K.   PROCESSING

WHAT IS COMMODITY PROCESSING?

Commodity Processing allows SDA and recipient agencies to contract with commercial food processors to convert raw bulk USDA commodities into more convenient, ready-to-use end products.

Commodity processing expands donated food use from a limited number of commodities to a broader array of nutritionally sound, popular items, while keeping labor costs to a minimum. Processing of donated foods provides industry the opportunity to market its finished products, giving the R/A the opportunity to receive a wider variety of popular table-ready end products.

WHAT ARE THE BENEFITS?

By participating in Commodity Processing, R/As find that they can: stretch their commodity dollars by ordering low-cost bulk products; eliminate back-hauling charges because the USDA vendors' deliver commodities directly to processors; increase the variety of end products; reduce labor costs and cash outlays for food preparation; and reduce storage cost.

PROCESSING AGREEMENT APPROVAL

A Processing Agreement is a written document that authorizes a commercial food processor to convert USDA donated foods into more convenient forms. Such agreements assist SFAs in maximizing donated foods, thereby contributing to the overall efficiency and effectiveness of their food service programs. The agreement begins on July 1 of each year and ends on the following June 30.

The concept of the Processing Agreements is that donated foods are provided to processors who produce approved end-products which the SFA obtains at a price reduced by the full value of donated foods contained in each end-product.

Federal regulations permit SDAs and/or SFAs to enter into agreements with commercial companies to process any of the donated foods available through USDA. Since several SFAs have similar needs, the SDA usually enters into a single state agreement under which all SFAs approved for the Food Distribution Program may participate. This eliminates the need for multiple SFAs to have identical agreements with the same processor for the same products. While any SFA may have its own agreement, such documents must conform to all Federal and State requirements and must be approved by the SDA prior to providing any donated foods to the processor.

APPROVED PROCESSORS AND END-PRODUCTS AVAILABLE

The SDA will provide to the SFA at the beginning of each school year any relevant information concerning processing agreements approved by both the

SDA and USDA. The information will, at a minimum, include the following and can be found on the Division of Food Distribution's Web Site at
http://www.kyagr.com/consumer/food/Processors/epd.htm

1. Name of approved processors.
2. Description of the approved end products and any identification codes.
3. Donated food(s) used in each end product.
4. Pounds of commodities to make one case, the estimated cost per pound, the value of commodities per case and the estimated cost per serving.

CHILD NUTRITION LABELS

The SDA suggests that processors obtain a Child Nutrition Label for each end-product containing meat, poultry (except chicken parts), fish, or a meat alternate such as cheese. However, this is not a requirement at this time.

VALUE PASS-THROUGH SYSTEMS

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A brief explanation of each system follows:

Fee-for-Service – This method is actually a net-price system since it reflects what the processor will charge, exclusive of the value of donated food, to produce an end product containing donated food. End products obtained using this method is billed at a net price. The net price is determined by reducing the agreed-upon full (gross) price by an amount at least equal to the value of donated food contained in a case of approved end-product identified in the processing agreement. The billing procedure may be handled in two ways. First, the invoice would show the full price, the reduction for the value of donated foods(s) and the net price.

Under the second option, the invoice would show only the net price provided a bid or other written documentation is on file which clearly indicates that the net price shown reflects the proper value of donated food was used to reduce the full price.

The SFA shall not pay a fee-for-service in excess of the maximum identified in the bid or agreement between the processor and the SFA.

Net-Off Invoice (NOI) – The SFA purchases an approved end product directly from a distributor and is billed at a net price. The net price is determined by reducing the agreed-upon full (gross) price by an amount at least equal to the value of donated food contained in a case of approved end-product identified in the processing agreement. The billing procedure may be handled in two ways.

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Under the second option, the invoice would show only the net price provided a bid or other written documentation is on file which clearly indicates that the net price shown reflects the proper value of donated food was used to reduce the full price.

Direct Discount – The selling of a finished end product by an approved processor directly to the SFA. Under this procedures, the processor directly invoices the SFA at the commercial price minus the value assigned to the commodities contained in the case as a net case price. The processor must maintain delivery and/or billing invoices to substantiate the quantity of end products delivered and the net price changed per case.

COST EFFECTIVE PROCESSING

Value of Donated Food

The value of donated food contained in one case of end-product is determined by multiplying the quantity of donated food needed to produce one case by the established price per pound. This per-case amount is identified for each approved item and provided to SFAs on the Division of Food Distribution's web site.

Procurement Standards

When purchasing foods for use in food service programs, the SFA must comply with Federal, State and local procurement standards. The primary purpose of these standards is to assure that open and free competition exists to the maximum extent possible. When the SDA or USDA enters into an agreement with a company to process donated food(s); this does not remove responsibility of the SFA to comply with the procurement standards*. The processing agreement permits the company to receive donated foods to process into end products, but it does not establish the price, which the SFA pays. The procurement procedures used by the SFA should establish the price to be paid by the SFA for all foods, including those end products containing donated foods. The SFA, as purchaser, has the responsibility to evaluate prices received and to determine the successful bidder.

*Contact the Kentucky Department of Education, School and Community Nutrition.

Prices for approved end products containing donated foods, which will be purchased under the NOI systems, should clearly state the full price (without donated foods), the value of donated foods, and the net price.

Determining Cost Effectiveness

As part of the procurement activity, the SFA should ensure that acquisition of an end product containing donated food is cost effective. Determining cost effectiveness is a simple process but extremely important in demonstrating

good management, and ensuring maximum benefits are obtained from the resources expended.

To determine if purchasing a particular end product containing donated foods is cost effective, the SFA should perform the following steps:

1.   The value of donated food contained in the end product should be added to the case (net) price to arrive at the total cost of the item. To calculate the cost per case of products (**except poultry**), take the number of pounds of donated food needed to make one case of end-product, x cost per pound of donated food, plus the fee-for-service equals the cost per case.

> Example: It takes 25.34 pounds of beef to make beef patties, x $1.03 (cost per pound of donated food)(beef) equals $26.10, plus $13.50 fee-for-service equals a total cost per case of $39.60. The direct cost to the SFA would be $13.50 per case plus any delivery charge from the distributor.

To calculate the cost per case of poultry products (under Guaranteed Minimum Return), take the number of pounds made available to the processor, x guaranteed percent for finished product, and divide by the case weight to arrive at the number of cases to be returned. Multiply the number of cases to be returned by the net case/fee-for-service price.

> Example: It takes 1,000 pounds of donated food (chicken) to make chicken patties, x 84% (guaranteed percent for finished product), equals 840 pounds, divided by 20-pound case weight equals 42

cases returned. 42 cases x $18.40 fee-for-service equals $772.80, plus any delivery charge from the distributor.

2.   Gross (without value of donated food) prices for the same and comparable products being sold in the area should be obtained.

> (NOTE: Delivery charges and all other costs should be included.) Consideration should also be given to including the SFA's cost to produce the same item, if the SFA actually has the capability for such production.

3.   The total cost of the item being considered should be compared with the cost data obtained.

4.   If the cost of the item (including the value of donated food) being considered is approximately the same as others, then it could be considered cost effective. However, if the total cost (including the value of donated food) of the item being considered is significantly higher, then it is not cost effective.

DIRECT DIVERSION VS. BACKHAUL OF COMMODITIES

Direct Diversion is when commodities are ordered by a SDA to be shipped directly from the USDA vendor to the processor. The SFA may request the processor and quantity of donated food to be processed on the Electronic Commodity Ordering System (ECOS). As food is ordered by the distributing agency, each SFA will be notified of the quantity of food shipped to the

processor via the ECOS system. At this time the SFA should contact the processor and place orders for the end products desired. Direct Diversion is encouraged for several reasons: (1) it eliminates the risk of taking the product in and out of freezer storage several times, thus providing a more controlled environment for the donated food; (2) it results in producing a better product that has a longer shelf life than products which have been backhauled; and (3) it results in significant savings in transportation and storage as well as increased processing charges.

Backhaul is when the processor transports the commodity from the SFA's or distributor's warehouse to its facility. A distributor may charge the SFA up to 90% of bid price per case for lump sum pickup by a processor. After the commodity is received in the SFA's distributor's warehouse, the SFA must contact a processor and choose their end products. The processor then initiates the process by completing a Backhaul Request Form and forwarding it to the SFA. The SFA approves the request and forwards a copy to the SDA. The SDA retains the record for file purposes. The food then is transported by the processor from the SFA's distributor to the processing plant. When frozen foods are thawed prior to processing, which is done when products are backhauled, a certain amount of moisture is lost from the product; this directly lowers yield of finished products to the recipient agency. Backhauling adds extra cost to the processing of the commodity. Poultry cannot be backhauled due to safety issues and the risk of contamination.

FOOD ORDERING

Prior to the beginning of each school year, the SFAs must determine the processor and the number of pounds to be diverted. Prior to placing the order in ECOS,, the SFA should contact the processor/broker to determine which end products they want to order and the number of pounds needed **_THIS IS EXTREMELY IMPORTANT._** If this is not calculated correctly, the SFA may get back more or less product than expected.

Once the donated food has been requested for processing and converted to end-products, the SFA **must accept delivery.** ? What does this mean? Donated food for processing is not sent to the SFA.

Once all processing requisitions have been placed through ECOS, they are totaled and truckloads are established. If there are not enough orders to make a full truck, the SDA may combine with another state to make a full truck, if available. If there is not enough interest to divert product to a certain processor, the SFA is notified and given the opportunity to choose another processor.

Notification

Processors may review allocation breakdown for each SFA once allocations have been made in ECOS. The SFAs should verify the exact amount of commodity delivered to the processor and when it was delivered via the ECOS system. If the SFA has any questions about the quantity of commodities being delivered, they should contact the SDA.

Processors are required to use the **NOTIFICATION OF DELIVERY FOR DISTRIBUTOR, RECIPIENT AGENCY AND STATE AGENCY (KY-FD-62)** to

notify all parties of impending delivery of end products. Processors must also make an appointment with the SFA's distributor at least 24 hours in advance of delivery of the finished product(s) and also notify the SFAs of the delivery date.

The SFAs must send the electronic Notice of Delivery of Donated Foods to Schools (KY-FD-3) to the distributor within 24 hours of notification from the processor. SFAs have 30 days free storage for processed items. The contracted distributor may assess a charge per month to SFAs for each unit (case) of processed items remaining in storage beyond 30 days for the convenience of the SFA or Department officials. This charge shall not exceed 25 percent of the stated charge per case for delivery to SFAs. Such charges may be assessed for a full month on the first day following the anniversary arrival date as reported by the distributor. The 25 percent increase per month may be assessed on the base charge only and not on a compounded basis.

Over Yield and Under Yield

If the guaranteed number of cases is not returned to the SFA, the processing company must provide the SFA with the difference. If the amount returned to the SFA from the processor exceeds the number of guaranteed cases, the excess product belongs to the SFA. The SFA must pay the fee-for-service for each case it receives.

Standard Yield: The processor guarantees a fixed number of cases will be produced using a fixed amount of commodity. The standard yield is always fixed at a level that requires the processor to add some commercial product to achieve the required yield. Standard yield could be used for other commodities

when a processor has significant manufacturing loss in the production of an end product.