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DECISION — THE COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-111810 DATE: MAR 30 1978

MATTER OF: National School Lunch Program Overclaim Against State of Florida

DIGEST: Since section 11 of the National School Lunch Act places the responsibility for determining eligibility for these funds on the States, there is no valid basis for the $1.7 million overclaim against the State of Florida as long as the State Department of Education had data which could reasonably support its conclusion that 21 school districts were eligible for the "especially needy" funds provided under the National School Lunch Program.

The Secretary of Agriculture requested our concurrence in refusing to pursue an overclaim in the amount of $1.7 million that was established against the State of Florida by the Office of Audit, U.S. Department of Agriculture (USDA). The Federal funds were provided to the Florida State Department of Education by the Food and Nutrition Service (FNS), USDA, after the State agency determined that the 21 school districts were eligible for "especially needy" funds which were provided under section 11 of the National School Lunch Act, 42 U.S.C. § 1759a (Supp. II, 1972.)

According to the Secretary, during the 1972-1973 school year, the Florida State Department of Education received complaints of financial distress from certain school districts that were participating in the National School Lunch Program. Under this program, FNS provides funds, non-food assistance and agricultural commodities to participating schools in order to enable them to serve nutritious lunches to students. 42 U.S.C. § 1751 et seq. (1970 and Supp. II, 1972). All of the districts complaining of financial distress cited the need to purchase more food in order to offset a decrease in USDA donated foods. [Additional funds were provided by Congress to cover this shortage of USDA-provided commodities (Act of March 30, 1973, Pub. L. No. 93-13, 87 Stat. 9) but were not available to the schools at the time in question. The additional funds were distributed in April, 1973.] In most cases, financial problems were compounded by rising food and labor costs.

Special financial assistance to schools serving reduced cost or free lunches to children eligible under criteria established under section 9 of the Act, 42 U.S.C. § 1758 (Supp. II, 1972) was available under section 11 of the Act, 42 U.S.C. § 1759a (Supp. II, 1972). In addition to the special assistance payments, which are allocated to States under a formula, that section also provided funds for "especially needy" schools under subsection (e) which read, in pertinent part, as follows:

> "Provided, however, that any school which requires a greater amount of reimbursement per meal served free or at a reduced price in order to fulfill the requirements of section 1758 of this title shall receive such greater amount if it can establish to the satisfaction of the State agency that it would otherwise be financially unable to support the service of such meals. The maximum per meal amount established by the Secretary shall in no event be less than 40 cents; and the Secretary shall establish a higher maximum per meal amount for especially needy schools based on such schools' need for assistance in providing free and reduced price lunches for all needy children." 42 U.S.C. § 1759a(e) (Supp. II, 1972) (since revised).

Section 11 was added to the National School Lunch Act in 1962, Pub. L. No. 87-823, 76 Stat. 944 (October 15, 1962), in order "to provide special assistance to those schools which, because of the poor local economic conditions of the area from which they draw attendance, are not financially able with the basic assistance provided under the act to (1) operate a lunch program or (2) meet the need for free or substantially reduced price lunches among those children unable to pay the full price of the lunch." H.R. Rep. No. 1672, 87th Cong., 2d Sess. 5-6 (1962).

In 1971, there was a flood of protest from local school authorities and State agencies after the USDA published proposed regulations providing for a reimbursement of approximately 5 cents in general assistance and approximately 30 cents in special cash assistance for each free or reduced price lunch served. The protestors advised Congress that unless the Federal contribution for free and reduced price lunches was increased, the States would be unable to continue their ongoing program to provide lunches to needy children as they were required to do by section 9 of the Act. H.R. Rep. No. 572, 92d Cong., 1st Sess. 2-3 (1971).

A congressional survey showed that a majority of States said they needed 40 cents or more in order to finance the expected number of free and reduced price meals. Florida was cited as a State with a large program, requiring a 51-cent reimbursement. Id. 3.

In response to the protests from the States, Congress amended section 11(a) of the Act "to require a minimum rate of reimbursement of 40 cents for every free and reduced price meal served in schools and a higher rate of reimbursement when the school is able to satisfy the State agency of its need for such additional assistance." Id. 5-6.

In order to determine whether the school districts qualified for the additional special assistance funds provided by the above amendment, the Florida State agency requested that each district submit financial statements covering the period July 1 through December 31, 1972. The State agency's determination of eligibility was based on factors which included:

(1) change in the net worth of school food service funds during the designated 6-month period,

(2) relationship of net worth to 1-1/2 months' average operating expenses, and

(3) sources of revenue supporting paid lunches.

Florida's evaluation of the submissions resulted in a determination that 21 districts were eligible for additional section 11 funds, retroactive to the beginning of the 1973-1973 school year. By the end of the year, approximately $1.7 million in "especially needy" funds had been distributed to the 21 districts.

The USDA Office of Audit conducted an audit of the Florida State Department of Education child nutrition programs which covered the period March 1, 1973 to February 28, 1974 (Rep. No. 2722-15-At). The auditors found that the State agency determinations of eligibility were improper and concluded that the 21 school districts that received approximately $1.7 million did not meet Federal criteria for "especially needy" funds.

The criteria in question were set forth in National School Lunch Act implementing regulations, 7 C.F.R. § 210.11(d), 1973 Ed. (since revised). Section 210.11(d) provided in pertinent part, as follows:

> "* * * especially needy school is one which establishes to the satisfaction of the State agency, or FNSRO where applicable, that it would be financially unable to support the service of lunches eligible for special cash assistance without an increase in the amount of special cash assistance * * * because of:
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> (1) The need to serve an especially high percentage of free and reduced price lunches; or
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> (2) unusual costs required to provide a Type A lunch in the school in spite of the observance of good management practices; or
>
> (3) other unusual factors indicative of a special financial need."

Additionally, the State agency was required to "determine to its satisfaction that revenues available to support the service of Type A lunches sold at regular prices in the school is [sic] sufficient to cover the cost of such service." Therefore, in order to be eligible for "especially needy" funds, the school had to establish that it was in financial distress by meeting one of the above conditions and that revenues available to support lunches sold at regular prices were sufficient to cover their cost.

The USDA auditors did not feel that any of the 21 districts met the above stated three criteria for financial distress. Their position was summarized by the Secretary as follows:

> "(1) The Need to Serve an Especially High Percentage of Free and Reduced Price Lunches
> The auditors determined that the percentage of free and reduced price lunches served in 21 districts ranged from 14 percent to 47 percent. They also maintained that 47 percent is not an 'especially high percentage,' and therefore, none of the 21 districts met this test.
>
> "(2) Unusual Costs
> The auditors found that the cost of providing a Type A lunch for the 21 districts range between 59.0 cents to 78.1 cents. Thus, they imply that the 21 school districts did not meet the 'unusual cost criteria.'
>
> "(3) Other Unusual Factors Indicating Special Financial Need
> The auditors determined that of the 21 school districts: (1) six had an increased lunch fund net worth that exceeded the $706,554 especially needy funds received; (2) eight had increased [sic] in net worth amounting to $201,292 of the $534,053 of especially needy funds received; and (3) seven could be construed to be in financial distress."

With regard to the first condition, the implementing regulation does not define what is a "high percentage of free and reduced price lunches." In the legislative history of the special assistance program, it was suggested that priority should go to schools "needing to serve, or serving, at least 35 percent of lunches" to needy children. H.R. Rep. No. 1673, 87th Cong., 2d Sess. 7 (1962). There is no similar indication of congressional intent in the legislative history of the 1971 amendment providing additional assistance for "especially needy schools." We would therefore agree with the Secretary that the determination of what constitutes a high percentage of free and reduced price lunches is generally

up to the State agency. The State agency cannot exercise its discretion in an arbitrary manner, however. In view of congressional expectations that priority for general school lunch assistance would go to schools serving "at least 25 percent of lunches" to needy children (H. Rep. 1673, supra) it would be unreasonable to find that these school districts serving only 14 percent of free and reduced price lunches had met the first criteria.

In attempting to determine whether the second test of "unusual costs" was met, the auditors compared the cost of lunches in the 21 districts (which ranged from 59 cents to 76.1 cents) with the national average cost of 74 cents. Thus, they imply that the unusual cost criteria was not met. According to the legislative history of the enactment which added "especially needy" funds to the Act, Florida requested a reimbursement of 51 cents in Federal funds in order to finance the expected service of free and reduced price lunches during the school year. That was the highest rate of needed reimbursement cited in the House report on H.R. Rep. 922, which became Pub. L. No. 92-153, November 5, 1971. This supports the Secretary's contention that it would have been more appropriate to compare the costs of the 21 school districts with the average cost throughout the State, rather than with the national average cost. Again, neither the statute nor the regulations specify how "unusual costs" are to be determined.

In determining whether the 21 districts met the third or "special financial need" condition, the auditors focused on the net worth of the school districts. While most districts increased their net worth, none exceeded a balance of 2 months' operating costs that is considered excessive to operating needs under Federal regulation. 7 C.F.R. § 210.15 (1973 Ed., since revised). In fact, none exceeded the State's more restrictive standard of 1-1/2 months' operating expenses.

Under the applicable statute and implementing regulations for the period in question, the districts were only required to meet one of the three financial distress criteria "to the satisfaction of the State agency." While the auditors may disagree with the factors considered in reaching a determination of eligibility for "especially needy" funds, the regulations did not provide specific guidance to the State agencies in determining financial distress.

Finally, the auditors note that 7 C.F.R. 210.11 (1972) requires that revenues available to support regular price lunches must be sufficient to cover their cost. This is to preclude the possibility of financial distress resulting from under-priced lunches served to non-needy children. The audit report takes issue with the manner in which indirect cost components [luncheon and kitchen space, heat, light, etc.] were allocated in calculating "revenues available."

The State agency considered these indirect cost components as revenue contributions from the districts. The agency applied these revenues to support lunches sold at regular prices, to the extent necessary to meet the costs not covered by collections. The remainder of the indirect cost contributions were applied to free and reduced price lunches.

The State agency apparently felt it was justified in believing that its method of allocation was acceptable to the USDA's FNS. The audit report states:

> "The Administrator of the State agency discussed this method of allocation with the Director, Children Nutrition Programs, FNSRO, Atlanta, Georgia, and the Director did not disagree. FNSRO personnel confirmed this to us."

The auditors take the position that revenues represented by the value of indirect cost contributions must be allocated evenly over all lunches, because these contributions are in the form of services and supplies which benefit all participants. Additionally, they argue that "the principle of consistency requires that the indirect cost contribution be allocated for revenue purposes on the same basis as for cost purposes." The audit report finds that an even allocation of the indirect cost contributions results in regular price lunch revenues not covering their cost. This was true in all of the 52 districts. Therefore, the audit report concludes, all of the districts were ineligible for the "especially needy" funds received.

Essentially we agree that it is theoretically proper to allocate indirect costs evenly among all types of lunches from both a cost and a revenue standpoint. When properly allocated, of course, indirect costs considerations may unnecessarily complicate the cost/revenue comparison computations. If the two allocations are made evenly among all types of lunches, one allocation would offset the other and "zero" would result. It is therefore our view that indirect items need not necessarily have been considered from either standpoint.

While the Regional Office of the FNS might have agreed with the State agency, the Secretary states that

> "We acknowledge that Florida failed to utilize acceptable accounting principles in justifying its allocation of especially needy funds. This was due, at least in part, to a lack of clarity in our regulatory requirements."

The Secretary states that the Department has amended its regulations and that the Department is working with the State to ensure a better accounting system. The Secretary advises that recurrence of this problem, per se, is now precluded.

The Secretary concludes by noting that all the funds in question were used to promote the goals of the National School Lunch Program and that there is a complete absence of any suggestion of willful duplicity or wrongdoing on the part of the State officials involved, and states that to pursue an overclaim in this case "would be to the substantial detriment of our program." In view of all the facts and circumstances involved in this situation, including a lack of clarity in Agriculture's regulatory requirements and the advice given to this State by FNS Regional Office personnel, we do not feel that any purpose would be served in objecting to the Secretary's recommendation that the technical noncompliance with this regulatory requirement not form the basis of collection action in this particular case.

It is difficult to determine which of the various factors discussed was primarily responsible for the State agency's determination that the 2 school districts in question were financially distressed. The Secretary emphasizes that the statute places the responsibility for determining eligibility with the States. He states:

> "While we might disagree with the judgment of a State Director, we would not take a fiscal exception simply because of the disagreement."

We must agree with the Secretary's position. The statute itself states that to be eligible for the greater reimbursement amounts, the local school districts must establish "to the satisfaction of the State agency" that it would otherwise be unable to support the costs of free and reduced price meals. The legislative history also makes it clear that it is the State's responsibility to determine if a school is financially in need of special assistance. For example, in H. R. Rep. No. 1672, 87th Cong., 2d Sess., (1962), relating to Pub. L. No. 87-823, it is stated:

> "The present administrative pattern will be continued with responsibility for selecting schools and disbursing funds left in the hands of State educational agencies. * * * [A]dministrative regulations of the Department will outline the factors to be considered by the States (or the Department in the case of private schools) in the selection of such schools." Id. pages 5-6.

More recent enactments relating to the special assistance program contained similar indications of congressional intent. Thus, assuming that the State agency had the data required by 7 C.F.R. § 210.15(d) (1973 Ed.), whose review(s) that could reasonably support the conclusion that a school district was in financial distress, there would be no basis upon which to take exception to the State agency's conclusion.

In reaching this conclusion, we have several comments. First, the information given us is not sufficient to determine whether all 21 school districts have reasonably supported their contention that they were in financial distress. Before deciding against taking collection action, the Secretary should determine that the State had reason to be satisfied that each school district was qualified for this additional aid. This is particularly important because the Secretary states that the judgments made by the State are not necessarily the ones his department would have made. The Secretary should therefore determine if State agencies are too easily satisfied that schools under their jurisdiction are in financial distress. Should he so determine, the Secretary should initiate remedial action, including, as necessary, new regulations or a recommendation for legislative action.

In summary, if the State agency had data that could adequately support a reasonable conclusion that each of the 21 school districts was "especially needy," there would be no basis for the overclaim of $1.7 million against the State of Florida.

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Deputy Comptroller General of the United States