

present. The use of administrative funds to procure property or services is an allowable cost (sometimes requiring FNS approval) and thus is appropriate to include in this section. We propose to include again the reference to 7 CFR parts 3016 and 3019, as these are the current Federal regulations that apply to procurement of property and services with program funds. As at present, State or local agencies may follow procurement procedures established by State or local regulations as long as these procedures do not conflict with Federal regulations. Also, as at present, Federal regulations do not relieve State or local agencies from responsibilities established in contracts relating to procurement of property, equipment, or services.

In paragraph (e), we propose to include the current requirements for the use of program income, rather than in a separate section. As at present, State and local agencies must use program income—income directly generated from program activities—for allowable program costs, in accordance with 7 CFR part 3016. We propose to provide two examples of program income: The sale of packing containers or pallets, and the salvage of commodities. We also state, as in current regulations, that program income does not include interest earned from administrative funds.

In paragraph (f), we propose to address the use of funds recovered as a result of claims against subdistributing and local agencies, and against participants. Currently, the State agency must use funds recovered through claims actions against subdistributing and local agencies in accordance with the provisions of 7 CFR 250.15 and FNS Instruction 410–1. We propose to incorporate this requirement in this paragraph for the sake of clarity. We also propose to require that the State agency use funds recovered as a result of claims against participants for allowable program costs. We propose to allow the State agency to authorize local agencies to utilize such funds for allowable program costs incurred at the local level, rather than returning them to the State. This authority is being proposed for State agencies since, in some instances, these funds can be used more efficiently and effectively at the local level.

Return of Administrative Funds, Section 247.26

Section 247.18 of the current regulations addresses closeout procedures. Under current procedures, if a State agency does not use all of the funds allocated to it for the fiscal year,

FNS recovers the unused funds at the end of the fiscal year. If, in the following fiscal year, OMB reapportions the recovered funds, FNS reallocates them to all State agencies. FNS reallocates to each State agency a share of the total reapportioned funds that is proportionate to its share of the total assigned caseload for the year in which the reallocation takes place.

As discussed in detail above, the Farm Security and Rural Investment Act of 2002 requires that the Department provide State agencies with a grant per assigned caseload slot to pay administrative costs. The law limits the amount of administrative funds provided State agencies to the amount provided under the formula described in proposed § 247.22. Therefore, administrative funds recovered at the end of the year and reapportioned by OMB will be used to support the program by generating caseload and the administrative funding that must accompany it. Such funds will not be reallocated to State agencies in the form of administrative funds in addition to the mandated grant per slot. We propose to include a description of this process in this proposed section 247.26.

Financial Management, Section 247.27

Currently, under § 247.9, State and local agencies must establish a financial management system that provides an accurate, current, and complete disclosure of the financial status of the program. Among the various aspects of the program's financial status, the State agency's system must include:

- (1) An accounting of all property and other assets procured with program funds.
- (2) An accounting of all program funds received and expended each fiscal year.
- (3) The accurate completion of required reports, and the maintenance of records identifying the source and use of administrative funds and program income (currently required under § 247.12).
- (4) Prompt resolution of audits and claims.
- (5) Prompt disbursement of funds for program costs.
- (6) Assurance that local agencies will develop and implement a financial management system that allows them to meet Federal requirements.

We propose to include financial management requirements for State and local agencies in this proposed § 247.27. In paragraph (a), we propose to state that State and local public agencies must establish a financial management system in accordance with the provisions of 7 CFR part 3016, and that

nonprofit organizations must follow financial management requirements contained under 7 CFR part 3019. We also propose to include the current statement that the State agency's financial management system must provide accurate, current, and complete disclosure of the financial status of the program, including an accounting of all program funds received and expended each fiscal year. We also propose to include the current requirement that the State agency must ensure that local agencies develop and implement a financial management system that allows them to meet Federal requirements.

In paragraph (b), we propose to include some of the important components of the State agency's financial management system, which are treated in more detail in 7 CFR part 3016. These include:

- (1) Prompt and accurate payment of allowable costs.
- (2) Timely disbursement of funds to local agencies.
- (3) Timely and appropriate resolution of claims and audit findings.
- (4) Maintenance of records identifying the receipt and use of administrative funds, funds recovered as a result of claims actions, property and other assets procured with program funds, and the generation and use of program income (as defined under the proposed § 247.25(e)).

Storage and Inventory of Commodities, Section 247.28

Currently, under § 247.4, the State agency is required to protect commodities from theft, spoilage, damage or destruction, or other loss. Other requirements relating to the storage of commodities are contained in 7 CFR 250.14, and pertain also to CSFP. Currently, under § 247.13(c), a physical inventory of all foods at each storage and distribution site is required on an annual basis. We propose to include, in this proposed § 247.28, the current requirements for storage and inventory of commodities, with only minor changes.

Under paragraph (a), we propose to include the current requirement that State and local agencies must provide for storage of commodities to ensure their protection from theft, spoilage, damage or destruction, or other loss. We propose to state specifically that State and local agencies may contract with commercial facilities to store and distribute commodities, which is presently contained under § 250.14 of this chapter. We also propose to indicate that the required standards for warehousing and distribution systems,