars did not include a Board member. Ten of these committees formulated policies for the \$7.7 million checkoff "Product Improvement/Production Technology" grant of 1997.
- Two committees that were funded entirely with non-checkoff dollars included Board members even though the committees engaged only in NPPC business. Another three committees that were funded partially with checkoff dollars did not include a Board member; these three committees engaged only in NPPC business.
- One consultant served on six committees which were funded under the same grant as his projects. We did not establish whether or not this consultant helped develop the work eventually awarded to him. At a minimum, this condition presented the appearance of a conflict of interest. Managers from another NPPC subcontractor also served on checkoff-funded program committees (see Finding No. 2).

Although the Board and the NPPC Board of Directors retained approval authorities, these committees framed the direction and policies eventually approved or disapproved by the respective boards. We concluded that neither organization was independent of the other because Board members were not represented on committees used to develop the direction of checkoff-funded grants, but were included in NPPC committees which dealt with non-checkoff-funded issues.

- c. NPPC Influence on the Board's Budget. The Board's budget was developed with assistance from the NPPC Board of Directors and the NPPC Budget Committee. These NPPC officers participated in prioritizing and placing projects in specific grant areas. This participation was also based upon a preliminary budget that was developed for the Board by an NPPC economist.
- d. NPPC Technical and Administrative Assistance for Developing Grant Proposals, Projects, and Subprojects. NPPC staff provided technical and administrative assistance during development of annual proposals for the eight grant areas. NPPC staff drafted and presented preliminary checkoff-funded grant allocations to both the Board's and the NPPC's budget committees. This means that NPPC employees and officers were in a position to influence the content of the annual contract proposals for the grants.

The Board administered the grants and projects through participation in selected committees and through limited oversight provided by the Board's Executive Vice President. While participation in the committees by Board members provided some control over the budgets for planned projects, Board members did not review or reconcile actual project expenditures to the corresponding budgeted amounts (see Finding No.3) to ensure projects were maintained and completed in accordance with their respective project budgets.

- e. NPPC Awarded All Eight Grant Areas. The Board has awarded all program grants to the NPPC since 1996. In prior years, two of the eight grants were awarded to a subgroup of the now defunct National Livestock Meat Board. The annual grant awards to the NPPC provides NPPC opportunities to influence information provided to the Board and other potential bidders before the grants are advertised for bid. We found that NPPC staff participated in planning and developing the methodologies approved by the Board to conduct and complete checkoff projects and subprojects. This arrangement provided advance notice to the NPPC on the details for each proposal. NPPC staff were also in influential positions within the Board's decision-making processes as staff consultants for committees. In our opinion, these factors make it unlikely the Board could or would award any grants to another entity.
- f. NPPC Administrative and Accounting Services and Support. Each year, the Board awarded a contract to the NPPC to provide administrative and accounting services. NPPC staff performed almost all the Board's administrative and accounting functions, including accounting for salaries, travel, receipts, distributions to State associations, and disbursement of funds for all of the Board's promotional, educational, and research projects. NPPC employs a Chief Financial Officer (CFO), a comptroller, a seven person accounting staff, and a personnel manager. The Board relied on the NPPC accounting staff and did not employ a financial manager, an accountant, or a personnel specialist. As a result, the NPPC accomplished all the Board's routine administrative and accounting responsibilities without sufficient oversight or validation by the Board.
- g. Credit for Board Projects. Publications and literature produced by the NPPC for the Board's checkoff-funded projects were promoted as NPPC products, rather than products of the Board. The standard credit line on such products is: **"National Pork Producers Council in cooperation with the National Pork Board."** In this way, the Board's contractor, the NPPC, claims primary credit for projects developed and funded by the Board with contributions from pork producers and importers. We believe the statement implies that the authorship of projects and the ownership of project materials originated with the NPPC rather than the Board, and does not acknowledge the contributions of producers and importers. In our opinion, the statement is an indicator of how the NPPC and the Board perceive the actual relationship between the Board, the NPPC, and checkoff contributors.
- h. Co-location with the NPPC. The Board's offices are located in a building owned and occupied by the NPPC. The Board pays rent to the NPPC and shares common facilities, such as meeting rooms, kitchen, library, receptionist, telephone system, and other equipment. The Board may be reached through the internet, but only through the NPPC domain at "nppc.org," which incidentally is maintained with checkoff dollars provided through the Board. The

co-location of headquarter offices of the Board and the NPPC may not be a significant factor in the Board's independence, but it promotes the perception of the Board's dependence on the NPPC.

The Board's Executive Vice President and NPPC officials vigorously defended the current structure of the Board and its relationship with the NPPC. Both organizations offered persuasive arguments to defend the individual factors we noted, as efficient and effective administration of the checkoff program. However, when the combination of factors is viewed as a whole, and in combination with Finding Nos. 2 (contracts) and 3 (cost accounting), these conditions show a Board that does not operate independently and without undue influence from the NPPC.

The Board and the NPPC should remember that while all pork producers are obligated to contribute pork checkoff dollars, they may not agree with the NPPC's priorities. Some producers are, in fact, opposed to the NPPC itself. To comply with the Act and protect the integrity of the checkoff program, the Board should maintain an arms-length business relationship with the NPPC. It should also provide better assurance to the Department and producers that checkoff dollars are not used primarily to advance NPPC goals and objectives.

RECOMMENDATION NO. 1a

AMS program officials should work with the Board and delegates to develop and implement a plan that ensures appropriate separation of the Board from the NPPC and assures appropriate accountability for Board expenditures of checkoff dollars.

AMS Response

AMS' March 9, 1999, written comments acknowledged that the Board must interact with its primary contractor to ensure proper oversight of NPPC's checkoff fund expenditures and delivery of contracted work products and services. The agency will require the Board to take action by August 1, 1999, to assure (1) Board officers/employees do not involve themselves in routine NPPC business matters and decisions or attend NPPC meetings which do not specifically involve Board related issues, (2) identify the Board's press releases and other public communications as being issued by the Board, (3) establish a unique internet domain and website for the Board, separate from that of the NPPC (by July 1, 1999), and (4) arrange for an independent third party review of the Board's present systems and policies for maintaining accountability of checkoff funds, including recommendations for improvements. Based on the results of the review, AMS will work with the Board to strengthen the Board's accountability. The review shall be completed and the results submitted to AMS by September 30, 1999. Improvements made as a result of the review shall be implemented by January 1, 2000.

In addition, AMS will require the Board to develop a clear policy for Board member participation in NPPC committee meetings funded, at least in part, with checkoff dollars. The policy shall be completed and submitted to AMS by August 1, 1999, and is subject to AMS approval.

OIG Position

We agree with management's decision for this recommendation.

RECOMMENDATION NO. 1b

AMS should instruct the Board to ensure that all checkoff-funded publications, literature, and other products properly emphasize the contributions of the nation's pork producers and the Board.

AMS Response

AMS will instruct the Board that it must claim credit on any communication, plan, project, publication, promotions, advertisements, and any other work product paid for with Board funds, including all credit and tag lines. AMS shall require the Board to submit a corrective action plan for this by July 1, 1999, and implement an AMS approved plan by August 1, 1999. AMS will also establish appropriate review and approval procedures.

OIG Position

We concur with management's decision for this recommendation.

**SUBCONTRACTING PRACTICES
NEED IMPROVEMENT**

FINDING NO. 2

The Board delegated authority to the NPPC to administer subcontracts without establishing controls to ensure the subcontracts were in the best interest of the Board. Public awareness of a recently questioned NPPC subcontract led the AMS, the Board, and the NPPC to strengthen controls over the NPPC's subcontracting practices. Nevertheless, the Board's oversight of subcontracting activities had not significantly improved. Specifically, the Board continued to authorize the NPPC to negotiate and administer subcontracts, including vendor selection and terms of agreement, without Board involvement. As a result, the Board cannot provide reasonable assurance that checkoff funds expended for NPPC subcontracts were adequately safeguarded from misappropriation, waste, loss, and misuse.

The NPPC advertised bids, selected subcontractors, negotiated and finalized subcontract terms, accepted deliverables (services and

products), and made final payments to subcontractors without review or involvement of Board members or employees. The Board's Executive Vice President stated although he was not aware of all the checkoff-funded subcontracts, he and the Board members worked closely with NPPC staff to develop each project. The director did not believe it was necessary for the Board to be involved with the NPPC's contracting operations.

While the Board need not be involved with all subcontracting activities, Board members have a duty to ensure the NPPC administers checkoff-funded subcontracts in the best interest of the Board. The following circumstances illustrate significant weaknesses in current practices.

- a. Management Information Systems are Needed to Manage Multiple Subcontracts. The Board did not require NPPC to establish a tracking or reporting function to control the progress of subcontractors engaged to accomplish projects under each grant area. Similarly, the NPPC did not initiate a tracking and reporting system on its own. As a result, neither organization could compile a list of active subcontracts and agreements funded by the Board, nor summarize the checkoff dollars obligated to each subcontractor.
- b. Subcontracting Policies and Procedures Should be Prescribed. The Board relied on NPPC staff to administer checkoff-funded subcontracts without prescribing adequate written procedures. The procedures are necessary to help assure NPPC staff properly implement Board contracting requirements and policies. Although the Board established written policies and procedures for contracts awarded directly by the Board, it did not require the NPPC to apply them to subcontracts for checkoff projects. Written procedures were not available for such activities as advertising bids for subcontracts, selecting appropriate subcontractors, negotiating the terms of subcontracts, and defining deliverable services and products.

The following examples are conditions we observed during the evaluation. Note the NPPC generally applied contract restrictions required by the Department.

- (1) Uniform Rates for Administrative Support Costs. The Board did not provide written guidance on how to reimburse subcontractors for routine support costs or to pay consultants for nonconsulting hours. An NPPC official stated project managers were authorized to negotiate different rates for routine support costs, such as travel and clerical assistance. For at least two subcontractors, this delegated authority increased the vulnerability of checkoff dollars to abuse.

Consultant A. The consultant obtained three subcontracts from the NPPC, none of which included provisions to reimburse the consultant for rental car costs. The project manager

verbally authorized the subcontractor to rent cars and be reimbursed for the expense, even though other consultants were not approved for such expenses. The consultant and the NPPC project manager acknowledged the consultant used the rental cars for personal reasons. They stated the consultant required NPPC to provide rental cars as a precondition to performing the contracted services. The consultant required a car as means for a quick return to his residence, due to family concerns.

Consultant B. The subcontract for consultant B, a chef, authorized payment of \$100 per hour for consulting services, but it did not provide for payments based on travel time or time spent for support services. The NPPC project manager authorized compensation for the chef at a rate of \$50 per hour for travel time, even though NPPC did not generally authorize such compensation. The manager also authorized \$50 per hour payments for nonprofessional support duties, such as grocery shopping and cleaning equipment. NPPC compensated the vendor without applicable contract provisions.

In our opinion, the situations involving these two consultants should clearly have been addressed in the vendors' contracts, based on Board policy, rather than on subjective criteria applied by individual project managers.

- (2) Disclosure of Potential Conflicts of Interest. The Board did not require the NPPC to obtain disclosure statements to detect potential conflicts of interest between subcontractors and their majority investors with either the Board or the NPPC. Disclosure statements are necessary when, as in this case, the contractor operates in an apparently limited environment of relatively few potential subcontractors.

For example, consultant A served on six program committees serving both the Board and the NPPC. All six committees dealt with the grant used by NPPC to fund the consultant's projects (see Finding No. 1). We did not find the consultant exercised influence within the committees to affect his contract work. However, having the contractor serve on the same committees that developed plans and budgets for his projects gave the appearance of a conflict of interest.

In a second example, subcontractor C received an advance payment of \$900,000 without providing collateral or preliminary services to secure the amount. The NPPC did not require the vendor to submit a disclosure statement (see item (3) below) to ensure the vendor did not have a conflict of interest with any of the NPPC officials involved with the contract terms. We obtained and reviewed financial information on the contractor and did not find any apparent conflicts of interest.

NPPC officials and the Board's Executive Vice President did not agree that conflict of interest certifications were necessary. We believe written disclosures of potential conflicts of interest are essential because many NPPC subcontracts deal with research that can be performed by organizations with close personal or business relations with NPPC and Board officials. The Board, NPPC, and many subcontractors were all located in Iowa, increasing the potential for business relationships between them.

- (3) Unsecured Advanced Payments. The Board's Executive Vice President did not prohibit the NPPC from making advance payments to subcontractors without adequate security or the Board's expressed approval. We found the NPPC prepaid subcontractor C \$900,000 of a \$1 million subcontract without collateral or other security. NPPC officials conferred with the Board's Executive Vice President before the advance payment was made. In our opinion, this transaction unnecessarily put \$900,000 in checkoff funds at risk from loss or unauthorized use. In the absence of adequate security, the transaction demonstrated questionable contracting practices and poor cash management.

Subcontractor C also received an additional \$300,000 for the project without an addendum to the contract; that is, the total cost of the services provided was \$1.3 million on a contract budgeted and approved for \$1 million. NPPC staff authorized the additional expenditures under purchase order, rather than contract addendum. NPPC disbursed two payments, totaling \$300,000, after revised contracting procedures prohibited the practice. An NPPC official stated that proceeds from sale of the animals at project completion may offset these additional expenses.

- c. Written Contracts. The Board and the NPPC, with AMS concurrence, established a policy that written subcontracts were not required for any products and services valued at \$25,000 or less. We identified three NPPC vendors without written contracts who provided more than \$25,000 in services for checkoff-funded projects. Moreover, we question the value of imposing an arbitrary dollar limit for requiring written subcontracts. The policy was established and violated largely because the NPPC had not implemented adequate controls to ensure written subcontracts were properly developed before work was started. Also, the Board did not exercise sufficient oversight of subcontracts and similar media used to obligate checkoff dollars.

We believe it is reasonable for producers to expect written contracts for all but the smallest expenditures of checkoff funds. Checkoff funds are not the same as operating cash earned through normal business transactions. They are contributions collected from producers through assessments based on production. Some contributions are clearly not voluntary; that is, some producers are vocal in their objections to pork assessments. As

a result, the Board and the NPPC should operate very cautiously to preserve both the appearance and the fact of protecting checkoff funds.

The Board could generate "boiler plate" contracts using inexpensive software combined with the advice of qualified legal counsel. "Boiler plate" contracts could include all required elements of a contract and leave key spaces blank. The contracts can then be tailored to particular tasks by filling in the blanks with such information as the vendor's name, type of service or product, cost, and timeframes for completion. This is an effective and inexpensive method to ensure that checkoff dollars receive at least the minimum expected value for cost.

We found four irregularities that arose because of the absence of proper contract controls.

- (1) Consultant A. The NPPC paid this consultant \$59,000 for work that was never put under contract. The consultant, a university associate professor, performed a technical study and produced a written report. The Board approved the project, budgeted for \$150,000, in 1996. The NPPC did not advertise this project for bid. Instead, the project manager awarded the work to the consultant because the manager believed the consultant was well qualified for the work on the basis of other services performed for NPPC by the consultant.

The manager and consultant agreed to terminate the project before the project's approved objectives were accomplished. Both parties agreed the results of the first phases indicated the project could not be completed as planned. The consultant stated a revised project proposal was currently under development, but the revised subcontract would not be awarded to him.

- (2) Consultant B. NPPC used the services of a particular chef beginning in 1996. At the time of our review, the chef had received about \$81,690 for services and expenses. Only about one quarter of the total amount disbursed to the chef, or about \$21,188, was covered by a written contract in force for only 8 months.

The NPPC began using the chef in September 1996 without a contract. In 1996, the chef received \$16,500 for services, plus about \$1,400 for expenses. NPPC continued to use the chef throughout 1997 and disbursed about \$25,654 for the chef's services for the first 4 months of the year. On May 2, 1997, the project manager and the chef signed a contract covering the rest of the year. Under the contract, the chef received a total of about \$21,098. However, the chef continued to provide services to the NPPC after the contract expired and without a written extension or continuation. At the time our fieldwork was completed, the NPPC had paid the

chef about \$16,990 for 1998 services without a written contract

NPPC's Chief Financial Officer (CFO) stated a 1998 contract was not necessary because the project manager did not expect to use the consultant beyond the \$25,000 limit. However, it was clear the project manager intended to continue to use the chef's services. We believe a prudent manager should recognize the potential use of the contractor in 1998 and either extend the 1997 contract or prepare a new one for 1998.

- (3) Vendor D. In 1998, the NPPC commissioned and paid this vendor \$25,000 for promotional services without a written contract in effect during the performance period. NPPC's project documentation included a contract which showed the vendor was required to provide the needed services during a 6-week period between March 20, and May 20, 1998, but the contract was not signed until July 14, 1998. The contract was also not signed by an authorized contracting official.
- (4) Vendor E. The NPPC contracting officer made a written agreement with a USDA agency on June 22, 1998. The expected checkoff-funded costs of the agency's services were budgeted for just under \$39,000. However, the signed contract stated the agency's services were to begin on April 1, 1998, over 2 months prior to the date of the agreement.

d. USDA Requirements. The NPPC awarded at least three 1998 subcontracts without requiring the contractors to adhere to USDA requirements. Part 4 of the 1998 agreement between the Board and the NPPC shows the NPPC agreed to obtain certifications from all subcontractors on equal employment opportunities, affirmative action, and veterans' preference provisions. NPPC also agreed it would enforce these terms, including corrective action for noncompliance.

- (1) The NPPC awarded a subcontract to a grocer (vendor F) who did not wish to be encumbered with USDA contract requirements. NPPC officials agreed with the vendor's objections and awarded a \$50,400 subcontract without consulting the Board or AMS. Even though the project manager and NPPC officials believed the vendor may have a valid objection, the NPPC should not have authority to determine which requirements are to be followed and which are not.
- (2) The NPPC awarded two subcontracts to vendors G and H, without requiring the subcontractors to certify they would apply non-discriminatory business practices. The two subcontracts were valued at a total of about \$90,000.

e. NPPC Requirements. NPPC officials revised the organization's subcontracting practices in 1997, in response to an AMS report on one NPPC contract. To test the effectiveness of the new

procedures, we conducted a limited review of the 51 subcontracts listed by the NPPC as active in July 1998. Our examination included only selected elements of subcontracts funded with checkoff dollars.

We determined that 15 of the 51 active subcontracts were not signed by the designated NPPC officials. The total value of the 15 subcontracts was about \$667,000. The revised NPPC guidelines required subcontracts valued at over \$25,000 to be signed by either the NPPC contracting officer or the CEO. Two of the 15 subcontracts were not signed by any NPPC official, and the remaining 13 (including those for vendors D, E, G, H, and I) were signed by managers who were no longer authorized to sign due to the changes in procedure.

We also found an addendum to a contract was unsigned. The subcontract, with vendor I, was amended to change the agreed-to billing terms. Although the original subcontract was signed by the CEO, the addendum was not signed by either the vendor or an NPPC official. The contract covered \$150,000 in checkoff project work and was likely to be unenforceable because the changes were not approved by an authorized NPPC official.

Finally, we found NPPC awarded three subcontracts, including a contract awarded to vendor H, that did not include timeframes or completion dates for the delivery of the contracted services. The total value of the three subcontracts exceeded \$121,000. In addition to common contracting requirements, NPPC guidelines also required contracts to include the expected timeframes for completion of the contracted services.

RECOMMENDATION NO. 2a

Require the Board to develop and implement sufficient oversight of the primary contractor's subcontracting practices and procedures. At a minimum, the procedures should include the establishment of an effective and accurate contract reporting system, and written policies and procedures for subcontracting operations funded by the Board.

AMS Response

AMS will require the Board to prepare written policies, procedures, and guidelines, governing the Board's review and approval of subcontracts entered into by its primary contractor. This should include (1) procedures for contractor reporting on contracts and agreements to the Board; (2) providing the Board with progress reports; and (3) developing a method for monitoring contractor compliance with the Board's written policies, procedures, and ensuring accountability for all checkoff funds. The Board must submit its plan to AMS for these policies, procedures, and

guidelines by September 1, 1999, and implement them by January 1, 2000.

OIG Position

We agree with management's decision for this recommendation.

RECOMMENDATION NO. 2b

Direct the Board to employ sufficient staff to ensure the primary contractor implements applicable practices, policies, and procedures, independent of the NPPC and other potential contractors. The staff should review and approve all significant subcontracts, considering the content, objectives, cost, and sensitivity of the affected contract proposal.

AMS Response

AMS will require the Board to develop a proposal for adequately staffing the Board to monitor and audit contracts and subcontracts to ensure proper administration of all checkoff funded activities and projects and compliance with the Board's policies and procedures. As an alternative, the Board may contract an independent firm to provide the necessary services in lieu of additional Board staff. The Board's response for this recommendation must also be consistent with AMS' response to Recommendation No. 2a. The Board's plan must be submitted by October 1, 1999, and implemented by January 1, 2000.

OIG Position

We concur with management's decision for this recommendation.

RECOMMENDATION NO. 2c

Instruct the Board to require contractors to prepare written subcontracts or agreements with all third parties when products and/or services are to be obtained with checkoff funds. This may be accomplished with automated or pro forma contracts or other economical means to properly protect the Board and checkoff dollars.

AMS Response

AMS will instruct the Board to require its contractor(s) to issue written subcontracts and agreements with all third parties for checkoff funded products and services and the conditions under which each document is to be used. The Board must submit the planned

procedures to AMS for approval by September 1, 1999, and implement them by January 1, 2000.

OIG Position

We agree with management's decision for this recommendation.

**COST ACCOUNTING
REQUIREMENTS NEED
STRENGTHENING**

FINDING NO. 3

The NPPC's cost accounting practices for checkoff-funded activities and indirect cost allocations did not provide enough details to ensure proper administration of checkoff funds. Neither the Board nor the NPPC staff reconciled expenditures for checkoff projects and subcontracts to the approved budgets for each project. Instead, the Board monitored summaries of expenditures which did not disclose the costs attributable to each project and obscured potentially inappropriate

expenditures. In addition, the Board did not validate NPPC's method for allocating the checkoff share for fixed costs. These conditions occurred because the Board did not require its primary contractor to develop an accounting system which provided a unique accounting number or code for each project and subcontract and because NPPC's indirect cost allocation method was unnecessarily complex. As a result, the Board did not identify or properly control costs charged to each project and could not provide reasonable assurance that indirect cost allocations charged to the Board were appropriate.

Part 3, Section II, paragraph A, of the Board's 1997 and 1998 agreements with the NPPC required NPPC to maintain adequate records itemizing receipt and expenditure of all Board funds. It is also a fundamental responsibility of management to ensure accounting records properly record each transaction so project costs can be continuously monitored. Such controls are necessary to assure management that costs are maintained within approved budgets and funds are not made available for other uses without the Board's authorization. Similarly, indirect cost allocations should be calculated on a less complex and uniform basis which can be readily identified and understood by those responsible for safeguarding checkoff funds.

- a. Project and Subcontract Accounting Codes and Classifications. The Board authorized NPPC to track expenditures by grant area and selected projects, rather than by individual projects and subcontracts. The Board permitted NPPC to provide only summary reports on the progress and costs of the grant areas and major projects. This allowed project managers to redirect checkoff funds, which were not expended as planned, to other uses within the same classification code. As a result, the Board could not effectively monitor and control actual project costs.

We examined records for six NPPC checkoff project accounts and found that each account recorded transactions from as many as six different subprojects. The trial balances for the six accounts totaled about \$1.5 million. The Executive Vice President and NPPC program manager stated the subprojects were interrelated. However, we concluded the subprojects were not always related (see Exhibit A for details).

We believe the following examples show how NPPC's cost accounting practices lead to inadequate control and potential misuse of checkoff funds.

- One account was charged \$73,408 for undefined supplies. The project manager stated "pinpointing" a project for a specific supply expense would be difficult, requiring a reviewer to go through every supply invoice to identify the appropriate projects for supplies, and even then, the review may not identify the project. In our opinion, \$73,000 is too large an amount to classify as undefined "supplies" spread over several projects. Although the project manager could not attribute the supply costs to specific projects after the purchases were originally recorded, the costs should have been attributable to specific projects when incurred.
- Twenty-five transactions, totaling \$41,628, could not be attributed to any of the projects in the six accounts. There was also no additional supporting documentation to show the costs should have been distributed to all projects in the account.
- Rather than accounted as an asset of the Board, \$1,105 was expended for furniture. We are concerned with the propriety of purchasing furniture with checkoff funds for program projects and accounting for it as a project expense. "Expensed" furniture is vulnerable to misappropriation when the project is completed.
- NPPC's CFO stated that staff developed a subaccount numbering system with three additional numbers to enable project managers to record transactions for each subproject; use of the subaccounts was at the discretion of responsible managers. The managers responsible for the six summary accounts we reviewed chose not to use subaccount numbers.

b. Allocation of Fixed Costs. A review of the NPPC chart of accounts showed the NPPC charged the Board a significant amount of fixed costs. The costs varied, but were applied to every checkoff-funded account. NPPC's fixed costs were a mix of direct salary and indirect overhead costs; the method used to assign fixed costs appeared to be more complex than necessary. We did not conduct a detailed analysis or evaluation to evaluate the impact of fixed cost determinations on checkoff-funded projects. However, we noted that fixed costs ranged from less than 5

percent to over 90 percent of total costs for selected checkoff funded accounts.

The Board's Executive Vice President and AMS program officials stated neither the Board nor AMS verified or tested the fixed costs charged by the NPPC. As a result, the Board could not validate the propriety of the costs charged to checkoff funds. The Executive Vice President and NPPC's CFO concurred the allocation used by NPPC was unduly complex and stated the complexity was caused by an early AMS ruling which prevented NPPC from using a more direct allocation method. As a result, NPPC accountants developed a series of calculations to distribute indirect costs without allocating them directly to individual checkoff and non-checkoff projects.

RECOMMENDATION NO. 3a

Require the Board to establish unique account numbers for each checkoff funded project and subcontract and to ensure that all monetary transactions attributable to each project/subcontract are accurately and completely recorded in the revised accounts. The Board should use the restructured accounts to better control checkoff expenditures through improved monitoring and yearend reconciliation of actual costs to approved budgeted amounts.

AMS Response

AMS will require the Board to include this recommendation in the development and implementation of the written policies and procedures governing the primary contractor's issuance of contracts referenced in the agency's response to Recommendation No. 2a. The Board must submit its plan to AMS for these policies and procedures by September 1, 1999, and implement them by January 1, 2000.

OIG Position

We agree with management's decision for this recommendation.

RECOMMENDATION NO. 3b

Review and annually validate the methodology used by the NPPC to allocate fixed costs to the Board and checkoff funds. Ensure the approved allocation methodology is sufficiently uncomplicated to be understood by Board members and program officials.

AMS Response

AMS will direct the Board to arrange for an independent review of the methodology presently used to allocate contractor overhead and other indirect costs. The Board will be required to recommend to AMS any necessary changes, based on the results of the review, in the process used to facilitate the Board's annual review and validation of NPPC's allocation of costs. This action may be accomplished in conjunction with the independent third-party review referred to in the agency's response to Recommendation No. 1a.

OIG Position

We concur with management's decision for this recommendation. However, we believe that AMS program officials also have a duty to annually review the propriety of NPPC cost allocations. AMS can accomplish this through a specifically directed review incorporated into the Board's required annual financial statement audit.

REVIEWS OF STATE ASSOCIATIONS DID NOT TEST FOR COMPLIANCE

FINDING NO. 4

State pork producer associations were not tested to determine if their checkoff expenditures complied with the applicable provisions of the Act. This condition developed because AMS and the Board did not perform or require compliance reviews to be performed at State associations. Thus, neither the Board nor AMS can provide reasonable assurance that State associations expend checkoff funds in accordance with the Act. As a result, an average of about \$10.5 million checkoff

funds distributed to State associations each year (\$31.6 million from 1995 through 1997) are vulnerable to waste, loss, and misuse.

The Act requires checkoff funds distributed to State associations be expended to finance pork promotion, research, and consumer information plans and projects, plus administrative expenses. The Act did not include provisions requiring the Board to conduct compliance reviews. Compliance tests are necessary to ensure the Act is implemented as intended.

The Board required State associations to submit documentation annually to show how they planned to use checkoff funds during the year. The Board also required State associations to submit copies of reports from periodic financial reviews, the type and frequency of which was determined by the amount of checkoff dollars distributed to the association. The Board also conducted onsite reviews at up to two associations per year, but compliance tests were not incorporated into the reviews. The Board's Executive Vice President stated the reviews focused on educating State associations on the proper use of checkoff funds, without determining if the associations actually complied. He added the Act did not require the Board to perform compliance reviews.

Our analysis of State association reviews verified the following.

- Education and cooperation appeared to be the primary focus of the Board's State association reviews.
- The Board did not use the amount of checkoff funds collected from State producers or expended by each State association as criteria for recent selections of associations for review. Based upon the Board's 1997 statistics, 6 of 10 States which received more than \$300,000 in distributed checkoff funds have not been reviewed since the Board initiated the review process in 1990. In addition, State associations for 2 of the 10 largest pork producing States have never been reviewed, including North Carolina, the State with the second most checkoff funds collected and expended.
- NPPC employees conducted the reviews rather than a Board employee or independent contractor. This practice is questionable because of a potential conflict of interest between the NPPC and State associations. Many State associations are members of the NPPC and may share support of the NPPC's work. In our opinion, it would be more prudent for the Board to employ or contract qualified persons who are independent of the NPPC to conduct such reviews.

RECOMMENDATION NO. 4a

Instruct the Board to more closely monitor State association expenditures of checkoff funds and periodically conduct compliance tests of them. This should include instructions for developing procedures to objectively select State associations for review and minimum requirements for planning, conducting, documenting, and reporting the results of reviews.

AMS Response

AMS will require the Board to revise its policy for reviewing State Pork Producer Associations by (1) determining the number of associations that shall be reviewed annually in order to ensure all associations are audited every 5 years; (2) developing and documenting uniform compliance tests to verify compliance with applicable laws, regulations, and policies; (3) conducting compliance reviews using Board personnel or independent, qualified personnel contracted by the Board; (4) reporting the results of reviews within 45 days, including corrective actions planned or taken as a result of each review; and (5) providing advance notice of scheduled reviews to AMS to facilitate potential accompaniment by agency personnel. The Board is to submit the State association review policy to AMS by November 30, 1999, and implement the plan by January 1, 2000.

OIG Position

We agree with management's decision for this recommendation.

COLLECTION SITE REVIEWS NEED BETTER CONTROLS

FINDING NO. 5

The Board did not effectively perform or document compliance tests at checkoff collection points. The Board's written procedures for these reviews were not sufficient to assure performance and documentation of effective and uniformly applied compliance tests. As a result, the Board cannot provide reasonable assurance checkoff funds were collected in accordance with the Act.

Section 1620(a) of the Act states assessments shall be payable by each producer who raises feeder pigs, seed stock, or hogs sold or slaughtered for sale and the assessments shall be remitted to the Board.

The Board commissioned a contractor to perform onsite reviews at markets and other pork checkoff collection sites each year. The reviewer arranged visits to several sites within a particular area. Due to the lack of available documentation, we could not establish the objective(s) of these reviews. We reviewed the Board's documentation for past reviews and found the reviewer did not record the methodology used to accomplish the reviews or disclose the scope and results of any tests performed. However, one apparent objective was to determine if selected markets complied with the checkoff collection requirements.

The Board required the reviewer to prepare written reports for each site visited. The reports showed the reviewer recorded only a short description of the market visited and a statement that the market complied. The records also did not include critical data about the reviews, such as criteria used to select the sites visited or collection date(s) tested.

In 1997, the reviewer planned 2 trips to review a total of 20 collection sites. However, the reviewer did not visit all the sites selected for review. We could not determine the number of sites the reviewer actually visited due to the lack of documentation. During one trip, the reviewer traveled to Washington and Oregon and visited only 6 of the 11 selected sites. The reasons documented by the reviewer for not visiting the sites included "too far to drive" and "time constraints." In one case, a producer "stood up" the reviewer and successfully avoided review. Also, the reviewer did not always document whether or not the visited sites complied with the Act. We noted the reviewer recorded compliance conclusions for only two sites reviewed in 1997.

The Board's Executive Vice President stated the Board also relied on statistical data from the Agricultural Research Service and the

Grain Inspection, Packers and Stockyard Administration, to estimate the effectiveness of the Board's collection activities. The Executive Vice President said the data indicated actual collections totaled over 95 percent of the statistical estimates provided by these agencies. The Board did not maintain a record of these statistical reviews or documentation of the results.

The contract reviewer retired in 1997. The Executive Vice President used the reviewer's departure as an opportunity to develop better defined written procedures for the compliance reviews and to arrange training for a replacement contractor. At the time of our evaluation, the Board had drafted new written procedures, replaced the reviewer, and provided training to the new reviewer.

RECOMMENDATION NO. 5a

Provide sufficient oversight to ensure the Board's written procedures for compliance reviews at checkoff collection sites include appropriate compliance tests and that the Board effectively implements the procedures. The Board's procedures should state clear objectives for the reviews, provide guidance for site selections, and establish uniform and effective compliance tests, as well as documentation and reporting requirements for each review conducted.

AMS Response

On January 12, 1999, the Board submitted a compliance manual on assessment collections to AMS for approval. AMS is presently reviewing the manual and will ensure that it establishes detailed and uniform procedures for conducting audits of assessment collections for all classes of swine and that it addresses all points cited in Recommendation No. 5a. In addition, the Board will be required to provide AMS advance notice of scheduled reviews to facilitate potential accompaniment by agency personnel. AMS plans to complete the review and approval process by June 1, 1999, and the Board must implement the new procedures by September 1, 1999.

OIG Position

We concur with management's decision for this recommendation.

II. NATIONAL PORK ELECTIONS SHOULD BE MORE INCLUSIVE

RESTRICTED VOTING OPPORTUNITIES INHIBIT PARTICIPATION

FINDING NO. 6

Election practices for Board delegates inhibited participation by pork producers who contributed checkoff assessments. State pork producer associations limited the number and location of sites available for producers to participate and did not permit mail-in ballots. The associations also did not ensure election participation was limited to bonafide pork producers. This occurred because the Board did not establish inclusive voting procedures or monitor State election practices. The Board did not direct State organizations to require voters to preregister and/or provide evidence they produced pork and complied with checkoff requirements. As a result, participation in delegate elections is accomplished by less than 3 percent of all producers and State and national elections for Board delegates are vulnerable to manipulation by ineligible producers.

Section 1617(b), of the Pork Promotion, Research, and Consumer Information Act states each State association shall provide nominations through a process that provides complete and equal access to the nomination process to every producer who has paid all assessments due.

We visited one State association (Iowa) to review State voting practices and interviewed association officials from four other States (Michigan, Minnesota, Nebraska, and North Carolina). We found all five associations limited voting to one day and to one location. All five State associations also permitted voters to self-certify their eligibility to vote without evidence of residency or pork production. The State associations estimated the average number of voters ranged from 25 to 100 participants. The number of voters in each States' most recent delegate elections (1998), ranged from 25 to 77 producers. For these years, 1997 and 1998, the number of voters represented less than 1 percent and less than 3 percent, respectively, of eligible producer in these States (See table on page no. 25 for details).

As an example, the North Carolina association held an election on August 4, 1998, for 1999 delegates. The State's Department of Environment and Natural Resources estimated there were about 2,500 pork producers in the State, of which a State official estimated only about 1 percent participated in the 1998 delegate election. The election was held at a motel in Raleigh, North Carolina. One State association official stated that, generally, the association's board of directors were the only voters. North Carolina permitted

mail-in ballots for the State association's own board of director elections, but not for Board delegate elections.

In another example, the Iowa association held their delegate election on July 15, 1998. Any Iowa producer was free to either participate or not participate. To participate, producers must travel to a hotel located near the association's offices. The State association did not permit mail-in ballots. Only 77 of an estimated 18,000 - 20,000 pork producers (less than one-half of 1 percent) participated in the election in this State.

The following table illustrates our finding:

<u>State</u>	<u>Estimated No. of Producers</u>	<u>No. of Voters</u>	<u>Ratio</u>
Michigan	2,200	50-60*	.0270
Minnesota	10,000	54	.0054
Nebraska	7,000	26	.0037
North Carolina	2,534	25	.0099
Iowa	19,000	77	.0041

* State organization estimate, actual number not available.

We believe these voting practices inhibited participation by bonafide pork producers. It is not reasonable to expect producers to drive to one city in a State to participate in an election because it does not provide "equal access" to rural producers located in all corners of the State. Potential alternative voting sites may include USDA's Farm Service Agency county offices and local pork producer associations. It is also inappropriate to permit participation in the elections by potential nonresident and/or nonproducing voters without some form of verification of eligibility. In order to comply with the Act, the Board's election practices should facilitate full participation by eligible producers, rather than limit access by restricting the location and timing of elections. Similarly, State associations and the Board have a duty to ensure that only eligible producers participate in delegate elections.

RECOMMENDATION NO. 6a

Direct the Board to develop and implement voting policies and procedures which ensure (1) Board delegate and similar elections provide complete and equal access to every producer who paid all assessments due and (2) only eligible producers participate in delegate and similar elections.

AMS Response

AMS will direct the Board to develop written procedures for State association to conduct statewide elections of nominees for appointment by the Secretary of Agriculture to the National Pork Producers Delegate Body. The revised voting procedures are to be submitted to AMS for approval by September 1, 1999, and implemented for elections occurring after January 1, 2000.

OIG Position

We agree with management's decision for this recommendation.

RECOMMENDATION NO. 6b

Require the Board to establish effective oversight review procedures to ensure State associations comply with the Board's election policies and procedures.

AMS Response

AMS will direct the Board to require each State association to certify, at the time of submission of names for nominees to the Board, that they comply fully with the revised and AMS approved voting procedures. AMS will also require the Board to include a review and certification of State association election procedures to ensure compliance with the revised procedures. The revised procedures are to be submitted to AMS for approval by September 1, 1999, and implemented by January 1, 2000.

OIG Position

We concur with management's decision for this recommendation.

EXHIBIT A - PROJECT ACCOUNT CLASSIFICATIONS

We examined records for six NPPC checkoff project accounts and found each account included transactions from as many as six different subprojects. This exhibit presents summaries of the six selected project accounts and, in our opinion, shows transactions for the subprojects should be separately accounted for rather than mixed in one account (see Finding No. 3).

Account Classification Which Included Payments to Consultant A

Program/Project Title: **Networking**

Year: **1997**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Networking and Value Added	14	\$44,025
Educational Meetings	7	16,887
State Networking Contacts	9	30,345
Networking Committee Meetings	5	701
State Networking Contact Meeting	22	17,988
Unsure/Could Not Recall	<u>1</u>	<u>154</u>
TOTAL	<u>58</u>	<u>\$110,100</u>

Program/Project Title: **Networking**

Year: **1998**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Value-Added Pilot Projects	14	\$9,497
Networking	1	2,000
Mail Service	<u>1</u>	<u>4</u>
TOTAL	<u>16</u>	<u>\$11,501</u>

EXHIBIT A - PROJECT ACCOUNT CLASSIFICATIONS

Account Classification Which Included Payments to Consultant B

Program/Project Title: **Retail Meal Solutions**

Year: **1997**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Research	11	\$125,869
New Product Creative	5	76,569
M.A.P.S. Support New Product Rollout	4	136,591
OP/Supplies	8	8,894
Reclassified Prepaid expenses	<u>1</u>	<u>4,550</u>
TOTAL	<u>29</u>	<u>\$352,473</u>

Program/Project Title: **New Products Research**

Year: **1997**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Visionary Design Research	21	\$64,593
New Product Research (consumer and technical/meat science)	13	82,295
New Product Research - consumer	4	39,904
New Product Research - technical and meat science	7	55,275
Conference Registration and Fees	6	6,605
Demand Enhancement Committee	49	1,621
Intern Help	1	68
Bozell Monthly Fee	12	300,000
Out of Pocket Expenses/Supplies	52	73,408
Storage Fee	1	25
Beginning Year Invoice Credits	2	<9,090>
Office Furniture	1	1,105
Replenish Petty Cash Expense	4	186
Unknown/Uncertain Transactions	<u>4</u>	<u>90</u>
TOTAL	<u>177</u>	<u>\$616,085</u>

EXHIBIT A - PROJECT ACCOUNT CLASSIFICATIONS

Consultant B (continued)

Program/Project Title: **New Products**

Year: **1998**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Technical Research and Development	10	\$8,966
Deep Basted Research	4	19,346
New Product Optimization Research	3	1,208
Fresh Ham Product Research	4	17,486
New Product - Qualitative Research	3	25,527
Conference/Meeting	1	225
New Products Committee	1	29
Shipping	1	212
Operating Supplies	4	599
Replenish Account	1	1
Reclassified Transaction	1	<16>
Unknown Transactions	<u>2</u>	<u><1,116></u>
TOTAL	<u>35</u>	<u>\$72,467</u>

Account Classification Which Included Payments to Subcontractor C

Program/Project Title: **Genetic Evaluation & Research**

Year: **1996**

<u>Subproject Title</u>	<u>No. of Transactions</u>	<u>Total Amount</u>
Maternal Line Program	18	\$85,971
Lean Growth Modeling	207	167,649
Terminal Line Program	7	447
Genetics Committee Meeting	103	33,473
Other-Book Purchase & Program Support	2	480
Unsure/Could Not Recall	<u>18</u>	<u>42,499</u>
TOTAL	<u>355</u>	<u>\$330,519</u>

EXHIBIT B - NATIONAL PORK BOARD COMMENTS ON OUR PRELIMINARY FINDINGS

National Pork Board

P.O. Box 9114 • Des Moines, Iowa 50306
(515) 223-2620

August 25, 1998

Steve Roberts
Office of Inspector General
P O Box 293
Kansas City, MO 64141

Dear Steve,

This letter is in response to your inquiry on possible solutions to issues identified in your review/evaluation of the pork checkoff program. My letter to you of July 2nd provided insight and facts in response to items that you identified in your exit interview.

Regarding collection and distribution of checkoff funds, some improvements appear to be needed in the process that was in place in 1997. The Board is committed to making improvements as evidenced by the way we are implementing the 1998 audits that you examined. Fine-tuning is required in the audits of markets and packers, but the core program is in place for 1998.

Regarding the farm-to-farm sales, I believe you realize that it is difficult to identify producers engaged in these types of sales. Although the law provides penalties that may convince producers to comply, it has been the Board's experience that encouragement and amnesty periods similar to other government social initiatives may be more effective in improving farm-to-farm compliance. Incentives vs. disincentives seem to be a more effective solution. Another point that I've made before regarding market and packer audits: another USDA agency - OIPSA - oversees financial accountability of these firms and therefore a very detailed Pork Board audit may not be necessary and could be duplicative.

Accountability of funds distributed to states is a point on which we have differing opinions. The Board and AMS exercise oversight through required reporting by the states and a third party auditor. This oversight is consistent with the Act and Order. Additionally, we believe the Board's common sense administrative reviews assure responsible operation of the checkoff program by states. Further, more states have producer boards who have fiduciary and program accountability.

As your review revealed, contracting relationships between NPPC and their subcontractors changed in 1998. You mentioned that the Board should be more directly involved in contracting. Although there maybe a few oversight processes that could be strengthened and still maintain a realistic, business-like relationship; micro-management of specific contract relationships and deliverables is not a productive business practice.

MEMBERS ■ Elyse Ver Meer, President, Leighton, IA ■ Arnie Seashman, Vice President, Flame Center, NE ■ Greg Roerboom, Marshall, MN ■ Bobby Bryan, Dilwyne, VA ■ John Kelloss, Yorkville, IL ■ Jim Ledger, Washington, IA ■ Jim Lewick, Albion, WY ■ Chet McManus, Fulton, SD ■ Ole Nielsen, Marlton, NJ ■ Sharon Oetting, Concordia, MO ■ Martin Parkritz, Mt. Lake, MN ■ Jimmy Pollock, Rinston, NC ■ Sharon Schwartz, Washington, KS ■ Edg Ward, Crawfordsville, IN ■ Mike Weller, Plain, WI ■ Mike Simpson, Executive Vice President

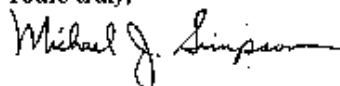
EXHIBIT B - NATIONAL PORK BOARD COMMENTS ON OUR PRELIMINARY FINDINGS

You raised the question about the multiple activities described within a NPPC Form A and their relationship to one another. In some cases, projects and activities could be separated and described in additional Form A's. However, the Board believes that the projects and activities categorized and funded using the current line item process (Form A's) effectively justify the related expenditures and therefore accountability.

As you know from our past discussions, the relationship between the Board and NPPC is a very sensitive issue with respect to: 1) the producer's and stakeholder's philosophy and role in the program, and 2) the expectations of Congress and the Secretary for an efficient and effective program that successfully achieves the objective of the Pork Act and Order. When the program started over 10 years ago, producers emphatically demanded that there be no unnecessary bureaucracy or duplication of services and that government would have oversight responsibility and not management responsibility. Producer leadership has maintained this philosophy. The Board has an independent process for selecting its programs, vendors and contractor(s). This process has resulted in the selection of parties that we believe have the best programs and can do the best job. It has always been the Board's position that the Pork Act contemplates a business-like relationship between the Board and NPPC and state pork producer associations. As a result, the Board has in place business-like practices that keep these relationships just that - - business-like.

Since the inception of the checkoff program, the Board has operated on the premise that there is a difference in the administration of government programs (i.e., food stamps, etc.) and programs wherein Congress has authorized producers to manage with government oversight (i.e., pork, beef and other commodity promotion programs). The Board fully understands that business principles and accountability apply to both, however the Board contends that strict government program administration does not apply in the pork checkoff program to the extent that it does in a government administered program.

Yours truly,



Michael J. Simpson
Executive Vice President
National Pork Board

cc: Arnie Stuthman, President
Barry Carpenter, USDA/AMS

EXHIBIT C - AMS RESPONSE TO THE DRAFT REPORT



United States
Department of
Agriculture

Agricultural
Marketing
Service

P.O. Box 96456
Washington, DC
20090-6456

March 9, 1999

TO: James R. Ebbitt
Assistant Inspector General
for Audit
Office of Inspector General

FROM: Enrique E. Figueroa, Ph.D.
Administrator
Agricultural Marketing Service

March 9, 1999

SUBJECT: ~~OIG Audit--Controls Over Pork Checkoff Funds--#01801-0001-KC~~

This memorandum is in response to the Office of Inspector General's (OIG) audit of controls over pork checkoff funds, Audit Report No. 01801-0001-KC.

We have reviewed the subject audit report. In general, we concur with the audit's findings and accept the recommendations. We will work closely with the National Pork Board (Board) to correct the deficiencies noted in the audit report and strengthen the Board's oversight of checkoff dollars.

It is also important to note that a petition being circulated within the pork industry to request that the Secretary of Agriculture conduct a referendum to determine if producers wish to terminate the checkoff program. The industry has been given 1 year to collect signatures. Consequently, the collection period will end May 1, 1999. In the event the required number of signatures are collected--15 percent of pork producers and importers--and the Secretary determines that a referendum will be conducted, we recommend that consideration be given to delaying action on some of the recommendations until after the results of the referendum are known.

Recommendation 1a: The Agricultural Marketing Service (AMS) Program Officials should work with the Board and delegates to develop and implement a plan that ensures appropriate separation of the Board from the National Pork Producers Council (NPPC) and assures appropriate accountability for Board expenditures of checkoff dollars.

Agency Response: It is incumbent on the Board to take appropriate steps to ensure that the Board operates independently including taking actions designed to reinforce the Board's identity and autonomy. AMS recognizes that the Board must interact with its primary contractor--National Pork Producers Council (NPPC)--to provide the required oversight of NPPC's expenditures of checkoff funds and delivery of contracted work products and services.

EXHIBIT C - AMS RESPONSE TO THE DRAFT REPORT

James R. Ebbitt

2

However, to ensure the appropriate separation of the Board from NPPC, AMS will direct the Board to take the following actions by August 1, 1999: (1) assure that Board officers and/or employees do not involve themselves in routine business matters of NPPC, including noncheckoff related internal NPPC decisions, and NPPC staff meetings not specifically for Board related issues, (2) identify all press releases used to communicate information on Board funded activities and other related information as being issued by the Board, (3) establish a Board unique domain name and web site separate from NPPC's website by July 1, 1999, and (4) arrange for an independent third party review of its present systems and policies for maintaining accountability for expenditures of checkoff funds and submit the results of such a review and any recommended changes identified as a result of the review. Based on the results of the review, AMS will work with the Board to strengthen the Board's accountability. This independent review must be completed and the results submitted to AMS by September 30, 1999. Identified improvements in the Board's systems for maintaining accountability must be incorporated before the beginning of the year 2000 budget which is January 1, 2000.

With respect to committees and taskforces, experience has shown that the committee process has been an efficient and effective way to incorporate input from grassroots level producers. The Board's present system facilitates obtaining ideas from the industry for projects which are consistent with the interests of the entire pork industry. However, AMS will require the Board to develop a policy that clearly sets forth the conditions under which Board members would participate in NPPC committees. This policy shall include a requirement that the Board will be represented at committee meetings, which are funded in whole or in part with checkoff funds. Such policy will be subject to AMS review and approval. Due date for completion and submission to AMS is August 1, 1999.

Recommendation 1b: AMS should instruct the Board to ensure that all checkoff-funded publications, literature, and other products properly emphasize the contributions of the nation's pork producers and the Board.

Agency Response: AMS will communicate to the Board in writing that the Board must claim credit on any communication, plan, project, publication, including promotions, advertisements, and any other work product paid for with Board funds. This requirement applies to all credit lines and tag lines as well. AMS will require the Board to submit to AMS a plan of the actions it will take to ensure that the Board receives primary credit for all Board funded work projects. The Board's plans must be submitted to AMS by July 1, 1999, and implemented by August 1, 1999. In turn, AMS will establish appropriate review and approval procedures.

Recommendation 2a: Require the Board to develop and implement sufficient oversight of the primary contractor's subcontracting practices and procedures. At a minimum, the procedures should include the establishment of an effective and accurate contract reporting system, and written policies and procedures for subcontracting operations funded by the Board.

EXHIBIT C - AMS RESPONSE TO THE DRAFT REPORT

James R. Ebbitt

3

Agency Response: AMS will require the Board to prepare and submit to AMS for review and approval written policies, procedures, and guidelines governing the Board's review and approval of subcontracts entered into by its primary contractor including the requirement that a contractor must issue written subcontracts and agreements with all third parties for checkoff funded products or services and the conditions under which each document is to be used. Additionally, the Board must (1) establish procedures for contractor reporting of contracts and agreements to the Board, (2) providing the Board with progress reports, and (3) developing a method for monitoring contractor compliance with the Board's written policies, procedures and ensuring accountability for all checkoff funds. The Board's plans must be submitted to AMS by September 1, 1999, and implemented by January 1, 2000.

Recommendation 2b: Direct the Board to employ sufficient staff to ensure the primary contractor implements applicable practices, policies, and procedures, independent of the NPPC and other potential contractors. The staff should review and approve all significant subcontracts, considering the content, objectives, cost, and sensitivity of the affected contract proposal.

Agency Response: AMS will require the Board to develop a proposed plan for adequately staffing the Board to (1) oversee accounting, finances and related activities, and (2) monitor and audit contracts and subcontracts to ensure contractors' proper administration of all checkoff funded activities and projects and compliance with Board developed policies, practices, and procedures. As an alternative, the Board may contract with an independent firm to provide the necessary services in lieu of additional Board staff. The Board's review and approval functions must be consistent with AMS' response to Recommendation 2(a). The Board's plans must be submitted to AMS by October 1, 1999, and implemented by January 1, 2000.

Recommendation 2c: Instruct the Board to require contractors to prepare written subcontracts or agreements with all third parties when products and/or services are to be obtained with checkoff funds. This may be accomplished with automated or pro forma contracts or other economical means to properly protect the Board and checkoff dollars.

Agency Response: Response included in the Agency response to Recommendation 2(a). Due dates are the same as established in the Agency's response to Recommendation 2(a).

Recommendation 3a: Require the Board to establish unique account numbers for each checkoff funded project and subcontract and to ensure that all monetary transactions attributable to each project/subcontract are accurately and completely recorded in the revised accounts. The Board should use the restructured accounts to better control checkoff expenditures through improved monitoring and year-end reconciliation of actual costs to approved budgeted amounts.

EXHIBIT C - AMS RESPONSE TO THE DRAFT REPORT

James R. Ebbitt

4

Agency Response: AMS will require the Board to include this recommendation in the development and implementation of "establishing written policies and procedures governing the primary contractor's issuance of subcontracts" which is referenced in the Agency's response to Recommendation 2(a). Due dates will be the same as established in the Agency's response to 2(a).

Recommendation 3b: Review and annually validate the methodology used by the NPPC to allocate overhead and other indirect costs to the Board and checkoff funds. Ensure the approved allocation methodology is sufficiently uncomplicated to be understood by Board members and program officials.

Agency Response: AMS will direct the Board to arrange for an independent review of the methodology presently used to allocate contractor overhead and other indirect costs. Based on the results of the review, the Board will recommend any necessary changes in the allocation process to facilitate the Board's annual review and validation of NPPC's allocation of costs. AMS will require that the results of the review and any necessary changes made in the allocation and validation processes be submitted to AMS for review and approval. This action could be accomplished in conjunction with the independent third-party review of the Board's systems and policies for accountability referred to in the Agency's response to Recommendation 1(a). Due dates will be the same as established in the Agency's response to 1(a).

Recommendation 4a: Instruct the Board to more closely monitor State association expenditures of checkoff funds and periodically conduct compliance tests of them. This should include instructions for developing procedures to objectively select State associations for review and minimum requirements for planning, conducting, documenting, and reporting the results of reviews.

Agency Response: AMS will require the Board to revise its policy for reviewing State Pork Producer Associations' (SPPAs) annual expenditures of checkoff funds distributed to them pursuant to section 1230.72(a) of the Order by (1) determining the number of SPPAs that shall be reviewed annually to ensure all SPPAs are audited every 5 years, (2) developing and documenting uniform compliance test procedures to verify SPPA budgets, projects, and expenditures are consistent with the requirements of the Act, Order, AMS Guidelines, and policies and procedures established by the Board, (3) conducting compliance reviews of each selected SPPA by utilizing Board personnel or independent qualified persons under contract to the Board, and (4) submitting a report of the results of the review and corrective action planned or taken to resolve the findings to AMS within 45 days after the date the review is completed. Additionally the Board will be required to provide AMS advanced notice of the dates of scheduled SPPA reviews so AMS personnel can accompany the auditor and participate, when deemed appropriate. The Board must also submit its revised SPPA compliance review policy to AMS for review and approval by November 30, 1999, and implement the plan by January 1, 2000.

EXHIBIT C - AMS RESPONSE TO THE DRAFT REPORT

James R. Ebbitt

5

Recommendation 5a: Provide sufficient oversight to ensure the Board's written procedures for compliance reviews at checkoff collection sites include appropriate compliance tests and that the Board effectively implements the procedures. The Board's procedures should state clear objectives for the reviews, provide guidance for site selections, and establish uniform and effective compliance tests, as well as documentation and reporting requirements for each review conducted.

Agency Response: AMS is presently reviewing a compliance manual for assessment collection prepared by the Board and submitted to AMS on January 12, 1999, for approval. AMS will ensure that the manual establishes detailed and uniform procedures for conducting audits of assessment collections for all classes of swine and addresses all points cited in this recommendation. Additionally, the Board will be required to give AMS advanced notice of the dates of scheduled checkoff compliance reviews at checkoff collection sites so AMS personnel can accompany the auditor and participate, when deemed appropriate. AMS plans to complete its review and approval process by June 1, 1999, and the Board must implement the new procedures by September 1, 1999.

Recommendation 6a: Direct the Board to develop and implement voting policies and procedures which ensure (1) Board delegate and similar elections provide complete and equal access to every producer who paid all assessments due and (2) only eligible producers participate in delegate and similar elections.

Agency Response: AMS will direct the Board to develop a written procedural manual which governs SPPAs conduct of the State-wide elections of pork producers as nominees for appointment by the Secretary of Agriculture to the National Pork Producers Delegate Body and submit the plan to AMS by September 1, 1999, and require all SPPAs to implement AMS approved voting procedures to conduct producer elections beginning January 1, 2000, for nominations to the 2001 Delegate Body.

Recommendation 6b: Require the Board to establish effective oversight review procedures to ensure State associations comply with the Board's election policies and procedures.

Agency Response: AMS will direct the Board to require each SPPA to certify, at the time of submission of names of nominees to the Board, that they comply fully with the requirements set forth in the AMS approved procedures. AMS will also require the Board to include in each Board conducted audit of an SPPA, and described in AMS' response to Recommendation 4a, a review and certification that SPPA's election procedures used for Delegate Body nominations comply with AMS approved procedures. Due dates will be the same as established in the Agency's response to 6(a).