



U.S. Department of Agriculture
Office of Inspector General
Western Region
Audit Report

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



Report No.
27099-15-SF
April 2001



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Western Region - Audit

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DATE: April 12, 2001

REPLY TO

ATTN OF: 27099-15-SF

SUBJECT: Food and Nutrition Service, National School Lunch Program
Food Service Management Companies

TO: Allen Ng
Regional Administrator
Western Region
Food and Nutrition Service

ATTN: Martin Tom
Chief of Financial Services

This report presents the results of our audit of Food Service Management Companies that contract with local School Food Authorities to manage food service operations under the provision of the National School Lunch Program. This audit was conducted in the State of Washington as part of a nationwide audit of Food Service Management Companies. The results of this audit may be incorporated into a nationwide summary audit report.

Your March 28, 2001, written response to the draft report is included as exhibit B of the report. Based on your response, we have accepted your management decisions on all recommendations in the report. The Office of the Chief Financial Officer (OCFO), U.S. Department of Agriculture, has responsibility for monitoring and tracking final action on the findings and recommendations. Please note that final action on the finding and recommendations should be completed within 1 year of each management decision. Please follow your internal agency procedures in forwarding final action correspondence to the OCFO.

We appreciate the cooperation and assistance provided by your staff during this audit.

/s/

SAM W. CURRIE
Regional Inspector General
for Audit

EXECUTIVE SUMMARY

FOOD AND NUTRITION SERVICE NATIONAL SCHOOL LUNCH PROGRAM FOOD SERVICE MANAGEMENT COMPANIES STATE OF WASHINGTON

AUDIT REPORT NO. 27099-15-SF

RESULTS IN BRIEF

This report presents the results of our review of Inter Pacific Management, Inc., a food service management company operating under the National School Lunch and School Breakfast Programs (NSLP/SBP) in the State of Washington. We performed this review as a part of a nationwide audit of food service management companies. We selected the State of Washington for review because this State had both fixed-rate-per-meal contracts and cost-reimbursable contracts. We judgmentally selected for review Inter Pacific Management, Inc., and the largest school food authority that contracted with it, the Evergreen School District.

Our objectives were to determine whether controls were sufficient to ensure that Inter Pacific credited Evergreen for: (1) the full value of USDA-donated commodities used, and (2) all volume purchase discounts, or other credits applicable to the NSLP/SBP.

Our review disclosed that Inter Pacific was not required to credit Evergreen for the full value of the USDA-donated commodities because Inter Pacific's actual costs were billed to the school district. We also determined that Inter Pacific contracted with the lowest bidders and these vendors have a general policy of not discounting their products or offering credits. However, we identified three separate instances in which Inter Pacific received a rebate from a vendor. We determined in each instance that the rebate was sent to the school district.

During our review, we also determined that Evergreen recorded the salaries and benefits of the four custodians as an expense to the NSLP/SBP. The accounting department at the school district inadvertently miscoded his expenditure and did not review its program expenditures to ensure that the program benefiting from the service was being charged.

KEY RECOMMENDATIONS

We recommend that FNS:

- ❑ Instruct the Washington State agency to ensure that Evergreen School District transfers \$60,959 in nonprogram related salaries and benefits to the appropriate program.
- ❑ Instruct the Washington State agency to have Evergreen School District review its program expenditures on a regular basis and establish controls that will allow nonprogram expenditures to be identified and assigned to the appropriate programs.

AGENCY RESPONSE

In its March 28, 2001, written response to the draft report, the Food and Nutrition Service concurred with the report finding and recommendations.

OIG POSITION

Based on the corrective actions planned, we have accepted FNS' management decision. FNS' written response is included as exhibit B of this report.

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INTRODUCTION

BACKGROUND

On June 4, 1946, Congress passed the National School Lunch Act (42 U.S.C. 1751-1760), which 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 program provides Federal assistance to help public and non-profit private high schools, as well as public and non-profit private residential child-care institutions, serve nutritious lunches to children. The Act, as amended, authorizes payment of general and special cash assistance funds to States based upon the number and category of lunches served, and special cash assistance for lunches served under the NSLP to children eligible for free or reduced-price lunches. In 1966, Congress expanded food assistance to include a School Breakfast Program (SBP), which was made a permanent program in 1975.

Through written agreements with the State agency, each School Food Authority administers the NSLP at the local, municipal, and school district level. The school authority is allowed to contract with a food service management company to manage the food service operation at its schools. The contract between the school authority and the food company may be either a fixed-rate-per-meal contract, or a reimbursement-of-costs contract. Both types of contracts should require that certain types of benefits accrue back to the school authority. In the case of fixed-rate-per-meal contracts, the food company is normally required under the contract to credit to the school authority the full value of any donated commodities that the food company received and used in the NSLP/SBP. For cost-reimbursable contracts, the food company may receive volume purchase discounts and rebates that would reduce the cost of goods purchased. The school authorities are entitled to share in the cost-savings received by the food companies even if the discounts and/or rebates occurred after the school authorities were billed.

In the State of Washington, the Office of Superintendent of Instruction granted the Evergreen School District authority to administer the NSLP. Evergreen in turn contracted with Inter Pacific Management, Inc., under a cost-reimbursable contract. Evergreen is responsible for program integrity and adhering to Federal and State requirements under its contract with Inter Pacific. Evergreen provides oversight to the individual schools responsible for the onsite operation of the NSLP/SBP and ensures that all commodities received by the schools or by Inter Pacific are used and that the full value of those commodities benefit only the schools' food service operations. In its

oversight capacity, Evergreen is also required to implement a meal accountability system and to approve student applications for free and reduced-price meals.

During fiscal years 1998-2000, the State of Washington Office of Superintendent of Public Instruction disbursed a total of \$369,622,210 in federal meal reimbursements to its school districts. Of that, Evergreen received a total of \$4,416,982 in federal meal reimbursements, and \$537,855 in USDA-donated commodities. Over that same period, Evergreen distributed all of USDA-donated commodities to Inter Pacific and reimbursed Inter Pacific \$9,977,423 for food, labor, general expenses, and management fees.

OBJECTIVES

Our objectives were to determine whether controls were sufficient to ensure that Inter Pacific Management, Inc., credited the Evergreen School District for the full value of USDA-donated commodities Inter Pacific used, and for all volume purchase discounts Inter Pacific received, or other credits applicable to the NSLP/SBP.

As noted in the Executive Summary, nothing came to our attention that suggested Inter Pacific did not credit Evergreen for the full value of USDA-donated commodities and for volume purchase discounts. However, during the audit we noted that Evergreen included nonprogram salaries and benefits to the program. Therefore, we expanded our audit objectives to include the development of this issue.

SCOPE

The audit scope covered the NSLP/SBP operations at the State of Washington Office of Superintendent of Instruction (State agency), the Evergreen School District, and Inter Pacific Management, Inc., for fiscal years 1998 - 2000.

This audit was part of a nationwide audit of Food Service Management Companies. We judgmentally selected Inter Pacific Management, Inc., in the State of Washington because the State had both fixed-rate-per-meal contracts and cost-reimbursable contracts. We then selected for review the largest School Food Authority in the State of Washington that contracted with Inter Pacific. This was the Evergreen School District.

We performed audit fieldwork from May 23, 2000 through July 21, 2000. We conducted this audit at: (1) the Food Nutrition Service Regional Office (FNSRO) in San Francisco, California; (2) the Office of Superintendent of Instruction in Olympia, Washington; (3) the Evergreen School District in Vancouver, Washington; and (4) Inter Pacific Management, Inc., at its Evergreen school field office in Vancouver, Washington.

The audit was conducted in accordance with generally accepted government auditing standards.

METHODOLOGY

To accomplish our objectives and support our findings, we performed the following steps:

- ❑ At the FNSRO, we reviewed the responsibilities over USDA-donated commodities by the FNSRO, the Evergreen School District, and Inter Pacific and the monitoring efforts performed to ensure that applicable regulations were met. We also reviewed the process followed to obtain, price, distribute, and reconcile USDA-donated commodities. In addition, we reviewed the management evaluations, reports, memos, guidelines, and procedures. Lastly, we reviewed the requirements and restrictions of contracts between school food authorities and food service management companies, and contracts between food service management companies and vendors.
- ❑ At the Office of Superintendent of Instruction, we reviewed the procurement requirements for school food authorities contracting with food service management companies. We also reviewed: (1) the correspondence between the Office of Superintendent of Instruction and the school food authorities, (2) monthly reports of school program operations, (3) financial status reports, (4) year-end financial status reports, and (5) recent audits of the Evergreen School District. In addition, we reviewed the monitoring efforts by the Office of Superintendent of Instruction to review the contract between the Evergreen School District and Inter Pacific Management, Inc.
- ❑ At the Evergreen School District, we interviewed the officials responsible for the requests for proposals from the food companies, the bidding process, pre-bid conferences, and the contract with Inter Pacific. In addition, we reviewed the: (1) correspondence between Evergreen and Inter Pacific, (2) contracts between Evergreen and Inter Pacific, and (3) expenditures claimed by Inter Pacific for the last 3 fiscal years. Moreover, we evaluated the procedures used to gather and consolidate monthly meal claims and Evergreen's monitoring efforts to ensure schools were adequately monitored. Finally, we documented the number of free, reduced, and paid lunches and breakfasts claimed from 1998 - 2000, and compared them to Inter Pacific's records for meal accountability.
- ❑ At Inter Pacific, we reviewed: (1) procedures followed to submit claims to Evergreen, (2) documentation supporting proper use of USDA-donated commodities, and (3) procurement process for contracting with vendors. We also interviewed vendors doing

business with Inter Pacific over the last 3 fiscal years to determine if any discounts, rebates, or any other incentives were offered or documented in the contract.

FINDING AND RECOMMENDATIONS

CHAPTER 1

EVERGREEN SCHOOL DISTRICT MISCODED THE SALARIES AND BENEFITS OF FOUR NONPROGRAM EMPLOYEES

FINDING NO. 1

Evergreen School District recorded the salaries and benefits of four nonprogram employees as an expense to the National School Lunch Program and School Breakfast Program (NSLP/SBP). This occurred because the accounting department inadvertently miscoded these expenditures in the accounting system and Evergreen did not have controls in place to ensure that program expenditures were coded correctly to the program that received the benefits. As a result, the expenditure account for the NSLP/SBP was overstated by \$60,959.

According to Federal regulations, "revenue received by the nonprofit school service are to be used only for the operation or improvement of such food service."¹ Additionally, Federal regulations state that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.²

Evergreen had inadvertently coded the expenditures for four nonprogram employees to the food program account when in fact the expense for these employees should have been charged to a district-wide support account. During the past 3 fiscal years, a total of \$60,959 was erroneously charged to the NSLP/SBP (see figure 1).

Miscoded Salaries and Benefits				
	FY 98	FY 99	FY 00	Total
Number of Employees	4	3	3	
Total Salaries and Benefits Miscoded	\$22,525	\$20,420	\$18,014	\$60,959

Figure 1: Nonprogram Salaries and Benefits Miscoded in the NSLP/SBP

¹ 7 CFR 210.14(a), dated January 1, 1998.

² 7 CFR 3016.20(b)(2), dated January 1, 1999.

Our follow-up determined that these employees were custodians who did not have agreements to work under the Food Program. For example, one employee worked as a custodian 2 hours a day to clean up the dining room after lunch and prepare the facility for a subsequent gym class. Another employee worked as a custodian several hours to clean up the dining room and other facilities. Over the past 3 fiscal years, a total of \$60,959 nonprogram salaries and benefits were charged to the program.

The Accounting Manager of Evergreen agreed that these salaries should not have been charged to the Food Program because these employees did not have any agreement to work for the Food Program. The Director of Budget and Fiscal Services at Evergreen School District also stated that it was a mistake to charge these salaries to the Food Program.

As a result of the audit, the Accounting Manager at Evergreen School District has stated that he will record the salaries and benefits of these employees to the appropriate account, District-wide Support Expenditure Account, starting in Federal fiscal year 2001.

Because the program funding was based on the number of meals served and Evergreen appeared to have support for all the meals it claimed reimbursement for, we are not recommending monetary recovery. However, according to the Accounting Manual of the State of Washington, nonprogram expenditures incurred and charged to the Food Program should later be transferred out to a sponsoring program. Since these salaries were nonprogram related expenditures, they should have been transferred to the appropriate program.

RECOMMENDATION NO. 1

Instruct the State agency to ensure that Evergreen School District transfers \$60,959 in nonprogram related expenditures to its benefiting program.

Agency Response

In its written response to the draft report, dated March 28, 2001, FNS stated, "We concur with your findings and recommendations. The audit report indicates the State agency (SA) agrees that they should have reclassified the cited salaries to a different account. We will ask the SA for the corrective actions once we receive the official audit report for transmittal to the State."

OIG Position

We accept FNS' management decision on this recommendation.

RECOMMENDATION NO. 2

Instruct the State agency to have Evergreen School District review its program expenditures on a regular basis and establish controls that will allow nonprogram expenditures to be identified and assigned to the appropriate program.

Agency Response

In its written response to the draft report, dated March 28, 2001, FNS stated, "We concur with your findings and recommendations. We will ask the SA for the corrective actions once we receive the official audit report for transmittal to the State."

OIG Position

We accept FNS' management decision on this recommendation.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	Nonprogram salaries and benefits charged	\$60,959	Accounting Classification Error
TOTAL MONETARY RESULTS		\$60,959	

EXHIBIT B – AUDITEE RESPONSE TO DRAFT REPORT



United States Department of Agriculture
Food and Nutrition Service

Western Region

Reply to
Attn of: 27099-15-SF

MAR 28 2001

Subject: FNS - National School Lunch Program
Food Service Management Companies

To: Sam W. Currie
Regional Inspector General for Audit

Food and Nutrition Service (FNS) have reviewed the draft audit report as requested. We concur with your findings and recommendations. Because the district is spending more for meals than it is getting back in reimbursement from the government, the reclassification of janitorial salaries will not reduce reimbursement. Nevertheless, the audit report indicates the State agency (SA) agrees that they should have reclassified the cited salaries to a different account. We believe the audit can stand as written.

We will ask the SA for the corrective actions once we receive the official audit report for transmittal to the State.

If you have any questions, please contact Joycelyn Chow at 415-705-1330, extension 228.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles R. Hendricks", is written above the typed name.

CHARLES R. HENDRICKS
Acting Regional Director
Financial Management
Western Region