

**BEFORE THE PENNSYLVANIA MILK MARKETING BOARD**

**Cooperative Milk Procurement Costs Hearing**

**ALL MILK MARKETING AREAS**

**October 5, 2020**

**Surrebuttal Testimony of Matthew I. Hartland, CPA/ABV**

Presented on behalf of the Pennsylvania Association of Dairy Cooperatives:

Dairy Farmers of America, Inc.,

Lanco Dairy Farms Co-op, Inc., Land O'Lakes, Inc., and

Maryland & Virginia Milk Producers' Cooperative Association, Inc.

My name is Matthew Hartland. My business address is 1800 Fruitville Pike, Lancaster, Pennsylvania, 17604. I am a manager in the Business Consulting Services Group of RKL LLP. I am a Certified Public Accountant and Accredited in Business Valuation and I have worked in public accounting since 2006. My experience is primarily concentrated in business valuation, financial analysis, financial modeling, general management consulting, and litigation support. My educational and professional background are summarized in PADC Exhibit 12.

I am presenting this surrebuttal testimony on behalf of the Pennsylvania Association of Dairy Cooperatives, or the “PADC”, whose members include Dairy Farmers of America, Inc., Lanco Dairy Farms Co-op, Inc., Land O’ Lakes, Inc., and Maryland & Virginia Milk Producers Cooperative Association, Inc.

I would like to address the increases in milk procurement costs of PADC cross-section coops in 2017 and 2018 and the questions raised by Mr. Mong regarding the accounting of the milk procurement costs of the PADC cross-section coops.

### **Increased Milk Procurement Costs in 2017 and 2018**

The primary reason for the increase in the weighted average milk procurement costs for the cross-section in 2017 and 2018 is due to increased contract hauling and logistics expenses. As has been noted in prior hearings, the cooperatives generally cover a larger geographic footprint than the processors in terms of milk procurement activities. Because of that, transportation costs are a significant portion of the cooperatives expenses and managing fluctuations in transportation costs is a significant burden the cooperatives must bear in order to constantly adapt to the changes in market conditions.

It should be noted that aside from the Dispatch Logistics and Hauling Costs, most other cost categories have remained relatively flat or in some cases have declined. There is no creeping up of costs due to the “varied scope of the cooperative enterprises”, as Mr. Mong has suggested, rather these are the same real and significant costs incurred by the cross-section cooperatives that have been presented since the beginning of these hearings.

Furthermore, the cooperative milk procurement costs do not represent the “marketing arm” of the cooperative as Mr. Mong suggested. In total, Line 25 “Advertising” costs for the entire cross section in 2017 account for just \$0.0016 cwt of the cross-section milk procurement costs and \$0.0015 in 2018.

#### **Accounting of PADC milk procurement costs**

Although the Board staff has not audited the PADC milk procurement costs, I am confident they would agree with RKL’s compilation of the PADC cross-section for 2017 and 2018, as they did for 2016.

Similarly, although Mr. Mong says he has not performed any inquiry or examination of the cooperative’s reported costs and doesn’t know if the accounting is correct, it is worth noting that his firm does prepare the audited financial statements for one of the cooperatives in the cross-section and should have sufficient information available to him to confirm those costs. In the world of public accounting, when a CPA performs an audit of financial statements they are in essence attesting to the correct accounting of the financial statements, which is exactly what Herbein and Company has done for one of the PADC cooperatives.

Each of the financial statements (and all relevant underlying and supporting detail) of the other cooperatives in the cross-section have also been audited by well-known and reputable CPA

firms. Although RKL has not audited the cooperatives' financial statements, we are comfortable relying on the information and have no reason to question the accounting.

I have spent a significant amount of time reviewing the financial data covering a two-year period (2017 and 2018) for each cooperative in the cross-section. As I noted in my prior testimony, while reviewing the information, I worked with each cooperative to be able to trace the reported cost data submitted for each Form 60C back to each cooperative's general ledger detail (which is the same detail supporting their audited financial statements). There is a significant amount of income offsetting some of the costs included in the PADC cross-section, and the following are examples of these offsets.

1. **Hauling reimbursement.** Each cooperative incurs contract hauling costs for the transportation of raw milk. Each cooperative also collects reimbursement from their member producers to offset these hauling costs. For 2017 total contract hauling costs for the cross-section amounted to approximately \$247.9 million and total contract hauling reimbursements amounted to \$228.4 million, indicating the total net contract hauling costs for the cross section of \$19.5 million or on average approximately \$0.079 per cwt (before administrative allocation). For 2018 total contract hauling costs for the cross-section amounted to approximately \$269.3 million and total contract hauling reimbursements amounted to \$250.9 million, indicating the total net contract hauling costs for the cross section of \$18.4 million or on average approximately \$0.078 per cwt (before administrative allocation). These are obviously significant costs that the cooperatives bear and there is a significant amount of offsetting income netted against those costs.

2. **Hauling by affiliated or related organization (Section 149.25).** One of the cooperatives has a related party trucking business that provides transportation services. The expenses of the trucking business offset by the associated revenue are included in the cross section under contract hauling costs.
3. **Other income (Section 149.32).** Some of the cooperatives provide services to affiliated or non-affiliated organizations and in turn receive reimbursement for those services. These reimbursements have been included in the cross-section to appropriately offset the cooperative's milk procurement costs.

Based on the evidence provided to me and my discussions with members of each individual cooperative, I am confident that the accounting is correct. I am confident that the expenses are categorized in the correct cost centers. I am confident in the methodology used to allocate labor costs, and I am confident that all relevant income has appropriately been offset against related expenses.

I'd like to thank the Pennsylvania Milk Marketing Board for this opportunity to present this information.