

Subpart C—Processing and Labeling of Donated Foods

§ 250.30 State processing of donated foods.

(a) *General.* This section sets forth the terms and conditions under which distributing agencies, subdistributing agencies, or recipient agencies may enter into contracts for the processing of donated foods and prescribes the minimum requirements to be included in such contracts.

(b) *Permissible contractual arrangements.* (1) A distributing agency, subdistributing agency, or recipient agency may contract for processing, pay the processing fee, and deliver the end products to eligible recipient agencies through its own distribution system. Distributing agencies shall assure that the acceptability of processed end products is tested with recipient agencies eligible to receive them prior to entering into a processing contract and shall develop a system for monitoring product acceptability. Distributing agencies may exempt end products from testing if they have been used previously, have been determined by the distributing agency to be acceptable by recipient agencies, and have had no changes in specifications.

(2) A distributing agency or subdistributing agency may contract for processing on behalf of one or more recipient agencies. All recipient agencies eligible to receive the donated foods to be processed may receive end products made from those foods and produced under such processing contracts by virtue of the distributing agency—recipient agency agreement required by § 250.12(b). Under this arrangement and subject to the approval of the distributing agency:

(i) Processors shall utilize either a discount or a refund system as defined in § 250.3 when they sell end products directly to recipient agencies, or

(ii) When selling end products through a distributor, such sales shall be in accordance with paragraph (e) of this section.

(3) Distributing agencies shall permit subdistributing agencies and recipient agencies to enter into processing contracts with a processor under arrange-

ments similar to those described in paragraph (b) (1) or (2) of this section.

(c) *Requirements for processing contracts.* (1) Contracts with processors shall be in a standard written form and shall be reviewed by the appropriate FNSRO. Processing contracts shall terminate on June 30 of each year. However, processing contracts may give contracting agencies the option of extending contracts for two 1-year periods, provided that any changed information must be updated before any contract extension is granted, including the information in paragraphs (c)(3), (c)(4)(ii), and (c)(4)(viii)(B) of this section. 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 contract extension occurs, and submitted its certified public accountant report as required under paragraph (c)(4)(xi) of this section before the contract may be extended. Distributing agencies shall develop criteria for use in evaluating and selecting processing contracts. The selection criteria shall be used in selecting or rejecting processors in a manner that ensures equitable treatment of processors. The selection criteria shall, at a minimum, include:

(i) The nutritional contribution which the end product will provide;

(ii) The marketability of the end product;

(iii) The distribution method which the processor intends to utilize;

(iv) Price and yield schedule data;

(v) Any applicable labeling requirements; and

(vi) The ability of the processor to meet the terms and conditions set forth in the regulations.

These criteria will be reviewed by the appropriate FNSRO during the management evaluation review of the distributing agency. Distributing agencies and subdistributing agencies which enter into contracts on behalf of recipient agencies but which do not limit the types of end products which can be sold or the number of processors which can sell end products within the State are not required to follow the selection criteria. In addition to utilizing these selection criteria, when a contracting

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agency enters into a contract both for the processing of donated food and the purchase of the end products produced from the donated food, the procurement standards set forth in Attachment O to OMB Circular A-102 must be followed. Recipient agencies which purchase end products produced under Statewide agreements are also required to comply with Attachment O of OMB Circular A-102. Contracting agencies shall not enter contracts with processors which cannot demonstrate the ability to meet the terms and conditions of the regulations and the distributing agency agreements; furnish prior to the delivery of any donated foods for processing, a performance bond, an irrevocable letter of credit or an escrow account in an amount sufficient to protect the contract value of donated food on hand and on order; demonstrate the ability to distribute end products to eligible recipient agencies; provide a satisfactory record of integrity, business ethics and performance and provide adequate storage.

(2) Standard form contracts shall be prepared or reviewed by the appropriate State legal staff to assure conformity with the requirements of these regulations and of applicable Federal, State and local laws.

(3) The contract shall be signed for the processor by the owner, a partner, or a corporate officer duly authorized to sign the contract, as follows:

(i) In a sole proprietorship, the owner shall sign the contract;

(ii) In a partnership, a partner shall sign the contract;

(iii) In a corporation, a duly authorized corporate officer shall sign the contract.

(4) At a minimum, each processing contract shall include:

(i) The names and telephone numbers of the contracting agency and processor;

(ii) A description of each end product, the quantity of each donated food and the identification of any other ingredient which is needed to yield a specific number of units of each end product (except that the contracting agency may permit the processor 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 flavorings or seasonings), the total weight of all ingredients in the batch formula, the yield factor for each donated food, and any pricing information provided by the processor in addition to that required in paragraph (c)(4)(iii) of this section as requested by the contracting agency and a thorough explanation of what this additional pricing information represents. The yield factor is the percentage of the donated food which must be returned in the end product to be distributed to eligible recipient agencies. For substitutable donated foods, at least 100 percent of the donated food provided to the processor must be physically contained in the end products with no allowable tolerance;

(iii) The contract value of each donated food to be processed and, where processing is to be performed only on a fee-for-service basis as defined in § 250.3, the fee-for-service;

(iv) A provision for:

(A) Termination of the contract upon thirty days written notice by the contracting agency or the processor and

(B) Immediate termination of the contract when there has been non-compliance with its terms and conditions by the contracting agency or the processor;

(v) In the event of contract termination, a provision for disposition of donated foods and end products in the processor's inventories or payment of funds in accordance with paragraph (j) of this section;

(vi) A provision for inspection and certification during processing, where applicable, by the appropriate acceptance service in accordance with paragraphs (g) and (h) of this section;

(vii) A provision that end products containing donated foods that are not substitutable under paragraph (f) of this section shall be delivered only to eligible recipient agencies and that end products containing both substitutable and non-substitutable donated foods may be delivered and sold in accordance with the requirements of paragraph (d) and (e) of this section;

(viii) Provisions that the processor shall:

(A) Fully account for all donated foods delivered into its possession by

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production and delivery to the contracting agency or eligible recipient agencies of an appropriate number of units of end products meeting the contract specifications, and where end products are sold through a distributor, that the processor remains full accountable for the donated foods until refunds or any other credits equal to their contracted value have been made to eligible recipient agencies in accordance with paragraph (k) of this section or to distributing agencies in accordance with paragraph (n)(2) of this section;

(B) Furnish to the contracting agency prior to the delivery of any donated foods for processing documentation that a performance supply and surety bond from a surety company listed in the most recent U.S. Department of Treasury Circular 570, an irrevocable letter of credit or an escrow account has been obtained in an amount that is sufficient to protect the contract value of all donated foods. Since the distributing agency is held liable by FNS for any donated foods provided to a processor the distributing agency shall determine the dollar value of the performance supply and surety bond, irrevocable letter of credit or the escrow account taking into consideration the

- (1) Value of donated foods on hand;
- (2) Value of donated foods on order and
- (3) Anticipated usage rate during the contract period;

(C) Use or dispose of the containers in which donated foods are received from the Department in accordance with the instructions of the contracting agency;

(D) Apply as credit against the processing fee or return to the contracting agency and identify:

- (1) Any funds received from the sale of containers, and
- (2) The market value or the price received from the sale of any by-products of donated foods or commercial foods which have been substituted for donated foods;

(E) Substitute donated foods with commercially purchased foods only in accordance with paragraph (f) of this section;

(F) Meet the requirements of paragraph (i) of this section for labeling end products;

(G) Maintain accurate and complete records pertaining to the receipt, disposal, and inventory of donated foods in accordance with §250.16;

(H) Submit processing performance reports in accordance with paragraph (m) of this section; and

(I) Submit annual reconciliation reports and make payments to distributing agencies for any inventory remaining at the termination of the contract in accordance with paragraph (n)(3) of this section.

(ix) A provision that approval of the contract by distributing agency shall not obligate that agency or the Department to deliver donated foods for processing;

(x) A description of the processor's quality control system and assurance that an effective quality control system will be maintained for the duration of the contract;

(xi) In instances when the processor is a multi-State processor as defined in §250.3, a provision that the processor agrees to obtain an independent audit by a certified public accountant in accordance with §250.18(b);

(xii) A requirement that inventory drawdowns shall be limited to the actual amount of donated foods contained in the end product. Additional commodity required to account for production loss shall be obtained from non-donated foods;

(xiii) A provision that the fee-for-service or value pass-through system to be used for the sale of end products to recipient agencies shall be described and be consistent with paragraphs (d) and (e) of this section.

(xiv) In instances when the distributing agency has delegated the responsibility for sales verification for end products provided by a distributor to recipient agencies at a discount, assurance that the processor will submit sales verification data to the distributing agency in accordance with §250.30(m)(1); and

(xv) A provision that the contracting agency shall give the processor a list of all recipient agencies eligible to purchase end products under the contract and provide updates for any changes

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which occur during the contract period.

(xvi) A provision that the processor shall not assign the processing contract or delegate any aspect of processing under a subcontract or other arrangement without the written consent of the contracting agency and the distributing agency.

(xvii) A provision that the processor shall provide pricing information summaries and updated pricing information summaries as required in paragraphs (d)(3) and (e)(2) of this section.

(xviii) A provision that the processor shall maintain documentation which demonstrates that the level of the processor's commercial production has not been reduced, as required in paragraph (f)(1)(iii) of this section.

(d) *End products sold by processors.* (1) When recipient agencies pay the processor for end products, such sales shall be under:

(i) A refund system as defined in §250.3 and in accordance with paragraph (k) of this section; or

(ii) A discount system which provides the price of each unit of end product purchased by eligible recipient agencies to be discounted by the stated contract value of the donated foods contained therein; or

(iii) An alternative value pass-through system under which the value of the donated food contained in each unit of end product shall be passed to the recipient agency and which has been approved by FNS at the request of the distributing agency. Any alternative value pass-through system approved under this paragraph must comply with the sales verification requirements specified in §250.19(b) of this part, or an alternative verification system approved by FNS. The Department retains the authority to inspect and review all pertinent records including records pertaining to the verification of a statistically valid sample of sales. FNS may consider the paperwork and resource burden associated with alternative value pass-through systems when considering approval and reserves the right to deny the approval of systems which are labor-intensive and provide no greater accountability than those systems permitted under paragraphs (d) and (e) of this section.

(2) When a processor delivers end products produced under a fee-for-service contract, the processor shall separately identify on the bill for the recipient agency the agreed-upon fee-for-service and any delivery costs.

(3) Processors shall provide pricing information summaries to contracting agencies and contracting agencies shall provide this information to recipient agencies as soon as possible after contract approval. If this pricing information changes during the contract period, processors shall provide updated pricing information to the contracting agency 30 days prior to the effective date of the change, which, in turn, shall provide this updated information to eligible recipient agencies.

(e) *End products sold by distributors.*

(1) When a processor transfers end products to a distributor for delivery and sale to recipient agencies, such sales shall be under:

(i) A refund system as defined in §250.3 and in accordance with paragraph (k) of this section; or

(ii) A hybrid system which provides a refund for the contract value of the donated food shall be provided to the distributor in accordance with paragraph (k) of this section and the price of each unit of end product purchased by eligible recipient agencies through a distributor shall be discounted by the contract value of the donated foods contained therein; or

(iii) An alternative value pass-through system under which the contract value of the donated food contained in each unit of end product shall be passed on to the recipient agency and which has been approved by FNS in accordance with paragraph (d)(1)(iii) of this section; or

(iv) When a processor arranges for delivery of processed end products produced under fee-for-service contracts by distributors, the products shall be delivered and invoiced using one of the following procedures:

(A) The recipient agency is billed by the processor for the fee-for-service and the distributor bills the recipient agency for the storage and delivery of the end products; or

(B) The processor arranges for the delivery of end products through a distributor on behalf of the recipient

agency. In this system, the processor's invoice must include both the fee-for-service and the distributor's charges as separate, clearly identifiable charges.

(2) Processors shall provide pricing information summaries to contracting agencies and contracting agencies shall provide this information to recipient agencies as soon as possible after contract approval. If this pricing information changes during the contract period, the processor shall provide updated pricing information to the contracting agency, which, in turn, shall provide this information to the eligible recipient agencies.

(f) *Substitution of donated foods with commercial foods.*

(i) All components of commercial foods substituted for any donated food must be of U.S. origin and identical or superior in every particular of the donated food specification. Records must be maintained to allow independent verification that the substituted food meets the above condition.

(ii) Poultry shall be eligible for limited substitution. Any processors that wish to substitute poultry must have a plan approved by both FNS and AMS. Only bulk pack chicken, chicken parts, and bulk pack turkey delivered by USDA vendors to the processor are eligible for substitution. No backhauled poultry product may be substituted. (Backhauled product is typically cut-up frozen poultry parts delivered to schools that may be turned over to processors for further processing at a later time.) Should a processor want to amend its approved plan, it shall submit any amendments to USDA for approval prior to implementing such amendments.

(A) Substitution of commercial poultry may occur in advance of the actual receipt of the donated poultry by the processor. Should a processor choose to use the substitution option prior to the commodity being purchased by the USDA, the processor shall assume all risks. Any donated poultry not used in end products because of substitution shall only be used by the processor at one of its facilities in other commercially processed products and cannot be sold as an intact unit. However, in lieu of processing the donated poultry, the processor may use the commodity

product to fulfill other USDA contracts awarded for delivery to another processor provided all terms of the other contract are met. Any variation between the amount of commercial poultry substituted and the amount of donated poultry received by the processor shall be adjusted according to guidelines furnished by USDA.

(B) The substitution plan shall contain a step-by-step description of how production will be monitored; a complete description of the records that will be maintained for the commercial poultry substituted for the donated poultry and the disposition of the donated poultry delivered; and how the substitution will be tracked for the purpose of monthly reporting to the State distributing agencies. Poultry substitution shall not be subject to the 100-percent yield requirement; however, the AMS Grading Service must verify processing yields. Should a processor choose to have all production of a specific end product, identified by name and product code, produced under AMS grading, then the label "Contains Commodities Donated by the United States Department of Agriculture. This Product Shall Only Be Sold to Eligible Recipient Agencies" shall not be required. Finished poultry end products that have not been produced under AMS grading supervision may not be substituted for finished commodity end products.

(iii) Processors shall maintain documentation that they have not reduced their level of commercial production because of participation in the State processing program.

(2) Documentation must be maintained by both parties in accordance with §250.16. Where commercial food is authorized to be substituted for any donated, the processor shall maintain records to substantiate that it continues to acquire on the commercial market sufficient purchases of substitutable food for commercial production and any amounts necessary to meet the 100 percent yield requirement. When there is substitution, the donated foods shall be used by the processor and shall not otherwise be sold or disposed of in bulk form. The applicable Federal acceptance service shall, upon request by the Department, the

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contracting agency or the distributing agency determine if the quality analysis meets the requirements set forth in the original USDA procurement specification and, in the case of concentrated skim milk replacing donated nonfat dry milk, determine if the concentrated skim milk contains the amount of milk solids as specified in the contract. When donated foods are nonsubstitutable, the applicable Federal acceptance service shall ensure against unauthorized substitutions, and verify that quantities of donated foods used are as specified in the contract.

(3) When concentrated skim milk is used to replace donated nonfat dry milk, the contract shall also specify (in addition to the requirements in paragraph (c) of this section):

(i) The percent of milk solids that, at a minimum, must be contained in the concentrated skim milk;

(ii) The weight ratio of concentrated skim milk to donated nonfat dry milk;

(A) The weight ratio is the weight of concentrated skim milk which equals one pound of donated nonfat dry milk, based on milk solids;

(B) In calculating this weight, nonfat dry milk shall be considered as containing 96.5 percent milk solids;

(C) If more than one concentration of concentrated skim milk is to be used, a separate weight ratio must be specified for each concentration;

(iii) The processor's method of verifying that the milk solids content of the concentrated skim milk is as stated in the contract;

(iv) A requirement that inventory drawdowns of donated nonfat dry milk shall be limited to an amount equal to the amount of concentrated skim milk, based on the weight ratio, used to produce the end product;

(v) A requirement that the contract value of donated food for a given amount of concentrated skim milk used to produce an end product is the value of the equivalent amount of nonfat dry milk, based on the weight ratio of the two foods;

(vi) A requirement that the concentrated skim milk shall be produced in a USDA approved plant or in a plant approved by the appropriate regulatory

authority for the processing of Grade A milk products; and

(vii) A requirement that documentation sufficient to substantiate compliance with the contract provisions shall be maintained in accordance with § 250.16(a)(4).

(4) Title to the substituted food shall transfer to the contracting agency upon the initiation of the processing of the end product containing the substituted food. Title to the equivalent amount of donated food shall transfer to the processor at the same time (except when the substitution is necessary to meet the 100 percent yield requirement or to otherwise replace missing or out-of-condition donated food). As with the processing of donated poultry into end products, AMS graders must monitor the processing of any substituted commercial poultry to ensure that program integrity is maintained. Once title has transferred, the processor shall use the substituted food in accordance with the terms and conditions of this part.

(g) *Meat and poultry inspection programs.* When donated meat or poultry products are processed or when any commercial meat or poultry products are incorporated into an end product containing one or more donated foods, all of the processing shall be performed in plants under continuous Federal meat or poultry inspection, or continuous State meat or poultry inspection in States certified to have programs at least equal to the Federal inspection programs. In addition to FSIS inspection, all donated meat and poultry processing shall be performed under AMS acceptance service grading. The cost of this service shall be borne by the processor. In the event the processor can demonstrate that grading is impractical, exemptions in the use of acceptance services shall be approved by the distributing agency prior to processing each order. Exemptions in the use of acceptance service graders will be authorized on the basis of each order to be processed provided the processor can demonstrate:

(1) That even with ample notification time, the processor cannot secure the services of a grader,

(2) That the cost for a grader would be unduly excessive relative to the

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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

(3) The documented urgency of the recipient agency's need for the end product precludes the use of acceptance services.

Prior to approving a processor's request to waive the acceptance service requirement the distributing agency shall 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 requirement.

(h) *Certification by acceptance service.*

(1) All processing activities of donated foods shall be subject to review and audit by the Department, including the applicable Federal acceptance service. The contracting agency may also require acceptance and certification by such acceptance service in addition to the requirements set forth in paragraph (g) of this section.

(2) In the case of substitutable donated foods, in deciding whether to require acceptance and certification, the contracting agency should consider the dollar value of the donated foods delivered to the processor.

(3) When contracting agencies require certification in accordance with paragraph (h) (1) or (2) of this section, the degree of acceptance and certification necessary under the processing contract shall be determined by the appropriate Federal acceptance service after consultation with the distributing agency concerning the type and volume of the donated foods and anticipated value of end products to be processed. The cost of this service shall also be borne by the processor.

(i) *Labeling end products.* (1) Except when end products contain donated foods that are substituted under paragraph (f) of this section, the exterior shipping containers of end products and, where practicable, the individual wrappings or containers of end products, shall be clearly labeled "Contains Commodities Donated by the United States Department of Agriculture. This Product Shall Be Sold Only to Eligible Recipient Agencies."

(2) Labels on all end products shall meet applicable Federal labeling requirements.

(3) When a processor makes any claim with regard to an end product's contribution toward meal requirements of any child nutrition program, the processor shall follow procedures established by FNS, the Food Safety and Inspection Service of the Department, the National Marine Fisheries Service of the U.S. Department of Commerce or other applicable Federal agencies for approval of such labels.

(j) *Termination of processing contracts.*

(1) When contracts are terminated or completed and the processor has commodities remaining in inventory, the processor shall be directed, at the option of the distributing agency and the FNSRO, to do the following:

(i) With respect to nonsubstitutable commodities, the processor shall:

(A) Return the commodities to the contracting agency;

(B) Pay the contracting agency for the commodities based on the Department's replacement costs, determined by using the most recent data provided by the Department; or

(C) Pay the contracting agency for the commodities based on the contract value stated in the processor's contract;

(D) Pay the contracting agency the CCC unrestricted sales price;

(ii) With respect to substitutable commodities, the processor shall:

(A) With the concurrence of any affected contracting agencies, transfer the donated foods to the accounts of other contracting agencies with which the processor has contracts;

(B) Return the foods donated to the contracting agency;

(C) Replace the commodities with the same foods of equal or better quality as certified in accordance with paragraph (f)(2) of this section and deliver such foods to the contracting agency;

(D) Pay the contracting agency for the commodities based on the Department's replacement costs, determined by using the most recent data provided by the Department; or

(E) Pay the contracting agency for the commodities based on the contract value stated in the processor's contract.

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(F) Pay the contracting agency the CCC unrestricted sales price.

(2) When a processor's contract is terminated at the processor's request or due to noncompliance or negligence on the part of the processor and commodities remaining in the processor's inventory are transported pursuant to paragraph (j)(1)(i)(A), (j)(1)(ii)(B) or (j)(1)(ii)(C) of this section, the processor shall pay the transportation costs.

(3) Funds received by distributing agencies upon termination of contracts shall be used in accordance with FNS Instruction 410-1, Non-Audit Claims, Food Distribution Program.

(k) *Refund payments.* (1) When end products are sold to recipient agencies in accordance with the refund provisions of paragraph (d) or (e) of this section, each recipient agency shall submit refund applications to the processor within 30 days from the close of the month in which the sales were made, except that recipient agencies may submit refund applications to a single processor on a Federal fiscal quarterly basis if the total anticipated refund due for all purchases of product from that processor during the quarter is 25 dollars or less.

(2) In instances when refunds are to be provided to distributors which have sold end products to recipient agencies at a discount, distributors shall submit refund applications to processors within 30 days from the close of the month in which the sales were made of the date of sale to recipient agencies in order to receive benefits.

(3) Not later than 30 days after receipt of the application by the processor, the processor shall make a payment to the recipient agency or distributor equal to the stated contract value of the donated foods contained in the purchased end products covered by the refund application, except that processors may group together refund applications for a single recipient agency on a Federal fiscal quarterly basis if the total anticipated refund due that recipient agency during the quarter is 25 dollars or less. Copies of requests for refunds and payments to recipient agencies and/or distributors shall be forwarded to the appropriate distributing agency by the processor.

(1) *Contract approvals.* Distributing agencies shall review and approve processing contracts entered into or renewed by subdistributing and recipient agencies prior to the delivery of commodities for processing under such contracts. The distributing agency which enters into or approves a processing contract shall provide a copy of the contract and of these regulations to the processors, forward a copy of the contract to the appropriate FNSRO, and retain a copy for its files.

(m) *Performance reports.* (1) Processors shall be required to submit to distributing agencies monthly reports of performance under each processing contract with year-to-date totals. Processors contracting with agencies other than a distributing agency shall submit such reports to the distributing agency having authority over that particular contracting agency. Performance reports shall be postmarked no later than the final day of the month following the reporting period; however, the final performance report for the contract period shall be postmarked no later than 60 postmarked days from the close of the contract year. The report shall include:

(i) A list of all recipient agencies purchasing end products under the contract;

(ii) Donated-food inventory at the beginning of the reporting period;

(iii) Amount of donated foods received during the reporting period;

(iv) Amount of donated foods transferred to and/or from existing inventory;

(v) Number of units approved end products delivered to each eligible recipient agency during the reporting period and the number of pounds of each donated food represented by these delivered end products;

(vi) Donated food inventory at the end of the reporting period;

(vii) [Reserved]

(viii) In instances in which sales verification has been delegated to the processor pursuant to §250.19(b)(2), sales verification findings shall be reported as an attachment to the December and June performance reports in whatever format the State distributing agency deems necessary.

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(ix) 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 State processing contracts 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.

(2) In addition to reporting the information identified in paragraph (m)(1) of this section, processors which substitute concentrated skim milk for donated nonfat dry milk shall also report the following information for the reporting period:

(i) The number of pounds of nonfat dry milk used in commercial products sold to outlets which are not recipient agencies; and

(ii) The number of pounds of concentrated skim milk, and the percent of milk solids contained therein, used in end products sold to recipient agencies.

(3) Distributing agencies shall review and analyze reports submitted by processors to ensure that performance under each contract is in accordance with the provisions set forth in this section.

(n) *Inventory controls.* (1) Distributing agencies shall monitor processor inventories to ensure that the quantity of donated foods for which a processor is accountable is the lowest cost-efficient level but in no event more than a six-month supply based on the processor's average monthly usage, unless a higher level has been specifically approved by the distributing agency on the basis of a written justification submitted by the processor. Under no circumstances should the amount of donated foods ordered by the contracting agency for processing purposes be in excess of anticipated usage or beyond the processor's ability to accept and store the donated foods at any one time. Distributing agencies shall make no further distribution to processors whose inventories exceed these limits until such inventories have been reduced.

(2) For processors substituting concentrated skim milk for donated nonfat dry milk, distributing agencies shall review the processors' monthly performance reports to ensure that:

(i) Donated nonfat dry milk inventory is being drawn down based on the amount of milk solids contained in the concentrated skim milk which was used in end products sold to eligible recipient agencies;

(ii) An amount of milk solids equivalent to the amount in the donated nonfat dry milk is contained in end products sold to eligible recipient agencies; and

(iii) Donated nonfat dry milk is not being sold in bulk form.

(3) The last monthly performance report for the contract period, as required in paragraph (m)(1) of this section, shall serve as the annual reconciliation report. As a part of the annual reconciliation, a processor which has entered into a contract with the contracting agency for the next year shall pay the distributing agency, at the contract value, for any donated food inventory held which is in excess of the inventory level which has been approved by the State distributing agency. A processor whose contract has been completed or terminated shall return or pay for commodities as required by subsection (j).

(4) Distributing agencies shall certify the accuracy of the annual reconciliation report and forward it to the FNS Regional Office. Such report shall be postmarked no later than 90 days following the close of the contract year. All monies shall be used in accordance with FNS Instruction 410-1, Non-Audit Claims, Food Distribution Program.

(5) Distributing agencies shall not submit food requisitions for processors reporting no sales activity during the prior year's contract period unless documentation is submitted by the processor which outlines specific plans for product promotion or sales expansion.

(o) *Processing inventory reports.* (1) Distributing agencies shall forward to the FNS Regional Office the inventory summary portion of the monthly performance report submitted by the processors in accordance with paragraph (m)(1) of this section for the last month of each Federal fiscal quarter. Such reports shall be postmarked no later than 60 days following the close of each Federal fiscal quarter, except that such reports shall be postmarked no later

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than 90 days following the close of the contract year.

(2) In addition to the reporting requirements in paragraph (o)(1) of this section, for each processor which substitutes concentrated skim milk for donated nonfat dry milk the distributing agency shall also report the following information for the reporting period:

(i) The number of pounds of nonfat dry milk used in commercial products sold to nonprogram outlets; and

(ii) The number of pounds of concentrated skim milk and the percent of milk solids contained therein used in end products sold to recipient agencies.

(p) *Cooperation with administering agencies for child nutrition programs.* If the distributing agency which enters into or approves contracts for end products to be used in a child nutrition program does not also administer such program, it shall collaborate with the administering agency by:

(1) Giving that agency an opportunity to review all such contracts to determine whether end products to be provided contribute to required nutritional standards for reimbursement under the applicable regulations for such program (7 CFR parts 210, 225, and 226) or are otherwise suitable for use in such program;

(2) Consulting with the agency with regard to the labeling requirements for the end products; and

(3) Otherwise requesting technical assistance as needed from that agency.

(q) *FNSRO review of contracts and inventory reports.* The FNSRO shall:

(1) Review all processing contracts and provide guidance, including written recommendations for termination, where necessary, to distributing agencies concerning any contracts which do not meet the requirements of this section;

(2) Allow distributing agencies 30 days to respond to any recommendation concerning contracts not meeting the requirements of this section;

(3) Review and analyze the processing inventory reports required by paragraph (o) of this section to ensure that no additional donated foods shall be distributed to processors with excess inventories until such inventories have been reduced;

(4) Assist distributing agencies in reducing such inventories; and

(5) Review annual reconciliation reports required by paragraph (n) of this section and ensure that payments for commodities have been made.

(r) *Availability of copies of processing contracts.* Contracts entered into in accordance with this Section are public records and FNS will provide copies of such contracts to any person upon request. The FNSRO will retain copies of processing contracts submitted by distributing agencies for a period of three years from the close of the Federal fiscal year to which they pertain.

(s) *Processing activity guidance.* Distributing agencies shall develop and provide a processing manual or similar procedural material for guidance to contracting agencies, recipient agencies, and processors. Distributing agencies must revise these materials as necessary to reflect policy and regulatory changes. This guidance material shall be provided to contracting agencies, recipient agencies and processors at the time of the approval of the initial agreement by the distributing agency, when there have been regulatory or policy changes which necessitate changes in the guidance materials, and upon request. The manual shall include, at a minimum, statements of the distributing agency's policies and procedures on (1) contract approval, (2) monitoring and review of processing activities, (3) recordkeeping and reporting requirements, (4) inventory controls, and (5) refund applications.

(t) *Waiver authority.* The Food and Nutrition Service may waive any of the requirements contained in this part for the purpose of conducting demonstration projects to test program changes designed to improve the State processing of donated foods.

(Approved by the Office of Management and Budget under control number 0584-0007)

[53 FR 20226, June 3, 1988, as amended at 53 FR 20598, June 6, 1988; 53 FR 27476, July 21, 1988; 53 FR 46080, Nov. 16, 1988; 54 FR 7525, Feb. 22, 1989; 54 FR 25564, June 16, 1989; 58 FR 39122, July 22, 1993; 59 FR 62984, Dec. 7, 1994; 61 FR 5272, Feb. 12, 1996; 67 FR 65015, Oct. 23, 2002]