Commodity Exchange

It's easy to think of the products you receive from the USDA Foods program as "free" food for your school meals program. After all, you don't write a check or pay an invoice to the federal government for them. Sure, your state may charge you a handling and distribution fee, but the commodities themselves have no direct cost to your school nutrition operation. Or do they?

Being Accountable

There's no such thing as a "free" commodity. Learn and apply the true value and costs of your USDA Foods.

BY BARRY SACKIN, SNS

The issue of the value of USDA Foods affects school districts in two ways. First, even though there may not be a direct cost for commodity items, school food authorities (SFAs) must account for the USDA Foods they receive (in bulk or processed forms) on financial statements and in audits. Second, the commodities you receive *are*, in fact, an asset, and you should apply the same diligence in using this asset as you do all other facets of your school nutrition program. Let's explore both of these issues.

Accounting for Your Commodities Federal law provides an entitlement to school districts for USDA Foods. For SY 2012-13, schools that participate in the National School Lunch Program (NSLP) are entitled to 22.75 cents for every lunch served in the preceding year. These funds are administered by the U.S. Department of Agriculture (USDA). Every year, school nutrition operations receive a deposit of dollars into their commodity "entitlement bank account" that is equal to the preceding year's lunches served times the current entitlement rate. At USDA, this is called the *Planned Assistance Level* (PAL). It is the amount of money available to pay for the USDA Foods that the government purchases and makes available to schools.

Let's say your district served 500,000 lunches in 2011-12. This number, multiplied by the entitlement rate (500,000 X 22.75 cents) means that your PAL is $113,750 for *this* school year, 2012-13.

For most SFAs (I won't get into the exceptions), the PAL deposit is not cash that can be used to pay your food bills. But the "money" in your entitlement account is very real and has value. Unlike money in your other bank accounts, however, it only becomes an asset when it is used. That is, until you actually receive USDA Foods, your account is not charged, and the PAL deposit is not an asset working for your operation.

Not adding the value of your USDA Foods to your financial statements until you receive the goods makes sense. In the middle of the school year, you are asked to submit your USDA Foods requests for the following year to your state agency. The state aggregates all the requests it receives and submits its list to USDA. Then you wait to see what products USDA actually will buy and make available in the USDA Foods program. Of course, not everything you want to menu will be available as commodities—and, indeed, there may be some items that you *don't* want. So, why should you count all of your USDA Foods allotment as an asset if you haven't, and may never, receive a portion of it?

One of the reasons USDA doesn't buy all of the products requested by SFAs and state agencies is the uncertainty of the marketplace. If prices spike, the item may cost more than the government is willing—and able—to pay. After all, higher prices will mean lower volume. This has serious implications for how you account for the USDA Foods you receive. On the one hand, USDA must provide a price estimate for each item it offers, so you can effectively allocate your commodity bank account to the items—and amounts—you want to receive. On the other hand, USDA won't know the actual price it will pay until it makes the purchase—and neither will you.

Complex Calculations Federal law allows a few different methods of valuing a school district's inventory of USDA Foods. One is the *Fair Market Value* (FMV) at the time a district receives the product. But determining what the FMV is at that time is

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difficult, because the prices in the marketplace may not be for products that match the USDA specification; also, they may vary regionally. Documenting how a price was derived is not easy. And using FMV on receipt means that each unit in inventory might be different depending when it was actually delivered. For example, if you receive USDA Foods ground beef several times during the school year, your inventory may include cases from each individual delivery.

Another method is the *actual price paid* by USDA. This carries the same challenges as FMV. That's because the price USDA pays is whatever the successful vendor bid, which doesn't necessarily equate to the fair market value.

The most common and reasonable value method that school districts can use is the *Commodity File Price*. On November 15 each year, USDA publishes a fixed price list for all USDA Foods it *may* buy the following year. Very recently, the government changed the way it calculates those prices to reflect a dynamic market environment. The November Commodity File Price is a rolling 12-month average of the prices actually paid. It is generally accepted that this will yield a more accurate estimate than whatever the spot price is on November 15.

Once a state or school district establishes which of the options it will use in valuing its inventory of USDA Foods, it must stick to it throughout the year. The district also must document the method it is using for future reference, as well as in backup documentation of the actual values used.

It's important to remember that each school district's entitlement bank account will be *charged* the actual price paid for the USDA Foods it receives. So, as is the case this year, schools will be receiving fewer pounds of most items for the same amount of entitlement dollars expended. This is because food costs are up across the board throughout the country. In general, state agencies manage the discrepancies between the actual prices and the SFA accounts, so that a district account may be over or under its entitlement in any given year without having to fully reconcile the differences.

In terms of financial accounting, the law requires that once a commodity item is *received* by the SFA, its value is treated like revenue to that operation. After all, the USDA Foods you receive *do* have value. They're *not* free ingredients and menu items. But this revenue is offset by the fact that the items you have received have been "purchased" (an expense) from your entitlement bank account, and they are now in inventory. Thus, the net effect is zero. If you didn't count USDA Foods as revenue *and* as an expense, you would significantly understate your food cost.

There are two bottom lines regarding the accounting of USDA Foods in a school nutrition operation's financial statements:

- An SFA *must* determine the particular method it will use in establishing the value of the commodity; and
- The SFA must record that value as revenue when the food is received.

Remember, the net effect of counting USDA Foods as revenue is zero, because these items are simultaneously counted as an expense in the form of food purchases.

Can You Bank on It? Now that you understand that USDA Foods have a value that can be calculated, the next step is to discover how to make the best use of your entitlement bank account. Too many school districts, making the mistake of viewing commodities as "free" food products, don't apply the same rigorous effort into making USDA Foods procurement decisions as they do with other expenses. This can be a very costly mistake!

First, what is the true cost of a particular commodity? Keep in mind that its "cost" is not the same thing as its "value." The value represents the amount that will be made to (and taken from) your entitlement bank, but there can be other costs and expenses associated with your use of USDA Foods, and these affect the portion as served cost. Remember, even though USDA has not charged you anything for the commodities it distributes, they weren't free. USDA paid growers, producers and processors for them. And you will "pay" for them by having the value of items you receive deducted from your entitlement bank account. So, for the purpose of making procurement decisions, the source of funds that were used—your entitlement bank account or your cash bank account—doesn't matter.

To calculate the cost, start with the value you have assigned a specific USDA Foods item in your financial statements. Then, it is a fairly simple calculation to take that value, divide it by the number of servings in each case of the product and determine the portion cost.

Quite the Process But is that the *only* cost for USDA Foods? In the case of "direct delivery" foods (the term USDA uses for so-called "brown box" commodities), there may be a state handling fee that must be added to the cost. Similarly, the state agency or a commercial distributor may charge a fee for storing and delivering USDA Foods to your district. These costs must be added to the base cost of the food item in calculating the portion cost.

Today, most school districts divert more than half of their USDA Foods items to further processors to make usable end products appropriate for school meal programs. This may change in the next few months and years in light of the current trend for schools to offer more scratch-prepared meals. But labor and space restrictions will constrain many districts to a "speed scratch" approach, and it's likely that many districts will continue to rely on a number of further-processed commodity menu items, ranging from meat patties and crumbles to applesauce and salsa. So, it's important to factor in the cost of processing to the ingredient cost of the USDA Foods you use in your menus.

There are several methods that processors may use in determining how they will pass on the value of the USDA Foods in the products they sell you. Regardless of the VPT method used, the effect is that what a processor charges you must be net of the pass through value of the raw ingredients from the USDA Foods it uses. Processors then add the cost of processing; this includes additional ingredients, as well as the other normal manufacturing and operating costs of a business (labor, equipment, packaging, etc).

Every processor must have an approved contract to process USDA Foods, and it must be able to supply an accurate statement of costs for each product. Each year, your state agency provides you with a *Summary End Product Data Schedule* (SEPDS) for the processed goods that have been approved "for sale" from your state each year. The SEPDS includes both the value of the commodity and the additional cost of production for each case of the product.

In the Final Analysis Finally, you must add the cost of distribution and, if appropriate, storage, both of which must be billed separately from the cost of goods. In some billing systems, distribution appears as a

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separate line on a single invoice from the processor or distributor. In other systems, the two costs are billed separately. But in analyzing your expenses to make thoughtful, smart purchasing decisions, you should be sure to include all of these costs when you calculate the portion cost as served.

Once you have determined the actual portion cost of items you want to serve, you will have a basis for comparison and for making decisions on the best use of your PAL. In some cases, it is possible that a USDA Food item, processed or bulk, may cost more than its commercial equivalent. Some of the additional cost may be due to the fact that there are additional operating costs for processors of USDA Foods than the same manufacturer has for the production of a comparable non-commodity commercial item. So, there may be occasions when it may be a better decision to buy, say, a commercially produced beef patty instead of a commodity beef patty.

A great example that I recall from my days working as a district school nutrition director was portion control (PC) ketchup packets. The price of a case of ketchup PCs from a commodity processor using USDA Foods tomato paste was more than buying an identical commercial item. But because the tomato paste was "free," many districts mistakenly ordered the processed item.

Similarly, it is possible that a commodity processed item may be cheaper than its brown box alternative. It's important to realize that not all brown box items are raw ingredients; USDA Foods offers a number of "value-added" items in its commodity catalog, including Frozen Strawberry Cups and Chicken Fajitas. It's worth doing the math to determine if the portion cost as served of these further-processed items is a better use of your PAL dollars than diverting completely raw commodities to a processor to make the same end item.

The same case might be made for a raw ingredient that you receive directly, without value added; it might cost you more in labor, packaging and other related costs to prepare for your meals. In both cases, you might find that commodity processing is the better alternative. And, when processing your commodities with commercial manufacturers, you typically get better consistency and assured delivery, something the USDA Foods program can't guarantee. When making your food procurement decisions, all such factors should be considered.

The "but commodities are free" argument is not without some merit. Your USDA Food entitlement is a source of revenue that doesn't accrue to a district until the food is delivered. It is possible that it is in a district's best interest to pay more per serving for a USDA Foods item (either further processed by USDA or commodity processed) versus a commercial product—if the alternative is *not fully utilizing your entitlement bank* to support your school nutrition operation. The possible additional costs of using commodities may be small compared to not accepting the full value of your PAL, which is a loss of revenue.

Food for Thought What's in the best interest of the kids and your program? That's the real bottom line. The heart of your program is the menu. For many SFAs, it will be a paradigm shift to plan commodities around menus, rather than planning menus around commodities. Among other challenges, the USDA Foods ordering cycle means menus must be planned far in advance of the next school year. But knowing what you want to serve, and how much you will need to serve it, will allow you to make the very best use of the value—and cost—of your USDA Foods entitlement.

As management of school nutrition programs grows more and more challenging, *every* decision a district makes gains in importance. Understanding the role of USDA Foods in your program, both in the foods you serve and your operation's financial success, is critical. USDA Foods are an entitlement that adds revenue and value to your program. Ensuring that you maximize these benefits and properly account for them is key to your long-term success. **SN**

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