

STATE MILK COMMISSION

AUDIT MANUAL



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SMC AUDIT MANUAL INDEX

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Introduction

Over the years, the State Milk Commission audit procedures have evolved to keep up with technological changes and to comply with conservative fiscal responsibilities. This audit manual was originally developed in 1996 and revised in 1998 and 2006. This revision is necessary to reflect current audit standards.

Due to budget restraints, the auditing staff no longer travel three weeks out of four each month but, rather, travel only once or twice a year. Audits are now performed as desk audits with the necessary support documents either sent to the auditors electronically or mailed. This manual will give procedures to be followed when doing a desk audit, as well as procedures for doing field audits. This manual will also give the procedures currently used to work the reports of receipts and utilization submitted by processing distributors.

It should be noted that this manual is not intended to detail all duties performed by the Commission auditing staff. Instead it is intended to address those tasks directly within the scope of auditing. Audit staff should refer to the Rules and Regulations for information on the responsibilities of the State Milk Commission.

File Locations

Not published.

Report Week

The period between the 7th and the 12th of each month is commonly referred to as Report Week, even though sales information may be received prior to the 7th. By the 7th of each month processors must submit reports on their receipts and utilization for the prior month. Processors with base may submit a copy of their federal order report in lieu of submitting Milk Commission forms. Distributors without base (non-processing general distributors, sometimes referred to as sub-distributors) are required to have their sales in by the 7th. Producer distributors must also submit their sales and a SMC-7 for the prior month by the 7th of each month. Cooperatives are required to submit by the 7th a breakdown of daily deliveries toward base. All of these reports will either be emailed or faxed to the audit staff. When the 7th falls on a weekend, reports are due from all of the above by the Friday before the 7th.

Prior to the 7th an auditor will set up the fax transmittal log, the transfer log, the report log and the monthly statistical report. (How to complete each report is explained in detail under Working Reports.) When reports, retail sales and deliveries are received, whoever receives them must log them into the report log. (Copy of log in the Forms section of the manual.) When reports are verified and settlements are emailed, whoever verified the report will record when the settlement was sent to the appropriate cooperative on the fax transmittal log. When a report is finished, the auditor working the report will log any transfers received and shipped on the transfer log. Also, when an auditor completes a

report he/she will enter the information contained on the Data section of the report into the monthly statistical report.

During report week, settlements are emailed to the cooperatives by the 12th of each month. Assessments are sent to the licensees also by the 12th with payment due to the Commission by the 15th.

Encryption of Files

Not published.

Working Reports

Reports are to be worked in the following order:

- a. Reports with assigned base and transfers in or out
- b. Reports with assigned base but no transfers
- c. All other reports

Large Reports (Processors with base)

Be sure to log the receipt of the report on the report log (RptLog) found on the server under the appropriate report month (see File Location section for more information). A column is provided for you to note the receipt of the Virginia sales and another column for receipt of the federal order or SMC-7 report. Once you have received the report, pull the prior month's report for comparison purposes.

The following steps should be taken when working large reports.

1. Check that all information has been received to complete the report:
 - a. Deliveries from cooperative(s)
 - b. Audit Adjustments (if applicable)
 - c. Copy of the federal order plus Virginia sales
 - d. Non-processing general distributor sales (if applicable)
 - e. Base assigned to plant
 - f. Prices for plant (Virginia and federal order)
 - g. Double check that you have the prior month's report
2. Check that the prior month's ending inventory is the current month's beginning inventory.
3. Check daily delivery totals to the assigned base. If they are less than the assigned base, check to see if there is a permanent agreement to accept less than base (letter should be on file). If not, you will need to obtain certification from the dairy that they agreed to accept less than base. This is important as cooperatives are penalized if they don't deliver base and plants are penalized on their discount if they don't accept base deliveries.

4. Open the prior month's monthly report for that dairy. Save it to the current report month folder and be sure to change the month on the file name.
5. The following is a listing of the worksheets contained on the reports and what information must be entered (if any) to each sheet.

a) Entry Worksheet:

1. Enter auditor's name.
2. Enter report code (1 if an original report; 2 if an audited report).
3. Enter the number of days in the month.
4. Enter the report month (MM/01/YY). (Try to always enter the day as 01 as the formula to calculate the assessment due date is generated by this date. Also, this is the only place you should need to enter the report month. Formulas should be on all the other worksheets to pick this date up from the Entry Page.)
5. Enter base assignment for each cooperative.
6. Enter total deliveries for each cooperative.
7. Enter butterfat test for each cooperative.
8. Enter any audit adjustments (settlement and assessment) for each cooperative.
9. Enter any distribution assessment audit adjustments.
10. Verify the date calculated properly. If not, check to see if this formula driven or hard coded. If hard coded, enter the month the assessment is due.
11. Enter Virginia's Class I skim and butterfat prices for each market.
12. Enter Virginia's Class II skim and butterfat prices.
13. Enter the assessment rate.
14. Enter the federal order Class I skim and butterfat prices for the plant if applicable.
15. Enter the appropriate code for whether a plant is fully regulated under a federal order (2) or not (1).
16. Periodically review contact information on entry page that shows to whom the report is emailed and to whom the settlements are emailed.

- b) Worksheet B: you will not need to enter anything on the SMC-6 since all information is formula driven. Page down to the SMC-7 and enter appropriate information from the plant's submitted report. Note: It will not be necessary to enter transfers and sales here. There are separate worksheets to handle these items and the totals are carried to the SMC-7 by formula. Be sure to review each cell before entering as some reports may have links to other sheets that will automatically supply information found on the SMC-7. This worksheet also contains the SMC-8 and this report must be reviewed to be sure the Class II, IA,

and Class I allocations total back to the total receipts on the SMC-7. There must not be any negative allocation in II, IA or I. If there is, you will need to adjust to other source milk to eliminate negative amounts.

- c) Sales Worksheet: Enter the appropriate sales for each market. Also enter in the butterfat test for each product from sales documents. (Note: not all reports will require you to enter the butterfat tests as some dairies use a standard test (i.e, 3.25%, 2.00%.) Check to see what other worksheets exists on this page which will require you to enter data. Also, check to see if the sales are linked to other worksheets before entering the sales. Some files will have entry pages for the sales that carry the totals over to the SMC-7A's.
- d) Assessment Worksheet: All entries are formula driven and will not require any manual entries.
- e) SMC-6B: Enter the daily deliveries for each cooperative. If there are no daily deliveries, formula is set up to calculate or enter the daily utilization on the SMC-6B. Watch the daily calculation for the 29th through the 31st. Depending on the number of days in the month, you will want to be sure no penalty is calculated base on days when there were no delivery days available. (i.e., February 2012 is a leap year, having 29 days. No penalty should be calculated on days 30 and 31.)
- f) SMC-40: There are no manual entries to this page. However, the SMC-40 must be reviewed to verify that it is in balance. The other source milk allocated to II, IA, and, if necessary, Class I must total to the other source milk receipts on the SMC-7.
- g) Transfers: Enter all Class I-A and II transfers received from or sold to licensed distributors. Formulas probably exist by market for the distributors from which the plant received products, pulling the Class I product pounds from the sales sheet. The Class I will be subtracted from the IA pounds by formula so be careful not to key over the formulas. You will need to manually enter the pounds of product by market sold to other licensed processors. A formula should exist to subtract these sales from the IA transfers out.
- h) Settlement: There are no manual entries to the settlement page. Everything is formula driven. However, the settlement page for each cooperative should be reviewed for accuracy. Verify that the price differential for federal order plants has been properly calculated. The price differential refers to the difference between Virginia's Class I price in each market and the Federal Order Class I price.
- i) Worksheet I: This sheet is only used if the producer recovery fund is in effect. It is so seldom used that on some reports the sheet may have been removed.
- j) School Sales: These sales are pulled from the sales page via formulas and require no manual entries. These sales should periodically be reviewed for

accuracy to ensure formulas are correctly carrying sales over from the sales page to the school sales worksheets. This could impact on school sales recap report, which is used for the monthly base assignment calculations at certain times of the year.

- k) **Macros or Recon sheet:** This sheet is where the reconciliation worksheet is located. You should make sure you are in balance prior to printing the report. It cannot be stressed enough that you should manually enter the reconciliation information and not copy and paste. In the case of deliveries, formulas probably exist in both columns to be sure they are in balance.
 - l) **Data:** This sheet contains the information to be posted to the Monthly Statistical Report (Monthly Stat Info). Be sure to copy and paste values when copying from this sheet into the monthly stat report.
6. Using the appropriate check off sheet for the report, be sure to verify that all items have been entered and reconciled on the Macro or Recon worksheet before printing off the report.
 7. If everything is in balance, go to "View, Macros" and run the appropriate macro to print the report for verification.
 8. Once you have printed the report and posted the data information (see 5.l. above), you need to set up the settlement(s) for emailing. Be sure to copy and paste values when setting up the settlement(s). For some reason, when copying and pasting the report month and the date the report was worked the information changes to invalid dates. It doesn't happen on all reports, however. If this happens, be sure to manually correct to the appropriate date or report month.
 9. Pull the copy of the transfers that should be under the FAX cover sheet. Post the transfers to the transfer log. After posting, place copy on clipboard in Auditors work area labeled "Transfers". Put the report with all the supporting documents and the prior month in the Auditors work area for verification.
 10. Open the Mthly Stat Report. Go to the data worksheet in the report you are working and copy the information. Paste, Special, Values the information into the Mthly Stat Report on the lines for the dairy. Once you have pasted the values, highlight the dairy to show it is completed.
 11. Periodically review the reports to be sure formulas are correct (i.e., all sales items are being picked up when converting units to pounds). If products are added to the sales, check to see if the formulas for calculating transfers received have been impacted as well as school sales, if appropriate. Also, if adding a cooperative be sure the information flows to the settlement for that cooperative, the discount page, and the Data sheet. Be sure to also notify the auditors responsible for the Monthly Stat Report and the Eastern Market Pool as it will impact on the accuracy of these two reports.

Working Reports Without Base (Medium Reports)

Medium reports are the Producer/Processor reports. You should receive an SMC-7 form and the Virginia sales (may be filed on an SMC-7A form) by market. You should also receive an SMC-7A for the ending inventory and one for the Class IA sales. The following steps should be taken in working the reports.

1. Log the report received on the ReptLog file. Be sure to log in both the sales and the SMC-7 report.
2. Open the prior month's report and save it under the current month being sure to change the name. (Refer to 4 above under Large Reports for more detail.)
3. Enter the correct month and year on the Entry Page.
4. Enter the information from the SMC-7 on worksheet B, being careful not to key over any formulas.
5. Enter the sales for each market and any IA sales on the Sales worksheet. Enter the inventory by product on this worksheet as well.
6. Be sure the report submitted by the producer/processor matches your file. If there are any differences, be sure to note what they are. If the differences are large, research to be sure you have entered everything correctly.
7. Once the report is balanced, print it for verification. To print, go to View Macros and execute the SMCPrint macro.
8. Post the information on the Data worksheet to the Mthly Stat Rept file and place the report in the auditors work area for verification.

Working Small Reports (Non-processing general distributors)

Small reports are licensed processors whose sales into Virginia are so small they aren't assigned base. Small reports may also be licensed processors without base whose products are sold into Virginia by other licensees commonly referred to as non-processing general distributors. The processors and non-processing general distributors must have their Virginia sales to us by the 7th of each month.

The small report will consist of the sales and the assessment. There will be a sheet for collecting the information needed for the Mthly Stat Rept and may also contain a sheet for recapping the non-processing general distributor sales. The following steps should be followed in working small reports.

1. Log the receipt of the Virginia sales into the MthlyReptLog file.
2. Open the prior month's file and save it in the current month's folder, being sure to change the name accordingly.
3. Change the month and year.
4. Enter the sales either the first sheet or on the non-processing general distributor sheet.
5. Print report and place in the auditors work area for verification.

6. Copy and paste values into the Monthly Stat report, highlighting the report name in yellow.

Posting to the Report Log

The report log is used to record the receipt of all reports, deliveries, and any retail sales reports received. The report log is set up in alphabetical order by licensee with any non-processing general distributors listed below the dairy. When a report is received, the auditor receiving the report will log in the date received. A column is provided for recording the date for the Virginia sales and a column for the SMC-7 or Federal Order report. A column is also provided for recording the date any e-mail or phone calls were made to obtain the report.

The daily deliveries are on a separate worksheet that is set up to record the receipt of the deliveries from the cooperatives for each dairy. The dairies are listed in alphabetical order. A separate column is provided for each individual cooperative.

The retailers section of the log is used to record the receipt of Virginia sales that aren't reported by the processors.

After updating the appropriate information, be sure to save the file.

Fax (E-Mail) Transmittal Log

This report is used to record the e-mailing of the settlements to the cooperatives. The report is set up with separate sheets for each cooperative, listing the dairies who receive deliveries from that cooperative.

After reviewing a large report, you will need to send the dairy's settlement(s) to the appropriate cooperative(s). Before emailing, verify that the settlement was updated for the current month's information. If not, notify the appropriate auditor to update. The information as to who the settlement should be sent should be located either on the report check-off sheet or on the entry page of the processor's report. Once you have sent the settlement, update the log for the date it was e-mailed. Print off copies of the email sent to the cooperative(s) and dairy and file in the appropriate box in the auditors' workarea.

After updating the appropriate information, be sure to save the file.

Monthly Stat Report

This report is used to capture the data that goes on the larger Distributor Data report. There are two worksheets within this file. The first is for recording the large report information and the second is for recording the small and medium report information. The information for the Monthly Stat Report is located in each report under the Data worksheet. The information is copied and value pasted into the Monthly State Report by the auditor who worked the report. Once the

values are pasted, highlight the distributor's name. After updating the appropriate information, be sure to save the file.

Transfer Log

The Transfer Log file is used to record the transfers sold and received between licensed distributors. The report has three worksheets: Base Holders, Non-Base Holders, and Base Transfers. No entries are made to the Base Transfer sheet. The information is pulled instead from the other two worksheets via formulas/links.

The Base Holders sheet is where you will record the receipts (transfers in) and distribution (transfers out) transfers by base holding dairies. If you are recording the transfers sold (out) by the dairy whose report you worked, you need only post the total pounds sold to a particular dairy in column B. If you are recording the receipts for a report you worked, you will need to record the pounds in column C. First locate the dairy that shipped or transferred the product to your plant. Next find the dairy whose receipts you are posting and record the pounds in column C. Next enter the market breakdown for these transfers, starting in column E.

If the dairy received products from a licensed non-base holding processor, you will record the amounts on the Non-Base Holders sheet. With these transfers you must record both the transfer distribution (transfers out) and the transfers received (transfers in), columns B and C. You will also need to record the breakdown by market, starting in column E.

When you have posted all transfers for the dairy, go to the Base Transfers sheet and verify that the pounds for the receipts and/or the pounds for the transfers out balance with the totals on the transfer pages. If everything has balanced, put the copy of the transfers on the clip board in the Auditors work area. If you don't balance, go back and verify you have posted everything correctly. Be sure to save the file after updating.

Verifying/Reviewing Worked Reports

Large Reports

Once a report has been worked, it must be reviewed for accuracy. The reviewer should verify the following information contained on the reconciliation worksheet for accuracy.

1. The correct Class I skim and butterfat prices for each market have been entered.
2. The correct Class II skim and butterfat prices have been entered.
3. The correct Federal Order skim and butterfat prices have been entered.
4. The correct base has been entered.
5. The deliveries are in balance.

6. The Total to be Accounted For product pounds and butterfat pounds agree with the report submitted by the dairy. If not, be sure the difference has been noted on the submitted report with an explanation of the change.
7. The Total Accounted For product pounds and butterfat pounds agree with the report submitted by the dairy. If not, be sure the difference has been noted on the submitted report with an explanation of the change.
8. The correct number of days in the month has been entered.

Additionally check the following:

1. Check to be sure the correct report month was entered on the entry page and that the base for each cooperative has been correctly entered. Verify that the deliveries are not less than base. If they are, a letter must be on file stating the agreement to accept less than base deliveries. In some cases there is a permanent agreement to accept less than base and this will be noted on the entry sheet. If there is an agreement to accept less than base, verify that the flag showing this has been set on the entry page (1 if agree, 2 if not).
2. Check the discount page to be sure the discount was properly calculated. If the deliveries are every other day, be sure the differences are calculated properly. Watch the penalty calculations for the 29th through 31st for those months having less than 31 days.
3. The allocations by class have been properly handled on the SMC-8. That is, check to be sure the total producer receipts balances with the total allocation to Class I, I-A, and II (Schedule 13). Verify that the total pounds allocated under Other Source agree with the total pounds of other source receipts on the SMC-7.
4. Verify that the SMC-40 is in balance.
5. Verify that the audit adjustments for the month are appropriate for the report month and not carried over from the previous report month.
6. Verify that there is a settlement page for each cooperative receiving Class I allocation.
7. Check the SMC-6 to verify that the penalty for not delivering base has been applied or that the cooperative is receiving allocation up to the amount of the deliveries if a letter exists agreeing to accept less than base.

Once the review has been completed, the report needs to be emailed to the appropriate individual(s) shown on either the entry page or on the report check-off sheet. Open the settlement files for emailing and verify that the current month's settlements were set up.

Email the settlements to the appropriate cooperative(s). Once the settlements have been sent, log the transmittal on the Fax (Email) Transmittal report. Print off the emails sent to the dairy and the cooperative(s) and place in appropriate box in Auditors work area.

Medium Reports

There is less involved in reviewing Medium Reports than there is with the Large Reports. Please do the following when verifying medium reports:

1. Verify that the month has been changed.
2. Verify that the report balances to the SMC-7. If not, what caused the differences? The auditor/assistant should have noted on the form what he/she determined the cause to be. If not and the differences are significant, investigate to see what the cause may be. Did the producer/processor complete the report incorrectly? Where non-processing general distributor sales added to the report? Is the difference in Class II and what constitutes the difference?
3. Verify that the assessment has been properly calculated. A producer/processor pays two assessments: a distribution assessment and a processing assessment.
4. Once the report is verified, email it to the person indicated either on the report or on the report check off sheet. Print off the confirmation that the email was sent. There is no requirement that this be logged into a report.

Small Reports

The following steps should be used in verifying small reports.

1. Verify that the month has been changed.
2. Verify that the sales have been entered correctly. Review the conversion factors occasionally to be sure they are correct and verify that the pounds have been properly extended.
3. Verify that the assessment has calculated properly.
5. Email the report to the person indicated on the report or on the check off sheet. Print off confirmation of the email being sent. There is no requirement that this be logged into a report.

SMC AUDITS

Prior to March 2002, SMC audit staff were on the road 3 weeks out of 4 each month being in the office only for report week. Due to budget restraints, it was determined it was more economical to have the audits done in the office. There are two sections on audits: one will be for performing desk audits and the other will be for performing field audits. Audit staff still visit their assigned dairies but on a less frequent basis than monthly. How often the auditor visits will depend on the reliability of the information submitted by the dairy. Staff should make an effort to visit all their assigned plants once or twice a year.

Preparing for the Audit – Desk

Prior to performing the desk audit, the auditor should review the monthly report (including supporting documents attached to the original) to see if there are any recurring problems. The sales should be reviewed to see if there are any un-explainable decreases or increases in sales. Were new products added? Were they packaged by the dairy or were they purchased? If purchased, were they obtained from a licensed processor and were they picked up in the transfers received?

Desk Audit

The following criteria for desk audits were issued on February 1, 2002.

- A. Any fully regulated distributor with less than 500,000 pounds of assigned base and/or Class I utilization that meets the following is eligible for a desk audit.
 - 1. The distributor has accounting systems deemed to be reliable and accurate.
 - 2. The distributor can provide appropriate documentation that can be utilized in the audit.
 - 3. The distributor's staff, involved in the accounting and reporting of the milk received and utilized, is knowledgeable and skilled in milk accounting.
 - 4. Periodically, the distributor must be able to provide a listing of customers for verification that sales are being reported in the correct markets.
- B. Any fully regulated distributor with more than 500,000 pounds of assigned base and/or Class I utilization that meets the following.
 - 1. The distributor has accounting systems proven to be reliable and accurate.
 - 2. The distributor can provide appropriate documentation that can be utilized in the audit.
 - 3. The distributor's staff, involved in the accounting and reporting of the milk received and utilized, is knowledgeable and skilled in milk accounting and conscientious about their work including finding and correcting problems.
 - 4. Periodically, the distributor must be able to provide a listing of customers for verification that sales are being reported in the correct markets.
- C. Non-processing general distributors will be desk audits provided they meet the following criteria:
 - 1. The non-processing general distributor has accounting systems deemed to be reliable and accurate.
 - 2. The non-processing general distributor can provide appropriate documentation for verification of sales in Virginia.
 - 3. The non-processing general distributor can provide a listing of customers for verification that sales are being properly classified by market.

The following criteria for desk audits were issued on February 1, 2002.

- A. All state order plants will be full on-site audits regardless of assigned base or Class I utilization.
- B. At least once a year distributors who are desk audits will have an on-site visit and an audit of at least one-month if their total Class I monthly utilization is at least 100,000 pounds.
- C. A distributor who is classified as a desk audit who implements a new accounting system will have an audit to verify the accuracy of the new system.
- D. A distributor who is classified as a desk audit has a change in staff responsible for accounting for milk receipts and utilization will have a field audit to verify the accuracy of the report.

Procedures for Desk Audits

The procedures are basically the same for a desk audit as for a field audit except you will not necessarily be auditing Class II. In a meeting held on March 4, 2002, the following recommendations were made by the Audit Team and were accepted by the Administrator and Deputy Administrator.

1. Obtain support for verification of Virginia sales by market from the dairy being audited.
2. Obtain a copy of the federal order printout (commonly called Pool Report) returned to the dairy by the federal order once the report has been worked. Attempts should be made to obtain this each month from the dairy. If it is not possible to obtain a copy of the printout the auditor should document this in the audit program.
3. Obtain a listing of Virginia customers by city. This does not need to be obtained every month but should be obtained at least every six months or once a year. If the auditor knows of significant changes in customers at the dairy, then the listing can be obtained more often.
4. Obtain copy of current invoice for selected customers. This should be done when the audit is finalized. If an audit is a monthly audit but adjustments are small enough that the audit can be finalized every three months, then the invoice information will be obtained before the three months are finalized. (Note: currently all Milk Commission audits are completed quarterly with the exception of Producer-Processors whose audits are done every 6 months. Non-processing general distributor audits are performed about every two years, depending on the volume of sales.)
5. Obtain a copy of the month's invoice(s) from the cooperative(s).
6. Send a verification letter of payment to the cooperative(s) for verifying payment.
7. Review organizational chart at least annually. This may be done more often if auditor is aware of changes at the dairy.

In addition to the above, an audit program and folder are prepared just as if this was a field audit.

Preparing for an Audit - Field

The following are for on-site audits; however, the information needed to perform a desk audit is the same.

Field Audits

1. Pull the audit copies of the dairy's monthly SMC reports for the months being audited.
2. Obtain any invoices from the cooperative(s) to the dairy being audited. If copies are not available, you can either contact the cooperative to obtain a copy or you may be able to obtain a copy from the dairy once you arrive. You will need to verify payment of these invoices when performing the audit.
3. Review the reports to be audited to see if there are any audit adjustments from the previous audit. If audit adjustments appear on the report, be sure a copy of the adjustments is attached. You will need to verify that payment was made.
4. Pull the copy of the last audit program front sheet which will have the ending inventory for the last audited month and, therefore, the beginning inventory for first month of your audit period.
5. A copy of the previous audit's management letter and a copy of any below cost findings for the previous audit should be placed in the current audit file. If there were any below cost findings, you will need to verify during your audit that whichever customers were cited previously are now in compliance with SMC Regulations pertaining to below cost.
6. Review the monthly reports you will be auditing to ascertain what changes may have occurred. Was there an increase or decrease in sales from previous months? Is there a substantial change in inventory from one month to the next? Is there a shrinkage problem? Is there over 2,000 pounds of excess shrinkage allocated to Class I? From what dairies are transfers (if any) being received? What dairies are receiving transfers from the dairy you will be auditing? What products are affected? Do any new products/labels appear on reports from one month to the next?
7. Review the organizational chart for the dairy to see whom you must contact at the dairy regarding your audit. (Put a copy of the organizational chart in your audit folder.) Also, review the report to see what products are being manufactured at the plant. Review the report to see if there are branch offices and, if so, where they are located. Do the branches sell into Virginia and are the sales being reported? Who are the non-processing general distributors (if any) and where are they located? Periodically you will need to audit the non-processing general distributor's sales for accuracy of reporting.

8. Prepare a label that shows the name of the dairy to be audited and the months affected. Place all material gathered into a folder and place the label on the folder.
9. Retrieve the reports for the months to be audited. Save the files to the server with an A at the end of the file name. Copy the files to a flash drive to take with you on the field audit. Go to the entry page for each report and put a 2, indicating this is an audit copy. Range value the original columns for the assessment and the settlement(s). Copy and paste the Original column into the Paid column. This must be done before entering any changes found on the audit. **Be sure you have saved the file with an A.** This is important as the original will be used to set up the next month's original report.
10. In preparing the audit, you must complete the Audit Program that becomes a part of the audit. A copy of the audit program may be found in the forms section of this manual. Also, you will need to verify that the assessment payments are being paid on time.
11. If traveling to perform field audits or an annual visit, contact the dairy and let them know when you will be coming. (NOTE: It is left to each auditor's discretion whether or not to contact the dairy prior to an audit when prior notification is not required by the dairy.)
12. If the audit involves overnight travel, you must contact two to three hotels/motels for rate comparisons. You will need to put this information on your travel authorization form. (See VDACS' Travel Reimbursement Form for the authorization form.)

Who to Contact

Prior to leaving for your audit, you should contact the plant to be audited and let the Office Manager know when you will be arriving, what months you will be auditing, and any other pertinent information. Once you arrive at the plant, you **must** check-in with the receptionist. Leaving a business card with the receptionist will help ensure you receive any phone calls. You will need to speak with the Office Manager who may or may not be the person responsible for completing the SMC monthly reports. If the Office Manager is not responsible for the report's completion, he or she should introduce you to the person who is. While at the dairy, you should try to meet the Controller and Sales Manager and any other member of management that time allows.

What Records will be Needed?

After meeting the person responsible for completing the report, you will need to ask for the following:

1. Records of receipts from all sources for milk that came into the plant for the months audited.

2. All sales by market and class for the months audited. If the plant is located outside the state, be sure you are given Virginia sales by market. Obtain a customer list by roll-up codes to ascertain if any Virginia customers' sales are excluded and out-of-state sales included. You will also want to verify the customers are reported in the correct market.
3. Inventory Records
4. Production Records
5. If the plant you are auditing is in a Federal Order, you need to ask for copies of the federal order reports and copies of the printouts the federal government sends back to the plant (commonly referred to as the pool report).
6. Records of transfers in and out. (Note: These may already be included in the receipt and sales records, depending on the plant. If a plant is licensed by SMC and appears in the audited plant's sales, it must be removed to the appropriate transfer out class.) Audit invoices for prices and to ensure the inclusion of all products received and shipped.
7. A current listing of Virginia Customers with prices. If this isn't possible, review the customer list (see #2 above) and ask for current invoices for the Virginia customers you select. The listing or the invoices must be reviewed to be sure the plant is selling at our presumed costs (below cost analysis).
8. Review the customer listing to be sure Virginia customers are classified into the current market. Also review the customer listing for non-Virginia customers who may be selling back into Virginia.

What audit procedures should be followed?

The audit program gives step-by-step procedures for performing the audit. There is also information available in an audit memorandum written by Mr. Edward C. Wilson, Jr., dated September 28, 1992. A copy of this memorandum is included in this manual under the Reference Material section. Below are the recommended procedures that SMC auditors are to follow when performing an audit.

Sales: Compare the reported Class I sales by market and product to the plant's records. Notate in red any corrections to the sales originally submitted. Make a copy of the document(s) containing the information that necessitates the correction(s). Number the source document and write the corresponding number next to the item being corrected. This documentation is necessary to prove your audit changes and to help the reviewer verify your change(s).

Compare the reported Class I-A sales by product to ascertain their accuracy. Notate any changes in red. As with Class I sales, copy the document(s) containing the information supporting the change(s).

Place a check mark (✓) next to the sales figures on the SMC-7 to show that they have been verified. If corrections are necessary, use two check marks (✓✓). Record on the Audit Program your tick marks and how they are to be used.

(NOTE: Most dairies have their sales on an automated system. Periodically the system should be checked to verify its accuracy.)

Producer Receipts: Verify the deliveries to the SMC-6B for the cooperative(s), if applicable. Verify that the correct butterfat test was used. The butterfat test does not appear on the SMC-6B but can be found on the SMC-6 and the Settlement Report for each cooperative. Compare the cooperative's invoice to the SMC-6B and SMC-6 to be sure pounds and butterfat test are in agreement.

Transfers In: Verify that the products being reported are actual transfers from plants licensed by SMC. If not, these receipts should appear in "Other Source" receipts.

Verify transfers-in by classification and market. This will be done by verifying the sales and verifying that the report's formulas have properly carried these sales to the appropriate market on the transfers-in report.

Obtain copies of invoices from the different plants to ascertain if all transfers received were reported. Also, review the invoices for the type of products received. Are similar products manufactured at the audited plant? If so, is there any way to differentiate the sales of like products between the plant's manufactured products and what was transferred in (i.e., product codes)? If there is no way to know which products sold were transferred into the plant, then all receipts of these products are Class IA for the plant shipping the products to the plant you are auditing.

Reconciliation of Settlement to Invoice: There are several steps that must be followed in order to properly verify a cooperative's invoice to a processor. They are as follows.

1. Verify the base (if shown) reported on the cooperative's invoices against the base reflected on SMC's settlement sheet for the cooperative.
2. Verify the butterfat test on the invoice against the test reflected on SMC's settlement.
3. Verify the deliveries shown on the invoice against the deliveries reported on the SMC's settlement.
4. Verify Virginia Class I allocations/payments by market to be sure the pounds and prices agree with the SMC settlement. Then verify that the total charges per market have been properly extended on the cooperative's invoice. This should be the same amount as the value per market reflected on the SMC settlement.
5. Verify that the total Class I pounds agree with the settlement.
6. Verify that the total Class IA and Class II pounds on the invoice (if shown separately) agree with the settlement. Also verify that these pounds have been valued at an amount which exceeds SMC's Class II price for that month.

7. Verify any audit adjustments reflected on the invoice against those shown on the settlement. If there is a difference, determine the reason. Usually this is the difference between Class I and Class IA/II pounds for the audit period. The Class IA and II pounds will have been valued by the cooperative at the appropriate over-order premiums and credits and allowances for each month of the audit period.
8. Verify that the delivery base discount on the invoice agrees with the discount reflected on the SMC settlement. Verify that the assessment amount also agrees with the settlement.
9. Verify that any other discounts are either allowable by Virginia regulations or are applied only to non-Virginia allocated pounds.
10. Verify all extensions.
11. Verify payment has been made. Indicate the check number and date for the partial payment and the final payment. Be sure partial payments are in accordance with regulation 2VAC15-20-81.C. In verifying payments, use confirmation letters. The confirmation letters should expressly state that the settlement amount is the amount for that plant and includes all credits and allowances. The confirmation letters must be signed by the cooperative certifying to the correctness of the information
12. Randomly review a month of the plant's accounts payable for the cooperative to be sure no additional, unallowable payments were made. Also, review a month's accounts receivables for same.
13. These are basically the same procedures to follow in verifying audit adjustments when reviewing audits.

Reflecting Amounts Paid on Settlement:

1. Once the invoice and settlement have been reconciled, the amount of pounds and prices paid for Class I should be entered in the "Paid/Reported Lbs./Price" column of the settlement.
2. If a plant is **not fully regulated**, the amount of pounds and prices paid for Class IA and II should also be recorded in the "Paid/Reported Lbs./Price" column, calculated at the Virginia Class II price only. The full amount paid for Class IA and II must exceed Virginia's Class II price. If a plant is **fully regulated**, only the Class IA and II pounds should be reflected.
3. If an invoice has audit adjustments or is strictly audit adjustments (i.e., Dairy Farmers of America separately bills for audit adjustments), offsetting transactions to discounts and over order premiums are allowed. (An example is included in the Reference Material section of this manual.)

NOTES ON THE SETTLEMENT SHEET

Settlement Sheet Purpose: The primary purpose of the settlement sheet is to reflect the amounts payable to licensed base-holding producers or their cooperative association of producers for base milk delivered for any given month.

How Settlement Figures are Derived: The information on the settlement sheet comes primarily from the SMC-6. The exceptions are under the delivered base discount section. The potential pounds are pulled from the SMC-6B, and the SMC assessment pounds are from the SMC-9. Specifically, the appropriate cooperative, base, deliveries, butterfat test and prices (Eastern, Western, and Southwestern Class I skim and butterfat, Class II skim and butterfat, federal order Class I skim and butterfat) come from the Entry sheet.

The Class I allocation for each cooperative and each market comes from the SMC-6. The prices for each market come from the Entry sheet. If a plant is fully regulated under a federal order, only the difference between Virginia's adjusted Class I price and the federal adjusted Class I price is applied to the Class I allocation per market. These prices will be at a 3.5 butterfat test. However, if a plant is not federally regulated, the Class I allocation for each market is valued at Virginia's Class I skim and butterfat prices adjusted to each cooperative's butterfat test. This price is calculated on the Entry sheet and brought to the settlement page via formulas. See General Information for an explanation of how to calculate these prices.

The Class IA and Class II allocation prices are determined in the same manner as the Class I price **except** the adjusted Class II price is used. The audited and paid columns of the settlement are compared in the adjustment section. Paid fields should reflect only the amounts actually paid; therefore, erase any figures which will not be or were not paid.

The information reflected on the settlement sheet comes primarily from the SMC-6. The exceptions are under the delivered base discount section. The potential pounds are pulled from the SMC-6B, and the SMC assessment pounds are from the SMC-9.

Paid/Reported Pounds/Price – Non-Federal Order Plant: A non-federal order plant's "Paid/Reported Lbs./Price" column of the settlement should reflect the **actual** amount of pounds and prices paid for each class of allocation.

Paid/Reported Pounds/Price – Fully Regulated Federal Order Plant: A fully regulated plant's "Paid/Reported Lbs./Price" column of the settlement should reflect the **actual** pounds and prices paid for all Class I allocation and **only** the pounds for the Class IA and II allocations. If the amounts of Class IA and II pounds have been settled at Virginia's Class II price or higher, the prices paid and the pounds *may* be shown in the "Audited" column of the settlement.

Standards for Finalized Audit Files

Finalized audit report standards were originally issued on September 29, 1992 via an Audit Memo written by Edward C. Wilson, Jr. A copy of that memorandum can be found in the Reference Material section of this manual. The following reflects the current SMC audit report standards for finalizing audits.

Audit File: The final audit report files should be arranged in the following manner.

1. The audits must be placed in a classification folder.
2. The first section of the classification folder should contain the following in the order given:
 - a. The Audit Report and Plan (commonly referred to as Audit Program) for the plant being audited.
 - b. A copy of the front sheet of the Audit Report & Plan marked “For Next Auditor”.
 - c. All Correspondence:
 1. Management
 2. Below Presumed Cost letter
 3. Auditor Comments form. (Not necessary if comments are put on the front section of the Audit Report & Plan.)
 4. Other correspondence
 - d. Audit Adjustment Log (not currently being used for all audits and is a log of outstanding audit adjustments).
 - e. Assessment Payment History (not currently being used).
3. The second section shall contain the Assessment Adjustment form (original assessment followed by audited assessment), and the Settlement Adjustment forms. This should be audited summation of the settlement adjustments form followed by the audited settlement sheets. Behind these will be verification of payment letter, the original invoices plus the original settlement sheet for each month. (Copies of the audited settlements going to the plant and the cooperative(s) are to be placed inside the folder in front of the adjustment forms. Holes should not be punched in these copies.)
4. The third section shall contain the original reports plus supporting documentation for any changes filed behind the original report section being corrected. That is, the copy of the federal order report will be filed behind the SMC-7, support for any changes to sales will be filed behind the appropriate market sales, etc. Adjustments are to be properly annotated to assist the reviewer when the audit is verified.
5. The fourth section shall contain the audited reports.
6. The fifth section shall contain the Below Cost Analysis and findings (plus any supporting documentation), as well as any equipment accounts checked and the supporting documents for these accounts.
7. The sixth section shall contain remaining work-papers.
8. The auditor of the **receiving** plant must give a copy of the transfers to the auditor for the **shipping** plant. The auditor of the shipping plant should file these transfers behind the original transfers sold section of the original report.

Once the file has been properly assembled, it should be filed in the “Audits to be Verified” drawer. The file should be placed to the back of the files to be verified and in front of “Audits Verified” section. This will insure the oldest files awaiting verification are verified first. The auditor will also record on the Audit Log the audit completed, the months audited, the auditor’s initials, the total number of months, when the field or desk work was

started and when it was submitted for review. Also, the auditor will need to update the Audit Tracking Report for the status of his/her audits. (See Audit Tracking Report section for more information.)

Audit Adjustments (Previously issued as an addendum to the audit manual and dated July 6, 2001)

A meeting was held on July 6, 2001, between Mr. Wilson, Deputy Administrator, and the audit staff for discussing of audit adjustments and billing to non-processing general distributors. The following guidelines were developed and became effective August 1, 2001.

The agency's policy currently is to only bill settlement adjustments of \$50 or more on processing general distributors assigned base. This policy will remain the same. However, if a cooperative advises an auditor that the cooperative will not settle an audit adjustment that is a credit to the dairy, the auditor will contact the dairy to ascertain the dairy's agreement. The auditor will file a written notation pertaining to the outcome in the appropriate audit folder.

Assessment audit adjustments for processing general distributors shall be made if the total adjustment is one dollar (\$1) or more. Non-processing distributors and Producer Distributors audit adjustments will continue to be billed no matter the dollar amount.

Audit Tracking Report

The Audit Tracking Report is used to record the status of each auditor's assigned audits, the amount of audits verified each month by auditor, reports worked and verified by auditor, each auditor's audit adjustments for the month, cost studies worked, pricing complaints, requests to meet competitor's prices, training completed, and various other important emails or phone calls received. Listed below are the worksheets contained in this file and what each sheet captures. .

Monthly Reports Worked

This section is broken down by type of report (major, minor or small) and by auditor by dairy by month. It is completed by the auditor who is assigned the responsibility for tracking this information. It is not currently being completed by each auditor.

Monthly Reports Verified

This section is similar to the Monthly Reports Worked section except it doesn't track the auditors' activities by dairies. Instead, the auditor responsible for completing this section will post the total major, minor and small reports verified by each auditor by month.

Audited Mo. Rpts

This section is completed by each auditor and reflects the status of each assigned dairy. To update, go to the appropriate month being audited for a particular dairy. If you have completed the field/office work but haven't finalized the audit, put a "2" in the appropriate column. If you have completed the audit for that month and have put it in the file cabinet for verification, enter a "1". If you have yet to audit the month, then leave blank. Formulas are written that will calculate the total months of audits with field/office work completed and the total for completed audits.

Audits Verified

This section records the total months of audits verified by each auditor, by type (major, minor, small). It is completed by the auditor who is assigned the responsibility for tracking this information. It is not currently being completed by each auditor. The information is pulled from the Audit Log report on the server. This log is updated by each auditor when completing an audit.

Audit Adjustments

Each auditor is responsible for completing this section. The auditors are assigned a code that must be used when completing this section. A listing of the auditors and their assigned codes can be found starting in cell I4. After entering the audit adjustments by dairy by cooperative, the auditor must enter a reason for the adjustment, starting at cell A84. The auditor assigned the responsibility for setting up the report each month will copy the formulas for YTD information from the prior month to the current month. The auditor will then range value the prior month's information and erase the audit adjustments entered by the auditors in the prior month.

Cost Study

Each auditor enters the information on their assigned cost studies to this sheet. It is used to keep track of when each study was started, when it was completed and the total hours spent on the study.

Pricing-Coupons-Surveys

This section tracks a lot of information. The first portion is where an auditor will enter the information on any pricing complaints received. What to enter should be self-explanatory.

The next portion is for recording any coupons or promotional requests. Currently, auditing staff are not handling coupons or promotions. They are handled instead by the Administrator and his administrative assistant. Auditing staff generally only are involved if the administrative assistant is out or if the person requesting authorization contacts the auditor directly.

Next is on actual price surveys completed by an auditor. At one time, auditors were required to monthly go to various retail stores and obtain prices for milk. Currently, price

surveys are supplied by outside sources; however, an auditor may still do a price survey and this is where he or she would enter the number done.

Next to the price survey section is the “Other” portion and this is where an auditor will record important, non-routine emails or phone calls. The type of information an auditor may record here is: requests to meet a competitor’s price, FOIA requests, any contact with a potential or new licensee, etc.

The last portion is for recording any internal or external training the auditor received during the month.

Review of Finalized Audits

The following steps should be followed in reviewing finalized audits.

1. Review audit report and program to ascertain if adjustments are required.
2. If adjustments are required, proceed directly to audited reports (#3). If not, proceed directly to #4.
3. Review the monthly audited reports to ascertain what items were corrected. Briefly review each correction’s supporting work papers to verify they do indeed support the adjustment. Review the reports for accuracy and accounting technical correctness and applicability.
4. If there are no adjustments, review the monthly audited reports to see if any corrections were made and that those corrections are properly supported in working papers. Also verify that there was a legitimate reason not to process adjustments.
5. Review the settlement pages and billings to insure they were adequately audited. Sample actual billings and settlements to the settlement pages to be sure they were accurately reviewed.
6. For audited months which require adjustments, verify corrections to audit report on software or printed report.
7. Some hints for reviewing audited reports for correctness of accounting principles and software application processing accuracy are:
 - a. Insure original “Total to Account For” and “Total Accounted For” with corrections reconcile to audited “Total to Account For” and “Total Accounted For” and distributor records.
 - b. Crosscheck audited SMC-7A’s to audited SMC-7 to insure sales are correctly reflected on SMC-7.
 - c. Verify receipts of total deliveries and related butterfat test are in agreement with the SMC-6 audited amounts.
 - d. Crosscheck transfers reflected on the SMC-7C to the SMC-7 to insure accuracy.
 - e. Crosscheck total discount on the SMC-6B to the SMC-6.
 - f. Review SMC-8 to insure “Reconciliation of Producers Receipts” reflect a balance of zero.

- g. Crosscheck Class I allocation by market from SMC-6 to monthly report of settlements.
 - h. Crosscheck that the net SMC total billing value from invoices checks to the net paid/reported on the monthly report settlement.
 - i. Review SMC-40 to insure settlement sheet values balance with the SMC-6 values.
8. Crosscheck net adjustment values to Settlement Adjustment Forms and Assessment Adjustment Forms.
 9. Crosscheck Settlement and Assessment Adjustment Forms to the adjusted total reflected for each cooperative/producer.
 10. Review management letter and other correspondence for:
 - a. Content that adequately addresses the primary reason(s) for the adjustment,
 - b. Notification of **all** affected parties, including cooperatives without base assignments or that have special arrangements to deliver base deliveries on behalf of the cooperative with base assignment.
 - c. Review addresses to insure proper parties are being communicated.
 - d. Review all correspondence for grammar, spelling, punctuation, etc.
 11. Make sure there are a least one original set of settlement and assessment adjustments for the auditor to email to appropriate parties.
 12. Pull the audit program, SMC-40's, summary of current audit adjustments (settlement and assessment) and all correspondence and give the packet to the Administrator for review. Post the date the audit was reviewed to the audit log.
 13. When the packet has been reviewed by the Administrator, he will give it to the auditor who prepared the audit. The auditor will email the letter and any settlement adjustments to the dairy and appropriate cooperative(s).

Non-processing general distributor Audits

Non-processing general distributor audits are primarily audits of Class I sales. The type of audit for a non-processing general distributor depends on whether or not their sales are included on a processor's report (major or large report) or are entered on a separate report (small report) for the non-processing general distributor (see #4 below under Procedures for Desk Audits of Non-processing general distributors). If the necessary material for the audit can be sent to the auditor by the non-processing general distributor, the audit shall be performed as a desk audit. However, if the material cannot be mailed or if the non-processing general distributor requests an on-site audit, the audit shall be handled as a regular field audit.

Procedures for Desk Audits

1. The auditor shall contact the non-processing general distributor to request the following material for the audit: (a) listing of all customers, including addresses, (b)

supporting documentation to verify the Virginia sales reported, (c) copies of invoices for selected customers, to be used in verification of compliance with the fair trade regulations, and (d) review of the information contained on the operations and organizational chart.

2. Pull copies of the non-processing general distributor's reports for the audit period. If the sales are included in a processor's monthly report of receipts and utilization, the sales information should be copied from either the original or audit copies of the monthly reports. If the non-processing general distributor's sales are entered as a small report, pull the audit copies for the audit period.
3. Follow the same procedures for auditing sales of a processor, marking changes in red.
4. If the sales were included on a processor's report, a copy of the non-processing general distributor's audited sales should be placed with the processor's audit copies. If the audit is of the non-processing general distributor's small reports, an assessment adjustment sheet should be prepared to show any changes in Class I assessments.
5. Prepare the audit program for a non-processing general distributor (see forms section for a copy of this program).
6. If auditing small reports, enter the Class I pounds in the sales comparison section of the audit program. If the audit is of sales units only (usually if sales are added to a processor's report), enter the units in the sales comparison section.
7. Refer to the auditing standards for processors on procedures for saving audited files, reviewing audits, etc.

Cooperative Audits

Regulation No. 2VAC15-20-40C.1 of the SMC Regulations states that producer deliveries must be "of merchantable milk which meets the requirements of health authorities having jurisdiction during the base-adjusting period, which shall consist of the months of September, October and November of the preceding year" and "shall only include milk from a producer's own licensed production unit". In order to insure this regulation is properly followed, the SMC audit staff must periodically audit cooperatives with Virginia base-holding producers. (NOTE: the Milk Commission at this time is not authorizing cooperative audits.) The following procedures should be followed when auditing cooperatives.

1. Audit production records for September through November. It is not necessary to audit all producers. Instead, pull a sample (not less than 10%).
2. Reconcile monthly production to all disposition methods, including dumped milk.
3. Review production records to be sure dumped milk and milk that was contaminated are not included in the production figures.

4. Verify that the milk produced in the audit period was actually delivered. For example, milk produced on November 30 must have been delivered on November 30 and not December 1 in order to be included in the base-adjusting period.
5. Review the production days included in the three-month totals by counting the days of production from September 1 through November 30. (September = 30 days, October = 31 days, and November = 30 days, for a total of 91 days.)
6. Verify daily production picked up by authorized haulers to the cooperative's producer production summaries.
7. Review summaries for accuracy of posting and math.
8. Review producer recaps for accuracy of posting and math.
9. Verify summaries to the cooperatives producer recaps, which provide the total cooperative production and producer payroll for each month.
10. Review producer tickets to SMC base-holding report to be sure producer is a base-holding producer and amounts reported to SMC agree.
11. Review postings to producer payroll reports to be sure postings are based on delivery dates and not picked up dates.

Cost Study Standards

In order to insure the cost studies prepared by the State Milk Commission's audit staff are standardized, the following guidelines are to be followed in preparing, documenting and publishing the cost studies.

1. All studies are to follow the procedures outlined in the Case and Company Cost Manual. The methods employed in allocating operating costs may vary depending on the type of cost and the circumstance, but cost allocated to cost centers as outlined in the manual and the methods of allocating costs from one cost center to another cost center, function, or element **must be strictly followed** to provide consistency and comparability from one study to another.
2. All studies are to be prepared in a manner that affords consistency of presentation so that the study of one processing plant compares to that of another in style, format, and content. Each study should have uniform presentation to include but not limited to consistent schedule formats, data formats, indexes, footnotes, supporting exhibits, and narrative information.
3. All studies **will include** a narrative portion that explains in detail the nature of the operation. This narrative should be updated with each study. A more detailed comprehensive narrative is to be prepared providing maximum detail of operations and marked as "**CONFIDENTIAL**" for management and other auditors.
4. All studies are to be programmed in a manner that affords consistent recording, processing and summarization of units, cases, resale items, prices and values, filling units, summary statistics, etc. The programming should allow for limited data entry beyond that of raw data; i.e., formula driven movement of calculated data from one

cell to another. The software should be basically inter-changeable from one study to the next with limited alteration or amendment.

5. All studies are to be completed with proper supporting documentation indicating source of information, appropriately annotated to indicate the nature of the information and its use. Supporting documentation and work papers are to be annotated with a referencing index and page numbers. They are to be headed with descriptions that clearly identify the information presented, its use, the method of calculation or allocation and its source. The schedules that are used from one study to the next are to be computer generated. The only manually generated information and data permitted will be one time items that are needed for a given study. All information and documentation provided by the processing plant personnel are to be annotated as to the source, date provided, use and referenced for indexing. Any calculations performed on documents supplied by the plants should have headings and information concerning the calculations used. All working papers are to be grouped by type, indexed, tabbed and bound.
6. All studies should account for total plant expenditures for all cost centers presented in the working schedules as well as the Case and Company schedules regardless of their use in the final unit processing costs. Adjusting entries to transfer costs and/or eliminate costs to create costs that are applicable to the period studied or more accurately represent the actual processing and operational costs associated with the study should be clearly defined and explained in a consistent and uniform manner.
7. All studies are to be performed in a manner that affords an adequate audit trail to identify the source, schedule or other documentation from which the information emanates. A uniform system of identification of supporting documentation should be interchangeable from one study to another. There should be an index of supporting documentation sequentially structured.
8. All studies should be performed in a manner that maximizes the use of formula driven calculation and movement of data in the classification and allocation of expenditures to the Case and Company functions and cost elements. The recording, manipulation and reporting of these costs should be consistent and uniform to the maximum extent possible. Auditors may exercise latitude in the creation of supporting work sheets to allocate costs of given expenditures to the main work sheet. However, the requirement of titles, headings and formats with methodology utilized/provided must be adhered to at all times.
9. All studies should provide for the maximum utilization of Excel technology to present a cost study report that is professional in appearance as well as informative.
10. Each study should provide comparative information using current information as compared to information gathered in previous studies as the processor deems appropriate. Also, the auditor should provided schedules and exhibits necessary to explain any significant variances in cost from current study to previous studies.

11. Each auditor has the responsibility to update the most current weighted average processing cost schedule (WAPCO) and insuring its accuracy before submittal to the Audit Team and/or Administrator for review.
12. Each auditor should review all costs presented for the period studies to ascertain if they are representative of normal re-occurring operating expenses or are one-time expenses that need adjustment to properly reflect their impact on the period studied. Each auditor should explain such expenditures and method of adjustment/allocation to reflect its impact of the period studied in the working papers.
13. All studies should be prepared using information and data furnished by the processor being studied as the base information upon which the final cost elements are to be derived. However, each change/adjustment to the original numbers should be annotated and reconciled to the original amounts provided. All such adjustments and explanation for amendment will then be easier to explain to the processor and SMC management.
14. Each study should include a SMC management analysis that summarizes the major cost elements and compares information from the previous study. This analysis may be part of the summary information prepared for the processor and not necessarily a separate report.
15. Each auditor has the responsibility of assuring the accuracy of the cost study and should take any measures necessary to provide for accuracy. A brief memorandum to the file detailing actual steps undertaken to provide for accuracy should be a part of the working papers.
16. All precautions should be taken by each auditor to keep working papers and other documents pertaining to cost studies off desk and in a secure place while the study is being completed. This also pertains to previous studies. All efforts necessary should be taken to remove/hide any name or other identification of the processor from any and all documents as soon as practical. Proper identification should always be the numbered code assigned to each cost study.
17. Each study shall also include a brief narrative summary of the study detailing information of major significance for management of the processor studied. This narrative shall be the basis of the information presented at the exit conference.
18. It will be the responsibility of each auditor to review with the Audit Team the methodology used in his/her cost study, keeping all informed that consistency is being maintained. The Audit Team and Administrator shall review and approve all methodologies utilized.
19. The Audit Team and Administrator shall be advised of all processes undertaken by each auditor to achieve standard cost studies. It will be each auditor's responsibility to insure that his/her study is consistent with all other studies to the maximum degree possible.
20. Each auditor shall conduct an exit conference. This conference shall include a brief overview of the methodologies utilized in the study, what information the printed study contains and the major findings of the study to include variances from the prior study.

Presumed Costs

The Commission's Regulations prohibit the sale, advertisement, offer to sale, or transfer of Class I fluid milk products at less than cost. Specifically, 2 VAC 15-20-100, Rules of Practice, section 2.c, states:

"No processing general distributor, producer general distributor or distributor, his officers, agents or employees, shall engage in, permit or encourage any method or device in connection with the sale of milk which results in increasing or reducing the net price for the product above the maximum price or below the minimum price when established by the approving authority."

The Monthly Presumed Cost Schedule prepared by SMC is a *guide* for distributors, wholesale and retail, in negotiating the sale price of their milk products. Distributors may sell their products at prices other than those appearing on the Monthly Presumed Cost Schedule **as long as** they utilize the accounting principles established in the Case & Company cost manual and submit this proof in writing to SMC. Each distributor has the following options in pricing his Class I products to Virginia customers:

1. Presumed costs may be used as a guide in determining minimum pricing which do not violate the below cost pricing prohibition.
2. Presumed costs may be used as a guide in determining minimum pricing with a distributor substituting certain individual cost elements unique to the individual distributor, such as, delivered base discount, actual finished product test, etc.
3. Case & Company cost studies may be used in determining minimum pricing for the processor if on file with the Commission. A processor's cost may be substituted for the weighted average cost determined by the Commission.
4. Meeting a lawful price of a competitor as long as the Commission is informed of such action.

The costs of Class I fluid milk products for resale are presumed to be the net invoice or transfer price plus six (6) percent. In the absence of approved cost analysis, the costs of Class I products processed and packaged by a licensed distributor are presumed to be comprised of the following cost elements at the plant's dock:

1. Net cost of raw milk, calculated at Virginia's Class I producer's price, adjusted to the test of the finished product.
2. A shrinkage factor of 2 % of the volume of each container computed utilizing the established Virginia Class II rate.
3. Virginia State Milk Commission assessment cost to the licensee adjusted to product.
4. The weighted average of all plant processing costs derived from Commission studies of processing general distributors.
5. Presumed product delivery costs percentages by volume delivery category.

The cost studies performed by the Commission are on a representative number of licensed processing distributors. They are used to basically update processing costs of Class I products from the receipt of producer raw milk through the processing and packaging of finished products to the loading platform. Every year, the cost studies are updated so that the most recent processing costs are available. The results are combined with other studies and a weighted average of all processing costs is determined and applied to the presumed cost for the dairy industry.

The cover page of the Monthly Presumed Cost Schedule contains the following information:

- ❑ the applicable month and effective date;
- ❑ the pricing elements used in the formulation of presumed costs for individual products, sales markets, and sales category (wholesale or retail);
- ❑ current month Class I skim prices by market;
- ❑ current Class I butterfat price by market;
- ❑ current Virginia State Milk Commission distribution assessment rate;
- ❑ and, the most current Class II skim and butterfat prices available.

The remainder of the report details platform and delivered unit presumed costs for each market, giving butterfat test of a given product, finished products and container sizes, presumed platform cost for Class I products sold where the customer picks up the products at the processor's dock/platform, and the presumed wholesale and retail delivered costs to customers given in three volume delivery categories: 0 - 13 cases of all products per delivery, 14 - 99 average cases per delivery, and 100+ average cases per delivery. The presumed delivery cost percentage for each category, according to Regulation 2 VAC 15-20-100,3.g.2, "may be adjusted each year by the annual percentage of change in the weighted average case delivery cost as determined by utilizing the accounting principles set forth in the Fluid Milk Products Cost Manual, March 1, 1979, prepared by Case & Company, Inc."

These percentages are applied to the platform cost for each product to arrive at the presumed product cost.

The presumed retail costs for the same delivery categories all have 6% applied to the wholesale presumed delivered costs. The 6% is the Commission's established presumed retailer cost for merchandising and sales.

The last page of the Presumed Cost Schedule for the dairy industry in Virginia is the raw product, shrinkage and assessment costs associated with each finished product. The costs are provided for each Virginia market and provide the raw cost for each finished Class I product by container size.

An integral part of the raw milk costs in Virginia is the allowance of the delivered base discount applied to producer prices. This discount is not included in the raw milk cost calculation as the delivered base discount percentage varies significantly among licensed processors. A licensed distributor can use the discount in justifying their minimum costs.

The Commission's prohibition against selling Class I fluid milk products below cost does not pertain to all sales. For example, the Commission does not control the pricing to accounts located outside its jurisdiction, such as out of state sales or sales in the counties of Arlington, Loudoun, Fairfax, and Prince William. Additionally, the Commission does not regulate the pricing to accounts located in areas of Virginia over which the State has ceded jurisdiction such as federal government reservations and properties. The Commission classifies these sales as Class I-A and as such would require, at a minimum, processors to settle with producers at the established producer Class II price. Lastly, the Commission does not regulate pricing to public schools, state institutions, of higher learning and state agencies. However, the Commission does classify sales in the latter described groups as Class I for producer settlement purposes and would require processors to settle with producers accordingly.

(The above information on Presumed Costs has been pulled from a presentation the Commission made to Virginia Dairy Tech on November 10, 1993. Some modifications were made.)

(NOTE: SMC AUDIT MEMORANDUM FROM EDWARD C. WILSON, JR., DATED SEPTEMBER 22, 1992, CLARIFYING REGULATION NO. 10, PARAGRAPH 7(G), STATES THAT ALL PRICING REGULATIONS ON FINISHED CLASS I PRODUCTS TO STATE AND LOCAL GOVERNMENTS AND POLITICAL SUBDIVISIONS ARE EXEMPT FROM BELOW COST PRICING. "AT NO TIME SHOULD A LICENSED DISTRIBUTOR BE CITED FOR BELOW COST SALES TO THOSE ENTITIES." PLEASE REFER TO THE REFERENCE MEMORANDUM SECTION OF MANUAL FOR A COPY OF THIS MEMORANDUM.)

General Information

Adjusted Class I Skim and Butterfat Prices:

When a plant is not fully regulated under a federal order, Virginia's Class I skim and butterfat prices for each market must be adjusted to the butterfat test of each cooperative. The following shows how the adjusted prices are calculated:

	<u>Skim</u>	<u>Fat</u>
VA's Class I Eastern price:	\$13.37	\$.9867
VA's Class I Western price:	\$13.17	\$.9847
VA's Class I Southwest price:	\$12.75	\$.9805
Cooperative X's butterfat test: 3.741512	Coop X's skim: $1 - (3.741512/100) = .96258488$	
Eastern Market Skim price adjusted: $\$13.37 \times .96258488 = \12.86975985		
Eastern Market Butterfat price adjusted: $\$.9867 \times 3.741512 = \3.69174989		

Total adjusted Class I Eastern Market Price: \$16.56150974

Western Market Skim price adjusted: $\$13.17 \times .96258488 = \12.67724287

Western Market Butterfat price adjusted: $\$.9847 \times 3.741512 = \3.68426687

Total adjusted Class I Western Market Price: \$16.36150974

Southwest Market Skim price adjusted: $\$12.75 \times .96258488 = \12.27295722

Southwest Market Butterfat price adjusted: $\$.9805 \times 3.741512 = \3.66855252

Total adjusted Class I Southwest Market Price: \$15.94150974

Chocolate Syrup Mix

On June 18, 1993, SMC issued Information Memorandum #VASMC: 93-5, regarding how to account for the receipt and utilization of 18 pound chocolate syrup mix in compliance with Regulation No. 7. (Please refer to Information Memorandum Section of Manual for copy.) According to this memorandum, receipts are to be accounted for as follows:

"All plants will be required to maintain production records to substantiate the gallons of water, sweetener, and pounds of powder used to make the syrup mix. The total gallons of water used per month should be multiplied by the weight factor of 8.34 to arrive at the total pounds of water used. The total pounds of water should be recorded as **other source receipts** on [the] Milk Commission report."

The utilization is to be accounted for as follows:

All state order plants will continue to use a weight factor of 8.0 lbs. per gallon of finished product for all disposition of this fluid product. [Fully regulated federal order plants] should continue to use a weight factor of 8.0 lbs. per gallon of finished product of all dispositions of this fluid product in the market areas controlled by the Virginia Milk Commission. . . . It will also be necessary to take the total pounds of water reported in other source receipts and amend (add) this same amount to the total Class I route dispositions on the federal report of receipts and utilization for SMC accountability only."

Determining Case Volume for Customers Utilizing Consolidated Billings and Payments

On March 13, 1992, SMC issued Information Memorandum #VASMC: 92-2, pertaining to how to determine case volume for customers who are utilizing consolidated billings and payments. Regulation 2 VAC 15-20-100.3.g states:

"However, when two or more wholesale accounts purchase Class I items from a distributor under a contractual agreement which provides for consolidated billing and payment, the

average case delivery for the entire group of accounts shown on the consolidated billing shall be used instead of delivery volume to each individual account."

The following should be used in determining the case volume for consolidated billings:

1. Total cases purchased during an average month
2. Total deliveries received (# of customers in consolidated billings X average deliveries per month)
3. Total case volume divided by Total deliveries equals Average cases per delivery

For example, "XYZ Supermarkets, Inc." has a total of 25 stores. In February, 1992, 11 of these stores received 24 deliveries each and 14 stores received 20 deliveries each during the month.

Total cases purchased during an average month: (41,779)

Total deliveries received (11 x 24 + 14 x 20): 544

Total case volume: 41,779/544

Average cases per delivery: 76.0

Bulk Transfers

The current ruling is that all bulk milk is to be transferred as Class II even though it may be subject to re-classification if circumstances warrant.

Federal Order Reports

Copies of some plants' federal order reports are being accepted in lieu of the SMC reports. This requires the plants submit their Virginia sales broken down by market and that any school sales also be listed separate by market. However, if both the federal order report and the SMC report are received, the Receipts and Utilization must agree.

Adjustment to Flavored Products:

Federal Order plants will use the federal government's conversion factors for flavored Class I milk products. These products should be corrected to reflect SMC's conversion factors. The difference between the Federal Order and SMC's pounds should be included in Class I-A.

Adjustment to Class I-A or Class II:

If during an audit it is determined adjustments are required to Class I-A or Class II receipts, a corresponding adjustment will need to be made to utilization.

Overage/Shrinkage

If the pounds on the SMC-7's Total To Account For exceeds the Total Accounted For (receipts exceed utilization), this is known as *shrinkage*. If the pounds on the SMC-7's Total To Account For are less than the Total Accounted For (utilization exceeds receipts), this is known as *overage*.