



UNITED STATES GENERAL ACCOUNTING OFFICE
RELEASED WASHINGTON, D.C. 20548

126027

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

RESTRICTED - Not to be released outside the General Accounting Office without the approval of the Office of Congressional Relations.

JANUARY 7, 1985

B-211447

The Honorable Mary Rose Oakar
House of Representatives



126027

Dear Ms. Oakar:

Subject: Government-Owned Surplus Dairy Products Held
in Inventory (GAO/RCED-85-43)

In your November 11, 1983, request and in subsequent discussions with your office you asked us to update information contained in our report entitled Government-Owned Surplus Dairy Products Held in Inventory (GAO/RCED-84-72, Dec. 20, 1983). In that report, which was addressed to you and Representatives Dennis Eckart, Marcy Kaptur, and James L. Oberstar, we provided information on the (1) quantity and value of dairy commodities in inventory, (2) most perishable commodities and the length of time they can be stored without deterioration, (3) prices at which deteriorated surplus commodities are being resold, (4) extent of spoilage and deterioration of the commodities, (5) dollar value loss of the dairy surplus due to deterioration, and (6) general condition of the warehouses. This report updates the information provided in our December 20, 1983, report and provides additional information regarding the U.S. Department of Agriculture's (USDA's) dairy purchases and commodity inspections. We have also added pertinent information that relates to your interest regarding the shelf life of the inventory and the extent of product spoilage. (See enc. I.)

USDA's dairy inventory has decreased from about 3 billion pounds as of September 23, 1983, to about 2.6 billion pounds as of September 21, 1984. This decrease follows several years of an upward trend in the level of USDA-owned dairy products. USDA dispositions of dairy products through sales and food programs increased by about 8 percent during fiscal year 1984, while USDA dairy purchases decreased by about 31 percent. USDA officials attribute the decreasing purchases to a healthier economy and the changes in dairy policy enacted in the Dairy Production Stabilization Act of 1983 (Title I of Public Law 98-180).

Although the dairy inventory has decreased, USDA now has a larger quantity of older dairy products on hand. USDA records indicate that the amount of spoilage occurring in its dairy inventory is minimal, but the condition of the inventory is uncertain because USDA has not reinspected much of the stored commodities since they were purchased.

530945

(022904)

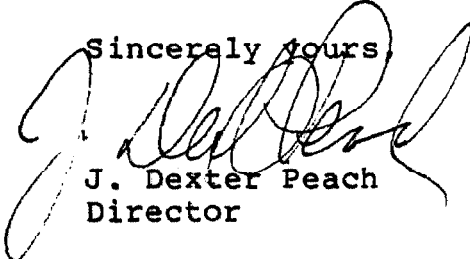
To follow up on our December 20, 1983, report, we interviewed USDA officials in Washington, D.C., and Kansas City, Missouri. We also reviewed pertinent USDA documents and files; however, we did not make a test check to verify inventory data. We are, however, test-checking data as part of an ongoing financial audit of USDA's Commodity Credit Corporation. Our objective, scope, and methodology are included in enclosure I. We conducted our review during the period June 1984 through September 1984, and except as noted above, the review was made in accordance with generally accepted government auditing standards.

USDA officials who provided oral comments on a draft of this report requested that our final report emphasize that the sales of nonfat dry milk for restricted use resulted from a USDA policy decision rather than the condition of the product. The officials provided us with a written statement of USDA's sales policy for dairy products (see enc. II). The USDA officials also provided us with updated information on the proportion of the dairy inventory that had been reinspected. We have revised our report to include USDA's requested changes.

- - - -

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from its issue date. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



J. Dexter Peach
Director

Enclosures-2

C o n t e n t s

	<u>Page</u>
ENCLOSURE	
I THE DEPARTMENT OF AGRICULTURE'S DAIRY COMMODITY INVENTORY	1
Objective, scope, and methodology	1
Questions and responses	1
What is the quantity and value of the dairy surplus inventory?	1
Which surplus commodities are most perishable, and what is the length of time they can be stored without deterioration?	2
At what prices are deteriorated surplus dairy products being resold, and what is the loss to the U.S. government?	4
How much of the dairy surplus is being lost due to rotting, age, or other deterioration?	6
What is the dollar value loss of the dairy surplus due to rotting, age, or other deterioration?	8
Are the food storage facilities USDA leases in good condition and properly maintained?	9
II LETTER DATED DECEMBER 5, 1984, FROM THE ADMINISTRATOR, AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE, DEPARTMENT OF AGRICULTURE	10
<u>ILLUSTRATIONS</u>	
Quantity and Value of Dairy Products in Storage	2
Dairy Product Age as of June 30, 1983, and June 30, 1984	2
Calendar Year 1983 Sales of Restricted Use Surplus Dairy Products	5
Sales of Restricted Use Surplus Dairy Products for the 6-month Period Ending June 30, 1984	6
Quantity of CCC Dairy Commodities That Has Been Reinspected Since Purchase as of June 30, 1984	7
Quantity of CCC Dairy Commodities That Has Been Reinspected Since Purchase as of December 4, 1984	8

ABBREVIATIONS

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
USDA	U.S. Department of Agriculture

THE DEPARTMENT OF AGRICULTURE'SDAIRY COMMODITY INVENTORY

USDA's dairy stocks acquired under its milk price-support program have declined somewhat since our December 20, 1983, report was issued. In that report, we stated that as of September 23, 1983, USDA's inventory of butter, cheese, and nonfat dry milk was about 3 billion pounds. As of September 21, 1984, this inventory had decreased to about 2.6 billion pounds.

USDA's Commodity Credit Corporation (CCC), which is a wholly owned government corporation, purchases the dairy products. CCC was created in 1933 to stabilize and protect farm prices as well as to help maintain adequate supplies and distribute agricultural commodities. CCC has no operating personnel; its programs are carried out primarily through the personnel and facilities of USDA's Agricultural Stabilization and Conservation Service (ASCS). ASCS' Kansas City, Missouri, Commodity Office is responsible for acquiring, handling, storing, and processing dairy commodities required to carry out CCC's program objectives.

OBJECTIVE, SCOPE, AND METHODOLOGY

As requested in Representative Oakar's November 11, 1983, letter and subsequent discussions with her office, our objective in this review was to follow up on our December 20, 1983, report.

To attain our objective, we reviewed applicable USDA documents, records, and policies regarding the status of the dairy inventory. We reviewed USDA commodity inspection standards and compared these standards to USDA's inspection records. We interviewed USDA program officials in Washington, D.C., and Kansas City, Missouri. In our 1983 report, we addressed the six specific questions listed below. We have updated our previous responses and have included new information pertaining to USDA's dairy purchases and commodity inspection efforts, the shelf life of the dairy inventory, and product spoilage.

QUESTIONS AND RESPONSES

1. What is the quantity and value of the dairy surplus inventory?

Both the quantity and value of USDA's dairy inventory decreased between September 1983 and September 1984. The butter inventory decreased by about 160 million pounds, the cheese inventory by about 110 million pounds, and the nonfat dry milk inventory by about 170 million pounds.

Quantity and Value of Dairy
Products in Storage

September 1983 Compared With September 1984

<u>Commodity</u>	<u>Pounds</u>		<u>Average price per pound</u>		<u>Dollar value</u>	
	<u>1983</u> ---(millions)---	<u>1984</u> -----	<u>1983</u>	<u>1984</u>	<u>1983</u> ----(millions)----	<u>1984</u> -----
Butter	524.3	362.9	\$1.50	\$1.50	\$ 786.5	\$ 544.4
Cheese	1,019.7	906.3	1.48	1.49	1,509.2	1,350.4
Nonfat dry milk	<u>1,524.7</u>	<u>1,356.5</u>	.93	.94	<u>1,418.0</u>	<u>1,275.1</u>
Total	<u>3,068.7</u>	<u>2,625.7</u>			<u>\$3,713.7</u>	<u>\$3,169.9</u>

The following table compares the age of the inventory as of June 30, 1983, and June 30, 1984. Although the total dairy inventory decreased, USDA had about 36 percent more cheese aged 1 year or older and about 24 percent more nonfat dry milk age 1 year or older. Quantities of butter decreased in all age categories.

Dairy Product Age as of
June 30, 1983, and June 30, 1984

<u>Age</u>	<u>Butter</u>		<u>Cheese</u>		<u>Nonfat dry milk</u>	
	<u>1983</u>	<u>1984</u>	<u>1983</u>	<u>1984</u>	<u>1983</u>	<u>1984</u>
	----- (thousands of lbs) -----					
1-6 mo	232,405	203,851	328,799	207,155	389,965	254,338
6 mo-1 yr	77,013	59,231	199,621	172,767	228,243	235,575
1-2 yr	156,034	123,337	261,369	360,366	488,953	362,619
2-3 yr	16,447	13,150	47,888	58,273	184,052	391,474
3-4 yr	5	1	2	2,715	17,575	98,334
4-5 yr	19	1	-	4	-	1,287
5-6 yr	31	1	-	-	-	-
Total	<u>481,954</u>	<u>399,572</u>	<u>837,679</u>	<u>801,280</u>	<u>1,308,788</u>	<u>1,343,627</u>

2. Which surplus commodities are most perishable, and what is the length of time they can be stored without deterioration?

During our review work for the 1983 report, USDA officials told us that they were uncertain as to when (age) dairy commodities begin to deteriorate. However, a USDA official pointed out that 2-1/2-year-old cheese and 3- to 4-year-old butter were still holding their quality. In an August 30, 1984, letter to the

Chairman, House Committee on Agriculture, the Deputy Secretary of Agriculture made a more definitive statement on the shelf life of dairy commodities. He said that

" . . . the shelf life of one-pound butter prints is about one year, while bulk butter can be stored for three to four years. Bulk cheese can be successfully stored for two to three years. After being stored for such periods, it can still be processed and stored successfully up to an additional two years."¹

According to ASCS dairy division officials, the information on dairy commodity shelf life contained in the letter is based primarily on USDA's experience in storing these commodities, rather than formal study. However, USDA's Agricultural Research Service conducted a study on the shelf life of processed cheese and concluded that, if properly stored, processed cheese will last up to 2 years.

The shelf life of nonfat dry milk is more indefinite. According to the Deputy Director, ASCS dairy division, USDA has stored nonfat dry milk for periods as long as 3 to 4 years and, with proper processing, still used the dry milk for human consumption. However, nonfat dry milk can absorb excessive moisture over time, and USDA has adopted a policy of selling some older, high-moisture nonfat dry milk for animal feed.

In our 1983 report, we stated that ASCS officials told us that dairy stocks were growing faster than they could be disposed of and if dairy inventories continued to increase over the next 2 years, deterioration could become a serious problem. At the time of our 1983 report, USDA's dairy inventory had been rapidly increasing for several years. USDA's fiscal year 1983 ending inventory was more than 4 times greater than its fiscal year 1979 ending inventory. During fiscal year 1984, this upward trend was reversed as USDA dispositions of dairy products through sales and food programs increased by about 8 percent and USDA dairy purchases decreased by about 31 percent.

ASCS dairy division officials said that both demand and supply factors have contributed to lower dairy surpluses and hence, lower USDA purchases. On the demand side, ASCS officials said that a healthier economy has allowed for higher commercial market dairy sales. On the supply side, ASCS officials cite a

¹The vast majority of the butter, cheese, and nonfat dry milk inventory is in bulk form rather than in consumer-ready form.

lower price support for milk and the milk diversion program as the reasons for curtailed production.²

3. At what prices are deteriorated surplus dairy products being resold, and what is the loss to the U.S. government?

The tables on pages 5 and 6 show the quantities of products USDA sold for restricted use during calendar years 1983 and 1984 through June 30, 1984.³ In commenting on a draft of this report, USDA officials asked us to emphasize that the nonfat dry milk sold for restricted use had a high-moisture content but was not deteriorated. The officials said that although the nonfat dry milk was sold on a restricted basis (i.e., for animal feed only), it was suitable for human consumption. The officials also said that the sales of nonfat dry milk resulted from a USDA policy decision rather than from the need to sell the products on a restricted basis because of its deteriorated condition. The officials agreed to provide us with a written statement of USDA's sales policy (see enc. II).

As of June 30, 1984, USDA had already sold more off-condition butter and cheese in calendar year 1984 than it had in the entire calendar year 1983. According to the Chief, Dairy Branch, ASCS' Kansas City Commodity Office, one reason for the increase in sales is that, as a result of lower USDA dairy purchases, the Dairy Branch has had more time to process sales of off-condition dairy products. The Dairy Branch Chief said that in 1983, USDA inventory contained off-condition butter and cheese but the staff did not have time to process sales of the products. Furthermore, according to the Dairy Branch Chief, feed costs and the milk diversion program have resulted in increases in the price of milk to cheese processors, and therefore, they are more willing to buy off-condition USDA cheese and reprocess it. As discussed in question 4 below, USDA's inventory may contain larger quantities of off-condition dairy products than its records indicate because much of the dairy inventory has not been reinspected since it was purchased.

²The Dairy Production Stabilization Act of 1983 (Title I of Public Law 98-180) lowered the support price for milk from \$13.10 to \$12.60 per hundred pounds and authorized a temporary (15 month) milk diversion program under which participating farmers are paid for reducing their milk marketings.

³USDA requires that dairy products sold for unrestricted use must be sold at a price approximating 110 percent of its purchase price, whereas products sold for restricted use can be sold at reduced prices.

Calendar Year 1983 Sales of
Restricted Use Surplus Dairy Products^a

Butter:		
Cost	\$	402,063
Sales receipts		<u>319,162</u>
Loss	\$	<u>82,901</u>
Quantity sold		268,042 lbs
Cheese:		
Cost	\$	2,309,768
Sales receipts		<u>1,455,426</u>
Loss	\$	<u>854,342</u>
Quantity sold		1,560,654 lbs ^b
Nonfat dry milk:		
Cost	\$	60,988,281
Sales receipts		<u>33,686,864</u>
Loss	\$	<u>27,301,417</u>
Quantity sold		64,881,150 lbs

^aIn the draft report provided for USDA comment, we used the term "deteriorated" rather than "restricted use" in this table's caption. Based on USDA's comment that the nonfat dry milk sold on a restricted basis had a high-moisture content but was not deteriorated (see p. 4), we revised the caption.

^bAccording to USDA officials, this figure includes about 1 million lbs of cheese, sold for unrestricted use, that was considered off-condition because of flavor problems.

Sales of Restricted Use Surplus Dairy Products
for the 6-month Period Ending June 30, 1984^a

Butter:	
Cost	\$ 487,400
Sales receipts	\$ <u>398,259</u>
Loss	\$ <u>89,141</u>
Quantity sold	324,933 lbs
Cheese:	
Cost	\$9,611,515
Sales receipts	<u>8,087,042</u>
Loss	<u>\$1,524,473</u>
Quantity sold	6,494,267 lbs ^b
Nonfat dry milk:	
Cost	\$38,006,666
Sales receipts	<u>20,437,668</u>
Loss	<u>\$17,568,998</u>
Quantity sold	40,432,624 lbs

^aSee note^a in previous table.

^bAccording to USDA officials, most of this cheese (about 6,250,000 lbs) was sold for unrestricted use, but was considered off-condition because of flavor problems.

4. How much of the dairy surplus is being lost due to rotting, age, or other deterioration?

Our 1983 report included an ASCS analysis of dairy inventory losses which indicated that during 1982, 0.092 percent of the dairy inventory was lost due to deterioration. We noted in that report that, as the inventory ages, losses due to deterioration could increase.

ASCS records for calendar years 1983 and 1984, through June 30, 1984, indicate that USDA dairy losses have risen slightly. In 1983 USDA dairy losses amounted to 0.072 percent of the inventory. Through June 30, 1984, ASCS records show dairy losses rose to 0.325 percent of the inventory due primarily to increased losses of cheese.

Although ASCS records indicate that dairy inventory losses have risen only slightly, the overall condition of the inventory

is uncertain because much of the dairy inventory has not been reinspected since it was purchased. USDA's Agricultural Marketing Service (AMS) inspects USDA commodities before USDA purchases them. Once purchased, ASCS standards provide that the products stored in inventory are to be reinspected at regular intervals as shown below.

	<u>First reinspection</u>	<u>Subsequent reinspections</u>
	----- (days) -----	
Butter:		
Bulk	180-210	180-210
One-Pound prints	120-150	120
Cheese:		
Barrel	60-90	60-90
Block	180-210	90-120
Processed	120-150	90-120
Nonfat dry milk	180-210	150-180

ASCS data on reinspections of dairy products stored in inventory shows that USDA reinspection efforts have fallen far behind reinspection frequency standards. According to ASCS data, even though all dairy commodities are to be reinspected at the intervals described above, much of the dairy inventory has not been reinspected at all since being inspected at purchase. The following table compares the quantity of dairy commodities in inventory with the quantity that has been reinspected since being purchased.

Quantity of CCC Dairy Commodities
That Has Been Reinspected Since Purchase
as of June 30, 1984

	<u>Quantity in store</u>	<u>Inspected</u>	<u>Percent</u>
	----- (pounds) -----		
Butter:			
Bulk	286,097,616	51,205,865	17.9
Print	113,477,234	422,532	0.4
Cheese:			
Barrel	551,190,090	39,226,885	7.1
Block	173,610,208	64,114,750	36.9
Processed	76,479,135	1,421,870	1.9
Nonfat dry milk	1,343,586,916	745,603,790	55.5

According to the Chief, AMS Dairy Grading and Standardization Branch, because of the inspection workload associated with the large dairy purchases of recent years and limited staff resources, AMS fell behind on reinspecting stored commodities, a function

which has a lower priority than other AMS inspection functions, such as inspecting products at time of purchase. The Chief said that AMS is beginning to catch up on reinspecting the stored inventory since dairy purchases have declined and AMS had hired additional inspectors. However, as the data above shows, as of June 30, 1984, much of the dairy inventory had not been reinspected since purchase.

In commenting on a draft of this report, USDA officials said that the proportion of dairy commodities that has been reinspected has increased substantially since June 30, 1984. Therefore, USDA provided us with the following updated information on the quantity of dairy commodities in inventory and the quantity that has been reinspected since being purchased.

Quantity of CCC Dairy Commodities
That Has Been Reinspected Since Purchase
as of December 4, 1984

	<u>Quantity</u> <u>in store</u>	<u>Inspected</u>	<u>Percent</u>
	----- (pounds) -----		
Butter:			
Bulk	228,487,183	55,758,553	24.4
Print	46,774,074	3,985,824	8.5
Cheese:			
Barrel	505,550,725	166,747,974	33.0
Block	106,568,865	68,677,176	64.4
Processed	13,239,501	11,400	0.1
Nonfat dry milk	1,095,131,265	724,837,240	66.2

In comparing the June and December data, it should be noted that the increased proportion of reinspected inventory results from both the decreased quantities in store and the increased quantities that have been reinspected.

Because only a portion of CCC's dairy inventory has been reinspected since purchase, ASCS records on deterioration of dairy commodities may not accurately represent the extent of deterioration. The condition of CCC's inventory cannot be determined until the inventory has been fully reinspected. If USDA is able to step up its inspection efforts, as the Chief, AMS Dairy Grading and Standardization Branch expects, more complete information on the condition of the inventory may be available in the future.

5. What is the dollar value loss of the dairy surplus due to rotting, age, or other deterioration?

ASCS records indicate that the dairy inventory dollar value loss for 1982, including losses resulting from restricted use sales and from warehousing problems, such as physical damage,

amounted to \$3,424,000, or 0.041 percent, of the inventory's value. For 1983 and the first 6 months of 1984, ASCS records show the dairy inventory dollar loss as \$962,907 (or 0.031 percent of the inventory's value) and \$1,627,296 (or 0.053 percent of the inventory's value), respectively.

ASCS inventory records may not present an accurate account of the losses USDA has incurred on its dairy inventory. As stated above in response to question 4, the condition of USDA's inventory cannot be determined until the inventory has been fully reinspected. Until the condition of the inventory is determined and deteriorated products are disposed of, the dollar value loss to USDA due to deterioration of dairy commodities cannot be determined. Furthermore, ASCS' loss figures do not include the loss incurred in selling nonfat dry milk for animal feed. According to ASCS officials, the nonfat dry milk sold for this purpose is high moisture, but not deteriorated. However, when USDA sells this high-moisture nonfat dry milk for animal feed, an inventory dollar loss occurs equal to the difference between the cost of the nonfat dry milk and the sale proceeds. In 1983 the loss USDA incurred in selling nonfat dry milk for animal feed amounted to \$27,301,417. For 1984, through June 30, USDA had incurred a loss of \$17,568,998 in selling nonfat dry milk for animal feed. These nonfat dry milk losses raised USDA's dairy inventory loss figures to about 0.910 percent for 1983 and about 0.626 percent for 1984, through June 30.

6. Are the food storage facilities USDA leases in good condition and properly maintained?

In our 1983 report we stated that an Office of the Inspector General audit completed in July 1983 found USDA contract warehouses generally in good condition. As part of our review work for the previous report, we reviewed inspection reports for the period January 1980 through September 1983 and found that the most frequent problem inspectors noted was that warehouses did not meet USDA's financial requirements. Additionally, ASCS officials said that since the dairy surplus had grown so large, individuals with no warehousing experience were obtaining government storage contracts. As part of an ongoing review, we are investigating the condition of warehouses storing USDA commodities.



United States
Department of
Agriculture

Agricultural
Stabilization and
Conservation Service

P.O. Box 2415
Washington, D.C.
20013

DEC 05 1984

Mr. J. Dexter Peach, Director
Resources, Community, and Economics
Development Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Peach:

At the November 29 GAO-USDA meeting to discuss the GAO draft report entitled "Government-Owned Surplus Dairy Products Held in Inventory", Keith Fultz and Patricia Manthe asked for a clarification of CCC-sales policy for its dairy products.

CCC currently offers all bulk dairy products for sale for unrestricted use at about 110 percent of their purchase prices. Additionally, CCC selects lots of cheese and nonfat dry milk and sells them at competitive prices. The cheese has developed hard to blend flavors and is sold for unrestricted use. The nonfat dry milk (NDM) is aged or standard grade because of moisture and is sold for restricted use as animal feed. The cheese is sold for human consumption at prices approximating or slightly below purchase prices. The NDM sold for animal feed is not off-condition nor unfit for human consumption. The prices received exceed more than half the purchase cost and are higher than any alternative sales outlet for NDM. The animal feed sales program serves as an inventory management tool and meets competition of imported casein--a protein derived from milk. Furthermore, the animal feed sales of NDM occur only after CCC supplies all available food outlets under domestic donation and foreign sales and donation programs.

Section 201 of the Agricultural Act of 1949, as amended, designates dairy products purchased by the Commodity Credit Corporation (CCC) under the milk price support program as nonbasic commodities. Since dairy products are not stored for substantial periods of time in normal trade practices, they are deemed nonstorable under section 408 and are exempt from the general sales provisions of section 407. Therefore, sales of dairy products are subject to CCC Docket CZ-200, Revision 4. Section 6 applies to commodities of questionable continued storage.

Mr. J. Dexter Peach, Director

2

The declared policy of Congress states that CCC "shall as rapidly as possible consistent with its existing authority, the operation of the price support program, and orderly liquidation, dispose of all stocks of agricultural commodities held by it." With respect to sales, it is the intent of Congress that CCC should interfere as little as possible with commercial markets in disposing of products acquired under the price support program.

Sincerely,



Administrator