

July 12, 1999

Board of Directors
Southeast Virginia Farmers Market Cooperative
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On February 9, 1999, the Deputy Commissioner of the Department of Agriculture and Consumer Services notified us of circumstances suggesting the possibility of fraudulent transactions involving the Southeast Virginia Farmers Market. Subsequently, the organization overseeing the Market, the Southeast Virginia Farmers Market Cooperative (Coop), authorized the Auditor of Public Accounts to audit the Coop's financial records for the period June 1998 through November 1998.

Background

In 1996, the General Assembly approved the appropriation of \$4.6 million for the construction of the Southeast Virginia Farmers Market (Market). The Farmers Market Board, a unit of the Department of Agriculture and Consumer Services, would oversee the Market's construction and initial development. One of the primary purposes of the Board is to promote the growth and development of farmers' markets.

On May 30, 1997, the Farmers Market Board awarded an operator's contract to the Coop to manage the Market. Subsequently, a construction contract was awarded June 30, 1997 and construction on the Market was completed May 20, 1998. The Market began operations in June 1998 and the Coop hired a Department of Corrections' employee to manage Market operations in July 1998.

On October 1, 1998, a local producer contacted the Department of Agriculture and Consumer Services to register a complaint about the Market. The producer complained that a relative had not received payment (estimated to be around \$100,000) for watermelons processed and sold through the Market.

To address the complaint, the Department of Agriculture and Consumer Services conducted reviews of financial records and preliminary interviews with Market personnel and affiliated producers. These reviews led to the involvement of the Southampton Commonwealth's Attorney and Sheriff's Department, who seized the Coop's records on November 19, 1998. The Commonwealth's Attorney and Sheriff conducted additional interviews that led to the request of this Office to conduct an audit of the Coop's financial records. Our review consisted of reviewing Coop financial documents and computer records, interviewing Coop and Market personnel, and performing an operation review of the Eastern Shore Farmers Market.

Interim Letter

On March 12, 1999, this Office issued an interim letter concerning the operation of the Market. The letter provided the Coop with interim information necessary to operate the Market, pending the resolution of our work and that of the Commonwealth's Attorney. This report incorporates all of the interim letter's findings and recommendations and represents the completion of our investigation.

Audit Work

The primary accounting record of the Coop and the Market was a checking account. We have reviewed the activity of the account and present our findings below.

Checks

During the period, the Coop wrote 109 checks totaling \$203,591. All checks appeared to have legitimate payees representing either vendors, employees, or producers. The Market wrote 50 checks to vendors for \$57,911 (28%). Our review found documentation supporting 44 of these checks, usually in the form of vendor statements, receipts, or bills. We could not find support for vendor payments totaling \$17,982. One employee received salary payments of \$1,301 supported by timesheets, although sometimes timesheets did not have any approval.

The Market wrote 52 checks to producers for \$144,379 (71%). Producers' payments either had inconsistent or no documentation. Payment information came from either a computerized word processing document or spreadsheet, and usually showed gross produce less Market charges. However, we could not trace payment information and charges to source documentation, such as weight tickets.

Deposits

The account showed deposits during the period of \$208,134, including \$9,400 from the sale of Coop stock and \$25,000 from credit line loans. The Coop had pre-printed receipts, but did not consistently use them, although the receipts allowed for documenting weights and other information. We were able to trace most buyer payments into the account as deposits and found support for the amount.

Conclusion

As discussed above, Market management did not have source documents to identify, weigh, or track producers' products. Without this documentation, we cannot determine what produce the Market received, processed, transferred, or sold. This lack of documentation prevents us from determining the appropriateness or inappropriateness of any claims against the Market.

Fundamental to the Market's operations must be its ability to document all activity processed through the Market. Lack of documentation prevents the Market from having the proper support for producer service charges and packing materials.

Recommendations

Obtain and Develop Experienced, Knowledgeable Management Personnel

The Coop has responsibility for developing Market policy and providing oversight, and is comprised of up to 14 local producers who serve as a Board of Directors. These Board members are knowledgeable about farming, but lack experience and knowledge regarding the day-to-day operations of the Market. Therefore, the Coop hired a Department of Corrections' (DOC) employee to manage the Market.

This DOC manager had no management experience in farmers' market operations. Additionally, while this individual assumed some managerial responsibilities for the Market, he understood that his primary role was overseeing Corrections' operations as both a buyer and producer, along with managing inmate labor. Lack of Market experience and confusion on his managerial responsibility contributed to ineffective leadership for the Market.

To address the lack of leadership, several Coop board members became more active in the management of the Market's day-to-day operations. However, as noted earlier, Coop board members do not possess the experience and knowledge concerning the Market's operations and had their own businesses to manage.

The Coop Board is a voluntary group designed to hire a manager and provide policy guidance rather than identify and address daily operating problems. Without an experienced market manager, the board members appear to disagree on how to operate the Market, thus hindering their promotional efforts. Overall, the Coop Board does not have structure or expertise to run the day-to-day operations of the Market and needs to immediately undertake the hiring of a competent full-time manager.

For the Market to operate effectively in 1999 and in future years, the Market must immediately come under the leadership of a competent, knowledgeable manager. This Manager should work through the Virginia Department of Agriculture and Consumer Services and other Commonwealth farmers' markets to facilitate his understanding of a farmers' market operation. Further, the Board must clarify market policies and the duties and responsibilities of both the DOC manager and Market manager.

The Farmers Market Board, under the direction of the Department of Agriculture and Consumer Services, has responsibility for overseeing the operations of each of the farmers' markets. Before the hiring of a Market manager, the Farmers Market Board should work with the Coop so that it has the tools to provide leadership and guidance to the Southeast Virginia Farmers Market.

The Farmers Market Board should provide specific guidance and resources to ensure that the Market develops effective operating procedures, controls, and documentation. If the Board should decide to terminate the Coop's contract, it should move as quickly as possible to identify a new organization to manage the Market or provide competent, knowledgeable management resources itself.

Develop Basic Operating Records and Procedures

During 1998, the Market acted as an intermediary between producers and buyers, receiving and disbursing funds, handling produce, and performing other services. For example, the Market received and weighed produce, graded and sorted it, and provided packing materials to ship the produce to the buyer. Subsequently, the buyer paid the Market, who deducted its costs (e.g., grading, storage bins) and paid the remainder to the local producer supplying the produce.

Our assessment showed a lack of controls, security, and understanding of what workers, producers, buyers, and brokers do and what they should be expected to do. As an example, consistent procedures to identify, weigh, and track producers' products do not exist. We found that producers or their employees weighed and delivered produce without anyone from the Market present or without verification of weights. Producers also operated portions of the grading line and used packing materials without anyone from the Market present. Further, these individuals processed their produce through the Market without completion of any paperwork.

The Coop's financial records showed a clear lack of basic business record keeping and experience. There was a general lack of source documents to identify, weigh, or track producers' products through the Market. Further, the level of involvement by Market personnel was unclear, leading to a misunderstanding as to what records to keep. While Market personnel attempted to keep records, it is apparent they did not understand

their duties and responsibilities. Consequently, personnel only kept what they thought appropriate. Lack of documentation for produce processed through the Market contributed to its financial problems since producers were not always properly charged for services and packing materials they were provided.

In order to properly set up the books and have proper controls, the Coop must first determine how the Market will operate and develop basic operating procedures. If the Market operates as it did in 1998, then fundamental to its operations must be the ability to separately identify and track every shipment it receives and follow this shipment through the Market to its ultimate sale. This process is basic to ensuring that all activity processed through the Market is documented, and that each producer receives his share of any sale based on the amount and quality of any produce he delivered and is properly charged for services provided by the Market.

If the Market operates like other farmers' markets in Virginia, then it would primarily rely on the buyer and producer to receive and weigh produce, process the produce, and provide packing materials for shipment. Subsequently, the buyer would directly pay the local producer supplying the produce. The Market would receive funds through the buyers renting storage facilities and using Market services (e.g., hydrocooler).

We recommend that the Coop consider having the Market operate like other farmers' markets in Virginia. This would restrict its role as an intermediary and allow it to focus on its basic service (e.g., storage). Further, it would greatly reduce the Market's responsibility regarding record keeping and processing.

Regardless of the type of operations established, the Market manager must develop and document basic operating procedures and record keeping requirements. The Market manager should provide training on basic procedures and record keeping to all Market employees and should provide basic information to all buyers, brokers, and producers using the Market facility.

Develop an Operating Plan

Neither the Coop nor Market management developed a clear operating plan or decided how they will work with producers, buyers, or brokers. Lack of an operating plan contributed to much of the confusion and misunderstanding of various parties involved in the Market.

This operating plan should serve as the basic document all parties can use to understand how the Market will operate. Brokers and buyers should use the plan to understand with whom they are contracting, who will receive payment, and the cost of doing business through the Market. Producers should use the plan to understand how they will sell their produce, what charges the Market makes, how the Market will identify and track their goods, and when and how much they will receive or owe.

Although each of the other farmers' markets in the Commonwealth operates somewhat differently, there is clear and adequate direction or leadership as to the role and duty of each of the parties. The Coop and Market management needs to clarify each responsibility within the operating plan and ensure that each understands their responsibilities and how they will work with the producers, buyers, or brokers in operating the Market.

Establish Broker and Buyer Contacts

There is no coordinated production or buying plan between the surrounding area producers, the Market, and the brokers or buyers, even though producers have begun planting crops. To date, the Market has only one committed buyer for the upcoming year, the Department of Corrections, but has discussions underway with several other potential buyers or brokers. At other farmers' markets, the markets establish a relationship with the brokers and buyers before the planting period to help coordinate with producers the amount and type of produce they expect to buy during the year. The producers then typically plan their crops to meet these expectations.

Market management needs to move forward on securing buyers and brokers for the coming season. The Coop needs to decide who is going to recruit buyers and brokers and under what terms. As part of these arrangements, it needs to be determined how each broker and buyer will operate and Market management needs to inform the producers of these arrangements and of the related Market operating costs.

Upgrade Market Security

The security of the Market facility needs to change dramatically. During 1998, access to the Market was unrestricted until the Market finally placed locks on the building. Further, the Market had no security fence or gate, which allowed producers, buyers, and brokers to easily access the facility at anytime and bypass the weigh station.

Fundamental to the operation of the Market is providing all parties secure storage and ensuring a means of properly tracking all goods under the Market's control. The Coop should consider a security fence or a security gate to restrict access. Further, Market personnel need to coordinate with the producers, buyers, and brokers during peak season to ensure that the weigh station and other operations in the Market have adequate staff to meet delivery and shipping needs.

Conflict of Interests

During 1998, the Department of Corrections operated as a producer, buyer, and Market Manager. Further, DOC provided inmate labor to perform several Market services, such as sorting or grading. DOC provided inmate labor instead of rent for space and services at the Market.

The use of DOC employees in the operations of the Market represents an inherent conflict of interest. For example, the DOC Manager sometimes had responsibility for grading produce in the Market. On several occasions, produce valued at \$0 (not suitable for consumption) was given to the DOC at no cost.

The Coop must clearly define the role of the DOC manager and limit market responsibility to Corrections operations as a buyer and producer. Further, the DOC manager should appropriately limit the use of inmate labor to the guidelines established between DOC and the Market. Restricting the roles of both the Department of Corrections Manager and inmate labor should resolve any potential conflict of interests in Market operations.

We provided information on these findings and recommendations to the Coop throughout the investigation.

AUDITOR OF PUBLIC ACCOUNTS

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