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December 28, 2015

MEMORANDUM

TO: School Nutrition Supervisors
Single Unit and Special Schools Administrators

FROM: Aimee F. Beam, RD, LDN *ABeam*
Education Associate, Child Nutrition Programs

SUBJECT: **SCHOOL YEAR 2015 - 2016 OPERATIONAL MEMO #33**
NONPROFIT SCHOOL FOOD SERVICE ACCOUNT FOOD REVENUE
REQUIREMENTS

On December 23, 2015, USDA released *SP 20-12016 – Nonprofit School Food Service Account Nonprogram Food Revenue Requirements*. The memo is attached in its entirety for your review. The purpose of this memo is to provide guidance on the revenue requirements.

If you have questions, please call 302-857-3356.

cc: Linda C. Wolfe, EdD, RN, Director, School Support Services
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Food and
Nutrition
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DATE: December 23, 2015

MEMO CODE: SP 20 – 2016

SUBJECT: Nonprofit School Food Service Account
Nonprogram Food Revenue Requirements

TO: Regional Directors
Special Nutrition Programs
All Regions

State Directors
Child Nutrition Programs
All States

Section 206 of the Healthy, Hunger-Free Kids Act of 2010 (HHFKA) amended section 12 of the Richard B. Russell National School Lunch Act by adding paragraph (q) on nonprogram foods. This amendment established requirements related to the revenue from the sale of nonprogram foods. On June 17, 2011, the Food and Nutrition Service (FNS) issued an interim rule, *National School Lunch Program: School Food Service Account Revenue Amendments Related to the Healthy, Hunger-Free Kids Act of 2010* (76 FR 35301), amending the requirements related to revenue from nonprogram foods at 7 CFR 210.14(f). FNS also issued guidance related to implementation of section 206 in policy memorandums SP 13-2014 (<http://www.fns.usda.gov/sites/default/files/SP13-2014os.pdf>) and SP 39-2011 (<http://www.fns.usda.gov/sites/default/files/SP39-2011r.pdf>).

State agencies and school food authorities (SFAs) continue to pose questions regarding implementation of these requirements and the interaction with the existing revenue requirements found in 7 CFR 210.14(a). This memorandum provides guidance on the revenue requirements including options for assessing compliance to fulfill the requirements in section 206.

Nonprogram Revenue Requirements

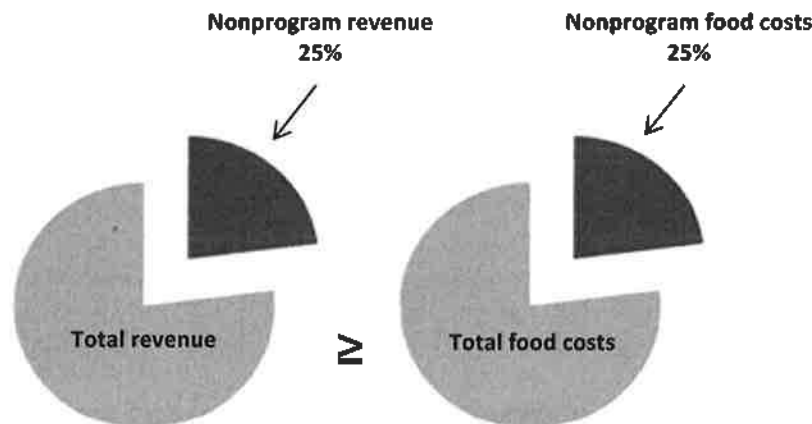
Under subsection 12(q) of the Richard B. Russell National School Lunch Act and 7 CFR 210.14(f), SFAs are required to ensure:

- All revenue from the sale of nonprogram foods accrues to the non-profit school food service account; and
- Revenue available to support the production of reimbursable school meals does not subsidize the sale of nonprogram foods.

Nonprogram Food Revenue
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Nonprogram foods include any nonreimbursable foods and beverages **purchased using funds from the nonprofit school food service account**. This encompasses all foods sold in schools as well as adult meals, foods sold outside of school hours or any foods used for catering or vending activities. For the majority of SFAs, a la carte foods offered during meal service account for the largest share of nonprogram foods.

SFAs are required to determine if the percent of total revenue that is generated from their nonprogram food sales is equal to or greater than the percent of total food costs that are attributable to the SFA's purchase of nonprogram foods. For example, if the costs of nonprogram food are 25 percent of the SFA's total food costs, then the amount of revenue generated from the sale of these nonprogram foods must be at least 25 percent of the total revenue in the school food service account.



To simplify the assessment, the statutory requirement states that only food costs are to be used to measure compliance. Research indicates that the cost of nonprogram foods, as a percent of total food cost, is a reasonable proxy for all costs associated with obtaining foods, (i.e., the cost of food, labor, direct and indirect costs). This means if an SFA is able to show that the percent of nonprogram food costs is less than the percent of nonprogram revenues, the SFA generated enough revenue to cover all reported costs associated with nonprogram foods. Thus, the requirement focuses on nonprogram food costs as a percent of total food costs in an effort to simplify the requirement and eliminate the burden of documenting labor and other costs.

Nonprogram Foods Sale Transactions

When nonprofit school food service account funds are used to provide goods and services (e.g., catering and vending) for outside entities such as the superintendent's office, school board, or student clubs, there are two separate transactions that occur. The first transaction is between the

school food service and the outside entity, which is typically associated with the school district but separate from the school food service, and the second transaction is between the outside entity and its customers. The school food service may provide goods and services to the outside entity only if **all** costs, including labor and any other costs incurred, are covered by the entity being served by the school food service operations (the first transaction). Any revenue generated through the second transaction between the outside entity and its customers may be kept by the outside entity. For example, an SFA may use nonprofit school food service account funds to purchase and prepare hamburgers for the Parent Teacher Association (PTA) which runs a high school concession stand during football games. If the cost associated with purchasing and preparing the hamburgers is \$2 per hamburger, the SFA must recoup at least \$2 per hamburger from the PTA; the PTA may then sell each hamburger for \$3 and keep the \$1 profit per burger.

SFAs providing goods and services to outside entities are strongly encouraged to develop a written agreement with the outside entity that identifies costs and any other responsibilities, as applicable. The agreement must include a stipulation that all risk relating to revenue losses must be covered by the outside entity and not the school food service. For example, if the PTA who is purchasing the hamburgers in the example above is unable to sell them due to the game being cancelled, the PTA is still responsible for reimbursing the food service the costs associated with the purchase and any labor that was involved in the SFA's preparation of the hamburgers.

Program regulations do not restrict revenues earned from the sale of competitive foods that are purchased with funds outside of the nonprofit school food service account, i.e. the general fund. However, State agencies and SFAs are reminded that to the extent such foods are sold on the school campus during the school day, the "Smart Snack" requirements at 7 CFR 210.11 apply.

Assessing Compliance Options

FNS understands there is wide variation in the capabilities of systems and mechanisms SFAs employ to maintain and monitor their school food service accounts. Separating out the SFA's costs for nonprogram foods from the costs for program food may be particularly difficult. In recognition of the current variations in system capabilities, FNS is providing a simplified approach for SFAs to assess compliance with this requirement going forward.

The simplified approach, while still requiring SFAs to separate their nonprogram food costs from their program food costs, allows SFAs to select a reference period by which compliance will be assessed. Rather than separating all costs for the entire year, SFAs will separate their nonprogram food costs from their program food costs for a period of at least 5 consecutive operating days (or 4 consecutive days for schools that only operate 4 days).

If the SFA is able to show that the percentage of nonprogram revenue generated is at least as great as the percentage of nonprogram food costs incurred during the reference period, the SFA is in compliance with Federal requirements.

SFAs with the capacity to obtain separate nonprogram and program food cost and revenue data for a period longer than 5 consecutive days (e.g., monthly, annual, biweekly) are strongly

encouraged to use data from the longer period to perform the assessment. All revenue and cost data used to assess compliance must reflect the same reference period. For example, if the revenue ratio is calculated using October 2014 data, the cost ratio must be calculated with October 2014 data. Similarly, if revenue information from the full 2014-2015 school year is used to calculate the revenue ratio, food cost information for the full 2014-2015 school year must be used to calculate the food cost ratio.

Detailed guidance on how to perform the cost/revenue assessment is provided in the attached question and answer document.

State agency monitoring

Compliance with the nonprogram revenue requirement is reviewed through the resource management section of the Administrative Review process. While noncompliance with the revenue from nonprogram foods requirements is not subject to fiscal action as defined under 7 CFR 210.18(m), State agencies must ensure that SFAs secure funding to make up any shortfalls in the nonprofit school food service account and/or otherwise take steps to ensure that nonprogram foods are priced sufficiently to meet the nonprogram foods requirement. It is important for State agencies and SFAs to work together to develop practices to ensure the financial viability of the nonprofit school food service account.

State agencies are reminded to distribute this guidance to SFAs immediately. SFAs should contact their State agencies for additional information. State agencies may direct any questions concerning this guidance to the appropriate FNS Regional Office.



Sarah E. Smith-Holmes
Director
Program Monitoring and Operational Support Division
Child Nutrition Programs

Assessing Compliance with Nonprogram Revenue Requirements

Overview of Assessment

1. What formula must be used to assess compliance?

Regulations at 7 CFR 210.14(f) require SFAs to ensure the revenue ratio is greater than or equal to the food cost ratio, as follows:

$$\frac{\text{Nonprogram food revenue}}{\text{Total program and nonprogram revenue}} \geq \frac{\text{Total nonprogram food costs}}{\text{Total program and nonprogram food costs}}$$

2. Are there alternative calculations SFAs may use other than the food cost/revenue proportion to assess compliance?

No. The revenue/food cost ratio is required by statute and regulations. FNS evaluated a number of alternative strategies but found none that would accurately capture statutory and regulatory intent.

However, SFAs with a full cost accounting system, one designed to measure the complete, true costs of goods and services or those that establish the sale price of nonprogram foods by a certain percentage mark-up, may actually be in compliance. SFAs will only be considered compliant if they meet the minimum requirements set forth in 7 CFR 210.14(f) and as described in this and other applicable policy memoranda.

3. How should school food service operations that offer a limited number of a la carte items (i.e. milk only) comply with nonprogram foods requirements?

Some SFAs may offer a limited number of nonprogram food items with an identifiable per serving cost (i.e., only sell milk a la carte) and are not able to accurately perform the assessment. In these instances, the SFA may be charging the full cost for the nonprogram foods offered, but due to the small number of these items in relation to the total revenue and cost, the assessment may overestimate the required increase.

State agencies may review these SFAs and determine that the compliance assessment does not fully represent the SFA's pricing practice and may instead base compliance on whether or not the SFA is recovering more than the per-serving food cost of these nonprogram items.

4. How is the revenue ratio established?

To establish the *revenue ratio*, divide the nonprogram food revenue by the total revenue of the school food service account.

$$\text{Revenue ratio} = \frac{\text{Nonprogram food revenue}}{\text{Total program and nonprogram revenue}}$$

The nonprogram revenue is the revenue generated from the sale of nonprogram foods. The total revenue is the sum of revenue from program foods plus the revenue from the sale of nonprogram foods, both of which are deposited into the SFA's nonprofit school food service account. To assist SFAs, FNS developed the *Nonprogram Foods Revenue Tool*, which identifies the dollar amount when a discrepancy occurs.

5. How is the food cost ratio established?

To establish the *food cost ratio*, divide the sum of all nonprogram food costs by total food costs.

$$\text{Food cost ratio} = \frac{\text{Total nonprogram food costs}}{\text{Total program and nonprogram food costs}}$$

Total nonprogram food costs are the food costs for all nonprogram food purchased with funds from the nonprofit school food service account. The total program and nonprogram food costs are the food costs for both program and nonprogram foods purchased with funds from the school food service account.

6. How does the comparison of the revenue ratio to the food cost ratio work?

The SFA must compare the revenue ratio to the food cost ratio and determine if the revenue ratio is equal to or greater than the food cost ratio. If the revenue ratio is equal to or greater than the food cost ratio, the SFA is properly pricing nonprogram foods and no further action is required.

$$\text{Revenue ratio} \geq \text{Food cost ratio}$$

If the revenue ratio is less than the food cost ratio, the SFA has priced nonprogram foods too low, and must increase nonprogram food prices until the revenue ratio is equal to or greater than the food cost ratio or contribute non-federal funds to the nonprofit school service account to address the revenue shortfall.

Step 1: Determining the reference period

7. Who establishes the reference period?

State agencies may establish the reference period for all SFAs or the State agency may allow each SFA to establish the reference period. The reference period may be a school week, a month, or year; however, the reference period must include at least 5 consecutive operating days (or 4 consecutive days for schools operating a 4 day week). The selected days must represent typical food service operations. Assessments cannot include data from summer school, holidays, or vacations or special circumstances that might distort the program and nonprogram foods data.

8. What data is needed for the reference period?

SFAs must collect the following SFA-wide information for the reference period:

- For nonprogram food revenue, the dollar amount of nonprogram food sales, including a la carte sales, adult meals, vending machines, and any other nonprogram food purchased with nonprofit school food service account funds.
- For total revenue, the dollar amount of program and nonprogram food sales.
- For nonprogram food cost data, include:
 - An itemization of all nonprogram foods to be offered during the reference period;
 - The per item/serving cost of each nonprogram food, including food sold only as nonprogram food, food sold as program and nonprogram food (crossover food);
 - The number of servings/items sold.
- For total food cost data, include all nonprogram food cost data and program food cost data. Program food cost data should be readily available using production records, invoices, etc.

Step 2: Identifying nonprogram foods offered during the reference period

9. What is a nonprogram food?

A nonprogram food means any food (other than reimbursable meals) or beverage purchased using nonprofit school food service account funds. Examples of nonprogram foods include a la carte foods, adult meals (see FNS Instruction 782-5) and food items purchased for vending machines, school stores, etc.

10. Must I identify all nonprogram foods offered throughout the school year?

For purposes of the nonprogram foods cost/revenue assessment, the SFA must identify only those nonprogram foods sold during the reference period.

11. How should costs and revenue from catering, vended meals, or purchasing for other entities be included in this assessment?

Due to potential complexities of accounting for food cost and revenues from catering, vended meals, or purchasing for other entities, including these costs and revenues during a reference period is not required.

SFAs may choose to include these costs/revenues to simplify the assessment. SFAs including these food service activities in their assessment MUST include BOTH the food costs of providing these services and the revenues generated in the calculations for the selected reference period.

If the revenues from these activities are not included in the calculation of the total revenue and cost ratios, SFAs must be able to provide proper documentation, such as purchase agreements, invoices, the agreement with the entity and information demonstrating the recovery of the full costs.

Step 3: Determining Nonprogram Food Costs

12. How is the total nonprogram food cost determined?

Total nonprogram food costs are the cost of all foods sold during the reference period, including foods sold only as nonprogram foods, and foods served in program meals and also sold as a nonprogram meal (crossover items).

To determine the total food cost of all nonprogram foods for the reference period:

- a. Determine the food cost for each nonprogram food sold by multiplying the cost per serving/item by the quantity sold as a nonprogram food.
- b. Add the food cost for each nonprogram food. The sum of the costs of all nonprogram food items sold during the reference period will be the total nonprogram food cost amount entered as the numerator in the food cost ratio.

Food cost for nonprogram item # 1 <i>(cost per serving X quantity sold as nonprogram food)</i>
+
Food cost for nonprogram item # 2 <i>(cost per serving X quantity sold as nonprogram food)</i>
+
Food cost for nonprogram item # 3 <i><u>(cost per serving X quantity sold as nonprogram food)</u></i>
Nonprogram food costs for the reference period

13. If records do not separate program and nonprogram food costs, how are these costs determined?

If records do not separate program and nonprogram food costs, SFAs are required to identify (a) all nonprogram foods sold during the reference period and (b) for each nonprogram food sold, identify the cost per serving/item by the quantity sold as a nonprogram food.

14. How do SFAs with fixed price Food Service Management Company (FSMC) contracts comply with the nonprogram foods requirements in 7 CFR Part 210.14?

An SFA with a fixed price FSMC contract may not have the food cost data needed to determine its compliance with the revenue from nonprogram foods requirements. This is because food costs are not disclosed in a fixed price contract awarded on a per meal basis and when revenues from nonprogram foods sales are converted into meal equivalents to which the fixed price cost is applied. To obtain the information it needs, an SFA issuing a solicitation for a fixed price contract should include language in its FSMC solicitation requiring respondents to agree to provide nonprogram foods cost information and ensure that the final fixed price contract implemented reflects this requirement. Fixed price FSMC contracts for SY2016-2017 must be amended to include this information for compliance with the nonprogram foods and revenues requirement in 7 CFR Part 210.14.

In the soon-to-be-released updated version of FSMC Guidance Handbooks for State agencies and SFAs, FNS will address this issue.

The updated FSMC guidance will provide the following instructions:

In the solicitation and contract, it is crucial for SFAs to provide specific information about the food service operation and all required products and services they are seeking to procure. For example, essential information includes:

- For fixed price per meal contracts, awarded on a per meal basis and with revenues from nonprogram foods sales converted into meal equivalents to which the fixed price cost is applied, the FSMC will annually provide information on food costs and revenues. The information must include food cost for reimbursable meals, food cost for non-program foods, revenue from non-program foods, and total revenue. Nonprogram foods include: a la carte; catering; vending; and student stores operated, or any other sales generated through the nonprofit school food service account not already described. This information is used to determine compliance with revenue from nonprogram foods at 7 CFR 201.14(f).
- Historical information on the type and value of nonprogram foods and meals to be offered such as other food service operations, for example, catering. When the FSMC will be responsible for providing the SFA with, or calculating nonprogram food costs and program revenues for compliance with the 7 CFR Part 210.14(f), the contract must clearly identify this requirement.

15. How is the cost determined for foods sold only as nonprogram foods?

For each food sold only as a nonprogram food, determine a per serving/item cost by dividing the case cost by the number of servings per case.

$$\frac{\text{Case cost}}{\text{Number of servings/items per case}} = \text{cost per serving/item}$$

For example, if a bag of whole grain oatmeal chocolate chip cookies is only sold on the a la carte line or in a vending machine, the price per bag should be determined using invoices and other information.

16. How is the cost determined for foods prepared from scratch and/or sold as both part of a reimbursable meal and as an a la carte item?

“From scratch” is an idiom meaning from the beginning. Therefore, food items prepared “from scratch” are food items that have been prepared from the beginning, using a recipe of ingredients yielding an end product. Crossover items are those foods sold as a part of a program meal and also served as a nonprogram food, (e.g., a serving of lasagna sold as part of a reimbursable meal and also as a single item on the a la carte line).

For each, determine per serving costs using food invoices to calculate the cost of ingredients and per serving cost in a recipe, and production records to determine the number of servings prepared. Determining per serving food costs may be difficult particularly for SFAs that prepare foods “from scratch”.

$$\frac{\text{Sum of major food costs in recipe}}{\text{Total Number of servings recipe yields}} = \text{Cost per serving of recipe}$$

SFAs should use the recipe and ingredient costs to develop a reasonable estimate for these items and may use discretion when including spices and other ingredients that are added in minimal amounts to the recipes.

17. Is a costing adjustment required if the portion of an item used in both the reimbursable meal and a la carte line is larger when sold as a nonprogram food?

The serving size is a major factor in determining the per item cost. For example, school lunch pizza may be cut to 10 slices per pizza but that same pizza is cut to only 8 slices per pizza for nonprogram slices. If the price per pizza is \$7.50, the per slice cost for the school lunch program would be \$0.75/serving (\$7.50/10) and for the nonprogram serving it would be \$0.94 per slice (\$7.50/8).

The Institute of Child Nutrition’s Food Buying Guide (<http://fbg.nfsmi.org/>) provides useful information for determining the serving sizes for food items either sold individually or incorporated into recipes.

18. How is the food cost for items used as both program and nonprogram foods determined?

The easiest way to determine the price for items that may be served as either program or nonprogram food is to determine the cost for the smallest serving size offered and then modify the costs accordingly for other serving sizes offered.

For example, if the SFA determined that the costs of a ½ cup of marinara served with spaghetti as part of a reimbursable meal is \$0.80 and the same marinara is served as a dip for breadsticks on the a la carte line as a ¼ cup serving, then the cost per ¼ cup serving should be determined as \$0.40. The price for the serving of marinara with the breadstick (1/4 c.) would be half the price of the amount served with the spaghetti (1/2 c.). These amounts should then be added accordingly to the price per serving of breadsticks or spaghetti.

*Example 1: Price per serving of breadsticks (2) = \$0.12
Price per serving of Marinara and breadsticks = \$0.40 + \$0.12 = \$0.52*

*Example 2: Price per serving of spaghetti (1 cup) = \$0.08
Price per serving of Marinara and spaghetti = \$0.80 + \$0.08 = \$0.88*

Step 4: Interpreting the Results

19. What steps should be taken if the revenue/food cost ratio comparison indicates that the revenue ratio is higher than the food cost ratio?

No further action is required. If the revenue ratio is equal to or greater than the food cost ratio, the nonprofit school food service account is not subsidizing nonprogram food activity.

20. What if the food cost ratio is higher than the revenue ratio?

If the food cost ratio is higher than the revenue ratio, the nonprofit school food service account is subsidizing the cost of nonprogram foods and the SFA must revise its nonprogram food pricing structure to increase the revenue to ensure the revenue ratio is greater than or equal to the food cost ratio. Alternatively, the SFA could provide non-federal funds in the amount of the revenue shortfall to the nonprofit school food service account. For example, if the revenue ratio is 21 percent and the food cost ratio is 23 percent, action must be taken to raise the price of nonprogram food or add non-federal funds as appropriate.

21. What actions can be taken to raise the price of nonprogram foods?

Simply raising revenue by the difference between the two ratios for each nonprogram food item will not resolve the discrepancy (i.e., in the pie chart example, raising the cost of all nonprogram foods by 5% will most likely not be sufficient).

To assist SFAs, FNS developed the *Nonprogram Foods Revenue Tool*, which identifies the dollar amount when a discrepancy occurs. Knowing the dollar amount of the shortfall allows SFAs to determine appropriate adjustments to their nonprogram food pricing structure.

There are a range of actions an SFA may take to adjust prices, including:

- If certain nonprogram food items are not generating enough revenue to cover the costs of producing the items, increase the price of these items to more accurately reflect the cost or re-evaluate whether these items should be sold as nonprogram foods.
- If multiple nonprogram foods are sold as a unit and are also offered as a reimbursable meal, price the nonprogram food unit above the cost of the reimbursable meals.
- Selectively increase the prices of some but not all nonprogram foods items (i.e. less healthy food marked up by a greater amount than healthier choices).
- Review sales records and increase the prices of the more popular items.

22. Must SFAs increase the prices of all nonprogram foods?

SFAs have discretion in how prices of nonprogram foods are adjusted. For example, SFAs may wish to not raise the prices for a la carte fruits and vegetables but raise prices for other a la carte foods.