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

Food and Nutrition Service
National School Lunch Program
Chartwells
Food Service Management Company

Report No.
27601-13-KC
March 2002
This report presents the results of our audit concerning the National School Lunch Program and one food service management company. Your staff’s February 28, 2002, written response is included as exhibit B and our positions are incorporated into the relevant sections of the report. We have discussed the comments concerning the Food and Nutrition Service’s (FNS) guidance for school food authorities on contract requirements relative to those authorities retaining title to U.S. Department of Agriculture (USDA) commodities with your national office and the Office of the General Counsel representatives. The consensus was that the FNS guidance should be followed when contracting with food service management companies and contracts with them should always specify that school food authorities retain title to USDA donated commodities. Do not take action on Recommendation No. 1 until you receive clearance from Office of Inspector General Investigations. Since the reply did not address what actions were taken or contemplated for any of the recommendations in the report, we are unable to consider any management decisions for them.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned for each recommendation, including estimated timeframes for implementation. Please note that the regulation requires a management decision be reached on all recommendations within a maximum of 6 months after report issuance. We appreciate the cooperation and assistance extended by your office and the Missouri State Agency during the review.

DENNIS J. GANNON
Regional Inspector General
for Audit
EXECUTIVE SUMMARY
FOOD AND NUTRITION SERVICE
NSLP – CHARTWELLS FOOD SERVICE MANAGEMENT COMPANY
REPORT NO. 27601-13-KC

RESULTS IN BRIEF

We performed this audit to determine whether sufficient controls existed to ensure that Chartwells, a food service management company (FSMC), credited the School Food Authorities (SFA) in the State of Missouri for the value of U.S. Department of Agriculture (USDA) donated commodities used in conjunction with fixed-price contracts under the National School Lunch Program (NSLP)/School Breakfast Program (SBP). We selected this FSMC for review based on information developed from our work on a prior nationwide audit of selected FSMCs on whether they had credited SFAs for the full value of USDA donated commodities used and for all volume purchase discounts, rebates, and other credits. This audit was performed in conjunction with a separate audit concerning an SFA’s controls over its cost reimbursable contracts with this FSMC (Audit No. 27601-14-KC). We determined that the Missouri State agency did not adequately ensure that SFAs received the value of the USDA donated commodities used by Chartwells for the NSLP/SBP. This occurred primarily because controls were not in place to ensure invoices from the FSMC to the SFAs were credited for the value of the commodities used to prepare meals. As a result, four SFAs contracting with Chartwells for food management services on a fixed-price basis did not receive the benefit of over $307,000 in donated commodities in the 3 school years ending June 30, 2001.

Also, we evaluated the State agency and SFA controls over the adequacy of requests for proposal and contracts under which the FSMC agreed to manage the SFA’s food service and, in particular, the FSMC’s compliance with Food and Nutrition Service (FNS) regulations and guidelines. We determined that, other than the situation already described, the controls were working as prescribed for the SFAs with a fixed-price contract.

KEY RECOMMENDATIONS

We recommend that the State agency review contracts to ensure they always contain the required clause granting SFAs the value of USDA donated commodities used in the school food programs. In addition, FNS should request all overpayments to be
collected, such as, the value of USDA donated commodities for which the SFAs did not receive benefit.

**AGENCY RESPONSE**

In its response to our draft report, the FNS regional office requested that our report acknowledge that there is a discrepancy between the Food Distribution Program and Child Nutrition Program regarding the interpretation whether SFAs retain title to USDA donated commodities. The FNS regional office contended FNS guidance for SFAs, “Contracting With Food Service Management Companies”, erroneously states that Federal regulations require that all contracts must state that the SFA retains title to the USDA donated commodities. In a later telephone communication, a regional office official stated that he generally concurred with the recommendations in the report.

**OIG POSITION**

We contacted representatives of the FNS national office and the Office of the General Counsel to determine whether the cited FNS guidance for SFAs correctly requires that all contracts must clearly provide that SFA's retain title to USDA donated foods. Personnel of both offices agreed that the FNS guidance should be followed when contracting with FSMCs. One FNS headquarters official stated that it could be inferred from the regulations (Title 7, CFR, part 250) that Federal regulations require that the SFA retain title to the USDA donated commodities. The official stated that under no circumstances should the title be transferred to the FSMC.

Before we can consider management decisions on the recommendations contained herein, we need to be advised of the actions taken or contemplated and the proposed time frames for completing them.
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INTRODUCTION

BACKGROUND

The Food and Nutrition Service (FNS), an agency of the U.S. Department of Agriculture (USDA), administers the National School Lunch Program (NSLP). The National School Lunch Act was passed in 1946, to safeguard the health and well being of the Nation's children and encourage the domestic consumption of agricultural commodities. The program provided Federal assistance to help public and nonprofit private schools serve nutritious lunches to children. In 1966, Congress expanded food assistance to include the School Breakfast Program (SBP), which became a permanent program in 1975.

Through the Missouri Department of Elementary and Secondary Education (State agency), FNS provides donated foods and cash reimbursements to School Food Authorities (SFA) for meals served in the NSLP/SBP. The Act, as amended, authorized payment of general and special cash assistance funds to State agencies. The general cash assistance is based upon the number of lunches served; whereas, the special cash assistance is based on the number of free or reduced-priced lunches/breakfasts served. Eligibility of children for free, reduced-price, or full-price lunches/breakfast is based on family household size and income. The total cash assistance each State agency receives shall not exceed the number of meals claimed by the SFAs.

SFAs may contract with Food Service Management Companies (FSMC) to assist in the food service operation involving the NSLP/SBP in one or more of their schools. However, the SFA is still responsible for overall program integrity and adhering to Federal and State requirements. A Request for Proposal or Invitation for Bid is provided to applicable bidders detailing the requirements each contract must meet. Federal regulations provide that a contract between a SFA and a FSMC may include either a fixed-price (fee per meal) or cost-plus-a-fixed-fee.1 The fixed-price or fee contract should specify that any credits and reductions for USDA donated commodities be indicated on the invoice to the SFA. The cost-plus-a-fixed-fee contracts should specify that the value of USDA donated commodities used be itemized in the regular monthly billings to the SFA to document savings resulting from commodity usage. Regardless of the type of contract, the contracts are to specify that the FSMC accepts liability for any negligence

on its part that results in any loss of, improper use of, or damage to USDA donated foods. In addition, the contracts are to require the FSMC to maintain accurate and complete records with respect to receipt, use/disposition, storage, and inventory of USDA donated foods.²

The General Accounting Office (GAO) performed an audit in August 1996, concerning the role and impact of private food service companies. GAO reviewed the contracts between SFAs and FSMCs and determined that they did not contain all eight required contractual provisions. Under Federal requirements, FSMC contracts must include a provision stating that the SFA retains control of the overall financial responsibility for the school meal programs, including the nonprofit school food service account. The GAO report stated that about 35 percent of FSMC contracts reviewed did not contain the required provision. GAO stated that Federal requirements further provide that all contracts must state that the SFA retains title to the USDA donated commodities. In addition, SFAs are to ensure that these foods offset the cost to SFAs of providing school meals. According to GAO, a few contracts reviewed did not contain this provision. GAO recommended that the Secretary of Agriculture direct the Administrator, FNS, to work with appropriate State officials to ensure that FSMCs' contracts contain the provisions required by USDA's guidance on contracting with FSMCs.³

The estimated NSLP/SBP funding for Federal fiscal year (FY) 2001 was over $7.25 billion. Funding for the NSLP/SBP for FYs 2000 and 1999 was about $7 billion and $6.8 billion, respectively. The Missouri State agency received about $123.9 million and $119.3 million for the 2000 and 1999 FYs, respectively. In addition to cash reimbursements, schools are entitled to receive USDA donated commodities. Nationwide, States received about $833 million and $692 million in commodities during FYs 2000 and 1999, respectively. The Missouri State agency received about $13.9 million in commodities during FY 2000.

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**OBJECTIVES**

The primary objective of this review was to determine whether sufficient controls existed to ensure that Chartwells credited its SFAs for the value of USDA donated commodities it used for SFAs operating under fixed-price food service contracts. We evaluated the State agency and the SFA's internal controls over the meal count system and the process followed to award contracts with FSMCs. Specifically, we evaluated State Agency and SFA's internal controls to ensure the sufficiency of 1) request for proposal and contract provisions under which

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³ GAO/RCED-98-217, "School Lunch Program Role and Impacts of Private Food Service Companies".
FSMCs agreed to manage the SFAs' food service, and in particular, FSMCs' compliance with FNS regulations and guidelines, and 2) FSMC procedures to account for USDA donated commodities and issue commodity credits to the SFAs for fixed-price contracts used.

SCOPE

We performed our review at the Mountain Plains FNS Regional Office in Denver, Colorado; the Missouri Department of Elementary and Secondary Education in Jefferson City, Missouri; the Poplar Bluff SFA in Poplar Bluff, Missouri; and the Marshall SFA in Marshall, Missouri, between March 13, and November 1, 2001. Our audit covered the 3 school years ending June 30, 2001.

Funding for the NSLP/SBP for FY 2000 was about $7 billion and the Missouri State agency received about $123.9 million. States received USDA donated commodities during FY 2000 with a value of about $833 million of which the Missouri State agency received about $13.9 million.

During school year 2001, 73 SFAs operated in Missouri that maintained food service contracts with FSMCs. Fourteen of the 73 SFAs maintained food service contracts with Chartwells. Ten of the fourteen SFAs were under cost reimbursable contracts, and the remaining 4 SFAs were under fixed-price contracts. We judgmentally selected the Marshall SFA, which entered into a fixed-price contract, based on the value of meal reimbursements from the State Payments by Fund report. We contacted all three of the other SFAs with fixed-price or fee contracts with Chartwells.

This audit was conducted in accordance with Government Auditing Standards.

METHODOLOGY

To accomplish our objectives and assess the internal controls, we reviewed records and interviewed officials at the FNS Regional Office, the State agency, and the Marshall SFA. We interviewed officials and personnel at three other SFAs by telephone. We also interviewed two of the contractor's vendors in person and by telephone. In addition, we also performed a quality control review of an independent auditor firm's working papers for the single audit for the year ending June 30, 2000, for the selected SFA. We evaluated the policies and procedures for contracting between SFAs and FSMCs at the FNS Regional Office and the State agency. We analyzed the contract documents, supporting documentation for the contractor's billings, and the SFA's claims for reimbursement. Records reviewed included compilations of daily meal count records, claims for reimbursement, contractor billings to
the SFA's, supporting documentation attached to the billings, contractor or
district physical inventories of USDA donated commodities, State agency
review documents, single audit reports for the selected SFA, requests for
proposals, bid specifications, bid proposals, and contracts.
FINDINGS AND RECOMMENDATIONS

CHAPTER 1
STATE AGENCY CONTROLS OVER THE SFAs WITH FIXED RATE CONTRACTS WERE NOT SUFFICIENT

Federal procedures and the clause under Federal regulations referenced in fixed rate contracts between Chartwells and SFAs that required USDA donated commodities accrue only to the benefit of the SFAs’ non-profit food service were not complied with or enforced. This occurred because controls were not in place to ensure Chartwells, a FSMC, credited the SFAs’ invoices for the value of USDA commodities that it used in preparing NSLP lunches. The Missouri State agency did not properly monitor the SFAs’ contracts to ensure that the SFAs received the value of USDA’s donated commodities. As a result, four school districts contracting with this FSMC on a fixed-price basis did not receive credit for over $307,000 in USDA donated commodities in the 3 school years ending June 30, 2001.

FINDING NO. 1
VALUE OF USDA DONATED COMMODITIES WAS NOT CREDITED TO SFAs

The value of USDA donated commodities used to prepare meals by Chartwells was not established or documented in a manner that ensured SFAs would receive credit for the value of such commodities. This occurred primarily because the Missouri State agency did not adequately review the contract between Chartwells and the four SFAs to ensure it contained the language, procedurally required, to provide that the amount SFAs were invoiced would be credited or reduced for the value of the USDA commodities used. As a result, Chartwells used $307,711 worth of USDA commodities that were not identified with appropriate credits or reductions to four SFAs’ invoices. Also, any increase in USDA donated commodities served only to increase Chartwells’ revenues, rather than to decrease the lunch prices paid by children. See exhibit A for a summary of monetary results.

Federal procedures state, in part, that for fixed-price contracts, in order to establish and document the commodity value-pass-through, the contract...
should specify that the credits or reductions would be indicated on the invoices to the SFA.  

The State agency reviewed three of the four SFAs’ contracts, using a checklist of required contract clauses and recommended clauses, before the FSMC and the SFAs signed their respective contracts. However, the checklist did not list a clause specifying that the credits or reductions for the commodity value would be indicated on the invoices provided by the FSMC to the SFA. The State agency reviewed the fourth SFA’s contract after the FSMC and SFA had signed it.

Accordingly, State agency officials did not question the fact that the contracts did not include a clause specifying that the credits or reductions for the commodity value would be indicated on the invoices provided to the SFA. State agency officials said they presumed that the value of USDA commodities was factored into Chartwells’ bids and did not review invoices to ascertain whether credits or reductions for commodity values were reflected on them.

At the Marshall SFA, we reviewed Chartwells’ charges and determined that the value of donated commodities, amounting to $126,306, was not deducted from any of the invoices for NSLP activity from 1999 through 2001. We expanded our review to determine the number of SFAs and the amount of USDA commodities received under fixed rate contracts with Chartwells within the State of Missouri. We identified four SFAs participating in the NSLP within Missouri under fixed rate contracts with Chartwells from 1999 through 2001. While under contract with Chartwells, those SFAs received USDA commodities totaling $307,711 during the 3-year period, of which $19,434 was bonus commodities. See the following table of commodities received by the SFAs while under contract with Chartwells during the audit period:

<table>
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<th>2001</th>
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</tr>
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<td>Totals</td>
<td>$91,829</td>
<td>$87,913</td>
<td>$127,969</td>
<td>$307,711</td>
</tr>
</tbody>
</table>

1/ Not under contract with Chartwells.

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We contacted all four of the SFAs to determine if their invoices from Chartwells included credits or reductions for the USDA commodities. Officials from the four SFAs telephonically advised us that their invoices from Chartwells did not contain credits for USDA commodities. We obtained and reviewed the contracts for the Marshall SFA and the three other SFAs that we contacted. We determined that none of the contracts for the four SFAs specified how they were to receive credit for the USDA donated commodities used in preparing the meals billed on FSMC invoices.

The Marshall SFA signed a contract as of July 1, 1995, with Daka Restaurants, L.P., which was subsequently acquired by Compass Group, the parent company of Chartwells. The Marshall SFA renewed the contract each year thereafter through the school year ending June 30, 2000. Chartwells was awarded another contract for the school year ending June 30, 2001. In response to our inquiry on whether its meal rates reflected the value of donated commodities received, Chartwells’ management asserted that the value of the commodities was included in setting the meal rates to be bid on the 2001 school year contract for the Marshall School District, which was the first year of the new contract. Upon our request, Chartwells provided summarized cost information, which they informed us was used in determining the proposed rates. However, our analysis of the data provided indicated that the rate proposed by the FSMC could only be reached by adding back in the value of the commodities the SFA anticipates receiving, thus negating any credit for the commodities in the bid rates.

Also, an FNS official stated that FNS National office policy is not to allow pre-credits in which the value of the commodities is included in the meal rates bid by the FSMC, since neither the FSMC nor the SFA know ahead of time whether the SFA will timely receive its maximum entitlement or receive it in a usable form. The official also stated that neither the FSMC nor the SFA know ahead of time if the SFA will receive bonus commodities and, if any are received, the quantity and type of bonus commodities. In addition, the official stated that if pre-credits are used at all, the commodity credits should only appear in sealed bids in which both the price with commodity credits and the price without commodity credits are clearly stated. Then, if the SFA receives its entitlement in a useable form, the company should use the price lowered for the commodity credit from that period forward.

(Note: A pre-credit for developing bids is not authorized by regulations. And, the use of a pre-credit by some bidders and not by others would result in an unfair advantage over those bidders not using USDA commodities to reduce their cost basis in developing their bids.) We
further concluded that any value assigned by the FSMC to USDA commodities was not documented in the contracts reviewed.

We also compared the bid rates by this FSMC for the Marshall School District contract for school year 2001 to the contract rates for SFAs with fixed-price contracts in two other States to substantiate Chartwells' assertion that it included the value of commodities in its meal rates. We noticed disparities in the assertions made by Chartwells and the rates for school districts in these other States. For example, in Kansas where the SFAs receive cash instead of commodities, we noted the rates were not always higher than in Missouri which allowed precredits. However, Chartwells management stated that the contract rates could not be compared because each SFA has a different cost situation. We further questioned Chartwells officials about the contract rates for Illinois, which required FSMCs to credit the commodities on their invoices to SFAs with fixed-price contracts. In contrast to their previous assertion, Chartwells management stated that the contract rates would be higher because this State did not allow precredits.

We referred Chartwells to Office of Inspector General (OIG) Investigations because the four SFAs with fixed-price contracts did not receive credit for USDA donated commodities.

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**RECOMMENDATION NO. 1**

SFAs did not receive any benefit.

**Agency Response**

The FNS reply did not address this recommendation.

**OIG Position**

In order for us to consider a management decision, we need to be notified that the disallowed costs have been recovered or an accounts receivable established for the amounts still owed.

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**RECOMMENDATION NO. 2**

Instruct the State agency to require SFAs to require Chartwells to credit SFAs for school year 2002 USDA donated commodities used to prepare school meals. Also, ensure that the
bid process and contracts are developed so that SFAs receive credit for USDA donated commodities in addition to revising the checklist provided to SFAs to include the contract language needed.

**Agency Response**

The FNS reply did not address this recommendation.

**OIG Position**

Before we can consider a management decision for this recommendation, we need to be notified of the actions taken or contemplated and an acceptable timeframe for completing them.

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**RECOMMENDATION NO. 3**

Instruct State agency officials to remind SFAs of their responsibility to ensure that their school food services receive the value of USDA commodities. Instruct the State agency to ensure all contracts are reviewed for sufficiency with program requirements before all parties sign them.

**Agency Response**

The FNS reply did not address this recommendation.

**OIG Position**

Before we can consider the management decision for this recommendation, we need to be notified of the actions taken or contemplated and the proposed dates for implementing them.

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**RECOMMENDATION NO. 4**

Instruct the Missouri State agency to review all fixed-price contracts between its SFAs and other FSMCs for similar conditions and take appropriate corrective action to ensure value of donated commodities are received and verified by SFAs in the future.

**Agency Response**

The FNS reply did not address this recommendation.
**OIG Position**

Before we can consider a management decision for this recommendation, we need to be notified of the actions taken or contemplated and the proposed dates for implementing them.
## EXHIBIT A – SUMMARY OF MONETARY RESULTS

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<td>SFAs With Fixed-Price Contracts Did Not Receive Benefit of USDA Donated Commodities</td>
<td>$307,711</td>
<td>Questioned Costs, Recovery Recommended</td>
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Reply to
Attn. of: 27601-13-KC

Subject: National School Lunch Program - Chartwells Food Service Management Company

To: Dennis J. Gannon
Regional Inspector General for Audit
Office of Inspector General
U.S. Department of Agriculture
5799 Broadmoor, Suite 600
Mission, Kansas 66202

We have reviewed the final draft and have just a few comments.

On page 2, the paragraph regarding the General Accounting Office’s (GAO’s) 1996 audit of food service management companies (FSMCs) still refers to the school food authority’s (SFA’s) retention of the title to USDA donated commodities. This section of the report fails to mention there is a discrepancy between the Food Distribution Program and Child Nutrition Program regarding the interpretation of title.

Our previous comments also pointed out that contrary to the information shown in this paragraph, Federal regulations do not “provide that all contracts must state that the SFA retains title to the USDA donated commodities.” We continue to ask that the report acknowledge that the Guidance for School Food Authorities, “Contracting with Food Service Management Companies,” erroneously states this is a regulatory requirement under 7 CFR Part 210.16(a)(6).

If you have questions, please let us know by contacting (303) 844-0355.

BRIAN ALLISON
Acting Regional Director
Child Nutrition Programs
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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