INTERIM GUIDANCE ON

WIC VENDOR COST CONTAINMENT

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Reason for Issuance

This guidance is intended to assist State agencies to implement vendor cost containment systems that meet the requirements of the WIC Vendor Cost Containment Interim Rule, which was published in the Federal Register on November 29, 2006 (70 FR 71708). The Interim Rule incorporates changes made to section 17(h)(11) of the Child Nutrition Act of 1966 (CNA) as amended (42 U.S.C. 1786(h)(11)), by the Child Nutrition and WIC Reauthorization Act of 2004 (Public Law 108-265). Section 17(h)(11) of the CNA, *Vendor Cost Containment*, imposes new requirements on State agencies to ensure that the WIC Program pays all vendors competitive prices for supplemental foods. While State agencies have flexibility under the CNA to design vendor cost containment systems that meet their individual needs, they also have increased accountability to demonstrate that these systems are operating effectively. A primary measure of effectiveness is a State agency's ability to contain the costs to the program of vendors that derive more than 50 percent of their annual food sales revenue from WIC food instruments (referred to in this guidance as "above-50-percent vendors"). The Food and Nutrition Service (FNS) expects that every State agency will view the new vendor cost containment requirements as both a mandate and an opportunity to enhance present performance.

Content of Guidance

This guidance enunciates federal policy on various requirements in the WIC Vendor Cost Containment Interim Rule (referred to throughout this document as the "Interim Rule") in order to facilitate implementation by State agencies. All State agencies are affected by the Interim Rule and will benefit from the information in this guidance. The contents have been organized to assist State agencies in carrying out the following actions:

1. Identify above-50-percent vendors (section 246.12(g)(4)(i)) and, if the State agency chooses to authorize such vendors after December 30, 2005, obtain FNS certification (section 246.12(g)(4)(vi) of the Interim Rule);

2. If the State agency intends to authorize above-50-percent vendors, determine whether above-50-percent vendors cost the program more than if participants used regular vendors (section 246.12(g)(4)(i)(D));

3. Implement or modify a vendor peer group system, competitive price criteria, and/or allowable reimbursement levels (section 246.12(g)(4)). Each State agency, regardless of whether it intends to authorize above-50-percent vendors, must implement a vendor peer group system (unless FNS exempts the State agency from this requirement), competitive price criteria, and allowable reimbursement levels; or

4. Request an exemption from the vendor peer group system requirement (section 246.12(g)(4)(v)) or an exception to the requirement to use a measure of geography in establishing peer groups (section 246.12(g)(4)(ii)(A)).

FNS will issue further guidance as necessary.

ABOVE-50-PERCENT VENDORS

Regulatory Provision

Section 246.12(g)(4) of the Interim Rule contains a new requirement that a State agency must establish a vendor peer group system, unless FNS exempts the State agency from this requirement. In implementing its peer group system, a State agency that chooses to authorize above-50-percent vendors must distinguish such vendors from other vendors within the peer group system. A State agency may distinguish above-50-percent vendors by establishing separate peer groups for them or by applying distinct competitive price criteria and allowable reimbursement levels to above-50-percent vendors that are in peer groups with other vendors.

Choosing to Authorize Above-50-Percent Vendors

Annually each State agency that operates a retail food delivery system (as defined in section 246.12(e) of the WIC regulations (7 CFR Part 246)) must identify the above-50-percent vendors that are currently authorized and any new vendor applicants that are expected to be above-50-percent vendors (section 246.12(g)(4)(i)). **This requirement applies to State agencies that use a vendor peer group system and to those that receive approval from FNS to utilize an alternative vendor cost containment system (such as a bid system).**

State agencies have the discretion to choose whether or not to authorize above-50-percent vendors. A State agency that chooses to authorize above-50-percent vendors must first identify these vendors in order to meet the requirements of section 246.12(g)(4)(i)(C) of the Interim Rule related to their selection and reimbursement

State agencies were required to complete the process of identifying currently authorized above-50-percent vendors by August 30, 2005, using the methodology contained in WIC Policy Memorandum #2005-2, dated December 14, 2004, the Interim Rule, and the draft cost containment guidance issued in July 2005. State agencies must apply this methodology annually to identify above-50-percent vendors. In accordance with the vendor cost containment legislation, every State agency that authorizes above-50-percent vendors after December 30, 2005, must obtain prior FNS approval through certification as discussed below.

Methodology for Identifying Above-50-Percent Vendors

Pursuant to regulatory requirements, this guidance provides a uniform procedure for all State agencies to follow in identifying above-50-percent vendors. The methodology relies on objective data and documentation of the revenue that a vendor derives annually from food sales. The State agency must obtain and assess the relevant information and designate each currently authorized vendor and new vendor applicant as an above-50-percent vendor or a regular vendor.

Assessing Current Vendors

To determine whether a currently authorized vendor meets the above-50-percent criterion in section 246.12(g)(4)(i) of the Interim Rule, the State agency must calculate annual WIC redemptions as a percentage of the vendor's total annual foods sales revenue. This calculation must be performed annually to allow the State agency to report its findings in the State Plan. The definition of "food sales" that State agencies must apply when identifying above-50-percent vendors is the "sale[s] of all foods that are eligible items under the Food Stamp Program (FSP)." These foods are intended for home preparation and consumption and include meat, fish, and poultry; bread and cereal products; dairy products; fruits and vegetables. Items such as condiments and spices, coffee, tea, cocoa, and carbonated and noncarbonated beverages are included in food sales only when offered for sale along with foods in the four primary categories. Food sales do not include sales of any items that are not approved for purchase with food stamp benefits, such as nonfood items, alcoholic beverages, hot foods, or food that will be eaten on the store premises. The term "food sales" used throughout this document refers to sales of FSP-eligible items, unless otherwise noted. The use of this definition does not require that a vendor be authorized by the FSP.

State agencies must provide the definition of "food sales" to vendors when requesting the amount of annual food sales revenue. Vendors that are FSP-authorized should already be aware of the FSP-eligible foods. State agencies should provide the attached list of FSP-eligible items to vendors (Attachment 1).

Section 246.2 of the Interim Rule defines above-50-percent vendors based on the percent of their annual revenue from the sale of food items. State agencies must use annual food sales data to assess a vendor. The annual period may be the most recent calendar year, fiscal year, or other 12-month period. If the food sales data obtained by the State agency covers less than a year (e.g., for a vendor that has been in operation for six months), the State agency should not annualize the amount of food sales. WIC redemption data used in the State agency's calculations should cover the same period covered by the vendor's food sales amount.

The State agency shall use the results of its assessment to classify each vendor as being either a regular vendor or an above-50-percent vendor during the subsequent fiscal year. State agencies must include commissaries and pharmacies in the assessment of above-50-percent vendors.

1. Identifying Potential Above-50-Percent Vendors from WIC and FSP Redemptions

    As an initial step in identifying above-50-percent vendors, the State agency should compare a vendor's WIC redemptions to the vendor's FSP redemptions for the same period. Since most WIC vendors are also FSP-authorized, a comparison of readily available WIC and FSP redemption data will reduce the level of effort a State agency must expend to identify above-50-percent vendors. If a vendor's FSP redemptions exceed its WIC redemptions, **no further assessment is required**. The vendor would be deemed a regular vendor. Collection of an annual food sales amount for the vendor would not be necessary.

To assist State agencies with the comparison of WIC redemption and FSP redemption data, FNS has included a report entitled *Authorized Vendors Identified as Potentially Meeting the 50-Percent Criterion* in The Integrity Profile (TIP) on-line system (see Attachment 2). This report lists all FSP-authorized WIC vendors whose ratio of WIC redemptions-to-(WIC + FSP) redemptions exceeds 50 percent.[1] It will also identify WIC vendors for which a ratio could not be calculated because the vendor is not FSP-authorized. State agencies will be able to generate this report beginning with the fiscal year 2005 TIP data submission.

2. Calculating the WIC Redemptions-to-Total Annual Food Sales Ratio

If a State agency is unable to determine that a currently authorized vendor is not an above-50-percent vendor using WIC and Food Stamp redemption data alone, then the State agency must collect food sales data from the vendor and compute the ratio of annual WIC redemptions to annual food sales in order to designate the vendor properly. The process is discussed in detail below.

a. The Required Procedure

To meet legislative requirements related to above-50-percent vendors, State agencies must obtain food sales data from vendors whose designation as a regular vendor or an above-50-percent vendor has not been confirmed through the use of WIC and FSP redemption data alone.[2] After obtaining the annual food sales amount from a vendor, the State agency will calculate the ratio of annual WIC redemptions to total annual food sales (i.e., WIC redemptions divided by total food sales) and designate the vendor as an above-50-percent vendor or a regular vendor. This scenario (Scenario 1) appears on the left-hand side of the attached *Flow Chart for Identifying Above-50-Percent Vendors Using Food Sales Data* (Attachment 3). The food sales amount used in this calculation must be a documented amount that includes sales of FSP-eligible items only. A documented food sales amount is an amount that is supported by written sales or financial statements, reports, tax forms, or other records sufficient for establishing FSP-eligible food sales. (The requirement for submission and retention of documentation is discussed below under *Documentation and Recordkeeping*.)

b. An Interim Approach

Since the definition of “food sales” used in this guidance is new to WIC vendors, and because vendors differ in their ability to derive this amount from

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[1] Since the WIC redemption data in this report pertains to a single State agency, the report will not identify shared vendors that would fall into the potentially above-50-percent category when WIC redemptions from another State agency are considered. Thus, State agencies will need to assess separately all vendors that are authorized by more than one State agency. Using the FSP authorization number of an authorized WIC vendor, a State agency will be able to access all WIC redemption amounts for a vendor.

[2] When obtaining food sales and/or gross sales data from vendors, State agencies should inform vendors that the amount(s) reported should include sales of infant formula.

available sales records and databases, as an interim procedure a State agency may estimate a vendor's FSP-eligible food sales and use this estimate to calculate the WIC redemptions-to-total food sales ratio. During fiscal years 2005 through 2007, a State agency may estimate the annual FSP-eligible food sales amount from a vendor's annual gross food sales amount. The attached *Regular Vendor Food Sales and Maximum WIC Redemptions Calculator* (an Excel application referred to as the *food sales calculator*) has been developed for this purpose (Attachment 4).

State agencies may employ the following procedures during fiscal years 2005 through 2007 as vendors (i.e., those that cannot be designated as regular vendors based on WIC and FSP redemption data) take the necessary steps to provide State agencies with an annual FSP-eligible food sales amount. These interim procedures do not alter the requirement that vendors must ultimately provide FSP-eligible food sales. Rather, they are intended to give State agencies flexibility to work with sales data that do not yet meet the new requirements. State agencies are not required to use the following procedures. They have the authority to deny authorization to vendors that fail to provide the required food sales data and documentation. However, these procedures should make the process of identifying above-50-percent vendors more manageable.

Scenario 1

Using a Documented Total Food Sales Amount to Identify An Above-50-Percent Vendor

This scenario indicates the steps a State agency should take to identify an above-50-percent vendor when the vendor provides a food sales amount that represents sales of FSP-eligible foods only, for which the vendor supplies acceptable documentation.

(1) Calculate the ratio of total WIC redemptions to total food sales (i.e., the annual WIC redemptions divided by the annual food sales). Include WIC redemptions for every State agency that authorized the vendor during the period being considered.

(2) Designate the vendor as an above-50-percent vendor if the ratio of annual WIC redemptions to annual food sales exceeds 50 percent. If the ratio is less than or equal to 50 percent, designate the vendor as a regular vendor.

Scenario 2

Estimating FSP-Eligible Food Sales from a Food Sales Amount That Includes Other Items

This scenario indicates the steps a State agency should take to identify above-50-percent vendors when a vendor provides a food sales amount that includes items other than FSP-eligible foods.

(1) Calculate the WIC redemptions-to-food sales ratio using the food sales amount provided by the vendor. If the State agency determines that the vendor is an above-50-percent vendor using a food sales amount that includes items other than FSP-eligible foods, then the State agency does not need to estimate a FSP-eligible foods sales amount. If this calculation does not indicate that the vendor is an above-50-percent vendor, proceed to step (2).

(2) Obtain a gross sales amount from the vendor. The State agency will use the vendor's gross sales to estimate the amount of FSP-eligible food sales.

(3) Estimate FSP-eligible food sales using the attached *food sales calculator*. Insert the name of the store, vendor identification number, a code for the store type, the vendor's annual gross sales, and amount of annual WIC redemptions (columns A through D and column H).[3] The *food sales calculator* will automatically apply the appropriate food sales share (column E) to the gross sales amount and compute an estimated FSP-eligible food sales amount (column F).

The food sales share (column E) was computed by Economic Research Service staff, USDA, using retail trade data from the 2002 Economic Census, adjusted to exclude foods that are not FSP-eligible.[4] The estimated food share varies from 94.7% for specialized food stores to 4.8% for pharmacies.[5] The *food sales calculator* will also compute the maximum amount of WIC redemptions the vendor can have and be classified as a regular vendor (column G). It will then compare this amount with the annual WIC redemptions (column H) and insert a "Y" in column I if the annual WIC redemptions exceed the maximum amount in column G.

(4) Compare the estimated FSP-eligible food sales amount in column F of the *food sales calculator* to the food sales amount provided by the vendor (which was

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[3] The *food sales calculator* will compute the estimated FSP-eligible food sales when the store type and annual gross sales are entered into the calculator. The vendor name and ID number are included so that the State agency will have complete documentation. The State agency may add other data elements, if desired.

[4] The Economic Census is conducted every five years.

[5] State agencies should work with military commissaries to obtain the required food sales data. FNS Instruction 806-4, Rev. 1, recognizes the uniqueness of commissaries as WIC vendors and provides guidance to State agencies on resolving any problems that might arise in obtaining required information.

used in step (1) above). Base the vendor's designation on the calculation that used the lower of the two amounts.

To illustrate, if the food sales amount used to calculate the WIC redemptions-to-food sales ratio in step (1) is $100,000 and the food sales amount estimated by the *food sales calculator* in step (3) is $90,000, then designate the vendor based on the results obtained in step (3).

To locate this scenario on the *Flow Chart*, follow the sequence in which the answer to the question, "Did the vendor provide a documented total food sales amount?" is "Yes" and the answer to "Did the food sales amount include FSP-eligible foods only?" is "No."

Scenario 3

Estimating FSP-Eligible Food Sales from a Documented Gross Sales Amount

As business entities, WIC vendors are required to report gross receipts or sales to the Internal Revenue Service on line 1a of various federal tax forms (e.g., Form 1065 (for partnerships); Form 1040, schedule C (for sole proprietorships); Form 1120 (for corporations). Businesses also report annual gross sales to State tax and revenue agencies, even if the State does not impose a sales tax on food. Thus it is reasonable to expect vendors to be able to provide State agencies with a documented annual gross sales amount, even if they report that they are unable to provide a distinct food sales amount. To estimate FSP-eligible food sales using a vendor's annual gross sales, the State agency would proceed as follows:

(1) Obtain the documented annual gross sales amount from the vendor.

(2) Insert the name of the store, vendor identification number, a code for the store type, the vendor's annual gross sales, and amount of annual WIC redemptions (columns A through D and column H) in the *food sales calculator*.

(3) Designate the vendor as an above-50-percent vendor or a regular vendor as indicated in column I of the *food sales calculator*.

To locate this scenario on the *Flow Chart*, follow the sequence in which the answer to the question, "Did the vendor provide a documented total food sales amount?" is "Yes" and the answer to "Did the vendor provide a documented gross sales amount?" is "No."

Scenario 4

Estimating FSP-Eligible Food Sales from an Undocumented Gross Sales Amount

In rare instances a vendor may not have written documentation of a store's annual gross sales amount due to some extraordinary occurrence or circumstance (such as a fire or natural disaster). In such instances, a State agency may allow a vendor to make a written self-declaration of the store's annual gross sales. The self-declaration should be made on a form developed by the State agency. It should include the self-declared gross sales amount, the period to which the gross sales amount applies (e.g., January 1, 2005 to December 31, 2005), the reason why the vendor is unable to provide either a documented food sales or gross sales amount, and the signature of the store owner or authorized representative.

To estimate a vendor's FSP-eligible food sales under this scenario:

(1) Obtain the vendor's self-declared annual gross food sales amount. Determine the reasonableness of the amount using relevant information, if any, that the State agency has available.

(2) Using the *food sales calculator*, compute the estimated FSP-eligible food sales.

(3) Designate the vendor as a regular vendor or an above-50-percent vendor based on the results in column I of the *food sales calculator*.

(4) Advise the vendor, in writing, that a documented food sales amount will be required for the upcoming three-month period (which the State agency will specify). Inform the vendor of the type of documentation that the State agency will accept.

(5) Reassess the vendor in 90 days using the vendor's documented food sales amount by computing the ratio of WIC redemptions-to-total food sales for the 90-day period. Compare the documented food sales amount with the estimated food sales amount derived using the *food sales calculator*. Confirm or modify the vendor's designation.

To locate this scenario on the *Flow Chart,* follow the sequence in which the answer to the question, "Did the vendor provide a documented total food sales amount?" is "No" and the answer to "Did the vendor provide a documented gross sales amount?" is also "No."

c. Additional Comments on Using the Food Sales Calculator

In certain instances a State agency may need to estimate food sales from gross sales data that cover less than a one-year period. It would still be appropriate to use the *food sales calculator*. The actual WIC redemptions in column I must apply to the same period of time as the gross sales data. For example, a State agency needs to determine whether a new vendor that has been authorized for eight months is an above-50-percent vendor. The State agency would obtain the vendor's gross sales amount for the eight-month period and the vendor's WIC redemptions for the same period and insert these amounts in columns D and H, respectively, of the *food sales calculator.*

Attachment 5 contains information on the development of the *food sales calculator*. State agencies that choose not to use the *food sales calculator* must, as part of the State Plan submission, describe their alternative policy and/or procedure for identifying above-50-percent vendors using food sales data.

3. Documentation and Recordkeeping

Vendors must provide documentation of the food sales amount reported to a State agency. For State agencies that choose not to authorize any above-50-percent vendors, a vendor's annual food sales will be a deciding factor in whether or not a vendor is authorized. For all other State agencies, a vendor's annual food sales revenue will determine whether the vendor is designated as a regular vendor or an above-50-percent vendor. Thus, vendors must be able to substantiate the amount of food sales reported. Although State agencies will take steps to minimize the reporting burden imposed on vendors (e.g., by using WIC and FSP redemption data to identify the vast majority of vendors who are regular vendors), State agencies will need to obtain documentation of food sales data from vendors whose status cannot be determined based on data already available.

It is the vendor's responsibility to maintain and submit the documentation required by the program. Section 246.12(h)(xv) of the WIC regulations states:

> "The vendor must maintain inventory records used for Federal tax reporting purposes and other records the State agency may require for the period of time specified by the State agency in the vendor agreement. Upon request, the vendor must make available to the State agency…all program-related records."

FNS encourages State agencies to confer with their vendor advisory committees, vendor associations, and/or other groups to understand the accounting or recordkeeping methods that retail food vendors customarily and reasonably employ. State agencies must notify vendors in the vendor agreement or handbook, as appropriate, that documentation of the annual food sales amount may be required, and that a vendor's failure to provide such documentation, as well as provision of false information, will result in denial of authorization or termination of the vendor agreement.

FNS recommends that State agencies collect a gross sales amount from vendors that are required to provide a food sales amount. Having the gross sales amount for a store can be useful to the State agency in assessing the reasonableness of the food sales amount. In addition, the gross sales amount reported to the State agency should correspond to the gross sales reported on State or Federal tax returns. Since business entities already are required to maintain records substantiating information reported on tax returns, requests from State agencies for such information should not impose a burden on vendors.

The State agency is not required to make an extraordinary effort to determine whether a vendor is an above-50-percent vendor, but should use its best judgment to classify the vendor after reviewing available information provided by the vendor, including information already on file (such as the size and location of the store). FNS does not expect State agencies to routinely verify the food sales and/or gross sales amounts reported by vendors. Verification refers to the process whereby the information presented (such as a vendor's sales report or financial statement) is validated through the use of an external source of information other than the vendor. FNS encourages verification of any questionable food sales information, particularly when the information affects a vendor's authorization.

4. Timing of the Annual Vendor Assessment

Starting with the fiscal year 2005 submission, State agencies will use data from the TIP report that is due to FNS annually by February 1st to identify above-50-percent vendors for the upcoming fiscal year. State agencies must assess vendors annually in sufficient time to include the results of the assessment in the next State Plan. A State agency may update or revise a vendor's designation at any time. Whenever a State agency determines that it has one or more above-50-percent vendors, and the State agency has not received FNS certification, the State agency must submit a request for certification to FNS within 90 days of making this determination.

Other Considerations

A State agency can accept a currently authorized vendor's written statement that the store receives more than 50 percent of its annual food sales revenue from WIC food instruments, and may designate the store as an above-50-percent vendor based on this statement. In addition, a State agency may automatically designate as above-50-percent vendors all vendors that are WIC-only stores. In such instances, the State agency does not need to collect food sales data from the vendor.

If a vendor was authorized by more than one State agency during the period under consideration, then the State agency must obtain the amount of WIC redemptions the vendor received from every other State agency that authorized the vendor and sum all of the WIC redemptions to calculate the ratio of WIC redemptions to total annual food sales.

A State agency that chooses not to authorize above-50-percent vendors still must determine whether any such vendors currently are authorized so that it can take appropriate action to end their authorization. State agencies must ensure that their decision not to authorize above-50-percent vendors does not result in inadequate participant access to supplemental foods. A State agency that authorizes above-50-percent vendors only when needed to ensure participant access must comply with all requirements of section 246.12(g)(4) related to such vendors.

Assessing Vendor Applicants

State agencies must assess all new vendor applicants during the vendor selection process and identify those that they expect will be above-50-percent vendors. Vendor applicants include a new store location for an owner that currently has a WIC-authorized store, and a vendor with no prior involvement with WIC. To conduct the assessment, the State agency must first ask vendor applicants whether they expect to derive more than 50 percent of the store's annual food sales revenue from WIC food instruments. If the vendor applicant's answer is "yes," no further assessment would be necessary. The State agency must designate the vendor as an above-50-percent vendor.

The State agency must further assess all vendor applicants that state that they do not expect to derive more than 50 percent of the store's annual revenue from WIC food instruments using the data sources and methodologies listed in *Table 1*. At its discretion, the State agency may use additional data sources and methodologies. Failure of a vendor applicant to provide documentation requested by the State agency shall result in denial of the vendor's application.

The indicators shown in *Table 1* provide the State agency with a composite picture of how the new vendor applicant is likely to operate if the store were authorized. They assume that a new store location is likely to be an above-50-percent vendor if other WIC-authorized stores operated by the same ownership entity currently are above-50-percent vendors. The indicators rely on historical and current data that the State agency maintains in its vendor management system and relevant documentation provided by the vendor applicant. If the State agency determines that the vendor applicant may be authorized, the State agency shall use the on-site preauthorization visit (required by section 246.12(g)(5) to confirm that the new store is or is not expected to be an above-50-percent vendor. State agency staff must document the findings of its assessment of each vendor applicant's status as a potential above-50-percent vendor.

The State agency shall monitor all newly-authorized vendors subsequent to authorization to assure that they have been properly designated as being or not being above-50-percent vendors. As required by section 246.12(g)(4)(i)(B) of the Interim Rule, such monitoring shall include a comparison of WIC and FSP redemption data and/or a review of WIC redemptions to total food sales within six-months from the date of authorization. At authorization, the State agency shall notify vendors in writing of this assessment and the requirement to provide proper written documentation of their total food sales.

As noted under item 4 above, *Timing of the Annual Vendor Assessment*, whenever the State agency determines that it has one or more above-50-percent vendors, and the State agency has not received FNS certification, the State agency must submit a request for certification to FNS within 90 days of making this determination.

Table 1. Methodologies and Indicators for Determining Whether a Vendor Applicant is Expected to be an Above-50-Percent Vendor

Indicator	Methodologies and Data Sources
The vendor applicant currently has one or more stores where WIC food sales are more than 50 percent of total annual food sales.	1) Determine if the vendor (i.e., the ownership entity) currently has one or more stores that are authorized by the State agency or by another State agency to accept WIC food instruments. 2) If the vendor (the ownership entity) has one or more stores that are authorized to accept WIC food instruments, determine whether any of these stores (including the applicant store location, if it is authorized by another State agency) are above-50-percent vendors.
The vendor applicant is expected to accept WIC as the primary form of payment for the sale of supplemental food items.	1) Request the percentage of anticipated food sales by type of payment, i.e., cash, FSP, WIC, and credit/debit. 2) If the applicant store is already open for business, request the total food sales during the last year. To the extent possible, validate the information on the percentage of anticipated food sales by type of payment and/or the total food sales against other data sources. 3) If the vendor (i.e., ownership entity) was previously authorized by the State agency, and the State agency has the necessary historical data (e.g., annual WIC and FSP redemptions, a total food sales amount, documentation that the store was a WIC-only store) determine whether the previously authorized store location(s) was an above-50-percent vendor.
The vendor applicant is expected to or currently offers for sale primarily WIC-authorized food items (i.e., does not offer a variety of foods, including meat, poultry, fish; bread or cereal; vegetables or fruits, and dairy products).	1) Request inventory invoices to substantiate foods that have been purchased for sale. 2) Determine whether a variety of foods in each of the following four categories will be or are currently being offered for sale on a continuous basis: meats, poultry, or fish; bread or cereal; vegetables or fruits; and dairy. Continuous basis means that on any given day of operation, a store offers for sale and normally displays in a public area no fewer than three different varieties of food items in each of the four categories. 3) Request the percentage of foods intended to be offered for sale in each category, i.e., 15% meat, poultry, or fish; 30% bread or cereal; 30 % fruits and vegetables; 20% dairy products, etc. 4) If the vendor selection process proceeds to the point of a site visit, determine through the site visit whether the percentages provided by the vendor are realistic.
The vendor applicant is dependent upon WIC authorization before the store can open for business.	On the vendor application, request the date the store will open for continuous business.

Establishing Competitive Price Criteria for Above-50-Percent Vendors

In accordance with sections 246.12(g)(4)(i)(A) and (C) of the Interim Rule, a State agency that authorizes any above-50-percent vendors must apply competitive price selection criteria to these vendors that are based on the prices charged by vendors that are not above-50-percent vendors. If a State agency elects to group above-50-percent vendors in a separate peer group(s) as permitted by section 246.12(g)(4)(i) of the Interim Rule, the State agency shall use competitive price criteria established for regular vendors to determine whether the prices offered by above-50-percent vendors are competitive, and thus whether they may be selected for authorization. The State agency has the discretion to determine which regular vendors to use for this purpose. (See the section on *Identifying Comparable Vendors.)*

If a State agency places above-50-percent vendors in peer groups with regular vendors, the State agency shall exclude the prices of the above-50-percent vendors in computing competitive price criteria for the peer groups. After determining the competitive price criteria for regular vendors, the State agency shall use the criteria to evaluate the competitiveness of the prices of the above-50-percent vendors assigned to the peer group. If the prices of the above-50-percent vendors exceed the competitive price criteria established for the peer group, then the above-50-percent vendors may not be authorized unless they are needed to ensure participant access to supplemental foods. Some regular vendors might also exceed the revised competitive price criteria and likewise must be deemed ineligible for authorization. The State agency must treat all vendors whose prices exceed the competitive price criteria equitably.

If a State agency must authorize vendors whose prices are not competitive because they are needed for participant access purposes, the State agency may not use these vendors' prices to establish competitive price criteria or allowable reimbursement levels for the peer group. The State agency must devise a means to reimburse non-competitive vendors as exceptions to the competitive price criteria and allowable reimbursement levels. FNS believes that exceptions to the established competitive price criteria and allowable reimbursement levels should be rare. Even if the State agency must authorize a vendor whose prices exceed the competitive price criteria, the State agency should seek to secure from the vendor the most competitive prices possible.

Whenever the State agency changes its competitive price criteria, it must make corresponding changes in the allowable level of reimbursement established for each peer group. In accordance with section 246.12(g)(4)(iii), a State agency may not reimburse a vendor for supplemental foods at a level that would make the vendor ineligible for authorization under the competitive price criteria applicable to the vendor. As discussed below under *Certification of Vendor Cost Containment System*, the State agency must set allowable reimbursement levels for above-50-percent vendors so that the average payments per food instrument (by type) to these vendors do not exceed average payments per food instrument to comparable vendors.

A State agency that authorizes or reauthorizes any above-50-percent vendors after December 30, 2005, must comply with the requirements in sections 246.12(g)(4)(i)(A) and (C) of the Interim Rule to establish new competitive price criteria and allowable reimbursement levels for above-50-percent vendors and must present documentation of compliance to FNS.

(See *Vendor Cost Containment Certification* below for specific requirements.) FNS expects that the new requirements related to competitive price selection criteria will, in many instances, result in a lowering of the competitive price range and allowable reimbursement levels applicable to all retail vendors. State agencies should make appropriate changes in the vendor agreement and advise vendors of these changes as required by the notification provisions in section 246.12(h)(7) of the WIC regulations.

Participant Access Determination

Section 246.12(g)(1) of the Interim Rule requires State agencies to authorize an appropriate number and distribution of vendors in order to ensure the lowest practicable food prices consistent with adequate participant access to supplemental foods and to ensure effective State agency management, oversight, and review of its authorized vendors. In making the decision to authorize or not authorize any vendor, the State agency shall ensure adequate participant access to supplemental foods. In developing its participant access criteria, the State agency must consider the availability of other authorized vendors in the area and any geographic barriers to using such vendors. Further, section 246.4(a)(14)(xiii) of the WIC regulations requires that a description of the participant access determination criteria be included in the State Plan. Each State agency that chooses not to authorize above-50-percent vendors shall use the participant access criteria included in its State Plan to determine whether a currently authorized vendor who is an above-50-percent vendor shall retain its authorization, and whether a new vendor applicant who is expected to be an above-50-percent vendor should be authorized for participant access reasons.

Administrative Review Requirements

Consistent with 7 CFR 246.18(a)(1)(ii) of the WIC regulations, vendors who are denied authorization because the State agency determines that they are expected to be above-50-percent vendors are eligible for an abbreviated administrative review. The validity and appropriateness of the State agency's ***criteria*** for determining whether a vendor applicant is expected to be an above-50-percent vendor are <u>not</u> subject to administrative review, as stated in sections 246.12(a)(1)(iii)(A) and (B). In addition, the State agency's participant access determination is not subject to administrative review as stated in section 246.18(a)(1)(iii)(C) of the WIC regulations. The administrative review is solely to determine if the State agency properly applied the criteria based on the documentation provided by the vendor applicant.

VENDOR COST CONTAINMENT CERTIFICATION

Regulatory Provision

Section 246.12(g)(4)(vi) of the Interim Rule contains a new requirement that a State agency that elects to authorize above-50-percent vendors shall demonstrate to the Department, and the Department shall certify, that the State agency's competitive price criteria and allowable reimbursement levels do not result in average payments per food instrument to above-50-percent vendors that are higher than average payments per food instrument to comparable vendors that are not above-50-percent vendors. State agencies that plan to utilize above-50-percent vendors after December 30, 2005, must obtain prior certification from FNS that they meet this legislative requirement.

The Purpose of Certification

Vendor cost containment certification verifies that the State agency that chooses to authorize above-50-percent vendors meets the requirement in section 246.12(g)(4)(vi). This requirement is one of two cost neutrality requirements contained in the Child Nutrition and WIC Reauthorization Act of 2004. Section 246.12(g)(4)(vi) prescribes that cost neutrality will be assessed by comparing the average payments per food instrument made to above-50-percent vendors to the average payment per food instrument to comparable regular vendors. Average payments to above-50-percent vendors may not exceed average payments to comparable regular vendors. Achieving cost neutrality begins with the selection of vendors that offer the program the most competitive prices in their geographic area. It also includes the application of reimbursement methods that limit payments to levels consistent with the competitive price levels applied to the vendors at authorization.

During the certification process, a State agency demonstrates to FNS that it has implemented methods that distinguish above-50-percent vendors from regular vendors at authorization; that it bases competitive price criteria and maximum allowable reimbursement amounts on the prices of regular vendors; that it applies appropriate reimbursement limits during the food instrument redemption process and makes price adjustments to any payments that exceed the maximum allowable reimbursement level; and that it reimburses above-50-percent vendors at a level that should achieve overall cost neutrality under section 246.12(g)(4)(i)(D) of the Interim Rule. Obtaining FNS certification does not guarantee that a State agency will achieve cost neutrality. Achieving cost neutrality requires the effective ongoing application of competitive pricing methods.

Identifying Comparable Vendors

Section 246.12(g)(4)(vi) gives the State agency discretion to define comparable vendors as it deems appropriate, as long as the State agency achieves cost neutrality of above-50-percent vendors. A State agency may place some or all above-50-percent vendors into peer groups with regular vendors or in peer groups by themselves. A State agency should define comparable vendors in a way that will meet the overall cost neutrality requirement in section 246.12(g)(4)(i)(D) of the Interim Rule. A State agency achieves overall cost neutrality if the average payments per food instrument (by type) to **all** above-50-percent vendors do not exceed average payments to **all** regular vendors. (See *"Assessing the Cost Neutrality of Above-50-Percent Vendors"*.)

State agencies should consider the usefulness of the following vendor characteristics for determining "comparability" among above-50-percent vendors and regular vendors:

1. *Store type*: Differences in store type are largely due to the underlying business model of the retailer. For example, supermarkets depend on high sales volume in order to lower the average cost per unit of goods sold, which if passed on to consumers, results in lower retail prices. Having high volume also allows supermarkets to spread fixed operating costs (rent, utilities, and insurance, for example) over many units sales, thereby contributing to lower retail margins--the difference between cost of purchased goods and their retail price. Because margins are low, supermarkets have a relatively high minimum sales requirement in order to achieve profitability, the point at which total sales exceeds total costs (food costs plus operating costs). To achieve high sales volume, supermarkets offer a wide variety of items and extensive store services. They also advertise widely and offer sales and promotions as incentives.

   In contrast, convenience store retailers offer a limited variety of products and services and are much smaller in selling area (floor space) than supermarkets. They provide "fill-in" grocery products, snack food and beverages, as well as sundries, operate extended hours, and offer easily accessible locations. These retailers typically must apply higher margins and prices than supermarkets in order to achieve profitability at a lower volume of sales.

   Other store types, such as supercenters, warehouse club stores, limited assortment stores, dollar stores, and drugstores sell retail foods under different business models, each with its own characteristics that determine profitability. All of these commercial retailers must compete in the marketplace in order to gain sales.

   An important distinction of above-50-percent vendors is their ability to avoid price competition, due to a primary dependency on redemptions of WIC participant vouchers. Rather than market forces, price is determined by the allowable reimbursement level of each voucher. For this reason, their business model is unlike that of other commercial food retailers. Competition among above-50-percent vendors is largely based on non-price characteristics such as convenient location, hours of operation, level of store services, including bi-lingual staff, service-based order filling, and promotions involving free merchandise of both food and non-food items. In order to maximize sales, order fulfillment most likely ensures that all participant vouchers are fully redeemed. In contrast, other vendors depend mostly on non-WIC sales, and are less likely to encourage full redemption of vouchers unless required to do so by the State agency.

Although sales volume may typically be equivalent to a small grocery store or convenience store, unlike these stores, the above-50-percent vendors carry a much smaller variety of items with relatively high inventory turnover. As a result, above-50-percent vendors may be able to obtain volume discounts from wholesale suppliers comparable to those obtained by similar volume grocery stores. Lower food costs contribute to greater margins relative to other similar-volume retailers.

2. *Firm size/number of stores operated*: Multiple-store firms tend to gain efficiencies in procurement and distribution compared with single-store retailers, particularly when the stores are located in the same market or geographic area. Multiple-store retailers have an advantage over single-store operators in wholesale cost, even when they do not own distribution warehouses. Many of the large, multiple-market retailers provide their own buying and distribution services. Others may operate buying offices but rely on grocery wholesalers for shipments from manufacturers and distribution to stores.

   Among above-50-percent vendors, multi-vendor firms may have lower procurement and distribution costs than single-store vendors, depending on the extent of services provided internal to the firm. This distinction may serve as important criteria when assigning comparable vendors.

3. *Gross sales*: Gross weekly, monthly, or annual sales volume is another peer group criterion that could be used to determine comparable vendors for above-50-percent vendors. As a measure of store size, gross sales (food and nonfood) are closely related to store type as an indicator of cost per unit of output. With higher volume of sales, a store's cost per unit is likely to be lower than that of a lower volume store; hence item prices are more likely to be negatively correlated with volume measures. Gross sales of commercial retailers are less comparable to above-50-percent vendors, however. Typically, gross sales include non-food sales and non-WIC food sales, which could include products with a different cost and profit ratio, while above-50-percent vendors sales are concentrated in WIC food categories.

4. *Food sales*: The share of sales derived from food can vary considerably between store types. While food sales of supermarkets average 73 percent of gross sales, supercenters may average only 36 percent, while convenience stores sell 45 percent in food. The volume of food sales by a retailer, once determined, may be more comparable to the sales of above-50-percent vendors than gross sales.

5. *Number of registers*: A store's number of checkout registers has often been used as a classification criterion, but there are limitations to this approach. Studies that have correlated selected WIC multiple-item food instrument values across stores or individual item shelf prices have typically found lower food instrument costs as the number of checkouts per store increased. According to a study of WIC vendors in Texas, the WIC-only stores had the highest food instrument cost, except for a few 1-2 register vendors (Burger Carroll and Associates, Inc., 2003). The impact on cost

containment of using number of registers as a comparability criterion would therefore be minimal in this particular case.

One way to address this shortcoming in comparability is to incorporate differences in food sales. By calculating food sales per register, a more appropriate measure of store size would result. With relatively high sales per register, WIC-only stores and other above-50-percent vendors may be more similar to larger grocery stores and supermarkets, which typically have been found to have lower voucher costs and shelf prices than smaller grocery stores. A greater cost containment impact on above-50-percent vendors would likely result if competitive prices, average food instrument values, and allowable reimbursements of larger grocery stores and supermarkets were applied to above-50-percent vendors.

6. *Geographic area*: Geographic area is a required criterion for assignment of vendors to peer groups. The use of BEA Economic Areas has been suggested as a workable definition of a marketplace in which vendors compete. (See the section of this guidance on *Vendor Peer Groups, Defining Geographic Markets*.) These areas tend to be quite large, encompassing multiple counties and having a metropolitan or micropolitan core area. Unlike other classes of vendors, above-50-percent vendors are typically concentrated in urban, residential areas. In these high population density areas, there are fewer supermarkets and a greater number of neighborhood groceries. Operating costs in urban areas are typically higher as well, due to rental rates, taxes, and insurance. Wholesalers may add a premium to servicing costs in urban locations due to the lack of inventory space, requiring more frequent deliveries, and lack of loading dock facilities, requiring less efficient front door unloading. These factors are likely to contribute to higher food prices. State agencies may consider comparing above-50-percent vendors in urban areas with similarly located comparable vendors.

7. *Price level*: The use of a price level, whether based on food instrument redemption amounts or shelf prices as a comparability criterion should be avoided. Assigning above-50-percent vendors to comparable vendors based on price levels will not serve the interests of competitive pricing or program food cost containment. Comparability and peer groups are best determined by non-price criteria. Ultimately, vendors having similar characteristics are more likely to have similar price levels than those that are different. An effective peer group system regards price as an outcome measure. By assigning above-50-percent to comparable peer groups, the State Agency is defining competitive price and maximum allowable food instrument reimbursement levels for effective cost containment.

In summary, careful analysis of the cost implications is necessary when determining comparable regular vendors for above-50-percent vendors. The criteria that a State agency uses to identify comparable vendors will largely determine whether it will be able to ensure that above-50-percent vendors are cost neutral. Determining which method best achieves the cost neutrality goal may require some trial and adjustment. Examples of competitive pricing methods that State agencies may employ to meet certification requirements include (1) placing above-50-percent vendors in a peer group by themselves to which the State agency applies statewide competitive price criteria and statewide maximum reimbursement levels applicable to regular vendors; (2) placing all above-50-percent vendors in a single peer group with the regular vendors whose competitive price criteria and maximum reimbursement levels would ensure cost neutrality; and (3) placing above-50-percent vendors in the same peer group as regular vendors, but applying different competitive price criteria and allowable reimbursement levels to the above-50-percent vendors to assure cost neutrality. State agencies also may place above-50-percent vendors in peer groups with comparable regular vendors and apply the same competitive price criteria and allowable reimbursement levels to the above-50-percent vendors and the regular vendors, as long as this achieves overall cost neutrality as defined by section 246.12(g)(4)(i)(D).

Submitting the Request for Certification

The State agency is responsible for providing sufficient information to allow FNS to determine whether its methodologies for applying competitive price criteria and maximum reimbursement levels are appropriate. Each State agency that elects to authorize any above-50-percent vendors after December 30, 2005, including currently authorized vendors and new vendor applicants, must submit a written request for certification to the FNS Regional Office that contains a **detailed** description of the following items numbered in sequential order as listed below:

1. The methodology the State agency used to derive new competitive price levels for regular vendors, which may not include the prices of above-50-percent vendors; and any other changes the State agency made to the competitive price criteria to secure the lowest prices for supplemental foods (e.g., requiring a vendor’s prices to be within 5 percent of the average prices for the peer group, rather than within 10 percent);

2. The State agency’s methodology for establishing allowable reimbursement levels for regular vendors and above-50-percent vendors, including:

    a. How the allowable reimbursement levels are linked to the competitive price criteria applied to the vendors at authorization to ensure that vendors continue to meet the competitive price criteria throughout the authorization period;
    b. How the State agency will ensure that average payments to above-50-percent vendors do not exceed average payments to comparable vendors;
    c. Whether the State agency has exempted any above-50-percent vendors from the competitive price criteria and allowable reimbursement levels for participant access reasons, and if so, how many vendors have been exempted;
    d. How the State agency applies peer-group-specific maximum allowable amounts to food instruments to redeemed food instruments; and
    e. If the State agency includes a factor to reflect wholesale price fluctuations, how the State agency derived this amount.

3. The State agency's methodology for grouping above-50-percent vendors in its peer group system (i.e., separately or in peer groups with regular vendors) and how the State agency identifies comparable vendors for each group of above-50-percent vendors;

4. If the State agency plans to exempt any ***non-profit*** above-50-percent vendors (except non-profit health or human services agencies or organizations such as Catholic Charities) from competitive price criteria and allowable reimbursement levels, explain:

    a. The reason the State agency decided to exempt such vendors (i.e., the benefits to the program) and the number of non-profit vendors exempted;
    b. Whether the non-profit above-50-percent vendors are needed to ensure participant access to supplemental foods;
    c. How the prices of the non-profit vendors compare to those of other vendors in their geographic area that are subject to competitive price criteria and allowable reimbursement levels; and
    d. How the State agency established the level of reimbursement for the non-profit above-50-percent vendors that it has exempted.

5. Confirmation that the competitive price criteria and allowable reimbursement methodologies described in the State agency's submission to FNS have been fully implemented. If the State agency has not fully implemented revised competitive price and allowable reimbursement methodologies, the State agency must provide the current status of its efforts to meet the requirements of section 246.12(g)(4)(vi) and its timetable for achieving full implementation;

6. Whether the State agency has exempted any ***pharmacy*** vendors from competitive price criteria and allowable reimbursement levels, and if so, confirmation that these pharmacies provide only exempt infant formula and/or WIC-eligible medical foods as defined in section 246.2 of the WIC regulations; and

7. The data specified in Tables 2-4 to demonstrate that the State agency's methodologies for establishing and implementing competitive price criteria and allowable reimbursement levels are achieving the required outcomes. The State agency also may provide additional data, if desired.

8. A copy of the report that the State agency will use to monitor average payments to above-50-percent vendors compared to average payments to regular vendors. Every State agency that chooses to authorize any above-50-percent vendors must have a means of monitoring average monthly redemptions to such vendors as compared to comparable vendors. FNS expects that each State agency will generate a report or other appropriate monitoring tool for this purpose. Attach a copy of the report(s) that the State agency plans to use to verify that its allowable reimbursement levels are operating effectively.

Table 2. Data for WIC Vendor Cost Containment Certification - Overview

Please provide the following information on the regular vendors and the above-50-percent vendors authorized by the State agency as of the most recent calendar month for which redemption data are available. Enter the month and year in the chart below.

1. How many authorized regular vendors did the State agency have as of _____(enter month and year)______?	1.
2. For all of these regular vendors combined, what was the total amount of WIC redemptions paid in (month and year) ?	2.
3. How many above-50-percent vendors did the State agency have as of (enter month and year)?	3.
a. Non-pharmacy above-50-percent vendors ▪ Number of *WIC-only* stores ▪ Number of other types of above-50-percent vendors (excluding pharmacies) b. Above-50-percent pharmacy vendors c. Total above-50-percent vendors (sum of a and b)	a. ▪ ▪ b. c.
4. What was the total amount of redemptions paid to these above-50-percent vendors in (enter month and year)? a. Non-pharmacy above-50-percent vendors b. Above-50-percent pharmacy vendors c. Total above-50-percent vendors	4. a. b. c.
5. How many peer groups of above-50-percent vendors (either separate peer groups or groups with regular vendors) has the State agency identified?	5.
6. How many above-50-percent vendors and regular vendors has the State agency authorized that do not meet competitive price criteria, but are needed to ensure participant access to supplemental foods?	6. above 50% _____ regular vendors_____

Table 3: Data for WIC Vendor Cost Containment Certification – Peer Group Structure

Please describe all vendor peer groups and identify the regular vendors that are comparable to each group of above-50-percent vendors. Insert lines for additional peer groups, as necessary. The information provided should describe the peer group system as structured to comply with the new vendor cost containment requirements.

Peer Group					Comparable Vendors Peer Group Number (6)
		Number of Vendors in Peer Group			
No. (1)	Description (e.g., supermarkets, chain stores, pharmacies) (2)	Regular Vendors (3)	Above-50% Vendors (4)	Total (5)	
1					
2					
3					
4					

Instructions:

Column 1 – Assign a sequential number to each peer group.
Column 2 – Describe the vendors in the peer group.
Column 3 – Insert the number of authorized vendors that are regular vendors.
Column 4 – Insert the number of above-50-percent vendors currently authorized.
Column 5 – Insert the total number of authorized vendors. This number should be the sum of columns 3 and 4, since the State agency must identify each vendor as being either a regular vendor or an above-50-percent vendor.
Column 6 – For each peer group that contains above-50-percent vendors, insert the number of the peer group that contains comparable regular vendors. The comparable vendor peer group is the peer group that the State agency uses to derive the competitive price criteria and maximum reimbursement levels that it applies to the above-50-percent vendors. If above-50-percent vendors are placed in a peer group with regular vendors, then the number in column 1 should be the same as that in column 6. If above-50-percent vendors are in separate peer groups, then the number in column 1 will be different from that in column 6.

Table 4: Data for WIC Vendor Cost Containment Certification – Average Payments to Vendors

Using the format below, provide the latest redemption data for the ten (10) most frequently redeemed food instrument types. Then indicate how these amounts have changed or will change with the implementation of the revised competitive price criteria and allowable reimbursement amounts. Prepare a separate chart for each group of above-50-percent vendors identified in Table 3.

Chart for: Above-50-Percent Vendors in Peer Group No.______

Food Instrument Type/Number and Description (1)	Number of Food Instruments Redeemed (2)	Average Redemption Price and Standard Deviation Per Food Instrument for (Insert Month and Year)				Difference in Average Redemption Amount Between Above-50% Vendors and Comparable Regular Vendors (5)	Average Redemption Price Per Food Instrument for (Insert Month and Year)	
		Above-50% Vendors (3)		Comparable Regular Vendors (4)			Above-50% Vendors (6)	Comparable Regular Vendors (7)
		Price	Std. Dev.	Price	Std. Dev.			

Instructions:

Begin by identifying the above-50-percent vendors to which the data in the chart refer. Insert the peer group number for the above-50-percent vendors and write it on the line at the top of the chart. All data in the chart should pertain only to the above-50-percent vendors in the peer group and the comparable regular vendors. **Complete a separate chart for each group of above-50-percent vendors and comparable regular vendors identified in Table 3.**

Column 1 – Insert the food instrument (FI) type or number and list the foods included on the FI. Include no more than two infant formula food instrument types, but complete the chart using the next most frequently redeemed food instrument types.

Column 2 – For each type of FI identified in column 1, insert the number of food instruments redeemed (paid) in the calendar month. The data in this column must apply to a month prior to the implementation of new competitive price criteria and allowable reimbursement levels. .

Columns 3 & 4 – Insert the average food instrument redemption amount (or mean) and the standard deviation for the above-50-percent vendors and for the regular vendors that the State agency has identified in the chart for Table 3 as comparable vendors.

Column 5 – Subtract the price in column 4 from the price in column 3 and enter the difference here. If the price in column 3 is less than that in column 4, enter the difference as a negative dollar amount.

Column 6 – Insert the average food instrument redemption amount for above-50-percent vendors ***after*** the State agency has applied the revised competitive price criteria and allowable reimbursement levels. If the State agency has implemented new competitive price criteria and allowable reimbursement levels before submitting its request for certification to FNS, then the data in column 6 should be actual redemption data for the above-50-percent vendors and comparable regular vendors. Insert the calendar month(s) to which the data pertain. If the State agency does not have actual redemption data, then the State agency must estimate the new average redemption amounts.

Column 7 – Insert the average redemption amounts for the corresponding group of comparable vendors. If the State agency has not yet implemented its revised competitive price criteria and reimbursement levels, insert the target date to which the estimated average redemption amounts would apply. In the narrative that accompanies this data, discuss the rationale for the State agency’s average redemption amounts, if estimated. The average redemption amount for above-50-percent vendors may not exceed the average redemption amount for comparable vendors.

9. If the State agency does not have such a report, describe the State agency's plans to develop and implement a report for monitoring average food instrument redemption amounts of above-50-percent vendors and comparable vendors. Include target dates for implementation, a description of the report contents or fields, and any other relevant information.

10. An explanation and illustration of the methodology the State agency uses to calculate and compares average payments per food instrument for above-50-percent vendors and regular vendors.

Notification of Certification

Upon receipt of the State agency's request for certification, the FNS Regional Office will review the information submitted and any other relevant data to determine whether the State agency's competitive price criteria and allowable reimbursement levels established pursuant to sections 246.12(g)(4)(i)(A) and (C) do not result in higher average payments per food instrument to above-50-percent vendors than to comparable regular vendors. If FNS determines that the State agency's competitive price criteria and allowable reimbursement levels meet this requirement, then FNS will notify the State agency that it has received certification. If the State agency fails to demonstrate that its methodology for establishing and implementing competitive price criteria and allowable reimbursement levels meets the requirement of section 246.12(g)(4)(vi), then FNS will disapprove the State agency's request for certification.

A State agency that fails to receive certification will be required to take the following corrective action until certification is received:

1. After December 30, 2005:

    a. May not authorize any new above-50-percent vendors unless such vendors are needed for participant access; and
    b. May not pay above-50-percent vendors more on average than the State agency pays regular vendors for each food instrument (by type). The average payment to regular vendors must be calculated without using data from any above-50-percent vendors.

    State agencies that have authorized any regular vendors that do not meet competitive price criteria, but are required for participant access, must lower the maximum reimbursement levels for regular vendors to competitive price levels and establish separate reimbursement limits for non-competitively-priced vendors authorized for access reasons. This is to prevent the inflation of maximum reimbursement levels for all vendors.

2. By June 30, 2006: Must have established peer groups consistent with criteria established by FNS.

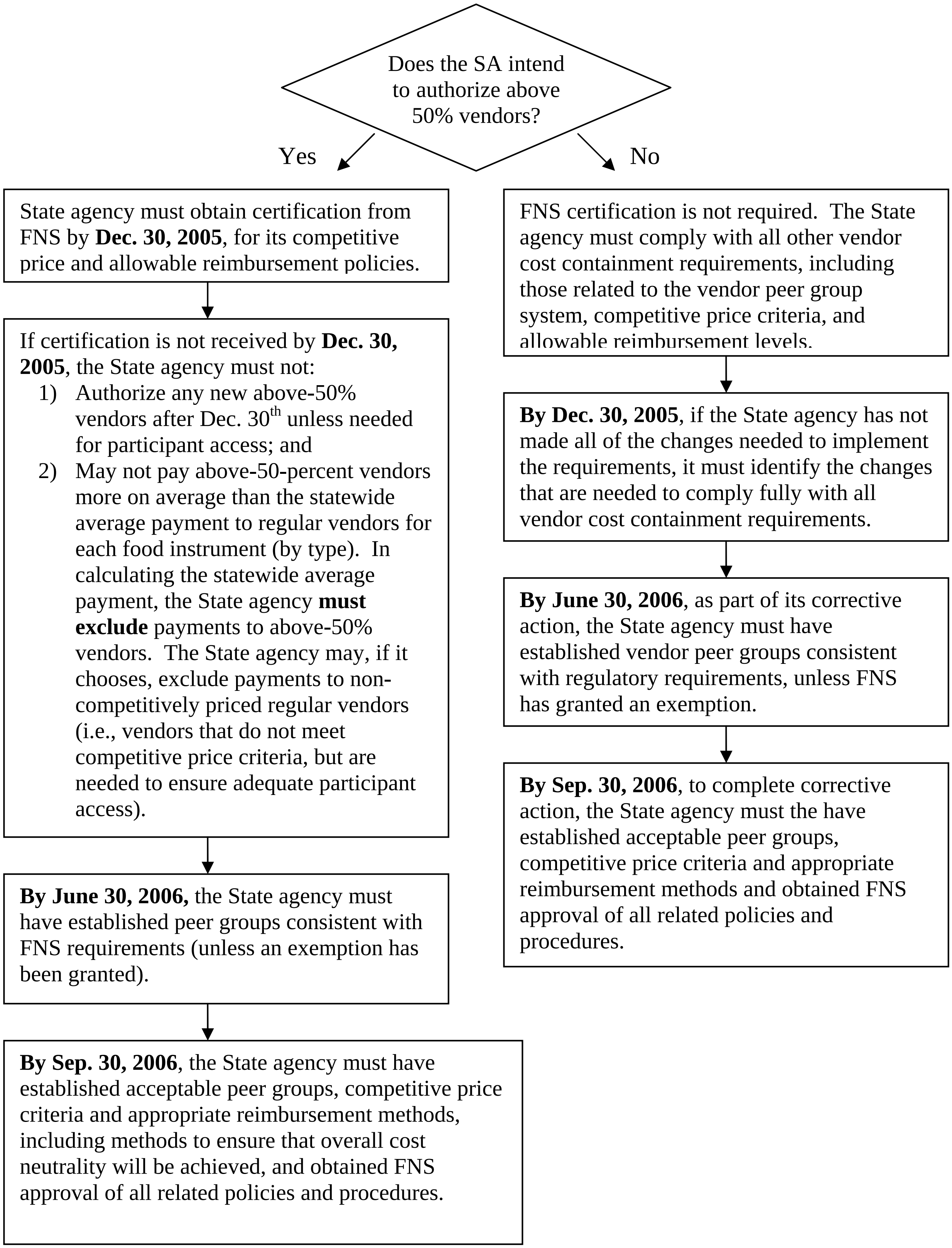
3. By September 30, 2006: Must have established acceptable peer groups, competitive price and appropriate reimbursement methods, including methods to ensure that above-50-percent vendors are not paid more than comparable vendors, and obtained FNS certification.

The *Figure 1* on the next page summarizes the WIC vendor cost containment corrective action timeline for State agencies that fail to receive FNS certification by December 30, 2005.

Term of the Certification

FNS certification that a State agency's competitive price criteria and allowable reimbursement levels meet the requirements of section 246.12(g)(4)(vi) of the Interim Rule will remain in effect until the State agency fails to demonstrate that it still meets the requirements. At least every three years following the initial certification, the State agency must demonstrate that it continues to meet vendor cost containment requirements. FNS will require annual submission of redemption data to demonstrate that above-50-percent vendors do not cost the program more than if participants transacted their food instruments at regular vendors.

***Figure 1*: WIC Vendor Cost Containment Certification Corrective Action Plan**



ASSESSING THE COST NEUTRALITY OF ABOVE-50-PERCENT VENDORS

This section provides guidance for State agencies that have received certification to authorize above-50-percent vendors under section 246.12(g)(4)(vii) of the Interim Rule and for those seeking such certification, on computing average food instrument payments for the purpose of monitoring redemptions to above-50-percent vendors and regular vendors. It also contains instructions for determining whether above-50-percent vendors are cost neutral to the program (i.e., whether they cost the program no more than if participants had used regular vendors).

Calculating Average Food Instrument Payments

To meet the cost neutrality requirement in section 246.12(g)(4)(i)(D) of the Interim Rule, the State agency must calculate the average redemption amounts for food instruments (by type) redeemed by regular vendors and above-50-percent vendors. The State agency must add the redemption amounts for all redeemed food instruments (or a representative sample of redeemed food instruments) of the same type and divide the sum by the number of food instruments of that type. If the State agency does not designate food instruments by type, it must calculate the average payment for each distinct combination of foods prescribed, by type and quantity, on the food instrument. On a quarterly basis, if the average price of the food instruments redeemed at regular vendors is equal to or greater than the average price of food instruments redeemed at above-50-percent vendors, then the State agency has achieved cost neutrality.

At least quarterly, the State agency must compute statewide average costs per food instrument (or per food item) to monitor compliance with the overall cost neutrality requirement in section 246.12(g)(4)(i)(D) of the Interim Rule. The State agency must use the results of the quarterly assessment to make any necessary adjustments in its competitive price criteria and/or maximum reimbursement levels in order to ensure cost neutrality for the next quarterly and ultimately for the fiscal year. The State agency shall maintain for periodic review by FNS the results of its quarterly assessment of payments to above-50-percent vendors as compared to payments to regular vendors.

Any State agency that is interested in calculating average food instrument payments based on a representative sample of food instruments (section 246.12(g)(4)(vi) of the Interim Rule), rather than all food instruments must submit a description of its proposed sampling procedure to FNS for review prior to its implementation. A representative sample is a randomly selected sample of a population that is large enough to make inferences or draw conclusions about the characteristics of that population. Each sample of food instruments must be such that all types of food instruments (e.g., pregnant woman, postpartum woman, breastfeeding woman, infant, child, etc.) are proportionately represented. Because of the complexity of conducting a true representative sample, FNS generally would not recommend that State agencies employ this procedure.

The State agency must calculate average payments for **every type of food instrument** (or combination of food items, or individual food items) redeemed by both above-50-percent vendors and regular vendors. The State agency must include all food instruments in its assessment of cost neutrality, except the following:

a. Food instruments (by type) that were redeemed by regular vendors only.

b. Food instruments (by type) that were redeemed by above-50-percent vendors only. The State agency must include the total dollar value of these food instruments in its report to FNS.

c. At State agency option, food instruments redeemed by vendors (above-50-percent and/or regular vendors) whose shelf prices exceeded the competitive price criteria and that were authorized to meet participant access needs. The State agency must include the total dollar value of the food instruments redeemed by these vendors in its report to FNS.

d. Food instruments redeemed by pharmacy vendors that supply only exempt infant formula and/or WIC-eligible medical foods, if the State agency has exempted these vendors from competitive price criteria and allowable reimbursement levels.

e. Food instruments redeemed by non-profit vendors that the State agency has exempted from competitive price criteria and allowable reimbursement levels.

If any quarterly assessment shows that average payments per food instrument to above-50-percent vendors exceed average payments per food instrument to all regular vendors, the State agency must take action to ensure compliance at the beginning of the next quarterly period. Such action includes adjusting competitive price criteria and maximum reimbursement levels. It is critical to complete the quarterly assessment at or prior to the beginning of the next quarter, even if this means using less than three months of redemption data, in order to effect any needed change at the start of the next quarter. No adjustments to payments previously provided to vendors or termination of vendors whose payments were within the maximum allowable amounts established by the State agency shall occur as a result of the findings of the assessment of cost neutrality.

FNS Assessment of Cost Neutrality

FNS will assess cost neutrality through management evaluation reviews and through other information available from the State agency. If FNS determines that a State agency has properly assessed cost neutrality, in accordance with the procedures set forth in the Interim Rule and this guidance, has conducted such assessments on a quarterly basis, and has adjusted competitive price criteria and maximum reimbursement levels each quarter, if necessary, then FNS will deem the State agency to have achieved cost neutrality.

FNS will assess a claim against a State agency and/or take other administrative action if it determines that the State agency has failed to properly assess cost neutrality, failed to conduct cost neutrality assessments on a quarterly basis, and/or has failed to take action, if necessary for any quarter, to achieve compliance at the beginning of the next quarterly period.

VENDOR PEER GROUPS

Section 246.12(g)(4) of the Interim Rule requires State agencies to establish a vendor peer group system (unless they are specifically exempted from the requirement) and to distinguish above-50-percent vendors from other vendors in the peer group system. Beyond these general requirements, the rule gives State agencies broad latitude to develop vendor peer group systems to meet their individual circumstances. Data obtained by FNS indicate that many State agencies already have vendor peer groups and most use two or more criteria to establish peer groups. The data also reveal that some State agencies could achieve greater cost containment by making modest changes to the structure of their vendor peer groups. This section of the Guidance considers various aspects of peer group development to assist State agencies in identifying areas for improvement. It also explains a new requirement that State agencies must use at least two criteria to designate peer groups, one of which must be a measure of geography.

The Benefit of Using Vendor Peer Groups

The use of peer groups is based on the philosophy that vendors with certain shared characteristics may be expected to have similar business practices and prices. For example, supermarkets operate under a similar business model that depends on a low-margin, low-price strategy that requires high sales volume to generate profits. Supermarkets typically compete with other supermarkets. In contrast, lower volume, higher cost neighborhood grocery stores typically do not compete with supermarkets on price. Rather, they offer convenient location and often longer business hours in order to generate sales. Although some degree of competition may exist between a local supermarket and a neighborhood grocery store, they are most likely to compete with other similar stores. Thus, by grouping vendors together based on these characteristics, a State agency can more easily identify the competitive price range for WIC foods and differentiate between vendors whose prices fall within or outside of this range.

The use of different peer groups results in greater cost containment than if State agencies used a statewide competitive price range and maximum reimbursement level for all vendors because they allow State agencies to determine the competitive price range and, as a result, the maximum reimbursement levels that are appropriate to specific vendor types. Additionally, grouping vendors by type can constrain price increases and prevent all peer groups from raising prices to a statewide maximum. State agencies must establish competitive price criteria and maximum reimbursement levels for **each vendor peer group** in accordance with sections 246.12(g)(4) of the Interim Rule.[6] As a general rule, the use of statewide competitive price criteria and maximum allowable reimbursement amounts for all peer groups is not permitted, unless the State agency has demonstrated the appropriateness of this practice in obtaining an exemption from the vendor peer group requirement.

[6] In some instances, a State agency might need to apply statewide competitive price criteria and maximum reimbursement amounts to above-50-percent vendors in order to achieve cost neutrality. Additionally, the use of statewide competitive price criteria and maximum reimbursement levels might be appropriate for some ITOs and geographic State agencies with very few vendors.

Selecting Peer Group Criteria

In the past, State agencies have used different criteria to establish vendor peer groups, depending in part on the availability of information collected and other factors. Typical vendor characteristics used to assign peer groups include: geography (defined in terms of zip code, county, or local agency service area); store type (for example, supermarket, convenience, and superstore); number of registers or checkout lanes; food sales or gross sales; WIC redemptions; physical size (selling area square feet); and type of ownership. Section 246.12(g)(4)((ii)(A) of the Interim Rule requires State agencies to use at least two peer group criteria, one of which must be an indicator of geography. The use of geography is consistent with the requirement in section 246.12(g)(4) of the rule that State agencies consider participant access by geographic area in establishing competitive price criteria and allowable reimbursement levels.

State agencies should not use a price measure as a peer group criterion. While price indicators may be useful in exploratory analysis, they should not be used in combination with other measures or characteristics. Ideally, the price measure is the outcome variable.

Evaluating Peer Group Selection Criteria

Various empirical tests can be applied to guide the selection of peer group criteria. Analytical methods include simple correlations; difference of means tests (are they significant); regression (hypothesis tests of price determinants); and analysis of variance. Simple correlations among pairs of peer group criteria can be used to select those that are most meaningful. For example, a high degree of positive correlation between number of checkout registers and food sales indicates these variables are good indicators of store size. In turn, each store type (convenience store or supermarket, for example) could be examined for similar correlations among peer group criteria. Some criteria may not be sufficiently correlated, such as the amount of WIC redemptions and store size. In States where above-50-percent stores account for a large share of redemptions, store size measures often are not positively correlated with the amount of WIC redemptions.

Tests for the difference between the average shelf or redemption prices can also be used to develop effective peer groups. These tests indicate whether differences observed between groups are statistically significant. If differences are not significantly different, additional evaluation is needed to determine whether other peer group criteria should be used, or if peer groups should be combined, for example. To illustrate, *Table 5* contains vendor data that a State agency is using to establish peer groups. In this example, the State agency is small and proposes to use two geographic areas consisting of a major metropolitan area and the remainder of the State. Within these areas, the State agency proposes to establish peer groups based on the number of cash registers and the square footage of the store. The State agency believes that four peer groups are indicated for the non-metropolitan area, but wants to determine whether differences noted in *Table 5 between* the average food package costs for the four peer groups are statistically significant.

Using a simple statistical test of the mean values (which requires a mean and standard deviation), the State agency found that the differences in the means of peer groups 1 and 2 and between groups 3 and 4 are significant; but the difference in the means of peer groups 2 and 3 are not. (See the tool in Attachment 8.) After finding that the differences between the means of peer groups 1 and 3 and between groups 2 and 4 also were significant, the State agency decided to combine peer groups two and three.

Table 5: **Establishing Vendor Peer Groups**

Store	Square Footage	No. of Cash Registers	Average Cost of Food Package A	Annual WIC Redemptions	Peer Group Number	Peer Group Average Cost for Package A
Super Foods	4,000	2	36.06	$ 57,877.00	1	
Market & Meat	5,000	2	36.72	$ 29,966.00	1	$ 36.25
Overland Grocer's	5,000	2	35.96	$ 49,306.00	1	
Marty' Mart	10,000	4	35.98	$ 77,716.00	2	
Emerson's	12,600	4	35.25	$ 150,806.00	2	
Davidson's	10,100	3	35.15	$ 64,916.00	2	
Good Eating Store	15,000	5	35	$ 134,967.00	2	$34.99
Thrifty Foods	14,000	5	34.66	$ 256,750.00	2	
More Thrifty Foods	12,000	5	34.65	$ 180,531.00	2	
Banana Boat Grocer	15,000	6	34.26	$ 105,186.00	2	
United Markets	26,000	6	37.32	$ 114,673.00	3	
Sam's	23,000	6	35.43	$ 42,000.00	3	
Super Foods 2	25,000	5	35.16	$ 179,655.00	3	
Healthy Eating	58,000	6	35.12	$ 230,674.00	3	
Save More	29,278	6	35.1	$ 98,206.00	3	$ 34.56
Appleton's	25,460	7	34.64	$ 247,613.00	3	
Max and Son	33,778	8	34.22	$ 65,335.00	3	
Save More 2	21,000	5	33.6	$ 147,559.00	3	
Wellington's	25,920	6	33.22	$ 131,226.00	3	
Flavor-Mart - Clinton	183,645	28	31.02	$ 331,732.00	4	
Flavor-Mart - Arden	187,572	54	30.4	$ 701,938.00	4	
Flavor-Mart - Surrats	189,741	54	29.91	$ 356,792.00	4	$30.46
Flavor-Mart - Warner	201,788	54	30.93	$ 597,760.00	4	
Flavor-Mart - Nelson	221,941	54	30.02	$ 348,190.00	4	

Standard Deviations:
Peer group 1 – 0.41
Peer group 2 – 0.55
Peer group 3 – 0.81
Peer group 4 – 0.51

Analysis of variance can evaluate vendor price differences both within and between peer groups. The more effective peer groups are those where the variation in price within groups is less than the variation in price measured between groups. Statistical regression methods can also be used to analyze the relevance or statistical significance of individual peer group criteria as each relates to price. This process can be used to identify the most meaningful criteria for developing peer groups. Careful analysis in the development of peer groups can result in more effective vendor cost containment. Peer group design is a critical element of an effective competitive pricing system.

Defining Geographic Markets

The purpose of using a measure of geography to define peer groups is to distinguish areas within the economic marketplace where firms (particularly retail food stores) compete based on common supply and demand factors resulting in wages and prices that are more similar than dissimilar. Geographic areas used to define economic markets can be quite large, and encompass urban, suburban, and rural locations. Commuting patterns, media advertising coverage, newspaper circulation and labor markets serve to define economic regions. Geographic areas are often larger than any single consumer would likely travel to purchase goods and services. It is important that geographic areas encompass economic market areas to the extent possible. The use of county, municipal or political boundaries, including WIC service areas, metropolitan and non-metropolitan areas, or similar definitions may not maximize food cost containment if defined areas do not constitute economic markets.

In order to develop geographic areas for peer groups that account for economic market areas, State agencies should consider the U.S. Bureau of Economic Analysis (BEA) Economic Areas (EA's). The BEA recently revised and updated their EA's to include the entire land mass of the United States. All U.S. counties are assigned to a unique economic area. Each of the 179 Economic Areas has one or more metropolitan (city population >50,000) or micropolitan (city population between 10,000 and 50,000) areas as its core, and includes surrounding rural counties that have been shown to be economically linked to the population cores. BEA EA's often transcend State boundaries, such as the Baltimore, MD-Washington, DC Metropolitan Economic Area which includes parts of Maryland and Virginia. State Agencies may define that portion of the EA that falls within State boundaries. Alternatively, States having a common EA may wish to share information about vendors in order to measure peer group average prices based on the larger economic region.

When applying BEA EA's or other geographic units to peer groups, the creation of submarkets within a larger region may be warranted. Although a single BEA can encompass an entire State, it might be beneficial from a food cost containment perspective to distinguish between sub-areas within the State. State agencies should consider the BEA EA's to be a good starting point for distinguishing geographic areas.[7] They do not eliminate the need to review vendors' prices to determine whether there are significant differences in the costs of some or all WIC foods in one or more sub-areas within the State agency's jurisdiction.

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[7] Additional information about Economic Areas, including the list of these areas, is available from the BEA online at http://www.bea.gov/bea/regional/data.htm.

Obtaining Approval to Use One Peer Group Criterion

A State agency that determines that using a measure of geography as a peer group criterion would not be beneficial from a cost containment standpoint may request FNS approval not to use such a measure. The State agency's request should indicate the following:

1. The measures of geography that the State agency considered in reaching its decision (e.g., counties, urban versus rural areas, the BEA economic areas, etc.); and

2. A brief summary of the findings from the State agency's analysis of price data (shelf prices or redemption data) for vendors in different geographic areas, along with data from the analysis.

A State agency plans to use a geographic criterion as the only peer group criteria must provide data to demonstrate that other vendor characteristics do not explain the differences in prices among vendors. For example, a State agency that authorizes different types of vendors would have to show that prices of WIC foods do not vary significantly by store type within the same geographic area.

A State agency that chooses to authorize above-50-percent vendors should submit its request for an exception to the geographic criterion requirement with the request for certification. Other State agencies should submit the request to FNS in ample time to meet the June 30, 2006 target date for having its peer group system in place.

EXEMPTION FROM THE VENDOR PEER GROUP SYSTEM REQUIREMENT

Regulatory Provision

Section 246.12(g)(4)(v) of the Interim Rule authorizes FNS to grant a State agency an exemption from the requirement to establish a vendor peer group system under the following two conditions:

1. The State agency elects not to authorize any above-50-percent vendors ***and*** demonstrates to FNS that establishing a vendor peer group system would be inconsistent with the efficient and effective operation of the program, or that the State agency's alternative cost containment system would be as effective as a peer group system; or

2. The State agency authorizes above-50-percent vendors whose WIC redemptions comprised less than five percent of the total WIC redemptions (dollars) in the year preceding a year in which the exemption is effective. (For example, total redemptions for above-50-percent vendors in fiscal year 2005 must be less than five percent of total redemptions in order for a State agency to qualify for an exemption from the peer group system requirement in fiscal year 2006.) The State agency also must demonstrate that its alternative vendor cost containment system would be as effective as a vendor peer group system and would not result in higher costs if program participants transact their food instruments at above-50-percent vendors rather than at regular vendors.

Requesting an Exemption

A State agency that requests an exemption from the vendor peer group system must demonstrate to FNS that it meets one of the conditions in section 246.12(g)(4)(v) of the Interim Rule by submitting the following information:

1. A State agency that elects not to authorize any above-50-percent vendors must submit written documentation that:

    a. Confirms that the State agency has assessed all authorized vendors and new vendor applicants and determined that it (1) does not currently authorize any above-50-percent vendors; and (2) has established policies and procedures to prevent authorization of any new vendor applicants that are expected to be above-50-percent vendors, and to terminate the vendor agreement with any authorized vendor that is determined to be an above-50-percent vendor subsequent to authorization;

    b. Describes the State agency's alternative vendor cost containment system, including how the system ensures that the State agency—

        (1) Authorizes vendors that offer competitive prices for supplemental foods compared to currently authorized vendors and other vendor applicants; and

(2) Reimburses vendors subsequent to authorization at levels that are consistent with the competitive price criteria applied to the vendor at authorization.

c. Demonstrates either of the following:

(1) That implementing a peer group system would be inconsistent with the efficient and effective operation of the program. For example, a State agency might explain that it has too few authorized vendors to establish effective peer groups or that the degree of variability in food prices and types of vendors is so minimal that the costs of implementing a vendor peer group system would outweigh any potential benefits to the program.

(2) That its alternative vendor cost containment system would be as effective as a peer group system. The State agency must explain how it applies competitive price requirements to currently authorized vendors and new vendor applicants under its alternative cost containment system. The State agency's submission should include relevant data (such as current redemption data) and documents (e.g., excerpts from the vendor agreement that describe competitive price requirements and terms of reimbursement) to support its case.

2. A State agency that elects to authorize any above-50-percent vendors must submit written documentation that:

   a. Substantiates that fiscal year 2005 redemptions to above-50-percent vendors authorized by the State agency comprised less than five percent of the total WIC redemptions in fiscal year 2005. (Redemption data will apply to the year prior to the year for which the State agency requests an exemption.) This shall include the total dollar amount and percent of redemptions to above-50-percent vendors and the total amount of redemptions to all WIC vendors;

   b. Demonstrates that the State agency has an effective process for monitoring the percent of redemptions to above-50-percent vendors on a monthly basis to ensure that this percentage remains less than five percent on average; and

   c. Demonstrates that the State agency's alternative cost containment system would be as effective as the vendor peer group system and would not result in higher food costs if program participants redeem food instruments at above-50-percent vendors rather than at regular vendors. The State agency shall apply the weighted mean methodology described on page 16 of this guidance to assess whether or not above-50-percent vendors result in higher costs to the State agency than regular vendors.

   The justification must explain how the State agency applies competitive price criteria and allowable reimbursements levels to currently authorized vendors and new vendor applicants; and include the average payments that the State agency makes to above-50-percent vendors and to regular vendors for either the standard food packages or the ten most frequently issued food instrument types for women, infants, and children.

As a guide to preparing the request for an exemption from the vendor peer group requirement, the State agency should refer to Attachment 6, *Preparing a Request for Exemption from the Peer Group Requirement,* and Attachment 7, *Worksheet for Assessing Statewide Maximum Reimbursement Amount.*

Due Date of the Request for Exemption

Since State agencies must be in compliance with the vendor peer group requirement by September 30, 2006, a State agency that desires to be exempted from the peer group system requirement in fiscal year 2006 should submit its request for exemption to FNS in ample time to permit initial review and, when necessary, followup on the request if additional information is required. FNS will review the information submitted by the State agency and determine whether the State agency qualifies for an exemption. A State agency that obtains an exemption from the peer group requirement still must implement competitive pricing criteria for vendor selection and allowable reimbursement levels to limit payments to vendors.

After fiscal year 2006, a State agency may submit its request for an exemption for the peer group requirement at any time during the year or as part of its State Plan.

Term of an Exemption

An exemption from the peer group requirement would remain in effect: until the State agency no longer meets the condition in section 246.12(g)(4)(v) on which the exemption was based; until FNS revokes the exemption; or for three years, whichever occurs first. During the period of the exemption, the State agency must provide to FNS annually in the State Plan documentation that it either authorizes no above-50-percent vendors, or that such vendors' redemptions continue to represent less than five percent of total WIC redemptions. State agencies that authorize above-50-percent vendors also should be able to demonstrate that these vendors are cost neutral to the program.

COMPETITIVE PRICE CRITERIA

Section 246.12(g)(4) of the Interim Rule requires State agencies to implement effective competitive price criteria. State agencies must establish competitive price criteria for each vendor peer group and assess each new vendor applicant and current vendors applying for reauthorization using the competitive price criteria applicable to its peer group. Competitive price criteria should be based on the shelf prices that vendors charge for all customers or prices that a vendor bids for supplemental foods, which may not exceed its shelf prices. To maximize the number of eligible persons who can receive program benefits, State agencies should select vendors that offer the lowest prices for supplemental foods while ensuring participant access by geographic area. This section of the guidance discusses how to choose appropriate data and methods for deriving competitive price criteria.

The Role of Shelf Prices

WIC food cost data comes in two forms: shelf prices and food instrument redemptions. The type of data that a State agency uses can potentially result in large differences in comparisons among vendors and vendor peer groups. State agencies must collect and utilize both types of price data to meet the requirements of section 246.12(g)(4) of the Interim Rule; and they should be aware of how the choice of data can affect food cost outcomes. Collection of shelf prices must occur at authorization and at least semiannually throughout the authorization period (sections 246.12(g)(4) and 246.12(g)(4)(ii)(B).

A vendor’s shelf prices, when correctly collected and applied, can provide an unambiguous measure of competitiveness with other vendors. The use of posted shelf prices of like or identical WIC foods can provide State agencies with an accurate indicator of a vendor’s competitiveness in the marketplace. Periodic collection of a vendor’s food item prices provides an accurate source of data for setting and adjusting allowable levels of reimbursement or not-to-exceed redemption values. Item prices are also needed to evaluate the validity of vendor peer groups, and to establish average peer group price levels and the range of acceptable vendor prices within them.

When developing price collection and analysis systems, State agencies should be aware of the potential problems and limitations of price collection and reporting. First, State agencies not already doing so will need to collect and compile accurate price data in an electronic format, such as a spreadsheet application. Some State agencies have relied on State and/or local agency staff to collect current vendor prices through site visits to authorized vendors. Requirements for vendors’ self-reporting should ensure that only shelf prices are reported, exclusive of temporary sales and discounts, and that any substitute items are specifically noted. The vendor should certify the accuracy of reporting, and the State agency should provide for periodic verification of data reported by vendors, with penalties imposed for intentional misreporting.

Although item prices can provide State agency’s with the means to compare vendors, identify higher-priced vendors, evaluate peer groups, and establish maximum allowable prices, they are not a direct measure of WIC program food costs. Prices are a good indicator of food costs; but due to the range of food choices available to WIC participants and differences in the variety of WIC foods offered by vendors, WIC food costs cannot be determined by food prices alone. State agencies must combine shelf price data with food instrument redemption data to get an accurate picture of a vendor's cost to the program.

The Role of Food Instrument Redemption Data

Using redemption data to establish competitive price criteria offers State agencies several advantages over price data, including ease of access to the data and the potential for simplifying price comparisons between and among vendors. State agencies can readily use redemption data to determine a vendor's or a peer group's contribution to overall program costs. The value of a redeemed food instrument is a direct measure of WIC food costs. In accordance with section 246.12(g)(4)(i)(D) of the Interim Rule, State agencies must use redemption data to assess compliance with the cost neutrality requirement for above-50-percent vendors. (See *"Assessing the Cost Neutrality of Above-50-Percent Vendors".)* FNS expects all State agencies to collect food instrument-specific redemption data by vendor. State agencies that do not use standard food instrument types, or that use electronic benefit transfer (EBT) systems, also must compare payments to above-50-percent vendors and regular vendors for the same foods.

State agencies should consider the potential shortcoming and limitations of using food instrument redemption data to make competitive price determinations, and to the extent possible, adjust their procedures to address these limitations. First, comparing redemption amounts does not have the same precision as comparing individual food item prices. For example, a typical food instrument might contain either a single food category where substitutions are allowed, such as a milk voucher allowing substitutions between forms (i.e., fluid, evaporated, and powdered milk) or a combination of unlike items, such as milk, eggs, and cheese. In addition, food instruments may allow a range of choices for the same item, which affects costs. For example, if the food instrument specifies fluid milk in gallon containers, the participant may choose between whole, two-percent, or skim milk varieties. Among one-pound cheese products, the food instrument may allow processed or natural cheese in a range of types, such as cheddar, Muenster, Swiss, or mozzarella.

Secondly, since food instruments typically do not provide information about the individual items actually purchased, the potential for less than full redemption of food instruments confounds comparisons between different vendors or of a single vendor over time. (The impact of partial redemptions may be less significant for State agencies that require vendors to ensure that participants obtain all foods prescribed on the food instrument.) For these reasons, a State agency should not use redemption data alone to establish competitive price criteria, but should consider shelf prices. **Through the periodic review of shelf prices, State agencies can determine whether average food instrument redemption amounts are consistent with the expected cost of fully redeemed food instruments**.

Analyzing Prices Using a Market Basket Index

The use of a market basket index can serve as an integral part of a State agency's methodology for comparing vendors' food prices. Because of the uniformity of goods in a market basket, the index can be used to measure how the cost of the same mix of food items varies between vendors. In the market basket method, a quantity weight or expenditure proportion is assigned to each major food category, such as cheese, juice, or infant formula.

The State agency may choose a market basket index that is representative of the typical monthly quantities of food prescribed for an individual food package or a combination of packages. Alternatively, expenditure shares can also serve as the weighting factor, in which the share of spending for a typical food or combination of foods in each WIC food category is first determined and then applied to all vendors.

Table 6 on the next page illustrates how a State agency might construct a market basket index using the quantities of food typically prescribed in a combination of food packages. Column 1 of *Table 6* lists each major WIC food category and its representative food item(s). Column 2 contains a quantity weight that the State agency assigns to each food category. In this example, column 2 reflects the quantity of food typically prescribed each month for a mother, child, and infant. Column 3 indicates the peer group's average price for the specific items in column 1, and column 4 shows the average or actual price for the vendor under consideration ("vendor A"). The quantity-weighted food cost for each category (column 5) is calculated by multiplying the quantity weight (column 2) by the item price (column 3). Column 6 shows the corresponding quantity-weighted food cost for vendor A (calculated by multiplying the weight in column 2 times vendor A's prices in column 4).

For the milk category, vendor A's price for 1 gallon of two percent fat fluid milk is \$2.10, while the peer group average price is \$2.25. When both are multiplied by the quantity weight, 9 gallons, the resulting food costs are \$18.90 and \$20.25, respectively. Food costs are calculated similarly for all food categories and summed. In a market basket, the sum of the peer group food costs (which is the standard against which all individual vendor indexes will be compared) equals an index value of 1.000 (or 100). Vendor A's food costs are calculated as an index value relative to the peer group food cost by dividing vendor A's market basket cost (\$195.67) by the peer group's market basket cost (\$205.96). Vendor A's market basket index of 0.95 (or 95) means that vendor A's costs for the three food packages are about 95 percent of the peer group's average cost.

Calculating the market basket index requires complete enumeration of survey items and the comparison of the same items for all vendors. To maintain uniformity across all vendors, an item price may be converted to a cost per unit (pound or ounce, for example). For a given peer group, the market basket should include multiple items in each WIC food category. In order to minimize the number of missing item prices, use of the minimum inventory requirement can serve as a basis for the market basket.

Using Standard Deviations to Set the Competitive Price Range

State agencies have flexibility in determining a competitive price for vendors and vendor peer groups. Currently, many State agencies establish competitive price criteria by taking the average price of selected food items (at either the statewide or peer group level) and adding a fixed percentage. Vendors that fall within the range of the average plus that percentage are considered "competitive". While State agencies can still calculate competitive prices in this manner, FNS recommends an approach that relies on using a standard deviation, which is a common measure of the spread of a distribution around the mean of that distribution.

Table 6: **Calculating a Market Basket Index**

WIC Food Category	Quantity-based weight factor[1]	Peer Group Average Price	Item Price, Vendor A	Quantity-Weighted Food Costs Peer Group Average Cost ($)	Vendor A Cost ($)
Milk (1 gal., 2% fat)	9 gallons	2.25	2.10	20.25	18.90
Eggs (1 doz., large)	3 dozen	1.50	1.89	4.50	5.67
Cheese (1 lb., cheddar)	3 lbs.	3.19	2.79	9.57	8.37
Similac Advance., 13 oz. (concentrate)	31 cans	4.34	3.99	134.54	123.69
Cereal, Cheerios, 15 oz	4 boxes	2.86	2.99	11.44	11.96
Infant cereal, rice, 8 oz. box	4 boxes	1.65	1.59	6.60	6.36
Juice, apple, 64 oz. shelf-stable	3 gallons (6-64 oz.)	2.49	2.79	14.94	16.74
Peanut butter, creamy, 18 oz.[2]	2 jars	2.06	1.99	4.12	3.98
Market Basket Cost:				$205.96	$195.67
Market Basket Index:				1.000	0.950

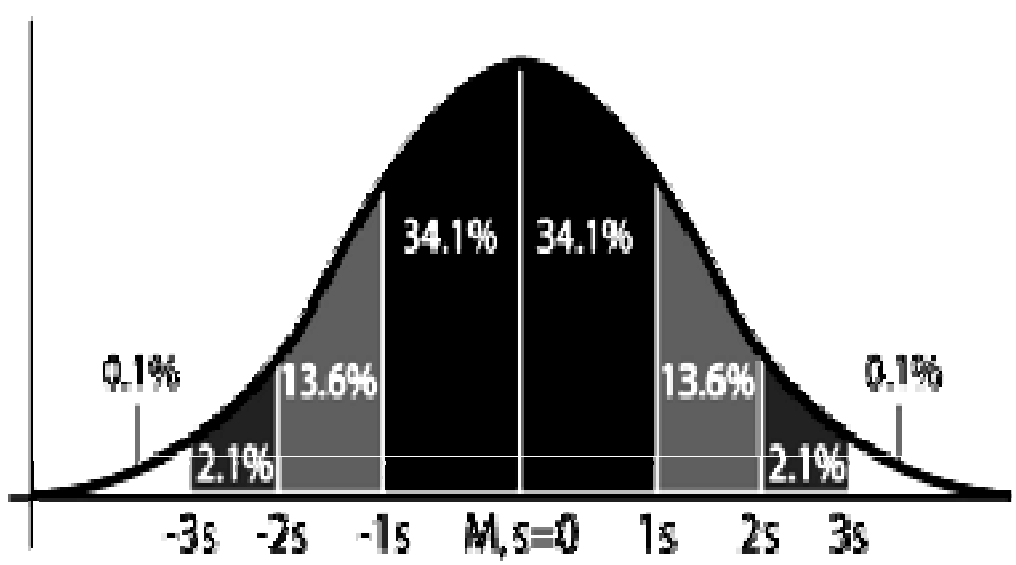
Footnotes

1. Quantity weights are based on typical monthly prescribed amounts for a mother, child, and infant, combined (source: Ohio WIC)
2. Peanut butter substitutes for dry beans, 1 lb.

There are many advantages to using a standard deviation versus a fixed percentage to calculate competitive prices. Unlike a fixed percentage, a standard deviation is not an arbitrary measure, but one that explains the natural variation in a distribution. If the distribution of prices between peer groups or food instruments is normal, the standard deviation will capture that variation and allow for the inclusion of appropriate vendors in a peer group and the exclusion of inappropriate vendors. Conversely, a fixed percentage does not account for the natural variation in a distribution. Consequently, if the distribution of prices differs between peer groups or food instruments, a vendor may be incorrectly included or excluded, depending on the size of the fixed percentage and the distribution of the price data.

A normal distribution is a symmetrical, single-peaked, bell shaped curve (see *Figure 2* below). All normal distributions are the same if examined in units of the standard deviation about the mean. (In *Figure 2* below, "s" indicates a standard deviation.) In a normal distribution, 68.2% of all observations are within one standard deviation of the mean, 95.4% of the observations are within two standard deviations of the mean, and 99.8% are within three standard deviations of the mean. In an actual distribution of vendor prices, State agencies may find that 100% of vendors are encompassed by this range. Thus, if a State agency establishes a competitive price criterion that is equal to a peer group average plus or minus one or two standard deviations (depending on how restrictive the State agency chooses to be), it can ensure that adding vendors that meet this criterion will not change the peer group average in a manner that is statistically significant. Properties of the normal distribution can also be used to set maximum allowable reimbursement levels.

Figure 2: A Normal Distribution



Having 30 or more vendors in a peer group increases the likelihood that the prices of the vendors in the group will approximate a normal distribution. When there are fewer than 30 vendors, a State agency should try to ensure that the distribution is not skewed by the high or low prices of one or two vendors. If the mean and standard deviation are influenced by one or more outliers, this could make it difficult to rely on the statistical properties of a normal distribution when applying the mean and standard deviations to competitive price criteria and allowable reimbursement levels.

State agencies can also rely on the properties of the normal distribution to ensure that maximum allowable prices are not set at levels that incorrectly exclude a vendor or that encourage vendors to raise prices to the maximum allowable level. Since 99.8% of observations will fall within three standard deviations of the mean, nearly every vendor's prices will be encompassed by a range that is equal to the average plus or minus three standard deviations. For State agencies that find that they have vendors that fall outside three standard deviations, or that wish to include a measure that will allow for a small amount of price inflation, a maximum allowable price that is equal to the peer group mean (or average) plus four standard deviations might be appropriate. All standard statistical packages calculate the mean and standard deviations, as does Microsoft excel. State agencies simply need to take the results of these calculations and apply them to the mean or average peer group price.

Summary

State agencies have flexibility in the development of competitive price criteria. In order to maintain effective cost containment, State agencies should review their practices in using a vendor's shelf prices and redemption data to establish competitive price criteria and maximum reimbursement levels. They should ensure that competitive price criteria are based on sound statistical methods and are defensible (i.e., they can be shown to result in the selection of the most competitively-priced vendors among those requesting authorization). State agencies must base competitive price criteria and maximum reimbursement levels on the prices of regular vendors only, and not on prices charged by above-50-percent vendors.

Through the use of competitive price criteria, State agencies should obtain a sufficient number of vendors to ensure participant access to WIC foods and contain costs through the exclusion of higher-priced vendors. A market basket index method is a simple and transparent procedure for comparing vendor prices. State agencies should consider using standard deviations to establish the competitive price range and maximum allowable reimbursement levels that can be empirically substantiated and are equitable across vendor peer groups.

APPLYING MAXIMUM ALLOWABLE REIMBURSEMENT LEVELS

Section 246.2 of the WIC Program regulations defines a "price adjustment" as "an adjustment made by the State agency, in accordance with the vendor agreement, to the purchase price on ***a food instrument*** after it has been submitted by a vendor for redemption to ensure that the payment to the vendor for the food instrument complies with the State agency's price limitations." Any amount that exceeds the maximum allowable reimbursement level for an individual food instrument (or food item if used as the basis for reimbursement) is an unallowable amount that the State agency must recoup or use to offset a future payment to the vendor.

Methodologies that apply maximum allowable reimbursement levels to food instruments on an aggregate basis are inconsistent with the requirement to set limits on a food instrument. Two examples of inappropriate approaches are as follows:

1. Compute the difference between the price on each redeemed food instrument (by type) and its maximum allowable reimbursement level, and then add these differences (positive and negative). If the sum of the differences indicates an overpayment, recoup this amount from the vendor.

2. Multiply the maximum allowable amount by the number of food instruments (by type) redeemed to determine how much the State agency could have paid the vendor for the redeemed food instruments. Subtract from this amount the sum of the actual prices of the food instruments redeemed. If the sum of the food instruments exceeds the aggregate maximum allowable amount for all of the food instruments, recoup the difference from the vendor.

Recouping Overpayments to Vendors

All State agencies must employ effective methodologies to ensure that payments made to vendors for individual food instruments (or individual food items) do not exceed the maximum allowable reimbursement level established for the food instrument. State agencies are advised that FNS will not approve a request for certification that proposes to recoup monies that were paid to a vendor for food instruments redeemed **within** the established maximum allowable reimbursement level for that vendor, in order to meet cost neutrality. This does not preclude a State agency from making price adjustments to food instruments in accordance with section 246.12(h)(3)(viii) of the Interim Rule and recouping amounts paid to the vendor above the established maximum allowable reimbursement rate applicable to the vendor.