



United States Government Accountability Office
Washington, DC 20548

January 30, 2009

The Honorable Herb Kohl
Chairman
The Honorable Robert Bennett
Ranking Member
Subcommittee on Agriculture, Rural
Development, Food and Drug
Administration, and Related Agencies
Committee on Appropriations
United States Senate

The Honorable Rosa L. DeLauro
Chairwoman
The Honorable Jack Kingston
Ranking Member
Subcommittee on Agriculture, Rural
Development, Food and Drug
Administration, and Related Agencies
Committee on Appropriations
United States House of Representatives

Subject: *Meal Counting and Claiming by Food Service Management Companies in the School Meal Programs*

The federal government spends about \$10 billion each year to provide meals to over 30 million students through the National School Lunch and Breakfast Programs. However, a 2007 study estimated that of this amount, \$860 million (8.6 percent) in school year 2005-2006 was paid improperly because of errors in the number of meals counted and claimed for reimbursement.¹ These programs are administered by the United States Department of Agriculture's (USDA) Food and Nutrition Service (FNS) through state agencies that, in turn, oversee local school food authorities (SFA). SFAs that participate in the lunch and breakfast programs receive federal cash reimbursements through the state agency for each meal served, and in the lunch program they also receive USDA commodity donations based on the number of meals served. In return, SFAs must serve meals that meet federal nutrition requirements and offer meals free or at a reduced price to students whose family's income falls below certain thresholds.

¹ USDA, FNS, Office of Research, Nutrition, and Analysis, *Erroneous Payments in the National School Lunch Program and School Breakfast Program: Summary of Findings*, Alexandria, VA, November 2007.

While most of the roughly 13,700 SFAs in traditional public school districts in the United States manage their own programs, about 13 percent choose to contract with private companies known as food service management companies (FSMC).² FSMC involvement in food service activities varies among SFAs, depending on the duties specified in the contract, but these duties may include meal-counting and -claiming activities. Regardless of the duties specified in the contract, however, FNS guidance states that SFAs remain responsible for the overall operation of the school meal programs, including overall financial responsibility. SFAs are also required to ensure the accuracy of lunch claims through effective internal controls.³

On the basis of concern about the nature and extent of FSMC involvement in meal-counting and -claiming activities, we studied the role of FSMCs in managing data used to support federal meal reimbursement claims.⁴ In particular, we examined (1) whether policies and regulations USDA provides states and SFAs on ensuring meal-counting and -claiming accuracy differ when meal services are managed by FSMCs compared with when they are managed by SFAs, and (2) whether there are differences in the accuracy of meal counting and claiming when meal services are managed by FSMCs compared to when meal services are managed by SFAs.

To develop our findings, we reviewed relevant federal laws and regulations on school meal programs, including those with regard to FSMCs. We interviewed officials from USDA, FNS regional offices, the School Nutrition Association, and other organizations that have conducted relevant research. We also conducted structured phone interviews with 19 state agencies in the three FNS regions—Mid-Atlantic, Midwest, and Northeast—with the highest levels of food service management contracting,⁵ and we conducted site visits to three SFAs that contract with FSMCs in York, Pennsylvania; Chicago, Illinois; and Schenectady, New York.⁶ In addition, we reviewed the FNS study that provided national estimates of improper payments in the school meal programs and worked with the contractor for the study to further analyze data to compare the accuracy of meal counting and claiming for SFA-managed and FSMC-managed meal programs.⁷

² Michael D. LaFaive, *A School Privatization Primer for Michigan School Officials, Media and Residents*, Mackinac Center for Public Policy, Midland, Michigan, 2007 (Mackinac study).

³ Internal control is “an integral component of an organization’s management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.” Source: GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3](#). (Washington, D.C.: November 1999).

⁴ This study is in response to House Report 110-258, which accompanied the appropriations bill for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies for fiscal year 2008.

⁵ Mackinac study.

⁶ These sites were selected to ensure a variety of FSMCs, contract types, and counting and claiming systems in the regions with high rates of contracting and their states with high levels of meal reimbursement.

⁷ These study data were collected to estimate improper payments nationally and not to compare differences between SFA-managed and FSMC-managed programs. However, we determined that the data are reliable enough for the purposes of our review. USDA, FNS, Office of Research, Nutrition and Analysis, *NSLP/SBP Access, Participation, Eligibility, and Certification Study—Erroneous Payments in the NSLP and SBP, Vol. I: Study Findings*, November 2007 (APEC).

We conducted this performance audit from January 2008 to December 2008 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit 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.

On November 21, 2008, we briefed appropriate congressional staff on the results of our analysis using the briefing slides we include in enclosure I. This report formally conveys information provided during that briefing. In summary, we reported the following findings:

USDA policies and regulations establish an oversight framework for school meal programs to help ensure accurate meal counting and claiming, and this framework is generally the same for meal services managed by both SFAs and FSMCs except for some additional oversight requirements for FSMCs. USDA regulations require that reviews be conducted at the federal, state, and local levels. FNS must conduct management evaluations of each state agency to review its administration of the school meal programs, including the state's review of SFA contracts with FSMCs. State agencies are required to conduct administrative reviews of each SFA's lunch program at least every 6 years, including a review of the meal-counting and -claiming system. Additionally, state agencies must compare SFA monthly lunch claims to a proxy for attendance to identify potential claim errors.⁸ When an SFA contracts with an FSMC, the state agency must also review the contract to ensure compliance with federal regulations,⁹ and some state agencies have developed prototype contracts to facilitate this review process. At the local level, SFAs are required to conduct annual on-site reviews of each school in the lunch program to detect problems that would lead to meal-counting and -claiming errors. SFAs are also required to review each school's daily lunch counts to identify potential overcounts. In addition, when an FSMC is present, SFAs must conduct periodic visits to monitor the FSMC's food service operation.

Meal-counting and -claiming errors occur at similar or somewhat lower rates when FSMCs manage meal services compared to when SFAs manage meal services. Errors can occur when cashiers improperly determine whether a meal is reimbursable. Error rates at this stage, which tended to be the highest, were generally the same between the two management types. Errors can also occur when meal counts are totaled and reported incorrectly, and are called aggregation errors. They can occur at the point of sale, when meal counts are sent from the school to the SFA, and again from SFA to the state. The differences in error rates between FSMC-managed and SFA-managed meal services were not statistically significant for these aggregation errors, with the exception of errors that occurred when meal counts were sent from the school to the SFA. In this case, error rates for FSMC-managed programs were lower than those of SFA-managed programs. We could not determine if FSMCs directly contributed to this lower error rate

⁸ The proxy for student attendance is determined by first adjusting for the difference between enrollment and attendance (attendance factor) and then multiplying this attendance factor by the number of students eligible for meals under each category.

⁹ In October 2007, USDA issued procurement regulations that require states to review FSMC contracts prior to execution. 72 Fed. Reg. 61, 479.

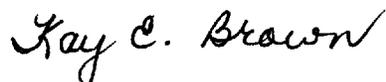
because FSMC involvement in meal counting and claiming varied across locations. Finally, FNS and state officials we interviewed said that they do not find additional meal-counting and -claiming problems when FSMCs manage meal services.

In conclusion, when SFAs contract with FSMCs to manage their meal services, SFAs remain responsible for the accuracy of meal claims, and a robust system of internal controls can help mitigate the risk of financial losses from FSMC errors in meal counting and claiming. Although this study focused on circumstances where SFAs contracted with FSMCs, the similar error rates found between SFA-managed and FSMC-managed programs, along with the 8.6 percent error rate in the program overall, suggest that the nature of the problem requires a programwide approach rather than a focus on FSMC-managed meal services. Additional analyses are needed to identify potential remedies. In a separate study, we are currently conducting a programwide review of these errors.

We provided a draft of this report to USDA for review and comment. In its comments, USDA's FNS generally agreed with the draft report and provided technical comments, which we have incorporated where appropriate.

We are sending copies of this report to relevant congressional committees and other interested parties and will make copies available to others upon request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>. If you or your staff have any questions about this report, please contact me at (202) 512-7215 or BrownKE@gao.gov. Contact points for our Offices at Congressional Relations and Public Affairs may be found on the last page of this report. GAO contact and staff acknowledgments may be found in enclosure II.

Sincerely yours,



Kay Brown
Director, Education, Workforce,
and Income Security Issues

Enclosures - 2



**Meal Counting and Claiming by Food Service
Management Companies in the School Meal Programs**

**Briefing for the
Subcommittee on Agriculture, Rural
Development, Food and Drug Administration,
and Related Agencies,
House Committee on Appropriations**

November 21, 2008

Contents

- Introduction
 - Objectives
 - Scope and Methodology
 - Summary of Findings
 - Background
 - Objective 1: Existing Policies and Regulations when School Food Authorities Contract with Food Service Management Companies
 - Objective 2: Accuracy of Meal Counts when Food Service Management Companies Manage Meal Services
 - Concluding Observations
 - Appendix I: Procurement of Point-of-Sale Systems
 - Appendix II: Standard Errors for Estimates
-

Introduction

- The National School Lunch and Breakfast Programs (school meal programs) provide meals to over 30 million students each year.
 - These programs are administered by the United States Department of Agriculture's (USDA) Food and Nutrition Service (FNS) through state agencies that then oversee local school food authorities (SFA), which usually coincide with school districts.
 - SFAs claim reimbursements from the state agencies based on the number of meals served. In school year 2005-2006, these reimbursements amounted to \$10 billion in federal funds.
-

Introduction

- FNS recently estimated that of this 2005-2006 amount, \$860 million (8.6 percent) in improper payments resulted from errors in the number of meals counted and claimed for reimbursement.¹ Improper payments include both overpayments in which the SFA receives more in reimbursements than it should, as well as underpayments in which it receives less in reimbursements than it should.
- While most of the roughly 13,700 SFAs in traditional public school districts in the United States manage their own meals services (including meal-counting and -claiming activities), about 13 percent contract out their meal services to private companies known as food service management companies (FSMC).²

¹ This estimate should be considered the maximum because the method FNS's contractor used to calculate it did not eliminate offsetting errors that might occur. The standard error for this estimate should be no larger than about \$210 million. For more details about standard errors, see appendix II. USDA FNS, Office of Research, Nutrition, and Analysis, *Erroneous Payments in the National School Lunch Program and School Breakfast Program: Summary of Findings*, Alexandria, VA, November 2007.

² LaFaive, M. D., *A School Privatization Primer for Michigan School Officials, Media and Residents*, Mackinac Center for Public Policy, Midland, Michigan, 2007 (Mackinac study).

Objectives

- We studied the role of FSMCs in managing meal count data used to support the federal reimbursement claim and examined³
 1. whether policies and regulations USDA provides states and SFAs on ensuring meal-counting and -claiming accuracy differ when meal services are managed by FSMCs compared with when they are managed by SFAs, and
 2. whether there are differences in the accuracy of meal counting and claiming when meal services are managed by FSMCs compared to when meal services are managed by SFAs.

³This study is in response to House Report 110-258, which accompanied the appropriations bill for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies for fiscal year 2008.

Scope and Methodology

For objective 1, we

- reviewed federal laws and regulations relevant to the operation of federal meal programs, including those with regard to FSMCs;
- conducted in-depth interviews with officials from USDA, USDA's Inspector General, FNS regions, the School Nutrition Association, and organizations that have conducted relevant research;
- conducted structured phone interviews with the 19 state agencies in the three FNS regions with the highest levels of contracting—Mid-Atlantic, Midwest, Northeast;⁴ and
- visited three SFAs that contract with FSMCs, to observe their meal-counting and -claiming procedures—York, Pennsylvania; Chicago, Illinois; and Schenectady, New York. We chose these SFAs to ensure a variety of FSMCs and meal-counting and -claiming systems in the regions with high rates of contracting and their states with high levels of meal reimbursement.

⁴ According to data from the Mackinac study, 75 percent of all SFAs that contract with FSMCs are in these three regions.

Scope and Methodology (cont.)

For objective 2, we

- reviewed an FNS study that provided the first nationwide estimates on improper payments in the school meal programs and worked with its contractor to further analyze data in order to compare the accuracy of meal counting and claiming for SFAs that contract with FSMCs with SFAs that managed their own meal programs;⁵
- focused our analysis on meal-counting and -claiming errors, known as noncertification errors;⁶ and
- performed a comprehensive literature review of available reports on improper payments and food service management companies in the school meal programs, including reviews by USDA's Office of Inspector General, state auditors, and research organizations.

⁵These data were collected to estimate improper payments nationally and not to compare differences between SFA-managed and FSMC-managed programs. However, we reviewed the study's methodology and determined that the data are reliable enough for the purposes of our review. USDA, FNS, Office of Research, Nutrition and Analysis, *NSLP/SBP Access, Participation, Eligibility, and Certification Study—Erroneous Payments in the NSLP and SBP, Vol. I: Study Findings*, November 2007 (APEC).

⁶Another source of improper payments is certification errors: errors resulting from mistakes in certifying the eligibility status of students.

Scope and Methodology (cont.)

We conducted this performance audit from January 2008 to December 2008 in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit 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.

Summary of Findings

1. USDA policies and regulations establish an oversight review framework for meal counting and claiming in which most requirements are generally the same for meal services managed by SFAs and FSMCs, with certain additional requirements that are specific to FSMC-managed programs, such as annual state review of SFA contracts with FSMCs and periodic visits by SFAs to monitor FSMC operations.
2. Data we obtained show that meal-counting and -claiming errors occur at similar or somewhat lower rates when FSMCs manage meal services compared to when SFAs manage meal services. Similarly, FNS and state officials we interviewed said that FSMC-managed programs are no more likely to experience meal-counting and -claiming problems than SFA-managed programs.

Operation of the Federal School Meal Programs

- SFAs participating in school meal programs receive cash reimbursements from the federal government through their state agency for each meal served.⁷ In the lunch program, they also receive USDA commodity donations based on the number of reimbursable meals served.
- In turn, schools must
 - serve nutritious and well-balanced meals, meaning the meals meet federal nutrition requirements, and
 - offer meals free or at a reduced price to students whose family's income falls below certain thresholds. Students whose family's income is above the threshold must buy a "paid meal."⁸

⁷ In 2008-2009, FNS basic cash reimbursement rates for meals are as follows: \$2.57 for each free lunch, \$2.17 for each reduced-price lunch, and \$0.24 for each paid lunch and \$1.40 for each free breakfast, \$1.10 for each reduced-price breakfast, and \$0.25 for each paid breakfast. FNS has higher reimbursement rates for Alaska and Hawaii, and for schools with high percentages of low-income students.

⁸ Children from families whose income is at or below 130 percent of the poverty level are eligible for free meals. Those whose income is between 130 and 185 percent of the poverty level are eligible for reduced-price meals.

Role of Food Service Management Companies

- Although most SFAs directly manage their meal programs, about 1,800 of the roughly 13,700 SFAs (13 percent) in traditional public school districts contract with FSMCs.⁹
- USDA regulations allow SFAs to contract with FSMCs to manage any aspect of their school food service. According to FNS guidance, however, SFAs remain responsible for the overall operation of the school meal programs, including overall financial responsibility.
- FSMC involvement can vary from district to district depending on the duties specified in the contract. FSMC duties may include food purchasing and storage, meal service, menu planning, and employee hiring and training.

⁹ Mackinac study.

Nationwide Study Found High Error Rates in School Meal Programs

FNS study estimated improper payments for 2006:¹⁰

Improper payments (combination of overpayments and underpayments)
 In millions of dollars (percentage of all reimbursements)

	Breakfast	Lunch	Total
Total federal reimbursements	\$1,938	\$8,060	\$9,998
Improper payments due to certification error¹¹	\$177 (9.1%)	\$759 (9.4%)	\$935 (9.4%)
Improper payments due to meal-counting and -claiming errors¹²	\$306 (15.8%)	\$555 (6.9%)	\$860 (8.6%)

Source: APEC study.

Note: Totals may not add up due to rounding.

- While the breakfast program is smaller in terms of dollars, there were higher rates of meal-counting and -claiming error in the breakfast program compared to the lunch program.

¹⁰USDA FNS, Office of Research, Nutrition, and Analysis, *Erroneous Payments in the National School Lunch Program and School Breakfast Program: Summary of Findings*, November 2007.

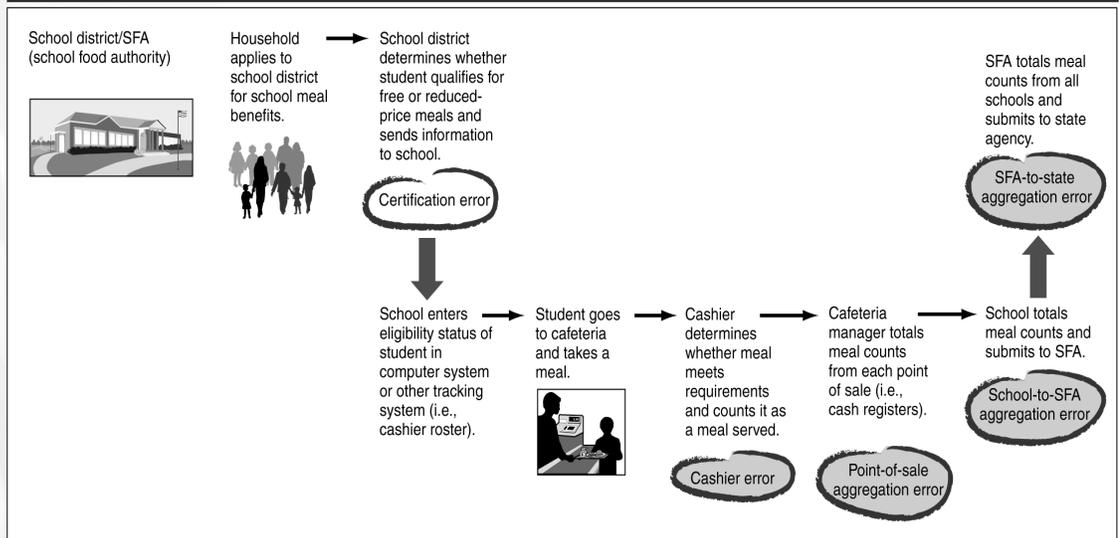
¹¹Certification errors result from mistakes in certifying the eligibility status of students. The standard errors for these estimates are provided in appendix II.

¹² These estimates should be considered the maximum because the method FNS's contractor used to calculate them did not eliminate offsetting errors that might occur. The standard errors for these estimates are provided in appendix II.

Meal-Counting and -Claiming Process

- According to the FNS study, there are two main types of meal-counting and -claiming errors, both of which may contribute to improper payments:
 - **Cashier error:** cashiers improperly determine whether a meal is reimbursable.
 - **Aggregation error:** meal counts are totaled and reported incorrectly at any of three stages in the meal counting and claims process:
 - Point-of-sale: Cash register totals of meal counts are inaccurate (see app. I for a discussion of point-of-sale system procurement, slides 36 and 37).
 - School-to-SFA: School totals reported to SFA are inaccurate.
 - SFA-to-state: SFA meal claims to state agency are inaccurate.

School Meal Process and Steps Where Errors Can Occur



Sources: GAO analysis, FNS Access, Participation, Eligibility, and Certification study; Art Explosion (clip art).

Background (cont.)

Counting and Claiming Errors Can Result In Overpayments or Underpayments

- Overpayments can occur when SFAs submit claims for reimbursement for more meals than they actually served to eligible children. If overpayments are detected, states may recover the overpayment from the SFA.¹³
- Underpayments can occur when SFAs submit claims for reimbursement for fewer meals than they actually served to eligible children. This results in a loss of revenue to the SFA.
- The cost to the federal government is the net amount of overpayments minus underpayments.

¹³ If the state fails to recover the overpayment from an SFA in the lunch program, FNS may assess a claim against the state agency.

Meal-Counting and -Claiming Process and Internal Controls

- Ensuring the accuracy of meal claims requires effective internal controls, including program oversight. USDA regulations establish an oversight structure that requires FNS to oversee states, states to oversee SFAs, and SFAs to oversee and monitor its FSMCs, if utilized.
 - Internal controls are the methods of ensuring that a program operates efficiently, with reliable financial reporting, and in compliance with laws and regulations.¹⁴
 - Regardless of the FSMC's level of involvement in meal-counting and -claiming activities, SFAs are required to ensure the accuracy of lunch claims through effective internal controls. Effective internal controls could include periodically comparing claims to source data, periodically observing the counting and claiming activities, and verifying that cashiers are properly trained.

¹⁴ Internal control is "an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." Source: GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3. (Washington, D.C.: November 1999).

USDA's Oversight Review Framework Is Generally the Same for Meal Services Managed by Both SFAs And FSMCs, with the Exception of Some Added Oversight Requirements

USDA policies and regulations establish an oversight review framework for FNS regions, states, and SFAs to help ensure accurate meal counting and claiming. This framework is generally the same for meal services managed by both SFAs and FSMCs, with some additional oversight requirements for FSMC-managed programs:

- FNS issues policies and guidance and conducts management evaluations of each state agency.
 - State agencies are to review monthly meal claims and conduct administrative reviews of each SFA's meal-counting and -claiming system for the lunch program. They are also required to review any contracts between SFAs and FSMCs to ensure compliance with federal regulations.
 - SFAs are to conduct annual on-site reviews of each school and review daily meal counts for the lunch program. In addition they are to conduct periodic visits to oversee FSMC operations.
-

Federal and State Oversight Framework

USDA regulatory requirements

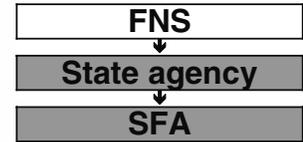
(Bolded text shows provisions specific to FSMCs)

FNS	•must conduct management evaluation of each state agency’s administration of programs, including state oversight of meal claims.
State agencies	•are required to conduct administrative reviews of each SFA at least once every 6 years, including review of meal-counting and -claiming systems for the lunch program; •are to perform monthly reviews of claims, comparing meal counts in each benefit category to a proxy for attendance; and • must review FSMC contracts annually to ensure compliance with federal regulations, including provisions requiring the FSMC to retain data used to support meal claims.
SFAs	•must conduct an annual on-site review of each school to review its meal-counting and -claiming system for the lunch program, • must conduct periodic visits to monitor FSMC operations, and •are to review daily meal counts to identify potential overcounting.

Objective 1: Program Controls



FNS Issues Policies and Guidance Requiring SFAs That Contract with FSMCs to Be Responsible for the Accuracy of the Claim



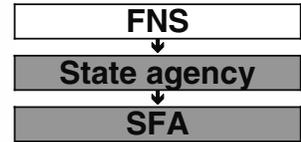
- SFAs that employ an FSMC must remain responsible for the accuracy of meal claims.
 - According to USDA regulations, the SFA official signing the lunch claim shall be responsible for reviewing and analyzing the meal counts to ensure accuracy.
 - FNS guidance to SFAs further clarifies that this responsibility must not be delegated by an SFA to an FSMC.
- Because they are responsible, the SFAs may be at risk for financial losses if they do not have adequate procedures in place to ensure accuracy.¹⁵

¹⁵ To guard against this potential loss, FNS guidance encourages SFAs to add a provision in the contract that requires the FSMCs to pay the SFA for any overclaims due to FSMC negligence or noncompliance with regulations.

Objective 1: Program Controls



FNS Conducts Management Evaluations

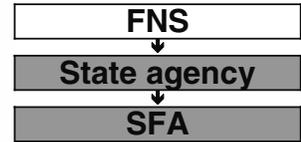


- FNS regional offices conduct management evaluations of each state agency that examine a variety of issues, including some that are specific to FSMCs:
 - reviews of FSMC contracts,
 - the claims payment process, and
 - state administrative reviews of SFAs.
- FNS guidance on management evaluations states that these evaluations should
 - determine whether the state agency is reviewing each contract to ensure compliance with federal requirements, including the requirement that SFAs oversee the FSMC's meal-counting and -claiming activities, and
 - determine whether the state agency is performing its administrative reviews and checking for compliance with FSMC specific provisions: e.g., SFA oversight of FSMC meal counting and claiming.

Objective 1: Program Controls



FNS Management Evaluations Identified Some Problems and Required Corrective Action

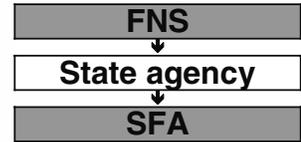


- FNS management evaluations in regions we visited found some contracts that did not include all required provisions, some of which were specific to FSMCs. These included the following:
 - In one state, the FNS region's management evaluation found that the state's administrative review of SFAs did not include a check that FSMC contracts included the provision that SFAs remain responsible for the accuracy of the meal claim.
 - Two regions similarly reported that in one state in each region, FSMC contracts did not contain all required federal provisions such as those requiring SFAs to remain responsible for the accuracy of the meal claim.
- In each case, we found that the states were required to take corrective action in order to improve their administrative and contract review procedures. For example, one of the states revised its contract review checklist to include a check for the missing required regulatory language.

Objective 1: Program Controls



States Generally Conduct the Same Administrative Reviews of SFA- and FSMC-Managed Programs

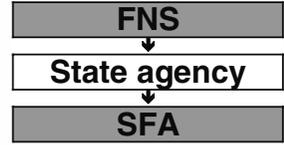


- USDA regulations require states to conduct administrative reviews at least once every 6 years for each SFA participating in the lunch program. The main meal-counting and -claiming procedures established in USDA regulations and FNS guidance apply to both SFA- and FSMC-managed meal services. These reviews include basic checks for internal control procedures such as
 - observing meals served to determine whether they meet federal reimbursement requirements and
 - checking to ensure that each type of cafeteria line provides accurate point-of-sale meal counts, and that counts are correctly recorded.
- Officials in states we visited said they generally follow the same meal-counting and -claiming procedures in their administrative reviews for all SFAs, regardless of whether an FSMC manages the programs.

Objective 1: Program Controls



States Must Review Meal Claims and Require SFA Approval of Each Claim



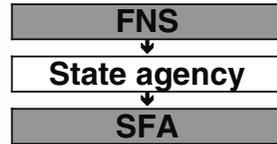
- States review meals claims by comparing meal counts in each reimbursement category to a proxy for student attendance.¹⁶
- In the three states we visited, state officials told us that they either prohibited FSMC employees from submitting the meal claim or they required SFAs to approve claims submitted by their FSMCs.
 - Two state agencies do not grant FSMC employees access to their state systems for submitting meal claims.
 - In the third state, the agency allowed FSMCs to submit meal claims but required SFAs to review and sign off on them.

¹⁶ The proxy for student attendance is determined by first adjusting for the difference between enrollment and attendance (attendance factor) and then multiplying this attendance factor by the number of students eligible for meals under each category.

Objective 1: Program Controls



States Review FSMC Contracts for Compliance with USDA Regulations



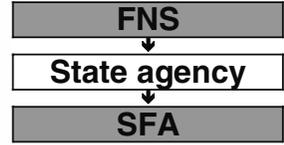
- USDA regulations require states to review SFA contracts with FSMCs.¹⁷ These reviews check that the contract includes required provisions, including the following, that pertain to meal counting and claiming:
 - FSMCs must maintain records needed to support the meal claims, and
 - FSMCs must report claim information each month to the SFA.
- According to FNS guidance, state review of these contracts is important because the contract is the basis for successful oversight of an FSMC by the SFA. The guidance also specifies that states must carefully examine the terms of a contract to ensure that
 - the SFA does not delegate those responsibilities assigned to the SFA by regulations, and
 - the services expected of the FSMC are clearly specified.

¹⁷USDA issued new procurement regulations in October 2007 that require states to review FSMC contracts prior to execution. 72 Fed. Reg. 61, 479.

Objective 1: Program Controls



Some States Develop a Prototype Contract to Speed Contract Review

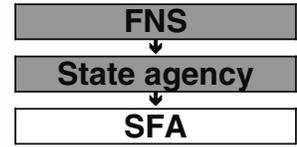


- FNS guidance encourages state agencies to develop a prototype contract to maximize efficiency in their review of SFA contracts with FSMCs. Of the 19 states whose officials we interviewed, 11 said they developed a prototype FSMC contract for use by SFAs:
 - Five of these states require SFAs to use their prototype contract.
 - Six states recommend that SFAs use their prototype contract.

Objective 1: Program Controls



SFAs Are Required by USDA Regulations to Conduct Annual On-site Reviews of Each School

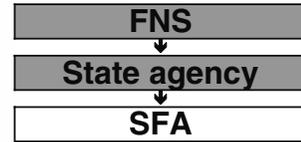


- USDA regulations require SFAs to conduct annual on-site reviews of each school's meal-counting and -claiming system for the lunch program, whether managed by FSMCs or not.
- According to regulations, these reviews are to ensure that the school's counting system, as implemented, yields the actual number of reimbursable free, reduced-price, and paid lunches on each day of operation.
- According to FNS officials, an annual on-site review should detect problems that would lead to meal-counting and -claiming errors. State agencies are required to check that SFAs conduct on-site reviews and document any corrective action required to fix identified problems.

Objective 1: Program Controls



State Officials Said SFA Annual On-site Reviews Generally Do Not Find Problems Related to FSMCs



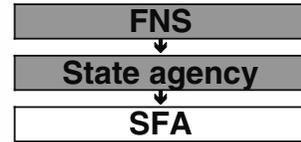
- When asked whether SFA annual on-site reviews found problems associated with FSMCs, most state officials we interviewed said that either the problems found were not related to FSMCs or that on-site reviews rarely found any problems at all. Of the 19 states we interviewed:¹⁸
 - Nine said that no findings seem related to FSMC use
 - Eight said that on-site reviews rarely find problems
 - Two said they did not know/had not analyzed

¹⁸ This question did not apply to one state since it has no FSMCs in public SFAs that have more than one school; only SFAs with more than one school need to conduct on-site reviews of each school in the SFA. Another state said both that there were no findings that seem related to FSMC use and that on-site reviews rarely find problems.

Objective 1: Program Controls



State Officials Questioned the Effectiveness of Annual SFA On-site Reviews, but for Reasons Unrelated to FSMCs

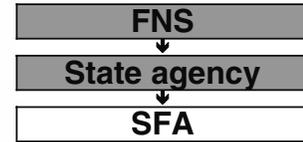


- Some state officials we interviewed questioned the effectiveness of SFA annual on-site reviews, but for one or more reasons unrelated to FSMCs. For example, some state officials said that the people conducting the reviews were not qualified to conduct them effectively. Other officials said that SFAs did not view the annual on-site review as an opportunity to monitor the food service employees. In addition, according to officials in one state, about 20 percent of the required SFA reviews had not been conducted at all. When this occurs, according to this state's official, they issue a corrective action plan requiring the SFA to conduct the annual on-site review within 20 to 30 days.
- We are currently conducting additional work in this area in a separate study.

Objective 1: Program Controls



SFAs Monitor the FSMC's Operations through Periodic Visits

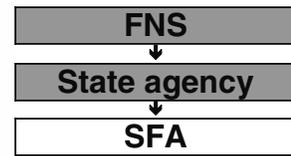


- USDA regulations require SFAs to monitor the FSMC's food service operation through periodic visits.
- USDA guidance states that these visits should determine if the FSMC's food service operation is in conformance with program regulations, as outlined in the SFA's agreement to participate in the program, and document their visits.
- USDA guidance further outlines that contract-monitoring responsibilities include evaluating data and documentation to support the meal claim.
- SFAs we visited varied in the frequency of their visits with FSMC officials.
 - Officials in one SFA reported that they met with their FSMC official several times daily, and conducted quarterly reviews of FSMC operations.
 - Another SFA's officials reported that they conducted weekly meetings with the FSMC.
 - A third SFA's officials said they regularly visited school cafeterias to monitor cashiers.

Objective 1: Program Controls



SFA Review of Daily Meal Counts and FSMC Level of Involvement Varied in the SFAs We Visited



- SFAs we visited varied in the extent to which they relied on FSMCs for meal-counting and -claiming activities and exercised oversight as allowed under FNS regulations.
 - At one SFA, all meal-counting and -claiming activities were done by SFA employees. Lunchroom managers submitted daily meal counts to the SFA office, which submitted regular claims to the state agency.
 - At another SFA, the FSMC was responsible for parts of the meal-counting and -claiming activities, including conducting edit checks of the data. The FSMC compiled daily meal counts from schools, and submitted a monthly claim report to the SFA for submission to the state agency.
 - At the third SFA, the FSMC was heavily relied upon for all aspects of the meal counting and claiming. An FSMC official worked with an SFA official to review claim data for errors and enter the claims into the state system, but the SFA official conducted the final verification and submitted the claim in the state's meal claim system.

Objective 2: Summary



Meal-Counting and -Claiming Errors Occur at Similar or Somewhat Lower Rates When FSMCs Manage Meal Services Compared to When SFAs Manage Meal Services

- SFA- and FSMC-managed meal services had generally similar rates of error at the following stages of the meal-counting and -claiming process:¹⁹
 - cashier errors (these rates tended to be the highest),
 - point-of-sale aggregation errors (these rates were relatively low), and
 - SFA-to-state aggregation errors (these rates were also relatively low).
- FSMC-managed programs had somewhat lower error levels for school-to-SFA aggregation than SFA-managed programs, and these differences were statistically significant.

¹⁹ Differences in error rates were not statistically significant.

Objective 2: Accuracy of Meal Counting and Claiming



Meal-Counting and -Claiming Errors Occur at Similar or Somewhat Lower Rates When FSMCs Manage Meal Services Compared to When SFAs Manage Meal Services (cont.)

Counting and Claiming Errors in the Breakfast and Lunch Programs, by FSMC- and SFA-managed Programs²⁰

Gross errors as percentage of all reimbursements (in millions of dollars)

	Breakfast program		Lunch program	
	FSMC-managed	SFA-managed	FSMC-managed	SFA-managed
Cashier error	6.4%	10.4%	4.6%	2.8%
	(\$16.1)	(\$172.9)	(\$63.3)	(\$180.4)
Point-of-sale aggregation error	0.8%	0.2%	0.1%	0.4%
	(\$1.4)	(\$3.3)	(\$1.0)	(\$25.2)
School-to-SFA aggregation error²¹	0.2%	4.5%	0.1%	2.4%
	(\$0.4)	(\$76.8)	(\$1.7)	(\$160.9)
SFA-to-state aggregation error	0.2%	2.1%	1.5%	1.5%
	(\$0.5)	(\$34.1)	(\$22.0)	(\$95.8)

Source: GAO and Mathematica Policy Research analysis of APEC data.

²⁰ See appendix II for standard error estimates.

²¹ Differences are statistically significant.

FSMC Involvement in Aggregating School-to-SFA Meal Counts Varied Depending on Location

- The extent to which FSMCs were involved in aggregating meal counts differed by location, making it difficult to identify why this type of error was lower in FSMC-managed programs.
 - FNS officials stated that FSMCs are likely to be involved in aggregating meal counts but said the extent to which this occurs can vary, depending on location.
 - In 12 of 19 states, officials we interviewed reported that FSMC employees are involved to a great or very great extent in point-of-sale and school-to-SFA aggregation. However, officials in 7 of the 19 states said FSMC employees were either not involved or involved to a little to moderate extent.
 - On our site visits to SFAs, FSMC involvement in aggregating meal counts varied from no involvement at one SFA to heavy involvement in another.

 - On the basis of this information, we could not determine whether FSMCs directly contributed to the lower error rate at the school-to-SFA level.
-

FNS and State Officials Stated that They Do Not Find Additional Meal-Counting and -Claiming Problems When FSMCs are Involved

- FNS officials we interviewed said that on the basis of their experience, the involvement of an FSMC should not affect the accuracy of meal counting and claiming.
 - Moreover, officials in 16 of 19 states we interviewed said their administrative reviews do not find problems any more or less frequently when FSMCs manage the program.
 - Some state officials we interviewed questioned the effectiveness of SFA annual on-site reviews in general but did not think they were any less effective when FSMCs manage the program.
-

Concluding Observations

- When SFAs contract with FSMCs to operate their school meal programs, a robust system of internal controls can help mitigate the risk that they will incur financial losses from FSMC counting and claiming errors—either because they are held responsible for overpayments or because they do not receive the total amount of federal funds to which they are entitled.
 - Although this study focused on circumstances where SFAs contracted with FSMCs, the similar error rates among SFA-managed and FSMC-managed programs, combined with the relatively high overall error rate, suggest that the nature of the problem requires a more systematic, program-wide approach rather than a focus specifically on FSMC-managed programs.
 - Because we did not assess the effectiveness of the various oversight elements we identified, it is not clear whether the framework itself is not adequate or the elements of the framework are not well implemented, or both. Additional analyses are necessary to identify potential remedies. In a separate study, we are currently conducting a program-wide review of these errors.
-

Appendix I: Procurement of Point-of-Sale Systems

- Point-of-sale software systems are one of the tools that SFAs and FSMCs can use to count meals.
 - USDA requires all procurement transactions conducted by SFAs or FSMCs, acting on behalf of SFAs, to be conducted in a manner providing full and open competition, consistent with the standards set forth in its regulations.
 - FNS officials told us that these standards are satisfied when, for example, an SFA's original request for proposals (RFP) includes a request for the FSMC to provide a point-of-sale system, or to act on the SFA's behalf in obtaining a point-of-sale system.
 - However, FNS officials also noted that if an SFA has an existing contract with an FSMC that does not provide for the FSMC to provide a point-of-sale system, and the FSMC later purchases a point-of-sale system without the SFA having issued a new competitive RFP, such a procurement would be in violation of USDA's procurement standards.
-

Appendix I: Procurement of Point-of-Sale Systems (cont.)

- FNS recently issued new regulations that, among other things, require states to review contracts prior to their execution and to ensure that the relevant procurement standards, including those related to full and open competition, are satisfied. These regulations are being phased in by states.
 - FNS is developing Web-based procurement training for state agency officials that address issues related to full and open competition. On December 10, 2008, FNS released an initial phase of the training on general procurement requirements and responsibilities. FNS plans to release training to SFAs at a later date.
-

Appendix II: Standard Errors for Estimates

Standard errors for dollar estimates of certification and meal-counting and -claiming errors for the breakfast and lunch programs, reported in slides 4 and 12 (in millions of dollars)²²

	Breakfast	Lunch	Total
Improper payments due to certification error	\$18	\$54	\$57 maximum
Improper payments due to meal-counting and -claiming errors	\$111 maximum	\$171 maximum	\$210 maximum

Source: APEC study; GAO analysis.

²²Standard error is a statistic used to calculate the range of values that express the possible difference between the sample estimate and the actual population value. We calculated maximum standard errors for some estimates because we did not have information on how error at one level (e.g., cashier) influences error at another level (e.g., point-of-sale aggregation). To calculate these maximum standard errors, we assumed there was no influence from one level to another (covariance).

Appendix II: Standard Errors for Estimates (cont.)

Standard errors for counting and claiming errors when FSMCs manage meal services compared to when SFAs manage meal services, reported in slide 32, as a percentage of all reimbursements (standard errors for dollars)

	Breakfast program		Lunch program	
	FSMC-managed	SFA-managed	FSMC-managed	SFA-managed
Cashier error	3.4% (\$9.2)	2.8% (\$52.7)	1.8% (\$29.5)	0.5% (\$33.0)
Point-of-sale aggregation error	0.5% (\$0.9)	0.2% (\$2.5)	0.1% (\$0.8)	0.2% (\$13.3)
School-to-SFA aggregation error	0.1% (\$0.3)	2.0% (\$35.3)	0.1% (\$1.7)	0.9% (\$62.6)
SFA-to-state aggregation error	0.2% (\$0.5)	1.2% (\$20.2)	1.0% (\$15.2)	0.8% (\$52.6)

Source: Mathematica Policy Research analysis of APEC data.

Enclosure II: GAO Contact and Staff Acknowledgments

GAO Contact

Kay E. Brown (202) 512-7215 or BrownKE@gao.gov

Acknowledgments

Jeremy Cox, Assistant Director, and Paul Schearf, Analyst-in-Charge, managed this assignment. Marcia Carlsen, Anar Ladhani, Joanie Lofgren, Kara Patton, and Lisa Reynolds made significant contributions to this report in all aspects of the work. Carolyn Boyce and Wilfred Holloway provided methodological assistance; Sheila McCoy provided legal support; and Susan Bernstein helped develop the report's message.

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548