



United States Department of Agriculture

## OFFICE OF INSPECTOR GENERAL





## FNS – National School Lunch and School Breakfast Programs

Audit Report 27601-0001-41

### What Were OIG's

#### Objectives

Our objective was to evaluate the methods FNS used to lower the error rates for NSLP and SBP. We determined if FNS, State agencies, and SFAs had adequate controls to (1) ensure children met the eligibility requirements, and (2) meal claims were supported and accurately reimbursed.

#### What OIG Reviewed

We conducted fieldwork for 120 schools within 61 SFAs that participated during fiscal years 2012 and 2013. We also reviewed cafeteria fund account data from July 2011 to June 2012.

#### What OIG Recommends

FNS needs to consult with the Office of the General Counsel to determine its regulatory authority to require households to submit income documentation with school meals applications. Based on this determination, FNS should take the appropriate actions to revise the programs' documentation requirements; FNS should also clarify criteria for identifying questionable applications and provide guidance and training for cafeteria fund management.

### **The Office of Inspector General (OIG) audited the Food and Nutrition Service (FNS) to evaluate how the agency has attempted to lower the error rates for the National School Lunch and Breakfast Programs.**

#### What OIG Found

The controls the Food and Nutrition Service (FNS) can place on the National School Lunch Program (NSLP) and School Breakfast Program (SBP) are limited by law to make the programs accessible to all children. During school year (SY) 2012-2013, as a result of the annual verification process, school food authorities (SFAs) reduced or eliminated benefits for 107,974 of the 199,464 sampled households because household income was unsupported or excessive. We estimated that FNS may have spent nearly \$12.5 million on lunches for students who later had benefits reduced or denied after being selected for verification. Further, at least 97 percent of households determined to be eligible for benefits based on household applications are not selected for verification and receive benefits based on self-reported income.

SFAs are required to verify any questionable application. During SY 2012-2013, 44 of the 56 SFAs we reviewed did not question any applications, even though we later identified at least 42 potentially questionable applications based on FNS' criteria. Further, 20 of our 61 sampled SFAs mismanaged and misused Non-profit School Food Service Funds intended to be used for operating and improving the school food service. As a result, SFAs accumulated excess cash, totaling \$4.8 million; expensed nearly \$6 million in capital expenditures in the year of purchase without obtaining prior approval from State agencies; and charged unallowable costs totaling \$166,933 to cafeteria funds. We did not identify any issues related to meal claims. FNS generally agreed with our recommendations, and we accepted management decision for all 10 recommendations.





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



DATE: April 28, 2015

AUDIT  
NUMBER: 27601-0001-41

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: FNS – National School Lunch and School Breakfast Programs

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 10 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 Objective

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### Background

On June 4, 1946, Congress passed the National School Lunch Act, now the Richard B. Russell National School Lunch Act (NSLA), which established the National School Lunch Program (NSLP).<sup>1</sup> NSLA has been amended several times, most recently in 2011. The School Breakfast Program (SBP) began as a pilot project in 1966, and was made permanent in 1975.<sup>2</sup> In fiscal year (FY) 2012, NSLP and SBP operated in over 100,000 and 89,000 public and nonprofit private schools and residential child care institutions, respectively. NSLP and SBP provided nutritionally balanced, low-cost or free meals to more than 31 million children each school day in 2012. NSLP and SBP cost a total of \$14.9 billion in FY 2012.

The Food and Nutrition Service's (FNS) national office administers the programs and provides technical assistance to the States through its seven regional offices. FNS enters into a written agreement with administering State agencies, which operate the programs through agreements with school food authorities (SFA) for local administration. SFAs are responsible for the administration of the programs at the school district level. Both SFAs and schools are responsible for onsite operation, including the implementation of meal accountability systems, and the review and approval of student applications for free and reduced-price meals.

Children are considered either income eligible (based on the household income provided on the application) or categorically eligible. Categorically eligible children are those children automatically eligible for free meal benefits because they, or any household member, receive benefits under other designated assistance programs (such as Supplemental Nutrition Assistance Program), or are children who are designated as members of "other source categorically eligible programs." Examples of "other source categorically eligible" children include, but are not limited to, homeless, runaway, migrant, and foster children. Categorically eligible children may indicate this eligibility on an application or be directly certified.<sup>3</sup> Households that are directly certified do not need to submit an application and are not subject to verification.

Participating SFAs receive cash reimbursements and donated foods from the Department of Agriculture (USDA) for each meal served to students. Meals must meet Federal requirements, and free or reduced-price lunches must be offered to low-income children. Any child at a participating school may purchase meals through NSLP and SBP. However, children from families with incomes at or below 130 percent of the poverty level are eligible for free meals. Those with incomes between 130 percent and 185 percent of the poverty level are eligible for reduced-price meals. Within the statutory requirements, local schools set prices for full-price meals, but must operate meal services as non-profit programs. Reimbursement rates for NSLP during school year (SY) 2012-2013 were \$2.86 for each free lunch, \$2.46 for each reduced-price

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<sup>1</sup> 42 U.S.C. § 1751 et seq. (November 2011).

<sup>2</sup> Child Nutrition Act of 1966, 42 U.S.C. § 1771 et seq.

<sup>3</sup> Direct certification means determining children eligible for free meals benefits based on documentation obtained directly from the appropriate State or local agency or other authorized individual. In most situations, direct certification of a child's eligibility status does not involve the household.

lunch, and \$0.27 for each paid lunch served.<sup>4</sup> Reimbursement rates for SBP during SY 2012-2013 were \$1.55 for each free breakfast, \$1.25 for each reduced-price breakfast, and \$0.27 for each paid breakfast served.

To assess the error rates associated with NSLP and SBP reimbursements, FNS funds studies about every 5 years. FNS published the first of these studies calculating national estimates of the amounts and rates of erroneous payments in the programs—the Access, Participation, Eligibility, and Certification (APEC) study—in November 2007. The study included representative samples of SFAs, schools, and students during SY 2005-2006. After reviewing 87 SFAs, the researchers found that—among other things—slightly more than 1 in 5 applicant students were erroneously certified or incorrectly denied benefits; household reporting error was substantially more prevalent than administrative error; and, for both NSLP and SBP, approximately 9 percent of total reimbursements were erroneous due to certification errors. The overall estimated error rates calculated by the study for NSLP and SBP, projected by FNS to FY 2012 levels, are about 16 and 25 percent, respectively.<sup>5</sup> FNS expects a second study, APEC-II, to be completed in the first half of calendar year 2015.

### *Related Prior Audits*

In 2014, a U.S. Government Accountability Office (GAO) audit reviewed (1) steps taken to help identify and prevent ineligible beneficiaries from receiving benefits in school-meal programs, and (2) opportunities that exist to strengthen USDA's oversight of the school-meals programs.<sup>6</sup> The audit proposed actions to strengthen oversight of the programs while ensuring legitimate access, such as exploring the feasibility of computer matching external income data with participant information to identify households whose income exceeds eligibility thresholds and verifying a sample of categorically eligible applications to help identify ineligible households. FNS generally agreed with the recommendations.

In 2014, an Office of Inspector General (OIG) audit reviewed USDA's compliance with the Improper Payments Information Act and OIG determined NSLP and SBP were not compliant for a third consecutive year.<sup>7</sup> Of the 16 high-risk programs in USDA, OIG found that FNS' NSLP and SBP reported improper payment percentages of 15.69 and 25.26, respectively.<sup>8</sup> USDA's Office of the Chief Financial Officer stated that it would issue guidance directing FNS to submit to Congress the required reauthorization proposals or proposed statutory changes necessary to bring NSLP and SBP into compliance.

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<sup>4</sup> School year is the period between July 1 and June 30. While FNS typically reported program data on a fiscal year, SFAs reported NSLP and SBP data based on school year.

<sup>5</sup> USDA FY 2012 Agency Financial Report (November 2012).

<sup>6</sup> GAO-14-262, *School-Meals Programs, USDA Has Enhanced Controls, but Additional Verification Could Help Ensure Legitimate Program Access* (May 2014).

<sup>7</sup> Audit 50024-0005-11, *U.S. Department of Agriculture Improper Payments Elimination and Recovery Act of 2010 Review for Fiscal Year 2013* (April 2014).

<sup>8</sup> High-risk programs are those that are considered vulnerable to significant improper payments. The Improper Payments Information Act considers a program susceptible to significant improper payments if improper payments exceed \$10 million and account for 2.5 percent of program outlays, or exceed \$100 million regardless of percent of program outlays.

In 2009, a GAO audit reviewed actions taken by States and SFAs to identify and address meal counting and claiming errors.<sup>9</sup> The audit found that when State reviews identified meal counting and claiming errors, these problems were not always resolved. Further, GAO stated that States' infrequent use of certain program sanctions may also affect the priority SFAs give to addressing errors. Only four States reported terminating an SFA from NSLP and SBP between 2004 and 2009. FNS officials concurred with GAO's recommendations and issued new policies regarding annual onsite reviews and State agency administrative reviews of SFAs.<sup>10</sup>

In 2004, an OIG audit reviewed NSLP, SBP, and the Child and Adult Care Food Program's afterschool supper program in Chicago, Illinois.<sup>11</sup> Over a 4-month period, the SFA claimed reimbursement for lunches and breakfasts its schools did not serve or that did not meet program requirements. Additionally, the SFA's application verification error rate nearly doubled, increasing from 18 to 35 percent after OIG independently performed the verification decision process based on the same supporting documents. As a result, students were either incorrectly categorized as being eligible for free or reduced-price meals when they were not, or were denied access when, in fact, they were eligible. FNS agreed with the recommendations and the State agency increased controls over the SFA's verification process.

## Objective

Our objective was to evaluate the methods that FNS used to lower the error rates for both NSLP and SBP. Specifically, we determined if FNS, State agencies, and SFAs had adequate controls to ensure (1) children approved for free and reduced-price meals met the eligibility requirements, and (2) meal claims were supported and accurately reimbursed.

We did not identify any issues related to meal claims.

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<sup>9</sup> GAO-09-814, *School Meal Programs: Improved Reviews, Federal Guidance, and Data Collection Needed to Address Counting and Claiming Errors* (September 2009).

<sup>10</sup> Policy Memo SP-14-2011 was issued on January 24, 2011. It provides a prototype checklist for SFAs to use when conducting annual onsite reviews and provides the minimum requirements for assessing counting and claiming procedures. FNS provided updated guidance on meal counting and claiming procedures to program administrators in the updated version of the *Coordinated Review Effort Manual* that was issued in January 2012. However, this manual was superseded by the school meal programs *Administrative Review Manual*, last updated on September 20, 2013.

<sup>11</sup> Audit 27010-0017-Ch, *Chicago SFA's Accountability and Oversight of the NSLP, SBP, and CACFP Supper* (September 2004).

## Section 1: Eligibility Determinations and Verification

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### Finding 1: FNS Should Require Applicants to Provide Proof of Income

Nationwide, SFAs must annually verify eligibility for a sample of household applications approved for free and reduced-price meal benefits.<sup>12</sup> During SY 2012-2013, as a result of the annual verification process, SFAs reduced or eliminated benefits for 107,974 of the 199,464 sampled households nationwide (about 54 percent) because the income claimed on the applications was unsupported or excessive.<sup>13</sup> This occurred because households are not required to provide proof of income when they apply for benefits, inhibiting SFAs from confirming that the income reported on applications is accurate. As a result, we estimated that FNS may have spent nearly \$12.5 million on lunches for students who later had their benefits reduced or denied after being selected for verification. Further, a large majority of households determined to be eligible for the National School Lunch Program and the School Breakfast Program based on household applications—at least 97 percent—are not selected for verification and receive benefits based on self-reported income.

The NSLA lists conditions for those who receive free or reduced-price meals. An adult member of the household seeking benefits must execute a household application.<sup>14</sup> No member of a household can receive a free or reduced-price meal unless “appropriate documentation relating to the income of such household (as prescribed by the Secretary) has been provided to the [SFA] so that the [SFA] may calculate the total income of such household.”<sup>15</sup> FNS’ implementing regulations define documentation as “[t]he completion of a free and reduced-price school meal... application,” which must include information regarding income earned by each member of the household.<sup>16</sup> Although the Secretary was given discretion to determine what documentation of income would be required, the regulations do not require a household to submit anything more than an application; no actual documentation of income must be submitted to support statements made in the application.

In 2014, an OIG audit reviewed USDA’s compliance with the Improper Payments Information Act.<sup>17</sup> Of the 16 high-risk programs in USDA, OIG found that FNS’ NSLP and SBP reported improper payment percentages of 15.69 and 25.26, respectively. We concluded that FNS was not in compliance with the Improper Payments Information Act’s requirement to have a gross improper payment rate of less than 10 percent for each high-risk program. In fiscal year (FY) 2013, the Office of Management and Budget designated 13 programs within the Federal

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<sup>12</sup> The standard sample size is the lesser of 3 percent of approved applications selected from error prone applications or 3,000 error prone applications.

<sup>13</sup> The changes made for these households impacted a total of 166,048 students. Of the 25,050,857 students eligible for free or reduced-price meals in SFAs required to perform verifications nationwide, only 319,221 lived in households that were subject to verification (1.3 percent). These nationwide verification data include totals from Washington, D.C., Guam, and Puerto Rico. We did not include verification totals from Oklahoma because the reported data were inaccurate and FNS could not provide revised amounts.

<sup>14</sup> 42 U.S.C. § 1758(b)(3)(B)(i) (January 2011).

<sup>15</sup> 42 U.S.C. § 1758(d)(2) (January 2011).

<sup>16</sup> 7 C.F.R. § 245.2 (June 2012).

<sup>17</sup> Audit 50024-0005-11, *U.S. Department of Agriculture Improper Payments Elimination and Recovery Act of 2010 Review for Fiscal Year 2013* (April 2014).

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government as “high-error,” because they each reported about \$750 million or more in improper payments in a given year. Of these 13 programs, NSLP had the second highest improper payment rate. To evaluate the methods that FNS used to lower the error rates for both NSLP and SBP and the adequacy of controls that FNS, State agencies, and SFAs used to ensure correct eligibility determinations, we reviewed the results of the SY 2012-2013 verification process.

For our audit, we reviewed a sample of 60 statistically selected schools from the 15 largest SFAs in California, Florida, and Texas and 60 statistically selected schools in Delaware, Rhode Island, and Wyoming.<sup>18</sup> While most of the SFAs involved were public, we did review some private schools, charter schools, and residential child care institutions. Our sample of SFAs included a variety of sizes, ranging from very large SFAs (with several hundred schools) to small SFAs (consisting of only one school).

FNS does not require households to submit income documentation with the applications. Rather, households are only required to submit a completed application to SFAs; regulations allow eligibility to be determined based on the self-reported, unsupported information provided on the application.<sup>19</sup> In contrast, laws for other FNS programs, such as the Supplemental Nutrition Assistance Program (SNAP) and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), require that (1) the eligibility of each applicant household be determined based on validation of income, or (2) that an individual seeking certification shall provide documentation of family income, respectively.<sup>20</sup> While SFAs may not be able to use household income information to verify household eligibility outside of the legally required sample (and doing so for all applications would cause undue burden on SFAs), the act of submitting household income documentation may discourage households from self-reporting inaccurate household income information.

### *Verification Process*

NSLA requires SFAs to annually verify the eligibility of the children in a sample of household applications approved for the school year.<sup>21</sup> It sets specific guidelines for the sample size, the standard being the lesser of 3 percent of approved applications or 3,000 applications, drawn from error-prone applications.<sup>22</sup> NSLA includes two alternate sample sizes that SFAs can qualify for based on non-response rates.

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<sup>18</sup> We nonstatistically selected California, Florida, and Texas because these States received the highest reimbursement amounts during FY 2011—31.4 percent of total NSLP and SBP reimbursements combined—and Delaware, Rhode Island, and Wyoming because of the low reimbursement amounts during FY 2011—0.6 percent of total NSLP and SBP reimbursements combined.

<sup>19</sup> 7 C.F.R. § 245.6(a)(5) (June 2012).

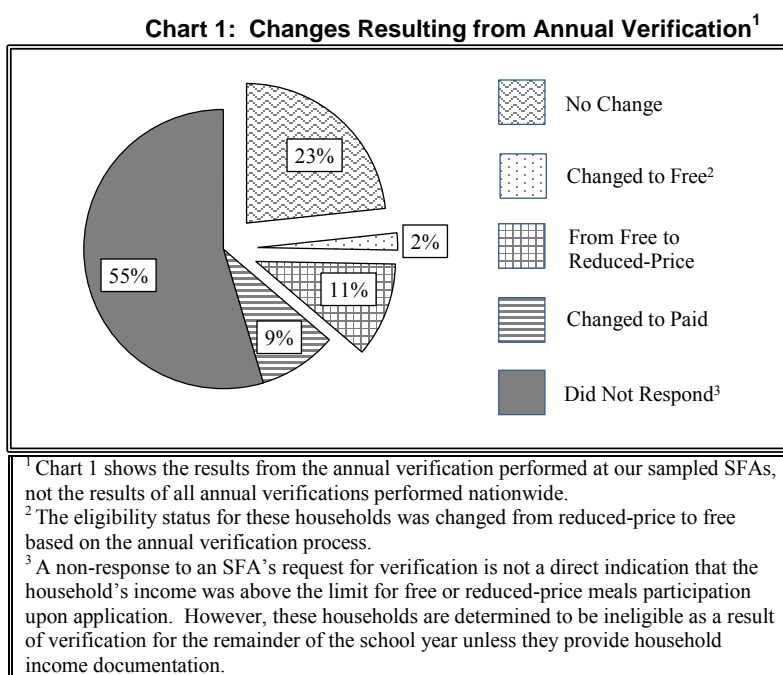
<sup>20</sup> 7 U.S.C. § 2020 (January 2012); 42 U.S.C. § 1786 (January 2012). Applications for SNAP and WIC are collected and approved year round while the majority of school meals applications are collected and approved at the beginning of each school year.

<sup>21</sup> 42 U.S.C. § 1758(b)(3)(D) (January 2011).

<sup>22</sup> “Error-prone” is defined as an application from a household whose income is within \$100 per month of the applicable Income Eligibility Guideline (the household size and income levels prescribed annually by the Secretary of Agriculture for determining eligibility for free and reduced price meals), or that otherwise meets criteria established by the Secretary of Agriculture. 42 U.S.C. § 1758(b)(3)(D).

Although each application contains a statement that the adult member of the household filling out the application must certify that the reported income level is accurate, we found the annual verifications typically resulted in a high percentage decrease in benefits. For example, during the SY 2012-2013 verification process, one of our selected SFAs in California with over 127,000 approved applications, reduced or denied benefits for 886 of the 1,020 sampled applications (87 percent). Based on these results, we conclude that it is likely that other students receiving free or reduced-price meals may not be eligible for them.

Chart 1 shows the changes in eligibility resulting from SY 2012-2013 annual verifications in our sampled SFAs. Of those households selected for verification, 64 percent were receiving either free or reduced-price meals at the beginning of SY 2012-2013, but were determined to be ineligible for NSLP and SBP benefits as a result of the verification process.<sup>23</sup> An additional 11 percent were receiving free meals when they were only eligible to receive reduced-price meals. These verified applications represent only 2 percent of approved households and less than 1 percent of participating students in our sampled SFAs.



If participants are selected for verification and want to continue receiving program benefits, they must provide support for the income claimed on their applications. Otherwise, if they do not provide proof of income, the participants are no longer eligible to receive free or reduced-price meals. In total, 55 percent of the applicant households

<sup>23</sup> The 64 percent includes the 55 percent of students that were denied benefits based on nonresponse to verification requests. A non-response to an SFA's request for verification is not a direct indication that the household's income was above the limit for free or reduced-price meals participation upon application. However, these households are determined to be ineligible as a result of verification for the remainder of the school year unless they provide household income documentation.

selected for verification (5,605 of 10,233) at our sampled SFAs did not respond to the annual verification request for SY 2012-2013. At one SFA in Texas, 796 of 1,188 sampled households did not respond to the verification request—a non-response rate of 67 percent.<sup>24</sup>

Based on our estimates, during SY 2012-2013, FNS may have spent about \$17.3 million on lunches for students who had their benefits reduced or denied after being selected for verification. If these students had received benefits based on their post-verification eligibility status for the period from the beginning of the school year until verification was complete, we estimated the cost to FNS would have been about \$4.8 million. However, because these households self-certify income and are not required to provide documentation, FNS may have overpaid nearly \$12.5 million for lunches for these households before their applications were verified.<sup>25</sup> The verified households represent less than 2 percent of students participating in the programs nationwide.

We also found that SFAs did not always thoroughly review income documentation during the annual verification process. In Florida, one household submitted income documentation consisting of a paystub for a State employee that indicated she was married. However, the application stated that her household consisted only of herself and her two children. The Florida SFA conducted no followup to determine whether or not the spouse, and therefore the spouse's income, should be included as part of the household. An SFA official told us that, since not all income documentation includes marital status, it would be unfair to consider this information for those households whose income documentation included it.<sup>26</sup>

During our review of an SFA in Texas, we found 10 household applications that listed multiple sources of income, but these households did not submit documentation for all income sources listed on the application when requested during verification. Although SFAs are required to followup with households if they do not submit adequate information to complete individual verification activities, the SFA did not followup to inquire about the other listed sources of income, and recalculated eligibility based only on the amount of income for which documentation was submitted.<sup>27</sup> If verifications are not being completed properly, annual verification reports may be inaccurate.

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<sup>24</sup> One application is completed per household.

<sup>25</sup> In calculating this estimate, we did not account for school breakfasts received since not all schools participate in SBP. We used the lowest reimbursement rates for each category of meal for SY 2012-2013 for our calculations and assumed a period of 50 school days from the start of the school year (generally late August or early September) to the deadline for completed verifications (November 15<sup>th</sup>). We assumed an 80 percent participation rate for students that were certified as free eligible prior to annual verification and a 70 percent participation rate for students that were certified as reduced-price eligible prior to annual verification. This estimate does not take into account that a household may be certified as eligible to receive free or reduced-price meals, but not participate in the meal service or may choose to pay the full price for their meals.

<sup>26</sup> FNS regulations require that verification include confirmation of income eligibility, they permit—but do not require—SFAs to confirm any other information required on the application, such as household size.

<sup>27</sup> 7 C.F.R. § 245.6a(f)(6) (June 2012).

We found that verifications resulted in a high percentage change in eligibility that could be prevented by implementing a simple control: requiring income documentation with each household application. While SFAs can only legally verify a small percentage of applications, inclusion of income documentation as a component of a complete household application would streamline the verification process and eliminate non-respondents. Further, the act of turning in income documentation with applications may discourage applicants from being dishonest about household income levels.

### *Cases of Fraud and Improper Payments*

FNS' Eligibility Manual contains guidance specific to "verification for cause" for SFA employees. This guidance states that SFAs can use "verification for cause" when known or available information indicates SFA employees may have misrepresented their incomes to receive free or reduced-price meals for their children. Since SFAs have access to their employees' salary information, it can be a good way for SFAs to address NSLP and SBP integrity concerns as evidenced by the numerous cases of alleged fraud and theft by deception involving school district employees during calendar years 2012 and 2013. However, it is unlikely that SFA employees are the only people abusing self-certification and SFAs may be able to identify more instances of fraud if they had access to documentation of household income.

- In [REDACTED], we found that a [REDACTED] at one small SFA in [REDACTED], who had previously been employed in the SFA's office, submitted an application for school meals. [REDACTED] listed household consisted of [REDACTED]. The application showed that [REDACTED]. The household was certified as eligible for free meals, even though—with the [REDACTED] salary—they only qualified for reduced-price meals.
- In 2012, Chicago Board of Education's Office of Inspector General reported 21 cases of principals and assistant principals who were found culpable of falsifying information on their applications.<sup>28</sup> For example, the investigation found that an elementary school principal and his wife, a high school assistant principal, asked the principal's mother to submit an application for their children because their annual income together exceeded \$230,000.
- In 2013, the Office of the State Comptroller in New Jersey issued a report on its review of applications from school district employees.<sup>29</sup> It found 101 public employees (or their spouses/domestic partners), including elected school board members and school district employees, who appeared to have materially underreported their income on school meal applications.

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<sup>28</sup> Chicago Board of Education, Office of the Inspector General, *Annual Report 2012*. Retrieved from [http://cps.edu/About\\_CPS/Departments/Documents/OIG\\_FY\\_2012\\_AnnualReport.pdf](http://cps.edu/About_CPS/Departments/Documents/OIG_FY_2012_AnnualReport.pdf). 26 August 2013.

<sup>29</sup> State of New Jersey, Office of the State Comptroller (2013). *Investigative Report: Fraudulent School Lunch Program Applications Filed by Public Employees*. Retrieved from [http://www.nj.gov/comptroller/news/docs/report\\_free\\_lunch\\_07172013.pdf](http://www.nj.gov/comptroller/news/docs/report_free_lunch_07172013.pdf). 18 July 2013.

- In 2014, a former school board president in New Jersey was convicted of theft by deception and tampering with public records for under-reporting her household income so that her children could receive free or subsidized lunches through NSLP.<sup>30</sup> She claimed she mistakenly omitted her husband's income. He worked for the *New York Times* and was the owner and head coach of a semi-professional football team. She was sentenced to 3 years' probation and ordered to perform 300 hours of community service.

Although an adult household member must certify the application is accurate, there are almost no consequences when a household misrepresents its income to receive free or reduced meals. FNS stated that households who misreport income information on the applications are removed from the programs for that year, but, typically, there are no penalties imposed unless the local authorities are involved in extreme cases. Applicants who misreported information on previous applications are able to reapply for the programs the following school year and are processed like any other applicant.

FNS is aware of its high level of improper payments in NSLP and SBP and is working to improve Federal and State oversight and technical assistance. However, while the Healthy, Hunger-Free Kids Act of 2010<sup>31</sup> did include some changes requested by FNS to improve accountability, it limited the agency's ability to act in this area because of concerns about potential barriers to participation. The mandated goal of providing easy access to benefits must be balanced against FNS' goal of reducing improper and erroneous payments. Some of the steps that FNS has recently taken to improve integrity of the programs include:

- **Administrative Reviews:** FNS recently revised the monitoring system in place to review NSLP and SBP. As required by the Healthy, Hunger-Free Kids Act of 2010, States will be required to conduct these administrative reviews of all SFAs on a 3-year cycle beginning in SY 2013-2014.<sup>32</sup> (The former cycle was 5 years.)
- **Final and Proposed Rules:** FNS has issued a final rule resulting from the Healthy, Hunger-Free Kids Act of 2010 that should reduce improper payments by requiring an independent review of initial eligibility determinations in SFAs that demonstrate high levels of administrative error.<sup>33</sup> Additionally, FNS plans to propose a rule to establish criteria for imposing fines against State agencies and program operators who jeopardize the integrity of any Child Nutrition Program and procedures to prohibit the participation of entities or individuals terminated from any of the Child Nutrition Programs. FNS expects this proposed rule to be published in the Federal Register in March 2015.

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<sup>30</sup> Spoto, MaryAnn, "Ex-school Board President Sentenced in Lunch Program Scandal," *The Star-Ledger* [Newark, New Jersey] 31 May 2014, NEWS sec.: 001. *FinCEN News*, 1 June 2014. This case was going through the legal process during the timeframe covered by our audit scope.

<sup>31</sup> Pub. L. No. 111-296 (December 2010).

<sup>32</sup> Pub. L. No. 111-296, 124 Stat. 3183 (December 2010).

<sup>33</sup> National School Lunch Program: Independent Review of Applications Required by the Healthy, Hunger-Free Kids Act of 2010, 79 Fed. Reg. 7049 (Feb. 6, 2014) (amending 7 C.F.R. §§ 210.15, 210.20, 245.6, 245.11).

- **Studies:** FNS has sponsored a number of studies that also support efforts to reduce erroneous payments, including “Modeling of High Risk Indicators of Certification Error in the National School Lunch Program”,<sup>34</sup> “Using American Community Survey Data to Expand Access to the School Meals Programs,”<sup>35</sup> an evaluation to develop eligibility estimates for school meals programs, in lieu of individual applications; and “Community Eligibility Provision Evaluation,”<sup>36</sup> an examination of program integrity and participation in high poverty areas.
- **Direct Certification:** The Healthy, Hunger-Free Kids Act of 2010 set benchmarks for State direct certification rates using SNAP data. States not meeting the required direct certification rate benchmarks for a given SY are required to develop and implement continuous improvement plans to describe the activities they will implement to reach more eligible children in future years. FNS stated that it approved 16 State plans in FY 2013, 28 State plans in FY 2014, and has 41 State plans under review in FY 2015.
- **Direct Certification with Medicaid:** The Healthy, Hunger-Free Kids Act of 2010 required FNS to conduct a demonstration project in which select SFAs directly certified students for free school meals based on income eligibility identified through Medicaid data. FNS is conducting an evaluation study of this project. An interim report was published January 2015, with a final report due to Congress no later than October 1, 2015. The project sets specific goals to include areas serving 10 percent of students certified for free and reduced price meals nationwide by the third year (SY 2014-2015) and ongoing in each subsequent school year.
- **Community Eligibility Provision:** The provision allows SFAs in high-poverty areas to offer free school breakfast and lunch to all students at no cost. It may be implemented in individual schools, groups of schools, or in entire school districts. To be eligible, SFAs and/or schools must: meet a minimum level (40 percent) of identified students for free meals in the year prior to implementing the provision and agree to cover with non-Federal funds any costs of providing free meals to all students above amounts provided in Federal assistance.<sup>37</sup> Federal reimbursement is based on claiming percentages derived from the identified student percentages.

In addition to the actions cited above, FNS conducted a study about 10 years ago where researchers found that upfront documentation of household income did not result in fewer observances of improper payments for the pilot districts.<sup>38</sup> However, because the study selected

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<sup>34</sup> USDA, FNS, Office of Research and Analysis. “Modeling of High Risk Indicators of Certification Error in the National School Lunch Program,” 2012.

<sup>35</sup> Panel on Estimating Children Eligible for School Nutrition Programs Using the American Community Survey. National Research Council. “Using American Community Survey Data to Expand Access to the School Meals Programs,” 2012.

<sup>36</sup> “Community Eligibility Provision Evaluation.” Prepared by Abt Associates for USDA, FNS, 2014.

<sup>37</sup> Identified students are students certified for free meals through means other than individual household applications; this primarily includes students who are directly certified.

<sup>38</sup> USDA, FNS, Office of Analysis, Nutrition and Evaluation. “Evaluation of the National School Lunch Program Application/Verification Pilot Projects: Volume I: Impacts on Deterrence, Barriers, and Accuracy.” *Special Nutrition Program Report Series*, No. CN-04-AV1, 2004.

SFAs to implement upfront documentation on a volunteer basis, the results are not reflective of NSLP and SBP as a whole. More specifically, very large districts did not implement upfront documentation during this pilot. The largest pilot district enrolled about 20,000 students and only one-third of its schools participated in the study. Although less than 2 percent of SFAs nationally enroll more than 25,000 students, about one-third of all public school students are enrolled in these very large districts.

Additionally, researchers from the prior FNS study were unable to obtain complete documentation of household income for 739 of 2,619 students (28 percent).<sup>39</sup> These students were not dropped from the analysis file, but, instead, the researchers imputed total household income. Although the researchers performed sensitivity tests and stated that “the findings presented... would not have been qualitatively different if we had used different imputation procedures,” failure to obtain household income from 28 percent of sampled students may indicate a research bias.

Further, only 32 percent of households sampled in the pilot districts (418 students) and 34 percent of households in the comparison districts (463 students) had household incomes below 185 percent of the Federal poverty level. Therefore, FNS concerns that requiring upfront documentation increases barriers to participation among some eligible students is based on a very small sample. The study also states that there is a “need for caution in applying the findings from the pilots to the national program.”

While FNS’ actions noted above are positive steps towards reducing SFA-caused errors and reducing the total number of household applications (through increased use of direct certification), they do not address the problems inherent in relying on program applicants to self-report income. As long as program benefits are awarded through this application process, FNS is at risk for improper payments because there is no assurance that household self-reported income is accurate.

OIG concluded that, since FNS does not require households to submit income documentation with the applications and the law limits verification activities, FNS does not have reasonable assurance that students who receive free or reduced-price meals are actually eligible for them. To reduce improper payments, it is critical that FNS work towards preventing ineligible students from receiving meal benefits. OIG believes that this can be accomplished by, at a minimum, requiring families to submit documentation of household income at the time they submit applications. We note that the Secretary has the authority to determine what constitutes appropriate “documentation” of household income,<sup>40</sup> which is reflected in the definition set forth in FNS regulations.<sup>41</sup> However, FNS officials told OIG that FNS cannot require additional documentation, other than an application, unless Congress amends the NSLA. FNS officials stated this definition has been used for at least 20 years, and any departure from it would be a

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<sup>39</sup> Researchers performed telephone surveys with 3,020 households. Researchers did not attempt to obtain income documentation from the 401 households that reported income above 400 percent of the Federal poverty level. They considered it unlikely that these households would be misstating income to such a degree that they were actually eligible for free or reduced-price meals (household income less than or equal to 185 percent of the poverty line).

<sup>40</sup> 42 U.S.C. § 1758(d)(2)(A) (January 2011).

<sup>41</sup> 7 C.F.R. § 245.2 (June 2012).

significant change requiring legislation. FNS officials acknowledged that, technically, FNS could propose changes to the regulations, but since it is a contentious issue, they believe that any change regarding the definition of documentation needs to have support from Congress.

Therefore, FNS should consult with the Office of the General Counsel (OGC) and determine if FNS has the authority to modify existing regulations so that households are required to submit income documentation with applications for free or reduced-price meals. Further, since households that misreport information on program applications are only prosecuted in extreme circumstances and are only removed from the programs for the remainder of the school year, FNS, in collaboration with State agencies, should develop a strategy for SFAs to verify for cause applications of households, which were found to have misreported income information on the prior year's applications.

## **Recommendation 1**

In consultation with the Office of the General Counsel, determine if FNS has the authority to modify existing regulations so that households are required to submit income documentation with applications for free or reduced-price meals. Based on this determination, take the appropriate actions to revise the programs' documentation requirements.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS has consulted with OGC on this matter and while the Secretary, as a legal matter, may have authority to propose a change as recommended, significant other legal, policy, and operational concerns remain. As this report acknowledges, implementing this recommendation could create barriers to participation for eligible children, cause significant administrative and record keeping burden for participating schools, and constitute a significant reconstruction of the application, certification, and verification processes.

On March 27, 2015, FNS amended its response to include:

FNS will continue the efforts of increasing direct certification and [the] Community Eligibility Provision (CEP), both successful strategies in improving Program Integrity and reducing erroneous payments.

FNS completed this action on February 3, 2015.

## **OIG Position**

We accept FNS' management decision on this recommendation. We accept FNS' decision to pursue improved program integrity and reduced improper payments through means other than modifying existing regulations to require households to submit income documentation with applications. However, we do not believe that the collection of income documentation with each

household application would cause significant administrative and record keeping burden for participating schools, and constitute a significant reconstruction of the application, certification, and verification processes as stated in the agency's response. For the record, our recommendation was not to require verification of income documentation for each submitted application as this would be contrary to statutory requirements, but rather to collect income documentation for each submitted application. During the verification process, this would reduce administrative burden on SFAs since they would not need to request income documentation. It would also eliminate the large percentage verification nonrespondents since the SFAs would already possess the documentation. Further, upfront collection of income documentation might deter some households from misreporting income on their applications.

## **Recommendation 2**

Develop a strategy, in collaboration with State agencies, for School Food Authorities to verify for cause applications of households, which were found to have misreported income information on their prior year's applications.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS generally agrees with this recommendation. FNS will collaborate with our State partners to determine opportunities to identify in subsequent school years, those households that, based on the results of the regular verification process, have been found to have misreported income. Feasible and reasonable strategies identified will be incorporated into verification for cause guidance, and will also be incorporated into the annually updated eligibility guidance.

FNS provided an estimated completion date of April 30, 2016, for this action.

## **OIG Position**

We accept FNS' management decision on this recommendation.

## Finding 2: SFAs Should Verify Questionable Applications

SFAs are required to verify any questionable application, a process also referred to as “verification for cause.” During SY 2012-2013, 44 of the 56 SFAs we reviewed did not question any applications, even though we later identified at least 42 potentially questionable applications based on FNS’ criteria.<sup>42</sup> This occurred because there were insufficient criteria for determining what constituted a questionable application and SFAs were allowed to choose whether to verify an application for cause on a case-by-case basis. As a result, SFAs interpreted the “verification for cause” requirement differently, subjecting both NSLP and SBP to potential increased improper payments.

Regulations state that “[SFAs] must verify any questionable application and should, on a case-by-case basis, verify any application for cause such as an application on which a household reports zero income or when the [SFA] is aware of additional income or persons in the household.”<sup>43</sup> FNS interpreted the phrase “case-by-case basis” to mean that deciding which applications to verify for cause is solely up to the SFAs’ discretion. Even if an SFA identified an application that met the criteria listed in the regulations, the SFA was not required to verify it for cause.

SFAs are required by law to annually verify a sample of approved applications. In the past, SFAs could verify any data contained in an application.<sup>44</sup> However, the Child Nutrition and WIC Reauthorization Act of 2004 changed the law so that SFAs could verify no more or less than their legally prescribed sample size.<sup>45</sup> This sample size varies, but does not exceed 3 percent of approved applications.<sup>46</sup> As an additional control in 2008, FNS began requiring SFAs to verify for cause any questionable application that was not selected for annual verification. Applications verified for cause are not considered part of the required annual verification sample.<sup>47</sup>

“Verification for cause” is an important control for reducing improper payments in NSLP and SBP. For example, after an SFA in Florida verified questionable applications in SY 2012-2013, 72 of 101 students (71 percent) were denied benefits or were recertified from free to reduced-price meals. Verification of questionable applications by a California SFA resulted in benefit reductions for 228 of 240 students (95 percent). However, for most of our sampled SFAs, this control was likely underused. During SY 2012-2013, 44 of 56 SFAs (79 percent) did not identify any applications to be verified for cause. Of the SFAs that did perform verifications for cause, none performed them on more than 1 percent of approved applications.

- Twenty SFAs we reviewed had no formal policy regarding “verification for cause” or chose only to verify the annual sample specified by NSLA. Many officials from these

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<sup>42</sup> Although 61 SFAs were included in our sample, 5 were residential child care institutions. Residential child care institutions are exempted from verification activities in the Federal regulations.

<sup>43</sup> 7 C.F.R. § 245.6a(c)(7) (April 2011).

<sup>44</sup> 42 U.S.C. §1758(b)(2)(C) (2003).

<sup>45</sup> Pub. L. No. 108-265, §§ 104(a)(2), 105(a), 118 Stat. 729, 733-34, 738-44 (June 2004).

<sup>46</sup> Pub. L. No. 108-265, § Sec. 105(a), 118 Stat. 729, 738-44 (June 2004).

<sup>47</sup> 7 C.F.R. § 245.6a(c)(7) (April 2011).

SFAs stated that they would call parents if they had questions about an application or if the application was incomplete, but they did not perform any formal verifications for cause. In our limited sample of applications, we found at least 1 application with zero income that was not verified for cause in 7 of these 20 SFAs.

- Twelve SFAs only performed “verifications for cause” if they received a whistleblower or hotline complaint about a household. They did not receive any such complaints during SY 2012-2013. In our limited sample of applications, we found at least 1 application with zero income that was not verified for cause in 8 of these 12 SFAs.
- Twelve SFAs had a policy regarding “verification for cause,” but did not consider any such verification to be necessary during SY 2012-2013. In our limited sample of applications, we found at least 1 application with zero income that was not verified for cause in 2 of these 12 SFAs.

We interviewed one employee from each of the 56 SFAs and found that 17 SFA employees could not tell us what constituted a questionable application. An additional 37 SFA employees provided inconsistent definitions.<sup>48</sup> The definitions ranged from applications linked to whistleblower complaints or applications with “extremely low” income. Other criteria the SFA employees used to identify a questionable application included applications with conflicting household income information, applicants with multiple applications, or applications for those households that called the office with questions about income limits.

Based on the various responses from SFA employees, decisions regarding questionable applications were subjective and inconsistent. The inconsistency in definitions was a result of insufficient FNS criteria.<sup>49</sup> Regulations provide examples of only two types of potentially questionable applications: when a household reports zero income and when the SFA is aware of additional income or persons in the household.<sup>50</sup> However, we found that even these existing criteria are not regularly applied. Only 4 of the 56 SFA employees stated that they would verify applications reporting no income. We reviewed a sample of 3,187 applications from those SFAs that did not identify any questionable applications and found 42 applications that reported zero income, but were not verified for cause. While FNS maintains that SFAs may have knowledge about how these households function with zero income without participating in assistance programs and, therefore, the SFAs would not need to verify them for cause, the SFAs are not required to document these justifications. Therefore, there is no way for State agencies to monitor whether SFAs are adequately assessing which applications to verify for cause.

Overall, there is little to no oversight of SFAs’ application of the “verification for cause” requirement. Although the administrative review guidance for State agencies that was in use during our audit scope states that State agencies should become familiar with the SFAs’ procedures for verification, it does not require that State agencies perform any specific review of

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<sup>48</sup> Of the remaining two SFAs, one did not respond to our requests for verification for cause review information and one did not perform any verifications for cause during our scope and did not provide a definition.

<sup>49</sup> FNS included additional instances of when SFAs may verify applications for cause on p. 97 of the August 2014 edition of the FNS “*Eligibility Manual for School Meals*.”

<sup>50</sup> 7 C.F.R. § 245.6a(c)(7) (April 2011).

applications verified for cause. FNS' new administrative review guidance manual directs State agencies to determine whether SFAs applied "verification for cause" appropriately, if applicable. However, State agencies are not required to review whether SFAs did not perform "verifications for cause" on applications that may have warranted it (such as zero income applications). Likewise, management evaluation guidance requires FNS regional offices to review how the State agencies ensure that SFAs have implemented the verification process correctly, but contains no specific requirement to review State agencies' oversight of the application of the "verification for cause" requirement.

### *Reduction in Benefits Due to Annual Verification*

According to FNS regulations, a household affected by a reduction or termination of benefits may re-apply for free or reduced-price meals at any time during the same school year, but it would be required to submit income documentation or proof of participation in assistance programs at the time of reapplication.<sup>51</sup> There is no such requirement for the next school year.

We found that, in 25 of 27 SFAs,<sup>52</sup> 963 of 2,138 students (45 percent) who were denied benefits in the prior school year were approved to receive free or reduced-price meals without providing proof of household income for SY 2012-2013.<sup>53</sup> Our review of eligibility status for those students denied benefits during the prior year's verification process at our sampled SFAs indicated that some households may continue to misrepresent income in following years with little to no accountability.

This occurred because SFAs did not choose to verify applications of households that were denied free or reduced-price meals as a result of the prior year's annual verification process. None of the 56 SFA employees we interviewed stated that they would use "verification for cause" in this circumstance. In addition, the regulations do not specifically require performing verifications for cause on applications for these households. These applications would likely only be verified if they were again selected as part of the annual verification sample. OIG maintains that, to strengthen FNS' defense against improper payments, the agency should consider a policy requiring SFAs verify for cause any application from a household when the household's application from the prior year was denied as a result of the prior year's annual verification process.

In 2014, a GAO audit<sup>54</sup> identified opportunities to strengthen oversight of the programs while ensuring legitimate access, such as exploring the feasibility of computer matching external income data with participant information to identify households whose income exceeds

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<sup>51</sup> FNS "Eligibility Manual for School Meals," p. 90 (October 2011).

<sup>52</sup> Although there were 56 SFAs in our sample that were required to conduct annual verifications, only 32 were able to provide us with the change of status data. Of these 32 SFAs, 5 did not have any students denied benefits in SY 2011-2012 as a result of verification.

<sup>53</sup> These students were found to be ineligible for either free or reduced price meals because either their household income was too high for the level of benefits they were receiving, or the household failed to respond to the request for proof of income.

<sup>54</sup> GAO-14-262, *School-Meals Programs, USDA Has Enhanced Controls, but Additional Verification Could Help Ensure Legitimate Program Access* (May 2014).

eligibility thresholds for verification and should be verified for cause.<sup>55</sup> FNS generally agreed with GAO's recommendations.

We concluded that SFA employees did not always identify potentially questionable applications and verify them for cause. In addition, FNS did not provide sufficient guidance to SFAs about how to identify questionable applications or to State agencies about how to ensure SFAs were correctly implementing this requirement.

### **Recommendation 3**

Update current regulations and guidance with the criteria explaining what constitutes a questionable application, including any additional instances of when verifications for cause are required. Ensure State agencies and SFAs are trained on the new criteria.

### **Agency Response**

In its March 23, 2015, response FNS stated:

FNS agrees that the eligibility guidance can be effectively updated to include additional information on what constitutes a questionable application. FNS will provide additional guidance and will provide training via webinar for State agency personnel on the additional guidance. FNS will make the webinar slides available for States to use for [its] own training of SFAs on identifying questionable applications.

FNS provided an estimated completion date of August 31, 2015, for this action.

### **OIG Position**

We accept FNS' management decision on this recommendation.

### **Recommendation 4**

FNS should consider a policy requiring SFAs to verify for cause any application from a household when the household's application from the prior year was denied as a result of the prior year's annual verification process.

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<sup>55</sup> Categorically eligible children are those children automatically eligible for free meal benefits because they, or any household member, receive benefits under other designated assistance programs (such as Supplemental Nutrition Assistance Program), or are children who are designated as members of "other source categorically eligible programs." Examples of "other source categorically eligible" children include, but are not limited to, homeless, runaway, migrant, and foster children.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS will consult with OGC to determine if this recommendation is possible under current legal authorities related to verification. In contrast to recommendation [number] 2 above, this pool of households is not comprised entirely of households that have misreported household income information. Some households do not respond to verification requests but are in-fact income-eligible. Considering all applications from these households as questionable applications subject to verification for cause may be considered a violation of the verification sample size established in Section 9(b)(3)(D)(iii) of the Richard B. Russell National School Lunch Act.

FNS provided an estimated completion date of July 31, 2015, for this action.

## **OIG Position**

We accept FNS' management decision on this recommendation.

## Section 2: Monitoring

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### Finding 3: FNS Needs to Strengthen Controls over SFAs' Cafeteria Funds

Twenty of our 61 sampled SFAs in 5 States mismanaged and misused Non-profit School Food Service Funds (or cafeteria funds), which are intended to be used for operating and improving the school food service. This occurred because the State agencies did not provide SFAs with specific guidance and adequate oversight for cafeteria funds management. As a result, SFAs accumulated excess net cash resources,<sup>56</sup> totaling \$4.8 million, expensed a total of nearly \$6 million in capital expenditures in the year of purchase without obtaining prior approval from the State agencies, and charged unallowable costs totaling \$166,933 to the cafeteria fund accounts.

According to FNS regulations, each State agency shall ensure that SFAs comply with the requirements to account for all revenues and expenditures of their nonprofit school food service. It shall ensure that SFAs comply with the Departmental regulations when managing cafeteria fund expenditures and monitor the SFAs' net cash resources.<sup>57</sup> To ensure each State agency adequately monitors SFA compliance, the regulations also require FNS to conduct a comprehensive management evaluation of each State agency, which includes evaluating implementation of monitoring responsibilities and oversight of SFA procurement activities.<sup>58</sup>

Before 2013, State agency reviews of SFAs emphasized oversight of application certification, meal claims, and nutritional standards, but cafeteria fund accounts were not consistently monitored.<sup>59</sup> In February 2013, the California Senate published the results of an investigation that found that, in recent years, the California Department of Education (CDE) has ordered eight school districts to repay nearly \$170 million in inappropriate or unsupported charges to cafeteria fund accounts.<sup>60</sup> This report prompted us to expand our scope to include a review of the cafeteria fund accounts for our sampled SFAs.

We reviewed SY 2011-2012<sup>61</sup> financial records at 61 SFAs in 6 States, as well as the oversight methods employed by the corresponding State agencies.<sup>62</sup> Of these six State agencies, one lacked an oversight procedure to monitor SFAs' net cash resources, and four did not specifically require SFAs to submit prior approval for expensing capital expenditures in the year of

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<sup>56</sup> Net cash resources means all monies, as determined in accordance with the State agency's established accounting system, which are available to or have accrued to an SFA's nonprofit school food service at any given time, less cash payable. Such monies may include, but are not limited to, cash on hand, cash receivable, earnings on investments, cash on deposit, and the value of stocks, bonds, or other negotiable securities.

<sup>57</sup> 7 C.F.R. § 210.19(a)(1) (January 2013).

<sup>58</sup> 7 C.F.R. §§ 210.19(a)(1), 210.29(a), (c)(2) (January 2013).

<sup>59</sup> Effective for SY 2013-2014, State agencies are required to include financial management as part of the new administrative review process.

<sup>60</sup> California Senate Office of Oversight and Outcomes report: *Food Fight: Small team of state examiners no match for schools that divert student meal funds* (February 2013).

<sup>61</sup> SY 2011-2012 ran from July 1, 2011 through June 30, 2012.

<sup>62</sup> We did not conduct a full financial audit at the 61 SFAs; instead, we reviewed SFAs' financial statements or financial reports and requested detailed accounting records when necessary. In addition, two of the three SFAs in California were trying to resolve cafeteria fund issues identified by CDE during our fieldwork.

purchase.<sup>63</sup> We also found that 2 of the 61 SFAs charged unallowable costs to their cafeteria accounts due to lack of knowledge. These issues are discussed in detail below.

### *State Agency Lacked Oversight of SFAs' Net Cash Resources*

Of our 61 sampled SFAs, 9 had net cash resources in excess of 3 months of average expenditures. Of these 9 SFAs, we found that 7—all in Delaware—lacked approved spending plans to limit the excess amount. This occurred because a State agency, the Delaware Department of Education (DDE), did not have adequate procedures in place to monitor SFAs' net cash resources. As a result, DDE allowed the seven SFAs to decide when and how to spend the \$4.8 million excess without knowing whether it would be spent timely and appropriately.

FNS regulations require SFAs to limit net cash resources “to an amount that does not exceed 3 months average expenditures for its nonprofit school food service or such other amount as may be approved in accordance with 7 C.F.R. § 210.19(a).”<sup>64</sup> If an SFA has excess net cash resources, the State agency must approve the excess and “may require the [SFA] to reduce the price children are charged for lunches, improve food quality or take other action designed to improve the nonprofit school food service.”<sup>65</sup> If the above three options are not feasible, the State agency is required to adjust the rates of reimbursement to the SFA. To ensure SFAs' compliance with this requirement, the regulations direct State agencies to monitor SFAs' net cash resources.<sup>66</sup> The regulations also require FNS to conduct a comprehensive management evaluation of each State agency's administration of NSLP. “FNS will evaluate whether the State agency has fulfilled its State level responsibilities, including, but not limited to the following areas: use of Federal funds... implementation of the State agency's monitoring responsibilities... oversight of school food authority procurement activities...”<sup>67 68</sup>

At the end of SY 2011-2012, 9 of the 61 reviewed SFAs had net cash resources in excess of 3 months of average expenditures. Among these nine SFAs, seven—all in Delaware—did not have an approved spending plan to limit the excess (see Table 1). We found these seven SFAs handled excess net cash resources inconsistently and inappropriately, due to lack of guidance from DDE. Two SFAs notified DDE of the excess and provided a general description of their spending plans, but DDE performed no follow up with these two SFAs and did not require them to submit detailed spending plans. Two other SFAs reduced their excesses by transferring cafeteria funds to a reserve account called “upgrade/equipment account,” which they erroneously excluded from net

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<sup>63</sup> Capital expenditures are defined as “expenditures for the acquisition cost of capital assets (equipment, buildings, land), or expenditures to make improvements to capital assets that materially increase their value or useful life.”

2 C.F.R. pt. 225, app. B, § 15a(1) (January 2012).

<sup>64</sup> 7 C.F.R. § 210.9(b)(2) (January 2013).

<sup>65</sup> 7 C.F.R. § 210.19(a)(1) (January 2013).

<sup>66</sup> 7 C.F.R. § 210.19(a)(1) (January 2013).

<sup>67</sup> 7 C.F.R. §§ 210.19(a)(1), 210.29(a), (c)(2) (January 2013).

<sup>68</sup> FNS uses a risk-based selection method to select State agencies for management evaluation on an annual basis. It issues final reports after the evaluation activities are completed, and it also requires the State agencies to take corrective actions when exceptions are noted.

cash resources calculations. Both SFAs informed DDE about this practice when they submitted biannual financial reports in January 2012, but DDE did not notify the SFAs to include the account in the net cash resources calculation until May 2013. An additional SFA did not notify DDE about its excess, and another SFA stated its excess was due to indirect costs not being assessed by the school district so sufficient funds could be maintained for both normal operations and its equipment replacement plan. Lastly, an SFA did not believe its net cash resources exceeded three-month average expenditures because it assumed net cash resources were equivalent to cash.

**Table 1: Excess Net Cash Resources (as of June 30, 2012)**

SFA No.	Net Cash Resources	3-month Average Expenditures	Excess Funds
1	\$2,677,275	\$863,891	\$1,813,384
2	\$1,507,750	\$658,459	\$849,291
3	\$1,122,467	\$799,755	\$322,712
4	\$2,844,704	\$2,825,356	\$19,348
5	\$2,088,594	\$1,536,436	\$552,158
6	\$2,679,471	\$2,060,533	\$618,938
7	\$1,957,199	\$1,313,325	\$643,874
<b>Total</b>			\$4,819,705

DDE's program director stated the State agency provided SFAs with information related to the net cash resources requirement in 2007, and DDE has also verbally reminded SFAs to limit net cash resources to 3 months' average expenditures during quarterly meetings, but the State agency did not have a formal monitoring process in place. DDE relied on single audits to monitor SFAs' financial resources, but these single audits did not include a review of SFAs' net cash resources.<sup>69</sup> In February 2014, DDE implemented a monitoring procedure which requires SFAs to report net cash resources annually. It also requires SFAs that report an excess to submit corrective action plans for State agency approval.

Of the six State agencies we reviewed, three monitored net cash resources annually, and two monitored net cash resources during administrative reviews.<sup>70</sup> DDE was the only State agency that did not periodically monitor the net cash resources. Although DDE conducted administrative reviews during SY 2011-2012 for two of the seven SFAs with an excess, net cash resources management was not included as part of the reviews. Further, although FNS regional offices are required to conduct periodic management evaluations of the State agencies, the latest management evaluation report for DDE—dated August 2011—did not detect DDE's lack of a monitoring procedure for

<sup>69</sup> All non-Federal entities that expend \$500,000 or more of Federal awards in a fiscal year are required to obtain an annual audit in accordance with the Single Audit Act Amendments of 1996, Office of Management and Budget Circular A-133, the Office of Management and Budget Circular Compliance Supplement, and Government Auditing Standards. A single audit is intended to provide a cost-effective audit for non-Federal entities in that one audit is conducted in lieu of multiple audits of individual programs.

<sup>70</sup> FNS requires the State agencies to monitor SFAs through an administrative review, which was once every 5 years until July 2013 and currently is once every 3 years.

SFAs' net cash resources. FNS' Mid-Atlantic regional officials were unaware of the issue, but stated that they would conduct follow up and include it in the next management evaluation for DDE.

#### *SFAs Did Not Obtain Prior Approval for Expensing Capital Expenditures*

Of the 61 reviewed SFAs, 22 treated capital expenditures as direct costs during SY 2011-2012. Of these, 20 SFAs in 5 States expensed nearly \$6 million of equipment purchases or cafeteria improvements in the year of purchase without obtaining prior approval from the respective State agencies.<sup>71</sup> This occurred primarily because the program personnel at some State agencies were either unfamiliar with the requirement or relied on SFAs' voluntary compliance without providing further guidance.

According to Federal cost principles, capital expenditures for general purpose equipment and capital expenditures for improvements to buildings or equipment which materially increase the value or useful life are unallowable as direct charges and require the prior approval of the awarding agency.<sup>72</sup> FNS delegates the prior approval requirement to State agencies, but further clarifies that FNS regulations prohibit the use of SFA cafeteria funds to pay for the cost of purchasing land or buildings, unless otherwise approved by FNS.<sup>73</sup>

Of the 61 SFAs we reviewed, 22 SFAs considered capital expenditures (equipment purchases or cafeteria improvements) as direct costs in SY 2011-2012, and 20 of them did not obtain approval from the State agencies before using these funds accordingly (see Table 2 below). Although the majority of the equipment purchases and cafeteria improvement were for program purposes, we found that an SFA in Florida spent \$207,763 on 11 vehicles, including 4 sport utility vehicles (SUVs) and 4 transit vans for the field specialists; 1 SUV for central office staff to conduct school visits; and 2 transit vans for food service facilities and the maintenance team.<sup>74</sup> FNS requires the SFA to determine the allowability of the costs when charging cafeteria funds. For a cost to be allowable, it must be necessary and reasonable. We questioned the necessity and reasonableness of vehicle purchases by this SFA.

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<sup>71</sup> Equipment is defined as "nonexpendable, tangible personal property having a useful life of more than 1 year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the governmental unit for financial statement purposes, or \$5,000." 2 C.F.R. pt. 225, app. B, § 15a(2) (January 2012).

<sup>72</sup> 2 C.F.R. pt. 225, app. B, § 15b(1), (3) (January 2012).

<sup>73</sup> SP 41-2011 Child Nutrition Reauthorization 2010: Indirect Cost Guidance, p. 20 (July 2011); 2 C.F.R. pt. 225, app. B, § 15b(4) (January 2012).

<sup>74</sup> Two vehicles were ordered in June 2011 (SY 2010-2011) but were paid for in July 2011 (SY 2011-2012).

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**Table 2: Unauthorized Equipment Purchases or Cafeteria Improvement**

State	SFAs with Capital Expenditures as Direct Charges	SFAs with Unauthorized Capital Expenditures	Total Unauthorized Capital Expenditures
Florida	7	7	\$4,703,800
Texas	3	1	\$428,925 <sup>1</sup>
California	2	2	\$88,329
Rhode Island	1	1	\$51,670
Delaware	9	9	\$700,614
Total	22	20	\$5,973,338

<sup>1</sup> The State agency retroactively approved the cafeteria improvement of \$428,925 after we notified it of the expenditure.

Of the six States we visited, only the Texas Department of Agriculture (TDA) had established a formal approval process for capital expenditures. The director of TDA told us that agency staff continuously educated SFAs on requirement compliance, but a few SFAs might still occasionally make mistakes. These mistakes would be identified and corrected through TDA's administrative review process. In California, CDE took a step to amend the problem by issuing an updated Management Bulletin "Cafeteria Fund—Allowable Uses" in May 2013. The updated guidance reminds SFAs to request prior approval for capital expenditures.<sup>75</sup>

The program operations director at the Florida Department of Agriculture and Consumer Services stated the agreement between the State agency and SFAs included relevant Federal regulations, which specify the prior approval requirement for expensing capital expenditures, but five of the seven SFAs we visited in Florida seemed to be unaware of this requirement. The other two SFAs' purchases were handled by the school district's purchasing department. In those cases, the purchasing department followed the district's internal procurement policy, which did not include requesting prior approval from the State agency. The responsible personnel at Delaware and Rhode Island's State agencies were not aware of this requirement; and they issued relevant guidance to the SFAs during our review.<sup>76</sup>

We discussed the prior approval requirement of expensing capital expenditures with FNS regional office officials. The officials at two FNS regional offices stated the prior approval requirement is included in NSLP and SBP regulations because the programs are subject to applicable Departmental regulations, but our review found that the program personnel at both the State and local levels either did not have this knowledge or did not comply with prior approval requirements when managing the cafeteria fund. According to FNS officials, obtaining the prior written approval before incurring the cost of a capital expenditure has been a longstanding requirement under Cost Principles for State, Local, and Indian Tribal Government.<sup>77</sup> FNS later issued a policy in March 2014, which emphasized the State agencies' prior approval process for equipment purchases and

<sup>75</sup> California now has one SFA that is utilizing an allowed pre-approved equipment list whereby items compiled on that list may be purchased by SFAs without prior approval.

<sup>76</sup> The SFAs we reviewed in Wyoming did not treat capital expenditures as direct charges.

<sup>77</sup> 2 C.F.R. pt. 225, app. B, § 15b(1), (3) (January 2012).

extended the flexibility to the State agencies to implement an option that would alleviate some administrative burden without departing from Federal cost principles.<sup>78</sup>

### *Unallowable Costs Were Charged by SFAs*

Of the 61 SFAs we reviewed, 2 charged a total of \$166,933 in unallowable costs to cafeteria fund accounts due to a lack of knowledge of the applicable Federal cost principle.

According to Federal cost principles, bad debt expenses are considered unallowable costs.<sup>79</sup> One SFA in Florida charged \$10,453 of uncollectible check (i.e., bad debt) expenses to its cafeteria fund account. Although a list of unallowable costs—including bad debt expense—was included in the agreement between the State agency and the SFA, the SFA’s senior accounting manager stated that she was unaware of this cost principle.

A Delaware SFA charged \$156,480 of indirect costs accumulated from previous years (SY 2009-2010 and SY 2010-2011) to the cafeteria fund at the beginning of SY 2012-2013.<sup>80</sup> However, FNS’ Indirect Cost Guidance states that it is unallowable to bill the cafeteria fund account for indirect costs that were paid from the general fund in prior years unless an agreement exists to show that the SFA has been “loaning” the cafeteria funds to cover the indirect costs in one or more prior years.<sup>81</sup> No accounting records showed that such a loan existed. The SFA supervisor stated that she used the cash basis accounting method to record and pay the bills, and she did not know the indirect cost entry for prior years was unallowable without corresponding accrual entries.<sup>82</sup> Although she had access to the FNS guidance, she was not familiar with the requirements therein.

During the course of our audit, we noted that FNS had already taken some initial steps to strengthen oversight of SFA cafeteria funds. For example, it issued its *Indirect Cost Guidance* in 2011 in accordance with requirements of the Healthy, Hunger-Free Kids Act of 2010. FNS also updated and streamlined its administrative review procedures at the beginning of 2012. The updated Administrative Review Guidance Manual was issued in March 2013 and included a resource management component for monitoring SFA cafeteria funds. In addition, FNS provided trainings to the State agencies on the updated administrative review process through conferences and webinars. However, we noted that the program personnel at some State agencies and SFAs were still unfamiliar with the details of the *Indirect Cost Guidance*.

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<sup>78</sup> SP-31-2014 State agency Prior Approval Process for SFA Equipment Purchases (March 2014).

<sup>79</sup> 2 C.F.R. pt. 225, app. B, § 5 (January 2012).

<sup>80</sup> The SFA accumulated 3 years’ indirect costs (SY 2009-2010, 2010-2011, and 2011-2012) and paid them on July 30 2012. Although July 2012 was the beginning of SY 2012-2013, because the SFA used the cash basis accounting method, we did not take an exception for the indirect cost incurred in SY 2011-2012.

<sup>81</sup> FNS SP41-2011 Child Nutrition Reauthorization 2010: *Indirect Costs Guidance for State Agencies and School Food Authorities*, p. 33 (July 2011).

<sup>82</sup> For cash basis accounting, revenue is recorded when cash is received and expenses are recorded when cash is paid. For accrual basis accounting, revenue is recorded when earned and expenses are recorded when goods or services are received.

Therefore, we concluded that FNS must periodically assess State agencies' oversight controls and provide them with sufficient training.

## **Recommendation 5**

Provide specific guidance to State agencies to ensure they adequately monitor the SFAs' net cash resources as required by FNS regulations.

### **Agency Response**

In its March 23, 2015, response FNS stated:

FNS agrees with the goal of ensuring program integrity by providing guidance to State agencies to ensure they adequately monitor [the] SFAs' net cash resources as required by regulation. In SY 2013-2014, we implemented the new Administrative Review process to include a new section entitled, "Resource Management." This section was specifically designed to provide a systematic approach to ensuring the overall financial health of an SFA's nonprofit school food service. The section consists of a review of four areas integral to the financial health of the SFA's food service: Paid Lunch Equity, Nonprogram Revenue, Indirect Costs, and Net Cash Resources. Additionally, on July 7, 2011, FNS issued memo SP 41-2011 Child Nutrition Reauthorization 2010: Indirect Cost Guidance.

FNS plans to issue additional clarification to State agencies to ensure they adequately monitor the SFAs' net cash resources through further updates to the Administrative Review Manual.

FNS provided an estimated completion date of October 31, 2015, for this action.

### **OIG Position**

We accept FNS' management decision on this recommendation.

## **Recommendation 6**

Instruct the Delaware Department of Education to review all SFAs' net cash resources and appropriately address the \$4.8 million in excess net cash resources.

### **Agency Response**

In its March 23, 2015, response FNS stated:

FNS supports this recommendation. FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course of action. If FNS determines

that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

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

## **OIG Position**

We accept FNS' management decision on this recommendation.

## **Recommendation 7**

Issue a reminder to State agencies that prior approval authority for treating capital expenditures as direct costs has been delegated to them and require them to establish a process to fulfill this requirement.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS concurs with this recommendation and will issue a policy memorandum to remind State agencies that prior approval authority for treating capital expenditures as direct costs has been delegated to them and require them to establish a process to fulfill this requirement.

FNS provided an estimated completion date of August 31, 2015, for this action.

## **OIG Position**

We accept FNS' management decision on this recommendation.

## **Recommendation 8**

Instruct the State agencies to work with the 20 SFAs to review nearly \$6 million of capital expenditures incurred in SY 2011-2012 and determine if those costs are truly allowable; if unallowable costs are determined, the State agencies need to recover the costs.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course of action. If FNS determines that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

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

## **OIG Position**

We accept FNS' management decision on this recommendation.

## **Recommendation 9**

Instruct the State agencies to recover \$166,933 in unallowable costs from two SFAs.

## **Agency Response**

In its March 23, 2015, response FNS stated:

FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course of action. If FNS determines that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

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

## **OIG Position**

We accept FNS' management decision on this recommendation.

## **Recommendation 10**

Require the personnel with oversight responsibilities of the cafeteria fund at the State agencies and SFAs to be trained periodically on cafeteria fund management.

## **Agency Response**

In its March 23, 2015, response FNS stated:

On March 2, 2015, [FNS] published a final rule entitled Professional Standards for School Nutrition Programs Personnel. This regulation established professional standards for school nutrition professionals. Under the final rule, which is effective July 1, 2015, annual training hours are required for school food service directors, managers, staff, and State agency directors. The regulation requires that each individual employee at the SFA level receive and complete training on the topics or areas applicable to his/her job.

Furthermore, State Directors of school nutrition programs must provide SFAs at least 18 hours annually in topics such as administrative practices; the accuracy of approvals for

free and reduced priced meals; the identification of reimbursable meals at the point of service; nutrition; health and safety standards and the efficient and effective use of USDA donated foods; and any other appropriate topics as determined by FNS to ensure program compliance and integrity or to address other critical issues.

In conjunction with the new rule, FNS has developed a database of currently available training resources (including on-line modules, in-person classes, and self-directed training) that State and local directors, managers and staff may use to meet the annual training requirements. This database includes financial management modules such as a module developed in conjunction with the National Food Service Management Institute titled: *Financial Management: A Course for School Nutrition Directors*. To emphasize the importance of cafeteria fund management as a topic and highlight the specific modules on this topic available to fulfill the requirement, FNS will include this topic as an example of training which directors, managers, and certain staff may take relevant to their job responsibilities.

FNS provided an estimated completion date of July 1, 2015, for this action.

## **OIG Position**

We accept FNS' management decision on this recommendation.

## Scope and Methodology

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We conducted a nationwide audit of FNS' National School Lunch and School Breakfast Programs and its enforcement of laws, regulations, and policies during FYs 2012 and 2013. We performed fieldwork at the FNS national office in Alexandria, Virginia; six regional offices (San Francisco, California; Denver, Colorado; Atlanta, Georgia; Boston, Massachusetts; Robbinsville, New Jersey; and Dallas, Texas); and seven State agencies.<sup>83</sup> We also performed fieldwork at 61 SFAs and 120 schools in 6 States (see Exhibit B for a list of audit sites). We performed audit fieldwork from September 2012 to August 2014.

We statistically selected 120 of 4,526 schools for review. We used a stratified sample with two strata. For stratum one, we nonstatistically selected California, Florida, and Texas because they received the highest reimbursement amounts—31.4 percent of total NSLP and SBP reimbursements combined—during FY 2011.<sup>84</sup> Within these 3 States, we selected the 15 SFAs that had both the highest level of meal reimbursement and the most associated schools. From these 15 SFAs, we randomly selected 60 schools for review.

For stratum two, we nonstatistically selected Delaware, Rhode Island, and Wyoming because of their low reimbursement amounts—0.6 percent of total NSLP and SBP reimbursements combined. Within these three States, we randomly selected 60 schools, and the related SFAs, for review. (See Exhibit C for additional information on our statistical methodology and results.)

To accomplish our audit, we:

- **Reviewed Criteria:** We reviewed the pertinent laws and regulations governing the NSLP and SBP and the current policies and procedures FNS established as guidance for State agencies, SFAs, and schools.
- **Interviewed FNS, State agency, and SFA Personnel:** We interviewed FNS national and regional officials, State agency officials, and SFA personnel to gain an understanding about their roles in monitoring the programs and to determine what controls are used to ensure (1) children approved for free and reduced-price meals meet the eligibility requirements, and (2) meal claims are supported and accurately reimbursed.
- **Conducted Site Visits:** We conducted visits at 38 schools and 20 SFAs to determine whether there are adequate controls to ensure that only actual meals served are claimed for reimbursement and that children approved for free and reduced-price meals met the eligibility requirements.

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<sup>83</sup> California Department of Education, Delaware Department of Education, Florida Department of Agriculture and Consumer Services, New York State Education Department, Rhode Island Department of Education, Texas Department of Agriculture, and Wyoming Department of Education. New York was originally selected as part of our nonstatistical sample, but was later removed in consideration of hardships caused by Hurricane Sandy.

<sup>84</sup> New York was originally selected as part of our nonstatistical sample, but was later removed in consideration of hardships caused by Hurricane Sandy. In its place, we added additional schools from California, Florida, and Texas, and created the second stratum that consisted of schools from Delaware, Rhode Island, and Wyoming.

- **Sampled and Reviewed Applications for Free and Reduced Price Meals:** For the 120 selected schools, we sampled and reviewed student applications to determine whether students' initial eligibility determinations were correct.
- **Verified Accuracy of SFA Claims:** We selected and verified one month's reimbursement claims from the selected schools and traced the number of meals served by category to the SFAs' meal claims.
- **Reviewed SFAs' Verification Processes:** We reviewed the SFAs' files for annual verification to determine whether verification was conducted accurately for the selected households and whether corrective actions were taken against households that provided inaccurate information or did not respond to the verification request. We also reviewed SFAs' questionable application processes to determine the basis for a questionable application and whether verification for questionable applications was done.
- **Reviewed State Agencies' Information Systems:** We obtained read-only access to the States' Information Systems to verify the systems' controls and availability of data. We reviewed enrollment information, verification data, and meal claims.
- **Reviewed State Agencies' Administrative Review Processes:** We reviewed the State agencies' administrative review processes to identify any deficiencies found, what the proposed corrective actions were, and whether they performed followup reviews to determine if deficiencies were corrected.
- **Reviewed SFAs' cafeteria funds:** We reviewed the SFAs' relevant accounting records related to NSLP and SBP to determine if SFAs used program funds for the intended purpose.

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.

## Abbreviations

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APEC .....	Access, Participation, Eligibility, and Certification
CDE.....	California Department of Education
C.F.R. ....	Code of Federal Regulations
DDE .....	Delaware Department of Education
FNS .....	Food and Nutrition Service
FTBPTBU .....	Funds to Be Put to Better Use
FY .....	Fiscal Year
GAO.....	U.S. Government Accountability Office
NSLA .....	Richard B. Russell National School Lunch Act
NSLP .....	National School Lunch Program
OGC .....	Office of the General Counsel
OIG .....	Office of Inspector General
SBP .....	School Breakfast Program
SFA .....	School Food Authority
SNAP .....	Supplemental Nutrition Assistance Program
SUV.....	Sport utility vehicle
SY .....	School Year
TDA .....	Texas Department of Agriculture
U.S.C.....	United States Code
USDA.....	U.S. Department of Agriculture
WIC.....	Special Supplemental Nutrition Program for Women, Infants, and Children

## Exhibit A: Summary of Monetary Results

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Exhibit A summarizes the monetary results for our audit report by finding and recommendation number.

Finding	Recommendation	Description	Amount	Category
1	1	Money spent on lunches for students later found to be ineligible as a result of annual verifications.	\$12,481,136	FTBPTBU <sup>1</sup> – Management or Operating Improvements / Savings
3	6	SFAs had excess net cash resources without approved spending plans.	\$4,819,705	FTBPTBU – Management or Operating Improvements / Savings
3	8	SFAs made unauthorized equipment purchases and cafeteria improvements.	\$5,973,338	Questioned Costs/Loans, No Recovery
3	9	SFAs charged unallowable costs to the cafeteria fund account.	\$166,933	Questioned Costs/Loans, Recovery Recommended
<b>TOTAL MONETARY RESULTS</b>			\$23,441,112	
<sup>1</sup> Funds to be put to better use.				

## Exhibit B: Audit Sites Reviewed

Exhibit B shows the organization and location of all sites reviewed.

Organization	Location
<b>FNS National Office</b>	Alexandria, VA
<b>FNS Mid-Atlantic Regional Office</b> Delaware Department of Education School Food Authorities: 1 2 3 4 5 6 7 8 9 10 11 12 13	Robbinsville, NJ Dover, DE [REDACTED], DE (2 schools) [REDACTED] DE (2 schools) [REDACTED] DE (2 schools) [REDACTED] DE (2 schools) [REDACTED] DE (1 school) [REDACTED] DE (2 schools) [REDACTED] DE (3 schools) [REDACTED] DE (1 school) [REDACTED] DE (1 school) [REDACTED] DE (1 school) [REDACTED] DE (2 schools) [REDACTED] DE (1 school) [REDACTED] DE (1 school)
<b>FNS Mountain Plains Regional Office</b> Wyoming Department of Education School Food Authorities: 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16	Denver, CO Cheyenne, WY [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (4 schools) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school) [REDACTED] WY (1 school)

Organization	Location
<b>FNS Northeast Regional Office</b> New York State Education Department* Rhode Island Department of Education School Food Authorities: 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17	Boston, MA Albany, NY Providence, RI  [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (2 schools) [REDACTED] RI (1 school) [REDACTED] RI (3 schools) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school) [REDACTED] RI (1 school)
<b>FNS Southeast Regional Office</b> Florida Department of Agriculture and Consumer Services School Food Authorities: 1 2 3 4 5 6 7	Atlanta, GA Tallahassee, FL  [REDACTED] FL (4 schools) [REDACTED] FL (7 schools) [REDACTED] FL (4 schools) [REDACTED] FL (3 schools) [REDACTED] FL (3 schools) [REDACTED] FL (4 schools) [REDACTED] FL (1 school)
<b>FNS Southwest Regional Office</b> Texas Department of Agriculture School Food Authorities: 1 2 3 4 5	Dallas, TX Austin, TX  [REDACTED] TX (5 schools) [REDACTED] TX (5 schools) [REDACTED] TX (4 schools) [REDACTED] TX (2 schools) [REDACTED] TX (1 school)
*New York was selected as part of our original nonstatistical sample, but was later removed from our sample in consideration of hardships caused by Hurricane Sandy. This occurred after we had performed some audit work for the New York State Education Department, but before we had performed any audit work for any of the selected schools or related school food authorities.	

Organization	Location
<b>FNS Western Regional Office</b> California Department of Education School Food Authorities: 1 2 3	San Francisco, CA Sacramento, CA  [REDACTED] CA (4 schools) [REDACTED] CA (11 schools) [REDACTED] CA (2 schools)

## Exhibit C: Statistical Sampling Methodology and Results

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Exhibit C details the OIG statistician’s description of the audit sampling methodology and results.

### Objective

This sample is designed to support OIG audit 27601-0001-41. To help achieve the objective of the audit, we developed a representative random statistical sample for review. The audit team reviewed the sample and collected data to support the audit findings. The information gathered were used to determine whether statistical projections were feasible.

### Audit Universe

The universe list was provided to the OIG statistician by the audit team. Due to travel and resource considerations, we initially made a decision to limit our universe to four States—California, Florida, New York, and Texas. Those were selected on the basis of highest dollar reimbursement amounts for NSLP and SBP combined. Due to the large territorial spread of schools in the 4 States included in our review, we further limited the universe in California, Florida, New York, and Texas to the top 16 school food authorities (SFAs) in those States based on the number of schools and dollar amount of reimbursements. We dropped New York from our sample because it was struck by Hurricane Sandy and needed time to recover from storm damage.

Since New York represented a large part of our initial universe and sample, dropping it from review meant that we had resources for additional work. We added another group of States to our review—Delaware, Rhode Island, and Wyoming. We selected these States to represent States with comparatively small NSLP and SBP reimbursement dollar amounts. Delaware, Rhode Island, and Wyoming were grouped in their own stratum.

Hence, our final universe consisted of schools within six States, which were grouped into two strata. Descriptive universe statistics are shown in Table 1 below.

**Table 1: Descriptive Universe Statistics per Stratum**

Universe Stratum I				Universe Stratum II			
State	Frequency	Percent	Cumulative Percent	State	Frequency	Percent	Cumulative Percent
CA	1,155 schools	32.50%	32.50%	DE	244 schools	25.00%	25.00%
FL	1,520 schools	42.80%	75.40%	RI	395 schools	40.40%	65.40%
TX	874 schools	24.60%	100%	WI	338 schools	34.60%	100%
Total	3,549 schools	100%		Total	977 schools	100%	

## Sample Design

Given the data structure diversity in the audit programs (data factors) and audit resource requirements (resource factors), we developed several designs to help us make informed decisions about which design(s) would be feasible for the objective of this audit. We considered various sample designs: simple random, stratified, multi-stage selections, etc. To keep our sample size as low as possible, while still achieving statistical representation of the universe, we decided to use a multi-stage stratified sample. We randomly selected 60 schools within each stratum for review. The sample size of 60 schools per stratum was calculated based on the following factors:

- **Audit Universe:** Stratum I consisted of 3,549 schools and stratum II consisted of 977 schools.
- **Expected Error Rate:** We did not know what error rate to expect. Additionally, we did not have any information about whether variation would be greater within the States or between them.
- **Precision:** We wanted to be able to report our estimates with a +/-10% precision in an attribute testing scenario.
- **Confidence Level:** We are using a 95% confidence level when reporting our estimates.

Table 2 presents summaries of counts for each stratum at stage one of sample selection.

**Table 2: Descriptive Sample Statistics per Stratum - Stage 1 Sample Selection**

Sample Stratum I				Sample Stratum II			
State	Frequency	Percent	Cumulative Percent	State	Frequency	Percent	Cumulative Percent
CA	17 schools	28.30%	28.30%	DE	20 schools	33.30%	33.30%
FL	26 schools	43.30%	71.70%	RI	21 schools	35.00%	68.30%
TX	17 schools	28.30%	100%	WY	19 schools	31.70%	100%
Total	60 schools	100.00%		Total	60 schools	100%	

Each school in our sample contained numerous applications for NSLP and SBP participation. To review a sample of applications at each school selected, we applied a second stage of sampling. We selected a simple random sample of 20 percent or 150 applications, whichever was less.

## Results

Based on the evidence collected in support of the findings for this audit, we decided not to project any values across the universe.

For our first finding, the audit team did not have direct access to income documentation from families, so our evidence was based on FNS' own verification of applications. Because three different sampling methodologies are used for FNS verification, we could not use this data to develop a statistical projection.

No projections were developed for the audit's second finding because we did not have a clear idea of the total number of applications for all SFAs. While we knew the total number of applications for our selected SFAs, we did not have this data for all SFAs.

The audit's third finding was added to the scope of work after the statistical sample was determined. Our sampling methodology did not support the data needed as evidence for this finding. Hence, projections were not used.

**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: March 23, 2015

AUDIT  
NUMBER: 27601-0001-41

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

FROM: /s/ <David G. Burr> (for): Audrey Rowe  
Administrator

SUBJECT: FNS – National School Lunch and School Breakfast Programs

This letter responds to the Office of Inspector General (OIG) official draft report for audit report number 27601-0001-41, FNS – National School Lunch and School Breakfast Programs. OIG audited the Food and Nutrition Service (FNS) to evaluate how the Agency has attempted to lower the error rates for the National School Lunch and Breakfast Programs. FNS is responding to the content, recommendations and Exhibit A in the audit report.

The Department of Agriculture's Food and Nutrition Service (FNS) is committed to reducing the rate of improper payments in the school meals programs. 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.

FNS, along with its State and local partners, has invested in system improvements and process reforms over the last several years that are beginning to pay dividends and promise long term reduction in program error. A number of these reforms were mandated by the Healthy, Hunger-Free Kids Act (HHFKA) of 2010. A few highlights include:

- The establishment of a **new Office of Program Integrity for Child Nutrition Programs** in 2014. The new office draws on the expertise of FNS research and policy staff in the Agency's capitol area and regional offices. The office is guided by a data and evidence driven approach to error reduction, and a commitment to the development and testing of scalable initiatives.
- Taking aim at certification error with **several projects focused on the applicants' perspective**. These include the 2015 release of a new model household application that incorporates elements of human-centered design to improve clarity and reduce the incidence of household reporting error; the planned development of a model electronic application; and a study to identify and better understand the underlying causes of household misreporting.

- The reduction of certification error through **improved administrative processes**. These projects include research trials to test the effectiveness of alternate communication protocols with households during the verification process, and a study to explore the potential for additional data matching against Federal and State data systems in both the certification and verification processes.
- **Working with States to achieve direct certification performance targets** and reduce their reliance on traditional applications – the single biggest source of improper program payments. The great majority of children from SNAP participating households are now certified for free school meals without application. As more States meet the direct certification performance targets mandated by HHFKA the number of children certified through the traditional application process will decrease further. Since direct certification is the key to CEP eligibility, high direct certification rates will allow more schools and school districts to eliminate their application processes altogether.
- **Nationwide implementation of the Community Eligibility Provision (CEP)**. A 2014 USDA study provides strong support for the CEP as an error reduction strategy. Almost 14,000 schools in more than 2,000 school districts serving 6.4 million children embraced the CEP in School Year 2014-2015, its first year of nationwide availability. FNS is now engaged in an effort to extend the CEP's benefits to remaining schools and districts that meet eligibility requirements.
- **Improved oversight, data collection, and performance reporting**. Almost all States have now adopted the Agency's redesigned administrative review process. The more rigorous risk-based review of school districts, conducted on a shorter 3-year cycle, is generating high value information that will support improved management analysis and performance tracking. FNS is now engaged in the development of reporting requirements to capture and summarize the right information to realize the full potential of this new data resource.
- **Targeted review of applications to address administrative error**. School districts with high rates of application processing error must now conduct a second review of all their certification decisions. This risk-based approach to error reduction imposes new accountability on States and local districts, and targets their efforts for maximum return.
- **Publication of a final Professional Standards rule** in March 2015 that implements new continuing education and training requirements on school nutrition program directors, managers, and staff to address persistent sources of program error and improper payments. The Agency anticipates near-term publication of a proposed Child Nutrition Program Integrity rule that provides States the authority to implement assessments for egregious or ongoing program compliance issues.

### **Additional note on measuring program error:**

FNS is concerned with the analysis and presentation of the results of the OIG's audit. A critical step in addressing program error is measuring it accurately. FNS conducted a carefully designed nationally representative study to measure improper payments in the school meal programs in School Year 2005-2006. The *Access, Participation, Eligibility, and Certification (APEC) Study*, released in 2007, found that about 1 in 5 certified students was improperly certified for free or reduced-price meals, a figure cited in the OIG report.

The OIG's audit examines outcomes from the verification process. The audit report's inadequate explanation of the verification process contributes to persistent confusion about the relationship between program error and verification outcomes. The two are not comparable. OIG presents the result of its verification findings in a way that appears to challenge APEC error estimates; the report may suggest to some that program error is as high as 50 percent or more.

To clarify, only a narrow subset of households approved for free or reduced price meals are included in the pool of applicants subject to verification sampling. The verification pool excludes all children certified by direct certification – well over half of all children certified for free meal benefits. Directly certified children are primarily SNAP recipients whose benefits depend on a rigorous income verification process. In addition, most school districts choose an even narrower “error prone” subset of applicants from the verification pool whose incomes fall within \$100 of the monthly eligibility thresholds – that is, applicants more likely to have made errors.

Finally, more than half of the applicants selected for verification who lose their benefits do so because they fail to respond to the school district's request for income documentation, not because their incomes were found to exceed the eligibility threshold. A 2004 USDA case study of large urban school districts found that just over half of nonrespondents were, in fact, income-eligible for at least the level of benefits they were originally certified to receive. Although dated and not nationally representative, that study suggests that a significant subset of nonrespondents remain income-eligible for program benefits, even though they are ineligible for failure to respond.

The audit report offers brief reference, in footnotes, to the error prone nature of the verification sample and the uncertain income levels of non-respondents. FNS suggests that a more thorough discussion of these points would provide a more accurate description of the verification process for the school meal programs.

### **FNS responses to the report's recommendations:**

#### **Recommendation 1:**

In consultation with the Office of the General Counsel (OGC), determine if FNS has the authority to modify existing regulations so that households are required to submit income documentation with applications for free or reduced-price meals. Based on this determination, take the appropriate actions to revise the programs' documentation requirements.

**FNS Response:**

FNS has consulted with OGC on this matter and while the Secretary, as a legal matter, may have authority to propose a change as recommended, significant other legal, policy, and operational concerns remain. As this report acknowledges, implementing this recommendation could create barriers to participation for eligible children, cause significant administrative and record keeping burden for participating schools, and constitute a significant reconstruction of the application, certification, and verification processes.

**Completion Date: February 3, 2015**

**Recommendation 2:**

Develop a strategy, in collaboration with State agencies, for School Food Authorities (SFAs) to verify for cause applications of households, which were found to have misreported income information on their prior year's applications.

**FNS Response:**

FNS generally agrees with this recommendation. FNS will collaborate with our State partners to determine opportunities to identify in subsequent school years, those households that, based on the results of the regular verification process, have been found to have misreported income. Feasible and reasonable strategies identified will be incorporated into verification for cause guidance, and will also be incorporated into the annually updated eligibility guidance.

**Estimated Completion Date: April 30, 2016**

**Recommendation 3:**

Update current regulations and guidance with the criteria explaining what constitutes a questionable application, including any additional instances of when verifications for cause are required. Ensure State agencies and SFAs are trained on the new criteria.

**FNS Response:**

FNS agrees that the eligibility guidance can be effectively updated to include additional information on what constitutes a questionable application. FNS will provide additional guidance and will provide training via webinar for State agency personnel on the additional guidance. FNS will make the webinar slides available for States to use for their own training of SFAs on identifying questionable applications.

**Estimated Completion Date: August 31, 2015**

**Recommendation 4:**

FNS should consider a policy requiring SFAs to verify for cause any application from a household when the household's application from the prior year was denied as a result of the prior year's annual verification process.

**FNS Response:**

FNS will consult with OGC to determine if this recommendation is possible under current legal authorities related to verification. In contrast to recommendation #2 above, this pool of households is not comprised entirely of households that have misreported household income information. Some households do not respond to verification requests but are in-fact income-eligible. Considering all applications from these households as questionable applications subject to verification for cause may be considered a violation of the verification sample size established in Section 9(b)(3)(D)(iii) of the Richard B. Russell National School Lunch Act.

**Estimated Completion Date: July 31, 2015**

**Recommendation 5:**

Provide specific guidance to State agencies to ensure they adequately monitor the SFAs' net cash resources as required by FNS regulations.

**FNS Response:**

FNS agrees with the goal of ensuring program integrity by providing guidance to State agencies to ensure they adequately monitor their SFAs' net cash resources as required by regulation. In SY 2013-2014, we implemented the new Administrative Review process to include a new section entitled, "Resource Management." This section was specifically designed to provide a systematic approach to ensuring the overall financial health of an SFA's nonprofit school food service. The section consists of a review of four areas integral to the financial health of the SFA's food service: Paid Lunch Equity, Nonprogram Revenue, Indirect Costs, and Net Cash Resources. Additionally, on July 7, 2011, FNS issued memo SP 41-2011 Child Nutrition Reauthorization 2010: Indirect Cost Guidance.

FNS plans to issue additional clarification to State agencies to ensure they adequately monitor the SFAs' net cash resources through further updates to the Administrative Review Manual.

**Estimated Completion Date: October 31, 2015**

**Recommendation 6:**

Instruct the Delaware Department of Education to review all SFAs' net cash resources and appropriately address the \$4.8 million in excess net cash resources.

**FNS Response:**

FNS supports this recommendation. FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course of action. If FNS determines that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

**Estimated Completion Date: March 31, 2016**

**Recommendation 7:**

Issue a reminder to State agencies that prior approval authority for treating capital expenditures as direct costs has been delegated to them and require them to establish a process to fulfill this requirement.

**FNS Response:**

FNS concurs with this recommendation and will issue a policy memorandum to remind State agencies that prior approval authority for treating capital expenditures as direct costs has been delegated to them and require them to establish a process to fulfill this requirement.

**Estimated Completion Date: August 31, 2015**

**Recommendation 8:**

Instruct the State agencies to work with the 20 SFAs to review nearly \$6 million of capital expenditures incurred in SY 2011-2012 and determine if those costs are truly allowable; if unallowable costs are determined, the State agencies need to recover the costs.

**FNS Response:**

FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course of action. If FNS determines that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

**Estimated Completion Date: March 31, 2016**

**Recommendation 9:**

Instruct the State agencies to recover \$166, 933 in unallowable costs from two SFAs.

**FNS Response:**

FNS received OIG's documentation to support the amount stated in this recommendation on March 18, 2015. Upon review of the documentation, FNS will determine the appropriate course

of action. If FNS determines that the questioned costs are valid and requires recovery, we will advise the State agency to proceed with the necessary collection efforts.

**Estimated Completion Date: March 31, 2016**

**Recommendation 10:**

Require the personnel with oversight responsibilities of the cafeteria fund at the State agencies and SFAs to be trained periodically on cafeteria fund management.

**FNS Response:**

On March 2, 2015, the Food and Nutrition Service published a Final rule entitled Professional Standards for School Nutrition Programs Personnel. This regulation established professional standards for school nutrition professionals. Under the final rule, which is effective July 1, 2015, annual training hours are required for school food service directors, managers, staff, and State agency directors. The regulation requires that each individual employee at the SFA level receive and complete training on the topics or areas applicable to his/her job.

Furthermore, State Directors of school nutrition programs must provide SFAs at least 18 hours annually in topics such as administrative practices; the accuracy of approvals for free and reduced priced meals; the identification of reimbursable meals at the point of service; nutrition; health and safety standards and the efficient and effective use of USDA donated foods; and any other appropriate topics as determined by FNS to ensure program compliance and integrity or to address other critical issues.

In conjunction with the new rule, FNS has developed a database of currently available training resources (including on-line modules, in-person classes, and self-directed training) that State and local directors, managers and staff may use to meet the annual training requirements. This database includes financial management modules such as a module developed in conjunction with the National Food Service Management Institute titled: *Financial Management: A Course for School Nutrition Directors*. To emphasize the importance of cafeteria fund management as a topic and highlight the specific modules on this topic available to fulfill the requirement, FNS will include this topic as an example of training which directors, managers, and certain staff may take relevant to their job responsibilities.

**Estimated Completion Date: July 1, 2015**

FNS has provided responses to the chart from the audit report, Exhibit A.

## Exhibit A: Summary of Monetary Results

Exhibit A lists findings and recommendations that had a monetary result, and includes the type and amount of the monetary result.

Finding	Recommendations	Description	Amount	Category	FNS Response
1	1	Money spent on lunches later found to be ineligible as a result of annual verification	\$12,481,136	FTBPTBU <sup>1</sup> - Management or Operating Improvement/Savings	FNS disputes this amount. We disagree with the method OIG used to make this estimate.
3	6	SFAs had excess net cash resources without approved spending plans.	\$4,819,705	FTBPTBU- Management or Operating Improvement/Savings	FNS is unable to concur with this figure until we review the supporting documentation provided by OIG.
3	8	SFAs made unauthorized equipment purchases and cafeteria improvements.	\$5,973,338	Questions Costs/Loans, No Recovery	FNS is unable to concur with this figure until we review the supporting documentation provided by OIG.
3	9	SFAs charge unallowable costs to the cafeteria fund account.	\$166,933	Questions Costs/Loans, Recovery Recommended.	FNS is unable to concur with this figure until we review the supporting documentation provided by OIG.
<b>TOTAL MONETARY RESULTS</b>			\$23,441,112		

<sup>1</sup>Funds to be put to better use.

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