United States Department of Agriculture

Food and Nutrition Service

1320 Braddock Place
Alexandria, VA 22314

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POLICY NO: FD-40: Processing

SUBJECT: Inventory Draw Down in USDA Foods Processing (Revised)

Issuing Agency/Office:	Food and Nutrition Service (FNS)
Title of Document:	FD-40 Inventory Draw Down in USDA Foods Processing (Revised)
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Summary:	This memorandum provides clarification on the value pass through methods available under 7 CFR 250.36 and on the timing of processor inventory reductions (also referred to as draw down) of USDA Foods under each system.
Body of guidance document follows.	

This memorandum provides clarification on the value pass through methods available under 7 CFR 250.36 and on the timing of processor inventory reductions (also referred to as draw down) of USDA Foods under each system. 7 CFR 250.37(b) outlines the basic requirements for reporting reductions of USDA Foods inventories[1]. This revision replaces the previous FD-40, dated January 12, 2005.

Value Pass Through Methods

There are four value pass through systems permitted under current regulations. These methods are described at 7 CFR 250.36. Per 7 CFR 250.36(f), an alternative value pass through method may also be used with prior approval from FNS and the State Distributing Agency (SDA). An approved value pass through system must be used in order to track the value of the USDA Foods contained in or needed to produce processed end products and ensure that each Recipient Agency (RA) receives the full value of the USDA Foods it chooses to divert to processors. For example, an RA diverts bulk apples to a processor to be used as an ingredient for cinnamon applesauce. The RA will purchase cases of applesauce from a distributor or the processor, at a discounted price, that excludes the value of the USDA apples contained in or needed to produce each case.

For all value pass through systems, the value of USDA Foods credited to the SDA or RA is determined by multiplying the USDA established price per pound by the quantity of USDA Foods contained in or needed to produce each finished case of end product. This price is listed in the FNS approved Summary End Product Data Schedules and is referred to in regulation as the contract value.

[1] Burden is approved in OMB control number 0584-0293 Food Distribution Programs, Expiration: 7/31/2023 Title: Processors' Performance Reports (250.37)

Refund or Rebate
Under this system, a processor sells end products to the SDA or RA at the commercial, or gross, price and must provide a refund or rebate for the value of the USDA Foods contained in or needed to produce the end products. Alternatively, a processor may deliver end products to a commercial distributor for sale to SDAs or RAs. In both cases, the processor must provide a refund to the appropriate agency within 30 days of receiving a request for a refund from that agency[2].

Products sold under this value pass through system begin as commercial sales and are not recognized as sales of end products containing USDA Foods until USDA Foods inventory is confirmed and the rebate is issued. Accordingly, a processor should not reduce inventory at the time of delivery to a commercial distributor. Inventory is drawn down from the appropriate agencies' USDA Foods inventory (also referred to as the agency's bank) when the processor issues the rebate to the SDA or RA. This inventory draw down constitutes the transfer of title for the USDA Foods from USDA to the eligible recipient. The rebate should be paid according to the value of the USDA Foods contained in or needed to produce the product, which is in effect at the time of payment.

Direct Discount
Under this system, a processor must sell end products directly to the SDA or RA (i.e., distributors are not involved) at a net price that incorporates a discount from the commercial case price for the value of USDA Foods contained in or needed to produce the end products. Inventory is drawn down from the appropriate agency's bank (i.e. title transfers) upon acceptance of the end product by the SDA or RA. Direct discount differs from direct fee-for-service, discussed below. Direct discount is used for commercial product and the price paid by the eligible recipient is calculated by subtracting the value of the USDA Foods contained in or needed to produce the product from the commercial price.

Indirect Discount (a.k.a. Net off Invoice)
Under this system, also known as net off invoice (NOI), a processor delivers end products to a commercial distributor, which must sell the end products to an eligible SDA or RA at a net price that incorporates a discount from the commercial case price for the value of USDA Foods contained in or needed to produce the end products. A commercial distributor is always involved under this system.

Product sales under this system begin as commercial sales and the products being sold are commercial products. An SDA or RA procures commercial products from a distributor and the distributor procures those products from a processor. The distributor pays the processor at the commercial price. If the eligible SDA or RA to which the product is being sold has the necessary USDA Foods inventory with the processor, the sale is converted from a commercial sale to an NOI sale. The SDA or RA then pays the distributor the NOI price which is calculated

[2] Burden is approved in OMB control number 0584-0293 Food Distribution Programs, Expiration: 7/31/2023 Title: Processing Refund Applications (250.36(b))

by subtracting the value of USDA Foods contained in or needed to produce the product from the commercial price and adding a fixed fee for storage and distribution by the distributor.

The processor must require the distributor to notify it of such sales, at least on a monthly basis, through automated sales reports or other electronic or written submission[1]. After the NOI sale is confirmed, the processor compensates the distributor for the discount provided for the value of the USDA Foods in its sale of end products to an eligible recipient.

FNS cannot assume that the end product delivered by the processor will be sold by the distributor to an eligible recipient. Therefore, the processor may not draw down inventory (i.e. transfer title to RA) until documentation is provided by the distributor that shows a sale to an eligible recipient with adequate USDA Foods inventory. This documentation may be a sales velocity report or other documentation acceptable to the processor that identifies the end product that was sold and the eligible recipient that bought the product[3].

The practice, sometimes referred to as closed stock-keeping unit (SKU) NOI, under which a processor sets up a separate SKU for a specific NOI product and restricts the sale of that product to only agencies with the necessary USDA Foods inventory, is allowable under the regulatory definition of NOI. This practice is essentially an internal accounting mechanism and is an allowable practice provided that it follows the procedures outlined above. The most common use of this practice is for sales of beef and pork end products.

Fee-for-Service

Under this system, a processor must sell end products to the SDA or RA at a fee-for-service (FFS) price, which includes all costs to produce the end products except for the value of the USDA Foods used in production. Unlike some of the other systems, this is not used for commercial products. Three basic types of fee-for-service are used, including direct FFS, FFS through a distributor, and what is commonly known as modified FFS.

Direct Fee-for-Service:

Under this system, the SDA or RA procures end products directly from the processor, pays the FFS price, and the processor either delivers the product to the agency or the agency picks the product up from the processor. The processor’s invoice to the SDA or RA must identify any charge for delivery of end products separately from the FFS price[3]. Inventory is drawn down from the appropriate agency’s bank (i.e. title transfers) upon delivery or pickup. Direct fee-for-service differs from direct discount, discussed above. Direct fee-for-service is used for non-commercial product and the price paid by the eligible recipient is calculated by summing all the costs to produce the end product, not including the value of the USDA Foods contained in or needed to produce the product.

Fee-for-service through a distributor:

The SDA or RA procures end products directly from the processor and also separately procures storage and/or distribution services from a distributor. The processor ships multiple pallets of

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[3] Burden is approved in OMB control number 0584-0293 Food Distribution Programs, Expiration: 7/31/2023 Title: Records Related to Processors' Receipt, Distribution, and Inventory of Donated Foods (250.37(d))

product to a distributor (or the distributor picks the product up from the processor) with a breakout of which RA owns which products. The agency pays the processor the FFS price and separately pays the distributor a fee for storage and/or distribution. Inventory is drawn down from the RA's bank (i.e. title transfers to RA) upon delivery to/pickup by the agency's contracted distributor.

Modified Fee-for-Service (MFFS):
The RA procures end products from a distributor, pays the distributor the FFS price plus a fixed fee for storage and distribution, and the distributor delivers the end product to the RA. The distributor, acting as the RA's authorized agent, procures and purchases end products produced with USDA Foods from the processor on behalf of the RA and pays the processor the FFS price. Inventory is drawn down from the RA's bank (i.e. title transfers) upon delivery to/pickup by the RA's contracted distributor.

Implementation in Processing Agreements and Contracts

In accordance with 7 CFR 250.30(i), processors providing end products containing USDA Foods to a commercial distributor must enter into a written agreement with each distributor, which includes financial liability, not less than monthly end product sales reporting, title transfer requirements under 7 CFR 250.11, and the applicable value pass through system to ensure that the value of USDA Foods and finished end products are properly credited to the SDA or RA[4].

The distinction made in this memorandum with regard to the use of commercial products in these value pass through systems, namely that Fee-for-Service cannot be used for commercial products, may not be reflected in all current processing agreements and contracts. Accordingly, although FNS is allowing flexibility for contracts already in place for school year 2021-2022 on this requirement, the expectation is that at the earliest opportunity and no later than school year 2022-2023, all impacted SDA or RAs will have compliant competitive procurement processes and contracts in place to operate the USDA Foods Processing Program.

State agencies should distribute this memorandum to Program operators. Program operators with questions should contact their State agency. State agencies with questions may contact the appropriate Food and Nutrition Service Regional Office.

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

[4] Burden is approved in OMB control number 0584-0293 Food Distribution Programs, Expiration: 7/31/2023 Title: Agreements Between Processors and Distributors (250.30(i))