

# **State Processing Program Handbook**



UNITED STATES DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

Food Distribution Division

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## WHAT IS PROCESSING?

Each year, schools, institutions, and day care centers throughout the nation receive millions of dollars' worth of donated food for their meal service operations from the U.S. Department of Agriculture (USDA). USDA buys the food under price-support and surplus-removal legislation and offers it to these recipient agencies through the Food Distribution Program of the Food and Nutrition Service. While some food items provided by USDA are purchased in ready-to-use forms, such as canned fruits or vegetables, other foods are provided in forms or quantities that may not be easily used, such as frozen whole turkeys. In order to make efficient use of these foods, many recipient agencies have turned to the food processing industry to convert the USDA donated foods into more convenient and usable forms.

Through processing, recipient agencies can economize on food costs, benefit from reductions in food preparation time and outlays for equipment, and make the most efficient use of donated food. Processing helps recipient agencies provide more varied and higher quality meals, reduces waste in the food preparation process, and stabilizes costs through portion control. Processing enables recipient agencies to realize significant cost savings. These cost savings can be in the form of a discount in the normal commercial price or by way of a refund from the processor.

Processing has become an integral part of day-to-day food service operations and its use will continue to increase as new menu items are developed by industry and introduced to the American palate. The processing of donated food must be done in accordance with the State Processing Program regulations (7 CFR Part 250.30).

## GLOSSARY OF TERMS

**Agreement- Donated Food, Processing:** A legal document entered into between a processor and a distributing agency or eligible recipient agency that provides for the further processing of USDA donated foods. Processing agreements are not viable until the distributing agency approves them prior to the commencement to processing. A processing agreement is also referred to as a processing contract.

**Agriculture Marketing Service (AMS):** The USDA agency responsible for purchasing surplus-removal items such as meat, poultry, fruits, and vegetables. AMS also provides end product certification that, at a minimum, certifies against non-diversion and non-substitution of donated food.

**Allocation:** The method of notifying FNS Regional Offices and distributing agencies of the amounts of Group A commodities purchased for eligible recipient agencies and the shipping periods for these donated foods.

**Announcement:** A document that is published when USDA formally announces its intention to buy a certain donated food. An announcement often contains donated food specifications, packaging requirements, and contractual and shipping information.

**Assessment Charge/Distribution Charge:** Distributing agency charges to recipient agencies for costs related to intra-State storage and distribution of donated food.

**Authorized Signature:** Signatures of company individuals responsible for all terms and conditions of the processing agreement. In a sole proprietorship, the owner must sign the agreement; in a partnership, a partner must sign the agreement; in a corporation, a duly authorized corporate officer must sign the agreement. If an employee other than these specified individuals signs the agreement, a power of attorney authorizing the employee's signature must accompany the agreement.

**Backhaul:** The pick up of a donated food from a distributing agency or recipient agency for processing and return. There may be an additional charge per pound to pick up the donated food.

**Batching:** This is a term used when the same kind of non-substitutable donated food is received by the processor from more than one State or locality, and those foods are combined during a production run. Batching during production runs that involves direct delivery of product by USDA vendors is generally encouraged due to the benefits gained through increased efficiency during processing, reduced AMS grading costs, and potentially increased yields of finished product. Batching of product between States may only be done with written concurrence of each State prior to reprocessing.

**Bonus Commodity:** A food item not charged against entitlement or against a program's appropriated funds. Bonus foods are to be used by the recipient agency on a "use without waste" basis. These foods are acquired through the price-support operations of the Commodity Credit Corporation or surplus-removal operations of AMS. In all instances, the foods are clearly "donated" to FNS, i.e., no cost is incurred by FNS.

**By-Products:** Products other than the specified end products produced during processing. If by-products are sold or used by the processor, their value must be credited to the distributing agency or the recipient agency. Credit arrangements for by-products between the distributing agency or the recipient agency and the processor must be established prior to any processing, documented as part of the agreement, and made available to the grader.

**Certified Public Accountant (CPA) Audit:** An independent audit of a multi-State food processor's operations that is required every one, two, or three years, depending on the volume and value of donated foods received each year.

**Child Nutrition Programs:** Refers collectively to the National School Lunch Program, the School Breakfast Program, the Summer Food Service Program for Children, and the Child and Adult Care Food Program.

**Child Nutrition Labeling Program:** A voluntary program administered by FNS that evaluates formulations to determine the contribution a serving of a commercially prepared product makes toward the Child Nutrition Program meal pattern requirements. When approved, a label is placed on the end product that states that the product meets USDA specifications and can be credited as a component(s) of the reimbursable meal pattern requirement.

**Claim Determination:** The decision as to the existence or non-existence of a liability to USDA. The determination establishes the basis and the amount of the liability, if any, and the party that is liable.

**Commingle:** To store, combine, or blend commercial food and substitutable donated food together into a single inventory at a processor's plant.

**Comminuted Meat:** An edible product resulting from the mechanical separation and removal of most of the bone from attached skeletal muscle of livestock or poultry carcasses. Comminuted meat can also be called mechanically deboned meat (MDM).

**Commodities:** Predominantly bulk foods donated or made available for donation to eligible recipient agencies by USDA.

**Commodity Credit Corporation:** A corporation under the general supervision and direction of the Secretary of Agriculture that is set up for the purpose of providing price-support to producers of agricultural commodities through loans, direct purchases, payments, and other means. Some of these price-support commodities such as grain, dairy, peanut, and oil products are available for distribution to FNS food assistance programs.

**Commodity File:** A USDA computer generated print-out that lists the donated food items, pack sizes, prices per pound, unit gross and net weights, commodity codes, and other information. The Commodity File, issued in mid-January, is used to determine the appropriate contract value for each donated food for the upcoming agreement year.

**Condemned Meat:** Meat or poultry that has been determined by FSIS to be unfit for human food due to adulteration, disease, contamination, or other conditions rendering it unusable for human



consumption. Condemned meat or poultry can also refer to product that has fallen on the floor or was improperly handled during production.

**Consignee:** The distributing agency, recipient agency, commercial warehouse, etc., that physically accepts delivery of the foods by railroad car, truck, or tractor trailer shipment. A receipt is signed to verify the acceptance of a food shipment, the quantity, and the condition in which it was received. The consignee receipt is part of the KC-269A form (Forwarding Notice).

**Contract Value of Donated Food:** The price assigned by USDA to a donated food that reflects USDA's current acquisition price, transportation and, if applicable, processing costs related to the food.

**Contracting Agency:** The distributing agency, subdistributing agency, or recipient agency that enters into an agreement with a commercial food processor for the conversion of donated food into finished end products.

**Delivery Order Number (D/O):** A unique number assigned to each shipment of food. Each delivery order specifies the State, quantity, shipping period, planned usage, and destination of a shipment. Multiple D/Os may be included on a food requisition.

**Demurrage Charge:** A penalty charge assessed by railroads for cars held by shippers or receivers of freight beyond a specified free time.

**Detention Charge:** A penalty charge assessed by motor carriers or piggyback companies for detaining equipment beyond a specified free time. Mechanical detention occurs when rail cars are detained beyond a specified free time.

**Direct Discount Sale:** The selling of a finished end product by a commercial food processor, directly to the distributing agency or the recipient agency. Under this procedure, the processor directly invoices the distributing agency or recipient agency at the net case price. The processor must maintain delivery and/or billing invoices to substantiate the quantity of end products delivered and the net price charged per case.

**Direct Refund Sale:** The selling of a finished end product by a commercial food processor, directly to the recipient agency. Under this value pass-through system, the processor invoices the recipient agency directly for the commercial/gross case price of the end product. The recipient agency must then submit a refund application to the processor.

**Direct Shipment:** Food ordered by a distributing agency to be shipped directly from the USDA vendor to the processor, rather than shipped to a distributing agency's or recipient agency's storage facility. Since the normal shipping practice is to ship foods to the distributing agency, this is sometimes called a "diverted shipment," "direct diversion," or "direct delivery."

**Distributing Agency:** The agency, usually an agency of State government, which enters into an agreement with FNS for the distribution of donated food to eligible recipient agencies.

**Distributor:** A commercial food purveyor who purchases, receives and/or stores commercial food products. Distributors in turn, sell, deliver, and bill the recipient agency or the distributing agency for the goods and/or services provided.

**Diversions:** A food shipment that has not been received (still in transit) that is rerouted to another location or State Distributing Agency.

**Donated Food:** Food donated or available for donation by USDA to eligible recipient agencies. Donated food is also referred to as “commodities.”

**End Product:** A finished product containing any amount of donated foods that has been commercially processed.

**End Product Data Schedule:** A standard form used to describe the finished end product being produced. Information detailed on this form includes formulation, quantity of donated food needed to produce a specific number of units of end product, and pricing, packaging and yield information.

**Entitlement:** A dollar value of commodity assistance, or cash-in-lieu of commodities, which is required by law to be provided to the Child Nutrition Programs and the Nutrition Program for the Elderly.

**Entitlement Foods:** Values of Group A or Group B foods that are “charged” against a distributing agency’s or recipient agency’s level of commodity assistance. The values of bonus foods do not reduce the entitlement funds.

**Entity code:** A unique code assigned to each distributing agency for each destination designated to receive donated foods. These codes are assigned by KCCO, and are a part of the name and address information.

**Fair Share:** A proportional quantity of an available donated food. Distributing agencies are offered a fair share of the total amount of a given food item that is calculated based on a distributing agency’s percentage of the national entitlement. Distributing agencies use a similar basis for allocating donated foods to eligible recipient agencies.

**Farm Service Agency:** The USDA agency responsible for acquiring products such as grain, dairy, peanut, and oil products under price-support activity.

**Fee-For-Service:** The price charged by pound or by case representing a processor’s costs of ingredients (other than donated foods), labor, packaging, overhead, and other costs incurred in the conversion of the donated food into the specified end product. Fee-for-service is an alternative to using a value pass-through system. It primarily applies to meat and poultry products or other non-substitutable donated foods.

**Fiscal Year:** The Fiscal Year is always October 1 thru September 30.

**Food and Nutrition Service (FNS):** The USDA agency responsible for administering domestic food assistance programs.

**Food Distribution Division:** The FNS division responsible for administering the donation of commodities to domestic food assistance programs.

**Food Safety Inspection Service (FSIS):** The USDA agency whose primary mission is to inspect the wholesomeness of meat and poultry products.

**Food Service Management Company:** A commercial enterprise or a nonprofit organization that is, or may be, contracted with by a recipient agency to manage any aspect of its food service in accordance with 7 CFR Parts 210, 220, 225, 226, and/or 250.

**Forwarding Notice:** The KC-269A form, sent by KCCO to the distributing agency, that provides advance notice of the quantities ordered for shipment, the ship-no-later-than date, and the contract vendor. *See definition of Notice to Deliver.*

**Free-On-Board (FOB) Destination:** A method of pricing in which a processor includes the transportation charges to a specific destination for a product. The processor is responsible for arranging and paying for transportation under this method of pricing. *See definition of Free on Board Plant.*

**Free-On-Board (FOB) Origin:** Title transfers at the point of origin. USDA is responsible for arranging and paying for transportation under this method.

**Free-On-Board (FOB) Plant:** A method of pricing in which a processor excludes the transportation charges on a product. Transportation charges are paid by the recipient agency. *See definition of Free on Board Destination.*

**Gross Price:** Under processing, the price paid by the contracting agency before the value of donated food used in the production of the end product is deducted.

**Group A Commodities:** Fruits, vegetables, meat, poultry, and fish products purchased by AMS with Section 32 funds. These foods may *also* be purchased with funds appropriated to FNS. Group A-type foods are purchased when American farmers produce more food than the normal commercial market needs, i.e., surplus removal. *See definition of Section 32.*

**Group B Commodities:** Grains, dairy, peanut, and oil products that are purchased by FSA with Section 416 funds. These foods may *also* be purchased with funds appropriated to FNS or they may be donated by FSA. When prices are low and food supplies are abundant, FSA acquires these excess commodities under price-support legislation to assist American farmers. *See definition of Section 416.*

**Indirect Discount System:** When the processor sells to a distributor at a gross price and the distributor sells to the recipient agency at a net price. Under this system, the distributor applies for the refund. This system is also referred to as the “hybrid” system.

**Indirect Refund Sale:** A value pass-through system under which the processor sells end products to a distributor at the commercial/gross price of the end product. The distributor then sells the end product to a recipient agency at the commercial/gross price, plus delivery costs. The recipient agency then

submits a refund application to the processor for the value of the donated food contained in the end product.

**Inventory:** The accounting of donated food for which a distributing agency, recipient agency, or processor is liable or responsible. In processing, the inventory can include food in physical inventory (on hand), in finished foods, or in book inventory. *See the definition of Perpetual Inventory.*

**Kansas City Commodity Office (KCCO):** An office of FSA that purchases grain, dairy, peanut, and oil products, under price-support authority and makes these products available to FNS outlets. These products may also be purchased by KCCO with FNS funds. KCCO also arranges shipments and makes payment for all commodities distributed through FNS food assistance programs.

**LS-44, USDA Donated Meat Production Information Form:** A supplemental report issued by AMS that accompanies the red meat grading certificate that indicates the total pounds of donated food received by recipient agency and the number of cases and/or pounds of end product produced from that starting weight.

**Monthly Performance Reports:** Reports submitted monthly by the processor to the distributing agency detailing sales of finished end products to recipient agencies, receipts of donated food, and information on the donated food inventory.

**Multi-State Food Processor:** A processor who has entered into a processing agreement with agencies in more than one State, or a processor who has entered into a processing agreement with an agency that is in a State other than where the processor's plant or business office is located.

**Net Case Price:** The price of a processed end product paid by the recipient agency after the value of donated food contained in the end product has been deducted from the gross price.

**Non-substitutable Food:** A USDA donated food that cannot be substituted with a commercially purchased product under the terms of a processing agreement.

**Notice to Deliver:** Form KC-269, issued by KCCO, to vendors seven days prior to the first day of the required shipping period for each delivery order. The KC-269 contains information such as authorized shipping dates, destinations, consignees, and stop-offs. *See definition of Forwarding Notice.*

**Offer and Acceptance System:** The method by which the distributing agency offers donated food to a recipient agency in advance of the shipment date. The recipient agency, in turn, accepts only the amount and varieties it wishes prior to arrival of food.

**One Hundred Percent Yield Factor:** A requirement that 100 percent of the value of the substitutable donated food actually contained in the end product be returned to the eligible recipient agency. Any manufacturing losses are to be made up by the processor with commercial foods of equal or better quality. This requirement was established to encourage efficient processing.

**Out-Of-Condition:** Foods found to be infested, deteriorated, or contaminated as the result of improper storage or latent defects for which the vendor, processor, recipient agency, distributing agency, etc., is responsible.

**Over/Short/or Damaged Report (FNS-57):** A form which consignees use to report overages and shortages in a shipment and commodities damaged in transit. KCCO uses this document to file claims against shippers or vendors.

**Perpetual Inventory:** A daily accounting record of the receipt and usage of donated food, which is updated with each transaction of receipt or usage. Perpetual inventory tracks on paper the amount of donated food that should be in physical inventory at any given time and is periodically reconciled with physical inventory.

**Piggyback:** Truck trailers loaded on top of flat bed rail cars and moved by rail to the destination.

**Processor:** Any commercial facility which processes or repackages donated foods. However, commercial enterprises, which handle, prepare and/or serve products or meals containing donated foods on-site solely for the individual recipient agency under contract are exempt under this definition. School food authorities that provide meals to other eligible outlets are exempt from being defined as processors if they provide accountability for the commodities and assurance that the value of the commodities is passed on to the school food authority's food service account.

**Procurement Division:** Refers to AMS procurement division: LS=Livestock, Py=Poultry, and FV=Fruits and Vegetables.

**Production Records:** Records kept by the processor that document the production of the finished end product. The records show the types and amounts of ingredients used to produce the end product and the amount of end product produced.

**Production Run (Red Meat and Poultry):** Term used to describe a specified manufacturing period. In most cases, a production run is based on each end product manufactured as stated on an individual LS-44 for red meat (beef or pork) or an individual grading certificate for poultry. The exception to this practice is when production occurs over two or more days and two or more LS-44s or grading certificates are generated. When more than one LS-44 or grading certificate is generated for the same delivery order number on a direct shipment or for the same recipient agency on a backhauled product for an identical end product, more than one LS-44 or grading certificate may be used in calculating the guaranteed minimum return.

**Quality Control Plan:** A processing company's plan that assures that the products produced meet minimum specifications for quality, pack size, and content.

**Recipient Agency:** Any of the following organizations within a State eligible to receive USDA donated foods: schools (public and private), residential child care institutions, charitable institutions, nutrition programs for the elderly, summer camps, Summer Food Service Program participants, and soup kitchens.

**Redonation:** Commodity that has been shipped to one State Distributing Agency (SDA) and is then moved to another SDA.

**Refund Application:** An application (usually a pre-printed form) completed by a recipient agency or distributor and sent to the processor that certifies the purchase of end products. Receipt of the refund application obligates the processor to refund the contract value of the donated food contained in the end products purchased.

**Refund System:** A value pass-through system through which a recipient agency purchases a processor's end products and receives from the processor, by means of a refund application, a payment equivalent to the contract value of the donated foods contained in the end products. *See the definition of Refund Application, Direct Refund Sale, and Indirect Refund Sale.*

**Rework:** Wholesome, salvageable product generated during a production run that is not acceptable as the specified product stated on the end product data schedule. Product such as broken patties or nuggets, or other defects such as missing breading, lumps, and ridges would be classified as rework product.

**Sale:** A sale represents the total number of units of a specific end product sold to a recipient agency. The documentation of a sale typically consists of a delivery ticket (showing the recipient agency signed for the particular product) and a billing invoice issued by the processor/distributor that delivered the product. Performance reports are compiled by summarizing the information contained in the sales documents for a specific reporting month. A processor may bill and report a sale each time a delivery takes place or he may choose to bill for product delivered over a specific period of time (i.e., on a monthly basis).

**Salvage:** Damaged donated foods that are still consumable that can be repackaged. Those foods determined unfit for human consumption may be sold as animal food.

**School Year(SY):** The school year begins each July 1 of the calendar year and ends June 30 of the following calendar year. Processing agreements are set up on a school year basis.

**Section 32:** Section 32 of Public Law 74-320, as amended, authorizes USDA to purchase nonbasic perishable foods available under surplus-removal operations, for the purpose of encouraging the domestic consumption of such foods by diverting them from the normal channels of trade or commerce. *See definition of Group A Commodities.*

**Section 416:** Section 416 of the Agricultural Act of 1949, as amended, authorizes USDA to donate basic nonperishable foods acquired through Federal price-support operations for use by needy persons, for use in nonprofit school lunch programs and nonprofit summer camps for children, and for use in charitable institutions to the extent that needy persons are served. *See definition of Group B Commodities.*

**Shipping Period:** A specified time frame for USDA's vendors to ship the donated food. The length of the shipping period varies with the type of donated food being shipped and the mode of transportation.

**Slip Sheet:** A thin fiberboard or corrugated cardboard sheet, used instead of a pallet, commonly "48" x "40" with a lip on one end and one side, on which product is stacked for shipment. The purpose of the lip is to provide a grasping point for the push-pull attachment.

**Specification:** A detailed description of the product which vendors to USDA must meet when selling commodities to USDA. Distributing agencies or recipient agencies may also use end product specifications in issuing bids for processed end products that utilize donated foods.

**Split Shipment:** Rail or truck deliveries with more than one stop-off or delivery point. *See definition of Stop-off.*

**Stop-Off:** Delivery of a partial load of donated foods to a destination designated by the distributing agency. The remaining portion of the carload or truck load will be delivered to another destination. *See definition of Split Shipment.*

**Subdistributing Agency:** An agency performing one or more distribution functions for a distributing agency other than, or in addition to, functions normally performed by common carriers or warehouse operators. A subdistributing agency may also be a recipient agency.

**Substitutable Food:** A USDA donated food that may be replaced by a commercially purchased food of domestic origin, of the same generic identity, and of equal or better quality to the donated food provided by USDA.

**Survey:** An FNS Regional Office contact with a distributing agency to determine the acceptability of a product, the amount of the product desired, and the preferred shipping dates for the product.

**Tare Weight:** The weight of the donated food packaging (containers).

**Transit Claim:** A claim against a donated food consignee resulting from:

- failure of the stop-off consignee to take proper protective measures;
- failure to submit complete documentation on lost or damaged shipments; or
- bills submitted to USDA resulting from failure of the consignee to unload within allowable free time.

**Truck Lot:** A quantity of food equal to a truck shipment. Generally, a trucklot is equal to approximately 40,000 pounds of donated food and contains between 700 to 1,400 cases of food, depending upon the food item.

**Value Pass-Through System:** A system used to ensure that the full value of the donated food contained in the end product is passed on to the eligible purchasing recipient agency. *See the definitions for Direct Sale, Indirect Sale, and Discount System.*

**Vegetable Protein Product:** A product that can be used to satisfy all or part of the meat/meat alternate requirement of the Child Nutrition meal pattern requirements when combined with meat, poultry, or seafood and when it meets the other requirements of 7 CFR, Part 210, 225, and 226 Appendix A., of the regulations. Vegetable protein products are processed so that some portion of the nonprotein constituents of the vegetable is removed. Vegetable protein products are safe and suitable edible products produced from vegetable (plant) sources, including, but not limited to soybeans, peanuts, wheat, and corn.



## History of the State Processing Program

USDA's domestic food assistance programs administered by the Food and Nutrition Service (FNS) are this nation's primary defense against hunger and malnutrition. Through the Food Distribution Programs, millions of Americans receive donated food assistance on a daily basis to help meet some of the nutritional needs of children and needy adults. The programs also help support markets for food that American farmers produce.

To aid American farmers, USDA buys food under price-support and surplus-removal legislation and makes this food available to State distributing agencies. In addition, for some programs, funds are appropriated to purchase foods, the type and variety of which are controlled by market conditions. USDA pays for the initial processing and packaging of the food and for transporting it to designated points within each State. Distributing agencies are then responsible for storing the food, transporting it throughout the State, and distributing it at the local level to eligible recipient organizations participating in the various food programs.

In August of 1935, Section 32 of Public Law 74-320 provided the first significant authority for Federal food donations. This legislation made funds available to USDA to encourage the domestic consumption of certain agricultural commodities by diverting them from normal channels of trade. The intent of Section 32 was to remove price-depressing surpluses from the market through Federal purchases and to put them to use in such a way as not to interfere with normal channels of trade. Fruits, vegetables, meat, and poultry are obtained under Section 32 authority. These foods are called Group A foods and are purchased by USDA's Agricultural Marketing Service (AMS).

In 1943, State agencies took over full administrative and financial responsibilities of the donated food program at the State level and became known as "distributing agencies." In 1946, the National School Lunch Act was passed. This Act provided for funds to be spent by USDA for agricultural commodities to be distributed among schools according to the needs and preferences of schools. Section 6 of this Act authorized USDA to purchase high protein meat and meat alternates that could not be obtained in sufficient quantities under other purchase authorities. Section 6 also required USDA to make donated foods available to States for school programs at a minimum level of commodity assistance. This level of commodity assistance is called the entitlement level.

Also during this time period, Section 416 of the Agricultural Act of 1949 authorized the acquisition and distribution of dairy products, grains, and oils through price-support activities. These foods are called Group B foods and are acquired by USDA's Farm Service Agency (FSA).

Historically, a State's entitlement level is composed of 80 to 90 percent Group A foods with the balance in Group B; however, this ratio may vary depending on market conditions and State preferences. Additional foods, known as "bonus" foods that are not counted against a State's entitlement level, may come from either Group A or Group B. Until recently, the primary bonus foods were Group B dairy products and flour.

Although the food donation programs date back to the 1930's, the authority for processing donated foods has only existed since the first processing regulations were issued in October 1958. It was not until

the early 1970's that FNS began taking an active role in encouraging donated food processing. The impetus for this encouragement came from changes in Child Nutrition legislation, guaranteeing a designated level of donated food assistance based on meals served within the State. As the supply of donated foods became more constant, States and schools saw the opportunity to convert donated products into more convenient or table-ready items. This change helped expand donated food use from a limited number of commodities to a broader array of commodities.

However, with the dramatic expansion in donated food processing, FNS and USDA's Office of the Inspector General (OIG) became aware that oversight responsibilities had not kept pace with program growth. Both agencies soon discovered that more controls were needed to protect Federal, State, and local interests. In order to determine the severity of the problem, OIG conducted two national audits in 1978 and 1985. These audits, which verified that the regulations governing the State Processing Program needed to be strengthened in program accountability, oversight responsibilities, and contractual provisions, resulted in two major revisions in the processing regulations in 1981 and 1986. The major areas of concern that were disclosed by these audits were:

- More State and Federal monitoring of processor operations was needed in the State Processing Program;
- Processors were maintaining excessive donated food inventory levels;
- Processors were substituting inferior quality commercial foods for donated food; and
- There were insufficient Federal regulations and guide-lines in place that contributed to poor program accountability.

Since that time, the State Processing Program has dramatically changed. With the increase in the variety of donated foods made available by USDA came the need to maximize donated food usage to produce nutritionally sound, well-accepted meal items, while keeping labor costs to a minimum. Distributing agencies and processing companies soon learned that working together was beneficial for everyone concerned. Below is a synopsis of the changes to the State Processing Program regulations that have taken place since 1958.

This first regulatory reference to the processing of donated foods required a written agreement between the contracting parties. At that time domestic food donation programs were administered by AMS.

This amendment revised contractual, performance, and review requirements as follows:

- Distributing agencies that provided donated foods to the Child Nutrition Programs, but which did not administer these programs, were required to consult with the State educational agency as to whether the processed products would meet the nutritional requirements for reimbursement under the Child Nutrition regulations.
- In the listing of ingredients on the end product data schedule, processors only needed to identify the total quantity of seasonings and flavorings used in the end product without

requiring the identification of specific ingredients. This provision was designed to ensure that processors' "trade secrets" would be protected.

- In order to avoid disruption in production, those donated foods that could be substituted with identical commercial product without prior approval from the distributing agency were listed in the regulations.
- The mandatory labeling requirements for substitutable commodities were removed from the regulations.
- Since FNS is not a party to the processing agreement, FNS disclaimed any liability with regard to the provisions of processing agreements or performance thereto. This revision substantially increased the accountability requirements for States and processors.
- Several new definitions were added to the regulations including contract value, distributor, food service management company, processor, and refund system.
- The definition of contract value provided the processor with two methods for determining the value of the donated foods:
  - USDA's cost of acquiring and delivering donated food based on USDA's most recent data or
  - The processor's most recent data documenting the cost of purchased foods meeting or exceeding the food specifications delivered to the processing plant. However, when the contract value of donated foods was approved at a lower value than USDA's cost, the processor had to maintain records to substantiate the lower delivered cost and that the food purchased met or exceeded the donated food specifications.
- Distributing agencies had to submit an annual processing State plan of operations and develop a processing manual for use by recipient agencies and processors.
- The specific requirements that must be contained in processing contracts were identified.
- The use of a subcontract was required when a portion of processing was delegated to another company.
- While FNS recommended the use of a bond whenever possible to protect the value of donated foods received by processors, the distributing agency could require *any* alternative methods of insurance that covered the value of the donated foods in inventory at any particular time.

- Distributing agencies became responsible for providing processors with a list of eligible recipient agencies.
- Processors had to supply a wholesale price schedule for end products.
- A refund system for sales through a distributor had to be used unless another system was approved by the FNS Regional Office.
- Distributing agencies could approve requests for additional substitution of donated foods by processors upon receipt of a written request.
- The use of acceptance services graders for all production runs was required when the value of meat or poultry exceeded \$10,000.
- Refund applications had to be submitted no later than 90 days after the close of the school year. The processor was required to make payment within 30 days of receipt of the refund application.
- Processors were required to must submit monthly performance reports and distributing agencies were required to submit quarterly inventory reports.
- The maximum allowable inventory level held by a processor was raised from 4 to 6 months. Distributing agencies could approve a higher inventory level if deemed appropriate.

This regulation required processors to provide for a 100 percent yield for all substitutable commodities.

This major revision of the regulations was brought about by a second OIG national audit on processing. It further increased the requirements on accountability.

- The term “multi-State processor” was defined for the purpose of determining which processors would be subject to the certified public accountant (CPA) audit requirement. Multi-State processors were required to have independent CPA audits performed of their operations.
- The requirement for distributing agencies to submit an annual State processing plan of operations was eliminated.
- Competitive bid procedures and selection criteria had to be used when the numbers of contracts were limited by the contracting agency.
- Agreement duration was limited to one year.

- Processors were required to provide bonds, letters of credit, or escrow accounts in order to protect the value of donated foods against losses.
- Processors were required to maintain a quality control system.
- The use of the “hybrid” system for sales through a distributor was authorized. A sales verification requirement had to be part of this value pass-through system. Additionally, distributing agencies could no longer approve alternate value pass-through systems.
- Refund applications had to be submitted within 60 days of the date of purchase for both recipient agencies and distributors operating under the “hybrid” system. Processors were required to pay refunds within 10 days of receipt of the refund application. Refund applications could be mailed directly to the processor rather than through the distributing agency.
- Advanced approval for substitution was required, except to meet the 100 percent yield requirement and in instances where foods were stored together in joint bins or tanks.
- The use of acceptance services graders was required for all meat and poultry processing except in very limited situations.
- Each processor was required to report the pounds of donated foods in finished end products in a distributor’s possession, along with the names of the contracting agencies under agreement with the processor.
- Processors were required to submit an annual reconciliation report.
- For excess inventories (over 6 months), the processor had to either seek approval for higher inventory levels or buy down inventory.
- Multi-State processors were required to submit independent CPA audit reports.
- The definition of contract value was restricted to USDA’s costs of acquiring and delivering donated food based on USDA’s most recent data.

The State Processing Program regulations were revised to allow the substitution of commercial concentrated skim milk for donated nonfat dry milk in processing agreements.

This regulation made the following changes:

- The definition of refund payment was amended to permit processors to credit distributors’ accounts for sales made under the “hybrid” value pass-through system. Previously, processors were limited to paying refunds to distributors.

- The concept of allowing alternate value pass-through systems to be used was reintroduced into the regulation; however, only FNS could approve alternate value pass-through systems.

This regulation made the following changes:

- Sales verification procedures under the “hybrid” and alternate systems were changed to:
  - require sales verification semi-annually rather than quarterly;
  - require a sample size that provided a 95 percent confidence level;
  - require a 10 percent reverification subsample by the distributing agency when sales verification was delegated to the processor; and
  - require that a corrective action plan be undertaken for invalid sales.
- The school year (July 1-June 30) was established as the basis of all processing agreements. Agreements could begin any time during this timeframe, but had to end on June 30.
- Processors were required to provide distributing agencies with basic information concerning end products, but could be assured that “trade secrets” would not be disclosed. Processors had to continue to identify all ingredients contained in an end product, but were not required to specify the amount of each non-donated food ingredient contained in the end product. The total weight of the batch, however, had to be specified so that the percentage of donated food in the formula could be determined.
- For sales through distributors under “hybrid” or alternate systems, distributors were allowed to retain invoices rather than forwarding them to the processor.
- All invoices had to list the amount of the discount or refund due for donated foods contained in the end products sold.
- At the time of contract termination, the Commodity Credit Corporation’s unrestricted sales price was added as an option for determining the commodity value.
- The date that refund applications had to be submitted was changed from 60 days from purchase to 30 days following the month of purchase.
- The requirement that processors report pounds of commodities in end products held by distributors was deleted.

- The language regarding processor payment for excessive inventories at time of reconciliation was clarified.
- The multi-State processor audit cycle frequency had to include the value of foods processed under the National Commodity Processing Program, in addition to the value under State processing agreements.

Technical errors in citations contained in previously issued regulations were corrected.

For School Year 1988-89 only, processors were allowed to delay refund payments for end products made from donated cheese. This regulation came about as the result of USDA's inability to make timely deliveries.

State performance standards were issued which required distributing agencies to administer an acceptable processing program. Distributing agencies were required to inform recipient agencies on an annual basis of the processing options. Distributing agencies or their recipient agencies were required to test end products and distributing agencies were required to monitor the acceptability of processed end products.

# Processing Agreement Approval

A processing agreement is a legally binding contract between a processor and a distributing agency or recipient agency. This agreement contains the provisions that permit processors to receive and utilize USDA donated food as an ingredient in the production of a finished end product. In turn, a processor agrees to pass the value of the donated food through to the recipient agency in the form of a lower cost for the product. As with any contractual arrangement, the processing agreement is designed to protect the interests of all parties involved -- processor, the distributing agency, and the recipient agency.

**Agreement Duration:** The agreement begins on July 1 of each year and ends on the following June 30. An agreement may be entered at any time during the year. Distributing agencies have the option of extending processing contracts up to two additional 1-year periods, providing that any changes to the original agreement are updated and the extension is signed by both parties. The distributing agency must ensure that all required reports have been submitted in compliance with the original contract and should be satisfied with the previous performance of the processor.

Processing agreements can be between either the distributing agency or a recipient agency and the processor. There are three basic types of agreements:

**State Agreement:** Under a State agreement, the distributing agency negotiates bids and/or prices, selects the processor and the end product(s) that will be produced, and enters into an agreement with the processor. Any eligible recipient agency may purchase end products from the approved processor.

**Recipient Agency Agreement:** Under a recipient agency agreement, the recipient agency enters into an agreement with the processor. This kind of agreement requires the approval of the distributing agency. Once approved, the recipient agency can purchase end products from the processor.

**Master Agreement:** Under a master agreement, the distributing agency enters into an agreement with the processor and only designated eligible recipient agencies may purchase end products from the processor.

## What Must Be Included In The Processing Agreement

It is essential that the processing agreement be accurately completed. The processing agreement must contain the following:

- State distributing agency information (State, agency, agency representative or contact person, address, and telephone number);
- Recipient agency information (if applicable);
- Processor information (the company name, company representative, address, and telephone number);



- Specific information regarding the processor's plant location(s);
- Effective dates (both beginning and ending dates must be specified) of the agreement;
- Information regarding the value pass-through system(s) the processor will use;
- Debarment certification which states that the processor has not been debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from certain transactions with the Federal or State government;
- Specific information that may be required in a "Special Provisions" article of the agreement, such as subcontracting information, dollar value of inventory protection provided by the processor, information regarding by-product credits (particularly for meat and poultry processing), etc.; and
- Names, addresses, titles, and signatures of the authorizing persons who represent the distributing agency and the processor.

#### What Should Be Included On the End Product Data Schedule

An end product data schedule is the document used to establish the amount of donated food that will be contained in each unit of finished end product. It lists the exact quantity of donated food needed to produce the end product and ensures that a specific amount of donated food is contained in the end product. Under the State Processing Program, only approved end products may be marketed; therefore, the sale of an end product **cannot** be made until the end product data schedule has been approved by the distributing agency. The end product data schedule is always provided as part of the agreement package.

There are three different end product data schedules in common use; one for bone-in poultry end products, one for preplated meals, and the other developed for all other donated foods. All sections of the end product data schedule must be completed prior to submission to the distributing agency. However, if there are portions of this form that are not applicable to the processing of that particular end product, the processor must indicate this on the end product data schedule. On each end product data schedule, processors must include a description of each end product to be processed, the quantity of each donated food being processed, the end product return or yield of donated food, the pricing structure of the end products, the product formulation, and the total batch weight. As part of the product formulation, processors must list any "other" ingredients used to yield a specific number of units of each end product. Distributing agencies may permit processors to specify the total quantity of any flavorings or seasonings that may be used, without identifying the ingredients that are, or may be, components of seasonings or flavorings. Thus, processors can be assured that formulations will not be disclosed, since only the quantity of donated food and total batch weights must be listed on the end product data schedule.

**The 100% Yield Factor:** The end product data schedule must reflect the actual yield of donated food supported by data contained in the processor's production and quality control records. For substitutable donated food, 100 percent of the donated food provided to a processor must be contained in the finished end product. For example, if a processor receives 75 pounds of butter, 75 pounds of butter must be contained in the end products. Any loss of the donated food during preparation or production must be replaced with a "like" amount of the same food from a non-donated source (i.e., no donated food losses occurring during production may be debited against the donated food inventory). This production loss must be reflected in the yield percentage on the end product data schedule. With rare exceptions, no end product should have a 100 percent yield of donated food. Processors must ensure that adequate internal control systems are in place to monitor and maintain updated production yield documentation.

Determining the guaranteed minimum return for end products containing non-substitutable donated foods is more complex than determining the yield for substitutable foods. This is more fully discussed in the *Substitution Issues* section of the handbook.

**Pre-Approvals:** If any changes are made to the product formulation or to the pricing structure, the processor **must** submit a new end product data schedule to the distributing agency for immediate approval. Processors will not be permitted to draw down on their donated food inventory for any new end product data schedules until they receive approval from the distributing agency (inventory drawdown is based on the number of pounds of donated food actually contained in a case of end product). Additionally, if a processor wishes to add new end products during the agreement year, the processor must submit a schedule to the distributing agency for approval **before** it attempts to sell and report sales of the products. Furthermore, new end products should be tested by the distributing agency or the recipient agencies before end product data schedules are approved.

**Correction to the End Product Data Schedule:** The instructions for completing the end product data schedule are found on the reverse side of the form. The contracting agency is responsible for checking all end product data schedules to see that the figures submitted by the processor are accurate. If errors are discovered, the processor should be contacted by telephone and the specific errors identified. At that time, the processor should make the decision as to whether the end product data schedule should be returned for corrections or whether the distributing agency can make the corrections and **initial and date them**. It is very important that corrections (whether made by the processor or the distributing agency) are made to all copies of the schedules.

**Proof of Marketability:** In the past, there have been instances where processors approved for the State Processing Program did not have sufficient sales to enable them to utilize all the donated foods provided to them in a 6-month period. This occurred because the processor had not generated sufficient business among recipient agencies within the State. The end result was that donated food inventory was carried forward on the processor's books month after month. In order to avoid this situation, processors who wish to participate in the State Processing Program should provide documentation to the distributing agency that a market exists within the State for the finished end products they wish to sell to recipient agencies. Examples of proof of marketability could be copies of bid awards and/or letters of intent to purchase from eligible recipient agencies located within the State. Processors may be required to provide this documentation as part of the processing agreement

submitted to the distributing agency. Processors may also be required to provide evidence to prove they can accept and store minimum truckload quantities of donated food.

Once the processor is approved for participation in the State Processing Program and receives donated food, the processor must actively market and sell the end products to eligible recipient agencies. The processor is expected to fully utilize the food inventory on hand and report sales to the distributing agency. Furthermore, the inventory level of each donated food in the processor's storage facility may not exceed a 6-month supply, unless the processor has requested and received **written** approval from the distributing agency to maintain a higher inventory level.

**Testing End Products:** Section 250.30(b)(1) of the State Processing Program regulations requires each distributing agency to test the acceptability of end products with the recipient agencies eligible to receive them prior to entering into a processing agreement. Additionally, distributing agencies must develop a system to monitor product acceptability throughout the agreement year. The methods to test and monitor end products are determined by each distributing agency. Some distributing agencies conduct taste tests of various processors' end products to determine which processors would be approved to do business in the State. Other distributing agencies enlist the help of the State Food Distribution Advisory Council members or students to assist in the testing of new end products or end products currently being received by recipient agencies. Additionally, school food service personnel often have an opportunity to taste a variety of end products manufactured by several processors when they attend food shows sponsored by State school food service associations. Such shows provide an opportunity to compare the end products of many processors and to determine which products they prefer. Distributing agencies are responsible for keeping in contact with the recipient agencies to learn whether the end products received throughout the year continue to be up to par. One way to do this is for distributing agencies to periodically survey the recipient agencies, requesting feedback on the end products received.

**Cost Effective Processing:** In determining which processors and end products should be approved, distributing agencies have been requested to take into consideration the overall cost of the end product. In the past, some distributing agencies have entered into agreements with processors who did not utilize donated food in a cost effective manner. For, example, donated turkey roasts have been supplied to processors who have simply ground them up to make items such as chili, taco filling, and sloppy joes. Turkey roasts are a high quality processed item for which USDA pays a premium price. The use of turkey roasts in ground turkey end products is an inappropriate use of this high quality commodity. Reprocessing agreements should only utilize bulk pack turkey or ground turkey that is less expensive and more readily available to produce these types of end products.

Often, processing agreements have been approved for end products that can be obtained very inexpensively in the commercial marketplace. For example, distributing agencies may approve agreements for the production of hot dogs from bulk chill pack turkeys. In order to determine the final cost of the end product to the recipient agency, it is necessary to include the value of the donated food contained in the end product plus the fee-for-service price per pound to produce the product. Turkey hot dogs may end up costing \$1.17 per pound produced under a processing agreement, whereas the same product might be purchased commercially for as low as \$.80 a pound. It might be more beneficial to have other products manufactured from the bulk turkeys, (i.e., cooked turkey roast, turkey ham, turkey roll, etc.) However, when a number of different products are being manufactured from whole birds, it

might be wise to include hot dogs as an end product in order to fully utilize all of the meat. As you can see, distributing agencies must consider many factors when selecting end products.

It is important to evaluate each processing contract to ensure that end products are appropriate and represent the best deal possible for the purchasing recipient agencies. Many donated foods come in a variety of forms and distributing agencies should determine which of these forms is the most appropriate for the processor to use in manufacturing the end products. For example, ground beef is available in frozen, coarse ground, fine ground, and patties. It would be imprudent for a processor to convert donated beef patties into an end product like meatballs or a different shaped patty. Instead, it would be appropriate for the distributing agency to order coarse ground beef to be direct shipped into the processor for further manufacturing into finished end products. It takes the cooperation of all parties involved to determine what end products are appropriate for program use and to ensure that the overall price of those end products represent a fair value to the recipients.

*Please refer to the Poultry Processing section for an in-depth discussion of cost effective processing of poultry items.*

**Inventory Protection:** In accordance with Section 250.30 (c)(4)(viii)(B) of the State Processing regulations, before receiving any donated food for processing, all food processors must furnish a performance supply and surety bond, an irrevocable letter of credit (LOC), or establish an escrow account sufficient to cover the amount of inventory **on hand and on order**. The surety company from which the bond is obtained **must** be listed in the most current Department of Treasury Circular 570, Companies Holding Certificates of Authority as Acceptable Sureties on Federal Bonds and as Acceptable Reinsuring Companies. This Circular is published on July 1 of each year and may be obtained through the Internet at: <http://www.ustreas.gov/treasury/bureau/finman/c570.html>

**Establishing the Amount of Coverage:** For new processors, the amount of coverage must be sufficient to cover the value of the first food order. Since most food orders are in truckload quantities, the initial bond, LOC amount, or escrow account must be equal to the value of one truckload for each commodity ordered. For example, a processor ordering cornmeal and butter must obtain, at a minimum, a bond of \$44,928 (\$1.025/pound x 43,200 pounds of cornmeal + \$1.0125/pound x 40,000 pounds of butter).

For processors with a history of participation in the State Processing Program, the amount of inventory protection must cover the amount of inventory on hand and on order, taking into consideration donated food usage up to the point of delivery. The distributing agency will determine the maximum amount of inventory to be covered by the bond/letter of credit/escrow account to see that all the donated inventory is protected.

State distributing agencies have been instructed to not order food if the inventory protection is insufficient to cover the value of inventory on hand and the requested food order, or when the food order would increase inventory levels above the maximum allowable inventory level. Section 250.30(n) of the regulations limits the amount of donated food a processor may hold in inventory to a 6-month supply, based on average monthly usage, unless the distributing agency has approved a higher inventory level based on justification provided by the processor. This established level represents the maximum allowable inventory level. Processors may choose to provide sufficient bonding to allow them to operate

at this level. Maintaining a 6-month supply provides processors with maximum flexibility in meeting their clients' demands for approved end products during the period of the agreement, especially at the beginning of the agreement year when the need for start-up inventories is most crucial. However, it is up to each processor to determine how much inventory up to the maximum allowable inventory level they wish to keep on hand and to ensure that inventory protection levels are in place accordingly.

**What is the Processor's Liability under these Sureties:** Processors are liable for the full value of all donated foods received under processing agreements each year and must maintain records to demonstrate compliance with such agreements for up to three years from the end of each agreement period, or longer if required for unresolved audits or investigative findings. If a processor's noncompliance with any aspect of the processing agreement results in a claim and the processor fails to honor such claim, the distributing agency must "call in" the bond/LOC/escrow account by transferring the liability from the processor to the bonding company or bank for up to the full value of the bond/LOC/escrow account. Prior to "calling in" the bond/LOC/escrow account, however, processors will be offered every opportunity to honor any claims.

**Are Continuation Certificates Acceptable:** Most continuation certificates are not designed to provide the ongoing level of independent coverage required for each processing agreement. Because continuation certificates are basically intended to extend the life of the bond, and not the specific amount of protection offered by the bond, continuation certificates should not be used to meet the bonding requirements of future processing agreements. Processors should submit a new bond **or** a bond renewal for every year they wish to participate in the Program.

Finally, if a processor elects to provide inventory protection through an LOC, the processor must ensure that the following clause is included in the LOC format:

"It is a condition of this Letter of Credit that it is deemed to be automatically extended without amendment for one year from the expiration date hereof, or any future expiration date, unless 30 days prior to any expiration date we notify you by registered mail that we elect not to consider this Letter of Credit renewed for any such additional period."

LOCs must be in effect for the entire period of the processing agreement to which they pertain and should remain in effect for an additional six months following the expiration date of the agreement. For example, if a processor's agreement is in effect from July 1, 1997, through June 30, 1998, the LOC should not expire **before** January 31, 1999. However, the LOC may be released if the distributing agency is **completely** satisfied with the reconciliation report submitted by the processor.

**Can a Surety Bond or LOC be Printed On Two Separate Pages?** Yes. Both surety bonds and LOC's can be printed on one or two pages. For legal reasons, the signatures must be on the bond.

**Bond Guidelines:** All food processors participating in the State Processing Program should be required to provide "**New**" or "**Renewed**" bonds each agreement year with a minimum value to cover food orders and existing inventories. This will be the case whether the processing agreement is newly approved or extended. At a minimum, the following information must be included in the bond:

- Principal's name (processing company);
- Signature of authorized processing company official (with witnessed signature);
- Title of authorized company official;
- Surety name (i.e., bank, insurance company);
- Amount of bond;
- Date of bond issuance;
- Effective date of bond must precede or coincide with the effective date of the agreement;
- Expiration date (not to expire before June 30, of any agreement year);
- Signature and title of surety official (with attester's signature);
- Surety company must be listed in the most current Department of Treasury Circular 570, *Surety Companies Acceptable on Federal Bonds*; and
- Bond Number.

***Note: Please ensure that the Attorney-in-Fact who signs the bond also signs the Power of Attorney where applicable.***

**LOC Guidelines:** If food processors participating in the State Processing Program wish to utilize an “irrevocable” LOC instead of a bond, at a minimum, the following information must be included in the LOC:

- Principal's name (processing company);
- Signature of authorized processing company official (with witnessed signature);
- Title of authorized company official;
- Surety name (i.e., bank, insurance company);
- Amount of LOC;
- Date of LOC issuance;

- Effective date of LOC must precede or coincide with effective date of end product data schedule;
- Expiration date;
- Signature and title of official (with attester's signature) and
- All LOCs **must** include the following provision:

“It is a condition of this Letter of Credit that it is deemed to be automatically extended without amendment for one year from the expiration date hereof, or any future expiration date, unless 30 days prior to any expiration date we notify you by registered mail that we elect not to consider this Letter of Credit renewed for any such additional period.”

**Selection of Value Return Systems:** The processing of donated food can usually be incorporated into the processor's normal manner of doing business, including production, pricing, and delivery of the end product. The specific value of the donated food **must** be the designated USDA value. The processor must ensure that the full value of the donated food contained in the end product is passed to the recipient agency. Processors can select any of the value pass - through (VPT) systems described below; however, the distributing agency reserves the right to disallow continued use of a VPT system if poor performance is indicated.

*Direct Discount Sale* - The recipient agency takes delivery of the finished end products and is invoiced directly by the processor at a net case price that reflects the full value of the donated food contained in the end products purchased.

*Direct Refund Sale* - The processor invoices the recipient agency directly for the commercial/gross price of the end product. The recipient agency submits a refund application to the processor within 30 days from the close of the month in which the sales were made. Within 30 days of receipt of the recipient agency's refund application, the processor must issue a payment directly to the recipient agency in an amount equal to the value of donated food contained in one case of end product, multiplied by the number of cases delivered to and accepted by the recipient agency. If the total refund due for any one quarter is \$25 or less, recipient agencies may submit the accumulated refund applications quarterly and processors may pay the accumulated refunds quarterly.

*Indirect Refund Sale* -Processors sell end products to distributors at the commercial/gross price of the end product. Distributors then sell end products to recipient agencies at the commercial/gross price, plus delivery costs. Each recipient agency must then submit a refund application to the processor within 30 days of the receipt of the end products. Within 30 days of receipt of the recipient agency's refund application, the processor must issue a payment directly to the recipient agency in an amount equal to the value of donated food contained in one case of end product, multiplied by the number of cases delivered to and accepted by the recipient agency.

*Indirect Discount Sale (“Hybrid”)* - This system is referred to as the “hybrid” system because it combines features of the discount and the refund VPT systems. The processor sells end products to a commercial distributor at the gross/commercial price. The distributor, in turn, sells the products to eligible recipient agencies at the net case price (i.e., the gross/commercial price less the discounted value of the donated food contained in each case purchased by the recipient agencies) plus the distributor’s markup for each case of product. Within 30 days from the close of the month in which the sales were made, the distributor must apply to the processor for a refund or credit for the value of the donated food in the end products. The processor then must provide a refund to the distributor within 30 days of receipt of the application for all valid sales to eligible recipient agencies. The processor must ensure that the distributor provides discounts of equal value to eligible recipient agencies as established in the processing agreement and the applicable end product data schedule(s).

If delegated by the distributing agency, processors using the “*hybrid system*” must also have a verification system in place to confirm sales reported by distributors. As part of this system, the processor must verify a statistically valid sample of reported discount sales made by distributors in a manner that ensures a 95 percent confidence level. This includes submitting written reports to the distributing agency as an attachment to the December and June performance reports, summarizing the verification results and submitting corrective action plans to the distributing agency to identify any invalid sales reported by the distributor. The distributing agency must review the processor’s findings and select a random sub-sample of at least 10 percent of all sales verified by the processor and reverify the sales by contacting the recipient agencies by telephone or through written correspondence. The distributing agency is then required to submit a copy of the processor’s review report and findings and the results of its reverification efforts to the appropriate FNS Regional Office.

**Other Systems:** Processors are permitted to use alternate VPT systems if approved by the distributing agency and FNS. These systems must comply with the sales verification requirements outlined in 7 CFR Part 250.19(b)(2) of the Food Distribution Program regulations or alternate verification system as approved by the or FNS. Additionally, FNS may consider the paperwork and resource burden associated with alternate VPT systems when considering approval and reserves the right to deny the approval of systems that are more labor intensive than those permitted by the regulations and provide no greater accountability than traditional systems.

*The section on Monitoring Activities discusses the process used to verify sales in both the hybrid system and the alternate VPT system.*

**Fee-For-Service Arrangements:** The processing of meat and poultry into finished end products are traditionally performed under fee-for-service arrangements. The definition of fee-for-service is the price by pound or by case that represents a processor’s cost of ingredients (other than the donated food), labor, packaging, overhead, and other costs incurred in the conversion of the donated food into the end product. Under fee-for-service arrangements, a discount or refund per case is not established; consequently, there is not a credit for the value of the donated food. The net price is based on a charge per pound or per case for processed finished product. Additionally, processors are responsible for returning the market value of any by-products (less costs) which result from processing meat and poultry.



Since the majority of end products produced under fee-for-service agreements contain meat or poultry, care must be taken to ensure that end products are sold only to outlets eligible to receive these donated foods and the value of the meat or poultry must be credited against the appropriate outlet's commodity entitlement. Also, meat and poultry products, which are non-substitutable donated foods, must be clearly labeled "Contains Commodities Donated by the U.S. Department of Agriculture. This Product Shall Be Sold Only to Eligible Recipient Agencies."

If by-products are produced as the result of converting donated food into finished end products, processors must give credit for by-products (after the processors' expenses are deducted from any sale of these by-products) through a reduction in the fee-for-service price by:

- a reduction in the fee-for-service by a specific dollar value amount reflected in the agreement; or
- by identifying by-product credits directly on the billing invoice.

End products produced under fee-for-service agreements may be delivered and invoiced to recipient agencies in one of the following ways:

- The processor delivers the end products directly to the recipient agency and bills the recipient agency for the agreed upon fee-for-service plus the delivery charge; or
- Delivery is made by commercial distributors. Processors may not sell end products directly to distributors at the fee-for-service price.
- Two options for arranging payment for end products are:
  - A dual billing system whereby the recipient agency is billed by the processor for the fee-for-service and the distributor bills the recipient agency for storage and delivery of end products; or
  - The processor makes arrangements with a distributor for delivery of end products on behalf of the recipient agency. In this situation, the processor's invoice must include both the processing fee and the distributor's charges as separate, clearly identifiable charges.

**Procurement Procedures and Bidding:** In addition to the State processing contracts, distributing agencies or their recipient agencies may enter into procurement contracts for the actual purchase of food. The procurement of processed products either by distributing agencies or recipient agencies must be done in accordance with the guidelines of Attachment O of the Office of Management and Budget (OMB) Circular A-102. Any eligible agency should not enter a contract where the processor cannot demonstrate the ability to meet the terms and conditions of the State processing program regulations and the processing agreement.

When a distributing agency or recipient agency is contracting for the purchase of processed products, it is important to remember that State processing agreements may be extended for two 1-year periods, provided that any information that changes is updated before any contract extension is granted. The processor must have performed to the satisfaction of the contracting agency during the previous contract year, submitted all required reports and any corrections to such reports up to the time that the contract extension occurs, and submitted its certified public accountant report as needed. Furthermore, there is no assurance that a particular donated food will continue to be provided by USDA for the duration of the agreement. Therefore, it is recommended that the procurement contract be for the same duration and time frame as the distributing agency's processing agreement. The unit price quotes and "bottom line" quotes in the bid contract should be provided on the basis of "with" and "without" donated food.

Distributing agencies which enter into processing agreements on behalf of their recipient agencies, but do not actually purchase the end product, are **not** required to follow the Federal procurement standards. However, if the distributing agency wishes to limit or restrict the number of processors or end products it will approve, the distributing agency must develop criteria for use in evaluating and selecting processors. The distributing agency must apply the selection criteria uniformly to ensure equitable treatment in selecting or rejecting processors. The selection criteria shall include at least the following:

- The nutritional contribution provided by the end product;
- The marketability of the end product;
- the distribution method the processor intends to utilize;
- The end product data schedule;
- Any applicable labeling requirements; and
- The ability of the processor to meet the terms and conditions set forth in the regulations

The primary objective of all procurement requirements is to ensure that purchase activities are conducted in a manner that provides for open and free competition among all interested parties. This has the dual objective of providing all interested processors an opportunity to compete as well as ensuring that the best price will be obtained for the quality of product or services solicited. Procurement procedures should in no way restrict or eliminate competition. Some examples of those practices that restrict competition follow:

- Placing unreasonable requirements on firms in order for them to qualify to participate in the procurement process, i.e. excessive bid bonds, unreasonable delivery schedules, etc.
- Non-competitive practices between firms which foster non-competition such as collusion;
- Organizational conflicts of interest, which can occur when a party responsible for determining bid compliance is linked with a subsidiary of the company under contract; and

- Any practices which would give one bidder an advantage over another. Examples include, entering into negotiations with a processor prior to the award under a competitive sealed bid method; limiting access to pre-bid meetings; or releasing the contents of a one company's bid to competing companies.

Since the procurement process may take several months, it is important that the contracting agency plan its purchase needs far enough ahead to provide adequate time for the procurement process to occur. The contract should be developed and cleared through the contracting agency's attorneys for legal sufficiency.

*Development of the Bid Invitation-* The bid invitation usually requires the bidder to incorporate into the contract any general conditions, any special provisions, and a pricing schedule. The bid should contain the at least following information:

- A description of the procurement method used, the location where the bid should be sent and the date the award will be announced;
- Information for completion by the vendor, including the signature and telephone number of the official for contract administration, the local representative, and the manufacturing point or the local distribution point for services;
- Information regarding inspection of plant facilities;
- Certification that the bidder has a valid processing contract with the distributing agency;
- Provisions for contract termination whereby either party may cancel the contract for cause within 60 days notification;
- Small and Minority Business certification; and
- All procurement contracts must contain a certification of compliance provisions of the following Acts and regulations.
  - Energy Policy and Conservation Act (PL 94-163);
  - Provisions of the Occupational Safety and Health Act and the standards and regulations issued thereunder;
  - Provisions of the Fair Labor Standards Act;
  - Access rights to books, documents, papers, and records as may be necessary to comply with Federal laws, regulations, and the processing agreement. Such records must be held and available for a period of 3 years from the termination of the agreement in the Federal fiscal year to which they pertain. Such records must be available to the contracting agency, USDA, or the General Accounting Office at any

reasonable time and place. If audit findings have not been resolved, the records must be retained as required until all audit findings are resolved; and

- Debarment, Suspension, Ineligibility, and Voluntary Exclusion—Lower Tier Covered Transactions (Executive Order 12549, Debarment and Suspension, 7 CFR Part 3017) Certificates.
- In addition to the above compliance certification, contracts that exceed a value of \$10,000 must also comply with: Executive Order 11246, entitled “Equal Employment Opportunity”, as amended by Executive Order 11375 and Department of Labor regulations (41 CFR Part 60).
- All contracts which have a value in excess of \$100,000 must comply with all compliance certification listed above plus the following
  - Section 306 of the Clean Air Act (42 USC 1857(h))
  - Section 508 of the Clean Water Act (33 USC 1368)
  - Executive Order 117389 & E P A regulations (40CFR Part 15).

*Special Provisions*—The special provisions section of the bid document or purchase contract contains provisions that are unique to the particular contract, rather than standard boilerplate language. The main special provisions sections include:

- The scope of the contract, i.e., the manufacture and supply of specific processed product made from commodities;
- The contract’s duration and any conditions regarding its renewal; and
- Any information regarding prompt payment discounts, pricing information such as FOB destination or any charges that may be incurred in fulfilling the agreement.

The contract should specify that the pricing/discounts should remain valid for the duration of the contract, unless otherwise stipulated. However, these prices could be changed during an annual renewal process.

If estimates of quantities of end product to be purchased are provided to assist in pricing, the contract should state that the contracting agency is not obligated to purchase a specified amount of end product, and that the processor will be obligated to fill orders placed under the contract.

Each contracting agency should develop a contract appropriate to its own needs. Other special provisions might include the following:

- Ordering procedures, deliveries, and billing procedures;

- Marking of containers;
- Liability;
- Insurance;
- Nutritional or other laboratory analysis;
- Food laws and standards;
- Rights of inspection;
- Delivery vehicles conditions and sanitation; and
- “Buy American” provisions.

*The Price Schedule*—This part of the procurement contract lists the bidder’s price per unit of end product to be supplied, the price for the total number of each unit to be purchased, and an aggregate amount or “bottom line” price for all units to be supplied. This figure is used for the basis of determining which bidder receives the bid award.

**Procurement Methods:** There are several procurement methods available, although the competitive sealed bid method is probably most appropriate for processing. Other methods include small purchase procedures, competitive negotiation, and noncompetitive negotiation. The small purchase method is used for contracts of less than \$10,000 in value annually. Most processing contracts will exceed this value. The competitive negotiation and noncompetitive negotiation methods are usually used when an award cannot be made principally on a simple total cost basis. These methods are frequently used for the acquisition of professional services. They may be used when adequate specifications cannot be developed to formally advertise the contract requirements. Under these methods, the solicitation document is called a “Request For Proposal” and an interested bidder must respond by submitting both a technical and cost proposal.

*Competitive Sealed Bids (Invitation for Bid)*—Under the competitive sealed method, sealed bids are publicly solicited and a firm fixed price contract (lump sum or unit price) is awarded to the responsible bidder whose bid is the lowest. This is the method of choice when the contractor wishes to have a fixed of firm price contract. It does not permit cost reimbursable provisions, including combinations of fixed fee and cost reimbursable provisions, even when those provisions are capped. In order for this method to work well, the following conditions must be present.

- The invitation for bid must include sufficient information in the specification or purchase description to determine that the bids submitted will provide the product that was requested;
- Two or more responsible bidders must be willing to compete for the contract;
- The procurement lends itself to a firm fixed price contract;

- In competitive sealed bids, formal advertising is required, and bids should be solicited from an adequate number of suppliers. The bid invitation should provide all the information necessary to allow the bidders to properly respond;
- It must be awarded to the responsible bidder whose bid is the lowest, provided the bid conforms to the requirements of the invitation. However, if the award is to be made on a basis other than the lowest price, the method of award must be clearly described in the general conditions. For example, if the lowest three bidders are to be selected on an aggregate basis, this must be clearly described. Any or all bids may be rejected when there are sound documented business reasons in the best interest of the program;
- All bids must be opened publicly at the time and place stated on the invitation and the notice of award to the bidder should be made in writing; and
- Where specified in the bidding documents, factors such as discounts, transportation costs, etc., should be considered in determining which bid is the lowest.

The following provisions shall not be allowed in the processing contract:

- Cost plus a percentage of cost/income to the contractor, however represented;
- Effective date of the contract before the signed date.

**The Bid Process:** Once the invitation has been developed and reviewed for legal sufficiency, the contracting agency must give bidders sufficient time to prepare and submit their bids. At least 45 days should be allowed from the time the bid is solicited to the time the bid is due. Bids should also be solicited from an adequate number of qualified sources and the invitation for bid must be publicized. To encourage participation, bid invitations may be sent to qualified offerors and it should be advertised in publications normally used by the offerors. The advertisement should include the invitation number and date, a brief description of the proposed procurement, and instructions for obtaining an invitation to bid.

After the invitation for bid has been announced, the contracting agency may want to have a pre-bid meeting to provide any information concerning contract performance requirements and to answer questions from prospective bidders regarding the solicitation. If any errors or omissions are identified during the meeting, the invitation should be corrected by written amendments.

At the time and place listed in the invitations, bids are opened publicly. They are first checked to see that the responsiveness criteria identified in the bid invitation are met. The responsiveness criteria may include information regarding the offeror's prior level of performance or experience and financial and technical resources. This information and a bid bond requirement, if required, may be used to determine the offeror's ability to meet the terms of the bid. All bids that do not meet these requirements are rejected.

**Monitoring of the Bid/Purchase Agreement:** The contracting agency must monitor the contractor on an ongoing basis to ensure compliance with the contract. Documentation should be maintained for any corrective action required and whether the corrective action was taken. The contract should be monitored for at least the following;

- Assurance that the processed product received is the same as described in the bid;
- Assurance that the bid price is the same as that charged on the invoice;
- Assurance that the supplier is in compliance with the provisions on delivery, value pass-through, etc., and
- That all record retention and reporting requirements are being met.

**Contract Value of Donated Food:** The contract value is the price assigned by USDA to a donated food which reflects USDA's current cost to acquire, package, and distribute donated foods. The contract values are used for a many reasons, including the following:

- determining the amount of refund or discount due to recipient agencies for finished end products;
- determining the value of the surety bond, escrow account, or LOC needed by the processor;
- determining the costs of replacement for production or commodity losses; and
- determining the amount of money the processor would owe the distributing agency or recipient agency for failure to meet the guaranteed minimum return.

Each year, FNS provides distributing agencies with the *Commodity File*, issued in mid-January, which lists USDA's current cost for acquiring each donated food. These values must be used in processing agreements for the upcoming agreement year (beginning July 1 of the current year and ending June 30 the following year). All processing agreements, regardless of the date the agreements were approved, must use the value contained in the mid-January *Commodity File*. However, FNS reserves the right to adjust commodity values during the agreement year if it is determined that USDA's acquisition costs have significantly changed. If this is the case, **all** agreements involving the particular commodity must be amended to reflect the new commodity value.

*Containers* - Processors are responsible for returning all funds received from the sale of donated food containers. The distributing agency will determine whether the funds will be returned either to the distributing agency or recipient agencies in the form of a cash payment or applied as a credit. If the distributing agency permits credit, the processor must provide a summary of the pricing information to the distributing agency as soon as possible after agreement approval. If the processor sells containers for commercial reuse, all USDA restrictive legends or markings must be completely and permanently obliterated or removed by the processor prior to resale.

*By-Products* - Salvageable material, not utilized in the production of end products, that is produced or derived from the manufacturing procedure used to process the donated food, must be disposed of in a manner as to realize the greatest value possible for the material. The distributing agency must make the decision as to how the material should be handled. In most cases the product is handled as follows (at the option of the distributing agency):

- The processor can accumulate the by-product and return it to the distributing agency or recipient agency; or
- The processor can return all funds received from the sale of salvageable by-product material. The funds can be paid to the distributing agency or the recipient agencies. Again, the return of the funds can be in the form of a cash payment or a reduction in the selling price of the end product based on the following:
  - The actual value received from the sale of the by-product; or
  - The fair market value of the by-product at the time it is further processed or refined by the processor minus any costs that the processor incurs in transforming the byproduct to a salable product.

Whichever method is selected, instructions for the disposition any by-products must be clearly spelled out in the processing agreement. The same procedures apply to the handling of donated food containers.

**Subcontracts:** Processors are not permitted to assign and/or delegate any of their duties or responsibilities to process donated food under the agreement without the prior written consent of the distributing agency. This includes subcontracting agreements or any other arrangements to process donated food. If a subcontract is approved, the processor remains responsible as the prime contractor to ensure that the donated food is accounted for and processed according to the terms and conditions contained in the processing agreement. The processor is obligated to inform the subcontractor of all requirements of the agreement. A subcontractor agreement must be filled out for each subcontractor and included with the primary processing agreement when submitted to the distributing agency for approval. If donated food is shipped directly to a subcontractor, appropriate arrangements will have to be made. Also, it is advisable that the provisions or terms of the subcontract clearly spell out the recordkeeping requirements of the subcontractor (i.e., production records, quality control records, sales records, inventory records for donated food, etc.).

**Substitutable Donated Foods:** Donated foods are divided into two main categories: substitutable and non-substitutable. Substitutable foods are those donated foods which may be substituted, interchanged, or commingled in storage and production with a commercial food of the same generic identity and of equal or better quality. The following donated foods are currently classified as substitutable under the State Processing Program: butter, cheese, corn grits, corn meal, flour, macaroni, nonfat dry milk, peanut butter, peanut granules, roasted peanuts, rice, rolled oats, rolled wheat, shortening, vegetable oil, spaghetti, and any other foods that FNS specifically approves as substitutable. Processors are not



required to obtain advanced approval from the distributing agency to substitute commercial products for donated foods classified as substitutable by FNS.

Processors must maintain documentation which proves that the commercial foods being substituted for donated food are of U.S. origin, are of the same generic identity, and are identical or superior to the donated food specification as evidenced by certification performed by or acceptable to the applicable Federal acceptance service.

**Non-Substitutable Foods:** Non-substitutable foods are all other donated foods provided by USDA that are not listed in the paragraph above. Non-substitutable foods may not be interchanged, commingled, or substituted with commercial foods in storage or in the manufacturing of the end product. However, processors may request FNS to allow non-listed donated foods to be considered as substitutable foods. To assist FNS in deciding approval, processors which request substitution of a non-listed donated food must submit copies of their purchase specifications to FNS. FNS will then determine whether the commercial food is of equal or superior quality to the donated food and is generically identical to the donated food.

When non-substitutable foods are approved by FNS as substitutable, such approval is granted only to that processor requesting the approval for only that particular commodity. Furthermore, permission to substitute only remains in effect for the duration of the agreement year in which the substitution was granted. If the same processor had an agreement the following year and wished to substitute the same commercial product, that processor would have to reapply to FNS.

Processors who substitute commercial foods for donated foods are responsible for maintaining documentation that their normal commercial purchases have not been reduced as a result of participation in the State Processing Program. Additionally, processors must be able to document that their commercial purchases of ingredients are adequate to cover production needs under the 100 percent yield requirement.

*See the Substitution Section which provides further details on the handling of substitutable and non-substitutable foods.*

**Use of Additives:** Because processors are only allowed to use ingredients in their end products that have been approved by the Food and Drug Administration, FNS does not restrict the types of ingredients that can be added to end products containing donated food. However, distributing agencies have the right to either reject specific end products or not enter into agreements with processors based on the commercial ingredients contained in the end products made with donated food. Processors are required to include a description of each end product, the quantity of each donated food being used, and the identification of any other ingredients which are needed to yield a specific number of units of each end product. Thus, any commercially acquired ingredients, including additives, must be clearly identified on the end product data schedule. In order to ensure that “secret” recipes are protected, distributing agencies permit processors to specify the total quantity of any flavorings or seasonings which may be used, without identifying the ingredients which are, or may be, components of seasonings or flavorings. In this way, only the quantity of donated food and total batch weights will be listed on the end product

data schedule. By identifying the commercial ingredients contained in end products using donated food, distributing agencies can decide whether a particular end product is a good choice for the recipient agencies to serve in their meal service operations.

Additives such as vegetable protein products and alternate cheese products have been incorporated into end products containing donated food for many years. If these additives are used in the manufacturing process of Child Nutrition Labeled products, they must be used in accordance with the regulations governing the National School Lunch Program, Summer Food Service Program, and Child and Adult Care Food Program, respectively 7 CFR Parts 210, 225, and 226, Appendix A.

**Quality Control System:** As part of the processing agreement, the processor must develop and maintain a Quality Control (QC) plan or system for the duration of the processing agreement. At a minimum, the QC plan should provide for the following:

- The processor must ensure that all donated food and ingredients which are added to the donated food are handled and processed in a sanitary and safe manner to ensure that a wholesome end product is delivered to the distributing agency or the recipient agency.
- The processor must store, handle, transport, and deliver finished end products in a safe and sanitary manner at the recommended temperature according to generally accepted commercial practices within the processor's industry for the specific donated food and end product(s) covered in the processing agreement.
- The processor must ensure that all end products produced under the processing agreement be processed according to the health and sanitation standards for plant facilities and food processing established by the locality or State in which the processor's plant is located or by the applicable Federal standards, whichever is higher.
- At the option of the distributing agency, samples may be pulled from the delivered end product for laboratory testing. Costs of such tests must be paid by the processor only if the product sample tested fails to meet either the agreement specifications or quality and wholesomeness standards.
- The processor must maintain end product batch identification. Each case of end product must be labeled as to the particular batch in which it was produced.
- The processor must ensure that if vegetable protein products or cheese alternate products are used in any end products produced for the National School Lunch Program, Summer Food Service Program, or Child and Adult Care Food Program, respectively, they must conform to 7 CFR Part 210, 225, or 226, Appendix A.
- The processor must obtain approval through procedures established by FNS, USDA's Food Safety Inspection Service, U.S. Department Of Commerce's National Marine Fisheries Service and/or other applicable Federal agencies of all labels which make any

claim with regard to an end product's contribution toward meal pattern requirements of any Child Nutrition Program.

- The processor must ensure that the end products are made in accordance with the processing agreement specifications, e.g., information which has been provided on the end product data schedule.

**Grading Requirements (Meat and Poultry Only):** All donated meat and poultry processing must be performed under the supervision of an Agricultural Marketing Service (AMS) acceptance service grader. This supervision guarantees that the end products are produced using donated meat or poultry and, if applicable, that the products produced meet the specifications as listed on the end product data schedule and the processing agreement. The costs to perform the meat and poultry grading services must be borne by the processor.

**Debarment Certification:** In an effort to curb fraud, waste and abuse, Presidential Executive Order 12549 requires Executive departments and agencies of the Federal Government to participate in a government-wide system to suspend and debar any individual and/or entity, including processors, from receiving Federal government assistance or benefits if they are found to be causing damage to any federally administered program. Once a Federal department or agency takes suspension or debarment action, that individual and/or entity may not receive benefits or assistance from **any** Federal program.

Under USDA's nonprocurement debarment and suspension regulation (7 CFR Part 3017, Section 3017.510), FNS has the authority to suspend or debar an individual and/or entity from participation in the State Processing Program if they are suspected of conducting questionable or illegal activities in that program. In order to protect the interests of USDA, FNS may place any individual or entity on suspension while FNS conducts an in depth review of any questionable activities. When FNS debars an individual and/or entity from the State Processing Program, that individual or entity is ineligible to receive program assistance and benefits until the period of debarment expires. FNS has the authority to use its resources to identify situations in which suspension or debarment may be a necessary action to protect the public interest or to gather substantive evidence, generally through investigations, to prove one or more of the causes necessary to impose a suspension or debarment action.

Individuals or entities can be debarred from receiving Federal assistance and/or benefits for various reasons, including the following:

- Conviction of or civil judgment for:
  - A fraudulent act or a criminal offense in connection with obtaining, attempting to obtain, or performing a public or private agreement or transaction;
- A violation of Federal or State antitrust statutes, including those prescribing price fixing between competitor, allocation of customers between competitors, and bid rigging;

- The act of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, or obstruction of justice; or
- An offense which indicates a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a person.
- Violation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as:
  - A willful failure to perform in accordance with the terms of one or more public agreements or transactions;
  - A history of failure to perform or of unsatisfactory performance of one or more public agreements or transactions;
  - A willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction; or
  - Failure to pay a single substantial debt, or a number of outstanding debts (including disallowed costs and overpayments, but not including sums owed the Federal Government under the Internal Revenue Code) owed to any Federal agency or instrumentality, provided the debt is uncontested by the debtor or, if contested, provided that the debtor's legal and administrative remedies have been exhausted.

**Destination Data Information:** Included in the agreement package is a copy of the *Destination Data For Delivery of Donated Food (Form FNS-7)*. This form is used to supply information about destination receiving points used by the distributing agencies for the receipt and distribution of donated food and other information needed for managerial purposes. Instructions on how to properly complete the form are found on the reverse side. The distributing agency may complete this form except for Blocks 2, 5, 6, and 7 before mailing the form to the processor. Processors must submit a separate form for each location where donated food must be shipped. Processors must not complete Blocks 15 and 16 as these blocks are for distributing agency use.

**Health Inspection Report (Optional):** Processors must store, handle, transport, and deliver end products in a safe and sanitary manner at recommended temperatures according to generally accepted commercial practices within the processor's industry for the specific donated food and end products covered under the agreement.

The agreement also requires the processor to ensure that all end products produced under the agreement must be processed according to the health and sanitation standards for plant facilities and food processing established by the locality or State in which the processor's plant is located or by the applicable Federal standards, whichever is higher.

The distributing agency may wish to request that the processor provide a complete copy of a Health Inspection Report for each storage site and the plant where the actual manufacturing will take place. This may be requested during the agreement approval process.

#### **End Product Labeling Requirements:**

All processed end products must meet the labeling requirements of the Food Safety Inspection Service (FSIS) (for meat and poultry products) and/or the Food and Drug Administration (FDA). There are three conditions, however, which require special labeling of end products produced under the State Processing Program:

- The labeling of shipping containers of end products;
- The labeling of end products containing vegetable protein products and cheese alternates; and
- Child Nutrition (CN) Labeling.

When end products are made with non-substitutable donated food, the processor must clearly label the exterior shipping containers with the following statement: “Contains Commodities Donated by the United States Department of Agriculture. This Product Shall Be Sold Only to Eligible Recipient Agencies.” Whenever possible, the individual wrapping or containers of these end products should also carry this statement.

#### **Vegetable Protein and Cheese Alternate Products:**

Vegetable protein products used in end products which are served in USDA’s Child Nutrition Programs to resemble and substitute, in part, for meat, poultry, or seafood must comply with the labeling and nutrition specifications set forth in the regulations governing the National School Lunch Program, Summer Food Service Program, and Child and Adult Care Food Program, respectively, 7 CFR Parts 210, 225, and 226, Appendix A. These end products must have a label containing the following statement: *“This product meets USDA-FNS requirements for use in meeting a portion of the meat/meat alternate requirement of Child Nutrition Programs.”* This statement must appear on the principal display panel area of the package. Cheese alternate products must bear a label that essentially makes the following statement: *“This product meets USDA-FNS specifications for cheese alternate products.”* In those States where State or local law prohibits the wording specified, a legend acceptable to both the State or local authorities and FNS must be substituted. The labeling of the product must comply with applicable regulations prescribed by FDA, USDA, or other government agencies. The term “cheese alternate products” denotes a class of products and not a product name.

**Child Nutrition (CN) Labeling:** When a processor makes any claim with regard to an end product’s contribution toward the meal requirements of any Child Nutrition Program, the processor shall follow

procedures established by FNS, FSIS, the National Marine Fisheries Service of the U.S. Department of Commerce or other applicable Federal agencies for approval of such labels.

**Distribution of Agreement Information:** All parties to the processing agreement must retain a copy of the signed agreement and any addenda for their records. This applies to all agreements whether they were approved by the recipient agencies or the distributing agency. The distributing agency is required to provide a signed copy of the processing agreement and any addenda to the FNS Regional Office. Because the processing agreement is considered a public record, the distributing agency or the FNS Regional Office will provide a copy of the agreement to any person upon request as a public record under the applicable Federal or State “Freedom of Information (FOI)” laws. However, because the FOI laws exempt the disclosure of information containing trade commercial or financial data, those portions of the processing agreement which contain the listing of ingredients contained in the processed end products and the price and yield schedules need not be made available as part of the public record (in accordance with Exemption 4 of the FOI Act, 5 U.S.C. 552(b)(4)).

All parties to the processing agreement, as well as the FNS Regional Office, must retain a copy of the processing agreement and any addenda for a period of three years from the close of the Federal fiscal year to which the processing agreement pertains. However, in instances where claims actions and/or audit findings have not been resolved, the records must be retained as long as required for the resolution of such actions or findings.

Copies of the actual agreement are rarely provided to the recipient agencies. Distributing agencies, for the most part, provide information contained on the end product data schedule to assist the recipient agencies in deciding which processor they will buy from and which end products they will select.

## Food Ordering

Once a processor's agreement has been approved and transmitted to the Regional Office, the processor may request orders for donated food. The distributing agency must have processing agreements in place before planned orders will be purchased. Before the orders are requested, it is also recommended that the processor submit the required performance bond, an irrevocable letter of credit, or an escrow account. The distributing agency may place an order without the bond, letter of credit, or escrow account but must ensure that one is submitted prior to the delivery of the donated food.

For all donated foods except bulk chicken and turkey, the distributing agency must schedule targeted delivery windows with its processors and submit the orders to the Regional Office with the scheduled targeted delivery windows. In the case of the bulk chicken and turkey, the distributing agency will first submit the orders to the Regional Office without requested targeted delivery windows but indicate its preference in the "Remarks" section. FNS Headquarters will then send the orders to the processors for scheduling. When the processor receives the orders, he must contact the appropriate distributing agencies and negotiate specific delivery/production schedules and schedule orders over time periods as defined by FNS. After the processors and distributing agency reach an agreement, the distributing agency must provide the order information to the Regional Office; processors will provide order and scheduling information to the appropriate contracting officer in the Agriculture Marketing Service (AMS).

The distributing agency should require the processor to place all requests for food orders in writing. If the decision to order food is based on a telephone conversation, the distributing agency should insist that the request be confirmed in writing in order to maintain the information in the company's file.

### **Destination Data Information (FNS-7):**

The distributing agency must ensure that the *Destination Data For Delivery of Donated Foods (Form FNS-7)* is completed. The processor may need to supply some of the information such as the receiving points for the receipt and distribution of donated foods. Instructions on how to properly complete this form are discussed in the *Agreement Approval* section of this handbook. This form must be completed in order to obtain an entity code necessary for processing food orders through the Kansas City Commodity Office (KCCO). If any of the information on the form changes, e.g., destination address, contact name, the "change" box in the "Type of Action" entry must be checked and the same entity code will be retained. However, if a processor's name changes, the "new" box in the "Type of Action" entry must be checked and a new entity code will be assigned. If a processor's agreement is terminated, the "cancel" box in the "Type of Action" must be checked.

**Food Order/Bond Worksheet:**

FNS has developed a worksheet that can be used by distributing agencies to assist them in determining when and if to actually place an order for a processor. (This worksheet may also be used to calculate the amount of inventory protection needed for establishing a bond.) The steps to follow include:

*Determine Inventory Liability*

- Begin with the processor's current inventory balance(from the last performance report submitted);
- Add food orders already placed but not delivered;
- Add amount of donated food requested;

This is the total amount of inventory under consideration.

*Determine Sales Volume*

- Determine total sales year-to-date;
- Determine average monthly sales figure;
- Project sales to be reported prior to the receipt of donated food;
- Determine estimated inventory at time of delivery of donated food;

Calculate maximum 6-month inventory level.

*Calculate Bond Coverage*

- Take the beginning inventory;
- Add orders placed but not received;
- Add order requested;
- Subtract the projected reported sales (prior to delivery)

Equals maximum inventory level expected. Then multiply this figure by the contract value of the donated food. (Compare this figure to the figure for bond coverage)

The key points to remember in these exercises are to determine the maximum amount of inventory to be covered by the bond/letter of credit/escrow account to ensure that the inventory is protected and to ensure that the processor has no more than a 6 month supply of donated food on hand. If inventory is over the 6 month level, steps must be taken to reduce the inventory or the distributing agency must issue the processor written permission to exceed the 6 month level.



**Placing the Food Order:**

The orders for donated food are placed by the distributing agency using the *FNS-52, Food Requisition*, a modified State form which incorporates all information and utilizes the format of the FNS-52, or can be placed electronically through the Electronic Data Interchange (EDI) system. Basic information required to complete the food order includes:

- State Name
- Name of Distributing Agency
- Units/Pounds
- Type of Action
  - Commodity Short Title;
  - Distributing Agency Code;
  - Delivery Year;
  - Fiscal Year of Purchase;
  - Section of Public Law;
  - Delivery Order Number;
  - Requested Shipping/Delivery Date; If applicable
  - Planned Program Usage;
  - Adjustment Codes; If applicable
  - Total Quantity of Food Requested; and
  - Entity Code and City.
  - Remarks Code; If applicable

**Processor Notification:**

Once food orders are placed, distributing agencies should send the processor a *Letter of Confirmation* which specifies the amount of food ordered, the requested shipping period, and the delivery order (DO)

number. After the order has been purchased, the distributing agency will receive a *Forwarding Notice* (KC-269A) for that order. The KC-269A contains the DO number, Notice of Delivery (ND) number(s)\*, contract number, gross/net weight of the order, total number of units to be shipped, the supplier filling the order, and the approximate shipping dates. There will be one KC-269A issued for each ND number pertaining to the order. The distributing agency should provide this information to the processor as soon as possible either by forwarding a copy of the form directly or calling the processor with the pertinent information. When the vendor is ready to ship the donated food, he will contact the distributing agency by means of facsimile machine or telephone (followed by written confirmation) to verify the shipment. The distributing agency should contact the processor if the shipment is different (number of cases/units being shipped) than indicated on the KC-269A.

\* An ND number is the number that is assigned to shipments by KCCO. For AMS products, each DO may have one or more ND numbers. For example, if a processor orders 44,000 pounds of green beans, the entire order might be filled by one plant and would be assigned one ND number. However, KCCO also may go to more than one plant to fill the order and have more than one ND number assigned. ND numbers are available through EDI.

**Notice of Shipment:** When the vendor is ready to make a delivery of donated food, it is responsible for contacting the appropriate party indicated on the FNS-7, *Destination Data For Delivery of Donated Food* and making an appointment. Concurrently, the distributing agency is contacted. It is helpful to develop a form to record this information

**Unloading Report:** A Warehouse and Consignee's Receipt of Government Donated Food (unloading report typically developed and provided by the distributing agency) **must** be completed at the time of delivery and returned to the distributing agency **immediately**. It is recommended that processors also retain copies of the unloading reports to submit with their monthly performance reports to serve as documentation for the amount of donated food received for the report month.

**Over, Short, Damage Report:** It is important for processors to carefully check each shipment to assure that their food order is complete and has been delivered in good condition. If there is a problem with the shipment, processors are required to submit an FNS-57, *Report of Shipment Over, Short, and/or Damaged (OS&D)* to the distributing agency, who will then submit the form to the KCCO. In addition, the OS&D report is required if the total number of units of end product delivered is not the same as the total units on the KC-269A or if the net weights do not agree. It is imperative that any damages, shortages, or overages are noted on the driver's delivery receipt prior to signing for the delivery. The subsequent completion of the FNS-57 will not nullify a previously signed clear delivery receipt.

**Procedures For Reporting Out of Condition Food At Receipt :**

Occasionally, the Regional Office will notify the distributing agency that a shipment is to be put on hold. The distributing agency must inform the processor immediately and follow the instructions of the Regional Office that follow the notification. If part of the shipment is damaged at the time of unloading, the processor must notify the distributing agency immediately. The distributing agency is to consult with

the Regional Office when guidance is needed or if USDA inspection of the food is required. Damage is reported when a donated food is unloaded in less than perfect condition (i.e., torn bags, crushed cartons, leakage, etc.). If damage has occurred, the condition of the shipment must be reported to the delivery carrier or his agent before the entire shipment is unloaded. Any damaged cargo that is determined suitable for human consumption shall be salvaged and accepted for program use. The distributing agency will provide guidance about what to do with the remainder of the shipment. When a shipment is delivered and all or a major portion of the shipment is apparently off-grade, out-of-condition, or damaged, the processor shall contact the distributing agency who will report all the facts pertinent to the arrival condition to the Regional Office. The Regional Office will provide disposition instructions to the distributing agency. The distributing agency shall obtain an inspection by a qualified person as determined by the Regional Office. Should the inspection confirm the findings of the initial examination, the shipment shall be held and full details reported immediately to the Regional Office. At a minimum, the report shall include the following information:

- Delivery Order (DO) number, contract number, and Notice of Delivery (ND) number;
- Railcar number and initial, piggyback trailer number, or truck/trailer identification;
- Name of shipper, origin, and date of shipment;
- Quantity and description of food in the shipment;
- Date and time shipment received;
- The problem that occurred and the quantity of donated food affected;
- Current status (unloaded, trailer left warehouse, etc.);
- Cause of condition, only if such cause is obvious (i.e., wrecked container, fire, temperature unit not operating);
- Protective services provided;
- Name, title, and telephone number of person who made inspection. If an inspection report was prepared, a copy of the report must be forwarded.
- A record of the name and location of the carrier's agent who was notified along with the agent's response, including the time and date. The name of the persons making the notification should also be included.
- Name of the person making the notification;
- Specific location with the transportation conveyance;

- Pictures of the damage, if available;
- Person and telephone number to contact regarding shipment; and
- For perishable foods, the information required in Item 26 of the FNS-57.

**Out-of-Condition Food Identified After Receipt:** If food at the processor is determined to be out of condition some time after the receipt but before processing, the DA shall provide all pertinent facts to the Regional Office for guidance. If it is suspected that the processor is responsible for the food going out of condition, the DA must follow the claims procedures in FNS Instruction 410-1, Rev. 1, and any appropriate FNS policies. Any food determined to be out of condition after processing is the responsibility of the processor and the DA.

**Direct Shipment Versus Backhaul:** Ordering food for shipment directly to the processor, rather than having donated food backhauled from recipient or distributing agencies' warehouses, can result in considerable cost savings for the recipient agency. For instance, the DA/RA will not have to pay additional transportation costs from their facilities to the processor. Whenever commodities have to be backhauled to a processor from local storage facilities, the recipient agencies purchasing the end products pay for the additional transportation charges through the increased cost of the end products. Also, by processing donated foods in truckload quantities rather than small lots, processors can achieve greater yields in the production of end products. They can use their equipment and labor at maximum efficiency. Furthermore, end products produced from donated food shipped directly to the processor may be superior to those made from donated foods that may have been held in storage under less than optimal conditions.

**Arranging Direct Shipments:** To arrange orders for direct shipment to a processor, the distributing agency should do the following:

- Enter into a processing agreement;
- Determine if the processor can accept truckload quantities of donated food;
- Determine what recipient agencies wish to have commodities processed by the particular processor and how much they want processed;
- Calculate full truckload quantities for each processor;
- Order the appropriate quantities of donated food through FNS;
- Notify the processor of the incoming quantities of donated food;
- Notify the processor of each recipient's fair share of the raw donated food.

**Inventory Controls:**

There are many challenges that can arise in managing the inventory being maintained by a processor. Many times even a single shipment of donated food will put the processor over the 6 month inventory limit. Should this occur, the Distributing Agency has the following options.

1. With the approval of the Regional Office, transfer the donated food to another processor or to another DA being served by the current processor. The distributing agency may request an entitlement adjustment for the transfer if the food is received and transferred in the current year.
2. Have the processor “buy down” the inventory to a proper level according to the processing agreement. Follow the instructions in FNS Instruction 410-1 Rev.1 and the appropriate FNS policies for establishing a claim against the processor.
3. Consider the ramifications of allowing the processor to retain more than a 6 month inventory. If acceptable, then give the processor **written** permission to maintain more than a 6 month supply of the donated food.

Processors should make every possible effort to *avoid* going into a negative inventory status. When this does occur, the distributing agency should work with the processor to take action immediately to resolve the problem. If donated food orders were delayed, causing the processor to use commercial inventory to ensure a constant supply of product to the recipient agencies, the distributing agency should notify the processor that:

- donated food is on order and the processor can offset his negative inventory upon receipt of the donated food or
- donated food cannot be obtained so the processor should **not** offer end products at the price discounted for the value of the donated food until further notice.

**If the processor continues to sell products at the discounted price to recipient agencies, he should be notified that he is going into negative status at his own risk. There is no guarantee that the negative inventory will be replaced.**

## Monitoring Activities

### Performance Reports:

Processors must submit performance reports to distributing agencies which outline the processing activity for that month. This report should include year-to-date totals of all processing activity. Processors must ensure that each monthly performance report is postmarked no later than the final day of the month following the reporting period. The September, December, and March reports will be considered Quarterly reports and the June report will be considered the annual reconciliation report. The June report should be postmarked no later than 60 days from the close of the contract year. The monthly performance report must include the following information:

- A list of all recipient agencies purchasing end products under the agreement;
- Donated food inventory at the beginning of the reporting period;
- Amount of donated foods received during the reporting period;
- Amount of donated foods transferred to and/or from existing inventory;
- Amount of donated foods processed during the report period;
- Number of units of approved end products, by product code, processed for each eligible recipient agency during the reporting period;
- Donated food inventory at the end of the reporting period;
- A certification statement that sufficient donated foods are in inventory or on order to account for the quantities needed for production of end products for processing agreements and that the processor has on hand or on order adequate quantities of foods purchased commercially to meet the processor's production requirements for commercial sales; and
- When sales verification has been delegated to the processor pursuant to Section 250.19(b)(2) of the Food Distribution Program regulations, sales verification findings must be reported as an attachment to the December and June performance reports in whatever format the distributing agency deems necessary. Non-compliance with this requirement may result in agreement termination by the distributing agency.

In addition to reporting the information identified above, processors who substitute concentrated skim milk for donated nonfat dry milk must also report the following information for the reporting period:

- The number of pounds of nonfat dry milk used in commercial products sold to outlets which are not recipient agencies; and
- The number of pounds of concentrated skim milk, and the percent of milk solids contained therein, used in end products sold to recipient agencies.

**Processor Accountability:** The processor must fully account for all donated foods received, used in production, and delivered to the distributing agency and/or the recipient agency. The end products must meet the specifications listed in the processing agreement and the end product data schedule, which is an integral part of the agreement. When end products are sold through a distributor, the processor remains accountable for the donated foods until refunds or any other credits equal to their contracted value have been made to eligible recipient agencies. Additionally, the processor must maintain accurate and complete records with respect to the receipt, disposal, and inventory of donated foods. There must be documentation in the processor's file to support the data on the performance report.

**Distributing Agency Responsibility:** The distributing agency is responsible for ensuring that the information on the performance report is complete and accurate and meets the requirements of the provisions set forth in 250.30(m) of the State Processing Program regulations

**Additional Requirements for Meat and Poultry Performance Reports:** The following information must be contained in the report and be verifiable by the distributing agency.

**Inventory of Donated Foods**

- The beginning inventory is the same as the ending inventory for the previous month;
- The quantity of donated food shown on the performance report as processed is same as shown on the Agricultural Marketing Service (AMS) grading certificates; and
- Documentation is attached to show the action taken by the processor for condemned donated food.

**Inventory of End Products**

- The rework data on the performance report agrees with the data on the AMS grading certificates;
- The cases (or pounds) of end product guaranteed was correctly calculated;
- The beginning inventory of end products is same as the ending inventory for the prior month;
- The cases (or pounds) of end products produced is same as the quantity shown on the AMS grading certificates;

- Documentation is attached to show the action taken by the processor for cases (or pounds) short in meeting the guaranteed minimum return; and
- Documentation is attached to show cases (or pounds) of end products delivered.

**Calculating Donated Food Usage:**

The following methods should be used in calculating the usage of donated foods which represents the reduction in inventory shown on the performance reports:

- *Substitutable Foods*-Multiply the number of cases sold times the number of pounds contained in a case of the end product as shown on the end product data schedule.
- *Non-substitutable Foods (Meat and Poultry)*- Report the number of pounds of donated meat and poultry processed as shown on the AMS grading certificate.
- *Non-substitutable Foods (Other Than Meat and Poultry)*-The reduction in inventory is to be the quantity of donated food put into production by the processor.

The performance report can reflect a reduction in inventory when the following occurs:

- *Refund method*-after the processor has made disbursement to eligible recipient agencies to cover the value of the donated food(s) in end products purchased;
- *Discount method/indirect sales*-after the processor has received proof of sales to eligible recipient agencies; and
- *Transfers from one State to another*-after the processor has received concurrence by the FNS Regional Office(s).

Donated foods received through direct shipments to the processor and by backhauling from recipient agencies should be shown on the performance reports.

If the processor picks up donated foods at the school district level, the processor must maintain a separate inventory for each school district. The processor must also maintain a separate accounting for each school district for donated foods that were allocated prior to the receipt of a direct shipment.

**Correction of Errors:** If there are errors on previous performance reports, corrections may be shown on the performance report for the current month rather than revising previous reports. If a performance report is amended, the revised report should be clearly marked to indicate that it is a revision of a previous report.



**Final Monthly Performance Report:** At the end of the agreement year, there is a final 90-day reconciliation period in which processors may adjust their sales to accurately reflect the sales for any month. This is the June performance report with year-to-date totals.

Under no circumstances will the processor be permitted to report any sales which occurred prior to the effective date or subsequent to the expiration date of the approved agreement.

As a part of the annual reconciliation, a processor who has entered into an agreement for the next agreement year may be required to pay the distributing agency the contract value of any donated food inventory in his possession which is in excess of a 6-month supply (if the processor has **not** been specifically approved to maintain a higher inventory level). Additionally, a processor whose agreement has been terminated must return, transfer, or pay, at the discretion of the distributing agency, for any donated food remaining in inventory as required by the State Processing Program regulations.

Prior to forwarding the final monthly performance report to the FNS Regional Office, distributing agencies must certify the accuracy of the report.

**On-Site Reviews:**

Every year each distributing agency must conduct on-site reviews of 50 percent of the processors whose total operations are conducted solely within that State. This means that a review of all “In-State” processors must be completed by the distributing agency every two years.

*Note: This two-year review requirement does not apply to on-site reviews of multi-State processors. Federal reviews do not supplant State monitoring responsibilities. State DA’s have the right to conduct their own reviews of processors whose facilities reside in another State.*

**Planning the Review:**

The following four areas must be evaluated during each review.

- Adequate records are being maintained to ensure program compliance;
- The sales documentation supports the inventory reductions reported on the monthly performance reports;
- The production and quality control records support the figures on the end product data schedules; and
- Adequate measures and procedures are in place to protect the donated food.

Focusing on these four areas, however, does not preclude the distributing agency from examining other areas of general concern or issues that may arise during the course of the review. Processors must be required to take corrective action on all deficiencies identified.

Prior to a review, the reviewer should contact the appropriate representative of the company by telephone, i.e., the person who has signed the agreement. The reviewer should confirm the conversation in writing, summarizing the points discussed and stating the agreed-upon date of the review. At a minimum, the following information should be made available for the review team.

- Request that applicable records be available at the time of the review including, but not limited to the following:
  - Processing agreements; including all end product data schedules
  - Subcontract agreements; including all end product data schedules
  - Bond, letter of credit, or escrow account documents;
  - Monthly performance reports;
  - AMS grading certificates; if applicable
  - Distributor sales reports; if applicable
  - Refund applications/check payments;
  - Sales invoices;
  - Daily or batch production records;
  - Quality control records;
  - Buy-back, by-product, container sales records;
  - Bills of lading for commodity receipts;
  - Physical and book inventory records;
  - Transfer authorizations;
  - Certification of U.S. origin and equal or better quality for substituted commercial foods;

- Invoices to support acquisition of commercial food to meet the 100 percent yield requirement;
- Insurance coverage, health certificates; and
- Past review/audit reports.

When the review team arrives, an entrance conference must be held with the processor's official representative(s) to discuss the purpose of the review, the program areas on which the review will focus, and the length of time the review team plans to spend at the processor's facility. The primary goal of the review team is to gain an overall understanding of the processor's operations and to obtain copies of all records that the review team will need to document receipt, storage, production of donated food, and the sale of end products to eligible recipient agencies.

#### **Interview**

*General questions related to the company may include:*

- When was the company formed?
- What is the structure of the company? (For example, is it privately owned?)
- Who are the officers of the company?
- How many employees are there?
- How many plant facilities are there and where are they located?
- What is the capacity of the plant facilities? That is, how many pounds of finished product are produced per day?
- What percentage of the total business is donated food processing?

*Suggested questions relating to the processing of donated food may include:*

- Does the processor contract with any other distributing agencies within the State to process donated food?
- Does the processor use subcontractors in any of the steps used to produce the finished end product(s)? Who are the subcontractors and what do they produce? What procedures/records are used to monitor the activities of the subcontractor?

*Suggested questions relating to the receipt and storage of donated food may include:*

- What are the procedures for receiving the donated food?
- Does the processor receive shipments directly from USDA? From distributing agency warehouses? From recipient agencies?
- If the donated food is obtained from State warehouses or recipient agencies, what procedures are used to obtain the food?
- What are the company's procedures for receipting for the donated food?
- What records are used to document the receipt of the donated food?
- If donated food is received damaged, how is it handled?
- Where are the donated foods stored?
- Are the donated foods commingled with commercial food in storage?
- Are the donated foods stored separately from commercial foods?
- Are the donated foods assigned separate warehouse lots?
- What records are kept for tracking donated food in inventory?

*Suggested questions relating to the sale of end products may include:*

- Which value pass-through system(s) is used?
- How are the end products marketed? Does the processor bid for supplying products?
- What is the cycle for reporting sales?
- What paperwork is generated from the sales activity?

#### DIRECT SALES

- How does the processor transport the end products to the distributing agency or recipient agencies?
- Does the processor bill for the end products?
- Does the processor use its own delivery vehicles? If not, ask the processor to describe how products are delivered.

#### INDIRECT SALES

- Which distributors does the processor use?
- How are the distributors selected?
- How does the company receive reports of recipient agency sales from distributors?
- Does the processor sell the end products at a discount to recipient agencies utilizing the hybrid value return system?
- Are distributors giving direct discounts to recipient agencies other than as described above?
- Does your company conduct sales verification? If so, describe the sales verification procedures.

*Suggested questions related to the production of end products may include:*

- What information is contained in the production records?
- Are commercial foods and donated foods commingled during production?
- Does the processor sell or reuse the containers/bags in which the donated foods are packaged? If containers are sold, are the recipient agencies or the distributing agency credited for their value?
- Have any donated foods been lost or damaged during production?

Describe the circumstances and how the damaged foods were handled.

#### SUBSTITUTABLE FOODS

- Does the processor substitute commercial food for donated food? Ask the processor to describe the substitution that takes place.
- How does the processor compensate for production losses to obtain the 100 percent yield?
- Does the processor purchase food commercially to make up the difference between food needed for production and the amount actually contained in end products?

*Non-substitutable Foods (Other Than Meat or Poultry)*

- Does the processor substitute the donated food with commercial food?
- Has the processor received approval from FNS to substitute?
- How does the processor label the end products?

#### MEAT AND/OR POULTRY

- How is meat/poultry stored?
- Does the plant have continuous FSIS inspection? If possible, the reviewer may want to make arrangements to interview the FSIS inspector.
- Is the processing of donated meat/poultry performed under AMS acceptance service grading? If possible, the reviewer may want to make arrangements to interview the AMS grader.
- Is grading performed under Option 1 or Option 2?
- Are copies of the grading certificates submitted with the monthly performance reports?
- How does the processor label the end products?

#### QUALITY CONTROL

- What information is contained in the quality control records?
- Who is responsible for monitoring the quality control plan? (If possible, the reviewer should arrange to interview the person responsible for quality control.)
- Are the raw foods and finished products analyzed for quality and safety?
- Who conducts the laboratory analysis?

#### PROTECTION MEASURES AND PROCEDURES

- Does the processor have a current performance and surety bond, letter of credit, or escrow account?
- If the processor substitutes commercial food for donated food, how is the quality of the commercial food documented?
- What agencies inspect the processor's facilities? How often are the facilities inspected?

- Does the processor have insurance for its facilities? Who is the underwriter for the insurance? What does the insurance cover?

Request a tour of the facility. It is helpful to tour the facility following the same steps as the donated food takes as it flows through the processor's operation (from the time it is received up until the end products are manufactured). During the tour, identify the records that are being maintained and the information which is being recorded, such as the recording of temperatures, product weight, quality control checks, etc. Based on observation and review of data, determine whether the records which the reviewer identified during the interview are being properly documented and maintained as described.

Conduct a facility inspection during the tour. Some suggested questions to consider are as follows:

- Do railcar/truck/unloading/loading docks appear to be adequate?
- Does storage space appear to be adequate?
- Are the storage rooms in good repair?
- Does ventilation appear to be adequate?
- Are donated foods stored to permit easy identification and provide accountability?
- Is inventory managed using "first-in", "first-out" (FIFO) Is pack date of the commodity monitored or is receipt date the only criteria used?
- Are foods stored separately from pesticides, herbicides, cleaning supplies, or other materials which could contaminate foods in storage?
- What is done with out-of-condition foods?
- Are foods palletized or on shelves?
- Are high-piled foods "tied-in" or "locked" for safety?
- Do aisles appear to be adequate for fire lanes and material handling equipment?
- Is the temperature appropriate for the type of storage? Temperature ranges are as follows: dry-45-70 degrees F; refrigerated-35-45 degrees F; freezer-0 and lower degrees.
- Are health inspection certificates on file? Were there any findings during the inspection? Have corrective actions, if necessary, been taken?
- Are there regular extermination treatments? Are the treatments completed by the processor or are they handled by an outside contractor?

- Is the storage area free of rodent and insect infestation?
- Are safeguards taken to protect the donated foods from theft?

#### **Observation of Production**

If feasible, watch an actual production run of an end product containing donated food and observe whether the following takes place:

- Is the donated food weighed before it is put into production?
- Which production records are being maintained on line?
- Are end products weighed during production and are the weights being recorded on the production records?
- Is the quality control system being followed?
- Are there any obvious flaws in the quality control system, e.g., weights being taken at inappropriate locations, inaccurate recording of weights, failure to record weights?

#### **Record Maintenance:**

During the course of the review, the reviewer must determine if each of the records is maintained in a fashion which ensures program compliance. If any record is unavailable for the review, the processor must be provided with the opportunity to explain where it is. Failure by a processor to maintain required records can be considered prima facie evidence of improper distribution or loss of donated foods.

If the reviewer questions the information on the records, a physical inventory can be conducted. The reviewer should be able to reconcile the book inventory against physical inventory at the processor's plant or storage location and in end products held by any distributors (for non-substitutable donated foods). If the figures cannot be reconciled, one reason may be that the processor is using donated food to subsidize the company's commercial production. This practice is not allowable and, if discovered, should be listed as a deficiency in the report.

#### **Monthly Performance Reports**

The processor's records must support the information reported on the monthly performance reports. The information to be included in the reports is described at the beginning of this section.



#### REVIEW STEPS

- Determine whether all monthly performance reports are on file at the company. Confirm that the monthly performance reports were **postmarked** no later than 30 days past the end of the month to which they pertain.
- Select a sample of reports for review. The sample should contain a representative number of months out of the period covered by the review and the months selected should be based upon the volume of sales and production. At a minimum, 2-3 months should be sampled. However, if a problem recurs during the review of the sample of reports, the review should be expanded to cover at least the current agreement year. If major errors are identified, provide the processor with the opportunity to dispute the findings and justify claimed inventory reductions. If the reviewer believes that the processor is fraudulently completing the monthly performance reports, the FNS Regional Office should be notified immediately.
- Using the sample months, compare the processor's records which document the receipt of the donated food(s) (e.g., bills of lading, shipping and delivery documents, recipient agency release forms) with the information contained on the performance reports.
- Using the sample months, determine whether the inventory level is within the 6-month limit. If there is an excessive inventory level, determine if the processor has obtained written permission from the distributing agency to maintain a higher level. If there is a negative inventory level, determine why it exists.
- If there was an inventory level greater than a 6-month supply, determine why and what actions, if any, are needed to address it.
- Determine if the processor is retaining records for a period of three years from the close of the fiscal year to which they pertain.

#### Sales Documentation

It is the processor's responsibility to ensure that the value of the donated food has been passed onto the distributing agency/recipient agencies. There are four value pass-through (VPT) methods described in the regulations: direct sale refund, direct sale discount, indirect sale refund and indirect sale discount. Distributing agencies are also permitted to use an alternate VPT system with the approval of FNS Headquarters.

#### REVIEW STEPS

- Obtain the processor's description of the VPT system used and verify that this system has been approved for use by the contracting agency. An unallowable system must be listed as a deficiency in the report.

- For the sample months, total the number of cases of each end product on sales records (e.g., distributor's sales reports, refund applications, sales invoices) and compare with the information contained on the monthly performance reports. For meat and poultry end products, determine if the number of cases reflected from the sales records also corresponds to the number of cases of end products produced from the grading certificates. If the figures do not match, attempt to reconcile the reports. If these attempts fail, provide the processor with the opportunity to justify claimed inventory reductions. If, after conferring with the processor, a discrepancy still remains, determine the appropriate corrective action. The processor may be required to submit corrected monthly performance reports or a claim can be established based on the difference between the pounds of donated food which were deducted from the performance report and the pounds for which the processor has actual sales records.
- Review the processor's sales documentation to determine if the prices paid per case are in line with those quoted on the end product data schedules, taking into account distributor markups. Ensure that VPT has occurred. For end products sold under fee-for-service, review the processor's sales documentation to determine if the prices paid per case are in line with those quoted on the end product data schedules. Confirm that the end products were delivered to recipient agencies in accordance with FNS' fee-for-service policy as outlined in the *Processing Agreement Approval* section of this handbook (under Value Return Systems).
- For the sample months, determine that only approved end products have been claimed and that sales were made only to eligible recipient agencies.
- For the sample months, determine that, if refunds were paid to recipient agencies/distributors, the refunds were made within 10 days of receipt of the application by the processor.
- If the indirect sale discount system is used and sales verification has been delegated to the processor, verify that sales verification reports have been submitted with the December and June monthly performance reports. Review the processor's sales verification procedures for adequacy. *See Section VI of this handbook, Sales Verification.*

#### **Production and Quality Control Records Review**

Processors are required to provide a description of each end product, the quantity of each donated food, the identification of any other ingredient which is needed to produce a specific number of units of each end product, the total weight of all ingredients in the batch formula, and the yield factor for each donated food.

Processors utilizing substitutable donated foods are required to provide a 100 percent yield. Production losses must be replaced by the processor with commercially acquired food of the same identity and of equal or better quality. The 100 percent yield requirement does not apply to the processing of

non-substitutable foods. Processors utilizing non-substitutable foods must meet or exceed the guaranteed minimum return contained on the end product data schedule. End products produced above the guaranteed minimum return must be returned to the contracting agency.

The processor must maintain adequate production records to support the information contained on the end product data schedules. A basic production record must include:

- Date of production;
- End product type;
- The pounds of donated food used in the end product's manufacture; and
- Number of cases produced.

All donated meat and poultry must be processed under FSIS inspection (or equivalent State inspection) and AMS acceptance service grading. However, the distributing agency can waive the grading requirement if the processor can demonstrate prior to a production run:

- That even with ample notification time, the processor cannot secure the services of a grader;
- That the cost for a grader would be unduly excessive relative to the value of foods being processed and that production runs cannot be combined or scheduled to enable prorating of the costs of services among the purchasers of end products; or
- The documented urgency of the recipient agency's need for the end product precludes the use of acceptance services.

Processors must maintain quality control records. Quality control records ensure that the end products contain consistent amounts of ingredients as stipulated on the end product data schedule. Quality control records are completed during production and often document individual portion weights at different points on the production line. The records indicate the average amount of donated food applied to, or contained in, a portion of end product and serve as a management tool in ensuring uniform product quality.

#### REVIEW STEPS

- For the sample months, obtain copies of the production records. If the processor does not maintain production records, the reviewer must ask the processor how the average figures utilized on the end product data schedules were determined and cite these findings as a deficiency in the report.
- If the processor utilizes substitutable donated foods, determine from the production records, the average number of pounds of donated food it takes to produce one case of

each end product. Compare this figure to Column 8 on the end product data schedule (the schedule for all donated foods *except* poultry). If the specified yield is not met, the causes should be determined when evaluating the quality control records.

- If the processor utilizes non-substitutable donated foods other than meat or poultry, determine from the production records if the guaranteed minimum return was met. If the guaranteed minimum return was not met, confirm how the difference between the actual and the guaranteed return was made up. Determine that the distributing agency/recipient agencies have received the value of any by-products produced, if applicable. Confirm that the pounds of non-substitutable donated foods put into production as indicated on the production records and the end product data schedule match the pounds of donated food used as reported on the monthly performance reports.
- If the processor utilizes donated meat or poultry, confirm that production occurred under FSIS continuous inspection (or equivalent State inspection) and AMS acceptance service grading. If production did not occur under AMS supervision, determine if an approved waiver was on file from the distributing agency. Evaluate the processor's justification for the waiver. Determine from the grading certificates (or production records if grading was waived) if the guaranteed minimum return was met. Determine that, if any rework was generated, it was either returned to the distributing agency/recipient agency, retained for future production use, disposed of according to State Processing Policy Number 26, or the value of the donated food in the rework was paid by the processor. Processors may also be permitted to pay for any buy-back products. Determine that if any buy-back product resulted from the further processing, it was returned to the distributing agency/recipient agency or the processor paid for the product. Buy-back credit can only be provided as a credit on the invoice. Determine whether the distributing agency/recipient agency has received the value of any by-products produced. By-product credit may be provided as a specific credit on the invoice or as a reduction in the fee-for-service price by the specific dollar amount. Confirm that the pounds of donated meat and poultry put into production as indicated on the AMS grading certificates match the pounds of donated food used as reported on the monthly performance reports.
- Obtain a copy of the processor's quality control plan. Evaluate the system and assess the adequacy of the system, i.e., if the system is followed, agreement specifications and yields would be met. For the sample months, obtain copies of the quality control records for the period being reviewed. Evaluate the records. If the figures included on the quality control records fall below the target weights of that allowed in the quality control plan, determine if corrective actions were taken. If corrective actions have not been taken, it is quite possible that the end product does not contain sufficient donated food to meet agreement specifications.

- If donated food containers have been sold by the processor, determine if the processor has credited the contracting agency(ies).
- If non-substitutable donated foods are being processed, verify that the end products have the following statement on the label:

“Contains Commodities Donated By the United States Department of Agriculture. This Product Shall Be Sold Only to Eligible Recipient Agencies.”

**Commodity Protection Measures and Procedures:**

The processor must furnish prior to the delivery of any donated foods for processing, a performance bond, an irrevocable letter of credit (LOC), or an escrow account in an amount sufficient to protect the contract value of donated food on hand and on order. The performance bond must be obtained from a surety company listed in the most recent U.S. Department of Treasury Circular 570.

REVIEW STEPS

- Obtain a copy of the bond, LOC, or escrow account.
- Review the monthly performance reports of the sample months to determine if the amount is sufficient to protect the value of the donated food.
- For bonds, determine if the firm issuing the bond is listed in Treasury Circular 570. For LOCs, determine if they are irrevocable and payable on demand to the contracting agencies. For escrow accounts, determine if the account is payable to the contracting agencies.

**Substitution Issues:**

The following donated foods may be substituted with commercial foods: butter, cheese, corn grits, cornmeal, flour, macaroni, nonfat dry milk, peanut butter, peanut granules, roasted peanuts, rice, rolled oats, rolled wheat, shortening, vegetable oil, and spaghetti. All the aforementioned commodities are subject to the 100 percent yield requirement. Other donated foods, may also be substituted if approved by FNS. Once a non-substitutable donated food is approved for substitution, the 100 percent yield requirement goes into effect, except for meat and poultry. The processor is responsible for replacing donated food with commercial food to meet the 100 percent yield requirement. When substitution occurs, all components of the commercial foods must be of U.S. origin and be identical or superior in every particular to the donated food specification. *Please refer to Section IX., Substitution, for a detailed discussion of substitution issues.*

REVIEW STEPS

- If the processor substitutes commercial foods for donated foods, obtain the processor’s documentation of the quality of the commercial foods. Minimum acceptable

documentation is a copy of the purchase specifications and copies of invoices for the substituted food.

- Assess if the substituted food is of U.S. origin, of equal or better quality, and generically identical to the donated food for which the substitution is made.

**Miscellaneous:** Follow-up on any known deficiencies, findings, and recommendations from previous audits and program reviews to determine whether appropriate corrective action was taken. Address any problems/irregularities which have arisen during the agreement period.

**Exit Conference:** After testing each of the above areas, the reviewer should summarize the findings, including any exemplary practices. A summary of the review and the findings should be presented to the processor's representatives by way of an exit conference.

Each problem area that is noted should be thoroughly explained to the processor, including citing the appropriate regulation provision and/or agreement requirement. The company should again be provided with the opportunity to discuss the reviewer's findings.

**Follow-up Letter:** A follow-up letter or report summarizing what was discussed at the exit conference and explaining what problems were disclosed during the review must be prepared. For any deficiencies, the letter or report must include:

- Each deficiency found;
- The factors contributing to each deficiency;
- Recommendations for needed corrective action, including time tables for completion and/or claim action to be pursued, if any; and
- Provisions for evaluating effectiveness of corrective actions.

The processor should be given 60 days to respond with a corrective action plan. A copy of the letter or report must also be sent to the appropriate FNS Regional Office. If the processor fails to comply with the necessary corrective action, the FNS Regional Office must be notified.

**Audits:** In the State Processing Program there are three kinds of audits that may be used to monitor program operations: independent Certified Public Accountant (CPA) audits, Office of the Inspector General (OIG) audits, and General Accounting Office (GAO) audits.

**CPA audits** are audits of the operations and records of a food processor conducted by independent certified public accountants. These audits are conducted to provide USDA with evidence that multi-State/multi-regional food processors are utilizing donated foods in accordance with the terms of their processing agreements with the distributing agencies. The Food Distribution Program regulations provide monetary thresholds which automatically trigger the audit requirement. The thresholds are

based on the total dollar value of donated foods received from all sources by a processor during an agreement year. There are three threshold levels:

- Processors who receive donated foods valued at \$75,000 or less must have an audit once every 3 years;
- Processors who receive donated foods valued between \$75,001 and \$250,000 must have an audit once every 2 years; and
- Processors who receive more than \$250,000 in donated foods must have an annual audit.

These audits must be conducted using the American Institute of Certified Public Accountant Standards, the Government Auditing Standards, and Audit Bulletin 27009d published by OIG. These audits are processed in the following manner:

- All multi-state/multi-regional audits will initially be submitted to FNS Headquarters for review.
- After the initial review, FNS Headquarters will acknowledge receipt of the audit and issue a letter requesting corrective action, if needed, based on deficiencies identified in the audit report. Concurrently, FNS Headquarters will transmit a copy of the letter and the subject audit to those FNS Regional Offices where the processor had contracts. This transmittal will also include a list of distributing agency concerns, if applicable. These are concerns which have been identified in the audit reports that can be attributed to distributing agency oversight activities.
- FNS Regional Office processing specialists are requested to furnish copies of the letter to the processor to all distributing agencies that had agreements with the processor. Audit handling procedures require that actual copies of the audit need only be furnished to those distributing agencies whose records were tested in the actual audit; however, copies of the audit may be provided to all contracting agencies. Once the distributing agency receives the letter and/or the audit report, those documents must be reviewed to make sure any problems that have been identified are corrected. This process must be done within 30 days of receipt of the information from the FNS Regional Office. Distributing agencies should report their comments back to the FNS Regional Offices. The FNS Regional Offices then forward any comments back to FNS Headquarters. If distributing agencies find any problems that were not identified by FNS Headquarters, FNS Headquarters will send another letter to the processor requesting that the additional concerns be resolved in order to close the audit.
- All audits should be resolved and closed by March 31 of each year. Those companies which have not resolved their audits by this date will not be eligible to enter into new agreements for the upcoming agreement year. FNS Headquarters will send a list of the companies out of compliance with the audit requirement to the FNS Regional Offices by

April 10 of each year. The FNS Regional Offices will then notify their distributing agencies.

- To reduce the paperwork burden, if no comments are received, this will be considered as concurrence with the findings of FNS Headquarters' review of the audits. A letter from the distributing agency which concurs with the findings is *not* required.

**OIG audits** are audits conducted by USDA's Office of the Inspector General. These may be initiated by OIG or at the request of FNS. The scope of these audits is to uncover fraud, waste, or abuse by a processor utilizing donated foods. Many of the OIG audits are the direct result of problems found during on-site reviews by FNS and distributing agency staffs. After OIG completes its audit, a final audit report is issued with recommendations for action by FNS. These recommendations could include recovery of monetary damages from the processor, implementation of new policies and procedures by FNS to enhance program accountability, and/or recovery of the value of donated food from a distributing agency because lack of oversight activities. These audits are resolved on a case-by-case basis with FNS Headquarters typically acting as the lead agency. In resolving and closing these audits, it is often necessary to obtain agreement information from the distributing agencies which had agreements with the processor during the period under audit. It is very important that this information be accurate, complete, and furnished in a timely manner. FNS Headquarters will keep the FNS Regional Offices and distributing agencies informed of the progress towards resolving and closing these audits. Remember that the records retention requirement is indefinite for any open audits. Be very careful to keep **all** records (agreements, inventory receipts, performance reports, annual reconciliation reports, correspondence, etc.) related to the company involved in the audit.

**GAO audits** are those conducted by the General Accounting Office, which is an investigating arm of the Congress. GAO audits of processing activities are rare; however, such audits would be handled in a manner similar to OIG audits.

**Sales Verification For Indirect Discount and Alternate VPT Systems:**

In the State Processing Program, a sale represents the total number of units of a specific end product sold to a recipient agency. Thus, if 12 cases of beef patties are sold and delivered to a recipient agency, this is considered one sale, not 12 separate sales. If the distributing agency permits a processor to use the indirect discount (hybrid) value pass-through (VPT) system or an alternate VPT system, the sales must be verified. The distributing agency may either design and implement a sales verification system or the distributing agency may delegate this responsibility to the processor. If the distributing agency has delegated the responsibility to the processor, the distributing agency must establish and provide guidelines to ensure that the processor's sales verification system is acceptable and effective. Because it is vital that the processor be fully aware of the importance of his/her sales verification responsibilities, it is recommended that the distributing agency furnish these guidelines to the processor during the contract approval process.

While sales must be verified at a minimum every six months, the distributing agency or the processor may also verify sales on a more frequent basis, such as monthly or quarterly. However, if sales verification is delegated to the processor, the processor **must** report the findings of the sales verification



to the distributing agency twice during the agreement year, and attach the results of the verification to the December and June monthly performance reports. These findings must cover the periods July through December and January through June, respectively. *It is important to note that distributing agencies typically delegate the sales verification to the processor.*

**Sampling Procedures:**

Sales verification sampling is primarily a function involving two factors: the size of the universe of total semi-annual sales and the level of confidence desired in the results. A sample size based on semi-annual sales which ensures a 95 percent confidence level is required under Section 250.19(b) of the Food Distribution Program regulations. A reportable sale is one in which there is valid documentation that the end product(s) were actually delivered to eligible recipient agencies and that the full value of the donated food was passed on as a discount to the recipient agencies. To ensure that the sample universe is complete, all sales reported to the distributing agency during the previous 6 months should be included in the universe. For example, the first sample universe would include sales reported to the distributing agency on the monthly performance reports for the months of July, August, September, October, November, and December.

**Determining Sample Size:** A table is provided in the *Appendix* which should be used to determine the size of the sample. This will provide the 95 percent confidence level required in the State Processing Program regulations. Using this table, “N” represents the total number of sales reported during the 6-month period. To determine the sample size (S) required, find the number of sales reported under Column “N”. The number to its right under Column “S” is the sample size needed. For example, if 1,600 sales records were reported during the 6-month period, 310 records must be verified. If the number of sales records reported falls between two population sizes, use the higher “N” to determine the sample size. For example, if 1,622 sales records were reported, the sample size would be based on 1,700 sales. In this case, 313 sales records must be verified.

To select the actual sample, a systematic method of selection should be used. Systematic samples are easy to conduct. When the sales of the systematic sample are drawn from a random universe of sales, it is equivalent to simple random sampling. The procedures outlined below must be followed in order to obtain a systematic sample of reported sales for verification purposes.

**Skip Interval:** To calculate the skip interval, divide the total number of sales by the required sample size. For example, if you have 900 reported sales in a universe with a required sample size of 269, the skip interval is “3” (900 divided by 269). Select a random starting point. The starting point must fall between 1 and the skip interval. In the above example, a starting point would be chosen randomly from 1 through 3; in this case, “2” was chosen. Therefore, the “2<sup>nd</sup> record” would then become your starting point (or the 1<sup>st</sup> sample record). Next, select the remainder of the sample. To select additional sample records, count forward (skip interval) 3 records beginning with the starting point determined above. Since the 2<sup>nd</sup> record was selected as the starting point in the above example, then the 5<sup>th</sup> record would be the next record sampled. Continue to select records in this manner until the required sample size is reached. In this example, the 2<sup>nd</sup>, 5<sup>th</sup>, 8<sup>th</sup>, 11<sup>th</sup>, 14<sup>th</sup>, etc., records would be selected until the required sample size of 269 records is obtained.

If you should reach the end of the records from which you are drawing your sample and you still do not have the required sample size, continue by going back to the beginning of sales records. You would proceed with the sample selection as specified above until you have obtained an adequate sample.

It may be necessary to increase the population size to compensate for “non-respondents” in the sample in order to ensure that the 95 percent confidence level is reached.

**Verifying the Sales:**

The processor or the distributing agency must contact the recipient agencies whose sales were selected for the sample in writing. At a minimum, the processor or the distributing agency should request that the recipient agency confirm the following information regarding the end product sale:

- Date of delivery;
- End product (code) purchased;
- Quantity purchased;
- Net price paid; and
- Name of the distributor.

The recipient agency should confirm the information regarding the accuracy of the sales by signing and dating the letter and forwarding it to the processor or the distributing agency. Follow-up by telephone calls should be made to all recipient agencies who failed to respond.

Verification is considered complete when a documented response is received from a recipient agency. However, if a recipient agency has been contacted by letter and telephone and has not responded, the processor must contact the distributor who reported the sale or the distributing agency must contact the distributor to learn whether the sales of end product were actually made. The processor or the distributor must provide documentation which will confirm the sale, such as copies of invoices that have been signed and dated by the recipient agency, canceled checks, check stubs, etc. Any unverified or unconfirmed sales must be considered as invalid sales. In the event that sales are determined to be invalid, refunds or credits may not be provided to the distributor and the processor cannot draw down on its commodity inventory.

**Sales Verification Report:** The sales verification report should contain the following information at a minimum:

- Period of time for which the sales verification was conducted;
- Total number of sales for the period of time covered by the sales verification;

- Results of the sales verification;
- A total of the sales verified, along with the name, address, and telephone number of each “verified” recipient agency;
- A list of all problems identified during the verification; and
- If applicable, the corrected performance reports.

If the distributing agency is conducting the sales verification, the results of that report, along with all supporting documentation, must be maintained on file. FNS Regional Office staff will review the sales verification report during the management evaluation process.

If the processor is conducting the sales verification, the results must be reported to the distributing agency on a semi-annual basis. The findings of the sales verification must be reported as an attachment to the December and June performance reports in whatever format the distributing agency deems necessary. The distributing agency must review the processor’s findings and select a random sub-sample of at least 10 percent of all sales verified by the processor and reverify the sales by contacting the recipient agencies by telephone or through written correspondence. The distributing agency is then required to submit a copy of the processor’s review report and findings and the results of its reverification efforts to the appropriate FNS Regional Office.

**Corrective Action:** When the sampling verification indicates that the full value of the donated foods has not been passed on to the recipient agency by the distributor, the distributing agency must project a claim against the processor, ensuring the verification system supports the claim. This claim projection must be resolved in accordance with FNS Instruction 410-1, Rev.1, *Non-Audit Claims-Food Distribution Program*. Performance reports and quarterly inventory reports must be adjusted to reflect any invalid sales identified during the verification. Additionally, the processor must develop a corrective action plan which is designed to eliminate the problems disclosed during the sales verification effort. Each processor is expected to keep records of the methodology used in selecting records for each sample, and retain the responses from recipient agencies for at least three years. Also, processors must maintain records of any corrective action plans submitted to the distributing agency.

If, in the review of the sales verification, instances of poor processor performance are identified, e.g., it is determined that the value of donated foods has not been passed on to recipient agencies or if end products have been improperly distributed, the distributing agency must take appropriate actions. Following are some possible actions which could be taken by the distributing agency:

- Require the processor to adjust its monthly performance reports to reflect any invalid sales;
- Require the processor to develop a corrective action plan designed to correct problems identified during the sales verification;

- Initiate an audit or review to determine the extent to which sales are to be disallowed;
- Establish a claim in accordance with *FNS Instruction 410-1, Rev. 1*;
- Require the processor to discontinue the abused VPT system and/or
- Terminate the processor's agreement.

**Product Acceptability:** A detailed discussion on testing and monitoring the acceptability of end products is included in the *Agreement Approval* section of this handbook. Please refer to that section for more information.

#### Food Losses and Claims:

Under the State Processing Program, processing agreements are entered between the distributing agency and the processor; FNS is not a party to the contract. Because of this contractual arrangement, the distributing agency is responsible for resolving any food losses which may occur at a processor's plant. Processors must report all instances of out-of-condition donated food to the distributing agency as soon as possible before the processor may take any action. The distributing agency, in turn, must act upon all instances of contamination, deterioration, spoilage, infestation, or latent defects involving donated food. However, if the food loss occurred because of unusual circumstances or if the amount of food found to be out-of-condition is substantial, the distributing agency must contact the appropriate FNS Regional Office to obtain specific technical assistance in handling the loss. See **Procedures For Reporting Out of Condition Food At Receipt** in the Food Ordering section.

#### Food Losses Identified Upon Receipt by Processors

If the processor receives out-of-condition donated food which has been backhauled from recipient agencies, the distributing agency must determine the recipient agency responsible for the loss and follow the procedures in FNS Instruction 710-1, *Commodities Found Out-of-Condition After Receipt by Distributing Agencies*.

**Claims:** Whenever there is a loss of a donated food, a claim determination must be made following the procedures outlined in FNS Instruction 410-1, Rev. 1, *Non-Audit Claims-Food Distribution Program*.

#### Claim Action and Determination

- The distributing agency is required to begin claim action immediately upon receipt of information concerning a donated food loss, and make a claim determination within 30 days of receipt of information of the loss. Exception: No claim determination is

required where the value of the lost food is \$250 or less, other than transit claims. The value used to calculate the claim amount is USDA's purchase price of the commodity at the time the loss occurred according to the latest figures supplied from the *Commodity File*.

- Upon determination that a claim exists and the value of the donated food loss does not exceed \$2,500, the distributing agency must aggressively pursue collection activity. The general policy is to collect claims in full through administrative action. However, claims which indicate fraud, the presentation of a false claim, or misrepresentation on the part of any party having an interest in the claim, must be reported immediately to the appropriate FNS Regional Office. Three written demands must be made at 30-day intervals **or less**, in terms which will inform the debtor of the consequences of failure to cooperate. Action must be taken immediately so that the claim can be paid by drawing down the processor's bond, letter of credit, or escrow account, if necessary. If the distributing agency fails to pursue a claim within 60 days from the date the claim was determined to exist, FNS has the authority to assess a claim against the distributing agency in the favor of USDA.
- Upon determination that a claim exists and the value of the lost foods exceeds \$2,500, the distributing agency must immediately transmit the claim determination to the appropriate FNS Regional Office, fully documented as to the facts and findings. The following information should be submitted to the FNS Regional Office:
  - Description and quantity of the lost commodity;
  - Time and place of the loss;
  - Name of persons having possession at the time of the loss;
  - Circumstances of the loss and the apparent cause;
  - Available evidence and documentation relating to the loss;
  - Date of discovery of the loss;
  - Current inventory on hand of the items found to be out-of-condition;
  - Description of the condition of the commodity;
  - General storage conditions where the commodity was being stored, e.g., temperature, pallet, sanitation, type of storage;
  - Schedules, including dates, of extermination treatment, if applicable;

- Precautions against theft or fire, with a copy of the local fire or police department's report, if applicable;
- A finding as to the presence or absence of fraud, negligence, or willful act, and a statement of the basis for such finding;
- A certificate of inspection by health officials;
- Manner of disposal of the out-of-condition commodity; and
- Mechanisms available to the processor to pay for the loss, e.g., bond, letter of credit, or escrow account insurance.

If the FNS Regional Office determines from its review of the claim determination that a claim does exist, the distributing agency must demand restitution from the entities liable, upon receipt of notice from the FNS Regional Office.

#### **Tracking Claims**

The distributing agency must maintain a register to track claims which would include, at a minimum, the following information:

- Name of processor responsible for the loss;
- Date of loss;
- Brief description of the loss;
- The amount of the claim determination; and
- Current action or the resolution of the claim.

#### **Compromise, Waiver, Suspension or Redetermination of Claims**

If it is determined that a claim must be compromised, waived, suspended, or redetermined, FNS Instruction 494-3, *Compromise, Waiver, Suspension and Settlement of Claims*, must be followed. The determination that a claim should be compromised or waived must be based on documented evidence of the following three conditions, all of which must be individually addressed, met, and fully documented. These conditions are:

- Verification that the debtor was not primarily responsible for the problem;
- Verification that the debtor has initiated corrective action; and
- Verification that collection has been appropriately pursued.

#### Claims Collection

All monies collected from a claim which exceed \$50,000 in its entirety must be returned to USDA. The distributing agency must contact the FNS Regional Office for instructions on how the funds must be transmitted to USDA.

The options for using the monies collected from claims totaling \$50,000 or less are categorized according to the type of donated food which was lost, i.e., entitlement or bonus foods. Entitlement foods are the donated foods purchased to meet the distributing agency's mandated level of commodity assistance and bonus foods are the donated foods which are provided free of charge by USDA and are not charged against entitlement levels.

Monies collected must be maintained in the distributing agency's salvage account. The FNS Regional Office must give prior approval to each deposit to or expenditure from the salvage account which is in excess of \$2,500. Following are the options for use of the monies:

#### Donated Foods Designated as Entitlement Foods

- Use the collected amounts in the distributing agency's or recipient agency's Food Distribution Program for program improvements if approved by the FNS Regional Office.
- Replace the lost donated food with commercially equivalent or in-kind items upon obtaining approval from the FNS Regional Office. In-kind replacement means replacement with the same foods. For example, butter must be replaced with butter. If the distributing agency permits the processor to replace in-kind, assurance must be provided that the commercial product is of U.S. origin, of the same generic identity, and of equal or better quality. If replacement in-kind is not practicable, lost donated food may be replaced with a *similar* food upon obtaining the approval of the appropriate FNS Regional Office. *Similar* replacement means replacing the lost donated food with foods of similar characteristics. For example, lost vegetables must be replaced with vegetables. The replacement product must at all times be:
  - Equal or greater in monetary value;
  - Of the same food group;
  - Desired by the recipients; and

- Of the same types as those normally donated by USDA.

Unprocessed food may be replaced with processed food. The monetary value of the replacement product must equal the value of the lost commodity, i.e., turkeys can be replaced with turkey roasts, however, the monetary value of the turkeys used to make turkey roasts must equal the value of the turkeys which were originally donated and lost.

**Donated Foods Designated as Bonus Foods**

- For bonus foods *without* caps (caps means a level of cash or commodity assistance that cannot be exceeded), any funds collected as the result of claims activities must be returned to USDA.
- For bonus foods *with* caps, any funds collected must be returned to USDA or must be used to replace the lost foods in-kind, upon approval of the FNS Regional Office.

**Processing Agreement Termination or Close Out:**

In the State Processing Program, the agreement year begins on July 1 of the current year and ends on June 30 of the next year. Although processing agreements may begin after July 1, processing agreements **may not** continue past June 30. Processing agreements can be terminated any time during the year for a variety of reasons, including the following:

- The processor may decide to discontinue processing donated food;
- The processor may be having financial difficulties and the distributing agency determines that agreement termination is appropriate;
- Deficiencies identified in the processor's operations may be serious enough to terminate the contract; or
- The appropriate food may no longer be available, etc.

Regardless of the cause for termination, whether it occurs mid-year or at the end of the agreement year, there are specific steps that must be taken to ensure that the donated food in the processor's possession or the value of the donated food is properly returned to either the distributing agency or recipient agency. When agreements are terminated at the end of the agreement year, the close-out procedures should correspond to the annual reconciliation process.

**Reconciliation and Close Out Procedure:**



Upon termination of a processing agreement, the distributing agency must complete a reconciliation of the processor's processing activities. The following must be reconciled:

- The beginning donated food inventory balance at the beginning of the agreement period. The beginning donated food balance will be zero (0) if the processor did not have an agreement the previous agreement year. If the processor had an agreement in the previous year, the distributing agency must verify that the amount of any carryover balances is accurate.
- The pounds of donated food received during the agreement period. The amount of donated food the processor lists on the monthly performance reports as being received must be reconciled to food requisitions for direct shipments and documents the distributing agency requires for backhauling, e.g., recipient agency release forms.
- The pounds of donated food transferred during the agreement period. The processor must obtain approval from the distributing agency to transfer donated food to or from another distributing agency's account or to or from another processor's facility. The transfers included on the monthly performance reports must be reconciled to distributing agency and FNS Regional Office approval letters.
- The number of units of end products containing donated food which have been sold during the agreement period. The total number of units of end products sold as reported on the monthly performance reports must be validated. It must also be determined that the end products claimed were approved, i.e., end product data schedules are part of the processor's agreement. In addition, it must be verified that the recipient agencies who received product from the processor were eligible recipients.
- The ending donated food inventory balance at the end of the agreement period. The distributing agency must validate the final donated food inventory balances.

**Accounting for Donated Food In the Processor's Inventory:**

When an agreement is terminated or concluded and the processor has donated foods remaining in inventory, the distributing agency must make a decision (with the approval of the FNS Regional Office) on the method to use to account for the donated foods. The distributing agency must direct the processor to use one of the following methods:

- For non-substitutable donated food, the processor may:
  - Return the donated food to the distributing agency, recipient agency, or other designated entity at the processor's expense. For example, under special circumstances, the donated food may be transported to another processor with whom the distributing agency or recipient agency has a processing agreement;

- Pay the distributing agency or recipient agency for the donated foods based on the value of USDA's replacement costs, determined by using the most recent data provided by USDA;
- Pay the distributing agency or recipient agency for the donated food based on the value stated in the processor's agreement; or
- Pay the distributing agency or the recipient agency the Commodity Credit Corporation (CCC) unrestricted sales price.
- For substitutable donated food, the processor may:
  - Transfer the donated food to the accounts of other contracting agencies with which the processor has agreements, with the concurrence of the affected contracting agency(ies) and the FNS Regional Office(s);
  - Return the donated foods physically in inventory to either the distributing agency or the recipient agency;
  - Replace the donated foods no longer in physical inventory with commercial foods of equal or better quality and deliver these foods to either the distributing agency or the recipient agency;
  - Pay the distributing agency or the recipient agency for the donated foods based on the value of USDA's replacement costs, determined by using the most recent cost data provided by USDA;
  - Pay the distributing agency or recipient agency for the donated food based on the value stated in the processor's agreement; or
  - Pay the distributing agency or the recipient agency the CCC unrestricted sales price.

In determining the option to use, the following must be considered:

- If the distributing agency requires the processor to physically return the donated food, all steps involved to accomplish this must be fully documented. This process should begin with a letter from the processor which provides details about the donated food being returned, such as the type of food being returned, the number of cases, contract numbers, pack dates, etc. Assurance must be provided that the product is wholesome and fit for human consumption before the product is returned. Reinspection of the product must be conducted by the appropriate Federal, State, or local inspection service.
- If the donated food is an entitlement item, and the distributing agency requires the processor to pay for the donated food remaining in inventory, the distributing agency

must obtain the most current value provided in the *Commodity File* and compare that to the value of the donated food stated in the processor's agreement. It is recommended that the distributing agency select the higher of the two values to ensure that the contracting agency's original entitlement level is not reduced as the result of the processor paying for the value of the donated foods. The funds received from the processor can be used by the distributing agency to replace the food in-kind that was kept by the processor. It is in the best interest of the distributing agency to ensure that the appropriate value of the donated food is recouped since neither the entitlement foods nor their values will be replaced by USDA. For bonus donated foods, the distributing agency must review the *Commodity File* value, the value in the processing agreement, and the CCC unrestricted sales price (which can be obtained from the FNS Regional Office) to determine which is the best value to use for the donated food remaining in the processor's possession. In determining which value is the most appropriate to use, the distributing agency may wish to take into consideration the circumstances under which the agreement was terminated.

- If the distributing agency permits the processor to replace the donated food, the processor must obtain a commercial product which is of U.S. origin and is identical or superior in every particular to the donated food specification. The distributing agency must require the processor to submit documentation, such as purchase specifications, which will verify the quality of the replacement commercial product.
- If the distributing agency permits the processor to transfer the donated food to other distributing agency accounts, the procedures outlined in Section V., *Food Ordering* (under *Inventory Controls*), must be followed.

#### Negative Inventories

Before making a decision as to how negative inventories should be treated, consideration should be given as to why the negative inventory balance occurred. For example, if the processor went into a negative inventory status because the distributing agency was unable to arrange timely delivery of donated food and this delay would have disrupted deliveries to recipient agencies, the negative inventory balances should be replaced by the distributing agency. Ideally, as part of the processing agreement, the distributing agency and the processor should determine how to handle such situations before they occur. However, if a negative inventory balance occurred after the processor was informed that the donated food would no longer be available, replacement product will not be guaranteed. The State Processing Program regulations clearly state that the processor goes into a negative inventory status at his own risk.

If more than one donated food is involved, the value of each donated food can be computed and the values of the positive amount can be offset against the value of the negative amount according to the category of the donated food, i.e., bonus against bonus; entitlement against entitlement. However, this offsetting is **only** permitted at agreement termination.

#### Costs Associated With the Return of Donated Foods

In the event a processor terminates an agreement before the end of the agreement year or if the agreement is terminated due to the processor's negligence or non-compliance with program requirements, the processor will be responsible for paying the transportation costs associated with returning the donated foods to either the distributing agency or the recipient agencies. If the agreement is terminated at the end of the agreement year or not approved for the next year, the distributing agency and the processor must negotiate who will pay the transportation costs.

#### Resolution of Outstanding Inventory Balances

It is important to resolve inventory balances on a timely basis. If the donated food is not returned by the processor and the distributing agency's collection actions have failed to produce results, the distributing agency may pursue collection of the claim by calling in the processor's bond, letter of credit, or escrow account. However, if this method is selected, all actions must be taken during the period of time the bond, letter of credit, or escrow account is in effect. If the bond, letter of credit, or escrow account has expired, and closeout of the inventory balances cannot be resolved, the distributing agency must establish a claim against the processor by following the procedures set forth in FNS Instruction 410-1, Rev. 1, *Non-Audit Claims-Food Distribution Program*.

**State Imposed Requirements:** The State Processing Program regulations do not prohibit distributing agencies or recipient agencies from imposing additional requirements on processors, as long as these requirements are not in conflict with Federal regulations. However, before adding additional requirements, distributing agencies or recipient agencies should carefully evaluate the impact of their decisions in terms of costs versus benefits and whether there are alternate means of accomplishing the same objective.

# Meat Inspection and Certification Requirements

## **Meat Inspection:**

When donated meat products are processed or when any commercial meat products are incorporated into an end product containing one or more donated foods, all of the processing must be performed in processing plants that are under continuous Federal meat inspection. USDA's Food Safety Inspection Service (FSIS) is the Federal agency that oversees the inspection of meat products. However, if a State has been certified to have an inspection program that is at least equal to the Federal inspection programs, the State may perform the inspection. State inspection is only acceptable for intrastate commerce. Any food that crosses state lines must be federally inspected. Meat inspectors assure that all meat packing plants maintain wholesomeness and sanitation requirements for meat and meat products. FSIS also plays a vital role in the Child Nutrition (CN) Labeling Program. This program involves the review of a processor's recipe or product formulation to determine the contribution a serving of a commercially prepared product makes toward the meal pattern requirements and a review of the CN Label statement to ensure its accuracy. *End product labeling requirements are discussed in further detail in Section IV, Processing Agreement Approval.*

## **Meat Certification/Grading:**

In the State Processing Program, all USDA donated meat products (beef and pork products) must be certified by USDA's Agricultural Marketing Service (AMS) meat graders to ensure non-substitution and non-diversion at a minimum (Option 1 Grading). Optional certifications should be described in careful detail on the end product data schedule and/or the processing agreement. Meat graders cannot perform these certification services unless the meat or meat products are produced in a federally inspected plant. *AMS graders also perform the same services for poultry products, which are discussed extensively in Section VIII., of this handbook, Poultry Processing.*

The United States has had mandatory meat inspection for products prepared for commerce since 1906. There is no charge for these inspection services. However, processors are responsible for paying the costs associated with securing an AMS grader to perform the certification of meat products. The cost of this service is usually comprised of travel, lodging, and an hourly rate multiplied by the number of hours spent overseeing the certification of product. However, in the event the processor can demonstrate that grading is impractical, the distributing agency may approve an exemption to AMS product certification prior to processing an order. Exemptions will be authorized on the basis of each order to be processed, provided the processor can demonstrate:

- That even with ample notification time, the processor cannot secure the services of a grader;

- That the cost for a grader would be unduly excessive relative to the value of foods being processed and that production runs cannot be combined or scheduled to enable prorating of the costs of services among the purchases of end products; or
- the documented urgency of the recipient agency's need for the end product precludes the use of graders.

Prior to approving a processor's request to waive the acceptance service grading requirement, the distributing agency must ensure, based on the processor's past performance, that the quality of the end product produced will in no way be adversely affected as a result of waiving the product certification requirement.

**Certification Options:**

The end product data schedule is used by distributing agencies, recipient agencies, and processors to specify the end products to be produced and the certification option (Option 1 or Option 2) under which the donated meat is to be processed. Prior to any certification, the processor must provide the grader with a copy of the applicable processing agreement and a copy of the end product data schedule for each end product being produced. These documents will indicate whether Option 1 or Option 2 is required by the distributing agency. Below are descriptions of Options 1 and 2 for donated beef and pork products.

**Option 1**

This option provides a certification to the distributing agency that the end products have been prepared from the specified donated commodity. Under this option, graders must supervise the processing activity to maintain proper accountability and integrity of donated foods during the processing procedures. This does not preclude the addition of commercial meat or other ingredients listed on the end product data schedule. Processors must provide the graders with detailed information concerning the type and quantity of donated product(s) to be produced. Graders will periodically check product and rework for condition prior to and during processing to ensure product has been properly stored and handled. Any product showing signs of mishandling or improper storage will be retained for FSIS inspectors to make an official determination (rework is the raw or cooked product that has been collected at the end of a production day and may be reused in subsequent productions).

**Option 2**

This option combines the certification requirements of Option 1 with additional optional certifications requested by the distributing agency in the processing agreement or on the end product data schedule. Although the following requirements are available for optional certification, each requirement is not necessarily applicable to every product. Distributing agencies and/or recipient agencies should determine the level of quality assurance they believe is necessary prior to designating optional certification requirements. This is not an all inclusive list:

- *Condition Examination* -When the addition of commercial meat is permitted on the end product data schedule, the non-donated meat must be examined for excellent condition.
- *Portion Size*-The desired portion size, applicable tolerances, and sampling criteria must be specified. The tolerances and sampling criteria must be reviewed for appropriateness by AMS prior to certification.
- *Amount of Breeding*-The limitations, tolerances, and sampling criteria must be specified. The tolerance and sampling criteria must be reviewed for appropriateness by the grader prior to certification.
- *Formulation*-When specified in the processing agreement, product will be certified in accordance with the formula on the end product data schedule.
- *Net Weight*-Prior to product freezing, 10 shipping units per production lot must be randomly selected and weighed to determine the net weight of product in the sample. Net weight is determined by subtracting a tare weight from the gross weight (the tare weight is determined by weighing empty shipping containers and packaging materials of the same kind and in the same numbers applicable to the 10 shipping units weighed). The total net weight of the sample must be equal to or greater than the total of the marked net weights in the sample. If the total net weight of the sample is less than the marked net weights in the sample, the lot must be rejected. However, lots that are rejected may be reworked and submitted one time only. When examining resubmitted lots, four packed containers per lot must be randomly selected and weighed. The finding of any sample unit in the resubmitted lot which is less than the marked net weight will cause the lot to be rejected.
- *Freezing Requirements*-The processing agreement or end product data schedule may specify that the end product must be frozen to a specific internal temperature within 72 hours after placement in the freezer and/or at the time of shipment. Graders must monitor product in storage to ensure compliance with the time and temperature requirement. Records of temperature verification must be maintained by the processor.
- *Special Labeling*-The processing agreement or the end product data schedule must indicate the use of special markings and/or labeling. Examinations must be performed in accordance with the U.S. Standards for Condition of Food Containers.
- *Packing/Packaging*-The examination of shipping and primary containers must be performed on each lot at the time of production. In addition, when certification is required at the time of shipping from a freezer, an examination must be performed for defects occurring during handling and storage. The U.S. Standards for Condition of Food Containers must be applied.

- *Final Certification*-Final certification at the time of shipping must be performed. Temperature (if required) and physical characteristics of the product will be examined.
- *Metal Detection*-The required level of sensitivity and other detailed requirements related to examination for the presence of metal should be specified in the processing agreement. If not specified in the agreement, the grader will conduct an examination for the presence of metal in accordance with the procedures set forth by AMS.
- *Other*-The processing agreement must specify any additional requirements, including related quality assurance provisions such as certification in accordance with a specification. If designated, the processing agreement or the end product data schedule must list the specification name and date of issue. All specifications utilized must be approved through AMS.

The processor must obtain a written waiver from an authorized representative of the distributing agency for any deviations from the certification requirements that are included in the processing agreement or the end product data schedule . A copy of the waiver must be provided to the grader prior to certification.

**Technical Requirements:**

Prior to production, the processor’s facilities and operations must be evaluated to provide the most efficient utilization of personnel while maintaining proper accountability and integrity of USDA donated meats. Unless otherwise specified in the processing agreement or the end product data schedule, a processor may commingle donated products from different recipients and/or distributing agencies. Unless specific instructions are included in the processing agreement, rework material, such as broken patties, may be held and used in another production run of similar end product.

Occasionally, sealing straps on containers of USDA donated meat products will be unintentionally broken during shipping and handling. In addition, processors may open a limited number of containers for product examinations, such as product condition, to ensure that the distributing agency is providing an acceptable product. In either case, if no apparent tampering of the product is evident, the product contained in the unsealed boxes shall be acceptable for processing purposes.

**LS-44—Production Information Form:**

The LS-44 is used by the AMS grader to document the production and acceptance of products being processed. The grader completes this form based on his observations of the production run and other information made available to him. While all sections of the LS-44 are important, please make sure the following portions of this form are completed by the grader:

- The date of production must be entered. This may be for a single day or up to a week’s production. If more than one day’s production is detailed on the form, the grader must enter the first day’s date in the date block, and enter each day’s production on a separate



line in the body. The date should be written to the left of the receiver block for each day the receiver is listed.

- The starting pounds of donated product (the number of cases and pounds) for each end product must be documented. If both the starting donated product and the finished are not on the same LS-44, then reference should be made between the LS-44 with the starting weights and the LS-44 with the finished product. If the processor is going to produce more than one end product, it is the responsibility of the processor to give information as to how many cases of donated product will go to each item.
- The amount of commercial meat, if any, used in the production of the end product must be documented.
- The name of the end product being produced as labeled on the product container, including the ounce size of the finished product, if applicable, must be indicated.
- The amount of rework product produced on prior production runs that will be included in the present production run must be shown on this form. Additionally, any amount of rework product held for inclusion in a subsequent production lot must be recorded. This amount should not include products reworked into the same production lot. The amount of rework generated, even if not used in a subsequent production lot, must be recorded.
- The amount of product which FSIS personnel has condemned and the reason for the condemnation must be documented.
- Any losses (other than normal production losses) of USDA donated product that appear to be excessive must be recorded. Such losses would be those which are considered over and above that normally associated with good commercial practices for a particular processing operation.
- The certificate number(s) which corresponds to the production information listed on the form must be indicated. These certificates may be issued by one or more graders on one or more days.
- The grader primarily responsible for the control of the production should sign the LS-44 in the signature block. It is not necessary for more than one grader to sign the form in the event of dual responsibility or product produced over several days.

**Total or Partial Quality Control Programs (TQC/PQC):** In order to produce end products which bear the Child Nutrition (CN) label, the processor's plant must have either a TQC or PQC program. The plan should be kept on file and be made available, if requested by inspectors, reviewers, or auditors. Quality control is the processor's responsibility.

**Handling Rework:**

Rework is defined as wholesome, salvageable product generated during a production run that is not acceptable as the approved end product from the end product data schedule. Rework may not be counted in determining whether a processor has met guaranteed minimum yield established on the end product data schedule. Any raw product that does not go through the entire production process should not be considered rework. Processors should continue to report rework on Part B of the monthly performance report. Rework which cannot be reincorporated into subsequent production runs should be dealt with according to State Processing Policy Number 26. All rework must be reconciled annually by the State. Rework in inventory may be carried forward into the next contracting year with the mutual consent of the DA and the processor.

# Poultry Processing

## Introduction

This section has been prepared to provide guidelines to assist distributing agencies and processors in the processing of the various poultry items being provided through the USDA food donation programs. Processing USDA donated poultry items into finished end products enables recipient agencies to receive the products they desire in forms that are convenient to use, and in many instances, improves portion control at the point of meal service. When done properly, the conversion process can be very cost effective and provide added convenience in meal preparation as well as increasing the variety of products available for menu planning. Proper product combinations and careful evaluation of processors' end products are essential to maximize product return and acceptability of the further processed products delivered to the recipient agency.

The definitions below are used within the discussion of donated poultry processing. In those few instances where the terminology can refer to both poultry processing and other donated food processing, these words are defined both here and in the Section II., *Glossary*, at the beginning of this handbook.

## Poultry Definitions

**Antioxidants:** Antioxidants are used in foods to prevent or inhibit oxidative deterioration of flavor and odor of fats and fatty compounds. These include natural occurring additives such as lecithin, Vitamin E, and certain sulfur containing amino acids. However, some of the most effective additives are synthetic compounds such as butylate hydroxyanisole (BHA), butylate hydroxytoulene (BHT), and propyl gallate.

**Bulk Pack:** Refers to chickens and turkeys that are specifically packed for further processing. Unless specifically required or agreed to by both the supplier and further processor receiving the product, this product will be delivered in a chilled (not frozen) form. Necks and giblets are not included with bulk pack product. Bulk pack turkeys may not be pre-basted.

**Buy-Back Parts:** Unused poultry parts not incorporated into end products. These remaining parts may be purchased by the processor, who would then credit the value to the distributing agency or recipient agency. Credit may not be given for primal parts such as breast and thighs or breast or thigh meat. Credit or buy-back arrangements between the distributing agency or recipient agency and the processor must be established prior to any processing, documented as part of the agreement, and made available to the grader.

**Byproducts:** Products other than the specified end products produced during processing. Typical by-products which result from processing poultry can be chicken broth, inedible bone, fat, skin, and tails. The value of by-products which are sold or used by the processor must be credited to the distributing agency or the recipient agency minus any costs associated with the sale (i.e. packaging, transportation, etc.) . Credit arrangements for by-products between the distributing agency or the recipient agency and the processor must be established prior to any processing, documented as part of the agreement and made available to the grader. Processors who do not sell or use any resulting by-products are not required to credit distributing agencies or recipient agencies for the value of the by-products. In these instances, a processor arranges for the destruction of the by-product and incurs any costs associated with its destruction. *Note: By-products can also be buy-back parts; see definition above.*

**Catch Weights/Random Weights;** Catch weight refers to the marked weights on products that, by the nature of their manufactured characteristics, are not packed to a standard weight. On these products, the weight of each container must be individually recorded. Recipient agencies, when releasing raw products with random weights to processors for further processing, should assure that the processor credits the actual net weights received instead of providing figures based on average net weights.

**Consumer Pack:** Refers to turkeys that are individually packaged in heat-shrinkable plastic film bags with good oxygen and moisture barrier properties. This product may be basted (injected with a basting solution) at the option of the supplier for commodity purchases for use in school lunch and other domestic food programs. This product is generally purchased without necks and giblets.

**Economic Adulteration:** Addition of an ingredient(s) to a product in excess of the generally accepted needs of the end product that results in a lowered value of the item being produced.

**Fabrication Procedures:** The manufacturing procedures used in making further processed poultry products. For example, when grinding or chopping, the fabrication procedures may include type of equipment used, size of grind, speed of chop, or other procedures that would affect the quality of the finished product.

**Formulation:** The quantitative listing of all ingredients contained in an individual end product.

**Grader:** A person licensed as a representative of AMS to examine and certify the production of end products containing USDA donated food.

**Guaranteed Minimum Return:** The minimum weight or number of units of processed product that will be produced and returned for a set amount of donated food provided. This information is obtained from information on the end product data schedule.

**Lipid Oxidation:** Union of fat with oxygen that generally results in a lowered acceptability of the food product due to deterioration of flavor and odor of the fats and fatty compounds.

**Mechanically Separated Meat (Comminuted Meat):** In poultry processing this term generally means the product that results from subjecting poultry frames to a mechanical deboning process where the raw product is finely ground and then by a mechanical separating process the meat is separated from the bone residue. The resulting product is generally used for manufacture of hot dog or bologna type

products and, in lesser amounts, is sometimes added to other products such as cooked roll type products, nuggets, patties, etc. It should not be confused with another mechanical separation process being utilized by the poultry industry which yields product that has a somewhat coarser texture. This type of product is generally found to be more acceptable in ground chicken or turkey products or in other cooked products where a firmer texture in the finished product is desired. *Note: Product labeled as ground is generally recognized by the poultry industry and FSIS as being derived from whole bone-in parts with or without skin in natural proportion.*

**Organoleptic:** A sensory perception or evaluation of the major quality factors of appearance, texture, and flavor as perceived by the senses of sight, smell, touch, sound, and taste of the individuals performing the evaluation.

**Packaging:** Packaging refers to the container that is used to protect, preserve or maintain the quality of the donated food. This container is sometimes referred to as a “primary container.”

**Packing:** Packing refers to the container that is used to include one or more primary containers. This container is sometimes referred to as a secondary container.

**Permeable Casing:** This refers to the primary container used to hold raw poultry products during the cooking and/or smoking process such as some turkey breast products or turkey ham casings. This type of casing allows for the loss of a certain amount of moisture from the product during the cooking and/or smoking of the product. Products cooked in this type of casing should be repackaged in a moisture and vapor proof casing before freezing.

**Primal Cuts/Primal Meat:** The meat or product derived from the breast and thigh of chickens and turkeys. Products derived from the breast and thigh (intact meat portions) may not be purchased or credited by the processor under buy-back or credit procedures. **Note:** *Buy-back or credit can only be given for carcass parts such as drumsticks, wings, tails, skin, necks, comminuted meat and frames, and giblets (when present). Buy-back arrangements between the distributing agency and processor must be established in writing prior to any product processing.*

**Rework:** Wholesome, salvageable product generated during a production run that is not acceptable as the specified product stated on the end product data schedule. Products such as broken patties or nuggets, or other defects such as missing breading or lumps and ridges in breaded products would be classified as rework product.

**Turkey Ham:** Product carrying this identification without the use of qualifiers (such as chunked and formed) must be made from whole turkey thighs that have not been subjected to any size reduction procedures.

**Wholesomeness:** This term means freedom from external evidence of any disease or condition which may render a carcass or product unfit for food.

**How to Select a Poultry Processor**

Selecting a processor is more than just choosing the end products that are desired. Distributing agencies should talk to other distributing agencies when either planning their first processing agreement or when considering using a processor for the first time. In order to make wise choices, distributing agencies must look at many different factors, such as the processor's integrity, the processor's dependability in making on-time deliveries, the processor's ability to produce end products with minimal problems and whether the processor has a proven record of good performance with other distributing agencies.

Once the above factors have been weighed and a list of potentially acceptable processors developed, other factors such as fee-for-service, guaranteed minimum return (GMR), product combinations offered by the processor, product formulation comparisons, number of servings returned, value of returned products, etc., must all be evaluated.

To compare the GMR projected by each processor, the distributing agency must also weigh the overall product value for all products being produced. To realize the highest product value for returned product, the distributing agency should select product combinations that include the return of higher valued products such as the white roast products and cured dark turkey products. Below is an example of two competing processors' bids based on the same overall product return for the same product combinations but with different returns of the individual products in the combination, in one delivery unit of 36,000 pounds of bulk pack turkey.

<i>Processor A</i>	<i>Guaranteed % Return</i>	<i>Pounds</i>	<i>Market Value/lb.</i>	<i>Total \$ Value</i>
<i>White Roll</i>	38	13,680	\$2.20	\$30,096
<i>Cured Dark Picnic</i>	21	7,560	\$1.20	\$ 9,072
<i>Bologna or Hot Dog</i>	22	7,290	\$ .80	\$ 6,336
<i>Total</i>	81	29,160	_____	\$45,504

\*\*\*\*\*

<i>Processor B</i>	<i>Guaranteed % Return</i>	<i>Pounds</i>	<i>Market Value/lb.</i>	<i>Total \$ Value</i>
<i>White Roll</i>	28	10,080	\$2.20	\$22,176
<i>Cured Dark Picnic</i>	20	7,200	\$1.20	\$ 8,640
<i>Bologna or Hot Dog</i>	33	11,880	\$ .80	\$ 9,504
<i>Total</i>	81	29,160	_____	\$40,320

It is obvious without doing the calculations that it would be more cost effective to select Processor A because of the delivery of more higher valued product. Below is an example of another situation where the overall returns are significantly different.

<i>Processor A</i>	<i>Guaranteed % Return</i>	<i>Pounds</i>	<i>Market Value/lb.</i>	<i>Total \$ Value</i>
<i>White Roll</i>	38	13,860	\$2.20	\$30,096
<i>Picnic</i>	21	7,560	\$1.20	\$ 9,072
<i>Turkey Frankfurters</i>	22	7,920	\$ .80	\$ 6,336
<i>Total</i>	81	29,160	_____	\$45,320

\*\*\*\*\*

<i>Processor B</i>	<i>Guaranteed % Return</i>	<i>Pounds</i>	<i>Market Value/lb.</i>	<i>Total \$ Value</i>
<i>White Roll</i>	20	7,200	\$2.20	\$15,480
<i>Picnic</i>	18	6,480	\$1.20	\$ 7,776
<i>Turkey Frankfurters</i>	58	20,880	\$ .80	\$16,204
<i>Total</i>	96	34,560	_____	\$40,320

In this example it is apparent that there is a significant increase in the overall GMR. However, the total value returned to the distributing or recipient agency is much lower due to the lower value of the additional products produced (hot dogs).

To determine which processing agreement would be the best for the recipient agency, it is necessary to evaluate the overall impact the difference in product return and product value has as compared to the increase in the number of servings represented by the increased return. If the product with the lower value and higher return (such as hot dogs) has a good student acceptance, the recipient agency may find that the processor with the higher GMR may represent the best value to the recipient agency due to the significantly higher number of servings and resultant lowered cost per serving for the returned product.

Fabrication procedures can also have a significant impact on the value of the finished end products. For example, the difference in market value for chicken patties or nuggets made from comminuted meat as compared to whole muscle or even chunked and formed products is significant. To illustrate this, on the next page are the current market prices for different fabrication procedures for chicken patties.

<i>Product</i>	<i>Price per pound</i>
Whole muscle white chicken patties	\$1.50 - \$1.70
Chunked and formed white patties	\$1.40 - \$1.50
Mechanically deboned white patties	\$0.90 - \$1.00

When evaluating bids from several processors, the distributing agency should compare similar fabricating procedures from other processors. In addition, the distributing agency must carefully evaluate bids for the lower cost method of producing patties or nuggets (preparation from mechanically separated product). There have been instances where the processing fee for product produced from comminuted raw product actually exceeded the market value for the end product. In these instances, the recipient agency would have been able to buy commercially produced product at a lower cost. In figuring the market value and processing fee costs, you must also add the cost of the USDA donated product to get a true value comparison of the two end products.

End products should be selected from products that have proven acceptance in the commercial marketplace. Products that have been successfully marketed will be more readily accepted by the student population since they are already familiar with them. Such items will also be more widely manufactured by poultry processors, resulting in more competition among potential bidders to produce the end product desired.

It is also important to be aware of what kinds of products best utilize white and dark meat, which end products are best made from whole muscle products, and which products require finely ground poultry meat. For example, the breast meat from turkeys should generally be used for oven cooked or roasted breast slabs and thigh meat for turkey ham products. For chicken, these primal meats would generally be best in chicken patties or nuggets. Incidental meat that remains on chicken and turkey carcasses after the major muscles have been removed may be used in bologna, hot dogs, or similar type products if these end products are acceptable to the recipient agency. In poultry processing, the processor must utilize or account for the **whole** bird.

Listed below are some of the more popular end products currently available:

**Chicken Products**

Barbecued Cooked Chicken

White Chicken Patties and Nuggets

Combination White and Dark Meat Patties and Nuggets

Barbecued Cooked Chicken Parts

Chicken Frankfurters

Chicken Corndogs

Chicken Bologna

Cooked Diced Chicken Meat

White Chicken Roll



Chicken Pot Pie

**Turkey Products**

Turkey Ham

Cured Dark Turkey (picnic)

White Turkey Roll

Oven Cooked or Roasted Turkey Breast

Turkey Salami

Turkey Sausage Patties or Links

Turkey Bologna

Turkey Frankfurters

Turkey Pastrami

Turkey Combination Roast (Raw or Cooked)

Turkey Corndogs

Turkey Burgers

Turkey Burgers - Barbecue Style

Turkey Canadian Bacon

Turkey Pot Pies

Ground Turkey (Bulk Pack Rolls)

Cooked Diced Turkey Meat

**Which Type of Poultry to Order:**

*Cut up or bulk pack chicken?* Many factors must be considered in the selection of end products that the recipient agency may desire from the various poultry products being further processed. For example, use of cut up chicken for reprocessing severely limits the number and types of finished end products that can be produced. Cut up chicken generally must be used for batter/breaded bone-in products, or if nuggets or patties are made, the meat must be mechanically separated, thus giving a much finer, usually less

desirable, texture to the patty or nugget. Bulk pack chicken is the better choice for further processing and uses fewer entitlement dollars.

*Consumer or bulk pack turkeys?* Use of the consumer pack whole turkey is more labor intensive and less economical since the turkeys are individually packaged in preprinted bags. Also consumer pack whole turkeys places limitations on the processors' ability to make certain products since the consumer pack product usually contains basting solutions.

When basting solutions are present, the processor is limited by FSIS regulations on the use of certain ingredients such as phosphates contained in the basting materials. Processors may not add more of the ingredient than the maximum amount permitted by FSIS regulations during the reprocessing formulation procedure. Usually the firm reprocessing the turkeys usually does not know the amount of the restricted ingredients that have been added by the original packer of the basted product. Therefore, as a rule, processors do not add any of this type of ingredient during reprocessing. These additives do provide important functions, having to exclude them in the final product can affect the organoleptic properties of the end product, and has a pronounced effect on the processor's ability to produce certain end products. Studies have shown that fresh chilled poultry provides increased yields by retaining its juices better during processing than frozen and then thawed poultry. In addition, using fresh chilled poultry will eliminate cellular damage caused by freezing and thawing.

Care should be exercised to select products that will utilize the primal cuts in higher value end products. For example, turkey ham and white turkey roll type products will have a higher product value than the bologna or frankfurter type products.

Distributing agencies with limited experience in using products available through processing can secure helpful information by consulting other distributing agencies with previous experience, through contact with commodity processing specialists in the FNS Regional Offices and through contact with AMS's product and processing specialists.

*Ground Products?* Since the thawing and subsequent refreezing of ground turkey can impact adversely on the shelf life and organoleptic properties of the product being made, it is generally advisable to either delay this until the product is prepared for serving and direct consumption or, if further processing is done, products should be made with seasonings and flavorings that will compensate for any flavor loss caused by the thawing and refreezing.

Another possibility would be to reprocess the ground turkey from the fresh state under in-plant delivery procedures similar to those used to convert raw turkey roasts into cooked product before delivery to the distributing agency. Prior arrangements must be made with the Commodity Procurement Branch of the Poultry Division, AMS, and the processor for in-plant fresh deliveries for further processing.

Ground products can be made into seasoned and unseasoned link and patty products and also make excellent fillings for tacos and burritos, as well as making sloppy joes, barbecue fillings and similar type products.

#### Specification Development:

Specifications which describe the way products will be processed play an important role in evaluating potential processors and product selection. Product specifications also provide guidelines for in-plant quality control by company employees and for grading supervision of production under Option 2 coverage. Written product specifications can also provide support for potential legal actions by the recipient agency should there may be disputes over agreement performance by the processor. Specifications must be written in a clear and concise manner. In addition to consulting processors, AMS representatives can assist in answering questions concerning the details of specification development. Areas that should be addressed in the product specifications include the following:

*Packaging and Packing:* Packing materials should be of sufficient strength and durability to adequately protect the product during shipment and storage. As a minimum, the packing materials should meet requirements of the national motor freight classification or uniform freight classification, as applicable. When the processing agreement specifies compliance with either of these certification programs, the packaging materials will meet specified construction requirements and bursting strength standards of the applicable certification program. The box manufacturer will print the required certification requirement on the bottom of the master container. Staples should not be permitted for final case closures. All cases within an individual delivery should be of the same size for each individual product.

Packaging material should provide adequate moisture and vapor barrier capabilities and should be adequately sealed. Thickness and type of packaging material should be sufficient to minimize product deterioration during frozen storage.

*Labeling:* FSIS requires certain mandatory labeling on all poultry products. The product name, statement of net contents, ingredients (when applicable), official inspection mark and assigned plant number, and a processor or distributor name and address must be on all master containers of poultry products. In addition to mandatory labeling, special labeling needs of the distributing agency should be clearly spelled out. As part of the optional labeling, it is strongly recommended that the name of the distributing agency and/or the recipient agency be required on all master containers of product.

*Fabrication and Processing Procedures:* Product fabrication and processing procedures must be written in sufficient detail to enable the grader to perform the critical check points necessary during the production run. These specifications should also include details on the way the product will be processed such as the method of deboning (i.e., whether product will be deboned by hand or by mechanical means). If mechanical separation is being used, the equipment used and procedures followed should be included; if product is ground, size of grind, number of grinds, etc., must be included. Methods of incorporating and mixing of ingredients when such procedures are critical to the proper manufacture of the end product should also be spelled out in detail.

*Formulation:* The amounts of the various poultry ingredients and other ingredients must be individually listed on the product formulations. Poultry ingredients should be listed by type, for example—turkey

skin, white meat, trim, mechanically separated meat, etc. Other ingredients play an important part in many aspects of product acceptability. They can enhance flavor, serve as binders to hold product together, affect product texture, assist in preserving product quality and flavor, and extend product shelf life.

The additional ingredients used to produce the finished end product must be present in sufficient amounts to perform the necessary functions, but should not be excessive to the product's needs. For example, water is a necessary ingredient used to create the desired quality and texture of poultry products. However, care should be used in its addition to products since it also affects the chemical and microbial deterioration of foods through its functions as a solvent for chemical reactions and as a source of water for microbes. An increase in the water content will increase the rate of various reactions such as lipid oxidation, enzymatic activity, and mold and bacterial growth.

Antioxidants are also used in some products to prevent or inhibit oxidative deterioration of flavor and odor of fats and fatty compounds. In addition to natural occurring antioxidants as described earlier, several synthetic compounds such as butylate hydroxyanisole (BHA), butylate hydroxytoulene (BHT), and propyl gallate are quite effective in inhibiting oxidative deterioration.

Salt, as an added ingredient, also serves several vital functions in product formulations. It acts as a flavor enhancer, as a binder and as a preservative. For health purposes, salt should not be excessive to product needs; however, care should be exercised to avoid undue restrictions on its use due to its important functions in food processing.

#### **End Product Data Schedule:**

The end product data schedule provides a description of the product to be produced, the product formulation, the end product return of the donated food and the pricing structure of the end products. Because poultry processing is more complex than processing other donated foods, a separate end product data schedule was developed for use with these agreements. USDA strongly recommends that this standard form be used, rather than a distributing agency developing its own end product data schedule. *See the Contract Approval section of this handbook for additional information about end product data schedules.*

End product data schedules and any attachments thereto must be signed by both the distributing agency and the processor. The processor is responsible for providing copies of the completed forms to the grader for use in supervising the production of the end product. In the event that both signatures are not present, the grader may not permit processing to begin until the validity of the end product data schedule has been verified. All sections of the end product data schedule must be completed or a note made on the form which indicates that specific data is not applicable.

It is important that the end product data schedule show what grading option coverage is desired. Formulation and product fabrication and processing procedures must be shown in sufficient detail to enable the USDA grader to properly supervise the processing operations. Processing and fabrication procedures are necessary only if Option 2 grading is utilized. Any waivers to the full coverage items

under Option 2 supervision must be listed on the end product data schedule and any attachments thereto. The list of procedures under Option 2 is not all inclusive. Should the State require additional checks by AMS graders, they should add those requirements in Article 35 of the processing agreement.

The reverse side of the end product data schedule outlines the data that should be placed on the form as follows:

*Column 1*-List the finished product name exactly as it appears on the product label. If product is CN labeled (see general definitions section of this handbook), the CN approval number should also be shown together with any company product code numbers (when applicable).

*Column 2*-Show the finished product carton net weight. This should be the same net weight as is shown on the product master container.

*Column 3*-When product is pre-portioned, show the size and/or number of portions in each case. If not applicable, show N/A in this column.

*Column 4*-Indicate net weight per portion within the case. Attach CN label, when applicable. See USDA's Food Buying Guide (PA 1331) for information to calculate contribution of the portion or size serving needed for bulk pack items. The distributing agency should have a copy of this document on file.

*Column 5*-Show percent of donated food in formulation for each end product listed. Balance of formulation should also be shown in this column or attached to end product data schedule.

*Column 6*-Use these columns when batter/breaded products are being manufactured. Indicate percentage of breading and percentage of vegetable protein product required for each end product.

*Column 7*-Indicate number of cases by individual product that are estimated to be returned from each truck load of donated food.

*Column 8*-Show percent of guaranteed minimum return for each end product listed on the end product data schedule. Use one load as basis for calculating the percentage of guaranteed return.

*Column 9*-Show the fee-for-service per pound of finished product charged by the processor to produce the finished end product.

*Column 10*-Show the fee-for-service per case of finished product charged by the processor to produce the finished end product. Note: Fee-for-service is defined as the price by pound or by case which represents the processor's cost for ingredients (other than the donated food), labor, packaging, overhead, and other costs incurred in the conversion of donated food into end products.

**Guaranteed Minimum Return:**

As discussed earlier, several factors can influence the guaranteed minimum return (GMR) of a finished end product. Since the GMR can serve as a basis for legal claims against the processor, for determining

replacement of unacceptable product, or for inclusion of additional product to meet the GMR shown in the processing agreement, it is essential that they be as realistic and accurate as possible. Unusually low returns can cause severe economic losses to the recipient agency when a processor, through careless processing procedures, has a much lower return of product than one might normally expect. For example if a processor does a very poor job of deboning, large quantities of the primal meat (breast and thigh meat) may remain on the carcass frame (bones) and either end up as mechanically deboned meat or in some cases may even be discarded.

If a recipient agency budgets a specific amount for processing costs based on a low GMR and the processor then delivers a much larger amount of product, it can cause severe problems for recipient agencies with tight budget limitations when they have to come up with the additional amount of money due the processor for the larger than expected finished product return.

When frozen birds are reprocessed, thawing losses, which can sometimes be as high as 7-8 percent, will result in a much lower product return. The size of the bird being deboned will also determine the amount of product being returned. The smaller birds will generally result in lower yields which, in some instances, can be as much as 4-5 percent. Since deboning smaller size chickens or turkeys may also result in lowered deboning efficiency, this will quite often be reflected in a higher fee-for-service by the processor. Processors will often place a qualifying statement on their processing agreements stating that if smaller turkeys (10-15 pound turkeys) are provided, the fee-for-service will be increased by X cents per pound. They will also place a qualifying statement on the end product data schedule stating that when smaller turkeys (10-15 pounds) are used, the GMR will be decreased by X percent, usually 3 to 5 percent. In lieu of the qualifying statements, the processor may wish to submit separate end product data schedules to cover circumstances where two forms of birds may be supplied (such as chilled or frozen) or to compensate for differences in return when smaller or larger sized birds are delivered.

*Note: Beginning in 1992, USDA has made available a heavier weight range of chickens for further processing. Distributing agencies should give serious consideration to utilizing these larger chickens when final product selection involves chicken patties and/or nugget type products. Since the thigh and drum portions on these larger size birds will significantly exceed meal pattern meat/meat alternate requirements, these thighs should not be used for batter/breaded parts, but rather deboned and made into products such as nuggets, patties, meatballs, or other portion controlled products.*

Even on the smaller size bulk pack chickens, the thigh portions will significantly exceed the quantity required for the meat/meat alternate requirement and they too should be further processed as described above.

Shown on the next page are estimated return percentages for the various parts derived from chickens and turkeys, as well as the deboned meat yield of the various parts. Keep in mind that there will be some product loss as the result of processing and that the loss can vary depending upon the efficiency and quality control of the processing plant.

#### Expected Return of Individual Parts from Whole Carcass Young Frying Chicken

*Average %*

*Range %*

<i>Breast</i>	<i>31</i>	<i>26-34</i>
<i>Drumsticks</i>	<i>16</i>	<i>14-17</i>
<i>Thighs</i>	<i>18</i>	<i>14-20</i>
<i>Backs</i>	<i>23</i>	<i>20-23</i>
<i>Wings</i>	<i>12</i>	<i>10-14</i>
<i>Total</i>	<i>100</i>	

#### Expected Meat Return of Young Chicken Parts

	<i>Average %</i>	<i>Range %</i>
<i>Breast</i>	<i>22</i>	<i>13-25</i>
<i>Wings</i>	<i>4</i>	<i>3-5</i>
<i>Drumsticks</i>	<i>9</i>	<i>7-11</i>
<i>Thighs</i>	<i>11</i>	<i>8-13</i>
<i>Comminuted Meat</i> (full back)	<i>10</i>	<i>8-12</i>
<i>Skin</i>	<i>11</i>	<i>7-16</i>
<i>Bones</i>	<i>33</i>	<i>25-40</i>
<i>Total</i>	<i>100</i>	

Net average meat return is 56%.

*Expected Meat Return 20 Pound (Tom) Commodity Turkey*

	<i>Average %</i>	<i>Range %</i>
<i>Breast</i>	29	25-33
<i>Wings</i>	5	4-6
<i>Drumsticks</i>	9	8-10
<i>Thighs</i>	13	12-14
<i>Comminuted Meat</i>	16	9-20
<i>Skin</i>	10	7-14
<i>Bones</i>	18	16-25
<i>Total</i>	100	

Average meat return is 72%.

*Expected Meat Return 12 Pound (Hen) Commodity Turkey*

	<i>Average %</i>	<i>Range %</i>
<i>Breast</i>	25	24-28
<i>Wings</i>	5	4-6
<i>Drumsticks</i>	10	10-11
<i>Thighs</i>	13	12-14
<i>Comminuted Meat</i>	15	9-20
<i>Skin</i>	12	7-18
<i>Bones</i>	20	20-30
<i>Total</i>	100	

Average meat return is 68%.

**Product Evaluation:** The acceptability of the various products offered by the processors is the single most important factor to be considered in selecting the firm to do the processing for the recipient



agency. Again, the experience of other distributing agencies and commercial acceptance of the specific product being considered can be used as important first steps in narrowing the number of products to be evaluated.

Evaluating the acceptability of the end product offered by the potential processor is the most important factor to consider in selecting the processor. Product testing must be conducted in a bias-free environment. Student and/or State advisory councils can be used for product testing. Individuals selected for testing should be instructed in the proper procedures to follow when evaluating the end products. The taste panel should be set up in a manner as to assure independent evaluation and rating by each panel member.

Samples submitted by the processors should be delivered in the same state as the production deliveries will be made. Since the sensory perceptions of products are changed somewhat by the freezing process, fresh products should never be accepted for evaluation from the processor if the production runs are to be delivered in the frozen state.

**Pre-Bid Certification:** To ensure that the sample products delivered for evaluation will be the same as those delivered under an awarded processing contract, the distributing agency may wish to use a *Pre-Bid Certification*, a service offered by AMS through the Poultry Division. Under this procedure, the processor provides written fabrication and processing procedures and formulations to the grader for each of the sample products being produced for evaluation. Distributing agencies wishing to obtain pre-production certified sample products for evaluation from potential processors should indicate this requirement within the request for bids. The costs associated with producing the pre-bid samples are the responsibility of each processor responding to the bid request. The grader will supervise production of samples produced in strict accordance with the written procedures. The samples are maintained under the control of the grader until delivery to the distributing agency or the recipient agency.

After manufacture, each sample is placed under USDA seal, and a certificate issued that certifies that each product was produced according to procedures on file with the grader. Products may be shipped by the grader directly to the distributing agency or recipient agency or may be delivered by the processor. The receiving agency can assure sample integrity on arrival by verifying that the seals referenced on the accompanying official grading certificate are still intact. Any evidence of tampering with these samples should eliminate the product from being evaluated by the taste panel.

When Pre-Bid Certification is used and a processor has been selected, the processing and fabrication procedures, as well as product formulations on file with the resident grader, will be used as the basis for production run certification by the grader under Option 2 grading procedures.

**Reprocessing Options:**

*Option 1*

The State Processing Program regulations require that graders supervise the processing of all donated poultry items regardless of the dollar value of the processing contract. As a minimum, graders are

responsible for ensuring non-substitution and non-diversion of the product. This supervision, referred to as Option 1 coverage, will be handled by continuous on-site coverage of the entire conversion process.

#### OPTION 2

Since continuous coverage of all processing is needed to assure non-substitution and non-diversion of the donated poultry and since most poultry plants have resident graders on duty, additional costs for Option 2 coverage are very minimal. The benefits gained by this coverage far outweigh any added costs for the increased coverage by the grader.

Following is a listing of the additional services that are provided under Option 2. In addition to the items listed below, distributing agencies or recipient agencies may request other types of certification by specifically listing them on the end products data schedule or in the processing agreement. If necessary, Poultry Programs of AMS will help develop specification procedures for additional certifications.

- *Formulation Verification*-The grader will verify that the formulation as listed on the end product data schedule will be adhered to by continuous on-site verification.

Formulations showing maximum and minimum amounts may be altered within the minimum/maximum range in order to balance batch amounts, without notification to the distributing agency. Additionally, formulation adjustments may be made at the end of a processing run if sufficient donated product is not available to manufacture complete batches of end product. The processor may add a sufficient amount of his own product to make a full batch. Any product added for this purpose must be of equal or better value to the donated product as determined by the USDA grader and identified on the grading certificate. Changes in formulation other than as described above are not permitted under Option 2 coverage unless authorized by the applicable distributing agency.

- *Processing and Fabrication Procedures Verification*-Changes in these procedures, for example, changing from whole muscle to chunked and formed, or chopped and formed, changing the size of the grind, when applicable, etc., can have a very pronounced effect on the texture, taste, and appearance of the end products. These procedures must be spelled out in sufficient detail on the end product data schedule and attachments to safeguard against changes during manufacture that will produce products that might have lower acceptability. No deviations from the written processing and fabrication procedures will be permitted under Option 2 unless the distributing agency gives written or verbal concurrence directly to the grader.
- *Batter/Breading Verification* (when applicable)-Batter/breading must not exceed the formulation amount listed on the end product data schedule. If not listed, batter/breading will not be allowed to exceed 25 percent of the breaded product. Verification by the grader is done at least once an hour, and any product exceeding the maximum amount of batter/breading specified on the end product data schedule will be retained by the grader until the distributing agency advises what should be done with the product. Under these procedures, graders will also check for batter/breading defects

such as missing breading, broken patties or nuggets, breading ridges, lumps, and acceptable color. These products may, if practicable, be reworked and reincorporated in subsequent batches. Any overcooked, scorched, or otherwise organoleptically off-condition product encountered will be segregated and rejected under the supervision of the grader.

- *Portion Control -Individual Weights*-When applicable, the net weight of individual portions will be checked on an hourly basis by the grader. Product exceeding tolerances established by AMS will be retained. Each hour's production must meet the specified portion weight tolerances. Average weights of subsequent hour's production will not be used to determine acceptability of any hour's production of finished product that is in noncompliance to specified portion size requirements.
- *Metal Detection*-The use of metal detection equipment to detect metal contaminants is extremely important, and distributing agencies have the option to require this service for all further processed items, raw or cooked. No waivers should be granted for this service. Procedures and sensitivity levels to use are established by AMS.
- *Freezing Requirements*-The rapid freezing of poultry products (0° F in 72 hours) is essential to maximize frozen shelf life of the product and to minimize product damage during the freezing process. Slow freezing results in larger ice crystals forming in the frozen product. When these frozen products are thawed, excessive moisture seepage and enlarged product voids may result from the slow freezing process. In comparison, quick freezing results in small ice crystals which causes less damage to the muscle fibers.

The frozen storage temperature of frozen products is also important in maximizing frozen shelf life of the various products. The generally accepted frozen storage temperature recommendation for frozen meat and poultry products is 0° F or lower. The grader will check freezing times, holding temperatures, and shipping temperatures to assure compliance with the specified temperature requirements. Products not frozen in accordance with the specified temperature requirements listed below will be retained unless released by the distributing agency.

Initial Freezing	0° F - 72 hours or less
Holding Temperatures	0° F or lower
Shipping Temperatures	2° F or lower

Internal product temperature of frozen poultry and poultry products must be 2° F or lower at the time of loading. Product with internal temperatures between 3° and 5° F will be tentatively rejected. Tentatively rejected product may be returned to the freezer and the temperature reduced to 2° F or lower and reoffered for shipment. Product exceeding 5° F or product that has been tentatively rejected and exceeding 2° F when reoffered will be rejected. This criteria provides for accuracy variances found in the thermometers. Waivers for any temperature deviations other than mentioned above should not be granted

indiscriminately .If product fails to meet 0° F in 72 hours during the initial freezing, or if holding temperatures elevate slightly, the processor should determine the reason(s) for the elevated temperatures and whether the end products should be shipped. If a distributing agency has questions on any product retention for noncompliance with temperature requirements, it is suggested that the distributing agency contact the grader to obtain more information on the product in question.

- *Test Weighing*-Prior to shipment, the grader will test weigh the product to assure that it meets the net weights marked on the cartons. Product shortages or overages will be listed on the applicable shipping certificate. The adjusted weights on the shipping certificate should be used by the distributing agency to determine compliance with guaranteed return requirements of the processing agreement rather than the product weight marked on the carton. Notification of overages or shortages will only be made by the grader to the distributing agency on the shipping certificate.

Another option available to the distributing agency is online test weighing. Using this method, the product is sampled hourly to ensure compliance with minimum weight requirements. The distributing agency is provided with the same level of assurance while the processor saves time and expense incurred during loading. The shipping certificate will show the same marked and net weight with the following statement in the remarks section. Total net weight of product represented on this certificate was determined using online test weighing procedures.

- *Condition Examination*-At the time of shipment, the grader will examine products to assure that they are organoleptically sound and that product temperatures do not exceed specified requirements. If a recipient agency requests an examination for packaging and packing defects, graders will perform the examination according to criteria established for the National School Lunch Program.

#### **USDA Certifications:**

*Pre-Bid Certificate* -As described previously, the Pre-Bid Certification Program is designed specifically to assist distributing agencies involved in processing donated poultry. It allows processors to submit samples of end products for evaluation by the distributing agency that have been produced in strict accordance with written formulations and fabrication and processing procedures. Sample integrity is rigidly maintained during production and delivery to the distributing agency by the grader.

After the distributing agency selects its processing contractor, the end product must be produced according to the same formulation and fabrication and processing procedures used to produce the end products that were sampled and evaluated. Using this program is the best way to guarantee that the final products delivered are exactly the same as those originally tested and selected.

*Production Grading Certificate*- Upon completion of a production run under both Options 1 and 2, the grader will prepare and mail the production grading certificate directly to the applicable distributing agency. Under Option 1 coverage, the production certificate will be the only official certification issued by the grader of the weight of end products produced. Therefore, recipient agencies will have to compare the weights listed on this certificate against product returned by the processor to determine compliance with the GMR listed on the end product data schedule.

This production grading certificate serves several important functions:

- It lists how much raw starting weight of product is made available to the grader. On backhauled product, the distributing agency or recipient agency should compare this weight against the amount that was shipped to the processor. On direct delivered product, the weight will be the amount determined by the grader by official test weighing procedures at the time the fresh product is delivered by USDA to the processor.
- It lists, by marked weight, the total weight of all finished products produced by the processor.
- It lists the amount, by weight, of all buy-back products produced by the processor for which the distributing agency or the recipient agency must be reimbursed or credits issued by the vendor. *Note: Buy-back parts purchased by the processor are **not** to be considered as part of the GMR. The price paid shall be based on either the Urner Barry or USDA price reports and shall be the market price for the product at the time of processing. The processor shall list in the processing agreement which price report will be used for pricing of buy-back products.*
- It lists the amount, by weight, of by-products produced by the processor. If the processor sells these by-products or uses them in commercial products manufactured, the distributing agency or the recipient agency must be credited for their value. The value for by-products should be stated by the processor in the processing agreement.
- It lists product condemnations and their cause when they exceed 1 percent of the raw bone-in or deboned weight as applicable. Such losses must be replaced by the processor even when the GMR has been met or exceeded. It lists on the production certificate any rework product that has not been reincorporated in subsequent production runs manufactured from the same unit of product being processed. The distributing agency should stipulate in the processing agreement the desired way to handle and report rework of product in the event that it results during production using one of the following methods:
  - Product may be blended into the raw formulated batches in accordance with FSIS procedures provided that the finished product is in compliance with labeling requirements established by FSIS. At the end of the production run, graders will record the pounds of rework remaining on the production certificate. During

processing, graders are to inventory pounds of rework remaining on each day's production worksheet.

- Rework product may be packaged and returned to the distributing agency. Graders will inventory the amount produced each day and will record totals on production and shipping certificates.
- Rework product may be saved for use in subsequent production runs. The saved rework must be weighed, inventoried, and stored under proper conditions. Graders will log the amount of rework saved on each day's production worksheet. Rework handled in this manner will be recorded on the production certificate as carryover and on subsequent certificates as added product. A condition examination is to be performed on all product prior to any subsequent blending.
- Rework product may be disposed of as a processing loss, provided the amount does not exceed 2 percent of the raw deboned weight. When this option is used the grader will certify the weight of rework disposed of on the production certificate. Rework exceeding 2 percent must be handled according to one of the methods described in this section. Note: Rework *is not to be counted towards the GMR*.

*Shipping (Delivery) Certification* -When Option 2 coverage has been requested, a second certificate is issued at time of shipment, verifying that all specification requirements have been met. This certificate will show any shortages or overages in the marked weight, and the total net weight column will reflect the adjusted weight being shipped. The distributing agency should use this adjusted net weight as the basis for determining compliance with GMR requirements. As with Option 1 certification, the distributing agency should verify actual receipt of the listed product totals through actual box count and weight tallying (on random weight containers) at receiving point locations.

#### **Backhauling**

Backhauling is the pickup of donated food from a distributing agency or recipient agency by the processor and transporting it to the plant where it will be further processed. Distributing agencies should discourage recipient agencies from backhauling poultry. Instead, the distributing agency should encourage shipping product directly to the processor for several reasons: 1) it eliminates the risk of taking the product in and out of freezer storage several times, thus providing a more controlled environment for the donated food; 2) it results in producing a better product that has a longer shelf life than product that has been backhauled; and 3) it results in significant savings in transportation and storage.

When frozen foods are thawed, which is done when products are backhauled, a certain amount of moisture is lost from the product. This directly lowers the yield of finished products to the recipient agency and can also have a detrimental effect on the organoleptic properties of the end products. Product shrink accrues to the account of the agency on backhauled frozen product. On the other hand, poultry products that are shipped directly to the processor for processing are shipped in the fresh state with any product shrink being absorbed by the shipper. The fresh products can also be processed when

received without the added handling costs that are involved in defrosting frozen products. These cost savings are usually passed back to the recipient agency in the way of lowered processing fees.

However, in the event that products are backhauled, the distributing agency or recipient agency warehouse staff must record the total number of cartons released to the processor, the net weight of each carton, and the aggregate weight of all cartons being picked up. On random weight products such as consumer pack turkeys, the warehouse staff must record the actual case weights and not use the USDA target carton weights. In many instances, actual weights may vary by several pounds or more from the target weights. Backhauled products also must be processed under AMS supervision.

## SUBSTITUTION ISSUES

In the State Processing Program, all donated foods offered by USDA to distributing agencies fall into one of the following categories: substitutable or non-substitutable. Substitutable foods are those donated foods which may be substituted, interchanged, or commingled (stored together) in storage and/or in production with a commercial food of the same generic identity and of equal or better quality.

The practice of substituting commercial product for donated food is commonplace in processing. As listed in the current regulations, the following donated foods are classified as substitutable:

butter	peanut granules
cheese	roasted peanuts
corn grits	peanut butter
cornmeal	rolled oats
flour	rolled wheat
macaroni	spaghetti
nonfat dry milk	vegetable oil
rice	shortening

Any donated food not listed above is considered non-substitutable. But, under certain conditions and with the approval of FNS, it is also possible for a non-substitutable donated food to be classified as substitutable (this will be discussed in more detail later in this section).

Prior to substitution, the processor must obtain the distributing agency's approval to substitute commercial product. The distributing agency must document all conversations with the processor relating to the substitution request, even if the distributing agency does not approve the request. There are three situations, however, under which the processor may substitute commercial food for donated food *without* advance approval of the distributing agency. These exceptions to the rule are:

- It is necessary to replace donated food with commercial food to meet the 100 percent yield requirement.
- The substitutable donated food and commercial food have been commingled through the use of joint storage tanks and bins. This situation occurs when a processor, due to the nature of his business, does not store certain foods in traditional warehouse storage. Instead, the donated food will be commingled with the processor's commercial product. An example of commingling would be when a bakery receives direct shipments of donated bulk flour. When the donated food arrives at the processing plant, it is blown directly into the large silos that already contain commercial flour. Once the donated flour is placed in these silos with the processor's commercial product, the identity of the donated flour is *lost*. *Non-substitutable food may not be commingled without the approval of the distributing agency.*



- The processing agreement permits the use of concentrated skim milk which has been purchased or manufactured by the processor for donated nonfat dry milk. Since the use of this type of substitution is not very common, please refer to Section 250.30 (f)(3) of the State Processing Program regulations for a complete listing of the requirements that are imposed when concentrated skim milk is substituted for donated nonfat dry milk.

Even though the above three situations allow a processor to substitute commercial product without advanced approval, processors are still obligated to inform the distributing agency of such substitutions. This notification is usually done at the beginning of the agreement year by means of a letter from the processor to the distributing agency, stating that the processor will substitute commercial product for the substitutable donated food under one or all of the three circumstances. Outside of the three aforementioned conditions for substitution, the distributing agency must give permission in writing to those processors who want to substitute commercial food for donated food.

In addition to requesting approval from the distributing agency to substitute commercial food for substitutable donated food, processors must maintain documentation that the commercial product substituted was domestically produced and of equal or better quality than the donated food specification. For example, if donated butter is Grade A, the commercial product which the processor wishes to substitute must be Grade A or better. The same concept holds true for all commodities that are classified as substitutable. Any questions as to the grade of a particular donated food provided by USDA should be directed to the appropriate FNS Regional Office. Substitution of commercial product produced outside of the United States is strictly prohibited.

When substitution occurs, the processor must substitute “like” foods. This means that the commercial food must be the same type of food as the donated food. For example, a processor may substitute commercial all purpose flour for donated all purpose flour; however, it would not be acceptable for a processor to substitute commercial all purpose flour for donated bakers hard wheat flour. In order to avoid this situation, it is important for distributing agencies to order the kind of donated food that will fit the processor’s needs.

When conducting a review of the processor’s operation, the distributing agency representatives should ask to see documentation from the processor to determine whether the processor met the requirements of equal or better quality and domestic origin. This documentation can be in the form of purchase specifications, invoices, and labels from containers provided by the processor. If it is determined that the processor failed to meet any of these substitution requirements, a claim should be assessed for the value of the donated food supplied to the processor during the entire agreement period.

As mentioned earlier in this section, it is possible for a non-substitutable donated food to be classified as substitutable under certain circumstances. In order for this to occur, a processor must request approval from FNS. Before approval can be granted, the processor must prove that the commercial product he intends to substitute is of equal or better quality and of domestic origin as compared to the USDA’s specifications for the non-substitutable commodity

Processors wishing to substitute commercial product for a non-substitutable commodity must make their request to FNS in writing and the request must be accompanied by purchase specifications, a laboratory analysis of the product, a guarantee that this is in fact the product they will be substituting during the agreement period, and any other documentation necessary to prove that the commercial product is of equal or better quality and of domestic origin. All requests for substitution should be sent to the following address:

Director  
Food Distribution Division  
Food and Nutrition Service, USDA  
3101 Park Center Drive, Room 502 POC  
Alexandria, Virginia 22302

Approval to substitute commercial product for donated food only applies to the processor who made the request and is valid for all processing contracts. Furthermore, permission to substitute only remains in effect for the duration of the agreement year in which the substitution was granted. If the same processor had an agreement the following year and wished to substitute the same commercial product, that processor would have to obtain approval from FNS.

To persons not familiar with the processing of donated food, the terms “substitution” and “replacement” may appear to have the same meaning. However, in processing, these terms have very different meanings and this difference comes into play primarily with the production of meat and poultry end products. But, as can be seen by the following example, there are some situations in which the processor may *replace* donated meat or poultry with commercial meat or poultry.

During a production run in which donated chicken was being converted into chicken nuggets, a 500-pound container of donated chicken falls onto the floor. This product, which is now considered unwholesome, is condemned by USDA’s Food Safety and Inspection Service (FSIS) inspector. Rather than pay the distributing agency for the loss, the processor may, with the concurrence of the distributing agency, replace the condemned donated chicken with commercial chicken that has been certified by the AMS grader to be of equal or better quality to that of the donated chicken. By doing so, the distributing agency benefits from receiving the chicken nuggets that would not have been produced if replacement was not allowed.

This type of situation is not viewed by FNS as a substitution since the processor is replacing what was given to him and subsequently lost due to negligence. Also, the replacement product has been graded by an independent source (AMS) who guarantees the replacement product quality.

Replacement of non-substitutable donated foods other than meat and poultry is a rare occurrence. Although donated fruits and vegetables can be lost just like in the chicken example given above, there are typically no AMS fruit and vegetable graders on site at processing plants which convert these foods into finished end products. Without an AMS grader present, there would be no one present to certify that

the replacement product is of equal or better quality than the lost donated food. Therefore, when fruit and vegetable losses occur, the processor must pay the distributing agency or recipient agency for the food loss.

The 100 percent yield concept *assumes* no losses are incurred in the preparation and manufacturing of the donated food. Any donated food losses will have to be replaced by the processor. This concept only applies to those donated foods that are classified as substitutable as listed earlier in this section or to those processors who have been granted approval by FNS to substitute commercial product for a particular non-substitutable donated food. Because substitutable donated foods can be commingled with commercial foods in storage and production, it is impossible to distinguish the two. Therefore, under the 100 percent yield concept, the processor agrees to make up for any loss that may occur during production with commercial product.

Manufacturing loss is the difference between the amount of donated food *needed* to produce a case of end product and the amount of donated food *contained* in a case of end product. It is impossible for a processor not to lose any donated food in the manufacturing of end products. For example, a very common occurrence in the production area of bakeries is the presence of some flour on the floor, on work tables and possibly in the air. Losses can also occur as the dough is mixed and scaled, as the product is baked and sliced, and during the delivery of the finished products. Therefore, when reviewing end product data schedules for end products utilizing donated foods (except for poultry), it is important to ensure that the processor states a manufacturing yield. If the processor does not state his manufacturing yield, (i.e., Columns 8 and 10 of the end product data schedule reflect the same figures), the distributing agency must not approve the end product data schedule until the processor indicates that there is a loss during production or documents that no losses or minimal losses occur during the manufacturing process.

#### **Guaranteed Minimum Return**

GMR is one of the most important concepts in the processing of donated foods and pertains primarily to processing of meat and poultry. Simply stated, it is the minimum amount of finished end product that is to be returned to the distributing agency (or recipient agency) based on the amount of raw donated food supplied to the processor. Prior to signing the processing agreement, the distributing agency must determine whether the processor's GMR on a particular end product is set at a reasonable level. This determination is made by comparing information submitted by processors on their end product data schedules.

If an end product data schedule states that the GMR for that particular end product is 75 percent, this would mean that for every pound of donated food a distributing agency provides to the processor, the processor will return  $\frac{3}{4}$  of a pound of finished end product. Additionally, in some instances, the GMR of a finished end product can exceed 100 percent. This usually occurs with end products that contain

several ingredients that are added to the donated food during the manufacturing process such as TVP or breeding.

GMR is used primarily with poultry end products or with products that contain a combination of non-substitutable and substitutable donated foods. Although you can determine the GMR for end products that contain substitutable commodities, this is not a common practice. If the GMR is used for end products containing substitutable donated foods, the GMR replaces the figure used to calculate the minimum amount of donated food which must be physically contained in the end product. This figure is identical to the figure used when calculating the 100 percent yield requirement (Column 10 of the end product data schedule). Because GMR is most commonly used with products that contain non-substitutable commodities, this section will only discuss GMR as it relates to end products containing non-substitutable commodities.

There are three documents that can be used to determine whether the processor has met the GMR listed on the end product data schedule: the end product data schedule, the AMS grading certificate (meat and poultry only), and the monthly performance report. All three documents are discussed below.

#### **The End Product Data Schedule**

There are two types of end product data schedules in use: one for end products containing poultry and one for end products made with all other donated foods. Column 8 on the poultry end product data schedule is used to record the GMR that the processor will guarantee. In order to ensure that the GMR is correct for each poultry production run, based on the information provided in the end product data schedule, the following calculation should be performed:

Estimated # of Cases of Finished End Product (Column 7) x Net Weight Per Case (Column 2) ÷  
36,000 or 40,000 pounds

(depending on whether the processor was supplied with fresh or frozen commodity) = GMR

The end product data schedule that is used for all other donated foods does not have a specific column where the GMR is recorded. However, the GMR can still be determined by performing the following calculation:

Net weight per case (Column 2) , # pounds needed to produce a case of end product (Column 8) =  
GMR.

#### **The AMS Grading Certificate**

The State Processing Program regulations require that all processing of donated meat and poultry take place under the supervision of an AMS grader. After production is concluded, the grader will issue a certificate listing detailed information about the particular production run. There are two pieces of

information contained on the grading certificate that can be used to determine whether or not the processor met his GMR for that production run:

- The amount of donated food that went into production and
- The number of pounds of end product that were produced.

The following example illustrates how to use the grading certificate to see whether the GMR was met during a production run:

A grading certificate states that 24,000 pounds (1,000 24-pound cases) of finished end product were produced from 36,000 pounds of donated poultry. The return from this production run was 67 percent (24,000 pounds ÷ 36,000 pounds). To determine whether the GMR was met, compare the 67 percent figure with the figure stated in Column 8 of the poultry end product data schedule. If 67 percent is equal or greater than the percentage stated on the end product data schedule, then the processor has met the GMR requirement. If the resulting figure is less than 67 percent, this means that the processor did not produce the required number of cases of end product. Therefore, the processor would be required to pay the contracting agency the value of the chicken that would have been included in the cases that should have been produced or provide commercial product replacement.

#### **The Monthly Performance Report**

Each month processors must submit performance reports to distributing agencies which detail the donated food processing activity that occurred during the previous month. This report shows the number of cases of end product delivered to the contracting agency during the month and also the amount of donated food that was received and used during the month. Distributing agencies should use this information to ensure that each production run met the GMR. If donated meat or poultry was used in production, a copy of each grading certificate should be attached to the monthly performance report. In order to determine whether the GMR for a particular end product was met, you should take the amount of end product produced and divide that number by the amount of product that went into production.

The basic formula used throughout this section has expressed the GMR as a percentage. This will work for all non-substitutable commodities including meat and poultry. As a reminder, for all non-substitutable commodities other than poultry you will need to calculate what the GMR is based on the information provided on the end product data schedule.

In addition to expressing the GMR as a percentage, the GMR can be calculated on a case basis. This method, however, is typically not used with end products containing donated poultry. To find out the minimum number of cases a processor should have produced for a particular production run, perform the following calculation:

The number of pounds of donated food that went into the raw batch formula (obtained from the grading certificate or the monthly performance report) ÷ by the amount of raw

donated food required to produce one case of finished end product (Column 8) = the minimum number of cases the processor should have produced based on the information provided on the end product data schedule. This formula works best for determining the return of red meat products.

You would then compare this figure with what was actually produced to determine whether or not the processor met his GMR. For example, a red meat grading certificate states that 36,000 pounds of ground beef were put into production to make charbroiled beef patties. From that 36,000 pounds, 1,510 cases of end product were produced. Column 8 of the end product data schedule states that it will take 24 pounds of donated beef to make a case of end product. By doing the calculation described above you would arrive at 1,500 cases (36,000 pounds ÷ 24 pounds). This would be the minimum number of cases the processor should have produced. In this example, the processor exceeded his GMR by 10 cases.

When processors do not meet their contracted GMR, the contracting agency needs to be compensated. Usually, the easiest way to do this is for the processor to pay the distributing agency or recipient agency the value of the donated food that would have been included in the cases that were not produced. For example, if the processor was short by 10 cases and, according to the end product data schedule it takes 24 pounds of beef to make a case, the processor would pay for 240 pounds of beef based on the donated food value as determined by the distributing agency and USDA. Another type of compensation would be for the processor to credit the invoice for the value of the commodity needed to make up for the loss.

If the latter option is chosen by the contracting agency, the processor should clearly state on the invoice or in a letter the reason for the credit. Another option would be to require the processor to make up any production losses with replacement commercial product, provided the product is identical to that requested. Ideally, prior to the beginning of the agreement year, the processor and the contracting agency should jointly agree which option of compensation is preferred prior to the beginning of the contract. It is important to maintain any documentation which supports the settlement for missed yields.

Since distributing agencies receive copies of each processor's performance report every month, the distributing agency staff must review this documentation to determine whether the processor is meeting his GMR for each production run.

In order to reduce the cost of some end products, many distributing agencies have approved processing agreements which use more than one USDA donated food item in the manufacturing of an end product. Frequently, both substitutable and non-substitutable donated foods are incorporated into the same product, such as when donated ground beef (non-substitutable) and process cheese (substitutable) are used to make a cheeseburger.

There are three possible combinations of value pass-through (VPT) systems that can be used for end products that contain both substitutable and non-substitutable donated foods. These VPT systems are listed in the order most frequently used by processors:

- Discount or refund system for the substitutable commodity and a fee-for-service system for the non-substitutable commodity.

- Fee-for-service system for both the substitutable and non-substitutable commodity being used.
- Discount or refund system used for both the substitutable and non-substitutable commodity being used.

#### SUBSTITUTABLE PORTION OF THE END PRODUCT

An inventory draw-down for substitutable commodities under a discount or refund VPT system is based on Column 10\* of the end product data schedule for all donated foods except poultry, which represents the pounds of donated food contained in a case of end product (this is the 100 percent yield requirement). In addition, all discounts and refunds for substitutable commodities must be based on Column 10\*.

#### NON-SUBSTITUTABLE PORTION OF THE END PRODUCT

When using a discount or refund VPT system for non-substitutable donated food, the inventory draw-down is based on the amount of donated food actually put into production. Since the intent of the refund or discount VPT system is to ensure that the value of the commodity is passed back to the recipient agency, processors who use this type of VPT system for non-substitutable commodities must base their discounts or refunds on the pounds needed to produce the product (Column 8\*).

#### SUBSTITUTABLE PORTION OF END PRODUCT

Inventory draw downs for substitutable commodities under a fee-for-service system are based on Column 10\* of the end product data schedule, the same as if they were used under a discount or refund VPT system. Again, the reason for this is due to the 100 percent yield requirement for substitutable foods. Under a fee-for-service system there are no discounts or refunds involved.

#### NON-SUBSTITUTABLE PORTION OF END PRODUCT

Inventory draw downs for non-substitutable commodities under a fee-for-service system are based on the number of pounds that actually went into production per the production record or the grading certificate if meat or poultry is involved. *Inventory reductions are not based on Column 8\* (pounds needed to produce a case).* The following example will illustrate the reason why a processor should not draw down inventory based on the number of cases produced multiplied by Column 8\* when using a fee-for-service system:

Processor X has been supplied with 1,000 pounds of donated ground beef to produce beef patties for a recipient agency. Column 8\* of Processor X's end product data schedule states that it takes 5 pounds of donated beef to make a case of beef patties. Accordingly, Processor X would have to produce a minimum of 200 cases of beef patties to meet the GMR (1,000 pounds ÷ 5 pounds). If the processor produced exactly 200 cases, the processor would draw down 1,000 pounds from inventory. However, if the processor produced any number of cases other than 200, such as 195, it would be incorrect to calculate the amount of drawdown by taking the number of cases produced, multiplied by the number of pounds of donated food contained in each case. The resulting figure would produce a

number that is higher than the actual amount of donated food put into production (195 cases x 5 pounds = 975 pounds or 205 cases x 5 pounds = 1,025 pounds).

The above example shows that the processor must use the actual amount of non-substitutable donated food put into production as the basis for determining the amount of inventory drawdown. Failure to do so may result in incorrect or negative book inventories. With this in mind, it is important to ensure that processors of non-substitutable donated foods report drawdown figures correctly on the monthly performance report.



