

GAO

Report to the Chairman, Committee on
House Administration, House of
Representatives

April 1994

HOUSE RESTAURANT SYSTEM

Response to Questions
on Service America
Corporation's
Operations of House
Food Services







United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-114891

April 8, 1994

The Honorable Charlie Rose
Chairman, Committee on
House Administration
House of Representatives

Dear Mr. Chairman:

This report responds to three questions you asked regarding Service America Corporation's operation of the House of Representatives Restaurant System from January 3, 1987, through August 3, 1991. We are also describing an issue about payroll benefit cost that Service America requested our assistance in resolving. Specifically, this report discusses

- the additional contributions due the federal retirement and savings programs on behalf of Service America food service personnel who were covered by the federal programs;
- the accuracy of fees paid the government covering vending services for the period January 3, 1987, through August 3, 1991;
- whether reported dining service sales and fees paid the government during the period January 3, 1990, through August 3, 1991, appeared accurate; and
- whether certain checks Service America received and retained from House restaurant customers represented collections due the government.

You also asked a question regarding government furnished equipment provided to Service America during its operation of the House Restaurant System. Information necessary to answer this question was only recently made available to us. Accordingly, as agreed with your office, we will respond to this question later.

Results in Brief

We determined that Service America owed the federal retirement and thrift savings programs an additional \$170,686 in various employer and employee contributions. Service America has either paid or recognizes a liability for \$153,179 of this amount but disputes the remaining \$17,507. This amount represents undercontributions by the employees. We believe Service America owes the remaining amount to the government because applicable laws and regulations make the employer responsible for employee undercontributions.

The actual vending fees due the government for the period January 3, 1987, through January 2, 1990, have been in dispute due to competing views as to whether a 1984 vending contract or a 1986 food service contract applied. We are uncertain as to which view should prevail because the contracts are not clear on this point.

Under one view, the pricing terms in a 1984 vending contract governed vending services during this period because a 1986 food service contract for the period did not explicitly cover vending services. Under this view, Service America would owe the government \$142,970 in additional vending fees. The Architect of the Capitol, using this view as its basis, billed Service America for \$142,970.

A second view is that the 1984 contract was superseded and that vending services were covered only by the terms of the 1986 contract. Under this view, Service America would owe the government \$3,090.

In commenting on a draft of this report, Service America and the Architect of the Capitol suggested a reasonable third view, namely that the 1986 contract entitled Service America's dining division to receive vending commissions formerly paid to the government under the 1984 contract and account for them as additional revenue under the 1986 contract. Under this view, Service America would owe the government \$405.

In addition, we determined that Service America owed the government an additional \$1,819 for the period January 3, 1990, through August 3, 1991; our calculation was based on a 1989 contract which covered this period. The Architect of the Capitol also billed Service America for most of the \$1,819 under the 1989 contract.

Service America disputed owing the government any additional fees for vending services on the basis that its actions were in accord with the expectations of the government and that its financial reporting was accepted by the government during the period January 3, 1987, through August 3, 1991.

Our tests of reported dining service sales for the 1989 contract period January 3, 1990, through August 3, 1991, did not disclose any inaccuracies in the amounts reported by Service America. However, the fees Service America paid the government on these sales were slightly lower than they should have been because volume purchase discounts received by Service America at its headquarters level had not been allocated to its dining and

other divisions. We did not quantify the effect of such discounts on the fees due the government because (1) Service America did not provide us sufficient information to do so and (2) in view of the government's contract fee of 1 percent, the discounts would have had to be significant to materially affect the fees due the government. For example, if Service America received and did not report a typical purchase discount on its \$5.6 million total reported House food service cost of goods sold under the 1989 contract, the fees due the government would have been understated by only \$1,129.

Our tests of a sample number of House restaurant customer checks received by Service America did not disclose any that were improperly retained by the corporation.

Background

The House Restaurant System is the name given to the operation of food and vending facilities on premises under the jurisdiction of the House of Representatives. Management of the House Restaurant System was placed under the jurisdiction of the Committee on House Administration by section 2 of H.R. 317, 92nd Congress, 1st Session (1971), which was enacted by Public Law 92-51, section 101, 85 Stat. 133 (1971), 40 U.S.C. 174k (1988). This act vests in the Committee, or its designated agent, all authority previously vested in the Architect of the Capitol by the Act of October 9, 1940, chapter 780, title II, section 208, 54 Stat. 1056, 40 U.S.C. 174k note, to manage and operate the House Restaurant System. Receipts from operation of the restaurant system were to be deposited into an account, the House Restaurant Revolving Fund, with the Treasurer of the United States as authorized by the Act of October 9, 1940.

Until January 1987, House food services were provided by congressional employees who were either under the direct supervision of the Select Committee on the House Restaurant, the Ad Hoc Restaurant Subcommittee, or the Architect of the Capitol. Vending services from mid-1984 to May 1992 were provided by Service America or the predecessor of its vending division—The Macke Company.

During 1985 and 1986, the restaurant system and its employees were under the supervision of the Architect of the Capitol. These congressional employees were covered by the federal retirement program, either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). These employees were participants in the Federal Thrift Savings Plan (TSP) if they were FERS employees and were

eligible for voluntary participation in TSP if they were CSRS employees. TSP is a retirement savings and investment plan for Federal employees. It is an integral part of the FERS retirement package and a supplement to the CSRS retirement package.

In December 1986, the Architect, as an agent for the Committee on House Administration, issued a 3-year contract (the 1986 contract) to Service America Corporation for operation of the House food service facilities beginning January 3, 1987. This was followed by a second 3-year House food service contract dated December 15, 1989 (the 1989 contract), with Service America. It began January 3, 1990. Each contract provided for the contractor to pay the government a fee of 1 percent of gross profit, defined as sales less the cost of goods sold.

Service America established a dining division that operated the House food service facilities and managed the two food service contracts. The Macke Company had an existing contract dated June 20, 1984, with the House Restaurant System. The Macke Company, now Service America's vending division, continued to provide the vending services at the House office buildings until May 23, 1992. By mutual agreement of the contract parties, the 1989 food service contract was terminated as of midnight, August 3, 1991.

Under the terms of the 1986 contract, Service America agreed to provide the right to work for 2 years to the House food service employees of the Architect who were displaced as a result of conversion to contractor operation. It also was required by law to (1) pay the federal payroll retirement and savings benefits of those employees it hired who elected to retain their CSRS and FERS coverage and (2) process those benefits in accordance with the federal retirement program regulations promulgated by the Office of Personnel Management (OPM) and the federal TSP regulations issued by the Federal Retirement Thrift Investment Board. The federal retirement benefits and processing requirements for the applicable CSRS and FERS covered employees still employed by Service America continued under the 1989 food service contract.

Scope and Methodology

Problems relating to federal retirement withholdings for Service America employees were initially disclosed in our financial audit report¹ on Service America's 1988 operations of the House Restaurant System. We added this

¹Financial Audit: Service America Corporation's 1988 Operation of the House Restaurant System (GAO/AFMD-90-87, August 23, 1990).

issue to our audit at Service America's request to assist the government and the contractor in resolving the matter.

To address this issue, we reviewed various laws and the OPM and Federal Retirement Thrift Investment Board's regulations on employee and employer requirements for federal retirement and TSP contributions and provided our interpretations of the requirements to Service America. We then determined the accuracy of Service America's computations of the additional amounts owed to the applicable government entities for such contributions. Next we computed the amount of the lost earnings owed by Service America for undercontributions to the TSP.

The other three issues covered during our audit relate to questions asked by the Chairman, Committee on House Administration. To determine the accuracy of vending fees, we reviewed the two House food service contracts and the 1984 vending agreement and identified the procedures and practices followed by Service America and the government under the contracts. We then developed information from Service America's accounting records on the amount of fees that should have been paid the government based on the contract provisions versus what was paid. Service America also assisted us in this effort by furnishing copies of records requested and performing initial calculations of fees payable to the government under different scenarios. (See appendix I.)

Service America reported monthly sales to the government by each of its 18 food service units for the House restaurant operations. Total cost of goods sold for the month was then subtracted from the total of the reported sales to compute the 1 percent of gross profit fee paid the government. To determine whether the sales reported to and the fees paid the government under the 1989 contract appeared accurate, we tested the data from three aspects. First, for a random selected number of the food service units, we verified the sales reported to the government for those units to the sales recorded in Service America's accounting records. The recorded sales were then tested by verifying the recorded amounts to Service America's accounting source documents, such as cash register tapes, for a randomly selected number of weekly periods.

Second, for 2 months of the contract period, we verified the reported cost of goods sold to the amounts recorded in Service America's accounting records. Our third and final effort involved verifying the mathematical accuracy of Service America's computation of the fees due the government for each month of the contract period.

We examined 32 checks deposited by Service America to determine if any of the checks represented collections due the government. We selected 23 of the checks by randomly selecting 2 months (March 1987 and March 1988) of activity under the 1986 contract and then, from all deposits during the selected months, randomly selecting the checks for examination. The other nine checks were furnished to us by staff of the House Committee on Administration. Our examination of the checks involved tracing the checks to Service America's accounting records (sales reports and accounts receivable ledgers) supporting the deposit transaction.

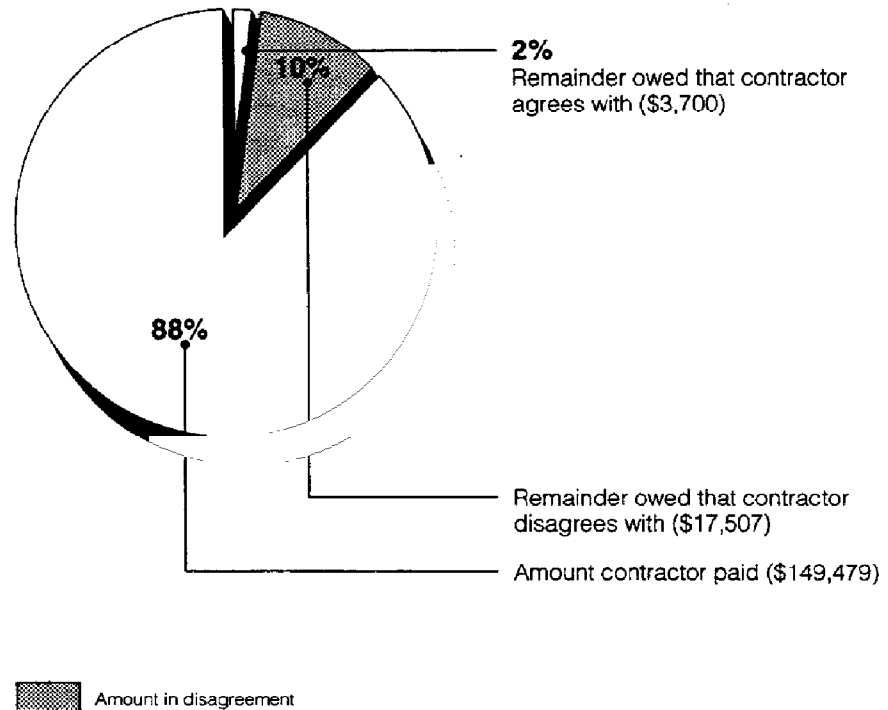
In performing our work, we discussed the issues and our conclusions with Service America representatives and its legal counsel and representatives of OPM, the Federal Retirement Thrift Investment Board, and officials of the Architect of the Capitol's office.

We performed our work from May 1992 to June 1993 in accordance with generally accepted government auditing standards. We discussed our findings with responsible contractor representatives and officials of the Architect's office and incorporated their comments where appropriate.

Additional Federal Retirement Program and Thrift Savings Program Contributions

We determined that Service America owed the federal retirement and thrift savings programs an additional \$170,686 in various employer and employee contributions. On October 1, 1992, Service America paid \$149,479 of that amount and has advised us that it recognizes its liability to be \$3,700 of the \$21,207 balance. The remainder, or \$17,507, involves the difference between required employee retirement contributions versus the amount Service America withheld from their salaries and paid to the Civil Service Retirement and Disability Fund. Figure 1 shows the percentages of the individual amounts to the total additional contributions owed.

Figure 1: Service America's Payments to OPM and the Thrift Savings Plan and Amount Still Outstanding
(Total Pie = \$170,686)



Service America told us that it should not be liable for the employee undercontributions since it paid the amount directly to the employees. However, applicable laws and OPM regulations make government agencies responsible for employee undercontributions resulting from administrative error and make Service America similarly responsible for former House Restaurant System employees who elected to remain in the federal retirement program. Consequently, we believe Service America owes the remaining amount to the fund.

Federal Retirement Program Contributions

Under the terms of the 1986 contract, Service America agreed to provide the right to work for 2 years to employees of the House food services displaced as a result of conversion to contractor operation. A number of former House food service employees were employed by Service America during the period that the 1986 and 1989 contracts were in effect.

Legislation² was enacted that authorized former House food service employees of the Architect who were employed by Service America to continue to participate in the federal retirement program—CSRS and FERS. The legislation required the Director of OPM to prescribe regulations under which (1) the former House food service employees electing to remain in the federal retirement program would pay into the Fund any employee contributions which would be required if such individuals were Congressional employees and (2) the employer (Service America) would pay into the Fund amounts equal to any agency contributions which would be required if the individuals were Congressional employees. Such regulations were subsequently issued by the OPM director (5 C.F.R. 831.202 (c), (d) (1993)).

Due to an administrative error, Service America inaccurately computed both the employer and the employees' share of retirement contributions, resulting in underpayment of the contributions to the retirement program. Our calculations showed that the underpayment of the employer's share of contributions amounted to \$138,588 and the underwithholdings of the employees' share amounted to \$17,992. The contractor paid \$139,073 to OPM on October 1, 1992, for the employer's contribution underpayment. The difference of \$485 from our calculation occurred due to Service America using an incorrect contribution rate and misclassifying one person as a CSRS instead of a FERS employee.

Contractor and Government Contracting Officer's Comments and Our Evaluation

In commenting on a draft of this report, Service America contended that it was not liable for the payment of the remaining portion of the employers' undercontributions to the Fund of \$17,507 (that is, \$17,992 less the \$485 October 1, 1992, overpayment) since it paid the amount to the applicable employees. It argued that an additional payment would constitute a duplicate personnel cost to the corporation. (See appendix IV for Service America's complete response to this issue.)

Under OPM's regulations, an agency is required to correct its administrative errors in cases where only a part of the required employee retirement deduction is made by paying the balance to OPM for the Fund (5 C.F.R. 831.111 (b) (2)). After such a payment, the agency may either recover this salary overpayment from each applicable employee or waive recovery. The legislation and OPM's regulations subjected Service America to the same requirements to make contributions for former House Restaurant

²Public Law 99-591, Title I, sec. 111, 100 Stat. 3341-348 (1986) and Public Law 99-500, Title I, sec. 111, 100 Stat. 1783-348 (1986), (40 U.S.C. 174k note).

System employees who elected to remain in CSRS or FERS as were imposed on a federal agency with regard to Congressional employees. Consequently, Service America should have paid the Fund the balance of the amount of the underpayments of the employees' share of retirement contributions and either recovered, or waived recovery, from the employees.

Federal TSP Contributions

An employing agency is required to pay a 1 percent contribution, called the "Agency (1%) Contribution," on behalf of FERS covered employees (5 U.S.C. 8432 (c)(1)(B)(C) (1988)). The Agency (1%) Contribution on a FERS employee's basic pay is required whether or not that employee elects to contribute to TSP. Some of Service America's former House food service employees elected to retain their FERS coverage, although none of these employees elected to contribute to TSP. Service America never made the Agency (1%) Contribution for its FERS covered employees. We determined that this undercontribution amounted to \$10,485 for the period January 3, 1987, through August 3, 1991.

Service America paid \$10,406 to the Architect of the Capitol on October 2, 1992, for payment to TSP and advised us of its willingness to pay the remainder of the contribution underpayment, or \$79, later. Upon receipt of Service America's payment, the Architect deposited the \$10,405.89 payment in the House Restaurant Revolving Fund. However, the House Restaurant System did not furnish TSP all salary information required to credit each employee's individual savings account until June 1993.

Under regulations prescribed by the Federal Retirement Thrift Investment Board, as directed by 5 U.S.C. 8432a (Supp. IV, 1992), an employing agency is also required to pay to TSP (on the employee's behalf) "lost earnings" resulting from the agency's not paying all or part of the agency's share of its contributions (5 C.F.R. 1606.5 (1993)). TSP computes the amount of the lost earnings and notifies the agency of the amount to pay. As of September 9, 1993, the House Restaurant System had not been charged by TSP for lost earnings on the Agency (1%) Contribution underpayment.

The Board requires TSP to compute the actual lost earnings based on the pay date that the contributions should have been made, the earnings' rate of the investment fund to which the contribution should have been deposited had the error not occurred, the amount of the late contribution, and the pay date that the contribution was actually paid to TSP. Service America recognized its obligation to pay for lost earnings on its

undercontributions to TSP but does not believe it should have to pay for such losses beyond a reasonable date after its October 1, 1992, payment. Service America's position is that the amount it forwarded to the Architect should have been paid to TSP shortly thereafter, thereby stopping any further earning losses. We agree.

Assuming 15 business days after receipt by the Architect, that is the period ending October 23, 1992, to be a reasonable period for processing the payment, using TSP earnings' rates for the applicable investment fund and the Board's procedures for computing lost earnings, we computed the lost earnings owed by Service America to be \$3,621. Service America agreed to pay this amount plus the remaining unpaid Agency (1%) Contributions (\$79) when it receives a final notice from the government's contracting officer for the applicable House food service contracts, the Architect of the Capitol.

Accuracy and Appropriateness of Vending Payments Under the 1989 and 1986 Food Services Contracts

For the 1989 contract, Service America did not compute the required fee payment to the government for the vending services in conformity with the pricing terms of the contract. As a result, an additional payment of \$1,819 is owed the government under the contract. Appendix II presents our computation of this amount.

In a draft of this report sent out for comment, we stated that we were unable to clearly determine the intent of the contracting parties regarding the amount that the government was entitled to receive for vending services provided during the period (January 3, 1987, through January 2, 1990) of the 1986 food service contract. The reason for our uncertainty was that it was not clear whether the amount of vending commissions the government was entitled to receive was to be determined under the terms of the 1984 vending contract or the 1986 food service contract.

In our draft report, we offered two possible ways to view the intent of Service America and the Architect of the Capitol regarding the payment of vending fees. One view is that the 1984 contract continued as a distinct contractual obligation to the government until January 3, 1990, the date when the 1989 contract clearly superseded all previous Service America vending contracts relating to House food services. Another view is that the 1986 contract includes vending services and supersedes the 1984 contract thus entitling the government to payment of a fee determined solely in accordance with the terms of the 1986 contract. These two views are discussed in detail in appendix I.

Under the first view, the government would be due vending commissions computed and paid solely according to the terms of the 1984 agreement, an amount \$142,970 more than Service America actually paid during the period of the 1986 contract. Under the second view, the government would be due \$3,090 resulting from Service America not paying fees on vending services in conformity with the pricing terms of the 1986 contract. Appendix III presents our computation of these amounts.

After we described the results of our audit to representatives of the Architect of the Capitol, the Architect used the first view as a basis for a letter dated October 8, 1992, to Service America requesting \$144,532 to cover the amount of the underpayment to the government for vending services. This amount was comprised of \$142,970 for the period covered by the 1986 contract plus \$1,562 (an amount that we and Service America initially computed) for the 1989 contract. Service America's counsel notified the Architect by letter of December 9, 1992, that Service America totally disputed the liability on the grounds that the House Restaurant System was aware and understood Service America's handling of vending commissions and it did not indicate any concern or disapproval of the manner in which Service America was handling them. Thus, the counsel asserted that Service America's handling of vending commissions was in accord with the expectations of the government.

**Contractor and
Government Contracting
Officer's Comments and
Our Evaluation**

In commenting on a draft of this report, Service America reaffirmed its counsel's December 1992 assertion that the company's handling of vending commissions was in accord with the expectations of the government. However, it suggested a third view on the handling of vending commissions previously paid to the government under the 1984 contract. This new view is that the 1986 contract entitled Service America's dining division to the vending commissions formerly paid to the government under the 1984 contract and account for them as additional revenue under the 1986 contract.

Service America told us that since its monthly statements were accepted by the Office of the Architect of the Capitol, and this issue was not brought to its attention until the time of our audit, it maintained that it properly paid the vending commissions due the Office of the Architect of the Capitol and the House Restaurant System. In effect, Service America took the position that the 1984 vending contract continued in force with the commission due its dining division, which reflected the commission as

revenue in calculating the one percent of gross margin payment to the government under the 1986 contract.

Although the Architect of the Capitol previously billed Service America \$142,970 based on the first view of the 1986 contract, the Architect of the Capitol in his written comments supported the view that the 1986 contract authorized Service America to receive as income the vending fees formerly paid to the government under the 1984 contract. In effect, this view treats the relationship between Service America's dining division and the vending division as being analogous to a contractor-subcontractor relationship. On that basis, the Architect of the Capitol concluded that Service America was entitled to receive the vending commission computed under the terms of the 1984 contract, include the commission with revenues received under the 1986 contract, and pay the government a commission on the total amount computed under the terms of the 1986 contract. Under this approach, the vending division would have been required to pay the dining division a minimum commission of 17 percent, as stipulated in the 1986 contract, on its annual vending sales. The dining division treated the commission as income to be added to other sales revenue in order to determine the gross profit on which Service America was required to pay one percent to the government under the 1986 contract.

Service America, however, reduced the vending fee payment required under the 1984 contract from 17 percent to 14 percent, thus the government received one percent of 14 percent rather than of 17 percent of annual vending sales. In commenting on a draft of this report, the Architect of the Capitol only challenged the authority of Service America to reduce the percentage from 17 to 14 percent.

In its comments, the Architect of the Capitol concurred that the intent of the parties is critical to determine the amount of commissions that should have been paid during the period in question. However, the Architect of the Capitol pointed out that the request for proposal for the 1986 contract provided that each offeror was required to submit a detailed financial pro forma of the first and second year's operation of the House Restaurant Food Service. He also stated that Service America's pro forma—that had not previously been provided or otherwise made known to us—indicated that Service America proposed to treat commissions from the Tobacco Stand and vending operations as receipts which would be added to restaurant sales to obtain the gross profit figure upon which the one-percent fee was based. Further, a review of the pro forma shows that

absent such a treatment of the Tobacco Stand and vending commissions, Service America would be unable to show a net gain on operations in its offer. He acknowledged that the Service America proposal, including the pro forma, was accepted without objection by the government, and that Service America had treated commissions consistent with this view by accounting to the Architect of the Capitol for vending commissions in the monthly income expense statements to the Architect of the Capitol required by the 1986 contract.

The Architect of the Capitol advised us that he views the pro forma as one of the conditions of Service America's proposal. Thus acceptance of the proposal would be considered binding on the government. While it might be argued that the pro forma goes only to the issue of the offeror's ability to perform the contract, a court could reasonably view the inclusion of such information in a required pro forma as a binding condition on the means of performance, once the offer is accepted. Moreover, the behavior of both Service America and the Architect of the Capitol during the course of the contract was consistent with this view. Also, assuming that this is the correct interpretation of the 1986 contract, we agree with the Architect of the Capitol that Service America had no authority to reduce the commissions paid by the vending division to the dining division from 17 percent to 14 percent. Under this third view, Service America would owe the government an additional \$405 in commissions under the 1986 contract.

No Inaccuracies in Reported Sales but Fees Paid on the Sales Were Inaccurate

Our audit did not disclose any inaccuracies in the sales that Service America reported to the government during the period January 3, 1990, through August 3, 1991. However, we believe that Service America incorrectly reported the cost of goods it purchased to generate those sales and, as a result, the fees it paid the government were not accurate.

We were informed by a Service America representative that the reported cost of goods sold under the two House food service contracts did not reflect volume purchase discounts from certain of its suppliers. This was because the discounts were based on overall purchases for the entire Service America Corporation, and it was Service America's policy not to allocate such discounts to its various operating divisions. Service America did not consider such discounts significant enough to justify the cost involved in making the allocation. Consequently, the cost of goods sold under the 1986 and 1989 contracts was overstated and gross profit—the difference between sales and cost of goods sold—was understated.

Since Service America was to pay fees to the government under the House food service contracts based on a percentage (1 percent) of gross profit, an understatement of gross profit resulted in an understatement of the fees paid the government. Because Service America could not provide us with sufficient information to estimate the amount of purchase discounts allocable to the House food service contracts, we were unable to quantify the additional fees due the government for the applicable discounts.

We note, however, that in view of the government's contract fee of 1 percent of gross profit under the contracts with Service America, such purchase discounts would have had to be significant to have a material effect on the fees paid the government. For example, we were advised by a Service America representative that a typical volume discount was about 2 percent. If Service America received and did not report a 2-percent purchase discount on its \$5,646,309 total reported House food service cost of goods sold for the 1989 contract period, the fee due the government would have been understated by only \$1,129.³

Contractor and
Government Contracting
Officer's Comments and
Our Evaluation

In its comments, Service America did not agree that the 1-percent gross margin calculation was understated due to its handling of vendor discounts since there was not a clear understanding it was to change prior practices and allocate small discount amounts to the House Restaurant dining units. Service America also stated that the "2% discount" mentioned in our report is not accurate and the reported total "Cost of Goods" sold would contain many items that were not subject to vendor discounts.

We have no reason to question Service America's statement that the 2-percent standard discount was not accurate for its rate, and that it did not receive discounts on all of the items in its cost of goods sold. We offered this example to illustrate that even at a maximum discount level, the effect of this issue on the government's 1 percent fee would be insignificant (\$1,129).

³Computed by multiplying Service America's total cost of goods sold (\$5,646,309) by the 2 percent typical discount rate and then multiplying the results by the government's contract fee of 1 percent.

No Cases Noted Where Service America Collected and Retained Amounts Due the Government

Although 11 of the 32 customer checks we examined were made payable to the House Restaurant System instead of Service America, we found that all 32 checks represented collection of Service America's accounts receivable and were properly deposited in Service America's bank account.

As of the effective date of Service America's 1986 House food service contract, the House Restaurant System had various accounts receivables due for prior charged sales to customers. Service America continued selling to those customers on credit, resulting in the customers having House food service account balances with two entities—Service America (the contractor) and the House Restaurant System's revolving fund (the government). The Office of the Architect continued to maintain the government's accounts receivable, with Service America maintaining its own accounts. This dual accounts situation complicated accounting for collections, especially when the customers forwarded checks to one entity when they belonged to the other. In addition, we were advised that most of the customers continued to make their checks payable to the House Restaurant System whether they were for the government or Service America.

A Service America representative and the Office of the Architect representative who maintained the government's accounts receivable informed us that each collection had to be reviewed to identify which account balance the customer intended to pay. Our test of 23 checks deposited by Service America in March 1987 and March 1988 disclosed that all 23 checks represented payments on Service America's accounts receivable. Five of the checks were payable to the House Restaurant System even though they were collections on Service America's accounts receivable.

In addition, we examined nine checks that staff of the Committee on House Administration furnished us. We were advised by the Committee staff that Service America had deposited these checks in its own bank account during the period April 1987 through May 1990. Three of the checks were payable to Service America but six were payable to the House Restaurant System. For each of these checks, we located documents supporting the checks as collection of amounts due Service America.

On October 20, 1992, Service America filed a voluntary petition under Chapter 11 of Title 11 of the United States Code with the United States Bankruptcy Court of the District of Connecticut, Bridgeport Division. The filing of the petition serves to stay judicial, administrative, or other action to recover claims against Service America that arose before it filed its petition (11 U.S.C. 362 (a) (1)). Proof of claim must have been filed with the bankruptcy court for allowance (11 U.S.C. 501, 502) unless included as an undisputed claim in the debtor's schedule of creditors (11 U.S.C. 521, 1106, 1111). The bankruptcy court ordered that claims must have been filed by February 1, 1993. We were advised by the Office of the Architect that the government did not submit a claim against Service America with the bankruptcy court, and we are unaware of whether the Architect's claim was included in the debtor's schedule of creditors.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send copies of the report to the Ranking Minority Member of the House Committee on House Administration, the Architect of the Capitol, the Director of the Office of Personnel Management, the Executive Director of the Federal Retirement Thrift Investment Board, the Director of House Non-Legislative and Financial Services, and the President of Service America Corporation. Please contact me at (202) 512-9489 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix VI.

Sincerely yours,



David L. Clark, Jr.
Director, Legislative Reviews and
Audit Oversight

Contents

Letter	1
Appendix I Recap of the Contractual Provisions and Billing Practices for Vending Services From June 20, 1984, Through August 3, 1991	20
Appendix II Computation of the Additional Amount Owed the Government for Vending Services Provided Under 1989 Contract	26
Appendix III Computation of the Additional Amount Service America Would Owe the Government for Vending Services Under Two Different Views	28

Contents

Appendix IV Comments From Service America Corporation	30
Appendix V Comments From the Architect of the Capitol	33
Appendix VI Major Contributors to This Report	37
Figure	7

Figure 1: Service America's Payments to OPM and the Thrift Savings Plan and Amount Still Outstanding

Abbreviations

CSRS	Civil Service Retirement System
FERS	Federal Employees Retirement System
OPM	Office of Personnel Management
TSP	Federal Thrift Savings Plan

Recap of the Contractual Provisions and Billing Practices for Vending Services From June 20, 1984, Through August 3, 1991

The U.S. House Restaurant System and Macke Company entered into an agreement dated June 20, 1984, for Macke to install and operate automatic vending equipment on the U.S. House Restaurant System premises. Macke agreed to pay the U.S. House Restaurant System monthly commissions at scaled rates established by the agreement. The rates were based on a percentage of annual sales and ranged from 17 to 25 percent. The agreement was to run for 2 years from the date of the completed installation of the automatic cafeteria and supplementary vending equipment. The agreement automatically renewed itself for similar 2-year terms unless either party gave written notice by registered or certified mail of its intention to terminate the agreement at least 60 days prior to its automatic renewal. The agreement could also be terminated for failure to take corrective action following notice of failure to perform. An employee of Service America told us that Macke's parent company merged with another company to form the Service America Corporation prior to 1987 and Macke thereafter became the vending division of Service America.

In August 1986, the Architect of the Capitol issued a Request for Proposals (RFP 8654) for contractor operation of the House Restaurant System. The RFP's Statement of Work, paragraph 3.01.2, entitled "Scope of Operations and Description of Facilities," stated that the contractor would manage and operate in its name, the food service areas and facilities of the House Restaurant System. It then stated that "Food services shall be provided by the Contractor within the food service support areas indicated below, during the hours of service listed for each." The contract listed specific facilities in the Capitol, the Rayburn Building, the Longworth Building, the Cannon Building, and House Office Building Annex No. 2 where food services were to be provided.

Paragraph 3.01.3 of the RFP's Statement of Work, entitled "Vending," stated that the House Restaurant System currently contracts with two companies, the Macke Company and Fruit-O-Matic, to provide vending services. It identified the number of vending machines each company operated and stated that each contract was subject to termination by the government. The RFP did not address whether the relationship between the House Restaurant System and the two vending service providers was affected by the award of the food service contract.

The Architect of the Capitol awarded the contract to Service America in December 1986 and entered into the Food Service Contract Agreement, effective January 3, 1987, to January 3, 1990, which incorporated the RFP's Statement of Work. The contract required Service America to pay the

**Appendix I
Recap of the Contractual Provisions and
Billing Practices for Vending Services From
June 20, 1984, Through August 3, 1991**

government a commission of 1 percent of gross profit, defined as sales less cost of goods sold. Service America's dining division managed the food service contract throughout the 3-year term of the contract. Service America's vending division, formerly the Macke Company, provided vending services to the House Restaurant System.

Service America's accounting records show that commencing January 3, 1987, the vending division ceased paying directly to the government the amount of vending commissions computed at the 1984 Macke agreement rate. Instead, the vending division paid the monthly commissions computed at a flat 17 percent until September 1, 1987, and a flat 14 percent thereafter to the dining division, which treated the commissions as sales revenues under the 1986 contract. The vending commission revenue was then added to the revenues received from the dining division's operation of food service facilities and areas. To determine gross profit under the 1986 contract, Service America subtracted the cost of goods sold by the dining division, but not the vending division, from the total revenues and paid the government a 1-percent fee on the resulting gross profit.

Under the terms of the 1986 contract, Service America's dining division submitted to the Architect's Office monthly income and expense statements that identified 17 revenue centers as generating income under the contract. We were advised by Service America that one of the revenue centers identified as "Unit 860 -Administrative Overhead" includes the payments received from the vending division. This was verified by our review of Service America's records. Vending commissions were handled in this manner throughout the 3-year term of the 1986 contract. The amount of the commission payments from the vending division to the dining division was changed from 17 percent to the flat 14 percent effective September 1, 1987, pursuant to a written memorandum dated August 10, 1987, from the contractor's district general manager to its dining division manager. It stayed at 14 percent for the remaining period of the food service contract. The memorandum stated:

"The vending commission rates which were established in 1984 were based on significantly less investment than is currently on site at the House of Representatives. . . . Unfortunately, this additional investment did not increase sales. . . . Therefore, effective with the September accounting period, the scaled rate will be eliminated and a flat rate of 14 percent applied to all sales."

Subsequently, in a letter dated January 13, 1989, to the Architect's Contracting Division, the contractor's district general manager stated the

Appendix I
Recap of the Contractual Provisions and
Billing Practices for Vending Services From
June 20, 1984, Through August 3, 1991

reasons for adjusting the commission to 14 percent. The letter also transmitted a copy of the 1984 U.S. House of Representatives vending contract (Macke agreement) and the August 10, 1987, memorandum.

Thereafter, the government's Request for Proposals for a contract for food service operations commencing January 3, 1990 (the date the 1986 contract was to terminate), stated that "the incumbent contractor currently contracts with Service America-Vending Division to provide vending service." During the preproposal conference, a prospective proposer asked for a breakdown of vending machine sales in order to assist in the evaluation of sales revenue. The government provided the information. Thereafter, Service America in its best and final offer dated December 13, 1989, addressed to the Architect of the Capitol stated that:

"For provision of vending services, Service America intends to exercise a sub-contract arrangement to satisfy the contractual requirements. All previous vending agreements shall thereby be superseded with the Award of RFP No. 9014 contract."

The Architect of the Capitol and the Service America Corporation entered into a contract effective January 3, 1990, until January 3, 1993, for Service America to operate food service areas and facilities. The Statement of Work expressly incorporated Service America's best and final offer of December 13, 1989, into the contract, which was dated December 15, 1989. Officials of the Architect's Office advised us that it was their intention to incorporate vending services into the 1989 contract. The 1989 contract required that Service America pay the government a fee of 1 percent of gross profit (sales less the cost of goods sold).

The 1989 contract was terminated by mutual agreement of the parties, effective August 4, 1991. Both the 1986 and 1989 contracts contained provisions authorizing the government to audit the contracts. The termination agreement provided that the government would audit the 1989 contract to determine, among other things, whether Service America properly paid the 1 percent fee to the government under both the 1986 and 1989 contracts. The termination agreement preserved any claim the government might have for contractor underpayment.

We were advised by an official of the House Restaurant System that Service America's vending division continued to provide vending services to the House restaurant facilities from August 4, 1991, through May 23, 1992. The services were provided pursuant to an oral agreement that

**Appendix I
Recap of the Contractual Provisions and
Billing Practices for Vending Services From
June 20, 1984, Through August 3, 1991**

included payment of commissions to the House Restaurant System at a rate of 26 percent of sales.

The parties to the 1989 food service contract clearly intended for vending services to be provided under the terms of the 1989 contract. The consolidated gross profit for Service America's vending and dining divisions amounted to \$9,245,325 for the period January 3, 1990, through August 3, 1991. This should have resulted in a fee payment to the government of \$92,453, or an amount \$1,819 greater than was actually paid.

However, we are unable to determine the intent of the parties regarding the amount that the government was entitled to receive for vending services provided from January 3, 1987, through January 2, 1990. We presented Service America and the Architect with two views regarding the computation of vending commissions paid to the government. Under one view, there were two distinct contracts requiring different payments to the government and the 1984 vending agreement remained in effect through January 2, 1990, when the second food service contract clearly superseded all previous vending agreements. Thus, the House Restaurant System would have been entitled to receive vending commissions computed and paid solely in accordance with the terms of the 1984 agreement from January 3, 1987, through January 2, 1990, an amount \$142,970 more than Service America actually paid during this period.

Another view is that the 1984 agreement was superseded by the 1986 contract and that vending commissions were controlled by the terms of the payment provision of the 1986 contract. Under this view, Service America was required to pay the government one percent of gross sales (including vending) less cost of goods sold (including vending). Thus if we compute the amount owed based on this view, Service America would have paid the government \$3,090 more than it actually paid.

However, Service America's practice during the period covered by the 1986 contract was not consistent with either of these two views. Instead, Service America's dining division received the vending commission payments from the vending division not merely as a conduit to be forwarded to the government without further reduction but, instead, as sales revenue to the dining division. The consequence of this action is that Service America (1) included the commissions in the dining division's total revenue from which the division's cost of goods sold was subtracted to arrive at gross profit and (2) paid the government a 1-percent fee on the

Appendix I
Recap of the Contractual Provisions and
Billing Practices for Vending Services From
June 20, 1984, Through August 3, 1991

vending commission payments as part of the 1-percent fee on gross profit payable under the 1986 contract.

Service America also changed the vending commission rates payable from the vending division to the dining division from 17 percent to 14 percent. We questioned whether the 1986 contract gave Service America the authority to reduce the rate.

The Architect of the Capitol by letter of October 8, 1992, asked Service America to remit to him \$144,532 to cover the amount of underpayment to the government for vending services. Service America's counsel notified the Architect by letter dated December 9, 1992, that Service America totally disputed the liability on the grounds that although the House Restaurant System was aware and understood Service America's handling of vending commissions, it did not indicate any concern or disapproval of the manner in which Service America was handling the commissions. Thus, Service America's counsel asserts that Service America's handling of vending commissions was in accord with the expectations of the House Restaurant System.

Subsequently, in commenting on a draft of this report, Service America and the Architect of the Capitol suggested a third view concerning the handling of vending commissions previously paid to the government under the 1984 contract. Their view, which is supported by a required pro forma included in Service America's proposal and the Architect of the Capitol's and Service America's course of conduct during the life of the contracts, is that under the 1986 contract, Service America would account for vending commissions as part of its income under the 1986 contract. Thus under the 1986 contract, the government would receive 1 percent of the gross profit—sales less cost of goods sold—with the vending commissions added to sales for the purpose of determining the government's 1 percent.

On October 20, 1992, Service America filed a voluntary petition under 11 U.S.C., Chapter 11, with the United States Bankruptcy Court of the District of Connecticut, Bridgeport Division. The filing of the petition serves to stay judicial, administrative, or other action to recover claims against Service America that arose before it filed its petition (11 U.S.C. 362 (a) (1)). Instead, proof of claims must be filed with the bankruptcy court for allowance (11 U.S.C. 501, 502), unless an undisputed claim is included in the debtor's schedule of creditors filed under 11 U.S.C. 521. See 11 U.S.C. 1106, 1111. We are unaware of whether the Architect's

**Appendix I
Recap of the Contractual Provisions and
Billing Practices for Vending Services From
June 20, 1984, Through August 3, 1991**

claim was included as an undisputed claim in such schedule. The final date for filing a claim against Service America with the Bankruptcy Court was February 1, 1993. We were advised by the Office of the Architect that the government did not submit a claim to the bankruptcy court against Service America.

Computation of the Additional Amount Owed the Government for Vending Services Provided Under 1989 Contract

Year/month (1)	Total vending revenue (2)	Vending cost of goods sold (3)	Vending gross profit (GP) (columns 2-3) (4)	Dining Service (DS) Gross profit (5)
1990				
January	\$13,804	\$6,657	\$7,147	\$148,505
February	24,708	12,167	12,541	501,803
March	26,030	12,542	13,488	825,601
April	20,359	10,173	10,186	496,446
May	22,140	10,391	11,749	685,155
June	25,715	11,487	14,228	603,978
July	23,878	11,658	12,220	388,774
August	21,879	11,179	10,700	288,306
September	21,691	10,986	10,705	448,941
October	21,494	10,235	11,259	423,337
November	16,397	8,415	7,982	259,461
December	19,521	10,016	9,505	281,149
Total 1990	\$257,616	\$125,906	\$131,710	\$5,351,456
1991				
January	\$18,629	\$9,227	\$9,402	\$261,540
February	19,392	9,725	9,667	444,085
March	24,960	10,856	14,104	786,288
April	18,806	10,352	8,454	514,070
May	19,167	9,154	10,013	627,851
June	25,652	11,582	14,070	591,148
July	21,470	10,394	11,076	400,262
August		^a		112,134
Total 1991	\$148,076	\$71,290	\$76,786	\$3,737,378
Total for Contract	\$405,692	\$197,196	\$208,496	\$9,088,834

**Appendix II
Computation of the Additional Amount
Owed the Government for Vending Services
Provided Under 1989 Contract**

Vending commissions included in DS GP (6)	Adjusted consolidated GP (columns [4+5]-6) (7)	Government fee		Additional vending fees (column 9-8) (10)
		Original 1% calculation paid to Architect (8)	Adjusted 1% calculation (column 7 X 1%) (9)	
\$1,690	\$153,962	\$1,157	\$1,540	\$383
3,074	511,270	5,018	5,113	95
3,298	835,791	8,256	8,358	102
2,749	503,883	4,964	5,039	75
2,867	694,037	6,852	6,940	88
3,376	614,830	6,040	6,148	108
3,066	397,928	3,888	3,979	91
2,620	296,386	2,883	2,964	81
3,021	456,625	4,489	4,566	77
2,654	431,942	4,233	4,319	86
1,977	265,466	2,595	2,655	60
2,644	288,010	2,811	2,880	69
\$33,036	\$5,450,130	\$53,186	\$54,501	\$1,315
\$2,347	\$268,595	\$2,615	\$2,686	\$71
2,415	451,337	4,441	4,513	72
3,259	797,133	7,863	7,971	108
2,406	520,118	13	5,201	5,188
1,627	636,237	11,405	6,362	(5,043)
4,238	600,980	5,947	6,010	63
2,784	408,554	4,003	4,086	83
(107)	112,241	1,161	1,123	(38)
\$18,969	\$3,795,195	\$37,448	\$37,952	\$504
\$52,005	\$9,245,325	\$90,634	\$92,453	\$1,819

^aVending fees were not included in Dining Service gross profit as reported to the Architect of the Capitol for August 1991. Therefore, vending cost of goods sold was not computed on this schedule.

Computation of the Additional Amount Service America Would Owe the Government for Vending Services Under Two Different Views

Year (1)	Vending revenue (2)	Vending cost of goods sold (3)	Vending gross profit (column 2-3) (4)	Dining Service (DS) gross profit (5)	Vending commissions reported by dining division (6)	Consolidated gross profit (GP) (columns [4+5]-6) (7)
<u>1987</u>						
Total 1987	\$280,732	\$120,882	\$159,850	\$5,350,632	\$44,428	\$5,466,054
<u>1988</u>						
Total 1988	213,386	89,632	123,754	5,139,756	29,874	5,233,636
<u>1989</u>						
Total 1989	207,629	93,266	114,362	5,552,825	29,068	5,638,119
Total contract	\$701,747	\$303,780	\$397,966	\$16,043,213	\$103,370	\$16,337,809

**Appendix III
Computation of the Additional Amount
Service America Would Owe the
Government for Vending Services Under
Two Different Views**

Gross-profit method			Vending agreement method				
Adjusted 1% on GP (column 7 @ 1%) (8)	Original 1% paid (9)	Difference over (under) paid (column 8-9) (10)	Commission per vending agreement ^a (11)	Adjusted 1% calculation on DS group (column 5-6 @ 1%) (12)	Original 1% paid (13)	Difference over (under) paid (column 13-12) (14)	Owed per vending agreement method (column 11-14) (15)
\$54,661	\$53,431	\$1,230	\$65,972	\$53,062	\$53,431	\$369	\$65,603
52,336	51,397	939	39,476	51,099	51,397	298	39,178
56,381	55,460	921	38,411	55,238	55,460	222	38,189
\$163,378	\$160,288	\$3,090	\$143,859	\$159,399	\$160,288	\$889	\$142,970

^aAs per the House Restaurant System's Agreement for Automatic Cafeteria services with the Macke Company, vending commissions were a percentage of monthly gross sales based on a specified annual rate retroactive to the first dollar of a specified annual sales amount as follows: (Note: The agreement, dated June 20, 1984, was for 2 years but was automatically renewable for similar 2-year periods unless either of the parties gave written notice of its intention to terminate the agreement.)

Annual sales	Annual percentage rate (Retroactive to first dollar)
\$0 - 200,000	17.00
\$200,001 - 230,000	18.50
\$230,001 - 260,000	21.25
\$260,001 - 290,000	23.50
\$290,001 and over	25.00

Therefore, under the terms of the agreement, the retroactive commission rate for 1987 would have been 23.50 percent on annual sales of \$280,732 and 18.50 percent for 1988 and 1989 on annual sales of \$213,386 and \$207,629, respectively.

Based on an internal notification from Service America's vending division (previously the Macke Company) to its dining division, the scaled rate was eliminated and a flat rate of 14 percent was established effective with the September 1987 accounting period. This change was made because the vending division had added more equipment and did not receive an increase in sales to provide the level of return on investment as projected under the agreement. The Architect of the Capitol was not informed of the change until January 9, 1989.

Comments From Service America Corporation

SERVICE AMERICA CORPORATION

100 First Stamford Place
P.O. Box 10203
Stamford, CT 06904-2203
(203) 964-5072

Dominic J. Santori
Corporate Vice President
Chief Financial Officer

December 22, 1993

Mr. Donald H. Chapin
Assistant Comptroller General
U.S. General Accounting Office
Accounting and Information Management Division
Washington, D.C. 20548

Dear Mr. Chapin:

This is in response to your letter to Mr. John Dee dated December 6, 1993, concerning the draft report issued by GAO related to its review of the House Restaurant System contract. A verbal extension of time to December 28, 1993, was approved by Mr. A. Whitsell from the GAO audit staff in order to prepare Service America Corporation's (SAC's) response to the draft audit report.

SAC representatives have reviewed the specific details in the draft report concerning the four major areas discussed. We would like to present the following comments regarding SAC's position:

Lost Earnings on Thrift Savings Plan

At the time SAC made the initial payment to OPM in October 1992, for the underpayment of CSRS and FERS contributions, we verbally agreed to also pay \$3,699.66 for the lost earnings calculated on the Thrift Savings Plan contributions. Subsequently, SAC filed for protection under Chapter XI of the United States Bankruptcy Code.

While SAC agrees with the calculation, it does not appear that a claim was filed in regard to this amount. SAC is unable to make payment since all debts were discharged as a result of SAC's plan of reorganization.

Under Withholding of CSRS and FERS Plan Deductions

This matter was not brought to SAC's attention until the time the audit review was performed by the GAO auditor and the amount was not determined until after the contract was terminated and the employees were no longer on SAC's payroll.

THE FOOD SERVICE MANAGEMENT PEOPLE

Appendix IV
Comments From Service America
Corporation

Mr. Donald H. Chapin
December 22, 1993
Page Two

Since the employees were actually paid correctly and SAC was unaware of the correct employee contribution rates for both plans, SAC does not agree that it has an obligation (page 12 of the draft report) to make this \$17,507.55 payment on behalf of the employees.

Because these employees are no longer employees of SAC, SAC would have no further recourse against them to collect the underdeductions from future payroll amounts, as was stated in October 1992, when the CSRS and FERS payments were made.

Accuracy of Vending Commission Payments

At the time the first contract was signed in January 1987, it was SAC's understanding that vending commissions would be reported through the Dining Services financial statements, even though the contract was not specific as to how the vending commissions would be reported. The second contract signed in January 1990, specifically included vending commissions in the new Dining Service agreement.

Financial statements were presented to the responsible employees in the Office of the Architect each month reflecting vending commissions as revenues in calculating the 1% of Gross Margin payment. No one questioned the discontinuance of the vending commission checks that were previously made as a separate payment.

The reporting of vending commissions in the Dining Services statements has been a standard practice of SAC for numerous other clients when it performs both vending and dining services.

SAC believes that since its statements were accepted each month and this matter was not brought to SAC's attention until the time of the GAO audit, SAC was accurately reporting the financial results and was also complying with the contract concerning payments due the Office of the Architect and the House Restaurant System.

Reporting of Vendor Discounts

The handling of vendor discounts was not specifically covered in either of the two contracts and was never discussed until the time of the GAO audit.

Standard SAC practice is to record these vendor discounts (generally based on total company volume purchases) at the corporate level and to not distribute the amount out to individual dining service locations.

The standard "2 % discount" mentioned in the draft report is not accurate and the total "Cost of Goods" mentioned on page 23 in the amount of \$5,646,309 would contain many items that

Appendix IV
Comments From Service America
Corporation

Mr. Donald H. Chapin
December 22, 1993
Page Three

were not subject to any vendor discount.

SAC does not agree that the 1% Gross Margin calculation was understated, since there was not a clear understanding that SAC was to change prior practices and allocate these small discount amounts out to the House Restaurant system dining units.

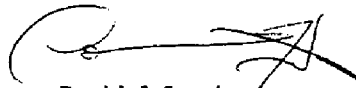
As was noted in the draft report, the maximum difference would have amounted to only \$1,129 over the entire four years and seven months of the contracts.

Handling of Accounts Receivable Payments

SAC agrees with the conclusions of the GAO auditor as described in the draft report. We have sufficient documentation to indicate that SAC worked in cooperation with the House Restaurant System to collect all unpaid balances that existed prior to and after the original contract signing of January 1987.

Please let me know if there is any further information required in order to bring this matter to a final conclusion.

Sincerely,



Dominic J. Sartori
Corporate Vice President
and Chief Financial Officer

DJS:mdm

c: Albert Turkus, Esq.
The Honorable George M. White

Comments From the Architect of the Capitol



Washington, DC 20515
December 21, 1993

**CERTIFIED MAIL-
RETURN RECEIPT REQUESTED**

United States General Accounting Office
Accounting and Information Management Division
Washington, D.C. 20548

Attention: Donald H. Chapin
Assistant Comptroller General

Gentlemen:

I have reference to the draft report submitted to Service America Corporation which was transmitted to us for comment by your letter dated December 6, 1993.

Of the four issues identified on the first two pages of the report, I will only comment on the second issue, the accuracy of fees paid the government covering vending services for the period January 3, 1987, through August 3, 1991; my office does not disagree with the report in any material respect regarding its treatment of the other three issues.

Furthermore, with respect to the second issue, this office agrees with the conclusion of the report stated on page 19 that the intent of the parties is critical to a determination of the appropriate vending fees to be paid during the period in question. Unfortunately, inasmuch as this office is unable to state what the intention was in 1986 when RFP 8654 was issued, in my judgment the fairest approach under the circumstances is to look to (1) the provisions of Contract ACho-86054, (2) the actions of the parties prior and subsequent to execution of the contract, and (3) the reasonableness of the Service America interpretation of the contract, to determine how much additional money is due and owing from them.

When my office was directed to contract for management of the House Restaurant System in 1986, we drafted a Request For Proposals for the services to be performed. Unfortunately, there was not a great deal of time available for drafting the RFP, and no one in this Agency can state with any degree of certainty at this time whether it was intended that the vending services then being provided to the House Restaurant System under a 1984 contract with a predecessor of Service America would be superseded by the contract that would result from the RFP. The RFP merely stated that vending services for the House Restaurants were currently being provided under two separate contracts, and it listed the fiscal performance of the vending contracts for several prior years.

Appendix V
Comments From the Architect of the Capitol

United States General Accounting Office
December 21, 1993
Page Two

Your report noted two competing views regarding the vending issue: one that contemplates the continuance of the 1984 vending agreement with two prior contracting parties, resulting in Service America owing \$142,970, and another that regards the 1986 contract as superseding the 1984 contract, resulting in Service America owing \$3,090. I would respectfully suggest a third view; one that more closely reflects the actual circumstances surrounding the issue. That view is that Service America treated the 1984 contract with its predecessor firm as analogous to a subcontract, with the vending commissions previously paid to the House Restaurant System, the prior manager of the operation, now paid to itself as part of its management fee. Such commissions, when added to Service America's gross profit, became the basis upon which it paid its 1% fee. The report noted this view with some suspicion, merging it with the second view "finding support more in Service America's practice during this period than in the 1986 contract's actual language . . ." The report went on to note "Service America acted as if the 1986 contract authorized its dining division to receive the vending commission payments from the vending division not merely as a conduit to be forwarded to the government without further reduction but, instead, as sales revenue to the dining division." (p. 34)

It is understandable that the report would take this approach since, to my knowledge, no one in the General Accounting Office looked at the proposal upon which award of the 1986 was based. Under the RFP, all offerors were required to submit a *pro forma* showing their proposed pricing structure. The Service America *pro forma*, which was incorporated in its proposal, indicated that commissions from the Tobacco Stand and from vending were to be treated as receipts which would be added to restaurant sales revenue to obtain the gross profit figure upon which the 1% fee was based. In fact, the commissions from the Tobacco Stand and vending were determinative in Service America being able to show an overall net gain on operations in their offer. Inasmuch as Service America's proposal, including the *pro forma*, was accepted by the government without taking exception to the manner in which vending commissions were proposed to be treated as receipts, both Service America and my office handled the vending issue in accordance with the contract. I am including herewith a copy of the *pro forma* that was accepted as a part of the Service America proposal as Attachment A.

I might note at this time that the matter was revisited in the 1989 contract, wherein Service America, in its best and final offer, proposed in writing to treat vending services as a subcontract, with all prior vending agreements superseded. Acceptance of the best and final offer thus, in effect, exercised the prior questions regarding vending, ratified the manner in which vending had been treated in the 1986 contract, and shows that neither party had contemplated that the 1984 agreements had been superseded by the 1986 contract. I am including a copy of the referenced letter dated December 13, 1989 as Attachment B.

See comment 1.

See comment 1.

Appendix V
Comments From the Architect of the Capitol

United States General Accounting Office
December 21, 1993
Page Three

With respect to the appropriate interpretation of the terms of the 1986 contract, the *pro forma* notwithstanding, in my judgment the Contractor could reasonably have concluded that the 1986 contract for management services incorporated the earlier agreement between its predecessor and the House Restaurant System, to the extent that the commission from vending sales would be added to its restaurant sales, upon which it was required to pay a 1% commission.

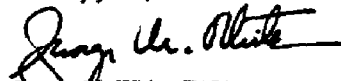
Had this office taken the position during performance of the 1986 contract that we were owed the actual vending commissions under the 1984 contract, or that vending services were not required under the contract, it is likely that the Contractor would have availed himself of the Disputes provisions of the contract, and prevailed, either on the basis that vending was included in the contract by the terms of its offer, or on the basis of the doctrine of *contra proferentem*. The ambiguity could be found in the definition of net sales, and from the fact that the RFP included "Vending Machine Commissions" in Subsection 3.01.5, which provided operating financial details for Fiscal Years 1980 - 1986. The only logical reason for including such information in the RFP was to provide offerors a basis for preparing their offers, which would give rise to the conclusion that the vending commissions were to be added to restaurant sales to form the basis for the 1% payment.

Finally, I agree with the conclusion of the report that nothing in the 1986 contract permitted Service America to unilaterally reduce the commission rates payable from one division to another from 17% to 14%.

In view of the foregoing, I believe that the "third view" expressed hereinabove should prevail with respect to vending sales under the 1986 contract, and that Service America should pay the government an additional \$3,090.00, adjusted upwards by the difference between the 17% commission rate and the 14% commission rate.

I trust this is responsive to your letter. Should the General Accounting Office have any additional questions I will, of course, be pleased to respond further.

Sincerely yours,



George M. White, FAIA
Architect of the Capitol

Attachments A and B

GAO Comments

1. We did not include the attachments to the Architect of the Capitol's December 21, 1993, letter.

Major Contributors to This Report

Accounting and
Information
Management Division,
Washington, D.C.

Arley R. Whitsell, Assistant Director

Office of the General
Counsel

Jeffrey Jacobson, Assistant General Counsel
Richard Cambosos, Senior Attorney



Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

**U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015**

or visit:

**Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC**

**Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.**

