Rules and Regulations

Federal Register
Vol. 51, No. 125
Monday, June 30, 1986

DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Parts 210, 225, and 226

[Amdts. 65, 8, and 13 respectively]

Meat Alternates Used in Child Nutrition Programs

Correction

In FR Doc. 86-10225 beginning on page 16807 in the issue of Wednesday, May 7, 1986, make the following corrections:

1. On page 16807, in the first column, the agency docket numbers were omitted from the heading and should have read as set forth above.

§ 210.10 [Corrected]

2. On page 16809, in the third column, in § 210.10(a)(2)(ii)(A)(*2*), in the tenth line, "and" should read "as".

3. On page 16810, in § 210.10(a)(3), in the table, in the second column, in the first line, "skin" should read "skim", and in the ninth line, "of tree" should read "or tree". In footnote 3 to the table, "Free" should read "Tree".

§ 225.20 [Corrected]

4. On the same page, in § 225.20(b)(2), in the table, under the heading "Bread and Bread Alternates", in the seventh line, "of" should read "or". In footnote 4 to the table, "of more" should read "or more".

§ 226.20 [Corrected]

5. On page 16811, in the third column, in § 226.20(a)(2)(ii)(B), in the third line, "meet" should read "meat".

6. On the same page, in § 226.20(c)(2), in the table, in the first column, under the heading "Bread and Bread Alternates", in the fifth line, "paste" should read "pasta". In the next entry in the table, "Cooked cereal grains", the entries in the second, third, and fourth columns should read as follows:

Age 1 up to 3: "¼ cup"
Age 3 up to 6: "¼ cup"
Age 6 up to 12: "½ cup"

7. On page 16812, in § 226.20(c)(3), in the table, in the heading of the fourth column, insert footnote reference "1" after the heading "Age 6 up to 12".

BILLING CODE 1505-01-M

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7 CFR Parts 250 and 252

Food Distribution Program; National Commodity Processing Program

AGENCY: Food and Nutrition Service, USDA.

ACTION: Interim rule.

SUMMARY: This interim rule will extend the National Commodity Processing (NCP) Program until June 30, 1987. NCP was established in the June 23, 1983 rule and extended until June 30, 1986 in the September 12, 1985 interim rule. This action will promote a regular supply of processed end products to eligible recipient agencies for the 1986-87 agreement year. This interim rule will address comments and incorporate amendments included in the February 4, 1986 proposed rule.

The February 4, 1986 rule proposed amendments designed to: (1) Increase uniformity of regulations governing State processing activities and those covering NCP and (2) increase NCP program accountability requirements to ensure program integrity.

EFFECTIVE DATE: July 1, 1986.

FOR FURTHER INFORMATION CONTACT: Ms. Alberta Frost, Director, Nutrition and Technical Services Division, U.S. Department of Agriculture, 3101 Park Center Drive, Alexandria, Virginia 22302, (703) 756-3585.

SUPPLEMENTARY INFORMATION: Under the provisions of the Paperwork Reduction Act of 1980 (Pub. L. 96-511), information collection requirements contained in §§ 252.4, 252.5, and 252.6 of this proposed rule have been approved by the Office of Management and Budget (OMB #2584-0325); approved for use through August 31, 1988.

Classification

This action has been reviewed under Executive Order 12291 and has been classified not major. We anticipate that this proposal will not have an impact on the economy of more than $100 million. No major increase in costs or prices for program participants, individual industries, Federal, State or local government agencies, or geographic regions is anticipated. The action is not expected to have significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S. based enterprises to compete with foreign-based enterprises in domestic or export markets.

This program is listed in the Catalog of Federal Domestic Assistance under No. 10.550. For the reasons set forth in the Final Rule related Notice to 7 CFR 3015, Subject V (48 FR 29115), this program is excluded from the scope of Executive Order 12372 which requires intergovernmental consultation with State and local officials.

This action has also been reviewed with regard to the requirements of Pub. L. 96-354, The Regulatory Flexibility Act. Robert E. Leard, Administrator of FNS, has certified that this rule will not have a significant economic impact on a substantial number of small entities. This action will ensure the availability of processed surplus commodities to eligible recipient agencies. The eligible recipient agencies include all outlets eligible for commodities under Parts 250 and 251.

Background

On June 23, 1983, the Department published interim regulations (48 FR 28609) which set forth a framework for the NCP Program. In part, the regulations were issued to satisfy the dictates of § 203 of the Temporary Emergency Food Assistance Act (TEFAA) (7 U.S.C. 612c note) which directed the Secretary to encourage the consumption of commodities made available without charge or credit under any nutrition program administered by the Secretary of Agriculture through processing agreements with private companies. Public comments were solicited concerning those interim regulations and all phases of program operation.

Under the 1983 interim rule, FNS entered into agreements with processors to convert donated commodities into end products desired by recipient agencies. Under those agreements, processors were permitted to market the end products nationwide to any recipient agency eligible to receive the specified commodity used in the end product. Dairy commodities and honey were made available under the NCP Program.

On May 13, 1985, the Department published a notice (50 FR 19993) announcing that the NCP Program would end on June 30, 1985, because the NCP Program had not achieved its stated goals. Subsequently, Congress extended Section 203 of the Temporary Emergency Food Assistance Act through September 1986. The Department implemented this directive by reauthorizing the NCP Program for one additional year in an interim rule published September 12, 1985. Those interim regulations expire on June 30, 1986. Subsequent legislation, the Food Security Act of 1985, Pub. L. 99–198, further extended Section 203 of the Temporary Emergency Food Assistance Act through June 30, 1987. The Department has decided therefore to reauthorize the NCP Program through June 30, 1987 and is publishing these interim rules to accomplish the extension.

On February 4, 1986, the Department published a proposed rule which contained four amendments to the September 12, 1985 NCP interim rule. Public comments to the proposed rule were solicited. Public comments to the proposed rule have been received and analyzed. The changes have been incorporated in this interim rule extension. A determination has been made that the public interest would be best served by issuing this rule as an interim rule, effective July 1, 1986, in order to avoid program disruption and continue the flow of commodities to processing companies and recipient agencies.

The current 7 CFR Part 252 expires on June 30, 1986. FNS is reprinting the entire interim rule for this extension, incorporating the changes proposed on February 4, 1986 and updating language to make it consistent with that contained in 7 CFR Part 250, the Food Distribution Program regulations.

Discussion of Proposed Rules

Following is a description of the proposed rule published February 4, 1986 and a discussion of public comments. During the public comment period, 69 comments were received. The proposed rule announced our intention to amend the NCP interim regulations by: (1) Requiring processors to verify 100 percent of reported discount sales through distributors without dual billing; (2) limiting the allowable discount through distributor value pass-through system to one specific system; (3) requiring all processors participating in NCP to obtain an annual audit of NCP activities; and (4) amending the Part 250 regulations by requiring State agencies to verify that recipient agencies registered to participate in NCP are eligible to receive donated food.

Sales Verification

The September 12 interim rule requires processors to verify a statistically valid sample of sales made through a distributor without dual billing. Results of FNS sales verifications and on-site reviews have indicated a high degree of inaccurate or invalid sales reported to FNS, often the result of inaccurate reporting by distributors. Under the February 4, 1986 proposed rule, processors would be required to verify 100 percent of all reported discount sales made through a distributor without dual billing. Of 20 comments received, 13 commentors opposed the proposal because of the time and labor costs to processors. Many said processors would discontinue discount sales made through a distributor without dual billing if the requirements of the interim rule were the same as the proposal. In response to these concerns § 252.4(c)(ii)(B) of the interim regulations maintains the current requirement that processors must verify a statistically valid sampling of all sales reported each quarter. Language has been added to require that the sample size shall have a 95 percent confidence level. The verification effort must determine whether NCP end products were sold to eligible recipient agencies and if the value of the donated commodities was passed on to the recipient agency. Sales verification must be done at the end of each quarter and the sample shall be taken from all sales reported within the quarter. Processors must report to FNS the level of invalid or inaccurate sales for each quarter and must simultaneously submit a corrective action plan to correct problems identified in the verification effort. The processor must also immediately submit adjusted monthly performance reports to eliminate invalid sales. If FNS determines that end products have been improperly distributed, FNS may assert a claim against the processor.

Value Pass Through

Section 252.4(c)(4) of the September 12, 1985 interim rule requires that processors return the agreement value of the donated commodity contained in processed products to the purchasing recipient agency. At the time of agreement approval, FNS reviews and approves the method selected by the processor for returning the value of the donated commodity in the end product to the recipient agency. The processor may choose a system which either: (1) Reduces the market price of a processed end product by the value of the donated food contained in the product (discount); or (2) refunds to the recipient agency the value of the donated food contained in the end product (refund). Under the current rule, FNS may approve any other value return system developed by the processor if the system ensures proper accountability.

Section 252.4(c)(4) of the September 12, 1985 interim regulation describes the varieties of value pass-through systems permitted in the NCP Program. These include: (1) Direct sale with discount; (2) direct sale with refund; (3) indirect sale through distributor with dual billing (under the dual billing system, the processor invoices the recipient agency directly for the end products purchased and the distributor bills the recipient agency for delivery of the end product); (4) indirect sale through distributor without dual billing and (5) indirect sale through distributor with a refund.

Based on on-site processor reviews, Office of Inspector General (OIG) audits and FNS sales verification results, FNS proposed in the February 5 proposal to impose certain conditions on discount sales through distibutors without dual billing. Under the proposal, processors using this system would be required to sell end products to distributors at the processor's commercial or gross price for the end product. The processor's invoice would reflect the value of commodities contained in the end product as established by the agreement. The processor would ensure that the distributor invoices the recipient agency at a price which reflects the value of the discount established by the agreement. The processor would ensure that the distributor submits a refund application to the processor within 30 days after the eligible recipient agency receives the processed end product. The processor would also ensure that the refund application includes certification of the purchase of end products by the eligible recipient agency through substantiating invoices and that the recipient agency has purchased the end products at the net case price which reflects the value of the discount established by the agreement. Within 30 days of the receipt of the refund application, the processor would issue payment directly to the distributor in an amount equal to the stated agreement value of the donated food contained in the purchased end products covered by the application. In no event could refund applications for purchases during the period of agreement be accepted by the processor later than 60 days after the close of the agreement period. FNS received 52 comments on this proposal. Of these, 43 commentors opposed the requirement. Those opposed said the delay in time between when the sale is made to the recipient agency and when the distributor received the refund from the processor would be costly to the distributor. The proposal was described as a "paperwork nightmare", "impossible" and "not practical." It was also criticized as causing higher prices for recipient agencies if implemented. Supporters said the change would ensure greater accountability.

The proposed change is intended to strengthen program accountability and ensure that eligible recipient agencies receive the full value of the commodities contained in the end products. The proposed change was also intended to address major program weaknesses disclosed during a national audit conducted by the OIG (Food Distribution Program, Evaluation of Food Processors and the National Commodity Processing System, Audit Report No. 27651-1-CH). The need for improvements in the allowable commodity value passthrough systems was a major audit finding. Specifically, the audit revealed that the refund system permits processors to enjoy an advantage because the processor receives the full price for the product and does not pay the refund equal to the value of the donated food until the refund application is submitted. Thus, the processor receives the benefit of a "float" created by the refund processing time. To address this problem in the context of the sale through distributor without dual billing, the Department believes that refund applications must be submitted and paid expeditiously. The 30 day application and payment timeframes of the proposed rule will ensure that refunds are expeditiously paid.

Also, the proposed change will ensure that an accountable audit trail is created by these sales. Therefore, the interim rule contains the requirement that the processor ensure that the distributor invoices the recipient agency at a price which reflects the value of the discount provided to the eligible recipient agency and that copies of that invoice accompany the refund application. The Department believes these refinements in the requirements for a sale through distributor without dual billing are necessary to ensure that the value of the donated food is passed to the recipient agency and that refunds are expeditiously handled. These new requirements are found in § 252.4(c)(4)(ii)(B) of the interim rule.

Based on these considerations, the Department is maintaining the requirement as it was proposed in the February 4, 1986 rule. This system will provide for more equitable distribution of the reporting burden between processors, distributors and recipient agencies. It will also strengthen program accountability by creating a clearer and more acceptable audit trail. This system is identical with that required in Part 250.15(e), the Food Distribution Program Regulations.

Audit Requirement

Section 252.4(c)(17) of the proposed rule would require all NCP processors to obtain an audit by an independent certified public accountant (CPA) at the end of each agreement year. Because it is not feasible for the Department to conduct on-site reviews or audits of all processors participating in the NCP Program, the Department proposed a requirement that processors obtain an annual audit by an independent certified public accountant. The audits would be conducted in accordance with financial and compliance elements of Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the Comptroller General of the United States. In addition, FNS would develop audit guidelines for use by auditors to ensure that these audits are of sufficient scope to include a thorough review of program requirements. FNS will also be responsible for providing training for auditors in accordance with requirements prescribed by the Secretary on the use of these guidelines. The proposal also required that all costs associated with CPA audits, including travel expenses to attend any FNS training sessions, would be borne by the processor. Seven commentors opposed the proposal, generally on grounds of cost. They also objected to the requirement that processors pay for FNS audit training. Nine commentors agreed with the proposal but questioned the annual requirement. Their concern was that the audit provisions should be identical to those required in 7 CFR Part 250, which governs State processing programs.

The Part 250 regulations require processors to conduct audits every one, two or three years, depending on the value of donated food received each year. Processors with food orders over $250,000 per year must have an annual audit. Those between $75,000 and $250,000 must have one every 2 years. Those under $75,000 must have one every 3 years. Because the NCP Program and the Part 252 regulations expire on June 30, 1987, processors receiving donated food valued at less than $250,000 during the agreement year ending June 30, 1987 would not be affected by the audit requirements contained in this part. Based upon comments received, the Department determined that the original annual audit requirement for all NCP processors was too stringent. The Department also believes the requirements of 7 CFR Part 250 would be sufficient to ensure program accountability. Therefore, § 252.4(c)(17) of the proposed rule is being amended to conform with the requirement contained in Section 250.15(t) of the Food Distribution Program regulations. During the 1986–87 agreement year, only processors receiving donated food valued in excess of $250,000 will be required to obtain an audit. The requirement that processors pay for FNS audit training is also eliminated. Audits will be conducted in accordance with Uniform Federal Assistance Regulations and the FNS Audit Guide for Multi-State Processors, requiring no additional FNS training.

Verification of Recipient Agency Masterfile

During the first three years of NCP, the Department has solicited the cooperation of State distributing agencies in verifying the NCP recipient agency masterfile. The voluntary recipient agency masterfile verification was extremely useful and enabled the Department to eliminate a significant number of ineligible recipient agencies from the masterfile. Some States, however, refused to verify the NCP masterfile so FNS has never had complete assurance that all registered recipient agencies were eligible to participate in the program. Since the recipient agency masterfile is supplied to each NCP processor, FNS must ensure that this list is as accurate as possible to maintain program integrity. To ensure the accuracy of the entire recipient agency masterfile, the Department proposed a requirement in section 250.11 that State distributing agencies verify the NCP recipient agency masterfile for recipient agencies registered in their State. Some options offered under the proposal to accomplish this task included: (1) State agencies verifying that recipient agencies listed on the NCP masterfile have a current agreement with the State under Part 250.8 and Part 251.5; (2) State agencies signing off on the recipient agency registration card prior to submission to FNS; and (3) recipient agencies submitting a copy of their approved current State agency agreement to receive donated food with the NCP registration card.

Of the 21 comments received on this subject, 19 supported the requirement. The requirement presents no undue hardships to State agencies who also agreed that State verification of the masterfile is necessary to ensure the integrity of the program. For these reasons, the proposal has been incorporated into the final regulations as originally proposed.

Bonding/Inventory Protection

Section 252.4(c)(5) of this rule retains the requirement that processors obtain a performance supply and surety bond or an irrevocable letter of credit sufficient to protect the contract value of all donated foods.

At a minimum, letters of credit must remain in effect for a reasonable period after the end of the contract period. This is necessary to ensure that protection is available in the situation where commodity losses are not discovered until after the end of the contract period.

FNS Sales Verification

Section 252.6(c) of the February 4, 1986 proposed rule notified NCP participants that FNS may conduct a verification of processor reported sales utilizing a statistically valid sampling technique. The June 17, 1983 and the September 12, 1985 interim rules did not contain a provision for FNS to conduct a sales verification of processor reported sales. However, FNS has conducted two separate sales verifications since the program began in 1983. The Department believes these verification efforts are essential to ensure program integrity and accountability and to ensure processors' compliance with the terms and conditions of the NCP agreement. No comments were received relative to this proposal.

Section 252.6(c) of this regulation retains the provision that, as part of an ongoing effort to ensure program accountability, FNS will continue monitoring processor reported sales under the NCP Program and may conduct a sales verification of processor reported sales. Section 252.6(c) of this regulation is being amended to clarify that FNS will continue to verify processor reported sales in order to ensure program integrity. These verification efforts will utilize statistically valid samples to determine the level of inaccurate or invalid sales. Based upon the results, FNS may project claims as necessary.

Monthly Performance Report

The terminology for the processor's "monthly activity report" in which the processor reports sales of products and donated food receipt and use has been changed to "monthly performance report." Also, two items of information which are routinely reported by processors on the current monthly activity report but which were not stated in the September 12 interim rule have been added to § 252.4(c)(9)(i) of this interim rule. The required items of information in the report include whether sales were made under a refund or discount system and the amount of donated food represented by reported sales.

Refund Payments

Sections 252.4(c)(4)(i)(B), 252.4(c)(4)(ii)(B), and 252.4(c)(4)(ii)(c) require that when end products are sold under the refund system, recipient agencies and distributors must submit refund applications within 30 days of the date of purchase of the end products in order to receive benefits. The processor must make payment to the recipient agencies and distributors within 30 days of receipt of the application. These timeframes are inconsistent with the final regulations amending Part 250 being published concurrently with this rule which require submission of the refund applications within 60 days and payment by the processor within 10 days.

The Department intends to publish a proposed rulemaking to solicit comments so as to establish consistency between Part 250 and the NCP Program.

List of Subjects in 7 CFR Parts 250 and 252

Aged, Agricultural commodities, Business and industry, Food assistance programs, Food donations, Food processing, Grant programs-social programs, Infant and children, Price support programs, Reporting requirements, School breakfast and lunch programs, Surplus agricultural commodities.

Accordingly, Parts 250 and 252 are amended as follows:

PART 250—FOOD DISTRIBUTION PROGRAM

1. The authority citation for Part 250 continues to read as follows:

Authority: Sec. 32, Pub. L. 74–320, 49 Stat. 744 (7 U.S.C. 612c); Pub. L. 75–165, 50 Stat. 323 (15 U.S.C. 713c); secs. 6, 9, 60 Stat. 231, 233, Pub. L. 79–396 (42 U.S.C. 1755, 1758); sec. 416, Pub. L. 81–439, 63 Stat. 1058 (7 U.S.C. 1431); sec. 402, Pub. L. 91–665, 68 Stat. 843 (22 U.S.C. 1922); sec. 210, Pub. L. 84–540, 70 Stat. 202 (7 U.S.C. 1859); Sec. 9, Pub. L 85–931, 72 Stat. 1792 (7 U.S.C. 1431b); Pub. L. 86–756, 74 Stat. 899 (7 U.S.C. 1431 nt); sec. 709, Pub. L. 89–321, 79 Stat. 1212 (7 U.S.C. 1446a-1); sec. 3, Pub. L. 90–302, 82 Stat. 117 (42 U.S.C. 1761); secs. 409, 410, Pub. L. 93–288, 88 Stat. 157 (42 U.S.C. 5179, 5180); sec. 2, Pub. L. 93–326, 88 Stat. 286 (42 U.S.C. 1762a); sec. 16, Pub. L 94–105, 89 Stat. 522 (42 U.S.C. 1766); sec. 1304 (a), Pub. L. 95–113, 91 Stat. 980 (7 U.S.C. 613c nt); sec. 311, Pub. L. 95–478, 92 Stat. 1533 (42 U.S.C. 3030a); sec. 10, Pub. L. 95–627, 92 Stat. 3623 (42 U.S.C. 1760); (5 U.S.C. 301), unless otherwise noted.

2. Section 250.11, previously reserved, is added as follows:

§ 250.11 Eligibility determination for recipient agencies and recipients.

Verification of recipient agency eligibility. State distributing agencies at the request of FNS shall (a) verify that recipient agencies registered to participate in the National Commodity Processing (NCP) Program have a current agreement with the State agency to receive donated food in accordance with Part 252.1 (c) and (b) State agencies shall report the results of such verification to FNS within timeframes determined by FNS.

3. Part 252 is revised to read as follows:

PART 252—NATIONAL COMMODITY PROCESSING PROGRAM

Sec.
252.1 Purpose and scope.
252.2 Definitions.
252.3 Administration.
252.4 Application to participate and agreement.
252.5 Recipient agency responsibilities.
252.6 Miscellaneous provisions.
252.7 OMB Control Number.

Authority: Sec. 416, Agricutural Act of 1949 (7 U.S.C. 1431).

§ 252.1 Purpose and scope.

(a) *Purpose.* This part provides a program whereby the Food and Nutrition Service (FNS) and private processors of food may enter into agreements under which the processor will process and distribute designated donated food to eligible recipient agencies. The intent of the program is to encourage private industry, acting in cooperation with the States and FNS, to develop new markets in which donated food may be utilized. It is expected that the processors will use their marketing abilities to encourage eligible recipient agencies to participate in the program. Additionally, recipient agencies will benefit by being able to purchase processed end products at a substantially reduced price.

(b) *Scope.* The terms and conditions set forth in this part are those under which processors may enter into agreements with FNS for the processing of commodities designated by the

Secretary of Agriculture and the minimum requirements which NCP processors must meet. Also prescribed are distributing agency and recipient agency responsibilities.

(c) *Eligible Recipient Agencies.* Recipient agencies shall be eligible to participate in the NCP Program to the extent of their eligibility to receive the food involved in the NCP Program, pursuant to Part 250.8 and Part 251.

§ 252.2 Definitions.

The terms used in this part that are defined in Parts 250.3 and 251.3 shall have the meanings ascribed to them therein, except as set forth in this section.

"Agreement value of the donated commodity" means the price assigned by the Department to a donated food which reflects the Department's current acquisition price, transportation and, if applicable, processing costs related to the food.

"Distributing agencies" means State, Federal or private agencies which enter into agreements with the Department for the distribution of donated food to eligible recipient agencies and recipients; and FNS when it accepts title to commodities from the Commodity Credit Corporation (CCC) for distribution to eligible recipient agencies under the National Commodity Processing Program. A recipient agency may also be a distributing agency.

"Donated food value return system" means a system used by a processor or distributor to reduce the price of the end product by the agreement value of the donated commodity.

"NCP Program" means a program under which FNS and private processors of food may enter into agreements under which the processor will process and distribute designated donated food to eligible recipient agencies.

"Recipient agency" means disaster organizations, charitable institutions, nonprofit summer camps for children, school food service authorities, schools, service institutions, welfare agencies, nutrition programs for the elderly, nonresidential child care institutions and emergency feeding organizations.

"Substitution" means the replacement of donated food with like quantities of domestically produced commercial food of the same generic identity and of equal or better quality (i.e., cheddar cheese for cheddar cheese, nonfat dry milk for nonfat dry milk, etc.).

§ 252.3 Administration.

(a) *Role of FNS.* The Secretary will designate those commodities which will be available under the NCP Program. Only commodities made available without charge or credit under any nutrition program administered by USDA will be available under NCP. FNS will act as the distributing agency and the contracting agency under the NCP Program. The Department will pay costs for delivering donated commodities to participating NCP Program processors

(b) *Food orders.* When NCP Program processors request donated food, FNS will determine whether the quantities ordered are consistent with the processor's ability to sell end products and/or the processor's past demonstrated performance under the Program. If the quantities are appropriate, FNS will request from CCC the donated food for transfer of title to FNS and delivery to a mutually agreed upon location for use by the NCP Program processor. The title to these commodities transfers to FNS upon their acceptance by the processor. FNS retains title to such commodities until:

(1) they are distributed to eligible recipient agencies in processed form, at which time the recipient agency takes title;

(2) they are disposed of because they are damaged or out-of-condition; or

(3) title is transferred to the NCP Program processor upon termination of the agreement.

(c) *Substituted food.* When FNS approves the substitution of donated commodities with commercial food, title to the substituted food shall transfer to FNS and the processor shall use the substituted food in accordance with the terms and conditions of this Part.

(d) *Inventory levels.* FNS will monitor the inventory of each food processor to ensure that the quantity of donated food for which a processor is accountable is at the lowest cost-efficient level. In no event shall a processor hold in inventory more than a six-month supply, based on average monthly usage under the NCP Program, unless a higher level has been specifically approved by FNS on the basis of justification submitted by the processor. Under no circumstances should the amount of donated food requested by the processor be more than the processor can accept and store at any one time. FNS will make no further distribution to a processor whose inventory exceeds these limits until such time as the inventory is reduced.

(e) *Recipient agency registration.* FNS will register, upon request, eligible recipient agencies. FNS will make available to food processors a listing of registered eligible recipient agencies for marketing purposes. Any processor desiring additional listings will be charged a fee for the listing which is commensurate with the Department's policy on user fees.

§ 252.4 Application to participate and agreement.

(a) *Application by processors to participate.* Any food processor is eligible to apply for participation in the NCP Program. Agreement applications may be filed with FNS at any time on an FNS-approved form. FNS will accept or reject the application of each individual food processor within 30 days from the date of receipt, except that FNS may, at its discretion, extend such period if it needs more information in order to make its determination. In determining whether to accept or reject an application, FNS shall take into consideration at least the following matters: the financial responsibility of the applicant; the ability of the applicant to meet the terms and conditions of the regulations and the NCP agreement; ability to accept and store commodities in minimum truckload quantities; historical performance under the State and NCP processing programs; anticipated new markets for NCP end products; geographic areas served by the processor; the ability of the applicant to distribute processed products to eligible recipient agencies; and a satisfactory record of integrity, business ethics and performance. In addition, the processors must demonstrate their ability to sell end products under NCP by submitting supporting documentation such as written intent to purchase, bids awarded, or historical sales performance. FNS will make a final determination based on all available documentation submitted.

(b) *Agreement between FNS and participating food processors.* Upon approval of an application for participation in the NCP Program, FNS shall enter into an agreement with the applicant food processor. All agreements under the NCP Program will terminate June 30, 1987.

(c) *Processor requirements and responsibilities.* In accordance with the following provisions and the NCP agreement, any processor participating in the NCP Program may sell to any eligible recipient agency nationwide a processed product containing the donated food received from FNS.

(1) The processor shall submit to FNS end product data schedules which include a description of each end product to be processed, the quantity of each donated food and any other ingredient which is needed to yield a specific number of units of each end product. FNS may 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. The end product data schedule must include the processors' free on board (FOB) plant price schedule for quantity purchases of processed products. The end product data schedule shall be made a part of the NCP agreement.

(2) When determining the value of the donated food, the processor shall use the agreement value of the donated food which shall be the price assigned by the Department to a donated food which reflects the Department's current acquisition price, transportation and, if applicable, processing costs related to the food.

(3) The processor shall demonstrate to the satisfaction of FNS that internal controls are in place to insure that duplicate reporting of sales under the NCP Program and any other food distribution program does not occur.

(4) The processor shall use a method of selling end products to recipient agencies which ensures that the price of each case of end product is reduced by the agreement value of the donated commodity and ensures proper accountability. In line with FNS guidelines and subject to FNS approval, the processor shall select one or more of the following donated food value return systems to use during the term of the agreement. Regardless of the method used, the processor shall ensure that the invoice clearly indicates the discount included or refund due on the end product and clearly identifies that the discount included or refund due is for the value of the donated food. Regardless of the method chosen for selling end products, the processor shall reduce his inventory only by the amount of donated food represented by the discount or refund placed on the end product.

(i) *Direct Sale.* A direct sale is a sale by the processor directly to the eligible recipient agency. The following two methods of direct sales are allowed:

(A) *Discount System.* When the recipient agency pays the processor directly for an end product purchased, the processor shall invoice the recipient agency at the net case price which shall reflect the value of the discount established in the agreement.

(B) *Refund System.* The processor shall invoice the recipient agency for the commercial/gross price of the end product. The recipient agency shall submit a refund application to the processor within 30 days of receipt of the processed end product and the processor shall pay directly to the eligible recipient agency within 30 days of receipt of the refund application from the recipient agency, an amount equal to the established agreement value of donated food per case of end product multiplied by the number of cases delivered to and accepted by the recipient agency. In no event shall refund applications for purchases during the period of agreement be accepted by the processor later than 60 days after the close of the agreement period.

(ii) *Indirect Sale.* An indirect sale is a sale by the processor through a distributor to an eligible recipient agency. Indirect sales can be made with or without dual billing. Dual billing involves the processor billing the recipient agency for the end product and the distributor billing the recipient agency for the cost of services rendered in the handling and delivery of the end product. The following three methods of indirect sales are allowed:

(A) *Sale Through Distributor with Dual Billing.* When end products are sold to recipient agencies through a distributor under a system utilizing dual billing, the processor shall invoice the recipient agencies directly for the end products purchased at the net case price which reflects the value of the discount established in the agreement. The processor shall ensure that the distributor bills the recipient agencies only for the services rendered in the handling and delivery of the end product. The processor shall maintain delivery and/or billing invoices to substantiate the quantity of end product delivered to each recipient agency and the net case price charged by the processor which reflects the discount established by the agreement.

(B) *Sale Through Distributor without Dual Billing.* When end products are sold to recipient agencies through a distributor without dual billing, processors shall provide refunds to the distributor and ensure that the distributor provides discounts of equal value to recipient agencies. Under this system, the processor shall sell end products to a distributor at the processor's commercial/gross price for the end product. The processor's invoice shall reflect the value of commodities contained in the end product as established by the agreement. The processor shall ensure that the distributor submits a refund application to the processor within 30 days after the eligible recipient agency receives the processed end product. The processor shall ensure that the refund application includes documentation of the purchase of end products by the eligible recipient agency through substantiating invoices and that the recipient agency has purchased the end product at the net case price which reflects the value of the discount established by the agreement. Within 30 days of the receipt of the refund application, the processor shall issue payment directly to the distributor in an amount equal to the stated agreement value of the donated food contained in the purchased end products covered by the application. In no event shall refund applications for purchases during the period of agreement be accepted by the processors later than 60 days after the close of the agreement period. The processor shall verify a statistically valid sample of discount sales made by distributors without dual billing in a manner which ensures a 95 percent confidence level. All such sales reported during a quarter shall be verified at the end of that quarter. Processors shall verify that sales were made only to eligible recipient agencies and that the value of donated commodities was passed through to those recipient agencies. The processor shall report to FNS the level of invalid or inaccurate sales identified in each quarter within 60 days after the close of each quarter. At the same time such report is submitted, the processor shall submit to FNS a corrective action plan designed to correct problems identified in the verification effort. The processor shall adjust performance reports to reflect the invalid sales identified during the verification effort required by this paragraph. If, as a result of this verification, FNS determines that the value of donated food has not been passed on the recipient agencies or that end products have been improperly distributed, FNS may assert a claim against the processor.

(C) *Sale Through Distributor with a Refund.* Under the refund system, processors shall sell end products to distributors at the commercial/gross price of the end product. Distributors shall sell end products to recipient agencies at the commercial/gross price of the end products. Processors shall ensure that their invoices and the invoices of distributors identify the discount established by the agreement. Recipient agencies shall submit refund applications to processors within 30 days of receipt of the processed end product. Within 30 days of the receipt of the refund application from the recipient agency certifying actual purchases of end product from substantiating invoices maintained by the recipient agency, the processor shall compute the amount and issue payment of the refund directly to the recipient agency. In no event shall refund applications for purchases during the period of the agreement be accepted by the processor later than 60 days after the close of the agreement period.

(5) The processor shall furnish to FNS prior to the ordering of any donated food for processing, a performance supply and surety bond obtained from surety companies listed in the current Department of Treasury Circular 570 or an irrevocable letter of credit to cover the amount of inventory on hand and on order.

(6) The processor shall draw down inventory only for the amount of donated food used to produce the end product. Processors shall ensure that an amount equivalent to 100 percent of the donated food provided to the processor under the NCP Program is physically contained in end products. Additional commodities required to account for loss of donated food during production shall be obtained from non-donated food.

(7) The processor shall contact FNS for approval of any substitution of donated food. If approved, the processor shall substitute for donated food like quantities of domestically produced commercial food of the same generic identity (i.e., cheddar cheese for cheddar cheese, nonfat dry milk for nonfat dry milk, etc.) and of equal or better quality. Substitution must not be made solely for the purpose of selling or disposing of the donated commodity in commercial channels for profit. Substitution is only appropriate when donated food and commercial food must be commingled or when delays in donated food shipment adversely affect production. The processor shall maintain records to substantiate that it continues to acquire on the commercial market amounts of substitutable food consistent with their levels of non-NCP Program production and to document the receipt and disposition of the donated food. FNS shall withhold deliveries of donated commodities from processors that FNS determines have reduced their level of non-NCP Program production because of participation in the NCP Program.

(8) The processor shall be liable for all donated food provided under the agreement. The processor shall immediately report to FNS any loss or damage to donated food and shall dispose of damaged or out-of-condition food in accordance with Part 250.7.

(9) The processor shall submit to FNS monthly performance reports reflecting the sale and delivery of end products during the month.

(i) The processor shall ensure that the monthly performance report is postmarked no later than the last day of the month following the month being reported. The processor shall identify the month of delivery for each sale reported. The sale and delivery of end products for any prior month may be included on the monthly performance report. The processor monthly performance report shall include: (A) The donated food inventory at the beginning of the reporting month; (B) Amount of donated food received from the Department during the reporting month; (C) Amount of donated food transferred to and/or from existing inventory; (D) A list of all recipient agencies purchasing end products and the number of units of end products delivered to each during the report month; (E) The net price paid for each unit of end product and whether the sale was made under a discount or refund system; (F) When the sale is made through a distributor, the name of the distributor; (G) the amount of inventory drawdown represented by reported sales; and (H) the donated food inventory at the end of the reporting month.

(ii) At the end of each agreement period, there will be a final 90 day reconciliation period in which processors may adjust NCP sales for any month.

(10) The processor shall maintain complete and accurate records of the receipt, disposal and inventory of donated food including end products processed from donated food.

(i) The processor shall keep production records, formulae, recipes, daily or batch production records, loadout sheets, bills of lading, and other processing and shipping records to substantiate the use of the donated food and the subsequent redelivery to an eligible recipient agency.

(ii) The processor shall document that sales reported on monthly performance reports, specified in paragraph (c)(9) of this part were made only to eligible recipient agencies and that the normal wholesale price of the product was discounted or a refund payment made for the agreement value of the donated commodity.

(iii) When donated food is commingled with commercial food, the processor shall maintain records which will permit an accurate determination of the donated commodity inventory.

(iv) The processor shall make all pertinent records available for inspection and review upon request by FNS, its representatives and the General Accounting Office (GAO). All records must be retained for a period of three years from the close of the Federal fiscal year to which they pertain. Longer retention may be required for resolution of an audit or of any litigation.

(11) The processor shall obtain, upon FNS request, Federal acceptance service grading and review of processing activities and shall be bound by the terms and conditions of the grading and/or review.

(12) The processor shall indemnify and save FNS and the recipient agency free and harmless from any claims, damages, judgments, expenses, attorney's fees, and compensation arising out of physical injury, death, and/or property damage sustained or alleged to have been sustained in whole or in part by any and all persons whatsoever as a result of or arising out of any act or omission of the processor, his/her agents or employees, or caused or resulting from any deleterious substance, including bacteria, in any of the products produced from donated food.

(13) The processor shall be liable for payment for all uncommitted food inventory remaining at agreement termination.

(i) When agreements are terminated at the request of the processor or at FNS' request because there has been noncompliance on the part of the processor with the terms and conditions of the agreement, or if any right of FNS is threatened or jeopardized by the processor, the processor shall pay FNS an amount equal to the CCC unrestricted sales price, the cost CCC of replacement on the date the agreement is terminated, or the agreement value of donated commodities, whichever is highest, for the inventory, plus any expenses incurred by FNS.

(ii) When the agreements are terminated at FNS' request where there has been no fault or negligence on the part of the processor, the processor shall pay FNS an amount equal to the CCC unrestricted sales price, the cost to CCC of replacement on the date the agreement is terminated, or the agreement value of the donated commodities, whichever is highest, for the inventory, unless FNS and the processor mutually agree on another value.

(14) The processor shall comply fully with the provisions of the NCP agreement and all Federal regulations and instructions relevant to the NCP Program.

(15) The processor shall label end products in accordance with § 250.15(j) and, when end products contain vegetable protein products, in accordance with 7 CFR 210, 225, or 226 Appendix A.

(16) The processor shall return to FNS any funds received from the sale of donated food containers and the market value or the price received from the sale of any by-products of donated food or commercial food which has been substituted for donated food.

(17) For any year in which a processor receives more than $250,000 in donated food, the processor shall obtain an independent audit conducted by a Certified Public Accountant (CPA) for that year. Processors receiving $75,000 to $250,000 in donated food each year shall obtain an independent audit conducted by a CPA every two years and those receiving less than $75,000 in donated food each year shall obtain an independent audit conducted by a CPA every three years. Processors in the three year audit cycle shall move into the two year audit cycle when the value of donated food received reaches $75,000. If the Department determines that the audit is not acceptable or that the audit has disclosed serious deficiencies, the processor shall be subject to additional audits by OIG at the request of FNS.

(i) Audits shall be conducted in accordance with the auditing provisions set forth under the *Standards for Audit of Government Organizations, Programs, Activities and Functions,* and the FNS Audit Guide for Multi-State Processors.

(ii) The costs of the audits shall be borne by the processor.

(iii) Audit findings shall be submitted by the processors to FNS.

(iv) Noncompliance with the audit requirement contained in this part will render the processor ineligible to enter into another processing contract until the required audit has been conducted and deficiencies corrected.

§ 252.5 Recipient agency responsibilities.

(a) *Registration.* Recipient agencies that have approved agreements with State distributing agencies to receive donated food may register with FNS on an FNS approved form to participate in the NCP Program. Upon request, FNS will provide recipient agencies with registration forms. Recipient agencies shall notify FNS when they are no longer eligible to receive donated food under an agreement. Failure to notify FNS shall result in claim action.

(b) *Recipient agency records.* Each recipient agency shall maintain accurate and complete records with respect to the receipt, disposal, and inventory of donated food, including products processed from donated food, and with respect to any funds which arise from the operation of the distribution program.

(c) *Refunds.* A recipient agency purchasing end products under the NCP Program from a processor utilizing a refund system shall submit a refund application supplied by the processor to the processor within 30 days of receipt of the end products. Recipient agencies must insure that any funds received as a result of refund payments be designated for use by the food service department.

(d) *Verification.* If requested by FNS, each recipient agency shall cooperate in the verification of end product sales reported by processors under the NCP Program. The recipient agency may be requested to verify actual purchases of end products as substantiated by the recipient agency's invoices and may also be requested to verify that the invoice correctly identifies the discount included or refund due for the value of the donated ingredient contained in the end product.

§ 252.6 Miscellaneous provisions.

(a) *Improper distribution or loss of or damage to donated food.* If a processor improperly distributes or uses any donated food, or causes loss of or damage to a donated food through its failure to provide proper storage, care, or handling, FNS shall require the processor to pay to the Department the value of the donated food as determined by the Department.

(b) *Disposition of damaged or out-of-condition food.* Donated food which is found to be damaged or out-of-condition and is declared unfit for human consumption by Federal, State, or local health officials, or by any other inspection services or persons deemed competent by the Department, shall be disposed of in accordance with instructions of the Department. This instruction shall direct that unfit donated food be sold in a manner prescribed by the Department with the net proceeds thereof remitted to the Department. Upon a finding by the Department that donated food is unfit for human consumption at the time of delivery to a recipient agency and when the Department or appropriate health officials require that such donated food be destroyed, the processor shall pay for any expenses incurred in connection with such donated food as determined by the Department. The Department may, in any event, repossess damaged or out-of-condition donated food.

(c) *FNS Sales Verification.* FNS may conduct a verification of processor reported sales utilizing a statistically valid sampling technique. If, as a result of this verification, FNS determines that the value of the donated food has not been passed on to recipient agencies or if end products have been improperly distributed, FNS may assert a claim against the processor. This claim may include a projection of the verification sample to the total NCP sales reported by the processor.

(d) *Sanctions.* Any processor or recipient agency which has failed to comply with the provisions of this part or any instructions or procedures issued in connection herewith, or any agreements entered into pursuant hereto, may, at the discretion of the Department, be disqualified from further participation in the NCP Program. Reinstatement by be made at the option of the Department. Disqualification shall not prevent the Department from taking other action through other available means when considered necessary, including prosecution under applicable Federal statutes.

(e) *Embezzlement, misuse, theft, or obtainment by fraud of commodities and commodity related funds, assets, or property in child nutrition programs.* Whoever embezzles, willfully misapplies, steals, or obtains by fraud commodities donated for use in the NCP Program, or any funds, assets, or property deriving from such donations, or whoever receives, conceals, or retains such commodities, funds, assets, or property for his own use or gain, knowing such commodities, funds, assets, or property have been embezzled, willfully misapplied, stolen, or obtained by fraud, shall be subject to Federal criminal prosecution under section 12(g) of the National School Lunch Act, as amended, or Section 4(c) of the Agriculture and Consumer Protection Act of 1973, as amended. For the purpose of this paragraph "funds, assets, or property" include, but are not limited to, commodities which have been processed into different end products as provided for by this part, and the containers in which commodities have been received from the Department.

§ 252.7 OMB control number.

The information collection and reporting requirements contained in this Part have been approved by the Office of Management and Budget under Control No. 0584–0325.

Dated: June 24, 1986.

Robert E. Leard,

Administrator.

[FR Doc. 86–14632 Filed 6–27–86; 8:45 am]

BILLING CODE 3410-30-M