



Food Distribution National Policy Memorandum

United States
Department of
Agriculture

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Food and
Nutrition
Service

POLICY NO.: FD-064: Processing (Revised)

3101 Park
Center Drive

SUBJECT: Management of Donated Food Inventories at Processors

Alexandria, VA
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Over the last several years, diversions of Department of Agriculture (USDA) donated foods to processors for processing into end products have increased, due in part to the implementation of National Processing Agreements and other mechanisms that have made processing more accessible to school food authorities (SFAs) and other recipient agencies. While the overall outcome has been beneficial, it has also resulted, in some instances, in excessive donated food inventories at processors. It is important that such inventories be maintained at acceptable levels, in order to ensure efficient distribution and use of donated foods. In accordance with 7 CFR 250.13(a)(2), donated foods must be requested and distributed only in quantities that can be consumed without waste. When donated foods are diverted to processors and not utilized for processing into end products, SFAs and other recipient agencies do not realize the full potential of an asset that can help their financial bottom line.

The purpose of this policy memorandum is to clarify the responsibilities of State distributing agencies (SDAs), SFAs and other recipient agencies, and processors in ensuring compliance with program regulations relating to maintaining and managing donated food inventories at processors, and to provide guidance in reducing such inventories when necessary. This policy memorandum revises the previous FD-064, which was dated February 6, 2007. Although this memorandum focuses on National School Lunch Program (NSLP) donated foods diverted to processors by SFAs, it is also applicable to donated foods diverted to processors by other recipient agencies in other USDA food assistance programs. It should also be noted that school co-ops or consortia, or other SFAs acting as a collective unit, are subject to the same requirements as a single SFA, in accordance with Policy Memorandum FD-067, and must be treated just as if they were a single SFA.

Monitoring Donated Food Inventories at Processors

In accordance with 7 CFR 250.30(n), the SDA must monitor a processor's donated food inventories to ensure that the quantity of donated foods for which a processor is accountable is at the lowest cost-efficient level, but not more than a six-month supply, based on the processor's average monthly usage. A processor's donated food inventories include both unprocessed donated foods and donated foods that have been processed into finished end products. Such monitoring must be achieved through the review of the processor's monthly performance reports. In order to ensure compliance with this requirement, the SDA should work with SFAs and processors to ensure efficient ordering and processing of donated foods, and timely sale of end products. Donated foods should

only be diverted to processors in amounts needed to produce the quantity of end products that SFAs can efficiently utilize during the school year. If the SDA finds that processors are not selling end products to SFAs and drawing down donated food inventories, it must determine the cause and work with processors and SFAs, as appropriate, to resolve the situation. The SDA should ensure that SFAs do not use processors for long term storage of donated foods, as this would increase storage costs for processors, and may ultimately result in higher prices charged for end products.

Application of the Six-Month Inventory Limit

The six-month inventory limit established at 7 CFR 250.30(n) is applicable to the State-wide inventory of donated foods at processors and also to individual SFA donated food inventories at processors. For the purpose of calculating inventory levels, SDAs and processors must use the school year, which begins on July 1 and ends on June 30 of the following calendar year. The average monthly usage is determined by taking the year-to-date usage reported on a processor's June monthly performance report (for the period ending June 30), and dividing by twelve months. Multiplying the resulting number by six will produce the allowable six-month inventory level.

Taking Action on Excessive Inventories

In accordance with 7 CFR 250.30(n), the SDA may, in certain instances, approve inventory levels in excess of the six-month limit if the processor provides written justification for maintaining larger inventories. For example, when donated food shipments are received late in the school year, it may be necessary for processors to carry over larger inventories into the following school year, when such foods can be processed into end products. However, in most cases it will be necessary for the SDA to work with processors and SFAs to ensure that action is taken to reduce inventories in excess of the six-month limit. The following sections of the memorandum describe some of the means by which such reductions may be achieved.

Rejection of Donated Food Orders and Reallocation of Inventories

The SDA should work with processors to identify SFAs that do not efficiently utilize their donated food inventory. Although the SDA must offer the "commodity offer value" of donated foods to each SFA in a school year, in accordance with 7 CFR 250.58(b), the SFA may receive less than the commodity offer value if the SDA determines, in consultation with the SFA, that the SFA cannot efficiently utilize such value, as indicated in 7 CFR 250.58(c). The SDA should contact the SFA to determine if its excessive donated food inventories at a processor are an indication that the SFA cannot efficiently utilize the donated foods. If the SDA determines that this is the case, it may reject any of the SFA's further orders of such donated foods for delivery to processors. The SDA may also reallocate the SFA's current donated food inventory at a processor to another SFA that may utilize the donated foods more efficiently. In accordance with 7 CFR 250.58(d),

another SFA may receive more than its commodity offer value if the SDA determines that such SFA may efficiently utilize more donated foods.

Transfers of Donated Food Inventories

The SDA may also reduce excessive donated food inventories at a processor by transferring donated foods to another processor with which the SDA has a processing agreement. However, before such a transfer is made, the SDA must ensure that the processor will be able to efficiently process the donated foods into end products and sell them to SFAs in a timely manner. Once such a transfer is made, the SDA may not approve a second transfer of the donated foods. A transfer of donated foods, as described above, may be a "paper transfer", rather than an actual physical transfer, if it is acceptable to all parties. In a paper transfer, the "original" processor writes the "receiving" processor a check for the value of the donated foods. Once the check is sent, the original processor may then use the donated foods in its commercial activities. The receiving processor must use the funds to purchase replacement food of the same generic identity, of U.S. origin, and of equal or better quality in all USDA purchase specifications than the donated food, for processing into end products. In a physical transfer, the actual donated food, or commercially purchased food of the same generic identity, of U.S. origin, and of equal or better quality in all USDA purchase specifications for that donated food, is transferred to another processor. The processor receiving the donated food is responsible for transportation expenses.

Since USDA donated bulk beef and pork and donated beef and pork products generally have unique purchase specifications, transfers of such foods must be physical transfers of the donated foods (i.e., without substitutions). Paper transfers may only occur if the receiving processor ensures that commercial replacement of beef or pork is acquired from a USDA approved vendor and meets every aspect of USDA's purchase specification. However, since boneless beef combos are fresh product that must be processed within five days of initial production, transfers of this type of donated food are prohibited.

The SDA may also transfer donated foods to another SDA doing business with the same processor, if the receiving SDA can ensure that end products processed from such donated foods will be purchased in a timely manner. If such a transfer occurs in the same school year that the donated foods were delivered to the processor, entitlement credit may also be transferred from the receiving SDA to the donating SDA (this type of transfer is sometimes referred to as a "redonation"). However, such entitlement credit must be acceptable to both SDAs, and must be approved and implemented by Food and Nutrition Service (FNS).

Value of Donated Foods in Transfers

The value of donated food used in paper transfers must be the commodity file value (i.e., material list value) of the donated food at the time of the transfer, multiplied by the

number of pounds of donated food transferred. However, if the commercial market price is significantly higher than the commodity file value, FNS may permit the receiving processor to credit an SFA for fewer pounds of donated food than transferred, although the processor must still use the commodity file value in effect at the time of the transfer to pass through the value of donated foods in the end products. The processor must provide the SDA with documentation of actual costs of purchasing food in the commercial market for processing into end products, and receive written permission from the SDA to credit the SFA for fewer pounds than transferred.

Payment for Excess Donated Food Inventories

In accordance with 7 CFR 250.30 (n)(3), a processor that has a processing agreement for the following year must pay the SDA for the value of any donated food inventory held at the end of the current year that is in excess of the six-month inventory limit, or that is in excess of a higher inventory level approved by the SDA in accordance with 7 CFR 250.30 (n)(1). However, payment by the processor to the SDA to reduce donated food inventories to required levels is not a preferred option. For this reason, we are using the regulatory authority provided under 7 CFR 250.30 (t) to waive the requirement, in 7 CFR 250.30 (n)(3), that a processor pay the SDA for the value of any donated food inventory held at the end of the current year that is in excess of inventory limitations. The SDA must first work with the processor to determine if a transfer of excess donated food inventories or other options for reducing inventories can be implemented, in accordance with the guidance described above. Although payment by the processor for the value of excess donated food inventories is still an option, it should be used only if other options are not feasible, such as in the following instances:

- The processor ceases participation in processing of donated foods, or ceases such participation in a State.
- The inventory remaining for an SFA is so small that it would be more costly to transfer such inventory to another processor or SDA.
- The processing agreement is terminated for noncompliance with its provisions.

The SDA must contact the FNS Processing Initiatives Team before approving payment for the value of excess donated food inventories, in order to ensure compliance with 7 CFR 250.13(a)(1)(ii), which prohibits the sale of donated foods without FNS approval.

Conclusion

Reallocations of donated foods to other SFAs, or a transfer of donated foods to another SDA that does business with the same processor, are preferable to transfers to another processor, since they do not involve an actual physical transfer of donated foods, or a payment from one processor to another. Physical transfers of donated foods also present some technical and safety issues, and may serve to discourage future involvement in processing of donated foods into end products. In all cases, processors may not report

donated food transfers on monthly performance reports until the transfers (physical or paper) are completed. Payment by the processor to the SDA for excess donated food inventories should only be used if other options for reducing inventories are not feasible, and must be approved by FNS.

FNS monitors donated food inventories at multi-State processors through its review of national monthly performance reports. If excess inventories are noted, FNS will contact the SDA to ensure that the problem is resolved, in accordance with the options presented in this memorandum. Should the SDA fail to correct inventory problems, FNS may cancel SDA orders of donated foods to the processor.

Questions regarding management of donated food inventories at processors should be directed to Sherry Thackeray at (703) 305 – 2652 or David Brothers at (703) 305 – 2668.

A handwritten signature in black ink that reads "Laura Castro". The signature is written in a cursive style with a large initial "L".

Laura Castro
Director
Food Distribution Division