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National School Lunch Program – Food Service Management Company Contracts

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TO: Audrey Rowe
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SUBJECT: National School Lunch Program—Food Service Management Company Contracts

This report presents the results of the subject audit. Your written response to the official draft report, dated December 14, 2012, is included in its entirety at the end of this report. Excerpts from your response and the Office of Inspector General's position are incorporated into the relevant sections of the report.

Based on your agency's written response, we are able to accept management decision on Recommendations 1, 3, 5, 6, 9, 12, 13, and 15. We can accept the Food and Nutrition Service's (FNS) management decision on Recommendations 2, 4, 7, 8, 10, 11, and 14 once we have been provided with the information as outlined in the report sections' OIG Position.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendations for which management decisions have not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions.

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National School Lunch Program – Food Service Management Company Contracts

Executive Summary

The National School Lunch Program (NSLP) was established to safeguard the health and well-being of our nation's children and to encourage the domestic consumption of agricultural commodities. The Food and Nutrition Service (FNS) administers NSLP in conjunction with designated State agencies. In fiscal year (FY) 2011, approximately 31 million children participated each day in NSLP and the School Breakfast Program, bringing the total disbursements to approximately $11 billion.[1] The U.S. Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Contracting Oversight requested that the Secretary of Agriculture conduct an audit of NSLP food service management company (FSMC) contracts. In response to the Secretary's request, our audit reviewed FNS' controls over State agencies and school food authorities (SFAs) that contracted with FSMCs for school year (SY) 2011.

SFAs can use two types of contracts to govern their relationship with FSMCs. In a fixed-price-per-meal contract, the FSMC charges a flat rate for each meal served and must credit the SFA for the full value of any food the Department of Agriculture (USDA) has donated. In a cost-reimbursable contract, the FSMC purchases and serves food for an SFA and submits invoices for payment; in this case, the company must pass along any purchase discounts and rebates it received for those purchases. Specifically, we assessed whether SFAs that contracted with an FSMC using a cost-reimbursable type contract received all purchase discounts and rebates the FSMCs obtained on their behalf, and those that used a fixed-price-per-meal type contract received the full benefit and value of all USDA-donated foods received.

While FNS has implemented several controls to ensure that NSLP funds and USDA-donated foods are used to benefit the program, with full credit being given for donated foods, it has not taken sufficient steps to ensure that those controls are followed.[2] Our review of the 18 SFAs showed that FNS did not exercise sufficient management oversight to ensure that SFAs received the full benefits of purchase discounts and rebates and other applicable credits (hereafter referred to as rebates), and the value of USDA-donated foods.[3] We identified significant issues at 11 of the 18 SFAs, which did not have sufficient controls in place to monitor FSMC contracts and school food service operations. Although FNS regulations list the SFA as the responsible entity, with State agency oversight, for ensuring compliance with NSLP requirements, we found that the majority of SFAs we reviewed did little or no monitoring of FSMC operations or their compliance with contract terms. FNS was not aware of the SFAs' inadequate monitoring because it did not require its regional officials to assess the State agencies' oversight of, or the

[1] References in this report to the National School Lunch Program also include the School Breakfast Program.
[2] While FNS did review State agencies' oversight of their SFAs for meal claims and nutrition, those reviews did not include an assessment of how the State agencies monitored the SFAs' compliance with FSMC contract provisions and operations
[3] We judgmentally selected 18 SFAs across 3 States, each covered by a different FNS region, that represented different-sized SFAs and FSMCs to assess FNS, State agency, and SFA oversight of FSMC contracts and operations.

SFAs' compliance with, NSLP requirements or contract terms. FNS stated that it took this approach because it believed that States and SFAs were in the best position to determine what kind of oversight steps they should perform. As a result, we questioned almost $1.7 million in unallowable FSMC charges and in USDA-donated foods that could not be accounted for. These questionable costs emerged from three separate areas, as described in our findings.

For purchase rebates, we found that 9 of the 12 SFAs in our review with cost-reimbursable contracts did not ensure that the FSMCs the SFAs contracted with provided sufficient rebates for purchases made on the SFAs behalf, as required by regulation and the signed contracts. Although the FSMCs did provide the SFAs with nearly $1 million in cost reductions for NSLP purchases, SFA officials were either unaware that they were entitled to the rebates or did not verify that they had received all rebates due to them. FNS officials stated that they believed the regulations implied that SFAs were responsible for periodically reviewing their cost reduction rebates from FSMCs. However, FNS neither clearly communicated this expectation either to the State agencies or to the SFAs, nor provided specific instructions to SFAs on how to most effectively monitor and track such rebates. As a result, we found that seven SFAs could not provide any assurance that they received the full amount of purchase rebates to which they were entitled for SY 2011. Also, we found two SFAs who were not aware of their FSMC's use of estimates to calculate purchase rebates, and therefore were underpaid by $1,400 during SY 2010.

For USDA-donated foods, we found that an additional two SFAs (and three of the nine SFAs mentioned above) did not properly track and account for the USDA-donated foods they received during SY 2011. While FNS required SFAs to record and track the use of donated foods, SFA officials generally passed their responsibility to the FSMCs. FNS officials were not aware of this because the agency listed the tracking of USDA-donated food as an optional item to be examined during its management evaluation reviews.[4] The agency also did not require State agencies to monitor how SFAs accounted for donated foods. In total, the five SFAs and the three FSMCs they contracted with could neither account for approximately $480,000 worth of USDA-donated foods nor demonstrate that they fully credited the SFAs for the food.

Finally, FNS allowed one State agency to implement a FSMC contract for nearly 200 SFAs that was neither a cost-reimbursable nor a fixed-price-per-meal type contract, which are the only two types of contracts authorized in the regulation. We also found that the use of this contract led to confusion on how to implement its unique contract provisions. Although FNS officials stated that they expressed their concerns to State agency officials about the unique contract provisions, FNS did not conduct any type of followup review after the contract was implemented Statewide.[5] FNS officials stated that it was not within their authority to actually approve or disapprove a State's contract. Though they were aware of some issues with the contract, they did not take any action to prevent the State agency from using it. We also found that neither the State agency nor the SFAs effectively monitored the FSMCs' compliance with the unique provisions of this contract. Based on the three FSMCs' failure to follow one of these provisions in that contract,

[4] FNS issues annual guidance to its regions for the management evaluation reviews performed of a State agency's administration of the NSLP, which includes a list of mandatory and suggested program areas and whether the State agency has implemented steps to ensure that SFAs are in compliance with program regulations.
[5] The last FNS management evaluation review performed of this State agency was in FY 2006.

we determined that the five SFAs we reviewed using this contract paid those FSMCs about $1.2 million in excess program costs during SYs 2009 through 2011.

During our review, we encountered a scope limitation that delayed and ultimately prevented us from reaching a conclusion on whether FSMCs provided all purchase rebates owed to the SFAs.[6] FSMCs and distributors caused many delays while providing us documents on critical elements of our audit objectives. For instance, it took over 100 days for one FSMC and one vendor to provide information on the total purchases made and rebates received between them. Once we received this information, we were still unable to reconcile the totals from both companies or arrive at any supportable conclusion. In addition, some FSMC documents we did receive contained inconsistent data, which led us to question their reliability—particularly the accuracy of information related to purchase rebates. We decided that completing a full analysis, as intended in the current audit, would unnecessarily delay the issuance of our report, and would also prevent us from timely recommending corrective actions to prevent the ongoing misuse of NSLP funds. The recommendations in this report are intended to assure, at a minimum, that SFAs are aware that they are to receive purchase rebates, and that they need to monitor those FSMC invoice reductions. We plan to perform additional work regarding purchase rebates and expect to issue any findings and conclusions in a separate report.

Recommendation Summary

We recommend that FNS work with one State agency and its SFAs to determine if the $1.2 million paid to three FSMCs represents unallowable program costs and should be recovered. FNS also needs to work with the State agencies to determine whether the approximately $480,000 in unaccounted for USDA-donated foods was fully credited to the SFAs' school food service. Overall, since many of the issues we identified went undetected by FNS and State agencies, FNS should evaluate its overall management evaluation process and oversight system to determine if alternative structures would better serve programs and make better use of limited resources. We also recommend that FNS enhance its NSLP management oversight by establishing a working group to provide recommendations to improve controls over SFAs that contract with FSMCs. FNS needs to improve its monitoring of SFA oversight for FSMC purchase rebates, and require State agencies to ensure that SFAs are tracking and monitoring the use of USDA-donated foods by FSMCs. Finally, we recommend that FNS work with State agencies nationwide to improve their contracts and ensure that State agencies and SFAs can properly monitor them.

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[6] The *United States Senate Committee on Homeland Security and Governmental Affairs,* issued a letter report to the Office of Management and Budget on December 4, 2012, reporting their concerns related to government food service contractors. The report identified the lack of transparency between Federal agencies and contractors which results in the difficulty to provide effective oversight of food service contracts and assurance that all purchase rebates and allowances are returned when required.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials supported our objectives of ensuring that SFAs receive full credit for purchase rebates and for USDA-donated foods used by the FSMCs. FNS officials also concurred with the need for continuous improvement in the agency's management evaluation process to identify areas that can be strengthened. They stated that FNS would implement additional policy guidance and training to further strengthen oversight activities. However, FNS officials expressed their concern that the audit report does not fully represent the significant actions FNS has taken to provide management oversight and guidance to States and SFAs regarding FSMC contracts.

OIG Position

While we recognize that FNS took significant actions to require that all costs to the program be net of applicable purchase rebates, and that the full value of all USDA-donated foods be credited to the SFAs, we found that FNS' current guidance and oversight did not fully address the issues we identified in our report. Based on FNS' response, we accept management decisions for Recommendations 1, 3, 5, 6, 9, 12, 13, and 15. Management decisions can be reached for Recommendations 2, 4, 7, 8, 10, 11, and 14 once FNS has provided us with the additional information outlined in the applicable report sections' OIG Position.

Background and Objectives

Background

The National School Lunch Act (42 U.S. Code 1751, *et seq.*) authorized and established the National School Lunch Program (NSLP) to safeguard the health and well-being of the Nation's children and encourage the domestic consumption of agricultural commodities. The Food and Nutrition Service (FNS), an agency of the Department of Agriculture (USDA), administers NSLP and provides oversight through its seven regional offices. FNS provides Federal assistance in cash, through meal reimbursements, and USDA-donated commodities to State agencies and local School Food Authorities (SFA) by entering into written agreements with a State agency, usually a State's Educational Agency, which administers the program Statewide.

FNS regional offices and State agencies are required to perform periodic program oversight through monitoring reviews and to assist SFAs in their operation of NSLP at the local level. FNS regional offices conduct periodic reviews, called management evaluations, of each State agency. State agencies, in turn, perform reviews, called the Coordinated Review Effort, of each SFA at least once every 5 years.[7] Federal regulations permit SFAs to contract with Food Service Management Companies (FSMCs) to manage their school food service operations. Although FSMCs can provide daily administration of the food service operations, SFAs that contract with FSMCs still retain the responsibility of ensuring that food operations comply with Federal regulations.[8] Federal regulations[9] require State agencies, as part of their monitoring responsibilities, to annually review each SFA and FSMC contract before it is signed, to ensure compliance with Federal requirements.

An SFA that contracts for its food service operations solicits bids from FSMCs by issuing either a request for proposal (RFP) or an invitation for bid (IFB) that details the contract requirements. The resulting contracts between an SFA and FSMC can be either cost-reimbursable or fixed-price-per-meal. In a cost-reimbursable contract, the FSMC submits monthly invoices to the SFA for all purchases it made on the SFA's behalf to operate the school food service. Under a cost-reimbursable type contract, any purchase discounts and rebates (hereafter referred to as rebates) that an FSMC receives reduce the cost of goods purchased and thus must be passed through to the SFA in order to reflect the actual cost of preparing the meals. In a fixed-price-per-meal type contract, the FSMC charges a flat rate for each meal served. Any USDA-donated commodities that are used in preparing the SFA's meals must be fully accounted for (under a cost-reimbursable type contract) or credited (under a fixed-price-per-meal type contract) to the SFA. The contract between an SFA and an FSMC is a major factor in assuring an SFA's food service

[7] The Coordinated Review Effort is a comprehensive on-site evaluation State agencies are required to perform of all of their SFAs, at least once every 5 years. FNS regulations identify two critical areas (meal claiming and meal elements) that are required to be reviewed, but allows each State agency the flexibility to include additional areas of review, based on its own determinations.
[8] Title 7, Code of Federal Regulations (CFR), Subchapter A, Section 210.21(b).
[9] 7 CFR 210.19(a)(6).

operation meets NSLP requirements and must be procured following Federal regulations regarding grantees.[10]

Following the issuance of several Office of Inspector General (OIG) audits relating to SFA and FSMC contracts, the crediting of purchase rebates and USDA-donated foods, and monitoring issues, FNS updated its regulations starting in 2007 and issued revised guidance[11] in 2009 for State agencies and SFAs. FNS took these actions, in part, to ensure that SFAs received the full benefit and value of all USDA-donated food received for use in the SFAs' meal service. For fixed-price-per-meal type contracts, the value of those USDA-donated foods is usually shown as a reduction on an FSMC's invoice. For cost-reimbursable type contracts, the amount of USDA-donated food used for the SFA's school food service is identified on the FSMC's operating statements provided to the SFAs. FNS also changed its requirements for cost-reimbursable type contracts, mandating that they must contain a provision that clearly requires that all costs to the program be net of applicable purchase rebates.[12] Furthermore, FSMCs are required to provide sufficient information to permit the SFA to identify allowable and unallowable costs and the amount of all such purchase rebates on invoices and bills presented for payment to the SFA.[13]

In July 2010, following an investigation by the New York Attorney General, a large FSMC settled for $20 million with the State of New York and 21 of its school districts for improperly withholding purchase rebates under cost-reimbursable contracts. As a result of the investigation and settlement, the U.S. Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Contracting Oversight requested that the Secretary of Agriculture conduct a broader audit on the topic. Later that same year, internal auditors of an Ohio SFA claimed that an FSMC did not credit the value of USDA-donated foods under a fixed-price-per-meal type contract back to the SFA. We conducted this audit in response to the Congressional request to the Secretary for a review of cost-reimbursable type contracts. We subsequently expanded the audit to include fixed-price-per-meal type contracts, based on the issues that were raised in Ohio.

Objectives

The objectives of the audit were to (1) assess the effectiveness of any controls implemented by FNS and selected State agencies as a result of our previous audits, (2) determine whether SFAs that signed fixed-price-per-meal contracts are receiving the full benefit and value of all donated foods provided to FSMCs, and (3) determine whether SFAs that signed cost-reimbursable contracts with FSMCs are receiving all purchase rebates.

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[10] 7 CFR 3016.36 and 7 CFR 210.21(b).

[11] *Guidance for State Agencies-Contracting with Food Service Management Companies*, January, 2009, and *Guidance for School Food Authorities-Contracting with Food Service Management Companies*, April 2009.

[12] 7 CFR 210.21 (f)(1)(i).

[13] 7 CFR 210.21 (f)(1)(ii)(A) and (iv).

FNS Oversight and Controls for SFAs and FSMC Contracts

Finding 1: FNS Needs to Enhance Its Management Oversight and Controls of SFAs That Contract with FSMCs

Our review of 18 SFAs showed that FNS did not exercise sufficient management oversight to ensure that SFAs received the full benefits of purchase rebates and USDA-donated foods. We identified significant issues at 11 of the 18 SFAs, which did not have sufficient controls in place to monitor FSMC contracts and school food service operations. Although SFAs are responsible, with State agency oversight, for contracting with FSMCs and monitoring their operations and their compliance with contract terms, FNS is responsible for ensuring that State agencies and SFAs execute those responsibilities. However, FNS was not aware of the significant issues we identified because it did not require its regional officials to assess State agencies' oversight of their SFAs' compliance with NSLP requirements or contract terms. FNS stated that it took this approach because it believed that States and SFAs were in the best position to determine what kind of oversight steps they should perform. Therefore, FNS did not require training on how to implement any of its rules or guidance, and did not conduct reviews to ensure that State agencies and SFAs adequately monitored FSMC compliance. As a result, we questioned almost $1.7 million in unallowable FSMC charges and in USDA-donated foods that could not be accounted for. Specifically, FNS allowed one State agency to implement a confusing FSMC contract with 187 SFAs. This contract had unique and unclear provisions that resulted in over $1.2 million in unallowable costs at the 5 SFAs we reviewed (see Finding 4). At the local level, nine SFAs could not provide any assurance that they received full credit for rebates, as required, for FSMC purchases made on their behalf (see Finding 2). Two additional SFAs (and three of the nine mentioned above) could not account for approximately $480,000 in USDA-donated foods (see Finding 3).

The Government Accountability Office (GAO) established five goals for internal control standards in Federal programs, which call for government agencies to establish adequate controls[14] that include (1) the Overall Control Environment; (2) Risk Assessments; (3) Control Mechanisms; (4) Communications; and (5) Performance Monitoring. We determined that FNS did not adequately address the five GAO goals, as described below.

Overall Control Environment: OIG issued several audit reports since 2001 that identified FSMC contracting and operations as a key program aspect requiring enhanced monitoring and review.[15] In response to our audit recommendations, FNS amended regulations, issued new rules, and implemented new contract provisions to ensure that FSMCs provided sufficient program cost reductions for purchase rebates and the value of USDA-donated foods to the SFAs. However, FNS did not implement sufficient monitoring to ensure that the new rules and guidance were being followed. For instance, during its annual management evaluation process—a key control measure for monitoring field-level operations—FNS allowed each regional office to determine

[14] GAO/AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government*, November 1999, and OMB Circular A-123, *Management's Responsibility for Internal Control*, December 2004.
[15] See exhibit B for the listing of past OIG audit reports.

whether it needed to assess its State agencies' monitoring of SFA and FSMC operations. Prior to FY 2012, FNS' management evaluations listed FSMC contracts and operations as an optional item to be reviewed. However, our previous audit work clearly demonstrated that FSMC purchase rebates and donated foods were a critical program aspect that needed more regular attention.

For instance, our 2002 report on this issue recommended that FNS ensure that its management evaluation guidance emphasize reviewing State agency and SFA oversight of FSMC operations. At that time, FNS responded that its guidance placed great emphasis on that area, and the agency would ensure that such emphasis continued. However, in 2010, FNS no longer required that its regional offices review State agency oversight of FSMC operations, but instead only recommended that they do so.[16] FNS officials stated that, even though regional officials were not explicitly required to review how State agencies monitor SFA and FSMC operations, the National office still expected them to do so, since this topic was well-covered at FNS conferences and in training. The three FNS regional offices we reviewed did not meet that expectation, and did not review FSMC operations in their management evaluation reports. This occurred because FNS National officials did not clearly communicate their expectations to their regional office staffs. FNS Headquarters officials agreed that oversight in this area needs to go beyond verifying that required provisions are present in contracts—which is currently the only element that FNS regional officials are required to review.

Risk Assessment: After our nationwide report in 2002, FNS implemented many key requirements that greatly reduced the risks associated with SFAs contracting with FSMCs. Once the initial actions were taken, FNS did not continue to assess these risks on an ongoing basis. For example, FNS implemented a web-based training tool, in part to help explain the SFAs' responsibilities in handling FSMC purchase rebates, but did not assess whether any SFA officials actually logged in to take the training. Had these assessments been performed, FNS might have detected the fact that no officials at any of the cited 18 SFAs had taken the training, or that they were still unsure about how to handle FSMC purchase rebates.

In our discussions with SFA officials about how they ensured credit for all purchase rebates, we received a variety of responses. While officials from three SFAs briefly reviewed every FSMC invoice to verify the purchase rebates, officials from two others stated that they were not even aware that they were supposed to be credited. They stated the FSMC, and not the SFA, was allowed to keep any purchase rebates it collected. These varied responses demonstrate an increased risk that FSMCs could improperly retain purchase rebates. FNS officials stated that discounts and rebates are just one of the many elements of the NSLP overall, and State agencies and SFAs face the ongoing challenge of ensuring that every aspect of the NSLP is monitored on a periodic basis. Without risk assessments, though, FNS cannot identify where and how to establish effective controls that would make the best use of those limited resources. FNS officials

[16] In FY 2010, FNS reviewed its management evaluation guidance and determined that, given its limited resources for conducting reviews, it could not require officials to review this program aspect.

agreed that using risk assessments or other types of data mining tools could potentially assist in targeting oversight action.

Control Mechanisms: FNS implemented a new web-based training tool in 2010 as a mechanism to inform State agencies and SFAs of program requirements, including the requirements relating to SFAs' use of FSMCs. However, we found that FNS did not require State agency and SFA officials to take the training, and a majority of those officials did not attend. For instance, out of three State agencies we reviewed, two reviewed only one of two training modules FNS developed. Although State agency officials were aware of the training tool, they found it too difficult to navigate and time consuming, and therefore opted not to use it. At the same time, none of the SFAs we reviewed took any portion of the training, or were aware that training even existed.

FNS officials did not make the training mandatory because that requirement would need to go through the regulatory clearance process, due to the potential burden placed on State agency and SFA staff. However, we found that FNS had not assessed the effectiveness of this key control mechanism to ensure that it was being used by the State and SFA officials that needed it. FNS officials stated that they were surprised by the low use of the training tool, and agreed that they should do more to publicize it.

Communication: FNS officials did not fully communicate with or perform proper oversight at one State agency that implemented a contract that governed the relationship between its SFAs and FSMCs. While FNS officials do not routinely review State agencies' FSMC contracts, they did so with this particular State's contract before it went into use for 187 SFAs Statewide. The contract was a combination of both fixed-price and cost-reimbursable type contracts. Its hybrid nature resulted from a State law that required procurement by sealed bids, for which Federal regulations require a fixed-price contract. FNS officials acknowledged the hybrid nature of the contract and informed State agency officials that the contract might lead to confusion at the SFA level. However, they did not prevent the State from using it or offer additional guidance to the State in monitoring the contract. The officials explained that they did not stop the State from using the contracts, and that regulations do not require FNS to officially approve FSMC contracts. Although FNS officials stated that they fully communicated their concerns to State agency officials, those officials stated that they would not have used their contract if FNS had rejected it. State officials said that the main reason they gave their contract to FNS to review was to ensure they were complying with NSLP requirements.

Performance Monitoring: Our review of FNS' web-based training tool found that it contained an explanation of program requirements, but did not include procedures, techniques, and methods (i.e., best practices) that State agencies and SFA officials could use to monitor program performance. FNS officials stated that they did not know of any industry-wide FSMC practices, or whether they could be useful for SFAs to monitor.

During our audit, we met with several private SFA and FSMC consultants that provided different procedures and techniques that SFAs could easily implement. For example, the industry consultants informed us that the amount of purchase rebates FSMCs receive from vendors generally falls within a certain range industry-wide. We identified two SFAs with a purchase rebate rate returned to them that was below the minimum percentage range for the industry, and subsequently determined that the FSMC was providing an estimated amount, instead of the actual amount of rebates received (see Finding 2). Monitoring such percentages would be an easy way for SFAs to determine whether they need to further investigate their FSMC purchase rebates by requesting supporting documents.

FNS officials questioned whether SFAs could perform in-depth contract monitoring, noting that State agencies and SFAs cannot obtain the breadth of information that was made available to OIG. However, the SFAs in our review that did monitor their rebate credits told us that they had no problems obtaining supporting documents from their FSMCs. Also, all SFAs receive monthly operating statements from their contracted FSMCs, which could, at a minimum, be used to determine whether the credits received in any particular month are in line with industry averages. We found that FNS already requires SFAs to monitor FSMC operations, but has not yet developed and provided those SFAs with the tools to use the information they already have so that the SFAs may obtain some assurance that rebates are being returned.

FNS officials explained that the new web-based training was developed to provide better guidance to State agencies and SFAs, but were surprised to learn that they were not taking the initiative to participate or were not aware the training was available. They agreed that they need to reassess their resources to provide better oversight of contracts between SFAs and FSMCs. We recommend that FNS create a working group to suggest strategies for improving State agency and SFA compliance with NSLP requirements. Also, FNS should improve its efforts to publicize the availability of the web training tool, and amend the existing training to incorporate specific strategies State agencies and SFAs can use in their oversight.

Overall, our audit identified weaknesses in FNS' management evaluation process, its key oversight activity for monitoring State agency, and, to a smaller degree, SFA-level operations. The management evaluation process occurs annually, and FNS selects State agencies based on a high risk indicator tool. State agencies that are not selected every 5 years are automatically selected. However, due to limited resources, the need to prioritize high-risk States, and other factors, some States go much longer without being evaluated. For instance, in one State where our audit found the largest problems with contracts and administrative oversight, FNS' last regional review occurred in FY 2006. The Attorney General in that State reached a $20 million settlement in 2010 with an FSMC accused of withholding credits for rebates from its SFAs.[17]

We believe that FNS needs to look at alternatives to its management evaluation process to be able to more frequently review a wide range of program areas, particularly areas that have been historically problematic. By implementing a meaningful plan of action to improve its control environment, FNS can improve accountability and have greater assurance that all levels of stakeholders are fully meeting their oversight responsibilities.

[17] Testimony Before the U.S. Senate Committee on Homeland Security and Government Affairs, Subcommittee on Contracting Oversight, October 2011.

Recommendation 1

Evaluate the management evaluation process, as well as State and field-level oversight activities, to determine if alternative structures would better serve programs and make better use of limited resources.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials stated that they will utilize a working group to evaluate the effectiveness of the management evaluation process in regards to FSMC contract oversight, and propose alternative methods to assess this operational area and make better use of limited resources. In addition, the working group will propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and regional office staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

OIG Position

We accept FNS' management decision.

Recommendation 2

Create a working group to re-assess the effectiveness of FNS' oversight, communication, and monitoring of SFAs that contract with FSMCs, and to develop recommendations for improving compliance with NSLP requirements. Develop a time-phased action plan, based on the working group's recommendations, to implement clear procedures for FNS regional staffs and State agencies to follow in performing program reviews of SFAs that contract with FSMCs.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to utilize a working group to evaluate the effectiveness of FNS' oversight, communication, and State agency monitoring of SFAs that contract with FSMCs using the management evaluation process, and propose alternative methods to assess this operational area and make better use of limited resources. In addition, the working group will propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and regional office staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

OIG Position

While we agree with FNS' response in establishing a working group to evaluate the effectiveness of oversight, communication, and State agency monitoring of SFAs that contract with FSMCs, the response did not state whether the proposed action plan would both be required and include the implementation of new procedures. In order to reach management decision, FNS needs to clarify that the agency will implement additional procedures for FNS regional and State agency officials to perform in their review of SFAs that contract with FSMCs.

Recommendation 3

Review and amend the web-based training tool to incorporate procedures, techniques, examples, and best practices that will assist State agencies and SFAs in providing better oversight of FSMC school food service operations.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to ensure that training materials incorporate procedures, techniques, examples and best practices to assist State agencies and SFAs in providing better oversight and monitoring of FSMC contracts. Specifically, FNS will add a new module to its existing Web-based procurement training providing technical assistance and guidance specifically related to the oversight and monitoring of FSMC contracts. FNS' estimated completion date for this action is July 1, 2013.

OIG Position

We accept FNS' management decision.

Recommendation 4

Determine the need to make FNS' web-based tool a requirement for State agencies and SFAs to review, and implement a process to track participation.

Agency Response

In the agency's response, dated December 14, 2012, FNS agreed to issue annual guidance to State agencies on the availability and need for completion of the web-based procurement training tool, and monitor its use to determine whether additional action is needed to ensure proper training. FNS plans to issue the additional guidance by July 1, 2013.

OIG Position

While we agree with FNS' issuance of annual guidance to State agencies and SFAs on the availability and need for completing the agency's web-based training, the response did not state whether the agency would make the recommended determination on whether State agency and SFA officials would be required to take the web-based training. In order to reach management decision, FNS needs to clarify whether such a determination will be part of its proposed corrective actions.

Recommendation 5

Establish a time-phased action plan to ensure that State agencies and SFAs are informed of the training and encouraged to use it as a resource in identifying their roles and responsibilities in contracting with an FSMC.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials stated that they will issue annual guidance to State agencies on the availability and need for completion of the web-based procurement training tool to assist them with identifying their roles and responsibilities in contracting with a FSMC. FNS estimates to complete this action by July 1, 2013.

OIG Position

We accept FNS' management decision.

Finding 2: FNS Needs to Improve Its Monitoring of SFAs' Oversight for FSMC Purchase Discounts and Rebates

OIG found that 9 of the 12 SFAs in our review with cost-reimbursable contracts did not ensure that the FSMCs they contracted with fully credited them for purchase rebates, as required. Although the FSMCs did provide the SFAs with nearly $1 million in cost reductions for purchase rebates, SFA officials were either unaware that they were entitled to those purchase rebates or did not verify that they had actually received all rebates due to them. This occurred because, although FNS officials stated that they believed the regulations implied that SFAs were responsible for periodically reviewing their cost reduction rebates from FSMCs, they had not clearly communicated this nor provided specific instructions to those SFAs on how to best monitor and track such rebates. As a result, we found that seven SFAs could not provide any assurance that they received the full amount of rebates they were entitled to for some $19 million in NSLP funds they received. At the same time, we encountered a scope limitation when requesting and reconciling purchase and rebate information from a vendor and an FSMC, and thus were unable to calculate whether any rebates were withheld in some cases. For officials at the remaining two SFAs, we found that they were not aware of their FSMC's use of estimates to calculate purchase rebates listed on the monthly invoices, and therefore were overcharged $1,400 in program purchases.

FNS requires that, for cost-reimbursable contracts, allowable costs that are paid to an FSMC must be net of all applicable rebates.[18] SFAs are required to actively monitor their contracts, and FSMCs are required to provide sufficient information to permit SFAs to verify that all rebates

[18] 7 CFR 210.21(f)(i).

received by the FSMC for purchases made on the SFA's behalf have been fully credited on each monthly invoice or operating statement.[19]

We noted similar issues in a 2002 OIG audit.[20] At that time, FNS did not require that FSMC contracts contain provisions to ensure that they passed along rebates to SFAs. Since FNS' implementation of our prior audit recommendations, FSMC contracts include a requirement that all invoiced costs be net of applicable rebates and other credits. FNS maintains that the regulations imply that SFAs must review supporting documentation to determine compliance with crediting for rebates. FNS also issued written guidance on the topic. However, the guidance did not provide enough information, such as examples of steps to take or types of documentation to request, for SFAs to practically carry out their monitoring duties.

All the FSMCs we sampled identified rebate amounts on their invoices to the SFAs. However, two SFAs did not have any process or procedure to track the rebates they received or request supporting documentation for purchase rebates. Officials at the two SFAs stated that they thought FSMCs, and not the SFA, were allowed to retain all purchase rebates, even though the signed contract clearly noted that all purchase rebates would be returned to the SFA. In both cases, SFA officials acknowledged that they had not read the contracts in their entirety, and thus were not aware of all of the contract provisions.

We found that five SFAs did keep track of the rebates they received from the FSMCs, but did not perform any type of analysis or review of supporting documentation to verify that they received all credits due. SFA officials stated that they did not implement a process because they were uncertain of how to monitor this aspect of the contract, and instead relied on the FSMCs to pass through the required rebates on monthly operating statements.

When examining one FSMC's records, used by three of these five SFAs, we encountered scope limitations. We attempted to substantiate the company's total rebate amounts by comparing the FSMC's purchases made and rebates received with the totals provided from one of its major vendors (which provided those rebates). Our analysis found that the FSMC's rebate totals were more than 30 percent lower than the rebate amounts reflected in the vendor's information, thus suggesting that the FSMC may have underestimated its rebate amounts. When we asked the FSMC to resolve the discrepancy, it provided us with updated numbers that included additional rebates that the vendor had taken into account but the FSMC's original totals had not. FSMC officials stated that they did not realize the scope of our request initially and hence did not include all rebates received from their vendor.[21] However, even the updated rebate numbers were still lower than those supplied by the vendor. Because subsequent data received from the FSMC were inconsistent, and also because the FSMC and vendor had significant delays (more than 100 days) in supplying us with the data, we decided to classify this as a scope limitation.

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[19] 7 CFR 210.21(f)(1)(ii)(A) and (B) and (iv).
[20] *Food and Nutrition Service National School Lunch Program Food Service Management Companies* (27601-0027-CH, April 2002).
[21] The FSMC also received allowances (another form of a rebate) for marketing and other incentives from its vendor that it omitted from the original totals provided to OIG.

Therefore, we were unable to determine whether the three SFAs were, in fact, getting the correct amounts of rebates.[22]

At the remaining two SFAs, officials were not aware that their FSMC provided them with rebates based on estimates, rather than the actual amounts.[23] While an FSMC is not prohibited from this practice, the SFAs never reconciled these estimates to the actual rebates the FSMC received. SFA officials stated that they noticed the credit amount for the rebates on the monthly operating statements, but did not request or review supporting documentation for the amount of rebates listed. Through discussion with an FSMC official, we determined that the FSMC did have information to accurately track and allocate the rebates to individual SFAs and could have provided the actual amounts owed the SFAs, but did not do so because SFA officials never requested that information. Since officials from both SFAs did not request or review supporting documentation, they were unaware that their contracted FSMC owed them an additional $1,400 of purchase rebates. Since the SFA paid the FSMC the gross purchase price, not reduced by the actual rebates the FSMC received, the $1,400 is considered to be an unallowable cost per NSLP regulation.[24]

As described in Finding 1, FNS did develop a web-based training program for State agency and SFA officials that explained the requirements for FSMC contracts and, particularly, that allowable program costs were to be net of all applicable rebates. Yet the training did not contain procedures, techniques, or methods that State agencies and SFA officials could use to monitor program performance. In addition, FNS officials were not certain whether they could require State agencies and SFAs to take the training, part of which would have at least informed SFAs that they were required to be credited for purchase rebates. We note that none of the nine SFAs in question took the training, and some officials we interviewed did not even know that the training was available.

When we discussed this with FNS officials, they agreed that SFAs need to do more to improve oversight of cost-reimbursable contracts. Yet they also maintained that FNS provides program direction, rather than specific methods of how SFAs should monitor their contractors. They believe that SFAs should establish practices that work best for them, given their available resources. While we agree that part of FNS' role is to provide overall program direction, SFAs told us that they do need further direction on how to carry out their oversight role. Based on our discussions with independent consultants for FSMCs and SFAs, we found that there are best practices available that are both simple and straightforward, such as comparing the percentage of rebates an SFA receives to the industry averages for such rebates. While such averages may not reflect the exact amount that any SFA is due from its FSMC, SFAs can easily use them to flag cases for additional followup when the rebates provided differ substantially from the averages.[25] Without training or guidance, however, many SFA officials are unaware that such methods are available.

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[22] We also note that one SFA that was not aware it was entitled to receive credits used the same FSMC that caused our scope delays.
[23] An FSMC official stated that they provided estimates due to delays in their receiving rebates from their vendors.
[24] 7 CFR 210.21(f)(1)(ii)(A) and (B).
[25] We used the industry averages to examine the rebate amounts provided by the FSMCs at the seven SFAs we selected for review. We did not find any substantial differences between the industry averages and the rebates they provided.

In conclusion, we believe FNS needs to clarify its guidance to State agencies and SFAs, so that they are aware of FNS' expectations, and provide them with specific examples of monitoring practices to prevent and detect credit underpayments from FSMCs.

Recommendation 6

Update guidance to clarify FNS' stated expectation that SFAs are required to periodically review FSMCs' supporting documentation for all purchase rebates received.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to issue an updated policy guidance memorandum to clarify FNS' stated expectation that SFAs are required to periodically review FSMCs' supporting documentation of all purchase rebates received. FNS plans to complete this action by January 31, 2013.

OIG Position

We accept FNS' management decision.

Recommendation 7

Instruct the State agency to assist two SFAs in recovering $1,400 in uncredited rebates from their contracted FSMC. Also, conduct a review of all SFAs that contracted with this FSMC to determine if other SFAs are owed additional purchase rebates.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials stated that they agreed with recovering any un-credited funds as appropriate according to Federal law and NSLP regulations. They stated they would confer with OIG prior to determining the appropriate action to take. They plan to complete these actions by August 1, 2013.

OIG Position

In order to reach management decision for this recommendation, FNS officials need to clarify whether they plan to instruct the State agency to (1) assist their SFAs to recover the $1,400 in un-credited rebates, and (2) review of all SFAs that contracted with this FSMC to determine if other SFAs are owed additional purchase rebates.

Finding 3: FNS Did Not Ensure Full Credit Was Given for USDA-Donated Foods

We found that two SFAs (and three of the nine SFAs mentioned in Finding 2) did not properly track and account for the USDA-donated foods they received during SY 2011. While FNS required SFAs to record and track the use of donated foods, SFA officials generally passed their responsibility to the FSMCs. FNS officials were not aware of this because the agency listed the tracking of USDA-donated food as an optional item to be examined during its management evaluation reviews. The agency also did not require State agencies to monitor how SFAs keep track of USDA-donated foods. In addition, FNS officials did not provide SFAs with specific procedures for recording and tracking USDA-donated foods, whether in bulk or processed form. In total, the five SFAs and the three FSMCs they contracted with could neither account for approximately $480,000 worth of USDA-donated foods nor demonstrate that they fully credited the SFAs for the foods.

FNS' requirements[26] and guidance state that FSMCs must maintain clear documentation of the value of any USDA-donated foods, whether in a fixed-price-per-meal or cost-reimbursable type contract. SFAs are also required to ensure that the USDA-donated foods used in their school food service are accurately valued, tracked, and credited. In accordance with Federal regulations, processors, FSMCs, and other entities are required to keep accurate and complete records with respect to the receipt, distribution/disposal, storage, and inventory of donated commodities.[27] Finally, whether donated foods are sent to an FSMC in bulk or processed form, FNS requires the SFA to ensure that the foods are used and that the SFA is fully credited for the foods' value.[28] For processed USDA-donated foods, this means that if an SFA receives 10 pounds of donated chicken that is sent to a processor to be part of a 50-pound batch of breaded chicken nuggets, the value of the 10 pounds must be tracked throughout the processing and distribution of the chicken nuggets, and appropriately credited back to the SFA.

For fixed-price-per-meal contracts, an FSMC is required to reduce the contracted price per meal by the value of USDA-donated foods received. FNS expects this reduction to be shown on the SFA's invoice.[29] FNS issued this new requirement in 2008, based on a recommendation in a previous OIG audit report,[30] which found that FSMCs were not clearly documenting whether the SFA received the benefit of USDA-donated foods. Although FNS implemented our recommendations, they did not implement a followup process to ensure that SFAs complied with the new requirement.

At one of the six SFAs we reviewed, with a fixed-price-per-meal type contract, we found that it handed over all USDA-donated food oversight responsibilities to its FSMC. In this case, State agency records showed the FSMC received $59,897 in USDA-donated food, but the FSMC provided the SFA with only $38,437 in credits. Although the credits were clearly identifiable

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26 7 CFR 250.51(b).
27 7 CFR 250.16 (a)(4).
28 7 CFR 250.54(a)(2).
29 7 CFR 250.51(b).
30 OIG Audit report 27601-27-Ch, *Food and Nutrition Service National School Lunch Program Food Service Management Companies*, dated April 2002.

on the monthly invoices, SFA officials did not verify they received the full amount because they relied on the FSMC to fully account for the value of USDA-donated foods. Thus, we found that the SFA did not receive $21,460 in credits for USDA-donated foods provided during SY 2011.

We found that the methods each SFA used to handle USDA-donated foods varied greatly. Some SFAs took nearly complete control over the receipt and use of USDA-donated foods, while others allowed their FSMCs complete control over those food items. For instance, 3 SFAs (of the 12 we reviewed) with cost-reimbursable contracts handled all USDA-donated foods themselves (tracking, processing, etc.), while 9 SFAs either did very little monitoring or allowed their FSMCs to work directly with food processors to convert donated bulk items into processed end products. Of these nine, we found that four SFAs did not track all of the USDA-donated foods sent on their behalf to food processors, and therefore did not know if the foods were properly accounted for on the FSMC operating statement.

To verify that the FSMCs were tracking USDA-donated foods properly, we compared the value of USDA-donated foods provided by each State agency to the FSMCs' operating statements. One company's operating statement showed that its SFA received a benefit of $172,796 in USDA-donated foods for SY 2011. However, when we compared that total to the State agency's documents on how much USDA-donated food the SFA should have received, we found that the SFA should have received $370,018—a difference of $197,222. In total, for all four SFAs that allowed FSMCs to order and track USDA-donated foods, we calculated a difference of approximately $457,000 between the value of donated foods the State agencies recorded and what the FSMCs recorded as being used in the NSLP.

We discussed the discrepancies we found at these four SFAs with FSMC managers, as well as staff at one food processor and one food distributor that served the FSMCs. Officials from one FSMC stated that the discrepancy must have stemmed from the USDA-donated foods being shipped from the State agency directly to a food processor, but the officials were unable to provide documentation to support their claim. To investigate the issue further, we contacted the food processor, which provided us with documentation that clearly showed the value of donated foods included in a processed end product.[31] The processor normally provides this documentation to the food distributor once its work is done. The distributor then ships the food items to the FSMC. However, officials at the food distributor stated that they did not routinely track USDA-donated food values and did not include their value on the invoices sent to SFAs or FSMCs.

Federal regulations require food processors and distributors to maintain records of the value of USDA-donated foods.[32] However, FNS' policy regarding those regulations does not require distributors to provide that documentation in a readily available or easily identifiable form.[33] Although a distributor official stated they could provide the value of processed USDA-donated foods shipped to SFAs and FSMCs, it would take detailed research of thousands of line items to

[31] The processor also accounted for any waste that may have occurred.
[32] 7 CFR 250.16 (a)(4).
[33] FNS Policy No. FD-007, *State Processing, Net Off Invoice Value-Pass-Through Method*, issued March 2003, and revised in December 2011.

arrive at that value. Since the distributor did not have the documentation readily available for us to review, it also would not be readily available to an SFA or FSMC for them to track processed USDA-donated foods.

We determined that since the State agencies, SFAs, and FSMCs could not account for the value of USDA-donated foods sent to processors and distributors, we were unable to conclude and FNS does not have assurance that the full value of donated foods was credited to the SFAs, as required. Although FNS amended its policy in December 2011, regarding how processors and distributors should document the value of processed USDA-donated foods, it still did not require distributors to have that documentation in a ready to use form. In addition, State agency officials were unaware of this issue because FNS did not require them to implement a process to hold their SFAs accountable for the value of USDA-donated foods.[34] In addition, FNS' web-based training for State agencies and SFAs did not include specific procedures for recording and tracking USDA-donated foods, whether in bulk or processed form. While monitoring the SFAs' tracking of USDA-donated food values was included as an optional item in FNS' management evaluation process, we found that none of the three FNS regional offices actually assessed this area as part of their reviews.

FNS needs to improve its oversight and controls to ensure that State agencies and SFAs fully account for USDA-donated foods, especially those items sent to food processors. To start, FNS should require its regional offices to review how State agencies and SFAs control and account for the full value of USDA-donated foods. In addition, FNS should require that State agencies and SFAs compare the value of USDA-donated foods to the amount of credit listed on the FSMCs' invoices or operating statements.

Recommendation 8

Work with the State agency to (1) ensure the SFA collects from its contracted FSMC the $21,460 in credits for USDA-donated foods, and (2) fully account for the $457,000 in USDA-donated foods to ensure that the SFAs receive full credit.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to recover any un-credited funds as appropriate according to Federal law and NSLP regulations. The officials stated that they would confer with OIG prior to determining the appropriate actions to take and plan to complete these actions by August 1, 2013.

OIG Position

While we agree with FNS' actions to recover $21,460 in un-credited funds, the agency's response did not address the $457,000 in USDA-donated foods that were not accounted for by the FSMCs or SFAs. In order to reach management decision, FNS needs to provide us with a

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[34] FNS, *Contracting with Food Service Management Companies: Guidance for School Food Authorities,* issued April 2009.

response that states how it will work with the State agency to account for the $457,000 in USDA-donated foods to ensure that the SFAs receive full credit.

Recommendation 9

Ensure FNS regional offices review how State agencies monitor the implementation of contracts between SFAs and FSMCs; specifically, how State agencies and SFAs account for all USDA-donated foods and any credits they received from their FSMCs.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials stated that in 2009, FNS strengthened the management evaluation of State agencies by establishing a NSLP Management Evaluation Risk Assessment Tool to select State agencies for evaluations based on risk rather than a calendar year. The tool includes an assessment of a significant number of State and/or local procurement issues, including FSMC contracts, as a "High Priority" risk indicator. Additionally, in FY 2013, the management evaluations of State agencies will assess the oversight of contracts between SFAs and FSMCs as evidenced by the addition of the USDA Foods and Processing of USDA Foods section in the FY 2013 management evaluation guidance, and the identification of this section, and the FSMC section as "critical areas" for management evaluations conducted in FY 2013. In a follow-up email, dated December 19, 2012, FNS provided OIG with the FY 2013 management evaluation guidance and stated that sections will remain "critical areas" in the management evaluation process until such a time FNS decides to move them to "non-critical." FNS will document the reason for moving these areas to "non-critical" as necessary.

OIG Position

We accept FNS' management decision.

Recommendation 10

Implement requirements for SFAs to ensure that the value of USDA-donated foods provided to FSMCs is properly accounted for and credited on the FSMCs' monthly invoices. In addition, require that State agencies, during their periodic reviews, monitor their SFAs to ensure compliance with this requirement.

Agency Response

In the agency's response, dated December 14, 2012, FNS agreed to issue an updated policy guidance memorandum to clarify FNS' stated expectation that SFAs properly account for and receive the credit on monthly invoices for USDA-donated foods provided to FSMCs, and that State agencies, during their periodic reviews, monitor SFAs to ensure compliance with FSMCs providing supporting documentation of all purchase rebates received. FNS estimated to complete this action by January 31, 2013.

OIG Position

While we agree with FNS' stated action, the agency's response did not state whether the proposed policy update memo would actually require that SFAs account for and collect the value of USDA-donated foods provided to FSMCs, and that State agencies would be required to perform the recommended monitoring. To reach management decision, FNS needs to clarify whether these actions will be incorporated as requirements in the new guidance.

Recommendation 11

Establish minimum requirements for State agencies to review their SFAs' process for documenting and accounting for the value of USDA-donated bulk foods sent to food processors.

Agency Response

In the agency's response, dated December 14, 2012, FNS responded that in FY 2013, the agency will assess the oversight of contracts between SFAs and FSMCs during management evaluations, as evidenced by the addition of the USDA Foods and Processing of USDA Foods section in the FY 2013 management evaluations guidance, and the identification of this section, and the FSMC section as "critical areas" for management evaluations conducted in FY 2013.

OIG Position

While we recognize that FNS has agreed to add a new section to the management evaluation guidance for improved oversight of USDA-donated foods, this action would not establish minimum requirements for State agencies to follow. In order to reach management decision, FNS officials need to clarify their plans to establish the recommended requirements for State agencies to follow.

Finding 4: FNS Needs to Improve Reviews of State Agency FSMC Contracts

FNS allowed one State agency to implement an FSMC contract for 187 of its SFAs that was neither a cost-reimbursable nor a fixed-price-per-meal type contract, which are the two types of contracts authorized in the regulation. Further, we found that the use of this alternative type of contract, which contained unique provisions, led to SFA officials' confusion in ensuring FSMCs' compliance. Although the State did submit the contract for FNS review before using it, FNS officials stated that it was not within their authority to actually approve or disapprove the contract. They were aware of some issues with the contract, but did not take action to prevent its use, even though FNS officials told us that they expressed concerns to the State agency about the potential confusion that its unique terms could create. We also found that once the State agency implemented the contract, neither State nor SFA officials effectively monitored the FSMCs' compliance with its unique provisions. Based on one provision of the contract, we determined that the five SFAs we reviewed paid about $1.2 million in excess program costs for

SY 2009 through SY 2011. We note that 182 other SFAs were subject to this same contract, and may also have similar problems with excess program costs.

One of the three State agencies we reviewed developed a contract that had elements of both cost-reimbursable and fixed-price-per-meal type contracts. It had the foundations of a fixed-price-per-meal contact, but if the FSMC's direct costs of operation did not equal the actual costs of operations, FSMCs were required to make adjustments each month and provide the difference to the SFA.[35] For instance, if at the beginning of the contract, the FSMC estimated that each meal served would cost $1, and if it served 1,000 meals, the FSMC would charge the SFA $1,000 for that month. However, if (after reconciling to actual costs) the FSMC's actual cost for the month was $0.80 per meal, the SFA would be entitled to the $0.20 difference. This would then result in a $200 refund ($1,000 - $800 = $200), required to be paid within 10 days after the end of the month. Regulations require that FSMCs exclude all unallowable costs from invoices submitted to SFAs for payment.[36]

Our review of 5 of the State agency's 187 SFAs that used the contract during SY 2009 through SY 2011, found that none ensured that their FSMCs were actually reconciling their costs on a monthly basis, as required. Instead, they allowed the FSMCs to perform this reconciliation on an annual basis. However, our analysis of a full year's invoices showed that there was a significant difference between performing the reconciliations annually, instead of monthly. For example, if costs for one month were $100 over what was estimated, and costs for the next month were $90 under what was estimated, in the yearly reconciliation, the FSMC would only need to pay the SFA $10 ($100 - $90). However, if conducted on a monthly basis, as required, the FSMC would have had to absorb the $100 loss for the first month, and pay the SFA $90 in the second month.

We reviewed the FSMCs' operating statements and invoices provided to the five SFAs and found that the SFAs were reimbursed approximately $210,000, based on annual reconciliations.[37] However, we recalculated that reconciliation on a monthly basis and determined that if the FSMCs had reconciled the food service accounts on a monthly basis, as the contract requires, the five SFAs would have been entitled to nearly $1.4 million in program cost reductions. Therefore, the FSMCs charged the SFAs about $1.2 million in unallowable program costs.

State officials stated that they provided a copy of the hybrid contract to FNS for review, and FNS officials viewed it as essentially a cost-reimbursable type contract, which is allowed under Federal regulations. FNS National officials did note concerns that some contract provisions might have been confusing in regards to monitoring costs, but did not take actions to stop the State agency from requiring its SFAs Statewide from using it. FNS officials stated that they did not officially communicate their approval of the contract because Federal regulations do not require FNS' approval before the State agency can implement their contract. FNS also did not ask the State agency to amend the contract terms.

[35] State agencies contract, Section 22 (G).
[36] 7 CFR 210.21(f)(1)(ii)(A) and (B) and (f)(2).
[37] Two SFAs did not contract with the FSMC for all three years. One SFA contracted for one and a half years while another was for two years.

Although FNS issued updated guidance for State agencies and SFAs explaining their responsibilities when contracting with FSMCs,[38] this guidance did not cover the issues that arose from this State's unique contract provisions. Despite FNS officials voicing concerns that the contract might be complex to implement and monitor, neither FNS nor the State agency provided guidance to the SFAs for ensuring compliance with the contract terms. Thus, SFA officials were unaware of what was required of them. At all five SFAs, officials were not even aware that the FSMC was required to perform monthly reconciliations, and one SFA was not aware it was entitled to the difference between the actual and direct costs.

The State agency did not review FSMC contract compliance during its Coordinated Review Effort, under which it reviews every SFA in the State over a 5-year period. Although they had indications from informal conversations with SFAs that FSMCs might not have been reconciling costs on a monthly basis, State agency officials explained that they were nutritionists, rather than accountants, and thus did not have the expertise to conduct the type of review needed to ensure that FSMCs were in compliance. In addition, the officials noted that FNS does not require contract compliance to be assessed in its Coordinated Review Effort guidance. We noted that FNS recently began a process to revise the Coordinated Review Effort, which it expects to complete next year. Therefore, as part of that effort, we believe FNS should put greater emphasis on SFAs' monitoring of FSMC operations and, in particular, in ensuring contract terms are enforced.

To prevent this situation from recurring, FNS needs to improve its oversight of State agencies' FSMC contracts. Although we concur that FNS is not specifically required to review and approve contracts, FNS officials should take appropriate action in situations where they become aware that a contract does not comply with Federal regulations regarding grantees. Moreover, when contracts contain potentially confusing or complex requirements, FNS should work with the State agencies to ensure that they provide necessary guidance to SFAs. Although contracts for NSLP food service are between the SFAs and FSMCs, the program itself is administered by FNS and the agency has a responsibility to provide sufficient oversight, particularly when this involves issues at the Statewide level.

Recommendation 12

Work with the State agency to determine if the $1.2 million in program funds should be recovered from the cited FSMCs.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to recover any un-credited funds as appropriate according to Federal law and NSLP regulations. FNS will confer with OIG prior to determining the appropriate action to take, with an estimated completion date of August 1, 2013. In a follow-up email, dated December 19, 2012, FNS stated that it would work with State agencies when determining if funds should be recovered.

[38] *Contracting with Food Service Management Companies: Guidance for School Food Authorities,* issued April 2009, and *Guidance for State Agencies,* issued January 2009.

OIG Position

We accept FNS' management decision.

Recommendation 13

Work with the State agency to develop an action plan to review the remaining 182 SFAs to ensure that FSMCs reconciled actual costs on a monthly basis and, if not, determine the amount of any additional cost reductions owed and ensure they are deposited in the SFAs' food service accounts.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to work with the regional office, OIG, and the State agency to determine the remaining 182 SFAs contracting with FSMCs. Upon identification of the 182 SFAs in need of a review, the State agency will develop an action plan to review the remaining SFAs to ensure that FSMCs reconcile actual costs on a monthly basis, determine additional cost reductions owed, and ensure these deposits are made to the SFA nonprofit school food service account. FNS estimated completion of these actions by August 1, 2013.

OIG Position

We accept FNS' management decision.

Recommendation 14

Develop a plan to review all State agency contracts nationwide and provide guidance to those State agencies, as needed.

Agency Response

In the agency's response, dated December 14, 2012, FNS agreed with the recommendation. The NSLP Management Evaluation Risk-Based Assessment Workgroup consisting of FNS Headquarters and regional office staff will convene to develop a plan for reviewing State agencies having a prototype FSMC contract through the management evaluation process, and estimated completion of its plan by September 30, 2013.

OIG Position

While we agree with FNS on the development of a plan to review State agencies' contracts, the response did not state whether the review process would be followed by issuing guidance State agencies if needed. In addition, the response did not provide information on how FNS would address those States that do not utilize prototype contracts. To reach a management decision, FNS needs to provide clarification on these two areas.

Recommendation 15

As part of the process to amend the Coordinated Review Effort, or other State methods of conducting local administrative reviews, ensure that the review process requires an assessment of SFAs' and FSMCs' compliance with all contract provisions.

Agency Response

In the agency's response, dated December 14, 2012, FNS officials agreed to utilize a working group to propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and regional office staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

OIG Position

We accept FNS' management decision.

Scope and Methodology

We encountered a scope limitation when we looked at whether SFAs received all purchase discounts and rebates to which they were entitled. We encountered numerous delays (over 100 days) in receiving documents from both FSMCs and related vendors. In addition, the FSMC and vendor documents we did receive contained inconsistent data, which led us to question the data reliability, particularly the accuracy and completeness of information related to discounts and rebates that FSMCs received from their suppliers and passed through to the SFAs.

In May 2012, an FSMC provided us with the total purchase and rebate data from one of its largest vendors, which we compared to the vendor's total sales and rebate data for that FSMC. The vendor's figures suggested that the FSMC understated its purchases by over $800 million and the related rebates by about $50 million. In June 2012, the vendor provided updated and significantly lower figures, explaining that the initial figures included both the FSMC's data and that of a buying group, owned by the FSMC, which has no connection with the NSLP. The vendor's new figures, while closer, still suggested that the FSMC had understated its total purchases by approximately $50 million and rebates by approximately $15 million. When we discussed this difference with FSMC officials in July 2012, they provided new data and explained that certain rebate categories had been inadvertently excluded from the initial figures supplied to OIG in May 2012. These updated figures still did not match those provided by the vendor, thus causing us to conclude that, without additional work, we cannot at this time determine whether this FSMC provided all purchase discounts and rebates to its SFAs. To avoid unnecessarily delaying the issuance of this report, we will continue this work and expect to issue any findings and conclusions in a separate report.

Our audit reviewed FNS' controls over State agencies and SFAs that contracted with FSMCs during SY 2011.[39] We performed our audit work at the FNS National office in Alexandria, Virginia, and three FNS regional offices: the Northeast Regional Office located in Boston, Massachusetts; the Midwest Regional Office located in Chicago, Illinois; and the Mid-Atlantic Regional Office located in Robbinsville, New Jersey. We also performed audit work at three State agencies in New Jersey, New York, and Ohio. We expanded our review to include SY 2009 and SY 2010, relating to New York's FSMC contract provisions. We performed our audit from October 2011 through August 2012.

According to FNS, there were approximately 23,000 SFAs participating in the NSLP. However, FNS did not maintain documentation on the extent of those SFAs' use of FSMCs to operate their school food service. In order to determine a universe of SFAs from which we could select our sample, we requested all 55 State agencies to provide details of their SFAs' use of FSMCs within each State.[40] Based on their responses, we found that there were approximately 3,000 SFAs that contracted with over 180 different FSMCs. FNS did maintain documentation on the value of USDA-donated food provided to SFAs in the NSLP, and of the approximately $1.1 billion provided nationwide, we determined that approximately $154 million was given to those

[39] A school year (SY) operates from July 1st in one year through June 30th of the following year.
[40] A State agency includes all 50 U.S. States plus American Samoa, District of Columbia, Guam, Puerto Rico, and the Virgin Islands.

3,000 SFAs during SY 2011. Also, FNS did not maintain an information system for the NSLP or a data system for tracking processed foods; therefore, we were unable to assess the controls in place.

We selected a judgmental sample of 18 SFAs in 3 States, with oversight of those State agencies provided by 3 of FNS' 7 regional offices. We selected our sample of SFAs to review based on the following factors; (1) a high number of SFAs within a State that contracted with an FSMC; (2) the types of FSMC contracts used, either cost-reimbursable or fixed-price-per-meal; and (3) the estimated size (i.e., small, medium, and large) of FSMC operations, which we determined based on the number of school food service contracts nationwide.[41] Of the 18 SFAs we selected, 12 had cost-reimbursable contracts and 6 had fixed–price-per-meal contracts with 5 different FSMCs (1 small, 2 medium, and 2 large). In addition, we requested supporting documentation for purchases and rebates from two vendors that supplied those FSMCs, and interviewed officials at one food processor and one distributor.

To accomplish our audit objectives we:

- Reviewed FNS regulations, policies, guidance, and instructions governing NSLP, specifically for SFAs that contract with FSMCs;

- Reviewed FNS' guidance to its regional offices on conducting management evaluation reviews, and reviewed the most recent management evaluations performed at the States we selected for review;

- Interviewed officials from FNS' National and regional offices, State agencies, and SFAs on the controls and procedures to monitor and oversee contracts with FSMCs;

- Reviewed the State agencies' Coordinated Review Effort guidance and reports for each of the SFAs we selected, and the corrective actions taken in response to any findings and recommendations;

- Evaluated the State agencies' controls for properly valuing USDA-donated foods and the processes used by SFAs to ensure their contracted FSMCs fully accounted for or provided full credit for the value of those foods used in the SFAs' school food service;

- Reviewed State agencies' FSMC contracts to ensure they met FNS requirements. Also reviewed the State agencies' processes to ensure SFA and FSMC contracts contained those required contract provisions;

- Evaluated SFA controls over the FSMC contract bidding and selection process to ensure they met Federal and State regulations regarding grantees;

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[41] We categorized the size of FSMC operations by the number of SFA contracts each maintained according to the data we collected from the State agencies. We defined a FSMC operation as small if it had between 1 and 10 contracts, medium between 11 and 100 contracts, and large if it had over 100 contracts nationwide.

- Analyzed SFAs’ school food service monthly operating statements and invoices provided by FSMCs to verify that the SFAs received all purchase discounts and rebates and applicable credits;

- Interviewed FSMC management officials and analyzed their processes for allocating and crediting SFAs for their share of purchase discounts and rebates;

- Evaluated FSMCs’ purchasing, sales, and distribution contracts and agreements with vendors for supplies and food used in the SFAs’ school food service;

- Interviewed FSMCs’ vendors and distributors to verify the amount of purchases and rebates the FSMC received;

- Interviewed a food processor regarding its process to track and record the value of USDA-donated foods received, processed, and shipped to FSMCs for use in SFAs' school food service;

- Interviewed officials from one State’s Attorney General’s office to gain a better understanding of the issues identified in the FSMC investigation and settlement; and

- Interviewed two third-party consultants to establish their roles and discuss issues with ensuring that all rebates are being returned by the FSMC to the SFAs.

We conducted this performance review in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Abbreviations

CFR............................Code of Federal Regulations
CRE............................Coordinated Review Effort
FY ....Fiscal Year
FNS ....Food and Nutrition Service
FSMC..........................Food Service Management Company
GAO...........................Government Accountability Office
IFB ....Invitation for Bid
NSLP..........................National School Lunch Program
OIG ....Office of Inspector General
SFA ....School Food Authority
SY ....School Year
U.S. ....United States
USDA.........................U.S. Department of Agriculture

Exhibit A: Summary of Monetary Results

Finding	Recommendation	Description	Amount	Category
2	7	FSMC purchase rebates owed to two SFAs	$1,400	Questioned Costs, No Recovery
3	8	Credit for USDA-donated foods	$21,460	Questioned Costs, No Recovery
3	8	Account for USDA-donated foods	$457,000	Questioned Costs, No Recovery
4	12	Unallowable program costs	$1,200,000	Questioned Costs, No Recovery
TOTAL			$1,679,860[42]	

[42] This amount would be returned to the applicable SFAs' food service accounts upon collection.

Exhibit B: List of Past OIG Audit Reports on SFA and FSMC Contracts

Audit Number	Audit Title	Issue Date
27601-0010-AT	FNS National School Lunch Program Controls Over Food Service Management Companies, South Carolina School Years 1997 through 1999	February 2001
27601-0009-TE	FNS National School Lunch Program Food Service Management Companies	March 2001
27099-0015-SF	FNS National School Lunch Program Food Service Management Companies	April 2001
27601-0012-KC	FNS National School Lunch Program Food Service Management Companies	May 2001
27601-0024-CH	FNS National School Lunch Program Food Service Management Companies – Midwest Region	September 2001
27601-0013-KC	FNS National School Lunch Program Chartwells Food Service Management Company	March 2002
27601-0027-CH	FNS National School Lunch Program Food Service Management Companies	April 2002
27601-0014-KC	FNS National School Lunch Program Food Service Management Company Cost Reimbursable Contracts in Missouri	December 2002
27601-0015-KC	FNS National School Lunch Program Cost-Reimbursable Contracts with a Food Service Management Company	December 2005

USDA’S
FOOD AND NUTRITION SERVICE'S
RESPONSE TO AUDIT REPORT

United States Department of Agriculture

Food and Nutrition Service

3101 Park Center Drive
Room 712

Alexandria, VA 22302-1500

DATE: December 14, 2012

AUDIT NUMBER: 27601-0001-23

TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: /s/ <Yvette S. Jackson> (for): Audrey Rowe
Administrator
Food and Nutrition Service

SUBJECT: National School Lunch Program – Food Service Management Companies Contracts

This letter responds to the Office of Inspector General's (OIG) official draft report for audit report number 27601-0001-23, National School Lunch Program – Food Service Management Companies Contracts. Specifically, the Food and Nutrition Service (FNS) is responding to the fifteen recommendations in the report.

FNS supports OIG's objectives to ensure State agencies and school food authorities (SFA) understand and fulfill their roles and responsibilities regarding the oversight and monitoring of contracts with Food Service Management Companies (FSMC), and that SFAs are receiving the full benefit and value of all donated foods provided to FSMCs and the full value of all credits, discounts, and rebates associated with cost reimbursable contracts.

FNS sees merit in the continuous improvement of the management evaluation process for State agency oversight of SFA monitoring of FSMC contracts, identifying areas that can be strengthened. In addition, the implementation of proactive measures, such as additional policy guidance and clarification, and training emphasizing State agency and SFA roles and responsibilities in contracting with FSMCs, will further strengthen oversight activities.

However, FNS believes the OIG report does not fully represent the significant actions FNS has taken to provide management oversight and guidance to States and SFAs regarding FSMC contracts. These actions include, but are not limited to:

- FNS issued two rules: "*Procurement Requirements for the NSLP, SBP, and SMP"*, dated October 31, 2007, requiring all costs to the program be net of applicable purchase rebates, discounts, and credits; and "*Management of Donated Foods in Child Nutrition Programs, the Nutrition Services Incentive Program, and Charitable Institutions*, dated August 8, 2008, requiring the value of all donated foods to be credited to the nonprofit school food service account;

- Issued numerous policy guidance memoranda between fiscal years (FY) 2008 to 2011 clarifying procurement and FSMC oversight requirements and provide technical assistance to State agencies for oversight of SFAs' monitoring of FSMCs; and
- Conducted trainings during numerous conferences such as the School Nutrition Association (SNA), American Commodity Distribution Association (ACDA), and other State conferences, to State agencies, SFAs, and Regional Office (RO) staff, to provide technical assistance and guidance from FYs 2008 to 2012.

In addition to the continuation of these proactive controls, FNS planned actions along with the proposed dates of implementation are specified below.

OIG Recommendation 1

Evaluate the management evaluation process, as well as State and field-level oversight activities, to determine if alternative structures would better serve programs and make better use of limited resources.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will utilize a working group to evaluate the effectiveness of the management evaluation (ME) process in regards to FSMC contract oversight and propose alternative methods to assess this operational area and make better use of limited resources. In addition, the working group will propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and RO staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

Estimated completion date: December 1, 2013

OIG Recommendation 2

Create a working group to re-assess the effectiveness of FNS' oversight, communication, and monitoring of SFAs that contract with FSMCs, and to develop recommendations for improving compliance with NSLP requirements. Develop a time-phased action plan, based on the working group's recommendations, to implement clear procedures for FNS regional staffs and State agencies to follow in performing program reviews of SFAs that contract with FSMCs.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will utilize a working group to evaluate the effectiveness of FNS' oversight, communication, and State agency monitoring of SFAs that contract with FSMCs using the ME process and propose alternative methods to assess this operational area and make better use of limited resources. In addition, the working group will propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and RO staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

Estimated completion date: December 1, 2013

OIG Recommendation 3

Review and amend the web-based training tool to incorporate procedures, techniques, examples, and best practices that will assist State agencies and SFAs in providing better oversight of FSMC school food service operations.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will ensure that training materials incorporate procedures, techniques, examples and best practices to assist State agencies and SFAs in providing better oversight and monitoring of FSMC contracts. Specifically, FNS will add a new module to its existing Web-based procurement training providing technical assistance and guidance specifically related to the oversight and monitoring of FSMC contracts.

Estimated Date of Completion: July 1, 2013

OIG Recommendation 4

Determine the need to make FNS' web-based tool a requirement for State agencies and SFAs to review, and implement a process to track participation.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will issue annual guidance to State agencies on the availability and need for completion of the Web-based procurement training tool and monitor its use to determine whether additional action is needed to ensure proper training.

Estimated Date of Completion: July 1, 2013

OIG Recommendation 5

Establish a time-phased action plan to ensure that State agencies and SFAs are informed of the training and encouraged to use it as a resource in identifying their roles and responsibilities in contracting with a FSMC.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will issue annual guidance to State agencies on the availability and need for completion of the Web-based procurement training tool to assist them with identifying their roles and responsibilities in contracting with a FSMC.

Estimated Date of Completion: July 1, 2013

OIG Recommendation 6

Update guidance to clarify FNS' stated expectation that SFAs are required to periodically review FSMCs' supporting documentation for all purchase rebates received.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will issue an updated policy guidance memorandum to clarify FNS' stated expectation that SFAs are required to periodically review FSMCs supporting documentation of all purchase rebates received.

Estimated completion date: January 31, 2013

OIG Recommendation 7

Instruct the State agency to assist two SFAs in recovering $1,400 in un-credited rebates from their contracted FSMC. Also, conduct a review of all SFAs that contracted with this FSMC to determine if other SFAs are owed additional purchase rebates.

Food and Nutrition Service Response:

FNS concurs with this recommendation and agrees with recovering any un-credited funds as appropriate according to federal law and NSLP regulations. FNS will confer with OIG prior to determining the appropriate action to take.

Estimated Completion Date: August 1, 2013 (estimate, contingent on OIG direction)

OIG Recommendation 8

Work with the State agency to (1) ensure the SFA collects from its contracted FSMC the $21,460 in credits for USDA-donated foods, and (2) fully account for the $457,000 in USDA-donated foods to ensure that the SFAs receive full credit.

Food and Nutrition Service Response:

FNS concurs with this recommendation and agrees with recovering any un-credited funds as appropriate according to federal law and NSLP regulations. FNS will confer with OIG prior to determining the appropriate action to take.

Estimated Completion Date: August 1, 2013 (estimate, contingent on OIG direction)

OIG Recommendation 9

Ensure FNS regional offices review how State agencies monitor the implementation of contracts between SFAs and FSMCs, specifically, how State agencies and SFAs account for all USDA-donated foods and any credits they received from their FSMCs.

Food and Nutrition Service Response:

In 2009, FNS strengthened the management evaluation of State agencies by establishing a NSLP Management Evaluation Risk Assessment Tool to select State agencies for evaluations based on risk rather than a calendar year. The tool includes an assessment of a significant number of state and/or local procurement issues including FSMC contracts as a "High Priority" risk indicator. Additionally, in FY2013, the management evaluations of State agencies will assess the oversight of contracts between SFAs and FSMCs as evidenced by the addition of the USDA Foods and Processing of USDA Foods section in the FY2013 ME Guidance and the identification of this section and the FSMC section as "critical areas" for management evaluations conducted in FY2013. FNS considers this recommendation "closed."

Completion Date: November 19, 2012

OIG Recommendation 10

Implement requirements for SFAs to ensure that the value of USDA-donated foods provided to FSMCs are properly accounted for and credited on the FSMCs' monthly invoices. In addition, require that State agencies, during their periodic reviews, monitor their SFAs to ensure compliance with this requirement.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will issue an updated policy guidance memorandum to clarify FNS' stated expectation that SFAs properly account for and receive the credit on monthly invoices for USDA-donated foods provided to FSMCs and that State agencies, during their periodic reviews, monitor SFAs to ensure compliance with FSMCs providing supporting documentation of all purchase rebates received.

Estimated completion date: January 31, 2013

OIG Recommendation 11

Establish minimum requirements for State agencies to review its SFA's process for documenting and accounting for the value of USDA-donated bulk foods sent to food processors.

Food and Nutrition Service Response:

In FY2013, FNS will assess the oversight of contracts between SFAs and FSMCs during management evaluations as evidenced by the addition of the USDA Foods and Processing of USDA Foods section in the FY2013 ME Guidance and the identification of this section and the FSMC section as "critical areas" for management evaluations conducted in FY2013. FNS considers this recommendation "closed."

Completion Date: November 19, 2012

OIG Recommendation 12

Work with the State agency to determine if the $1.2 million in program funds should be recovered from the cited FSMCs.

Food and Nutrition Service Response:

FNS concurs with this recommendation and agrees with recovering any un-credited funds as appropriate according to federal law and NSLP regulations. FNS will confer with OIG prior to determining the appropriate action to take.

Estimated Completion Date: August 1, 2013 (estimate, contingent on OIG direction)

OIG Recommendation 13

Work with the State agency to develop an action plan to review the remaining 182 SFAs to ensure that FSMCs reconciled actual costs on a monthly basis and, if not, determine the amount of any additional cost reductions owed and ensure they are deposited in the SFAs' food service accounts.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS Headquarters will work with the RO, OIG and the State agency to determine the remaining 182 SFAs contracting with FSMCs. Upon identification of the 182 SFAs in need of a review, the State agency will develop an action plan to review the remaining SFAs to ensure that FSMCs reconcile actual costs on a monthly basis, determine additional cost reductions owed, and ensure these deposits are made to the SFA nonprofit school food service account.

Estimated date of completion: August 1, 2013

OIG Recommendation 14

Develop a plan to review all State agency contracts nationwide and provide guidance to those State agencies, as needed.

Food and Nutrition Service Response:

FNS agrees with this recommendation. The NSLP ME Risk-Based Assessment Workgroup consisting of FNS Headquarters and Regional office staff will convene to develop a plan for reviewing State agencies having a prototype FSMC contract through the management evaluation process.

Estimated Date of Completion: September 30, 2013

OIG Recommendation 15

As part of the process to amend the Coordinated Review Effort, or other State methods of conducting local administrative reviews, ensure that the review process requires an assessment of SFAs' and FSMCs' compliance with all contract provisions.

Food and Nutrition Service Response:

FNS agrees with this recommendation. FNS will utilize a working group to propose a method for State agencies to include an assessment of SFAs' and FSMCs' compliance with all NSLP requirements as part of the State agency local administrative review process. The working group will consist of FNS Headquarters and RO staff, State agency staff, and SFA staff. The proposed action plan will be established by December 1, 2013.

Estimated completion date: December 1, 2013

Informational copies of this report have been distributed to:

Administrator, Food and Nutrition Service
Attn: Agency Liaison Officer

Government Accountability Office

Office of Management and Budget

Office of the Chief Financial Officer
Attn: Director, Planning and Accountability Division

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