Food Distribution National Policy Memorandum

United States Department of Agriculture

Food and Nutrition Service

3101 Park Center Drive

Alexandria, VA 22302-1500

DATE: February 25, 2004

POLICY NO: FD-023: National School Lunch Program (NSLP)

SUBJECT: Accounting for Donated Foods in Cost-Reimbursable Contracts Between School Food Authorities and Food Service Management Companies

Federal regulations implementing the Department's domestic commodity donation program at 7 CFR 250.12(d), allow school food authorities (SFAs) and other recipient agencies to contract with food service management companies (FSMCs) to conduct their food service operations. In contracting with an FSMC, the recipient agency must ensure that the full value of donated foods is used to its benefit.

Pursuant to Federal regulations at 7 CFR 210.16(c), contracts entered into between SFAs and FSMCs may be "cost-reimbursable" contracts. Under a cost-reimbursable contract, the SFA pays the FSMC for the food costs, supplies, labor, etc., used during a billing cycle. Food costs are often determined by measuring a change in inventory, utilizing the following formula:

<u>Beginning Inventory + Product Received – Ending Inventory = Quantity of Food Used</u>

The quantity of food used is then multiplied by the FSMC's cost for the food item to determine the billing amount. However, a significant drawback under this method is that the SFA may be charged for donated foods provided to the FSMC, if they are inventoried with commercially purchased foods. Such charges would violate Federal regulations.

To ensure that the FSMC does not include donated foods when computing the food costs billing, the SFA must include controls in its cost-reimbursable contract for differentiating between donated foods and commercially purchased foods in the inventory records. Such controls do not necessarily require the maintenance of separate donated food inventories. Further, the contract terms must clarify the responsibility of the FSMC to ensure that its food cost billings do not include charges for donated foods. All donated foods received for the SFA during the contract period must be accounted for; SFAs may also require separate reporting by the FSMC of donated foods used during the billing cycle.

State agencies and SFAs must review all current cost-reimbursable contracts to ensure that contract provisions assure compliance with program regulations. Contracts that do

not provide this assurance must be amended accordingly. Appropriate actions to recover any erroneous charges must also be pursued.

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