

August 1996

FEDERALLY DONATED MEAT AND POULTRY

Information on Extent and Impact of States' Restrictions on Processors



Resources, Community, and
Economic Development Division

B-272562

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Congressional Committees

Each year, the U.S. Department of Agriculture (USDA) purchases and donates hundreds of millions of dollars' worth of agricultural commodities, including meat and poultry, to support various domestic food assistance programs. Over half of the donated agricultural commodities go to food assistance programs for children, the largest of which is the National School Lunch Program. Schools receive the donated meat and poultry in a finished product form, such as hamburger patties, whole turkeys, chicken nuggets, or bulk "fine-ground" beef, and either use the product immediately to prepare lunches or store it for future use. At a later date, a state or school may decide to send some of the fine-ground beef to a commercial processor to further process it into products such as barbecue-flavored hamburgers or meatballs. The commercial processor, often located out of state, could receive similar orders to process donated meat from another state or school. To gain greater production efficiency, some large processors may combine federally donated meat or poultry received from multiple sources, a process known as batching. However, the contracts of some state agencies¹ and/or local school food authorities² restrict commercial processors from batching their products under certain conditions. Batching restrictions are almost never an issue for poultry, which is generally processed into a finished product before being sent to the schools.

Batching is different from "commingling"—another term associated with the handling of federally donated foods. Commingling refers to a process in which federally donated food (e.g., flour, butter, cheese) is stored, combined, or blended with commercially purchased food. Federal regulations prohibit the commingling of donated meat or poultry.

The Healthy Meals for Healthy Americans Act of 1994 (P.L. 103-448, Nov. 2, 1994) required GAO to study the incidence and effect of states' restricting commercial processors from combining federally donated meat or poultry from multiple sources. As agreed with your offices, we examined the (1) reasons for and extent of state agencies' and schools' batching restrictions; (2) impact that batching restrictions have on commercial

¹State agencies include state education agencies and/or state departments of agriculture that distribute federally donated foods. Fifty-four state agencies operate in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and Guam.

²"Local school food authority" refers to any local school district or other entity, such as a private school, that manages the school's food service. In this report, we use the term school for these entities.

processors, schools, and the federal government; and (3) mechanisms that state agencies and schools use to ensure compliance with batching restrictions.

Results in Brief

According to USDA officials, batching restrictions are not imposed for food safety reasons but rather because the taste of stored meat and poultry deteriorates over time. Some state agencies and schools do not want their meat or poultry combined with another state's or school's meat or poultry that has been stored for a longer time or under questionable conditions. Eight of the 54 state agencies that distribute federally donated meat and poultry have no contracts with commercial meat and poultry processors that receive products from multiple states (known as multistate processors); 18 have contracts without batching restrictions; and 28 have contracts restricting batching. However, these 28 contracts usually provide for a waiver from these batching restrictions under certain conditions.

According to most of the multistate processors we interviewed, batching restrictions do not affect their operations in terms of increased costs or decreased yields³ for several reasons: (1) Some states' contracts contain no batching restrictions, (2) batching is not a standard processing procedure for some processors because of their size and because of their accounting and inventory controls, or (3) processors can request waivers from batching restrictions. However, a few of the multistate processors expressed some concern that the batching restrictions, if not waived, might limit their ability to operate at full production capacity. These processors told us that they absorb any higher operating costs that result from the restrictions and do not pass them directly on to the schools. We did not independently verify that additional costs were incurred or that any such costs were either absorbed by the processor or passed along in a contract bid price. Additionally, state agencies' batching restrictions have no effect on costs to the federal government. When these restrictions come into play, the federal government has already relinquished ownership.

To help ensure compliance with their batching restrictions, state agencies and schools rely on the on-site graders of USDA's Agricultural Marketing Service (AMS). Graders perform end-product certification for meat and poultry products. These graders are required to be on-site during the processing of meat and poultry donated by USDA. In addition to this

³Halting operations to segregate the processing of one state's meat or poultry from that of another state's meat or poultry almost always increases waste and, as a result, decreases yield.

oversight, states and schools rely on periodic audits conducted by certified public accounting firms, which are required by the Food and Consumer Services (FCS), and reviews by USDA's Office of Inspector General.

Background

The federal cost to support school lunches in fiscal year 1995 was over \$5 billion, including over \$600 million in federally donated commodities, such as beef, poultry, flour, and canned vegetables. In school year 1995-96, USDA sent to schools meat and poultry valued at about \$340 million (about 181 million pounds of beef and pork and about 157 million pounds of chicken and turkey).

Within USDA, FCS administers the school lunch program, and AMS purchases the meat and poultry donated to the program. In some cases, state agencies order finished products from FCS that are ready to be used in preparing school lunches, such as plain hamburger patties or chicken nuggets. AMS buys and ships these finished products to a designated point, either a state agency or, in some cases, a large school district. As a second option, state agencies can order raw products from FCS that need more processing, such as "coarse-ground" beef in bulk, whole chickens, or whole turkeys. In this case, AMS buys the meat and poultry and arranges for the shipping directly to a processor. The schools pay for the additional processing and the shipping to the state and/or its schools. This option is known as direct diversion. As a third option, state agencies can order from FCS fine-ground meat or poultry in bulk. This option accounts for about one-half of the donated meat that AMS buys and distributes to the schools. The schools can use this meat and poultry for such products as taco filling, meatloaf, and spaghetti and chili sauces. In the case of meat, schools store bulk fine-ground beef for later use, and some schools may eventually ship this ground beef back to a multistate processor for reprocessing into another product, such as meatballs and hamburger patties. This shipping for further processing is known as backhauling.

State Agencies Have Imposed Batching Restrictions to Ensure Product Quality

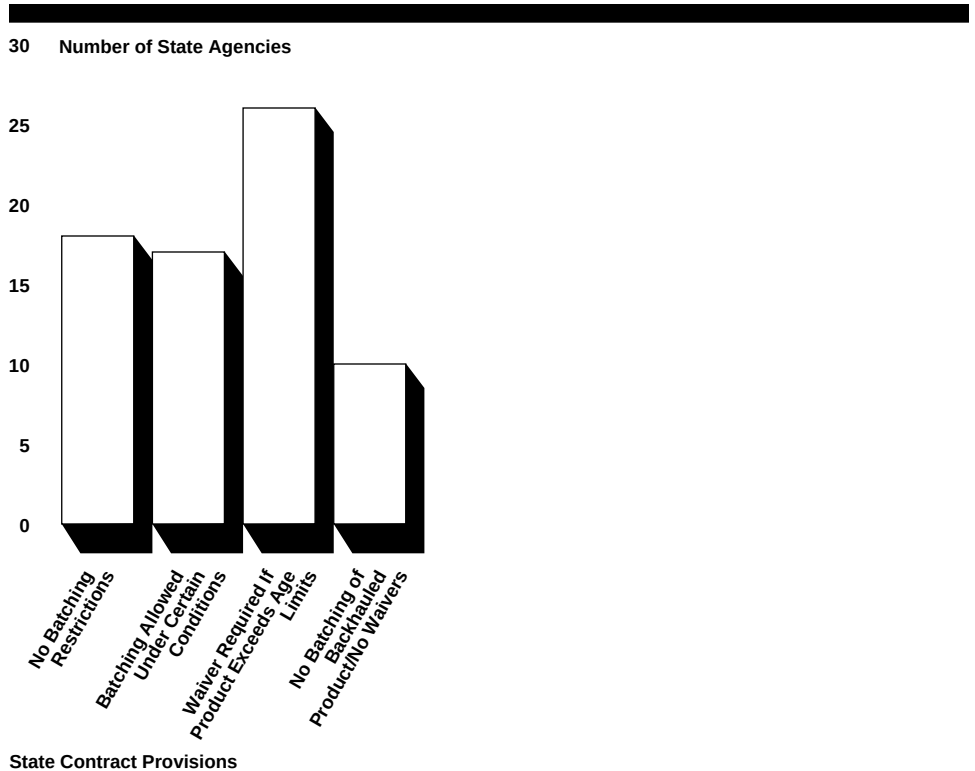
All state agencies that have contracts with multistate processors use the model contract prepared by the American Commodity Distribution Association as the basis for their agreements. The special provisions section of this model contract, article 35, allows state agencies to place conditions on the processor.⁴ Batching became an issue between state agencies and multistate processors in the late 1980s, when some state

⁴If a school wants to use a commercial processor for backhauled meat or poultry, the school also signs the state agency's contract.

agencies and schools became concerned about processors who were combining donated meat from multiple sources. The state agencies were particularly concerned about donated meat being stored for extended periods, causing the taste of the product to deteriorate. Consequently, they included batching restrictions in their contracts. In accordance with FCS' policy, contracts usually provide for a waiver of the batching restrictions if the processor first obtains permission from the school(s).

Currently, 54 state agencies distribute federally donated meat and poultry to the schools. Of this number, eight have no contracts with multistate processors. Another 18 have contracts that impose no restrictions on batching. The remaining 28 state agencies have contracts containing a number of types of batching provisions. For example, contracts contain clauses permitting batching under certain conditions; prohibiting the batching of products that have been stored over a specific period of time—6, 9, or 12 months—unless waived; and prohibiting batching with other backhauled meat under any condition. In the 1995-96 school year, only California prohibited all batching. Figure 1 provides a summary of states' batching restrictions, and appendix I provides a list of the batching restrictions by state.

Figure 1: Summary of State Agencies' Contract Provisions on Batching



Note: Number of state agencies adds to more than 54 because some states have multiple contract clauses dealing with batching.

Although these batching restrictions apply to poultry in theory, they are almost never applied in practice because poultry is usually sent to the state as a finished product, such as chicken parts or chickens nuggets.

Batching Restrictions Are of Minimal Concern to Processors

Of the 17 multistate processors with whom we spoke, most said that batching restrictions were not a concern.⁵ For example, some processors stated that their operations were too small to process more than one order at a time or that they preferred keeping each production run segregated for accounting and inventory purposes. Therefore, they would not combine orders from multiple sources even if they were allowed to do so. Eight processors told us that batching restrictions, if not waived, would

⁵Two of the 19 processors did not respond to our requests for information.

affect the costs and yields of their operations; but most said that the effect would be minimal. Batching restrictions require the production line to be stopped and started. The cost effect occurs because wages are paid during the downtime. Yield is affected by increased rework. Rework is wholesome, salvageable product generated during a production run that is not acceptable as the specified product. A product such as broken patties or nuggets or a product with other defects such as missing breading or ridges would be classified as a rework product. The rework product, or 100 percent of its value, must be returned to the schools.

Batching restrictions usually have had no impact on poultry processing because of the nature of the poultry industry. Poultry production and processing often occur under a single owner who controls the poultry from breeding through the finished product. USDA officials stated that state agencies and schools usually order the finished poultry product, thereby eliminating any concerns about batching.

Because the impact on multistate processors has been minimal, batching restrictions have had no measurable effect on costs and yields to the schools. According to most of those processors who told us that they do incur some additional costs associated with batching restrictions, they do not pass these costs directly on to the schools. In terms of yields, schools are not affected because their contracts guarantee them a specific yield. We did not independently verify that additional costs related to batching restrictions were incurred or that any such costs that were incurred were either absorbed by the processor or passed along in a contract bid price for processing donated meat.

The state agencies' contractual batching restrictions have no effect on the federal government. The federal government owns the meat and poultry from its initial purchase through initial processing and delivery to a state, school, or multistate processor. At the time that batching restrictions come into play, the federal government has already relinquished ownership.

Mechanisms Are in Place to Monitor Contract Restrictions

Rather than establish internal controls to ensure compliance with their batching restrictions, state agencies rely on three external mechanisms: (1) on-site AMS graders, (2) contractually required audits by certified public accounting firms, and (3) periodic reviews by USDA's Inspector General.

FCS requires an AMS grader to generally oversee all donated meat and poultry processing. This oversight is intended to guarantee that the end products are produced using only federally donated meat or poultry, and, if applicable, that the products meet certain contractual specifications, such as batching restrictions. AMS' guidelines on how graders are to do their jobs also state that graders must certify that meat and poultry items comply with certain contract terms.

In addition, FCS requires that processors be audited periodically by a certified public accounting firm, and this requirement is also a standard clause in all state agencies' contracts to ensure that contract specifications have been met.

Finally, USDA's Office of Inspector General conducts periodic audits that address processors' compliance with the prescribed procedures and controls governing the processing of donated commodities. In the last 5 years, the Office has conducted three such reviews. Our review of these reports and a discussion with a cognizant official in USDA's Office of Inspector General did not identify any direct violations of batching restrictions.

Agency Comments

We provided copies of a draft of this report to USDA for its review and comment. We met with the Director of FCS' Food Distribution Division and other cognizant agency officials. These officials agreed with the information contained in the draft report and provided some clarifying comments that we incorporated into the report. In addition, the Director of AMS' Compliance Division provided clarifying comments that we incorporated into the report as appropriate.

Scope and Methodology

To determine the extent of batching restrictions for the 1995-96 school year, we asked officials in FCS' headquarters to list all multistate processors who handle federally donated meat and poultry. In addition, we shared this list with officials of the American Commodity Distribution Association to identify any needed additions or deletions. We then asked the multistate processors on the list to identify which of their state agency contracts had batching restrictions. Finally, through officials in FCS' seven regions, we obtained a copy of article 35 (special provisions section) from each of these contracts.

To determine the reasons for imposing restrictions on batching, we spoke with officials in FCS' seven regions, which cover the 54 state agencies. We also spoke with state agency officials in 16 states that backhaul fine-ground beef for further processing.

To assess the impact of batching restrictions on processors, we spoke with 17 of the 19 multistate commercial processors, visited a multistate commercial processor and observed its operations, and met with officials from the American Commodity Distribution Association. We did not independently verify the information these officials provided.

To identify the mechanisms that state agencies and schools use to ensure adherence to batching restrictions, we spoke with AMS and FCS officials and reviewed their monitoring guidelines and requirements. We also reviewed reports by USDA's Office of Inspector General on multistate commercial processors of federally donated meat and poultry.

We conducted our review from April 1996 through August 1996 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of Agriculture and other interested parties. Copies will also be made available upon request.

If you or your staff have any questions about this report, I can be reached at (202) 512-5138. Major contributors to this report are listed in appendix II.

A handwritten signature in black ink, appearing to read "Robert A. Robinson". The signature is fluid and cursive, with the first name "Robert" being the most prominent.

Robert A. Robinson
Director, Food and
Agriculture Issues

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House of Representatives

Restrictions on Batching Donated Meat and Poultry

Contract provisions on batching donated meat and poultry											
State or other entity	No restrictions	Batching allowed; over certain age, waiver from states and/or schools needed					Batching allowed under certain conditions			No batching with backhauled product ^{b/} no waiver	
		Beef—12 mos.	Pork—12 mos.	Beef—9 mos.	Pork—9 mos.	Beef/pork—6 mos.	Diverted with diverted ^a	Within same state	With approval		
Alabama							X	X		X	
Alaska	X										
Arizona	X										
Arkansas	X										
California								X			
Colorado				X		X					
Connecticut				X		X					
Delaware	X										
D.C.	X										
Florida										X	
Georgia										X	
Guam ^c											
Hawaii ^c											
Idaho	X										
Illinois	X										
Indiana								X			
Iowa				X		X					
Kansas ^c											
Kentucky								X		X	
Louisiana	X										
Maine ^c											
Maryland				X		X	X				
Massachusetts				X		X					
Michigan	X										
Minnesota							X	X		X	
Mississippi ^c											
Missouri	X										
Montana						X					
Nebraska						X			X		
Nevada				X		X	X				
New Hampshire	X										
New Jersey				X		X					

(continued)

Appendix I
Restrictions on Batching Donated Meat and Poultry

State or other entity	Contract provisions on batching donated meat and poultry									
	No restrictions	Batching allowed; over certain age, waiver from states and/or schools needed					Batching allowed under certain conditions			No batching with backhauled product ^b / no waiver
		Beef—12 mos.	Pork—12 mos.	Beef—9 mos.	Pork—9 mos.	Beef/pork—6 mos.	Diverted with diverted ^a	Within same state	With approval	
New Mexico									X	
New York				X	X					
N. Carolina								X		X
N. Dakota	X									
Ohio								X		X
Oklahoma	X									
Oregon	X									
Pennsylvania									X	
Puerto Rico	X									
Rhode Island ^c										
S. Carolina								X		X
S. Dakota	X									
Tennessee								X		X
Texas	X									
U.S. Virgin Islands ^c										
Utah							X			X
Vermont ^c										
Virginia		X	X							
Washington		X				X				
W. Virginia				X	X					
Wisconsin		X				X				
Wyoming	X									
Total	18	3	1	9	11	2	5	9	3	10

^aDirect diversion refers to one of the options states have for receiving federally donated meat. Under this option, state agencies can order from the Food and Consumer Service raw products that need more processing, such as coarse-ground beef and whole turkeys. In this case, the Agriculture Marketing Service buys the meat or poultry and arranges to ship it directly to a processor. The schools then pay for the additional processing and shipping to the state and/or its schools.

^bBackhauling refers to a shipping process that schools use to have their fine-ground beef in bulk reprocessed into other products after it has been stored for some time.

^cDoes not have a contract with a multistate processor.

Major Contributors to This Report

Juliann M. Gerken, Assistant Director
John M. Nicholson, Jr.
Patrick J. Kalk
Kathy R. Alexander
Carol Herrnsstadt Shulman

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