

# Cash/CLOC Background and Monitoring Requirements

## I. BACKGROUND

The fundamental difference among the three commodity purchasing systems is the location of food purchase decision-making.

- 1) In the COMMODITY system food purchase decisions are centralized at the national level. USDA decides which foods will be purchased, when they will be bought, the form in which they will be bought, the type of packaging and when they will be delivered. Although input is elicited from State agencies, the market demand decisions are largely concentrated in Washington. DC.
- 2) The CLOC system represents a movement toward decentralization of food purchasing authority. CLOC SFA's are given letters of credit for the cash equivalent of their commodity entitlement. USDA decides on the general type of food to be bought with letters of credit in order to support specific agricultural markets (e.g., by issuing beef, pork or turkey letters of credit) but SFA's are allowed to purchase the targeted commodities locally in a form and in a size that best suits their needs and have it delivered at a time convenient to them. For example, if they lack modern kitchen equipment or find that labor costs are excessive, they can choose prepared foods (e.g., pizza) instead of purchasing raw ingredients (e.g., flour, tomato sauce, oil) and preparing meals "from scratch". Alternatively they can use letters of credit for the same raw ingredient donated by USDA (e.g., bulk ground beef), but packaged according to their own specifications.
- 3) The CASH system decentralizes the purchasing activity to its logical extreme. As with CLOC SFA's, CASH school districts are given the cash equivalent of their commodity entitlement. However, other than requiring that the money be spent on the food service program, USDA places no restrictions on local food purchasing. The money need not even be spent for food; it can be spent on labor, equipment or for any other legitimate food service operating expense. If the money is used to purchase food, that food must be of domestic origin.

### A. Establishment and Distribution of Commodity Entitlement

In order to determine the total value of the cash or letters of credit to be allocated to each SFA in the program, USDA calculates the amount of each SFAs commodity entitlement. At the beginning of each School Year, an estimate of the cash value of each CASH and CLOC SFA's annual commodity entitlement is obtained by multiplying each district's total NSLP participation (number of reimbursable NSLP lunches served) from the second preceding year by the current commodity rate (\$.1725 in SY 2004-2005). In December of each year, these estimated entitlements are adjusted to reflect actual school year participation from the prior year. By the end of the year each CASH and CLOC SFA receives a commodity entitlement based on the actual count of reimbursable lunches served in the prior year.

This procedure for generating entitlement estimates was adopted in large part because the Commodity system operates in a similar manner.

Once entitlement estimates are established, CASH and CLOC SFA's receive direct deposits at the beginning of each quarter of the school year; July 1<sup>st</sup>, October 1<sup>st</sup>, January 1<sup>st</sup> and April 1<sup>st</sup>. CASH SFAs receive the cash value of their entitlement in equal disbursements - 25 percent of their entitlement each quarter. CLOC SFAs receive a proportionately greater share of their entitlement at the beginning of the school year; 36 percent in each of the first two quarters, 21 percent in the third quarter and 7 percent in the final quarter.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

The reason for a disproportionate disbursement of funds during the school year to CLOC SFAs is that this plan offers the best approximation of USDA's purchase plan in which purchases of commodities are most intensive during the early part of the school year. In order for a CLOC system to have a market impact and surplus removal capability that compares favorably to the current procurement process, it is necessary that CLOC SFAs have the same relative purchasing capacity during the same time frame in which USDA purchases are being made. A similar entitlement allocation formula was not adopted for CASH SFAs since in the demonstration there was no intention to target school district purchases toward specific Commodities or specific times of the school year.

### B. Cash Entitlement Utilization

Once in receipt of their commodity entitlement dollars, CASH SFAs have almost complete freedom in determining how these dollars should be spent. The only restrictions imposed upon CASH SFAs with respect to expenditure of entitlement money is that (1) expenditures have to be related to the operation of school feeding programs and (2) foods purchased have to be of domestic origin. Because these dollars are generally commingled with all other funds budgeted for food service operations (and, in some cases, with all funds for school district operation), special monitoring for compliance with these two restrictions is very difficult. The use of these funds by SFAs is, of course, subject to established auditing procedures currently a part of the NSLP.

### C. CLOC Entitlement Utilization

Commodity purchases for schools are guided by a procurement plan that reflects USDA's best estimates of agricultural surpluses and school food program preferences. The CLOC system is intended to match this procurement plan as closely as possible in order to mirror the commodity support to the agricultural markets. Unlike their CASH Counterparts, CLOC SFAs are restricted to spending their entitlement dollars on specific agricultural products.

The linkage between the CLOC system developed by FNS and the procurement plan established by USDA is in principle straight-forward. Each time USDA makes a decision to enter a commodity market information about this pending purchase is promptly forwarded to those responsible for operating the CLOC system. Included in this information is the type of product expected to be purchased, the anticipated value of the contracts awarded including funds added to cover transportation of goods to State distributing points, and the period within which commodities are to be shipped to designated State distribution points. Specifications for each letter of credit are established as follows. First, the specific commodity purchased by USDA establishes the general type of product which SFAs can purchase.

However, CLOC SFAs are not required to purchase exactly the same type of product as USDA (e.g., whole turkeys). Rather, they are required to purchase products that are composed in whole or in part of the agricultural product (e.g., turkey breasts, turkey dogs). Second, the total value of USDA's procurement contracts, inclusive of transportation charges, is divided by the value of the entire estimated food procurement plan established by USDA. This calculation results in the percentage of the procurement budget to be allocated to each specific commodity. This percentage in turn is multiplied by each CLOC SFAs estimated annual commodity entitlement, and the resultant dollar value is the amount of entitlement money available to each CLOC SFA for the specific commodity purchases.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

The second way in which the CLOC system is linked to USDA's commodity procurement plan is with respect to the period of time allowed for local purchases.

The intent is to have the time frame for letter of credit purchases match the time frame for USDA purchases. The letter of credit purchase period encompasses the time from USDA's announcement that they are entering a particular commodity market until the time of Contract award. For fruits and vegetables the purchase period is usually slightly longer than 35 days. For commodities purchased on a continuous cycle such as meat and poultry products the purchase period is approximately 3 months. This places SFAs in the market at the same time as successful bidders for USDA commodity procurements and gives SFAs a reasonable period of time in which to arrange their letter of credit purchases. Delivery periods of CLOC purchases extend through the last date specified for shipment of USDA donated commodities to designated distribution points.

### D. CLOC Issuance

To understand how the CLOC system works, the following apple purchase example is used. Well before USDA actually buys apples it surveys State agencies for potential demand. At the time of this survey, CLOC SFAs receive from the contractor a "CLOC Alert" to put them on notice that USDA might soon purchase apples and that SFAs should examine their requirements for apple-related products in advance of an authorization to buy apples or apple products. A CLOC Alert commits the contractor to nothing and imposes no obligation on an SFA.

Assume that subsequent to the survey of State agencies, USDA announces its intent to buy apples with the assumption that purchases would be made amounting to 10 percent of USDA's food procurement budget. Within two to five days of the bid announcement, SFAs receive a CLOC authorization permitting them to spend up to 10 percent of their estimated entitlement on apples. The CLOC authorization provides considerable information to an SFA in addition to the amount of money which can be spent. It defines the period within which purchases must be made and the date by which purchased products must be delivered. These two sets of dates rarely coincide: the period for accepting purchases usually is much longer than the period in which purchases are required to be made.

Under the CLOC system SFAs are required to make a commitment to buy a specified product during the same time that USDA is in the market but can space the delivery of this product to best meet the particular requirements of their food service operations. In addition to setting money and time specifications, the CLOC authorization specifies a set of products that are termed "full-credit items". These are items which schools can pay for completely with commodity entitlement dollars. Such items are usually defined as any product that removes approximately the same amount of a commodity from the market per dollar spent as the form of USDA commodity purchases.

For example, SFAs could use their apple letter of credit to buy fresh apples, canned apples, apple sauce, apple juice concentrate, etc. and allocate the entire cost of these products to their CLOC accounts. The flexibility of the letter of credit system is further extended by the notion of "partial credit" for processed food items that contain at least some fraction of the targeted commodity. If an SFA wishes to purchase a highly-processed product like apple pie filling the CLOC system developed by FNS is set up to give SFAs credit (or a discount) for that element of the processed food item that is made from the target commodity even though this target commodity may represent a small fraction of the overall food item formulation.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

In the case of apple pie filling SFAs would receive credit for a predetermined percentage (50%) of the total dollar value of the product. The proportion of credit given represents the ratio of: (1) the average weight of the commodity removed from the market by the SFA dollar spent on the product and (2) the weight of commodity removed from the market by USDA purchases per dollar spent by USDA. This partial credit element of the CLOC system is intended to give SFAs as much flexibility as possible in using their commodity dollars while still ensuring that SFAs buy the generic commodity that is the subject of USDA's procurement action. Most SFAs use most of their letters of credit for the purchase of full credit items.

The other major condition attached to a CLOC authorization is that the product purchased has to be formulated from a target commodity (or commodities) of domestic origin and that final authorization to use entitlement funds to pay for these items depends upon some evidence that the purchase has in fact been made. School districts must certify that products purchased with CLOCs are grown and produced in the United States. School districts are no longer required to obtain documentation from distributors certifying that CLOC purchases are of domestic origin.

During School Year 2004-05, 48 separate CLOC authorizations were issued to each participating CLOC SFA. Of this number, four separate authorizations were issued for beef, dairy, grains and oil seeds. These are products that USDA purchased routinely (at least monthly) during the course of the school year and rather than issue a separate letter of credit at the time of each individual USDA purchase, quarterly letters of credit were issued for those products to simplify tracking and monitoring of SFA purchases of these commodities (or commodity groups). All other letters of credit were issued in the manner described for apples.

## II. MONITORING THE COMMODITY LETTER OF CREDIT (CLOC) SITES

Since its inception in the early 1930s, the National School Lunch Program (NSLP) has been guided by two major objectives: to provide nutritionally sound meals to school children and to encourage the consumption of domestic agricultural products. Federal support for schools participating in the NSLP comes from direct cash subsidies as well as the donation of agricultural commodities. Donated commodities are purchased in the market by the United States Department of Agriculture (USDA), although some products are moved directly out of government stocks.

Since the 1980's, there has been considerable debate over the feasibility of an alternative to the donation of commodities in the NSLP. Despite the many positive aspects of the commodity donation program, it was the subject of criticism in the late 1970s and early 1980s. The timing of deliveries, the need to transport and store the donated commodities, the choice of commodities provided, and the commodity-form and unit size were criticisms frequently heard. A Congressional directive as part of the 1981 Agricultural Appropriations Act mandated the USDA to conduct a 3-year study of two alternatives to the existing commodity donation program -- an all cash approach and a voucher approach that used Commodity Letters of Credit (CLOC). This mandated study got underway in School Year 1982-83 with 96 School Food Authorities (SFAs) from 29 States assigned to one of three options under the study: commodity donation, cash, and CLOC. Cash sites in the study were allocated cash equivalent to the amount that USDA would have used in buying donated commodities for them. Few limitations were placed on these funds. Cash SFAs were required to spend the money on the food service program.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

CLOC SFAs also received cash equivalent to the value of the donated commodities they would have received but the expenditure of this cash was restricted to foods containing those commodities that USDA was buying for donation through the NSLP. These CLOC sites received Commodity Letters of Credit which specified the commodity they were to purchase as well as the purchase and delivery periods. In this way CLOC funds were used to provide market support for the same commodities USDA was supporting through its purchases.

Final results of the evaluation of this initial demonstration were published in 1986<sup>1</sup>. Most SFAs were pleased with the flexibility offered by the alternatives. However, SFA's used their increased flexibility to buy more highly processed foods resulting in fewer pounds of raw commodity being removed from the market for some commodities.

At the conclusion of this evaluation USDA recommended that the alternatives be discontinued. The results of the study did not provide compelling evidence sufficient to warrant the dismantling of the existing commodity donation program. The evaluation did point out deficiencies in the current commodity donation program which required some attention. Congress laid the groundwork for improving the commodity distribution system with the passage of the Commodity Distribution Reform Act and WIC Amendments (P.L. 100-237). Improvements in the commodity donation program over the last 5 to 10 years have focused on the reduction of fat and salt content of donated commodities, improved labeling and product identification, increased product varieties, improved packaging, improved scheduling of deliveries and the adoption of unitized deliveries.

Although the evaluation of the initial demonstration ended in School Year 1984-85, those sites that participated in this demonstration were allowed to continue under these alternatives through a series of legislative enactments.

In 1989 the Conference Report accompanying the Child Nutrition and WIC Amendments Act (P.L. 101-147) authorized the Secretary of Agriculture to review the CLOC procedures and make appropriate modifications to assist the Department in meeting its mandate to support domestic agricultural markets. The Food and Consumer Service (FNS) developed modifications in the CLOC operating procedures that became effective at the beginning of School Year 1990-91. These modifications focused on: (1) the definition of the CLOC's in terms of commodity specificity as well as the timing of the purchases and deliveries; (2) the crediting policies; and (3) the guarantee that CLOC purchases were of domestic origin. The results of the evaluation of the modified CLOC system were published in 1992<sup>2</sup>. Results of this study indicate that a number of the major differences in the performance of CLOC and Commodity school districts found in the previous study and that were the focus of this the CLOC modifications had been narrowed. The CLOC districts were able to enter the market at the same time as USDA and remove approximately the same amount of product from the market as the matched commodity sites. However, there was still some question as to whether equivalent market impact is obtained by CLOC purchases. In addition, there was insufficient information to judge the administrative feasibility of CLOC at either the State or national level.

The Child Nutrition Amendments of 1992 (P.L. 102-342) signed into law on August 14, 1992 extended through September 30, 1994 the CASH/CLOC option to those SFA's that have been operating under these alternatives. The Healthy Meals for Healthy Americans Act of 1994 made these sites permanent.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

### A. CLOC Monitoring and Accounting

SFAs are required to document purchases to be allocated against their commodity entitlement funds by completing a reporting form developed specifically for the information requirements of the program and by submitting an invoice purchase order or contract indicating a commitment to buy the product in question. The documentation is reviewed to make sure that purchases listed on the CLOC Reporting Form corresponds to accompanying documentation and that these purchases were made within the specified time period. A decision as to whether the purchase is an acceptable letter of credit transaction is made generally within three business days. Purchase data to be entered in the data base are total cost of purchase, standardized food description, date of purchase, transaction code and credited amount. During School Year 2004-05, 6,241 separate CLOC purchases were approved and entered into the CLOC tracking system.

If the purchase is approved, the amount of the approved purchase is deducted from the SFA's CLOC. Each approved purchase is posted to accounts maintained by a firm under contract to FNS. At regular intervals, computer-generated copies of accounts maintained by the contractor are forwarded to SFAs for their review. These reports include a history of all transactions made by the SFA with respect to each letter of credit. As well as, a summary of the account status of all CLOCs issued to each SFA.

A major challenge for the CLOC system is the calculation of predetermined percentages of the total dollar value of partial credit items. While many of these percentages have been calculated for previous years, it is essential that these calculations be reviewed each year in light of potential changes in market conditions. In addition, there may be new processed products introduced that SFAs would like to purchase with their CLOC funds that would require the calculation of the appropriate partial credit proportion.

For example, suppose an SFA wished to purchase apple pies with its apple CLOC. To determine the percentage of the total dollar value of the apple pies that could be credited to the apple CLOC, the following information must be available: (1) an estimate of the total amount of apples removed from the market with the USDA apple purchases using commodity conversion factors to estimate the farm-equivalent weight<sup>3</sup> (2) the estimated dollar amount of USDA apple purchases: (3) the product formulation of the processed product (apple pies): (4) an estimate of the total amount of apples removed from the market with the SFA purchase of apple pies: and (5) the estimated dollar amount of the SFA apple pie purchase. The pounds of apples removed from the market per dollar spent on USDA apple purchases must be calculated and a calculation for the SFA apple pie purchases must be completed. The ratio of these two numbers represents the portion of the SFA apple pie purchase that would be creditable to the apple CLOC. Generally SFAs are asked to obtain the product formulation information from the vendor or the products manufacturer. If an adequate formulation cannot be obtained from industry sources, a generic formulation must be developed subject to the review of the SFA.

### B. CLOC Trades

SFAs may trade commodities under the current commodity system. If an SFA has accepted delivery of certain commodities for which the district has little or no need these products may be exchanged with another SFA for a more desirable product mix. Trades may even occur across State lines, although trades over long distances are uncommon because of the transportation expenses involved.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation. March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## Cash/CLOC Background and Monitoring Requirements

Trades are also permissible under the CLOC system. Under a CLOC system a trade is quite simple to accomplish since it involves only a paper transaction. Under the commodity system the actual products have to be exchanged. In School Year 2004-05, 51 trades were made.

---

<sup>1</sup> St. Pierre, Robert G. et. al. Evaluation of Alternatives to Commodity Donation in the National School Lunch Program: Final Report. Volume 6, 1986.

<sup>2</sup> Daft, Lynn M. and Donald W. Westfall. Commodity Letter of Credit Modification Demonstration Evaluation, March, 1992

<sup>3</sup> Farm-equivalent weight is the weight of a raw agricultural commodity at the farm gate that is required to produce a given unit of a food product containing that commodity. For example it takes approximately 1.25 pounds of raw apples coming out of the orchard to produce 1 pound of canned applesauce.

## **LEGISLATIVE HISTORY**

In 1981 Congress mandated that the Department of Agriculture (USDA) conduct a three-year demonstration to look at alternatives to the commodity donation program. Two alternatives were tested in a nation-wide sample. The Cash alternative gave money instead of commodities to school districts. Districts could use the money for any school food program expenditure. The CLOC (Commodity Letter of Credit) alternative also gave money instead of commodities to districts. However, Districts were required to spend the money to support specific agricultural markets. The CLOC program was mirrored to reflect the Commodity Program in terms of agricultural support and surplus removal with CLOC's being issued to coincide with the purchase cycle of the commodity program. Payments for both programs are based on the same SY entitlement rate as the commodity program.

At the end of the demonstration USDA recommended that the alternatives be discontinued. However, the demonstration sites were allowed to continue under the alternatives by various Congressional acts. In 1994 Congress allowed the demonstration sites to stay CLOC and Cash permanently. At present the program is administered by Ender York, Inc., Fairfax, VA funded by a USDA contract.

## **CASH OVERVIEW**

There are 33 Cash sites that are allowed to use their funds in any capacity related to food programs. These sites receive quarterly checks totaling 25% of their total entitlement amount. The sites may also receive bonus commodities directly thru their State agencies.

## **CLOC OVERVIEW**

There are 24 CLOC sites. Both urban and rural districts are represented as well as a wide range in the number of free and reduced meals.



Type	City	State	DISTRICT NAME	
CLOC	GREEN FOREST	AR	GREEN FOREST SCHOOL DISTRICT	
CLOC	TUCSON	AZ	FLOWING WELLS SCHOOLS	As of School Year 2008 (beginning July, 2007) swithing back to the commodity program
CLOC	GILROY	CA	GILROY UNIFIED SCHOOL DISTRICT	
CLOC	GREELEY	CO	WELD CO. SCH. DISTRICT	
CLOC	WINDSOR	CT	WINDSOR PUBLIC SCHOOLS	
CLOC	BROOKSVILLE	FL	HERNANDO CO. SCHOOL DISTRICT	
CLOC	PARKERSBURG	IA	PARKERSBURG COMMUNITY SCHOOLS	
CLOC	FRUITLAND	ID	FRUITLAND IDAHO PUB. SCHOOLS	
CLOC	PARIS	IL	COMMUNITY SCHOOL DISTRICT #4	
CLOC	PORTLAND	ME	PORTLAND PUBLIC SCHOOLS	
CLOC	TROY	MI	TROY SCHOOL DISTRICT	
CLOC	GONVICK	MN	CLEARBROOK-GONVICK SCHOOL	
CLOC	INDIANA	PA	INDIANA AREA SCHOOL DISTRICT	
CLOC	BATESBURG	SC	LEXINGTON SCHOOL DISTRICT #13	
CLOC	ELK POINT	SD	ELK POINT S.D. #61-3	
CLOC	LOUDON	TN	LOUDON COUNTY SCHOOL DISTRICT	
CLOC	COVINGTON	VA	ALLEGHANY COUNTY SCH. DIST.	
CLOC	SPRINGFIELD	VA	FAIRFAX COUNTY PUBLIC SCHOOLS	
CLOC	LYNDON	VT	LYNDON TOWN SCHOOL DISTRICT	
CLOC	LONGVIEW	WA	LONGVIEW S.D. #122	
CLOC	SEATTLE	WA	SHORELINE PUBLIC SCHOOLS #412	
CLOC	MERRILL	WI	MERRILL SCHOOL DISTRICT	
CLOC	RIVER FALLS	WI	RIVER FALLS SCHOOL DISTRICT	
CLOC	FRANKLIN	WV	PENDLETON CO. SCHOOL DIST.	
CLOC	TEN SLEEP	WY	WASHAKIE COMM. CON. SCH.DIS.2	