



Food and
Nutrition
Service

Park Office
Center

3101 Park
Center Drive
Alexandria
VA 22302

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

SUBJECT: Management of USDA Food Inventories at Processors

Further processing of United States Department of Agriculture (USDA) donated foods (also known as USDA Foods) into end products can provide many program benefits. However, USDA Food inventories must be maintained at acceptable levels in order to ensure their efficient distribution and use. In accordance with 7 CFR 250.10(a), USDA Foods must be requested and distributed only in quantities that can be consumed without waste. Additionally, per 7 CFR 250.35(d), USDA Food inventories at processors cannot be in excess of a six-month supply, based on the processor's average monthly usage, unless a higher level has been approved by the State Distributing Agency (SDA) on the basis of a written justification.

The purpose of this policy memorandum is to clarify the responsibilities of SDAs, School Food Authorities (SFAs) and other recipient agencies, and processors relating to maintaining and managing USDA Food inventories at processors. This memorandum also provides guidance on reducing such inventories when necessary. This policy memorandum revises the previous FD-064 (Revised), dated March 20, 2012. Although this memorandum focuses on National School Lunch Program (NSLP) USDA Foods diverted to processors by SFAs, it should 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.

Monitoring USDA Food Inventories at Processors

The SDA must monitor a processor's USDA Food inventories, including both unprocessed USDA Foods and USDA Foods that have been processed into finished end products. As part of its monitoring process, the SDA must review the processor's monthly performance reports in order to ensure compliance with the six-month inventory limit. The SDA must also work with SFAs and processors to ensure the efficient ordering and processing of USDA Foods and the timely sale of end products.

USDA 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 USDA 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 USDA 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 250.35(d) is applicable to the State-wide inventory of USDA Foods at processors and also to individual SFA USDA 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 the processor's June monthly performance report (for the period ending the previous June 30), and dividing by ten months, which is the length of most school years. Multiplying the resulting number by six will produce the allowable six-month inventory level for the school year beginning on July 1.

Per 7 CFR 250.35(d), SDAs are permitted to approve inventory levels at processors that are higher than six months. FNS recommends that SDAs require processors to submit requests for higher inventories as part of the processor's December monthly performance report so that the SDA can take action, when needed, to manage or reduce inventories at processors. In addition, processors should submit a written request to the SDA prior to and in anticipation of surpassing the six-month inventory limit. The request must include a detailed justification for the need for higher inventories. This justification may include, for example, a higher anticipated average monthly usage, as compared to the previous year, based on executed contracts and orders on hand for the upcoming year. The justification must include specific plans for USDA Food drawdown, product promotion, or sales expansion and must demonstrate the processor's ability to efficiently store and process such quantity of USDA Foods.

Taking Action on Excessive Inventories at the End of a School Year or End of a Processor's Contract

If, at the end of the school year, a processor has USDA Food inventories in excess of a six-month supply, or that is in excess of a higher inventory level approved by the SDA, the SDA has three options. Per 7 CFR 250.35(e), the SDA may permit the processor to carry over such excess inventory into the next year of its agreement, if it determines that the processor may efficiently store and process such quantity of USDA Foods and that the excess inventory is not due to systemic mismanagement of processor inventory. The SDA may also direct the processor to transfer excess inventory to other SFAs, or to transfer it to other SDAs, in accordance with §250.12(e) (transfers can occur at other points in the school year, as discussed below). However, if these actions are not practical, the SDA must require the processor to pay for the USDA Foods held in excess of allowed levels at the replacement value of the USDA Foods. Prior to payment in these cases, SDAs must justify to FNS the determination that the other options are not practical.

If payment is approved at the termination of a processor's contract then the higher of the replacement value or contract value must be used. Payment by the processor for the value of excess USDA Food inventories should be used only if the other options are not feasible and SDAs must justify this determination to FNS.

Rejection of SFA USDA Food Orders and Reallocation of SFA Inventories

The SDA should work with processors to identify SFAs that do not efficiently utilize their USDA Food inventories. Although the SDA must offer, at a minimum, the “commodity offer value” of USDA 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 USDA Food inventories at a processor are an indication that the SFA cannot efficiently utilize the USDA Foods. If the SDA determines that this is the case, it may reject any of the SFA’s further orders of such USDA Foods for delivery to processors. The SDA may also reallocate the SFA’s current USDA Food inventory at a processor to another SFA that may utilize the USDA Foods more efficiently.

Transfers of USDA Food Inventories Between Processors

The SDA may also reduce excessive USDA Food inventories at a processor by transferring USDA 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 receiving the transfer will be able to efficiently process the USDA 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 USDA Foods. A transfer of USDA Foods, as described above, may be a “paper transfer,” rather than an actual physical transfer, if it is acceptable to all parties. If the processors cannot come to agreement regarding the use of a paper versus physical transfer, the original processor may deny the transfer. The SDA may then re-allocate the excess food to other SFAs doing business with the processor. If no SFAs are doing business with the processor, the SDA may consider transferring the pounds to another state.

In a paper transfer, the “original” processor writes the “receiving” processor a check for the value of the USDA Foods. Once the check is sent, the original processor may then use the USDA 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 USDA Food for processing into end products. The value of USDA Food used in paper transfers must be the replacement value (as defined in 7 CFR 250.2) of the USDA Food at the time of the transfer (as dictated by the SDA), multiplied by the number of pounds of USDA Food transferred.

Paper transfers of bulk poultry must be proportional white and dark pounds based on each processors percent allocation for the whole bird. For example, if the original processor allocates 50% white pounds and 50% dark pounds they will reduce the book inventory by equal amounts and multiply the pounds by the assigned USDA cost per pound. The receiving processor will bank the pounds based on their approved percent allocation for white and dark meat pounds. Paper transfers of excessive only white or only dark meat should not occur. The whole bird dark chicken pounds cannot be transferred to another processor that only processes the USDA bulk leg.

In a physical transfer, the actual USDA 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 USDA Food, is transferred to another processor. The processor receiving the USDA Food is responsible for transportation expenses.

Since USDA donated bulk beef and pork generally have unique purchase specifications, physical transfers of such foods must either be the USDA beef and pork, as purchased by USDA, or for physical transfers that include substituted bulk beef and/or pork, must be between two processors that are both permitted to substitute beef and pork in accordance with 7 CFR 250.34 and their respective processing agreements. Paper transfers of donated beef and pork products may only occur if the receiving processor ensures that commercial replacement of beef or pork is acquired in accordance with 7 CFR 250.34 and is certified to be of the same generic identity, of U.S. origin, and of equal or better quality in all USDA purchase specifications for that USDA Food. Since boneless beef combo is a fresh product that must be processed within five days of initial production, physical transfers of boneless beef combo are prohibited.

Transfers of USDA Food Inventories Between SDAs

The SDA may also transfer USDA Foods to another SDA doing business with the same processor, if the receiving SDA can ensure that end products processed from such USDA Foods will be purchased in a timely manner. However, the SDA must request FNS approval. If such a transfer occurs in the same school year that the USDA Foods were delivered to the processor, entitlement credit may also be transferred from the receiving SDA to the donating SDA. However, such entitlement credit must be acceptable to both SDAs and must be approved and implemented by FNS.

FNS' Role in Controlling Inventories

In accordance with 7 CFR 250.12(e) and 7 CFR 250.35(d), FNS may also require an SDA to transfer entitlement and/or USDA Foods at a processor's facility, if inventories of USDA Foods are excessive or may not be efficiently utilized. This action is sometimes referred to as "sweeping" inventories. The SDA must maintain a record of all transfers from its inventories and of any inspections related to such transfers.

FNS monitors USDA Food inventories at multi-State processors through its review of national monthly performance reports and processor audit 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 USDA Foods to the processor or transfer inventory to another SDA or processor.

Conclusion

Reallocations of USDA Foods to other SFAs, or a transfer of USDA 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 USDA Foods, or a payment from one processor to another. In all cases, processors may not report USDA Food transfers on monthly performance reports until the transfers (physical or paper) are completed. Payment by the processor to the

SDA for excess USDA Food inventories should only be used if other options for reducing inventories are not feasible. FNS monitors USDA Food inventories at multi-State processors and has authority to cancel SDA orders of USDA Foods to the processor or transfer inventory to another SDA or processor.

/s/ Original Signature on File
Laura Castro
Director
Food Distribution Division

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