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Office of Inspector General
Midwest Region
Audit Report

Food and Nutrition Service
National School Lunch Program
Food Service Management Companies



Report No.
27601-0027-CH
APRIL 2002



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



DATE: April 30, 2002

REPLY TO
ATTN OF: 27601-0027-Ch

SUBJECT: NSLP – Food Service Management Companies

TO: Roberto Salazar
Administrator
Food and Nutrition Service

ATTN: Lael Lubing
Director, Grants Management Division

This report presents the results of our audit of the Food and Nutrition Service's National School Lunch Program as operated by Food Service Management Companies in six FNS regions nationwide. The conditions presented in this report have also been provided to the regional offices in regional-level reports or summaries of findings. The conditions reported here represent those findings of nationwide scope which require corrective actions at the Headquarters level.

Based on your office's response to the official draft report, dated March 28, 2002, we have accepted your management decisions for Recommendations Nos. 3, 4, 7, 8, 9, and 10. Summaries of the management decisions are attached. Please follow your agency's internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer.

We have not reached management decisions on Recommendations Nos. 1, 2, 5, or 6. Management decisions on these recommendations can be reached once you have provided us with the additional information outlined in the report section, OIG Position.

If you have any questions, please have a member of your staff contact Stephen W. Fowkes, Director Food and Marketing Division, at 202-720-7805.

/s/
RICHARD D. LONG
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

FOOD AND NUTRITION SERVICE NATIONAL SCHOOL LUNCH PROGRAM FOOD SERVICE MANAGEMENT COMPANIES

REPORT NO. 27601-0027-CH

RESULTS IN BRIEF

This report presents the results of six regional audits of the National School Lunch Program (NSLP) as operated by Food Service Management Companies nationwide. Our

objective was to determine whether sufficient controls existed to ensure that management companies complied with program requirements in crediting SFA's for the value of USDA-donated commodities and purchase discounts and rebates. We found that 5 of the 8 management companies we reviewed improperly retained benefits from 53 SFA's valued at about \$6 million. This occurred, in part, because FNS' requirements and instructions were not always clear. In addition, some management companies manipulated the terms of their contracts with the SFAs in order to reduce their own costs and retain benefits that should have accrued to the SFAs. Based on the results of these audits, OIG-Investigations has opened cases on three of these management companies.

Under the NSLP, FNS provides cash reimbursements to States to provide nutritious meals to school-aged children. The States administer the program through the SFA's, which in turn contract with food service management companies to provide the food service. Food service contracts may be either fixed-rate or cost-reimbursable. In a fixed-rate contract, management companies charge a flat rate for the meals served and must credit the SFA for the full value of any USDA-donated commodities used. In a cost-reimbursable contract, management companies, as an agent of the SFA's, make purchases for and submit invoices to the SFA's for payment. In these cases, the companies must pass along any purchase discounts and rebates they receive.

We reviewed 65 SFA's served by the 8 independent management companies in 7 States nationwide. The management companies operated both fixed-rate and cost-reimbursable type contracts.

- Four of the five companies that operated under fixed-rate contracts at 46 SFA's we reviewed withheld credit for \$5.8 million in USDA-donated commodities that were used in the NSLP. The management companies profited by using the USDA-donated commodities and

failing to properly credit those SFA's with the commodities' value. We found that FNS did not require State agencies and their SFA's to include a specific procedure in contracts for crediting the value of the commodities to the SFA's, even though Federal regulations required that commodities solely benefit and be used in an SFA's non-profit food service operation. As a result, the USDA-donated commodities were being used to assist for-profit companies, thus decreasing the funds available to the SFA's for use in operating their food service programs. These 4 management companies operated Federal food programs at nearly 30 percent of the 1,648 SFA's nationwide that contracted with management companies in school year 1999.

- Two management companies that maintained cost-reimbursable contracts nationwide profited at the expense of 7 of the 19 SFA's we reviewed by retaining over \$280,000 in discounts and rebates they received on purchases made for their food service operations. To accomplish this, the management companies amended, eliminated, or ignored terms included in the requests for proposal issued by the SFA's. Contrary to FNS regulations, the management companies were able to include contract terms that favored them, because FNS did not mandate specific contract terms and provisions. This resulted in management company contracts lacking sufficient controls to determine exactly how the company would pass through purchase discounts and rebates in the determination of net costs. Further, the lack of FNS mandated contract provisions inhibited some States from properly addressing these requirements during reviews and development of SFA prototype contracts and bid documents. These 2 management companies contracted with over 18 percent of the 1,648 SFA's that had management company contracts nationwide.

Finally, we found that SFA's turned over most aspects of their programs, including meal accountability, to the management companies. There was little or no SFA oversight. In all, 16 of the 24 SFA's we visited did not have adequate controls in place to ensure accurate meal claims or to prevent management companies from being reimbursed for nonprogram costs. Neither the FNS Regional offices nor the States were aware that the SFA's were not providing the required oversight of management company operations. The meal accountability systems used by the SFA's resulted in inaccurate meal claims and provided the SFA's with reimbursement for 83,904 meals that were unsupported. In addition, SFA's improperly used \$1.2 million in NSLP funds to reimburse three management companies for nonprogram (unallowable) costs.

KEY RECOMMENDATIONS

Each OIG region through the appropriate FNS regional office made all recommendations for the recovery of NSLP funds. However, we are

recommending that FNS establish specific parameters for appropriate contract terms for States and SFA's to follow to ensure that the SFA's, not the management companies, benefit from the value of USDA-donated commodities, purchase discounts, and rebates. FNS also needs to amend regulations and guidance to reference those parameters for appropriate contract terms. In addition, we are recommending that FNS amend regulations to require each State agency to annually review and approve each contract before contract execution, and that FNS emphasize in its management evaluations a review of State and SFA oversight of management company operations.

Finally, we are recommending that States: (1) ensure that the SFA's understand that contracting with a management company does not alleviate their oversight responsibility and their need to maintain reliable meal accountability systems; and (2) require all new contracts to stipulate that, as the agents of the SFA's, management companies must comply with competitive procurement requirements for all goods and services charged, and that such charges be net of all purchase discounts and rebates are to be properly credited to SFA food service accounts and require rebid of all current contracts that do not include this requirement.

AGENCY RESPONSE

In its response to the official draft, dated April 10, 2002, FNS generally agreed with the findings and recommendations except for Recommendation No. 6, in which agency officials expressed the opinion that the recommended action was not the most effective means of addressing the cited conditions. However, FNS also stated that some of the recommended actions would require changes to the existing regulations and thus could not be implemented at this time. We have incorporated applicable portions of the FNS response, along with our position, within the Findings and Recommendations section of the report. The FNS response is included in its entirety as exhibit B of the audit report.

OIG POSITION

Based on FNS' response, we have reached management decisions on Recommendations Nos. 3, 4, 7, 8, 9, and 10. Management decisions on the remaining recommendations can be reached once FNS has provided us with the additional information outlined in the report section, OIG POSITION. For Recommendation No. 6, and for those recommendations which FNS officials stated could only be addressed in the long-term through regulatory changes, we requested additional responses citing the proposed corrective actions to be taken along with their associated timeframes.

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INTRODUCTION

BACKGROUND

On June 4, 1946, Congress passed the National School Lunch Act (42 U.S.C. 1751) which authorized and established the National School Lunch Program (NSLP). The purpose

of the NSLP is to safeguard the health and well-being of the Nation's children and encourage the domestic consumption of agricultural commodities. The U.S. Department of Agriculture's (USDA) Food and Nutrition Service (FNS), through seven FNS Regional Offices (FNSRO), is responsible for the administration of the NSLP. The NSLP provides Federal assistance in cash and USDA-donated commodities to States in order to benefit schools' nonprofit food services.

FNS enters into written agreements with a State agency, usually a State's Educational Agency, which administers the program Statewide. The State agency is required to perform program oversight through monitoring and assisting school food authorities (SFA) in their operation of the NSLP at the local level. The SFA's are required to provide meals to children that meet certain requirements, and accurately count and claim the number of meals served to children. FNS provides cash reimbursements to State agencies based on the monthly claims submitted by SFA's that detail the number of meals claimed as being served. In addition, FNS provides special cash assistance, through higher reimbursement rates, for reduced-price and free meals served to children determined as eligible to receive such benefits.

FNS permits SFA's to contract with food service management companies to operate their nonprofit food service operations. Although management companies can provide most of the routine administration of the food service operations, the SFA retains the responsibility of ensuring that food operations comply with program regulations. An SFA solicits bids from management companies through issuing either a request for proposal (RFP) or invitation for bid that details the contract requirements. The contract type may be either a fixed-rate-per-meal or cost-reimbursable type. In a fixed-rate-per-meal contract, management companies charge a flat rate times the number of meals claimed as being served, regardless of the costs to prepare those meals. However, in a cost-reimbursable contract, management companies, as the SFA's agent, make purchases on behalf of the SFA's and submit the invoices to the SFA's for payment.

Both types of contracts should require that certain types of benefits accrue back to the SFA. In a fixed-rate-per-meal contract, management companies are required to credit the SFA for the full value of any USDA-donated commodities that the management companies received and used in the NSLP. Under a cost-reimbursable contract, any purchase discounts and rebates the management companies may receive, as the agent of the SFA, that would reduce the cost of goods purchased must be passed along to the SFA's, as these represent a reduction in the actual costs involved in preparing the meals.

During fiscal year 2000, FNS disbursed approximately \$5.6 billion in Federal reimbursements for 4.5 billion meals claimed as being served to students, and over \$800 million in USDA-donated commodities. Of the 19,329 SFA's nationwide, 1,648 of them had contracted with a management company during fiscal year 1999 to operate the NSLP/SBP in their schools. In addition, based on the data collected from the 7 FNS regional offices, they reported that there were at least 19 management companies operating an SFA's non-profit food service in 41 states.

OBJECTIVES

The objectives of this audit were to determine whether sufficient controls exist to ensure that (1) food service management companies credit SFA's for the full value of USDA-donated commodities and/or volume purchase discounts and rebate as applicable; and (2) that management companies and SFA's administered the NSLP in accordance with applicable laws, regulations, and FNS guidelines. As part of these objectives, we reviewed the FNS National Office's policies and procedures, and evaluated the FNSRO's oversight of State agencies management companies, and SFA's to ensure their compliance. Specifically we evaluated the controls over: (1) requests for proposal (RFP) and contracts under which management companies agree to manage the SFA's' food service; (2) management companies' procedures to account for USDA-donated commodities and issue commodity credits to SFA's when fixed-rate-per-meal contracts are used; (3) procedures to ensure that volume purchase discounts, rebates, or other credits are properly accounted for by management companies and credited to the SFA's under cost-reimbursable type contracts; and (4) procedures to ensure the accuracy of meal counts, claims, and management companies' billings.

SCOPE

This nationwide audit of food service management companies' administration of the NSLP covers fiscal years 1998 through 2000 (covering the school years that operated from July 1, 1997, through June 30, 2000), but we expanded our review to earlier periods as indicated in the report. We performed our audit at the

FNS National Office in Alexandria, Virginia, and six FNS Regional Offices. We judgmentally selected six States based on the highest number of management company contracts, or the highest percentage of SFA's using management companies within a State or nationwide. In addition to the six States we selected based on the above criteria, we reviewed one other State as part of an OIG Audit and Investigative joint effort.

Within the seven States, we judgmentally selected eight management companies. Seven of these companies were selected based on the highest activity. One was selected based on information disclosed during our audit.

We visited 24 SFA's and performed a limited review of the management company contracts and other documents of an additional 41 SFA's. During fiscal years 1998 through 2000, 47 of the 65¹ SFA's we reviewed maintained fixed-rate-per-meal contracts and 19 SFA's had signed cost-reimbursable contracts with management companies. The number of fixed-rate-per-meal and cost-reimbursable contracts we reviewed does not necessarily represent the proportion of fixed-rate to cost-reimbursable nationwide.

The audit was conducted in accordance with Government Auditing Standards established by the Comptroller General of the United States.

METHODOLOGY

To accomplish our audit objectives, we reviewed FNS regulations, procedures, guidelines, and memorandums issued concerning USDA-donated commodities and procurement of goods and services relevant to management companies. In addition, we interviewed officials with the Child Nutrition and Food Distribution divisions of FNS, and determined the scope of activity of management companies nationwide. Also, we reviewed the FNS regional offices' monitoring efforts of, and policy, procedures, and memorandums issued to, the State agencies relating to SFA's contracting with management companies. Through interviews of FNS Headquarters and regional office officials, we determined the scope of activity of management companies within each region and selected our States to be visited.

At the seven State agencies, we reviewed their policies, procedures, and memorandums issued to an SFA when contracting with management companies, and the SA's monitoring efforts to ensure an SFA met program requirements. Through interviews with SA officials and our review of records, we selected one management company in each state

¹ One SFA in New Jersey had a fixed-rate-per-meal contract for school years 1998 and 1999 and then signed a cost-reimbursable contract with the same management company for school year 2000.

and the 24 SFA's that contracted with that management company. In addition, we selected and performed a limited review of another 41 SFA's based on the problems disclosed during our fieldwork. Furthermore, we obtained and reviewed documents relating to SFA contracting with that management company, and the value of USDA-donated commodities received.

We reviewed the SFA's procedures for issuing RFP's and subsequent contracts with management companies to operate the nonprofit food service. We reviewed records and interviewed SFA officials to evaluate their monitoring efforts at the individual schools and procedures for ensuring the accuracy of meal claims. In addition, we reviewed records and interviewed SFA officials to ensure that; (1) for fixed-price-per-meal contracts, they received proper credit for USDA-donated commodities and they used the commodities to prepare a school lunch, and (2) for cost-reimbursable contracts, that they received applicable portions of income, rebates, and discounts, relating to any SFA's allowable cost.

When needed, we interviewed officials at each management company that was responsible for contracting and operating an SFA's school food service, and reviewed the management companies' procedures used in documenting their accounting of all applicable discounts, rebates, and allowances reviewed for purchases made on behalf of an SFA. In addition, we interviewed the management company's vendors to determine whether they paid discounts and rebates. Furthermore, we reviewed the management company's procedures to submit meal claims and document their policies in contracting with vendors. However, for the management company in Illinois, we did not attempt to review their records, other than copies made available by SFA officials, or interview management company personnel because of the ongoing investigation. The OIG Investigative staff in St. Louis, Missouri, performed interviews and reviewed original management company documents.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	MANAGEMENT COMPANIES PROFIT FROM USDA AND OTHER BENEFITS INTENDED TO SUPPORT AN SFA's NONPROFIT FOOD SERVICE
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Five² of the eight management companies we reviewed improperly received benefits, either in the form of purchase discounts or USDA-donated commodities, which were intended to benefit the SFA's' nonprofit food services. The lack of clear instructions from FNS, in conjunction with inadequate oversight by the State agencies and SFA's, allowed the management companies to reduce their costs and retain the SFA's benefits. FNS had not required any specific contract language or procedures for State agencies and SFA's to follow to ensure that an SFA received the full benefit from USDA-donated commodities and purchase discounts and rebates. In addition, we found that some management companies, when developing their responses to SFAs' Requests for Proposal (RFP), took advantage of the fact that the SFAs were not provided with explicit requirements for contract provisions. This allowed them to insert contract provisions that were contrary to Federal regulations, and which essentially allowed management companies to retain benefits that should have accrued to the SFAs' food service programs. Even where State agencies had prototype contracts that required the value of purchase discounts and USDA-donated commodities to be credited to the SFA's, there were no specific procedures governing how and when those credits were to be made. As a result, the purchase discounts and USDA-donated commodities were used to enrich the management companies instead of benefiting the SFA's as required by Federal regulations.

² One management company for an SFA in New Jersey retained commodity benefits under a fixed-rate-per-meal contract during school years 1998 and 1999, and retained discounts and rebates under a cost-reimbursable contract during school year 2000.

FINDING NO. 1

**MANAGEMENT COMPANIES
FAILED TO PROPERLY CREDIT
SFA'S FOR THE VALUE OF USDA-
DONATED COMMODITIES USED IN
THE NSLP**

Four of the five management companies that operated the food service programs under a fixed-rate-per-meal contract at 47 SFA's we reviewed profited by withholding the value of USDA-donated commodities used in the NSLP. The management companies benefited by using the USDA-donated commodities and failing to credit to 46 of those SFA's the value of donated commodities they

received and used on the SFA's behalf. FNS did not require State agencies and their SFA's to make the commodity value pass-through a requirement in the RFPs. As a result, the USDA-donated commodities made available through USDA's Food Distribution Program were being used to assist for-profit companies, thus decreasing the funds available to the SFA's for use in operating and improving their food service programs. The improper benefits to these four management companies totaled almost \$5.8 million over 5 years.

Federal regulations³ state that an SFA must ensure that all Federally donated food received by the SFA and made available to management companies accrue only to the benefit of and be used in the SFA's nonprofit food service. FNS Guidance for School Food Authorities, dated June 1995, requires that all contracts contain the above provision and reaffirm the SFA's responsibility. Moreover, FNS recommended that in order to establish and document the commodity value pass-through, fixed-price contracts should specify that the credits or reductions would be indicated on the invoices to the SFA. However, FNS did not require this specification.

Our review in 5 States of 47 SFA's that maintained fixed-rate-per-meal contracts, found that 46 SFA's did not receive proper credit for USDA-donated commodities. Four of the five management companies at the 46 SFA's did not properly pass through to the SFA's the full value of commodities used, even though Federal regulations and several of the SFA's RFP's contained that requirement. In addition, an SFA allowed the management company to write a new RFP, which omitted the requirement to credit the market value of USDA-donated commodities to the SFA. The same contract requirement was also omitted by some State agencies since, instead of developing a State prototype RFP, they used FNS' checklist of required contract terms that did not require the management company to credit the SFA for the value of USDA-donated commodities.

Although Federal regulations require that USDA-donated commodities benefit the SFA and be used solely for a school's food service, FNS' instructions to SFA's do not make the commodity value pass-through a

³ 7 CFR 210.16 (a)(6)

requirement in the RFP's. Although FNS recommended that management companies pass through the value of USDA-donated commodities, they did not require an SFA's RFP to contain language that would have ensured the commodity value pass-through. FNS Headquarters officials agreed that, in a fixed-price-per-meal contract, the value of USDA-donated commodities should be credited to the SFA. The lack of specific procedures for crediting USDA-donated commodities has led to contradictory methods by State agencies, SFA's, and even FNS regional offices to ensure that the value benefit an SFA's nonprofit food service operation.

An official at the FNS' Mountain Plains Region (MPR) stated that FNS regulations do not mention how to credit commodities, and when an FSMC uses the food, the SFA gets the benefit. In addition, FNS-MPR officials stated that the regulations did not specifically require the management companies to provide a "credit" to SFA's for the value of commodities, and that FNS guidance only **suggests** that a credit be shown on the invoices. Therefore, the FNS-MPR did not enforce the invoice crediting of USDA-donated commodities. We found that one of the State agencies in this region, Missouri, would not perform any "suggested" procedures, but followed only what FNS specifically required. Therefore, the State agency's required contract language for SFA's did not include crediting for the value of USDA-donated commodities on the management company's invoices.

In some cases, management companies circumvented the value pass-through provisions in the RFP. Although the Illinois State agency had made the value pass-through part of the State agency's RFP prototype since 1991, the management company in that State was able to retain a large portion of that value. This management company, as well as two others across the country, calculated a precredit amount for USDA-donated commodities that usually matched the current year entitlement rate established by FNS (between 13½ cents and 14½ cents per reimbursable lunch). However, for some of the SFA's we reviewed, the value of commodities received usually exceeded this amount, totaling as much as 20 cents per meal. This meant that under the terms of the contract, the SFA's were paying the management companies up to 6½ cents per meal for commodities that cost the companies nothing. In addition, the entitlement rate does not take into account the value of bonus commodities being offered (which can be almost 5 cents per meal) and made available to SFA's after the beginning of a school year. Since the management company would have signed a contract with an SFA prior to the start of a school year, the company could not have factored bonus commodities into the bid meal rate. During the period of our review, the management companies that practiced this kind of precredit

arrangement received over \$160,000 that should have been used to reduce the cost of the NSLP to the SFA's.

We found that officials at all levels, FNS regional, State, and local, were unsure how USDA-donated commodities were to be handled when an SFA contracted with a management company. Although FNS' guidance did discuss how an SFA could ensure it received full value for USDA-donated commodities, the guidance did not make those procedures a requirement. In addition, we found that FNS' 1995 guidance was not widely distributed to all SFA's for their reference in contracting with management companies, so SFA's were not aware of how USDA-donated commodities were to be handled and the suggested procedures to ensure they received the full benefit.

The lack of specific required procedures from FNS provided inconsistent handling by State agencies and SFA's and allowed management companies to devise unusual and untraceable methods in determining the value to pass through for USDA-donated commodities. To follow current requirements already implemented by some State agencies, and to better document the value of USDA-donated commodities passed through, the management company should be required to bid as if no commodities were available and then reduce their monthly invoice by the value of commodities used each month. In addition, FNS' recommended language in their guidance (dated June 1995), that an SFA should receive a reduction on the monthly invoice for the value of USDA-donated commodities used, should also be a requirement. Crediting for the full value of USDA-donated commodities on a management company's invoice would help ensure that SA's and SFA's realized the full benefit from USDA-donated commodities.

In all, during the period of our review, the management companies received excessive profits of almost \$5.8 million at the expense of the nonprofit food service programs at the 46 SFA's we reviewed. These management companies operated NSLP/SBP programs at nearly 30 percent of the 1,648 SFA's nationwide that contracted out their food service operation.

We believe that FNS should establish required procedures to ensure that the SFA, and not the management company, benefits from USDA-donated commodities. In addition, FNS should require the State agencies to include language in their prototype RFP's stipulating the means by which commodity credits are to be made, and require that any contracts that contain material deviations from the State's prototype RFP be rebid. Furthermore, FNS needs to ensure that all regional offices and State agencies are aware of this problem and that all SFA's that contract with management companies on a fixed-price-per-meal basis are likewise

aware that they are entitled to be reimbursed for the value of donated commodities.

RECOMMENDATION NO. 1

Develop a short-term and long-term action plan to ensure that the SFA, not the management companies, benefit from the value of USDA-donated commodities solely provided to support SFA nonprofit food service operations. Specifically, until FNS has developed and implemented long-term policy, procedures, and any necessary regulations, require that all fixed-rate-per-meal contracts; (1) be bid as if no USDA-donated commodities would be available, and (2) require that the full value of commodities used by management companies be reflected on the monthly invoices to the SFAs as a credit or reduction to the amount billed.

Agency Response

In its response, FNS agreed that actions need to be taken. However, FNS stated that based on consultation with their Office of General Counsel, they cannot issue a policy to State agencies that instructs them to notify SFA's that FSMC contracts must be bid as if no commodities are available, and that a credit or reduction on the monthly invoice be made for the full value of USDA-donated commodities. FNS stated that these requirements could only be mandated through regulatory authority.

FNS proposed an alternative course of action that included a memorandum to be sent to all State agencies within 90 days of report issuance. The memorandum will require that States notify all SFA's of the problems identified in this audit, reiterate FNS policy and guidance, and recommend that State agencies and SFA's review current FSMC contracts for compliance with current guidance. In addition, the memorandum will also notify State agencies of FNS' intention to study and identify needed regulatory changes. FNS will convene a team of national and regional staff and include representatives from State agencies, SFA's, and FSMC's to begin long-term analysis of program weaknesses addressed in this audit. The team would report its findings and long-term action plan no later than December 31, 2002.

OIG Position

We agree that, pending a determination of what regulatory changes are needed to correct the noted problems, it is appropriate that State agencies and SFA's be notified of the results of this audit until action by FNS can be taken. The proposed notification does not place any specific responsibility on the State agencies for ensuring that corrective actions are taken. Most

of the SFA officials we interviewed nationwide expressed little interest in monitoring the FSMCs' compliance with program requirements as long as their costs for operating the food service programs did not exceed the amount of their reimbursements under the NSLP and SBP.

We cannot reach a management decision until FNS officials provide a further response stating the corrective actions they plan to take to address the problems noted and the timeframes for their implementation.

RECOMMENDATION NO. 2

Ensure that all State agencies receive an updated copy of FNS' Guidance for State Agencies and Guidance for School Food Authorities - Contracting with Food Service Management Companies, updated to contain all amendments recommended in this report, and direct the State agencies to distribute the revised guidance to its SFA's.

Agency Response

Although FNS stated that it agreed with this recommendation, they stated that regulatory changes are needed to bring the guidance into full conformity with the recommendations in the audit report. Therefore, FNS plans to issue two revisions to its current guidance. The first, to be issued by March 2003, would provide new guidance to clarify and strengthen those areas within the current regulatory requirements. The second revision will occur after final regulations have been published addressing Program changes.

OIG Position

In order to reach management decision, FNS needs to provide us with clarification of which areas it intends to strengthen under the interim guidance. In addition, FNS needs to provide us with its proposed timeframes for making regulatory changes, the proposed nature of those changes, and timeframes for issuing final guidance to the State agencies.

RECOMMENDATION NO. 3

Notify all FNS regional offices to instruct their State agencies and their SFA's that management companies must comply with the terms listed in the RFP and that only minor deviations can be approved by their State

agency. In addition, the guidance should specify that unapproved material deviations will require rebid of a management company contract.

Agency Response

In its response, FNS stated that they would issue a policy memorandum within 90 days of report issuance. The memorandum will notify all its regional offices to instruct their State agencies and SFA's that FSMC's must comply with the terms listed in the RFP and that only minor deviations can be approved by a State agency.

OIG Position

We accept FNS' management decision.

FINDING NO. 2

MANAGEMENT COMPANIES FAILED TO CREDIT SFA'S FOR THE VALUE OF PURCHASE DISCOUNTS AND REBATES

Of the 19 SFA's we reviewed nationwide with cost-reimbursable contracts, 7 did not receive credit for the discounts and rebates their 2 management companies received on food purchases. The management companies were able to retain these benefits by amending, eliminating, or ignoring terms included in the RFP's issued by the SFA's that would have required them to pass through any

discounts or rebates for purchases made on the SFA's behalf. Since FNS failed to mandate specific contractual terms relating to purchase discounts and rebates, the management companies were able to use contract terms that allowed them to retain the discounts and rebates. In addition, FNS did not issue clear monitoring procedures for their State agencies to follow in determining exactly how a management company should pass through the value of purchase discounts and rebates. Based on the management companies' records, we determined that 7 SFA's paid \$284,108 to reimburse the management companies for costs that they did not incur.

Departmental regulations⁴ require that costs billed to an SFA under a cost-reimbursable contract are to be the actual purchase price after deducting all cash discounts, trade discounts, rebates, and allowances received. The Office of Management and Budget guidelines issued under these procurement standards⁵ state that for a cost to be allowable, it must be net of all applicable credits. In addition, although not listed as a requirement, FNS Guidance for School Food Authorities – Contracting with Food Service Management Companies⁶ states that an SFA's contract should

⁴7 CFR Part 3015, which was subsequently replaced with 7 CFR Parts 3016 and 3019.

⁵OMB Circular A-87; Attachment A; Item C.1.i; revised May 4, 1995, as further amended August 29, 1997.

⁶Contracting with Food Service Management Companies; Guidance for School Food Authorities; dated June 1995.

incorporate controls over food purchasing and how trade discounts and rebates are to be passed through to the SFA.

We found that management companies were able to use the lack of clear procedures to retain discounts and rebates that should have been credited to the SFAs. This occurred even though FNS requires that purchase discounts and rebates must be credited to the SFA's account, since the management company is an agent of the SFA and must comply with the same procurement regulations that an SFA would be required to follow. Lack of clear and specific procedures has led to confusion not only within State agencies and SFA's, but among Headquarters officials as well.

We reviewed the RFP's for 19 SFA's in 6 states that maintained cost-reimbursable contracts during school years 1998-2000 (school year July 1 – June 30). All 19 SFA's, while not using the exact wording of the State's prototype RFP, used similar language regarding the handling of discounts and rebates on purchases related to the SFA's food service operations. Each of the RFP's required that the management company credit any discounts or rebates for purchases made on the SFA's behalf. However, in 2 States, Michigan and New Jersey, we found that 2 management companies benefited by retaining the value of purchase discounts and rebates.

- In the State of Michigan, we reviewed the signed contracts between 9 SFA's and the selected management companies and found that 6 of the 9 SFA's signed contracts that contained language that differed significantly from the RFP. The State agency did not identify this material change and as a result, in each case, the contracts revised the terms of the RFP to state that the SFA was entitled to receive discounts and rebates only from local vendors. The contracts also stated that any discounts or rebates received from regional or national level vendors were to be retained by the management company. As a result of the revised contract terms, the 6 Michigan SFA's failed to receive discounts and rebates totaling over \$230,000 for school years 1998 – 2000. This could have been prevented had the State agency reviewed and approved the management company's contract prior to implementation.
- Even though one SFA in Michigan and one SFA in New Jersey signed contracts with their management company that required that all discounts and rebates be credited to the SFA's food service account, the SFA's still did not receive all they were entitled to. For Michigan, the management company received and retained \$24,790 of the \$28,177 in discounts and rebates that should have been credited to the SFA. In New Jersey, one SFA was not

credited at all for 1 year's worth of discounts and rebates totaling over \$47,000 in direct violation of the contract terms.

One of the two management companies was allowed to amend an SFA's contract because current FNS regulations and guidance do not contain specific requirements for contract terms. The other management company was allowed to retain discounts and rebates because FNS has not provided guidance on the method by which an SFA should ensure that it receives the discounts and rebates to which it is entitled. These two management companies alone contracted with 300 (18 percent) of the 1,648 SFA's that had management company contracts nationwide.

To assist State agencies and SFA's in contracting with management companies, FNS issued formal guidance in June 1995. The guidance presents an overview of the Federal standards for State agencies and SFA's and highlights certain provisions as Federal requirements that must appear in the contract documents. With regards to developing a cost-reimbursable contract, the guidance states that SFA's should incorporate controls over food purchasing and explain how trade discounts and rebates are to be passed through to the SFA. However, this provision was not highlighted and was therefore not a contract requirement. In addition, FNS requires State agencies to review the management company contract but lacks regulatory authority to require States to approve a food service management company contract before implementation.

Since FNS has not issued specific language requirements, management companies were able to remove contract terms that would have required them to credit SFA's for purchase discounts and rebates. In addition, even if the contract required the management company to pass back cost reductions, FNS had not issued clear procedures on how the SFA was to ensure that it received all back discounts and rebates. The lack of specific contract language and clear procedures from FNS was compounded by an inadequate review process by the SFA's and the State agency. Furthermore, if State agencies were required to approve a management company contract prior to implementation they would have additional assurance that the RFP terms were not amended in the signed contract.

We found in our reviews of different food company contracts in seven States, that when FNS has required specific contract language (such as with the Energy Policy and Conservation Act, required by OMB A-102), specific language was included in the RFP's and signed contracts. Based on our review nationwide, FNS needs to require specific contract language regarding purchase discounts and rebates. In addition, FNS needs to strengthen its policies and procedures to ensure that SFA's receive the discounts and rebates to which they are entitled. Furthermore, FNS

needs to ensure that all FNS regional offices, State agencies, and SFA's are aware of these problems we found during our audit.

RECOMMENDATION NO. 4

Amend FNS Guidance for School Food Authorities to identify specific contract terms that a State agency and SFA must use to ensure that management companies, as agents of the SFA's, comply with all applicable competitive procurement procedures that should result in net costs being charged to an SFA so that the SFA, and not the management company, receives the benefit of cost reductions in the form of discounts, rebates, and allowances. (One of the required terms for cost-reimbursable contracts must state that all costs charged to the SFA must be net of all discounts, rebates, and allowances received by a management company, and that this cost reduction shall be shown on the monthly invoice or operating statement as a credit or reduction to the amount billed.)

Agency Response

FNS agreed with this recommendation and stated it will amend and issue, by March 2003, a revised guidance for SFA's to help ensure that FSMC's comply with all applicable competitive procurement procedures that should result in net costs being charged to an SFA.

OIG Position

We accept FNS' management decision.

RECOMMENDATION NO. 5

Amend FNS regulations to require that State agencies include language in their RFP prototypes that require contract review by State officials prior to the SFA signing and implementing a management company contract.

Agency Response

In its response, FNS stated that its response depended on the outcome of suggestions from a group of State agency officials on the best way to ensure that procurement and contract activities comply with Federal requirements.

OIG Position

To reach management decision, FNS needs to provide us with a further response specifying its proposed corrective actions and the planned timeframes for their implementation.

RECOMMENDATION NO. 6

Amend FNS regulations and Guidance for State Agencies to require each State agency to annually review and approve each contract between any SFA and management company to ensure compliance with all the provisions and standards set forth in 7 CFR 210.16, before contract execution.

Agency Response

In its response, FNS stated that it disagreed that the action required by this recommendation would be the most effective means to ensure compliance with 7 CFR 210.16. FNS stated that it will solicit responses from a group of State agency officials on the best way to ensure that procurement and contract activities comply with Federal requirements.

OIG Position

To reach management decision, FNS needs to provide us with its alternate proposals and the timeframes when a final recommendation would be made.

RECOMMENDATION NO. 7

Notify all FNS regional offices to inform their State agencies that all new contracts must require that only costs net of all discounts or rebates are allowable costs to be charged to the SFA's nonprofit food service account and any current contracts that do not contain this requirement must be rebid as soon as possible.

Agency Response

In its response, FNS agreed to issue guidance, within 90 days of report issuance, to all its regional offices to inform State agencies of this requirement.

OIG Position

We accept FNS' management decision.

CHAPTER 2

BETTER OVERSIGHT OF MANAGEMENT COMPANIES NEEDED TO ENSURE PROGRAM INTEGRITY

FINDING NO. 3

Of the 24 SFA's we visited nationwide, 16 did not exercise proper oversight of their contracted management companies. Four SFA's failed to adequately monitor their schools' meal accountability systems to ensure their accuracy; another three failed to ensure that food service funds were used to benefit the NSLP; and another nine failed to do both. Furthermore, even though regulations require that an SFA determine student eligibility, we found that one SFA delegated that responsibility to its management company. Both the FNS regional offices and State agencies failed to ensure that the SFA's provided the required oversight of management company operations. As a result, the meal accountability systems used by the SFA's did not ensure accurate meal claims for which they received reimbursement for 83,904 meals that were unsupported. In addition, we found SFA's improperly used \$1.2 million in NSLP funds to reimburse three management companies for non-program or unallowable costs.

Federal regulations⁷ require FNS to perform comprehensive management evaluations of each State's administration of the NSLP, including the State agency and SFA compliance with regulations. The State agencies are also required⁸ to perform reviews of an SFA's compliance with the NSLP regulations, including the requirements listed in 7 CFR 210.16 dealing with SFA oversight of management companies.

Federal regulations also require each SFA to establish internal controls to ensure the accuracy of the monthly claim for reimbursement and annually review those controls,⁹ and they require each SFA to correctly approve each child's eligibility for free and reduced price lunches and meal supplements based on prescribed requirements.¹⁰

Of the 24 SFA's we visited in 7 States nationwide, 16 failed to provide proper oversight of their food service operation and contracted management companies. Although both the FNS regional office and State agency performed the required reviews, they failed to detect problems with the SFA's meal accountability system or the SFA's oversight of

⁷ 7 CFR 210.30 (a).

⁸ 7 CFR 210.18 and in 210.19 (a)(6).

⁹ 7 CFR 210.8 (a)(1).

¹⁰ 7 CFR 210.7 (C)(1)(i).

management company operations. In four of the seven States we reviewed, the undetected problems were serious.

- In Michigan and Illinois, 8 of the 11 SFA's we reviewed claimed over 80,000 more meals than their management companies billed, valued at over \$48,000. In addition, 7 of those 8 SFA's used nearly \$300,000 in program funds to reimburse a management company for 350,000 school meals without documentation to support that those meals were served.
- Lack of controls over the meal claiming and billing process was also found in the State of Missouri. Although the net effect of the number of meals overclaimed was negligible, it was an indication of the lack of oversight.
- Similarly, one SFA in Newark, New Jersey, failed to reconcile the number of meals claimed by the SFA to the number of meals billed by the management company. Although there was a minimal overpayment made to the management company (for about \$80 worth of meals), our review of the 2 prior years found that the management company billed the SFA for over \$180,000 less than was allowed for by the 1998 and 1999 contracts. Again, the net effect to the food service program was minimal, but without proper SFA oversight, this underpayment could have easily resulted in an overclaim of food service funds.

Another issue not detected by the FNS regional office or State agency was the proper use of food service funds. Federal regulations¹¹ require that revenue received by the nonprofit school service be used only for the food service operation. However, our review of SFA's in three States found that food service funds were not being used to support the SFA's school food service. Two management companies operating in the States of New Mexico and Washington charged and were paid for unauthorized costs. In addition, a management company in the State of Missouri was allowed to improperly retain food service revenue and receive the associated benefits.

- In New Mexico, a management company billed two SFA's for unauthorized variable costs totaling over \$40,000. The variable costs were based on a percentage of income (sales) and were charged as a separate line item expense. The SFA's did not detect the problem because they did not review or request documentation in support of the variable costs charged.

¹¹ 7 CFR 210.14 (a).

- Unauthorized costs were charged to one SFA in the State of Washington, which reimbursed a management company for non-program salaries and benefits. The SFA did not detect the irregularity because it did not review program expenditures on a regular basis. The management company benefited by receiving over \$60,000 in NSLP funds that could have been used to operate or improve the food service. SFA officials stated that until our review, they were unaware there were any problems with management company operations. This was a response we encountered nationwide.
- The Missouri State agency allowed an SFA to sign a management company contract that allowed all food service income to accrue to the management company. Not only was all daily revenue collected by the management company and deposited in its bank account, the SFA signed over the funds received from the State agency representing the reimbursement claim. Over a 3-year period, 1998 through 2000, the management company gathered over \$750,000 in food service funds. Although the management company did provide the SFA with a year-end check, the management company and not the SFA received the monetary benefit for the entire year. This lack of oversight by the SFA was compounded by the fact that SFA personnel did not review the billing invoices before they issued any payments.

Failure by both the FNS Regional offices and State agencies to detect specific problems relating to SFA's and management companies, was further evidenced by an improper delegation of duties that both State and Federal agencies approved. One FNS regional office and State agency allowed an SFA to delegate all the student eligibility determinations to the management company. Even though prohibited by Federal regulations, the State agency approved the SFA's RFP with the provision that allowed the management company to determine how many students were eligible for free or reduced-price meals.

When we discussed this issue with State agency officials, they stated that they were not aware that the SFA's RFP was approved with the delegation of duties. However, we found that the State agency should have been aware of the delegation because the FNS regional office also allowed it. In a memo, dated August, 1993, to all State directors in the Midwest Region, the FNS regional office stated that it was acceptable for the management company to perform the student eligibility process and for the SFA to make it part of the contract. When we discussed this issue with a FNS regional office official, she stated that FNS was in error when it approved the delegation of duties. On July 6, 2000, the FNS regional office rescinded the 1993 memo thereby canceling the approval. At the time for the cancellation, management companies operating in the Midwest region had been determining student eligibility for free or

reduced-price meals for 7 years. Although immediate action had been taken by FNS and State agency officials once they were aware of problems with SFA and management company operations, we concluded they need a more proactive approach.

FNS needs to provide additional guidance to FNS regional offices to help detect and prevent widespread violations of NSLP regulations. In addition, the FNS regional offices should ensure that their State agencies are aware of the problems we disclosed and that they have the procedures in place to detect these and other program violations. Furthermore, FNS should ensure that State agencies make their SFA's aware of the problems in contracting with management companies and reaffirm the SFA's role in ensuring that their food service operation is in compliance with Federal requirements.

RECOMMENDATION NO. 8

Ensure that the guidance used in performing management evaluations emphasizes a review of a State agency's and SFA's oversight of management company operations.

Agency Response

In its response, FNS stated that its current guidance for Coordinated Management Evaluations of State Agency Operations places great emphasis on the area of oversight of management company operations and will continue this emphasis. In addition, FNS requested that the recommendation be changed to require FNS continue its level of effort in reviewing this area.

OIG Position

Because of the changed guidance provided in the response, we can reach management decision.

RECOMMENDATION NO. 9

Require the FNS regional offices to ensure that their State agencies have procedures that ensure all SFA's who contract with management companies for food services continue to maintain reliable meal accountability systems that produce accurate monthly claims for reimbursement.

Agency Response

In its response, FNS concurred with this recommendation and stated that it would issue guidance, within 90 days of report issuance, to its regional offices to follow that would ensure that a State agency's procedures ensure that all SFA's that contract with a FSMC maintain reliable meal accountability systems.

OIG Position

We accept FNS' management decision.

RECOMMENDATION NO. 10

Require the FNS regional offices to ensure that their State agencies notify their SFA's that the SFA's are responsible for performing annual on-site reviews and evaluating the meal claim information, and that contracting with a management company does not alleviate their oversight responsibility of food program operations.

Agency Response

In its response, FNS concurred with this recommendation and stated that it would issue guidance, within 90 days of report issuance, to its regional offices for them to follow that would ensure that a State agency notifies its SFA's that they are responsible for performing annual on-site reviews, and contracting with a FSMC does not alleviate their oversight responsibility of food program operations.

OIG Position

We accept FNS' management decision.

EXHIBIT A – NATIONWIDE SUMMARY OF SITES SELECTED

OIG REGION	STATES SELECTED	NUMBER OF MANAGEMENT COMPANIES REVIEWED	NUMBER OF SFA's REVIEWED	NUMBER OF FIXED-RATE CONTRACTS	NUMBER OF COST-REIMBURSABLE CONTRACTS
Northeast	New Jersey	1	1 ¹²	1	1
Southeast	South Carolina	1	3	1	2
Midwest	Illinois	1	8	8	-
	Michigan	1	9	-	9
Great Plains	Missouri	1	37	36	1
Southwest	New Mexico	2	6	1	5
Western	Washington	1	1	-	1
TOTALS		8	65	47	19

¹² The same SFA and management company signed a fixed-rate contract for school years 1998 and 1999, then signed a cost-reimbursable contract for school year 2000.

EXHIBIT B – FNS’ RESPONSE TO THE DRAFT REPORT



MAR 28 2002

United States
Department of
Agriculture

Food and
Nutrition
Service

3101 Park
Center Drive
Alexandria, VA
22302-1500

SUBJECT: Official Draft Audit Report Number 27601-0027-CH,
National School Lunch Program: Food Service Management Companies

TO: Richard D. Long
Assistant Inspector General for Audit
Office of Inspector General

We appreciate the opportunity to comment on the official draft of the subject National School Lunch Program audit report and request that this correspondence be included in the final report. Thank you for your consideration of the comments we provided to the discussion draft audit report.

This report represents the findings of six Office of Inspector General (OIG) regional audits. We have reviewed the five OIG regional audit reports that have been issued. However, we have only reviewed the official draft of Audit Report Number 27601-11-Hy. If Audit Report Number 27601-11-Hy has not been issued prior to issuing the final report of the national audit, we are requesting that references to this audit be removed from the national audit. If the regional audit is issued, we are requesting that any references in the national audit to that regional audit reflect the language of the final regional audit report.

Recommendation No. 1: Develop a short-term and long-term action plan to ensure that the SFA, not the management companies, benefit from the value of USDA-donated commodities solely provided to support SFA nonprofit food service operations. Specifically, until FNS has developed and implemented long-term policy, procedures, and any necessary regulations, require that all fixed-rate-per-meal contracts: (1) be bid as if no USDA-donated commodities would be available, and (2) require that the full value of commodities used by management companies be reflected on the monthly invoices to the SFAs as a credit or reduction to the amount billed.

FNS Response to Recommendation No. 1: We agree actions must be taken to ensure that SFAs receive the benefit of USDA donated commodities provided under FSMC contracts. However, based on consultation with our Office of General Counsel regarding current regulations, the Food and Nutrition Service (FNS) cannot issue a policy to State agencies that instructs them to notify SFAs that FSMC contracts must be bid as though no USDA donated commodities are available, and that a credit or reduction in the monthly SFA invoice must be made for the full value of USDA donated commodities used in the

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meals. This requirement could only be mandated through regulatory authority. Therefore, we describe below a proposed alternative course of action to address this recommendation.

(1) FNS will issue a memorandum to all State agencies within 90 days of report issuance requiring that they notify all SFAs of the problems identified through this audit with regard to the value-pass-through of donated foods in fixed-rate-per-meal-FSMC contracts. The memorandum will reiterate the provisions of current policy and guidance on FSMC contracts emphasizing the requirement that all donated foods must accrue to the benefit of the SFA. FNS will recommend that State agencies and SFAs review current FSMC contracts for compliance with current guidance. The memorandum will also provide an opportunity to notify State agencies of FNS's intention to study the findings and recommendations from this audit to determine regulatory changes needed. Such notification of impending regulatory changes will provide State agencies the opportunity to evaluate their current system; increase awareness of the issues regarding FSMC crediting of donated commodities; facilitate constructive dialogue with industry; and provide insightful comments and feedback to the proposed regulatory changes.

(2) FNS will immediately convene a team composed of representatives from State agencies, SFAs, the American School Food Service Association, and Regional office and Headquarters staff to begin work on the long-term analysis of program weakness addressed in this audit. Due to the complex financial issues surrounding program inconsistencies and value-pass-through, we are requesting that OIG designate a representative to serve on this work group. The team will report findings and provide a detailed action plan to OIG no later than December 31, 2002.

Recommendation No. 2: Ensure that all State agencies receive an updated copy of FNS' Guidance for State Agencies and Guidance for School Food Authorities – Contracting with Food Service Management Companies, updated to contain all amendments recommended in this report, and direct the State agencies to distribute the revised guidance to its SFAs.

FNS Response to Recommendation No. 2: We agree with the recommendation. However, regulatory changes are needed to bring the guidance into full conformity with the recommendations of the audit report. Therefore, we plan to issue 2 revisions to the guidance both of which will be developed with Regional office and State agency input. In the interim, prior to a regulatory change, revisions will be made to the guidance to clarify and strengthen those areas within our current regulatory authority. This should be accomplished by March 2003. The second revision to the guidance will be made after a final regulation has been published addressing Program changes. At this time, we are unable to provide an estimated completion date for the second revision.

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Recommendation No. 3: Notify all FNS Regional offices to instruct their State agencies and their SFAs that management companies must comply with the terms listed in the RFP and that only minor deviations can be approved by their State agency. In addition, the guidance should specify that unapproved material deviations would require rebid of a management company contract.

FNS Response to Recommendation No. 3: We agree with the recommendation. This will be accomplished within 90 days of report issuance through a policy memorandum to all FNS Regional offices.

Recommendation No. 4: Amend FNS Guidance for School Food Authorities to identify specific contract terms that a State agency and SFA must use to ensure that management companies, as agents of the SFAs, comply with all applicable competitive procurement procedures that should result in net costs being charged to a SFA so that the SFA, and not the management company, receives the benefit of cost reductions in the form of discounts, rebates and allowances. (One of the required terms for cost-reimbursable contracts must state that all costs charged to the SFA must be net of all discounts, rebates and allowances received by the management company, and that this cost reduction shall be shown on the monthly invoice or operating statement as a credit or reduction to the amount billed.)

FNS Response to Recommendation No. 4: We agree with the recommendation. This will be accomplished by March 2003 by reissuing "Contracting with Food Service Management Companies – Guidance for School Food Authorities" to all State agencies.

Recommendation No. 5: Amend FNS regulations to require that State agencies include language in their RFP prototypes that require contract review by State officials prior to the SFA signing and implementing a management company contract.

FNS Response to Recommendation No. 5: Our response to this recommendation is contingent upon the outcome of the actions taken as reflected in our response to Recommendation Number 6.

Recommendation No. 6: Amend FNS regulations and Guidance for State Agencies to require each State agency to annually review and approve each contract between any SFA and management company to ensure compliance with all the provisions and standards set forth in 7 CFR 210.16, before contract execution.

FNS Response to Recommendation No. 6: We disagree that the action required by this recommendation is the most effective means to ensure that each contract between an SFA and FSMC complies with 7 CFR 210.16. To determine a viable solution to this problem, we will solicit advice from a group of State agency representatives in order to seek their

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input on ensuring that procurement and contract activities fully comply with Federal requirements. Based on this advice appropriate regulatory proposals will be made.

Recommendation No. 7: Notify all FNS Regional offices to inform their State agencies that all new contracts must require that only costs net of all discounts or rebates are allowable costs to be charged to the SFA's nonprofit food service account and any current contracts that do not contain this requirement must be rebid as soon as possible.

FNS Response to Recommendation No. 7: We agree with the recommendation. We will issue guidance to address this recommendation within 90 days of report issuance.

Recommendation No. 8: Ensure that the guidance used in performing management evaluations emphasizes a review of a State agency's and SFA's oversight of management company operations.

FNS Response to Recommendation No. 8: The current Guidance for Coordinated Management Evaluations of State Agency Operations places great emphasis on the area of oversight of management company operations. We will continue to ensure that this emphasis is maintained. We have enclosed a copy of the current guidance for review and are requesting that the recommendation be modified to recommend that FNS continue its level of effort in this area.

Recommendation No. 9: Require the FNS Regional offices to ensure that their State agencies have procedures that ensure all SFAs who contract with management companies for food services continue to maintain reliable meal accountability systems that produce accurate monthly claims for reimbursement.

FNS Response to Recommendation No. 9: We agree with the recommendation. We will issue guidance on this subject within 90 days of report issuance.

Recommendation No. 10: Require the FNS Regional office to ensure that their State agencies notify their SFAs that the SFAs are responsible for performing annual on-site reviews and evaluating the meal claim information, and that contracting with a management company does not alleviate their oversight responsibility of food program operations.

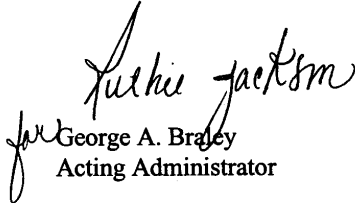
FNS Response to Recommendation No. 10: We agree with the recommendation. We will issue guidance on this subject within 90 days of report issuance.

Additionally, we are requesting technical changes to the report language as specified below.

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1. References to “bid” should be changed to “bid/proposal.”
2. On page ii, 1st sentence, we are requesting that the sentence be amended to read as follows: “Four of the five companies that operated under fixed-rate contracts at the 46 SFAs we reviewed withheld credit for \$5.8 million in USDA-donated commodities that were used in the NSLP.”
3. On page ii, 3rd sentence, we are requesting that the sentence be amended to read as follows: “We found that FNS did not require State agencies and their SFAs to include a specific procedure in contracts for crediting the value of commodities to the SFA, even though Federal regulations required that commodities solely benefit and be used in a SFA’s non-profit food service operation.”
4. Page 7, 2nd paragraph: The Mountain Plains Regional Office believes that their position, as described in the first sentence of this paragraph, was misinterpreted. Therefore, we are requesting that this sentence either be removed from the final audit report or that the statement be quoted verbatim. Additionally, we are requesting that the paragraph be revised as follows: “FNS-MPR officials stated that the regulations did not specifically require management companies to provide the “credit” to SFAs for the value of commodities on the invoice. FNS guidance only suggests that the credit be shown on the invoice. Therefore, the FNS-MPR did not enforce the invoice crediting of USDA-donated commodities. One State agency in the MPR, Missouri, did not include contract language for crediting of the value of USDA-donated commodities on the management company invoices because the State agency interpreted this to be a “suggested” practice and not a federal requirement.”

Please contact us if you need additional information.


George A. Braley
Acting Administrator

Enclosure

