

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL

STATEMENT OF THE HONORABLE PHYLLIS K. FONG
INSPECTOR GENERAL

Before the
Subcommittee on Contracting Oversight
Senate Homeland Security and Governmental Affairs Committee

October 5, 2011



Good afternoon, Chairman McCaskill, Ranking Member Portman, and Members of the Subcommittee. Thank you for the opportunity to testify about the Office of Inspector General's (OIG) work to help improve the Food and Nutrition Service's (FNS) oversight of State agencies and local school food authorities (SFAs) that contract with food service management companies to provide meals for the National School Lunch Program (NSLP) and the School Breakfast Program.¹ As both our audit and investigative work demonstrate, USDA and its agencies must remain vigilant in their oversight of companies that provide food to the public under the auspices of Federal programs.

I will begin my testimony with a brief summary of OIG's mission and the work we do. Then, I will outline how FNS administers NSLP before discussing our completed and planned work in support of enhancing FNS' oversight of food service management companies.

OIG's Mission

OIG's mission is to promote the economy, efficiency, and effectiveness of USDA programs and operations by performing audits and investigations to reduce fraud, waste, and abuse. The Inspector General (IG) Act of 1978 established a dual reporting responsibility, whereby IGs report both to the head of their respective agencies and to Congress.² This unique reporting relationship protects OIGs' independence and objectivity as we conduct our oversight responsibilities.

USDA OIG conducts audits designed to ascertain if a program is functioning as intended, if program payments are reaching those they are intended to reach, and if funds are achieving their

¹ For simplicity and for the purposes of this statement, references to "NSLP" will generally include the School Breakfast Program.

² 5 U.S.C. app. 3, §§ 1-13.

intended purpose. When we find problems with the programs we assess, we make recommendations we believe will help the agency better fulfill its mission. We do not have programmatic or operating authority over agencies or programs; instead, agencies are responsible for implementing our recommended corrective actions. We also conduct investigations of individuals and entities that are suspected of abusing USDA programs—these investigations can result in fines and imprisonment for those convicted of wrongdoing in addition to agency disciplinary actions for USDA employees found to have engaged in misconduct.

NSLP Overview

FNS uses a multi-layered approach to reimburse States that provide meals to children under NSLP. Typically, FNS enters into written agreements with State agencies, such as education departments, to administer NSLP. These agencies, in turn, enter into agreements with SFAs to deliver the program at the local level, such as at schools within a district. SFAs can either manage the program themselves—buying and serving food—or they can contract with food service management companies to provide meals. Federal funds flow from FNS to State agencies, which reimburse SFAs based on the number of meals claimed. OIG does not provide day-to-day oversight of FNS, State agency, SFA, or food service management company interactions or administration of NSLP. Instead, to ensure program compliance, each NSLP administrative level maintains oversight of the next.

In general, USDA regulations require food service management companies to pass savings and applicable credits along to the SFAs with which they contract. These contracts can either be fixed-rate or cost-reimbursable. In a fixed-rate contract, a management company charges a flat rate for the meals served and must credit the SFA for the full value of any food USDA has

donated.³ In a cost-reimbursable contract, a management company purchases and serves food for an SFA and must submit invoices for payment; in this case, the company must pass along any purchase discounts and rebates it receives.⁴ Regardless of the type of contract, an SFA's share of Federal funds is based on the number of meals claimed.

In fiscal year 2010, approximately 43 million children participated in NSLP and the School Breakfast Program, which together served an estimated 7.2 billion meals in 14,000 school districts, with disbursements totaling approximately \$12.5 billion in Federal funds.

Related OIG Audits

In 2002, OIG completed an audit of 8 food service management companies contracting with 65 SFAs in 7 States.⁵ We determined that over half of the companies (5 of 8) improperly retained \$6 million in cost savings that should have been passed on to the SFAs with which they contracted. Management companies with fixed-rate contracts received a total of \$5.8 million in USDA-donated food but did not credit this amount to their SFAs. This occurred both because FNS requirements for companies crediting SFAs with the value of donated food were not clear, and because some companies revised their contracts to retain savings that should have accrued to the SFAs with which they contracted. The remaining \$280,000 involved management companies with cost-reimbursable contracts. Although the bid solicitations for the food service work (i.e., requests for proposal) required that rebates, credits, and discounts be passed along to

³ 7 C.F.R. § 210.16(a)(6).

⁴ 7 C.F.R. § 210.21(f)(1)(i).

⁵ The States were Illinois, Michigan, Missouri, New Jersey, New Mexico, South Carolina, and Washington. We selected six of the States because they had either the highest number of food service management company contracts, or the highest percentage of SFAs using such companies. We reviewed the seventh State (Illinois) as part of a joint effort between our audit and investigation groups. *Food and Nutrition Service National School Lunch Program, Food Service Management Companies* (27601-0027-CH, April 2002).

the SFAs, the companies that won the bids either modified their contracts to amend or eliminate the requirement, or they ignored it.

In 2005, we followed up with an audit of one of the management companies that had cost-reimbursable contracts with 298 SFAs in 22 States.⁶ We found the company had violated its contracts with 106 of the SFAs in 8 States by not crediting them with varying amounts of discounts, rebates, and other cost savings it had received, totaling \$1.3 million.⁷ The eight State agencies did not enforce the contracts and company officials claimed that keeping these savings allowed them to lower overall prices. However, when we compared its prices to another food service management company's (which had also bid for the contracts), we found that it charged significantly more for 29 of 35 identical items we reviewed. Even though the company kept its cost savings, it still charged SFAs more for food than the other company would have.

Overall, our 2002 and 2005 audits recommended that FNS should establish specific contract terms for State agencies and SFAs to use when contracting with food service management companies. The terms would ensure that SFAs benefited from the value of food donated by USDA (in fixed-rate contracts) and any discounts or rebates that companies received (in cost-reimbursable contracts). We also recommended that FNS amend its regulations and guidance to require these specific contract terms, that State agencies approve contracts prior to their SFAs signing them, and that State agencies require SFAs to enforce contract provisions. In 2007, FNS

⁶ The States were Arizona, California, Connecticut, Florida, Idaho, Kansas, Massachusetts, Michigan, Minnesota, Missouri, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Washington, and Wisconsin. We selected them because the company's contracts with SFAs in these States provided for discounts and other savings to accrue to the company. *Food and Nutrition Service National School Lunch Program Cost-Reimbursable Contracts with a Food Service Management Company* (27601-15-KC, December 2005).

⁷ The States were Arizona, Connecticut, Michigan, Minnesota, Missouri, Rhode Island, South Carolina, and Washington.

revised its regulations accordingly and, in 2009, FNS issued updated guidance to State agencies and SFAs.

However, the issue of food service management companies improperly retaining savings that should be passed on to SFAs continues to be a concern. In July 2010, after an investigation by the State of New York's Attorney General, a company agreed to a \$20 million settlement to resolve a lawsuit after it fraudulently retained discounts and rebates. The settlement prompted a Member of the United States House of Representatives to request of the Secretary of Agriculture that an audit be conducted to determine if this practice was happening in other school districts nationwide.

Accordingly, OIG is initiating an audit this month (October 2011) to assess the effectiveness of corrective actions implemented by FNS and State agencies in response to our previous recommendations. We will also determine if food service management companies with cost-reimbursable contracts are passing discounts and savings along to SFAs. We plan to examine a sample of SFAs' cost-reimbursable contracts with food service management companies nationwide for fiscal years 2010 and 2011.

Related OIG Investigations

OIG investigations have demonstrated that the issue of food service management companies' business practices extends beyond the practice of keeping savings owed to SFAs. For example, in 2003, one of our investigations showed that a food service management company in Greenwich, Connecticut, overcharged school districts and other customers over \$8 million for costs it never incurred. The company admitted that it had inflated invoices and made false claims to the Government. In December 2008, in the U.S. District Court for the Southern

District of New York, the company agreed to pay over \$3.5 million to the Government and to reimburse the school district nearly \$8.5 million.

Other types of food companies, such as suppliers, have also been subject to our investigations for conspiring to sell or transport food illegally. For example, our investigations helped disclose that the owner and employees of a food company in Houston, Texas, forged export certificates to send food past its expiration date to Middle Eastern companies, including some that supplied U.S. troops.⁸ The owner was charged with conspiracy to defraud the Government through false claims. In November 2010, the company and its owner entered into a settlement agreement with the U.S. Attorney's Office for \$15 million. In December 2010, the Federal Court for the Southern District of Texas sentenced the company's owner to serve 2 years in jail and to pay a \$100,000 fine. In April 2010, a former purchasing agent for the company was sentenced to serve 3 years' probation and to pay, with the owner, over \$2 million in restitution.

Conclusion

In summary, OIG's audit and investigative work has sought to enhance FNS oversight of food companies participating in NSLP, and to help ensure that Federal funds intended to provide nutritious meals are used for that purpose. OIG is committed to strengthening USDA and its agencies' controls over such companies in order to better safeguard both Federal funds and NSLP objectives.

This concludes my testimony. Thank you again for inviting me to testify before the Subcommittee, and I would be pleased to address any questions you may have.

⁸ International health certificates for exported food and plant products originating from the United States are issued by USDA's Animal and Plant Health Inspection Service (APHIS) and must be completed by accredited veterinarians. The export certificates help APHIS facilitate safe trade; monitor the movement of risk material; protect against the introduction of pests and disease; regulate the import and export of plant and animal products; and provide exporters with an understanding of import countries' requirements.