



United States Department of Agriculture

OFFICE OF INSPECTOR GENERAL





Healthy, Hunger-Free Kids Act of 2010—Controls Over Food Service Account Revenue

Audit Report 27601-0001-22

What Were OIG's Objectives

Our objective was to evaluate the controls that FNS has in place to ensure that SFAs comply with the food service account revenue requirements outlined in Sections 205 and 206 of HHFKA. In addition, we evaluated FNS' compliance with the requirements outlined in Section 307 of that Act with regards to indirect food costs.

What OIG Reviewed

We reviewed FNS' policies and procedures for ensuring compliance with Sections 205, 206, and 307 of HHFKA, and reports from SFAs, for school years 2013 through 2015.

What OIG Recommends

FNS needs to redesign controls to provide reasonable assurance that SFAs comply with the paid lunch equity and nonprogram food revenue requirements of sections 205 and 206, and that their reports are on time and complete. It needs to supply SFAs with updated guidance concerning indirect costs. The agency needs to establish a date for publishing the annual paid lunch price report.

OIG audited FNS' controls to ensure that SFAs comply with Federal requirements for paid lunch equity, revenues from nonprogram food, and indirect costs.

What OIG Found

The Department of Agriculture's (USDA) Food and Nutrition Service (FNS) cannot ensure that School Food Authorities (SFA) are in compliance with the paid lunch equity and nonprogram foods revenue requirements (Sections 205 and 206) of the Healthy, Hunger-Free Kids Act of 2010 (HHFKA). This occurred because FNS does not have sufficient controls in its Administrative Review Manual to detect SFA noncompliance with those sections. As such, FNS cannot provide assurance that SFA revenues are sufficient to ensure that children with free and reduced price meals receive the full value of Federal funds for healthy nutritious meals.

HHFKA requires FNS to annually publish paid lunch prices for SFAs that receive Federal assistance, but FNS' controls to ensure submission of timely and complete reports from State agencies are ineffective. Also, FNS has not established a reporting date for annually publishing the prices. Without this information, FNS cannot determine if paid lunch prices provide enough revenue to support nutritious meals for all children, and Federal subsidies intended to support free meals for low-income children may continue to be used to fund paid meals.

We also found that FNS has not issued updated guidance on indirect costs, as required by HHFKA. FNS believes that its original guidance from 2011 is sufficient since a subsequent study confirmed information already published by the agency. However, without additional guidance, SFAs may not fully understand their responsibilities regarding payment of indirect costs, and may be making incorrect payments.

FNS generally agreed with our recommendations and we were able to accept management decision on all four recommendations.



United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: September 28, 2015

AUDIT
NUMBER: 27601-0001-22

TO: Audrey Rowe
Administrator
Food and Nutrition Service

ATTN: Mark Porter
Director
Office of Internal Controls, Audits and Investigations

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Healthy, Hunger-Free Kids Act of 2010-Controls over Food Service Account
Revenue

This report presents the results of the subject review. Your written response to the official draft is included at the end of the report. Excerpts from the response and the Office of Inspector General's (OIG) Position are incorporated into the relevant sections of the report. Based on your written response and subsequent clarifications, we have accepted your management decision on all four recommendations.

In accordance with Departmental Regulation 1720-1, final action is to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. For agencies other than the Office of the Chief Financial Officer (OCFO), please follow your internal agency procedures in forwarding final action correspondence to OCFO.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publically available information and will be posted in its entirety to our website (<http://www.usda.gov/oig>) in the near future.

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Background and Objectives

Background

The Richard B. Russell National School Lunch Act as reauthorized by The Healthy, Hunger-Free Kids Act of 2010 (HHFKA) provides funding for Federal school meal and child nutrition programs and increases access to healthy food for low-income children. The National School Lunch Program (NSLP) is a federally assisted meal program providing low-cost or free lunches to more than 30 million children, using cash payments of over \$11 billion in fiscal year (FY) 2014. NSLP operates in over 100,000 public and nonprofit private schools and residential child care institutions. The Food and Nutrition Service (FNS) administers the program at the Federal level. At the State level, NSLP is administered by State education agencies, which operate the program through agreements with School Food Authorities (SFAs), who are responsible for operating the program in one or more schools. Between FYs 2012-2014, there were over 19,000 SFAs participating in the NSLP annually.

HHFKA required several changes in NSLP, including equity in school lunch pricing (Section 205), use of revenue from nonprogram food (Section 206), and a requirement that FNS provide guidance on program rules pertaining to indirect costs (Section 307). Section 205 requires equity in school lunch prices to ensure that children receiving free and reduced price lunches receive the full value of Federal funds. Section 206 requires that revenue from the sale of nonprogram foods sold accrue only to the school food service account; revenue can no longer be allowed to benefit student organizations or school programs. Section 307 requires FNS to issue guidance to ensure the indirect costs associated with the nonprofit school food service account funds are limited to those expenses that are reasonable and necessary to provide quality meals. FNS implemented Section 205 and 206 requirements effective with the school year (SY) beginning July 1, 2011, and forecasted that these new requirements would add about \$2 billion annually to SFA net revenues.¹

HHFKA's Section 205 mandated equity in school lunch pricing by requiring SFAs to gradually raise paid lunch prices, starting in July 2011, until the SFAs' prices match the subsidized lunch rate they received for free lunches, less the subsidized paid lunch rate. Each year, the SFAs compare the average price charged for paid lunches to the difference between the higher Federal reimbursement provided for free lunches and the lower Federal reimbursement provided for paid lunches.² If the average paid lunch price is less than the difference, an SFA must either gradually adjust the average lunch price or provide non-Federal funding to cover the difference.³ SFAs also may vary paid lunch prices by school, as long as the average revenue requirement is met across the SFA. FNS is required to publish annually these SFAs' paid lunch prices, which it posts on its publicly available website.

¹ Federal Register Vol. 76, No. 117, June 17, 2011, Table 2.

² In SY 2014-2015, the average price SFAs were required to charge was \$2.65. The \$2.65 price was the difference between FNS' reimbursement rate of \$2.93 for a free lunch and \$.28 reimbursement for a paid lunch.

³ To assist SFAs' compliance with these requirements, FNS created a Paid Lunch Equity tool to help SFAs calculate the difference and/or to add non-Federal funding if necessary.

Additionally, Section 206 of the HHFKA requires SFAs to accrue revenue generated from the sale of nonprogram foods to the nonprofit school food service account, instead of benefiting other school programs or student organizations. A nonprogram food is a food sold in a participating school other than reimbursable meals and is purchased using funds from the nonprofit school food service account of the school. Examples of nonprogram foods include adult meals and a la carte items, such as extra milk. SFAs must ensure that revenues generated from the sale of these nonprogram foods are equal to, or greater than, the proportion they contribute to the total cost of SFAs' foods.⁴

SFAs incur both direct and indirect costs. Direct costs are incurred specifically for operating the program and typically include the food and food service wages. Indirect costs are incurred for the benefit of multiple programs and are typically administrative overhead, such as facilities management, utilities, etc. Under Section 307, HHFKA required FNS to issue indirect cost guidance within 180 days of enactment, conduct a study of indirect costs, and issue additional guidance based on the results of the study. HHFKA provided \$2 million for a study to assess the extent to which SFAs pay indirect costs, which FNS published in March 2014.⁵ After the study was complete, the section required USDA to issue additional indirect cost guidance⁶ and permitted the Secretary of Agriculture to issue regulations regarding indirect costs.

The Richard B. Russell National School Lunch Act requires a unified accountability system designed to ensure that participating SFAs comply with NSLP requirements. The HHFKA amended some of the provisions related to administrative reviews of SFAs, including requiring that reviews be conducted every 3 years to evaluate program compliance. These reviews are conducted by State agencies using FNS' published review guides, which cover a wide range of program requirements, such as certification, reimbursement, nutrition, resource management, and other general compliance areas. Sections 205 and 206 are covered in the resource management section of the *Administrative Review Manual*.

FNS developed the Resource Management Risk Indicator Tool which uses a risk-based approach to determine the depth of these reviews. FNS officials stated that the purpose of this tool "is to forecast and/or assess, through the use of known indicators, situations that may result in non-compliance."⁷ Prior to a State agency onsite review, FNS requires the State agency to conduct an off-site assessment. For this off-site assessment, SFAs respond to a list of questions. The State agency uses those responses to complete the tool. If those responses trigger a comprehensive review, the State agency must conduct an additional evaluation of Section 205 and 206 program elements during its on-site review.

⁴ FNS created a Nonprogram Food Revenue tool to assist SFAs determine these requirements.

⁵ Glantz, Frederic B., Carissa Climaco, Anne St. George, Christopher W. Logan, Elizabeth Giardino, Marina Komarovsky, and Vinh Tran. *School Foodservice Indirect Cost Study*. Project Officer: John R. Endahl. Prepared by Abt Associates for the U.S. Department of Agriculture, Food and Nutrition Service, March 2014.

⁶ FNS has not issued additional guidance, see Finding 3.

⁷ FNS Administrative Review Manual (last updated September 3, 2014), p. 106.

Objectives

Our objective was to evaluate the controls that FNS has in place to ensure SFAs comply with the food service account revenue requirements outlined in Sections 205 and 206 of HHFKA. In addition, we evaluated FNS' compliance with the requirements outlined in Section 307 of that Act with regard to indirect food costs.

Section 1: Controls for Paid Lunch Equity (Section 205) and Nonprogram Foods (Section 206)

Finding 1: FNS Needs to Ensure SFA Compliance with Sections 205 and 206

FNS cannot ensure that SFAs are in compliance with the HHFKA paid lunch equity and nonprogram foods revenue requirements of Sections 205 and 206 because its administrative review process lacks adequate controls. This occurred because the *Administrative Review Manual* is not designed properly to detect SFA noncompliance with the HHFKA paid lunch equity and nonprogram foods revenue requirements. Without effective controls, FNS cannot provide assurance that SFAs are generating adequate revenue from paid lunches and nonprogram foods. That revenue, generated either through price increases or by contributing sufficient non-Federal funds to make up for the difference between paid and free lunch reimbursements, intended to ensure that children eligible for free and reduced price lunches receive the full value of Federal funds for healthy nutritious meals.

Office of Management and Budget (OMB) Circular A-123 requires agencies to establish and maintain internal control to achieve the objective of compliance with applicable laws, such as Section 205 and 206.⁸ HHFKA required FNS to prescribe and administer a “unified system” ensuring SFAs comply with the Act.⁹ In response, FNS developed a State administrative review process for State agencies to monitor SFA compliance with laws and regulations.¹⁰

To ensure compliance with Sections 205 and 206, FNS relies primarily on the administrative review process conducted by State agencies. Within the administrative review process, State agencies review the Resource Management portion of the SFA’s operations.¹¹ FNS developed a risk-based approach to determine the depth of review needed for the Resource Management section of the administrative reviews, called the Resource Management Risk Indicator Tool. FNS stated in the *Administrative Review Manual* that the purpose of this tool “is to forecast and/or assess, through the use of known indicators, situations that may result in non-compliance.”¹² Prior to a State agency onsite review, FNS requires the State agency to conduct an off-site assessment. For this off-site assessment, SFAs respond to a list of close-ended questions (requiring only a “YES/NO” response with an optional comment field). The State agency uses those “YES/NO” responses to complete the tool.¹³ If those responses trigger a comprehensive review, the State agency must conduct an additional evaluation of Section 205 and 206 program elements during its on-site review.¹⁴ Our review results indicated instances where additional evaluations of SFAs were warranted, but the additional evaluations were not

⁸ OMB Circular A-123, *Management’s Responsibility for Internal Control* (December 21, 2004).

⁹ Pub. L. 111-296 Sec.207 (December 2010).

¹⁰ 7 CFR § 210.18 (January 2014).

¹¹ The Resource Management section of the *Administrative Review Manual* focuses on ensuring the overall financial health of an SFA’s nonprofit school food service. The review focuses on four areas: Maintenance of the Nonprofit School Food Service Account, Paid Lunch Equity, Revenue from Nonprogram Foods, and Indirect Costs.

¹² FNS *Administrative Review Manual* (last updated September 3, 2014) p. 106.

¹³ The information derived from the Off-site Assessment Tool is added to the Resource Management Risk Indicator Tool by the State agency.

¹⁴ If a risk is identified in three or more of the six areas, the State agency must conduct a comprehensive review.

triggered by the Resource Management Risk Indicator tool. Therefore, the State agencies were unable to identify those SFAs and ensure that they were in compliance with Sections 205 and 206.

FNS Improvements Are Needed in Providing Guidance to SFAs on the Reporting Process for Equity in School Lunch Pricing

To meet the requirements of Section 205 of HHFKA, FNS created the Paid Lunch Equity (PLE) tool to help SFAs calculate their paid lunch price increase requirement and non-Federal source contributions. In our review of 12 SFAs¹⁵ in 6 State agencies, we found that 5 SFAs in 4 State agencies did not effectively use the PLE tool. Three of the five SFAs did not complete the PLE tool or did not timely complete the tool¹⁶ and two incorrectly used the PLE tool.¹⁷

For example, one SFA responded in its off-site assessment to the State agency that it had used the PLE tool, and, although the tool required a price increase, it did not raise prices accordingly. Despite its claim to the contrary, we noted that the PLE tool was not used to determine paid lunch prices for SY 2014-2015, as the tool was only filled out one week prior to our visit to the SFA in March 2015. The SFA responded in its off-site assessment that it had increased prices in SY 2013-14 by \$0.50, and did not want to impose a greater hardship on families. The SFA also responded that it uses non-Federal funds to support its paid lunch prices in the amount of approximately \$300,000. The concern with these responses is that if lunch prices were in fact increased by \$0.50 the previous school year and approximately \$300,000 in non-Federal funds were used to support paid lunch prices, the PLE tool would not have indicated that the SFA needed to raise prices, as our calculation of the PLE determined. We also determined that the \$0.50 increase in lunch prices in SY 2013-14 did not occur. Our visit occurred four months after the administrative review was conducted. The administrative review did not discover the discrepancy or recommend any corrective actions for this area.

Because the off-site assessment was inaccurate, State agency reviewers did not identify program areas in need of a comprehensive evaluation during the onsite portion of the administrative review, and subsequently did not follow up with the noncompliant SFA in issuing corrective actions, which allowed the lack of paid lunch equity to go undetected.

The *Administrative Review Manual* states that “corrective action is required for any violation of resource management requirements noted during the off-site assessment phase.” The manual also states that “if the [State agency] identifies the need for corrective action during the risk assessment process, the [State agency] must verify during the onsite portion of the Administrative Review that the SFA has taken the required action(s) necessary to ensure compliance.”¹⁸ However, the manual does not define how to identify SFAs requiring corrective action during the off-site assessment phase or specifics for verifying compliance during the onsite phase; this demonstrates a weakness in the administrative review process. By not defining the questions in the off-site assessment phase that signal a need for corrective action, reviewers

¹⁵ OIG reviewed two SFAs in each State agency.

¹⁶ Two SFAs completed the tool after the school year started and thus could not timely utilize the results of the tool to make necessary changes to lunch prices to comply with Section 205 of HHFKA.

¹⁷ SFAs used incorrect lunch counts and did not use weighted costs for lunch prices.

¹⁸ FNS *Administrative Review Manual* (last updated September 3, 2014), p. 109.

were not able to identify the program areas that need followup for ensuring compliance with paid lunch equity during the onsite assessment portion of the administrative reviews.

FNS Needs to Improve Guidance to SFAs on the Reporting Process for Nonprogram Foods Sold in Schools

To meet the new requirements of Section 206 of HHFKA, FNS created the Nonprogram Food Revenue (NFR) tool for SFAs to calculate the required amount of nonprogram food revenue. We found that none of the SFAs reviewed could demonstrate compliance with Section 206. Of the 12 SFAs reviewed, 4 SFAs did not fill out the tool; 7 did fill out the tool, but could not differentiate food costs between nonprogram and program food costs; and 1 SFA did upgrade its IT system to handle separating costs, but incorrectly reported free meals given to employees under program food costs, even though such meals are not eligible for Federal reimbursement (because the meals are served to adults, they should be reported under nonprogram food costs).

During the off-site assessment phase, State agency reviewers did not identify SFA program areas that needed additional onsite evaluation because the responses to the nonprogram food revenue questions did not accurately portray the situation. For example, one SFA responded in its off-site assessment that, according to the results from the NFR tool, it was in compliance with Section 206. The SFA responded in the assessment that the compliance question was not applicable, as the SFA did not sell nonprogram foods. We conducted our review at the SFA 4 months after the administrative review was conducted, which did not recommend any corrective actions for this area. Our review disclosed that the SFA did sell nonprogram foods, and that the NFR tool had not been filled out for that school year, or any prior school years, to determine compliance with Section 206.

Overall, our review identified a weakness in the administrative review process as the procedures prescribed by FNS' *Administrative Review Manual* may not detect noncompliance with nonprogram food revenue requirements. The off-site assessment phase uses close-ended questions requiring only "YES/NO" responses, which is insufficient to fully identify areas of noncompliance. Also, the *Administrative Review Manual* does not help State agency reviewers determine the depth of review required for the onsite portion of the administrative review.

These noted weaknesses in the level of detailed inquiries and required support for SFA responses during the off-site assessment, coupled with the lack of more comprehensive reviews, reflect that State agency administrative reviews are not adequate to detect noncompliance at the SFA level. FNS officials explained that HHFKA added more requirements and required more frequent reviews.¹⁹ FNS stated that the use of "the [Resource Management Risk Indicator] Tool is expected to lead to a more targeted review that will ultimately facilitate streamlined, consistent, and effective management of program resources at the SFA level."²⁰ FNS officials explained that problems were expected to be found with Section 206 compliance, but not to the extent OIG's audit team identified. FNS expected challenges in splitting out costs between program and nonprogram foods, but not in almost every SFA that was sampled by OIG. FNS explained that, as part of the 2013-2014 Administrative Reviews, State agencies were required to submit

¹⁹ HHFKA changed review periods from every 5 years to every 3 years.

²⁰ FNS *Administrative Review Manual* (last updated September 3, 2014), p. 107.

two SFA administrative reviews and, through review, FNS would be able to assess the adequacy of the new administrative review process and evaluate whether changes are needed. We acknowledge that FNS has developed a new administrative review process that will need revision during the first few years of implementation, but we believe that additional controls over the State agency reviews of SFAs are necessary to ensure compliance with Sections 205 and 206 of HHFKA.

Recommendation 1

Redesign controls to provide reasonable assurance that School Food Authorities (SFAs) comply with paid lunch equity and nonprogram food revenue requirements. At a minimum, FNS should revise the Resource Management Risk Indicator Tool to include sufficient detail for identifying whether SFAs have properly used the Paid Lunch Equity (PLE) and Nonprogram Food Revenue (NFR) tools.

Agency Response

In its September 23, 2015, response, FNS stated:

FNS is currently assessing the Resource Management Risk Indicator Tool to determine the types of changes needed to more effectively ensure that school food authority [*sic*] are complying with the paid lunch equity and nonprogram food revenue requirements. FNS is also reviewing the Resource Management Risk Indicator Tool to assess the best approach to ensure sufficient detail is obtained from the SFAs showing how they are complying with the requirement appropriately.

FNS provided an estimated completion date of August 31, 2016, for this action.

OIG Position

We accept FNS' management decision on this recommendation.

Finding 2: FNS Needs To Better Monitor Program Paid Lunch Prices

FNS did not annually publish the prices SFAs charged for paid lunches to determine whether these prices are increasing in order to “provide additional revenue to support nutritious and [healthy] meals for all students.”²¹ This occurred because FNS does not have effective controls to ensure the paid lunch price reports are complete and submitted timely by the State agencies and published annually, as required by HHFKA.²² Without the complete and timely reporting of SFA-paid lunch prices, FNS and other stakeholders cannot ensure SFAs are effectively increasing paid lunch prices. If paid lunch prices do not increase,²³ Federal subsidies to support free meals for the lowest-income children may continue to be used to fund paid meals. Ultimately, this may impact all children by limiting the funds available for healthy meals.

HHFKA added Section 12 (p) to the National School Lunch Act requiring USDA to establish procedures to annually collect and publish the paid lunch prices charged by SFAs.²⁴ FNS has promulgated regulations that require that SFAs report prices charged for paid lunches to the State agencies and that State agencies report these prices to FNS.²⁵ However, FNS has not established a reporting date for annually publishing the prices. FNS’ policy only states that “because of the need to post information as soon as possible after the due date, State agencies must ensure that complete and accurate information is provided for publication.”²⁶

FNS policy requires submission of the paid lunch price report from the State agencies by the last operating day of November. For SYs 2011-12 and 2012-13, FNS extended the paid lunch price report deadlines. The SY 2011-12 deadline was extended to June 30, 2012, so FNS could establish an email address for State agency submissions and the SY 2012-13 deadline was extended to January 30, 2013, due to the State agencies’ workload involved from the new meal pattern implementation certification. We found that all six of the State agencies in our review submitted incomplete and/or late paid lunch price reports. The Wisconsin and New Mexico State agencies submitted incomplete paid lunch price reports. The paid lunch price report for school year (SY) 2014-15 submitted by the Wisconsin State agency did not include paid lunch prices for 62 SFAs. The State agency ran the paid lunch price report without these SFAs’ paid lunch pricing information because the State agency did not want to submit a late report to FNS. The paid lunch price report for SY 2014-15 submitted by the New Mexico State agency did not include information for 113 SFAs because the State official thought that SFAs that did not

²¹ Federal Register Vol. 76, No. 117, June 17, 2011.

²² Pub. L. 111-296 Sec. 205 (December 2010).

²³ FNS explained in the Federal Register that “the revenue received by schools for paid meals is often too low to cover the cost of those meals. An examination of school meal production costs shows that it cost about \$2.28 to produce a school lunch in school year 2005–06. While USDA’s reimbursement for a free meal (\$2.50), including cash and commodity foods ... was about 9 percent higher than reported production costs total revenues from a paid meal... was 13 percent less. Total revenue from a paid meal represented only 80 percent of the value of Federal support for a free meal. Funding paid meals below the cost of their production effectively shifts Federal subsidies designed for the lowest-income children to others. It can negatively affect all children by limiting the funds available to provide nutritious meals.” Federal Register Vol. 76, No. 117, June 17, 2011.

²⁴ Federal Register Vol. 76, No. 117, June 17, 2011.

²⁵ 7 C.F.R § 210.14(e)(7) (January 2014).

²⁶ FNS Memorandum SP 18-2012, Paid Lunch Price Report (February 24, 2012).

charge any student for paid lunches should not be included in the report.²⁷ However, the FNS policy memo requires that the paid lunch price report include all SFAs, including those that do not charge for paid lunches. If the paid lunch price reports submitted by the State agencies are incomplete, this further delays FNS from providing complete and timely information to its stakeholders.

Additionally, the State agencies in Alaska, Maryland, Wisconsin, Indiana, South Carolina, and New Mexico submitted a number of paid lunch price reports late.²⁸ This occurred because FNS extended the deadlines for the first two SYs of implementation and State agency officials were not aware of the current year deadline for submitting the paid lunch price report. In some cases, some State officials stated they were aware of the changes in deadline, but were awaiting additional guidance with an extension of the due date based on previous FNS policy memos. Furthermore, we found that FNS either did not annually publish the prices for paid lunches that SFAs were charging or did not publish them timely, as required by HHFKA. For example, FNS was 2 years late in publishing the paid lunch price report for SY 2012-13 (see Table 1). Also, as of July 2015, the paid lunch price report for SY 2014-15 had not been published.

Table 1: Paid Lunch Price Reports

| School Year (SY) | Due Date to FNS | Actual FNS Publication Date | Time Lapse |
|-------------------------|------------------------|------------------------------------|---------------------|
| SY 2011-12 | June 30, 2012 | May 17, 2013 | 10 Months |
| SY 2012-13 | Jan. 30, 2013 | Feb. 24, 2015 | 2 Years |
| SY 2013-14 | Nov. 30, 2013 | Feb. 24, 2015 | 1 Year and 2 Months |
| SY 2014-15 | Nov. 30, 2014 | Not Published (as of July 2015) | 7 Months |

In reviewing the reporting and oversight processes we determined that there are multiple reasons for the delays that occurred. We found FNS’ national office relies on its regional offices to oversee the State agencies for the paid lunch price reports. However, the regional offices’ oversight is hampered, as the memoranda instruct the State agencies to submit the paid lunch price reports directly to the FNS national office. In addition, FNS has not established a reporting date for annually publishing the prices, even if the reports were timely and complete. FNS

²⁷ SFAs participating in NSLP under Provision 2 or the Community Eligibility Provision offer free lunches to all students.

²⁸ Number of paid lunch price reports submitted late for each State agency: Alaska—3, Maryland—1, Wisconsin—2, Indiana—1, South Carolina—1, and New Mexico—1. The Paid Lunch Price Reports were submitted between 4 days to 3 months late.

policy only states that “because of the need to post information as soon as possible after the due date, State agencies must ensure that complete and accurate information is provided for publication.”

When asked what challenges prevented the report from being published annually, FNS officials described many challenges faced by SFAs, including staff turnover and an increased workload due to the new nutrition requirements. FNS stated that these challenges caused delays in collecting and reviewing paid lunch price reports according to the schedule. It is our position that, without this information, FNS cannot determine whether SFAs are appropriately increasing paid lunch prices in order to “provide additional revenue to support nutritious and [healthy] meals for all students.” Additionally, without the reports, FNS cannot determine the “revenue gap” between free reimbursement and paid meal revenue levels, nor can it determine when paid meal parity will be reached by all SFAs. Finally, without publishing the reports timely, stakeholders do not have access to comprehensive information regarding how much SFAs are charging for school lunches.

Recommendation 2

Establish a date for publishing the annual paid lunch price report.

Agency Response

In its September 23, 2015, response, FNS stated:

OIG indicated that the paid lunch price report is needed to determine if school food authorities (SFAs) are in compliance with the paid lunch equity (PLE) requirement. The report was not intended to be and is not used as a monitoring tool. It does not collect the data needed to determine compliance if the SFA uses non-Federal funds in addition to or in lieu of adjusting paid lunch prices. Compliance with the PLE requirement is monitored through the administrative review process. The administrative review process for PLE compliance depends on the method(s) used by the SFA to comply with PLE and allows for immediate technical assistance to ensure that SFAs are correctly using whatever compliance method(s) they have chosen. The paid lunch price report is intended to provide, as OIG pointed out, an overview for interested stakeholders and to provide FNS with general information about average paid lunch prices across the nation.

Although FNS disagrees with OIG’s assessment of FNS’s monitoring of paid lunch prices, FNS will establish a date for publishing the annual paid lunch price report. Each State’s consolidated report is due to FNS by the end of November. FNS will post the report on the FNS website no later than March 1.

FNS provided an estimated completion date of March 1, 2016, for this action.

OIG Position

We accept FNS' management decision on this recommendation. To clarify, we recommended this action so that FNS and other stakeholders have a better tool for monitoring that SFAs are effectively increasing paid lunch prices. The finding and resulting recommendations were not directed toward compliance.

Recommendation 3

Develop and implement controls to ensure the paid lunch price reports are complete and submitted timely by State agencies.

Agency Response

In its September 23, 2015, response, FNS stated:

FNS indicated to OIG that there were challenges and delays relating to submission of timely, accurate, and complete reports from SFAs through their State agency. However, the audit findings erroneously indicated that the data in the report is to determine compliance with the PLE requirement.

FNS will develop additional guidance and clarifications for SFAs and State agencies on the information needed and the submission process. This information will be provided through a policy memorandum.

FNS provided an estimated completion date of November 30, 2015, for this action.

OIG Position

We accept FNS' management decision on this recommendation. To clarify, we recommended this action to ensure controls were put in place so that complete and accurate information was timely made available for FNS and other stakeholders.

Section 2: Indirect Costs (Section 307)

Finding 3: FNS Needs to Improve its Indirect Cost Guidance

FNS has not provided additional guidance to State agencies, as required by HHFKA, to ensure their SFAs fully understand the indirect costs they may or may not be responsible for paying. HHFKA required FNS to issue guidance on indirect costs in the first 180 days after passage of the Act; complete a study of those costs by October 1, 2013; and then issue additional guidance based on the results of the study. FNS did issue guidance in the first 180 days (in July 2011), stated that it would publish an update accordingly, and then completed the study (in March 2014). However, FNS has not issued the additional guidance. FNS officials stated this occurred because the study only confirmed information the agency had already published. The agency concluded that changes to the guidance were unwarranted. However, we contend that, since the issuance of the initial guidance, there have been changes in indirect cost requirements, as noted in OMB's new uniform cost guidance, published in December 2013.²⁹ Additionally, an OIG report in April 2015, in which SFA officials stated they were unaware of the FNS guidance, further underscores the need for appropriate guidance.³⁰ Without the additional guidance required by HHFKA or, as stated in FNS's initial July 2011 guidance, SFAs may not fully understand the indirect costs they must pay.

HHFKA's Section 307 required that FNS, within 180 days of the Act's enactment, "issue guidance to school food authorities participating in the school lunch program...covering program rules pertaining to indirect costs." In response to this requirement, FNS published guidance in July 2011 regarding indirect cost applications, development, and requirements.³¹ The guidance also provided examples that could be used by the school food service account staff for classifying expenditures for both direct and indirect costs.

Section 307 provided \$2 million for a mandated study of indirect costs, with a required completion date of October 1, 2013. In March 2014, FNS issued the study of indirect costs, which showed that about 13 percent of SFAs actually paid some indirect costs. The study did not examine the adverse impact of indirect costs to SFAs that are paying them. Instead, the study referred to a forthcoming School Nutrition and Meal Cost Study that would "provide an opportunity to investigate the relationship between charging indirect costs and SFA finances."³² Prior to the mandated report, FNS' last commissioned study, published in 2008, showed that 16 percent of SFAs actually paid some indirect costs.

After the 2013 study was published, the HHFKA required FNS to issue additional guidance based on the results. Prior to the study's release, FNS provided guidance to State agencies for conducting reviews and sent a letter to SFAs detailing the information to be provided to reviewers. However, by the conclusion of our fieldwork in July 2015, FNS still had not published additional guidance to help SFAs understand indirect cost management.

²⁹ Federal Register Vol. 78, No. 248, December 26, 2013.

³⁰ Audit Report 27601-0001-41, *FNS—National School Lunch and School Breakfast Programs* April 28, 2015.

³¹ FNS Memorandum SP41-2011, *Child Nutrition Reauthorization 2010: Indirect Cost Guidance* (July 7, 2011).

³² FNS *School Foodservice Indirect Cost Study* (March 2014), page 86.

FNS officials explained that the initial guidance, consisting of over 100 pages, issued in July 2011, was comprehensive and the regulations regarding indirect costs had not significantly changed.³³ FNS noted that the 2014 indirect cost study only confirmed what FNS already knew about indirect costs and how indirect costs were charged and paid. However, the initial 2011 guidance is the only guidance available to SFAs, and it includes a statement that promises “guidance will be updated to include any necessary and pertinent information based on the findings of the indirect cost study.”

FNS needs to update its guidance, as required by HHFKA, to ensure that SFAs have the most up-to-date information. In December 2013, OMB consolidated cost requirements in its regulations for both direct and indirect costs, which thus made portions of FNS’ 2011 guidance outdated. Additionally, we recently reported that some State agencies and SFAs were unfamiliar with the details of FNS’ indirect cost guidance and we recommended recovery of improperly charged indirect costs.³⁴ Updated guidance would provide SFAs with a better understanding of indirect costs they may or may not be responsible to pay.

Recommendation 4

Provide updated guidance for indirect costs to SFAs.

Agency Response

In its September 23, 2015, response, FNS stated:

In response to the Healthy Hungry Free Kids Act of 2010, FNS issued guidance on indirect costs within the required timeframe. This guidance provides comprehensive coverage of program rules as they pertain to indirect costs, including allowable indirect costs that may be charged to the nonprofit school food service account. Additionally, after completing the study required by the legislation, the guidance was assessed to determine whether additional clarification or updates were necessary. Based on this assessment, additional changes were not deemed necessary. FNS will reissue the guidance incorporating updated citations and references.

FNS provided an estimated completion date of January 31, 2016, for this action.

OIG Position

We accept FNS’ management decision on this recommendation.

³³ Our audit found direct and indirect costs were significantly changed in regulations published in December 2013 that allowed, for example, a “non-Federal entity that has a federally negotiated indirect cost rate may apply for a one-time extension of a current negotiated indirect cost rates for a period of up to four years.” Federal Register Vol. 78, No. 248, December 26, 2013.

³⁴ Audit Report 27601-0001-41, *FNS—National School Lunch and School Breakfast Programs*, April 28, 2015.

Scope and Methodology

We conducted this audit to determine the adequacy of FNS' controls over food service account revenue specific to the requirements outlined in Sections 205 and 206 of the HHFKA for SFAs participating in NSLP during SYs 2012-13 through 2014-15.³⁵ Additionally, we evaluated FNS' compliance with the requirements for indirect costs, as outlined in Section 307 of HHFKA.

We conducted survey fieldwork to gain an understanding of HHFKA requirements and controls in place at the FNS national office in Alexandria, Virginia; the FNS southwest regional office in Dallas, Texas; the Texas Department of Agriculture, Food and Nutrition Division in Austin, Texas; and one SFA in Texas. Survey fieldwork was conducted from September 2014 through November 2014.

At FNS' national office, we familiarized ourselves with FNS' policies, program operation, and internal controls for the implementation of Sections 205, 206, and 307. At the FNS regional office, we evaluated its oversight responsibilities and operating policies related to Sections 205 and 206 of HHFKA. At the State agency, we evaluated the role of the agency in developing and implementing policies applicable to Sections 205 and 206 of HHFKA, including oversight responsibilities and guidance to the SFAs.

We conducted audit fieldwork at the FNS national office, 6 State agencies, and 12 SFAs from December 2014 to July 2015. We non-statistically selected State agencies responsible for the oversight of SFAs in Alaska, Indiana, Maryland, New Mexico, South Carolina, and Wisconsin. To select our sample of State agencies, we compared data provided by FNS on participation and cash payments to data provided by the U.S. Census Bureau to identify trends and potential areas for review.

At the selected State agencies, we evaluated their processes for ensuring SFAs are complying with HHFKA and FNS procedures, including any laws or regulations that may impact the objectives of this audit. We also examined the State agencies' process for conducting the resource management section of administrative reviews to determine whether State agencies are verifying SFA compliance with Sections 205 and 206 of HHFKA. For specific testing, we selected a non-statistical sample of two SFAs per each State agency visited that had either an administrative review in process or had recently completed a review, if there were no review in process, to observe the State agency's most current procedures. At the SFA, we evaluated the accuracy of its determination of paid lunch price increases and nonprogram food revenue requirements. We also verified the source information used by the SFA to determine its validity.

To accomplish our audit, we:

- **Reviewed Criteria:** We reviewed the pertinent laws and regulations governing Sections 205, 206 and 307 of HHFKA, NSLP, and current policies and procedures FNS established as guidance for State agencies and SFAs. We also reviewed any procedures

³⁵ A school year term is from July to June. For example, SY 2012-2013 runs from July 1, 2012 through June 30, 2013.

State agencies had established as guidance for SFA compliance with Sections 205 and 206.

- **Interviewed FNS, State Agency, and SFA Personnel:** We interviewed FNS national and regional officials, State agency officials, SFA personnel, and other stakeholders to gain an understanding of their roles in monitoring NSLP and to determine what controls are used to ensure (1) SFAs are increasing paid lunch prices as required in Section 205, and (2) SFAs are meeting nonprogram food revenue requirements as required in Section 206.
- **Conducted Site Visits:** We performed fieldwork at 6 State agencies and 12 SFAs to determine whether there are adequate controls to ensure that SFAs are increasing paid lunch prices and meeting requirements regarding nonprogram food revenue.
- **Reviewed State Agencies' Submission of Paid Lunch Prices:** For the six State agencies visited, we reviewed their submission of FNS-828 report, *School Food Authority Lunch Price Report*.³⁶
- **Reviewed State Agencies' Administrative Review Process:** We reviewed the State agencies' Administrative Review process to identify any deficiencies related to the SFAs' compliance with paid lunch equity and nonprogram food revenue requirements in HHFKA. We also verified whether any corrective actions were proposed.
- **Reviewed SFA's Food Service Account Records:** At the SFAs we visited, we reviewed relevant accounting records used in the Paid Lunch Equity tool and the Nonprogram Food Revenue calculator to determine the accuracy of the tool and verify the validity of the information provided.

During the course of our audit we did not rely on or verify information in any agency electronic information systems and we make no representation regarding the adequacy of any agency computer systems or the information generated from them.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those 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.

³⁶ The School Food Authority Lunch Price Report is a template developed by FNS for State agencies to report SFAs' most frequently charged paid lunch price for each category (elementary school/middle school/high school) established by the SFA at the beginning of each school year. FNS requires that State agencies submit their reports no later than the last operating day of November of each year.

Abbreviations

| | |
|-------|---------------------------------------|
| FNS | Food and Nutrition Service |
| FY | Fiscal Year |
| HHFKA | Healthy, Hunger-Free Kids Act of 2010 |
| IT | Information Technology |
| NFR | Nonprogram Food Revenue |
| NSLP | National School Lunch Program |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| PLE | Paid Lunch Equity |
| SFA | School Food Authorities |
| SY | School Year |
| USDA | U.S. Department of Agriculture |

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



**United States
Department of
Agriculture**

Food and
Nutrition
Service

3101 Park
Center Drive
Room 712

Alexandria, VA
22302-1500

DATE: September 23, 2015

AUDIT
NUMBER: 27601-0001-22

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

FROM: Audrey Rowe /S/
Administrator

SUBJECT: Healthy, Hunger Free Kids Act of 2010- Controls over Food Service
Account Revenue

This letter responds to the Office of Inspector General (OIG) official draft report for audit report number 27601-0001-22, Healthy, Hunger Free Kids Act of 2010- Controls over Food Service Account Revenue. OIG conducted the audit to evaluate the controls that the Food and Nutrition Service (FNS) has in place to ensure that School Food Authorities (SFAs) comply with the food service account revenue requirements outlined in sections 205, 206 and 307 of the Healthy, Hunger Free Kids Act of 2010 (HHFKA). FNS is responding to the content and recommendations in the audit report.

The Department of Agriculture's FNS is committed to assisting SFAs in complying with federal requirements for paid lunch equity, revenues from nonprogram food and indirect costs. The Agency recognizes the critical importance of minimizing error in order to maintain public trust in the programs, and to ensure that the full value of program resources are used to serve healthy meals to eligible children.

Comments on Finding 2: Monitoring Program Paid Lunch Prices

FNS is concerned with OIG's description and analysis described in finding 2: "FNS Needs to Better Monitor Program Paid Lunch Prices." The legislation required us to publish the paid lunch prices each year as well as provide procedures that allow SFAs to average the pricing of paid lunches throughout the SFA. In response to the legislation, FNS developed the annual paid lunch report for SFAs to provide paid lunch data, and procedures for averaging paid lunch prices.

The most frequently paid lunch price report collects the most common price charged in each grade group, meaning that if the majority of the schools in a particular age grade group in the SFA charges a particular price, this is the price reported on the School Food Authority Paid Lunch Price Report (this is the OMB approved form to collect this annual data).

SFAs must calculate the average paid lunch price across the SFA using the procedures provided by FNS to determine the required price increase. FNS provided detailed instructions including an Excel tool to assist SFAs in this calculation. This average paid lunch price is weighted by the number of lunches served at each price point.

OIG is not correctly assessing or interpreting the purpose of this paid lunch price data collection. It is imperative to note that while the annual paid lunch price data collected provides a general sense of paid lunch prices across the SFAs, this data does not provide an appropriate metric to assess compliance progress with the PLE provision. Even if one were to attempt to use annual paid lunch price data to gain insight into PLE compliance, the data does not indicate which SFAs contributed nonfederal funds or how many are in compliance by meeting the interim targets. One would only be able to determine the relationship between the frequently charged paid lunch price in each grade and the annual equity level.

FNS responses to the report's recommendations:

Recommendation 1:

Redesign controls to provide reasonable assurance that School Food Authorities (SFAs) comply with paid lunch equity and nonprogram food revenue requirements. At a minimum, FNS should revise the Resource Management Risk Indicator Tool to include sufficient detail for identifying whether SFAs have properly used the Paid Lunch Equity (PLE) and Nonprogram Food Revenue (NFR) tools.

FNS Response:

FNS is currently assessing the Resource Management Risk Indicator Tool to determine the types of changes needed to more effectively ensure that school food authority are complying with the paid lunch equity and nonprogram food revenue requirements. FNS is also reviewing the Resource Management Risk Indicator Tool to assess the best approach to ensure sufficient detail is obtained from the SFAs showing how they are complying with the requirement appropriately.

Estimated Completion Date: August 31, 2016

Recommendation 2:

Establish a date for publishing the annual paid lunch price report.

FNS Response:

OIG indicated that the paid lunch price report is needed to determine if school food authorities (SFAs) are in compliance with the paid lunch equity (PLE) requirement. The report was not intended to be and is not used as a monitoring tool. It does not collect the data needed to determine compliance if the SFA uses non-Federal funds in addition to or in lieu of adjusting paid lunch prices. Compliance with the PLE requirement is monitored through the administrative review process. The administrative review process for PLE compliance depends on the

method(s) used by the SFA to comply with PLE and allows for immediate technical assistance to ensure that SFAs are correctly using whatever compliance method(s) they have chosen. The paid lunch price report is intended to provide, as OIG pointed out, an overview for interested stakeholders and to provide FNS with general information about average paid lunch prices across the nation.

Although FNS disagrees with OIG's assessment of FNS's monitoring of paid lunch prices, FNS will establish a date for publishing the annual paid lunch price report. Each State's consolidated report is due to FNS by the end of November. FNS will post the report on the FNS website no later than March 1.

Estimated Completion Date: March 1, 2016

Recommendation 3:

Develop and implement controls to ensure the paid lunch price reports are complete and submitted timely by State agencies.

FNS Response:

FNS indicated to OIG that there were challenges and delays relating to submission of timely, accurate, and complete reports from SFAs through their State agency. However, the audit findings erroneously indicated that the data in the report is to determine compliance with the PLE requirement.

FNS will develop additional guidance and clarifications for SFAs and State agencies on the information needed and the submission process. This information will be provided through a policy memorandum.

Estimated Completion Date: November 30, 2015

Recommendation 4:

Provide updated guidance for indirect costs to SFAs.

FNS Response:

In response to the Healthy Hungry Free Kids Act of 2010, FNS issued guidance on indirect costs within the required timeframe. This guidance provides comprehensive coverage of program rules as they pertain to indirect costs, including allowable indirect costs that may be charged to the nonprofit school food service account. Additionally, after completing the study required by the legislation, the guidance was assessed to determine whether additional clarification or updates were necessary. Based on this assessment, additional changes were not deemed necessary. FNS will reissue the guidance incorporating updated citations and references.

Estimated Completion Date: January 31, 2016

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