

# Food Fight:

## Small team of state examiners no match for schools that divert student meal funds

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*This report was prepared for the California Senate Rules Committee*

February 6, 2013



*Prepared by Jim Sweeney*

California Senate Office of  
Oversight and Outcomes

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## Executive Summary

Squeezed by years of unrelenting budget cuts, some California school districts are illegally dipping into student meal funds, misappropriating millions of dollars intended to feed California's poorest children.

In recent years, in cases that seldom receive any public attention, the California Department of Education (CDE) has ordered eight districts to repay nearly \$170 million to student meal programs. Perhaps more troubling, department officials candidly acknowledge they have no idea how big the problem may be and fear they may have uncovered only a hint of the ongoing abuse, an investigation by the Senate Office of Oversight and Outcomes has found.

The uncertainty reflects a challenged oversight system designed by the federal government, but carried out by a small, overmatched team of state examiners who are mostly nutritionists and dietitians, not accountants. Nutritional standards are their top priority and the system is set up to be collaborative, with prearranged inspections of cafeterias and food service operations. Perhaps as a result, most of the

### **Students Shortchanged:**

**Cafeteria fund diversions documented in this report contributed to conditions that discouraged the target population – poor, often hungry students – from seeking free or reduced-price meals.**

**Cost-saving shortcuts included serving processed rather than fresh foods, short lunch periods, rundown cafeterias and insufficient staff to properly plan and manage an optimum food service operation.**

**Los Angeles Unified, for example, has 20- and 30-minute lunch periods at many schools and continues to struggle with low participation rates among eligible students. A former Santa Ana Unified food service director said “the food was terrible” and the meal program was woefully understaffed although the district had amassed an illegal \$16 million surplus in its cafeteria account.**

**The Senate Office of Oversight and Outcomes found that state and federal checks fail to catch most violators and that whistleblowers may be silenced by realistic fears of retaliation.**

recent investigations have been triggered by whistleblowers.

In the biggest case, state officials identified more than \$158 million in misappropriations and unallowable charges that Los Angeles Unified School District drained from its cafeteria fund over a six-year span.

The department also has disallowed cafeteria fund charges at a dozen other districts, including San Diego, Santa Ana, San Francisco, Baldwin Park, Centinela Valley and Compton. San Diego and Santa Ana are challenging the department's findings, which would force the districts to repay \$4.5 million and \$2.7 million, respectively.

In every case, the funds involved were supposed to be spent primarily on free and reduced-price meals that experts say are frequently the best and often the only complete meals that many low-income children receive in a given day.

“From my point of view, they are literally taking food out of the mouths of kids,” said Richard Zeiger, chief deputy state superintendent of public instruction. “They say, ‘Well, we can do it cheaper.’ I say you should do it better.”

State and federal subsidies are paid as reimbursements for meals served. So, all eligible students who line up for lunch or breakfast at school are fed. But cafeteria fund diversions contributed to conditions that discouraged the target population – poor, often hungry students – from seeking free or reduced-price meals, school officials said.

Cost-saving shortcuts included serving processed rather than fresh foods, short lunch periods, rundown cafeterias and insufficient staff to properly plan and manage an optimum food service operation.

“Our core priority was to get kids in eating and to make it a good experience for them,” said Michael Eugene, a former business manager over food services at Los Angeles Unified. “But, in order to do that, we really needed to make sure that the money for the program was spent on the program.”

Los Angeles Unified, which has 20- and 30-minute lunch periods at many schools, continues to struggle with low participation rates for its eligible students.

“They refused to let the secondary students have more than 30 minutes for lunch and they turned them all loose at once,” said Dennis Barrett, Los Angeles Unified's food service director until he retired last June. “I



said, ‘We have 80 percent of them who are free and we’re only serving a third of them. The others can’t get in to eat if they wanted to.’”

At Santa Ana Unified, former food service director Jan Monforte said “the food was terrible” when she was hired to run the program in October 2010. “None of the food met the requirements of what we were supposed to be serving,” she said. Santa Ana’s food service operation also was woefully understaffed although the cafeteria account had amassed a \$16 million surplus that was more than double the federal limit for the program.

At Baldwin Park Unified, where a \$6.5 million cafeteria fund surplus also exceeded the federal limit, the district agreed to spend \$2.7 million on salad bars, fresh fruits and vegetables under a mandatory five-year plan to trim the surplus.

As part of a national focus on childhood obesity, the federal government recently ordered schools to improve the nutritional content of student meals. Obesity increases the risk of heart disease, diabetes, high blood pressure and other health problems. In California, 38 percent of children are obese or overweight, according to a 2012 University of California study.

Numerous studies also have shown a link between proper nutrition and academic achievement.

Federal regulations require schools to keep student meal funds in a separate account used only for “the operation or improvement of such food service.” When federal, state and other cafeteria revenues are held in the same account, as they are in most districts, all of the funds are subject to the strict federal guidelines.

But the Senate investigation found an oversight system that offers glaring opportunities to disregard rules so complex that districts easily can and often do contest violations as arguable interpretations of the law.

The misappropriations addressed in this report are not examples of funds skimmed or pocketed for personal profit. Instead, they are in most cases attempts by school districts to use cafeteria funds to pay for a greater share of personnel, utility and other costs. Some charges were clearly improper. Los Angeles Unified used cafeteria funds to buy lawn sprinklers and to pay salaries of employees at the district’s television station, Eugene and Barrett said. Auditors also found that L.A. Unified and other districts charged their cafeteria accounts twice for some expenses.

Most of the money involved comes from the federal government. The U.S. Department of Agriculture sends more than \$2 billion a year to California for the National School Lunch Program, breakfast, after-school and snack programs, as well as commodities used in student meals. California augments that with another \$145 million a year. On average, the combined funds help pay for 2.4 million free and reduced-price lunches every day for lower-income students.

The California Department of Education serves as the USDA's steward of the subsidized meal programs. In that role, CDE is required to review school food operations every five years. Other food services, such as those at adult and child care centers, must be checked more frequently.

The department has fewer than 60 field examiners to monitor nearly 3,000 school districts and other agencies that serve meals. It has not completed all of the reviews required in any single year since 2001. Moreover, the field examiners CDE sends in are nutritionists, not accountants or financial specialists, and they rarely take more than a cursory look at the books.

The existing rules also provide what amounts to a three-year statute of limitations. That is how long districts must retain financial records, leaving two years in every five-year cycle that CDE does not review. Only when districts have a record of recent violations must they keep records longer than three years. And CDE does not always go back three years, even when it has reason to. In two cases, involving the Santa Ana and San Diego districts, the department inexplicably elected to review and hold the districts accountable for only one year of disallowed charges. It only later decided to go back three years in San Diego, even though district officials had publicly acknowledged the disputed charges went back three years.

Aside from CDE's periodic reviews, it's unclear how much close scrutiny cafeteria funds receive on a regular basis. Almost all districts are audited annually by an independent, outside firm. But those audits typically do not include the cafeteria fund, a CDE official said. When they do, not all auditors know the complex rules that apply, and the state's audit guide provides no help on what may and may not be charged to cafeteria funds, CDE officials said.

In a reflection of the oversight gaps, nearly all of the cafeteria fund cases the state has pressed in recent years were instigated by whistleblowers, not the state's examiners. In other words, most of the districts that have been caught were tripped up by inside informants after eluding the state's oversight, in some cases for years.

In the case of Los Angeles Unified, the district had been warned internally – by its own auditors and a number of top managers – for nearly a decade that it was misappropriating cafeteria funds, yet continued to do so until a district employee finally raised the issue with state and federal officials.

Although the district has agreed to repay the \$158 million plus interest to its cafeteria fund, it is being allowed to pay off that debt with a growing general fund subsidy of its \$300 million cafeteria program. As such, ongoing general fund payments for food services, which topped \$80 million in the last school year, will count as payments toward the \$158 million owed to the cafeteria fund. Los Angeles Unified also will not have to repay millions diverted from its cafeteria fund earlier in the decade, before the misappropriations began to raise concerns internally.

Deliberate misuse of cafeteria money is a crime, although rarely, if ever, prosecuted. Federal law provides up to a \$25,000 fine and/or five years in prison, for “willful misapplication” of cafeteria funds. Yet, federal officials said they were unaware of any school officials ever prosecuted for intentionally diverting meal funds to cover other district expenses.

In one California case, in which employees at Oxnard Union High School District were inflating subsidized meal counts, federal reimbursements jumped 53 percent in a single year, yet set off no alarms at either the state or federal level. The inflated meal counts began shortly after the state’s monitors completed a regular review of the district and, thus, were not scheduled to return for another five years.

The fraudulent counts continued for more than three years, until a district employee called state and federal authorities in 2008. The informant disclosed that cafeteria supervisors were gaming the system, claiming meal counts that were just below a threshold that they knew would trigger a state review. The district was ordered to repay \$5.6 million.

Nearly five years after that case was uncovered, neither the state nor the federal government has initiated any changes that would flag a similar, conspicuous spike in meal counts.

The push to divert cafeteria funds for other purposes has created career-threatening conflicts in some districts, according to leaders of the California School Nutrition Association, a professional organization that includes many food service directors.

“Those districts that are doing it illegal are playing hard ball with it,” said Lynette Rock, food service director at Torrance Unified and president-

elect of the nutrition association. “They say, ‘You want to contact the state and let them know we’re cheating? That’s fine. How long do you want your job?’”

Baldwin Park’s food service director, Geoffrey Monsour, recently sued that district, alleging the superintendent and others harassed and retaliated against him after he told state officials that his supervisors rejected his advice and used cafeteria funds for unallowable purposes.

In Santa Ana, Monforte – an experienced food service director who also warned the district it was violating the expenditure guidelines – was abruptly fired without explanation two days short of her one-year anniversary, when she would have cleared probation. Problems that Monforte identified and attempted to rectify were later cited by the state in its order to repay \$2.7 million in unallowable charges.

Baldwin Park challenged the state’s findings, refusing to pay \$1.5 million in disputed charges for nearly five years, until CDE suspended the district’s federal meal payments. Santa Ana also is contesting the state’s order and has cited an “absence of guidance” from the state, although its former food service director said she understood the rules.

Notably, top administrators at Santa Ana, Baldwin Park and San Diego said the charges and accounting methods the Department of Education disallowed in each of their cases are no different than those that could be found at districts all over the state. Such assertions have raised concerns that improper uses of cafeteria funds may be widespread.

Los Angeles Unified officials also said it was difficult to get clear guidance on allowable charges from the state Department of Education. The district’s own auditors and administrators, however, had for years been citing the state and federal rules that the district was violating.

As it continued to misappropriate millions of dollars from its cafeteria fund, Los Angeles Unified depleted a longstanding surplus and began running ever-increasing deficits in its food service program.

In January, 2009 – a few months before the state would learn the extent of Los Angeles Unified’s diversions from its cafeteria account – the district held a press conference to appeal for increased state meal subsidies. The district’s news release was headlined: “Cafeteria fund cash flow may leave neediest LAUSD students hungry.”

Two years later, the district requested a \$70 million advance on its federal meal payments to cover cash flow at the start of a new school year. When

the state balked, the district withdrew the request.

In response to the recent rash of cases, the state Department of Education moved in June to increase the role and presence of its own Audits and Investigations Division in the regular, periodic reviews of food service programs. For the first time, the department's auditors also will help train the frontline staff who conduct those reviews.

In addition, new federal regulations will soon tighten the review cycle from five to three years, although it's not yet known whether the Department of Education will receive the additional staffing necessary to handle what looks to be potentially a 40 percent workload increase.

The Senate Oversight Office recommends that the state Department of Education assess the workload and staffing needs of its food services oversight team and request sufficient federal funding to enable the unit to aggressively carry out its responsibilities. The state also should require annual school audits to include the cafeteria account, and the state's audit guide should be revised to provide clear and comprehensive guidance on what expenses can be paid with food service revenues. We also recommend that CDE prepare simplified guidelines on acceptable charges and publicize enforcement actions, to encourage compliance.

The state's oversight would benefit from legislation that reinforces new federal regulations and eliminates conflicts with others. The Senate Oversight Office also believes the level of ongoing scrutiny would be improved, perhaps substantially, if food service directors were given access to all cafeteria-related financial records.



## Introduction and Background

A New York prosecutor who led an investigation of food service contracts told a congressional committee that it is difficult to overstate the importance of the subsidized meals that millions of students receive every day.

“Many American children get only one nutritious meal per day ... the one that they receive at school because of the National School Lunch Program,” former Assistant Attorney General John Carroll testified in 2011. “We all can theorize about why, in the most fertile country in the world this is so, but it is a fact.”

Congress passed the Richard B. Russell National School Lunch Act in 1946 in response to concerns about widespread malnutrition and to provide an outlet for surplus agricultural commodities. Today, the \$11 billion program feeds more than 31 million children in more than 101,000 schools and day care centers.

The National School Lunch Program (NSLP) subsidizes 80 percent of the 3 million lunches served on average every day in California’s public schools. The U.S. Department of Agriculture (USDA), which administers the lunch program, also pays for school breakfast, snack, afterschool and summer meal programs.

For the 2012-13 school year, the federal government pays up to \$2.94 for each free lunch and \$1.85 for each free breakfast served. In California, the state also helps, providing 22 cents for each free and reduced-price lunch or breakfast. The subsidies, however, were never intended to cover the full cost of providing school meals.

Statewide, the federal lunch and breakfast funding, including commodities, totals more than \$2 billion a year. The state adds another \$145 million a year. For Los Angeles Unified, the nation’s second largest school district, the federal subsidy alone amounted to nearly \$250 million in fiscal year 2010-11.

## **Rules, regulations and the state's role in an essentially federal program**

To qualify for free meals, students must be from families with incomes at or below 130 percent of the federal poverty level. For a family of four, that threshold is \$29,965 for the 2012-13 school year (the federal poverty level is \$23,050 for a family of four). For reduced-price meals, the eligibility line is raised to 185 percent of the federal poverty level, or \$42,643 for a family of four.

All of the federal meal money is funneled through the state, which oversees compliance with nutritional standards, financial rules and eligibility verification for the federal government. To carry out those responsibilities, the federal government pays the California Department of Education (CDE) more than \$30 million a year. That covers 98 percent of the budget for the department's Nutrition Services Division, which includes a team of 58 employees who monitor and regularly review nearly 3,000 school and other meal programs throughout the state.

Federal rules require student meal funds to be maintained in a separate cafeteria account and used only for "the operation or improvement of such food service, except that such revenues shall not be used to purchase land or buildings, unless otherwise approved by (the federal government), or to construct buildings." When federal, state and other food service revenues are comingled in the same account, as they are in most districts, all of the funds are subject to the strict federal guidelines.

The state Department of Education enforces a far more extensive body of federal rules and regulations that have been compiled over the long life of the program. It also follows the 635-page California School Accounting Manual, which includes 57 pages of rules and directions for assigning charges to restricted funds, such as cafeteria accounts.

The department weaves into the regulatory mix the applicable sections of a more permissive California Education Code. But when state and federal rules conflict, the federal rules prevail. Those conflicts have been at the root of contentious disagreements between districts and the state Department of Education.

The collective body of state and federal rules and regulations is unusually complex. The most recent advisory bulletin issued by the department in May 2012 was six pages, singled-spaced with 19 electronic links to more information.



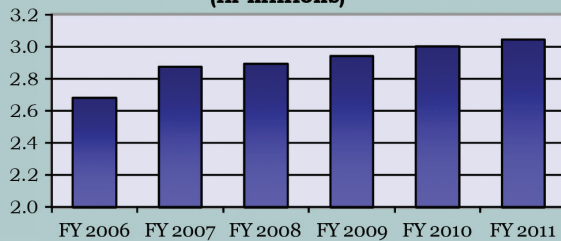
## California schools must feed low-income students

California’s public schools are not required to participate in the National School Lunch Program. But the state Education Code requires them to provide at least one “nutritionally adequate free or reduced-price meal” every day to students who would qualify under the federal criteria. The Legislature last year passed AB 1595 by former Assemblyman Mike Eng, D-Monterey Park, which would have extended that requirement to charter schools. The bill was vetoed by Gov. Jerry Brown.

To participate in the National School Lunch Program, school districts must sign a lengthy agreement with the state Department of Education in which the district promises to operate a “nonprofit school food service and observe the limitations on the use of nonprofit school food service revenues” as outlined in federal regulations.

### National School Lunch Program (NSLP)

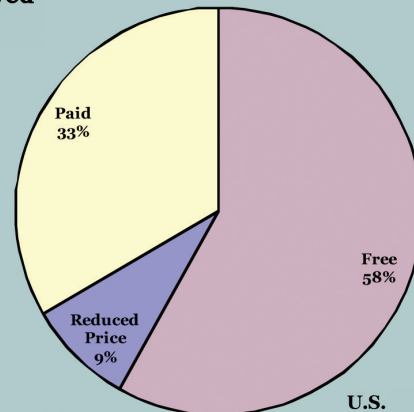
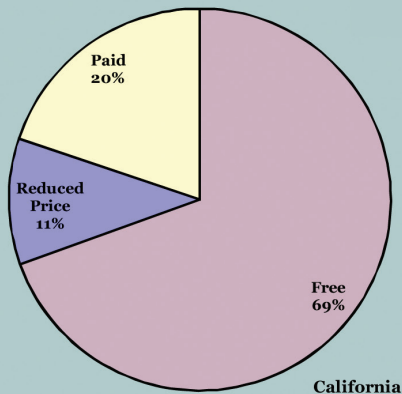
**Average Daily Lunches Served in California (in millions)**



**Total NSLP Cost (\$)**

	California	U.S.
FY 2007	\$1,137,895,863	\$8,739,305,559
FY 2008	\$1,225,148,247	\$9,317,582,952
FY 2009	\$1,320,777,061	\$9,992,478,487
FY 2010	\$1,436,099,014	\$10,878,432,714
FY 2011	\$1,473,721,533	\$11,303,784,818

**Percentage of Meals Served by Category**



Source: U.S. Department of Agriculture

The contract requires districts to agree to limit cash reserves in cafeteria accounts to no more than three months average expenditures of their food service program, a key federal rule designed to prevent districts from hoarding cafeteria revenues or using cafeterias as money-making operations for other, unrelated purposes.

Districts gather and verify eligibility information from students, keep records of the number of free and reduced-price meals served and then bill CDE for reimbursement from the USDA and the state.

Although complex and voluminous, the rules generally limit cafeteria fund expenditures to employees, supplies, utilities and improvements that are necessary and directly related to the delivery of student meals. The rules also permit charging indirect costs for a food service program's share of central administration costs, such as human resources, payroll and other expenses that are not billed directly.

For employees, such as custodians and activity supervisors, who spend only a portion of their shift on food service-related activities, federal regulations require that they document hours charged to the cafeteria fund. The timesheets are known as personal activity reports and can be compiled daily or monthly, but must be filled out and signed by the individual employee. Federal regulations permit alternative cost allocation methods if approved in advance by, not the USDA, but the U.S. Department of Education. That's a difficult process, however, and CDE officials said they were unaware of any district that has received federal approval of an alternative accounting method.

Utility expenses can be charged fully to a cafeteria account if schools have separate meters on their kitchens. Most do not. As an alternative, utilities and similar expenses can be billed under an indirect cost rate set by the state, or they may be tallied through a process that determines the portion of a campus's floor space occupied by its kitchen. That portion, or percentage, is then multiplied by the total utility bill to determine how much can be charged to the cafeteria fund.

Federal rules generally prohibit use of cafeteria funds for new construction or improvements that would extend the life of a facility. But fine lines have been drawn over the years as the state has taken questions about the rules to their federal counterparts for clarification.

For example, if a district buys a walk-in freezer, federal rules permit charging the cafeteria fund for the freezer as well as any expenses – such as wall and electrical modifications – viewed as necessary to install and wire the freezer. But rewiring an entire food service area to bring it up to

code is not an allowable expense, because it would extend the life of the building.

Similarly, cafeteria funds may be used to replace floor tile in a food service area, but not in a multi-purpose room where meals are served, if that room is also used for other activities, such as dances and school events.

When districts get caught with excess reserves, they have several options to reduce the surplus over five years. They can spend the money on better food such as fresh fruits and vegetables, lower meal prices or make other improvements to the food service program. Absent one of those choices, federal law requires the state to reduce reimbursements to a district.

Districts that have misappropriated funds or made improper charges against their cafeteria funds can be ordered to repay the money in question, plus interest and a financial penalty. The state Education Code also authorizes the state Superintendent of Public Instruction, who heads the Department of Education, to punish districts by requiring them to repay double the amount misappropriated from a cafeteria fund. In practice, CDE has required only repayment, plus interest.

One federal regulation may actually serve as a disincentive to ferret out fund misuse. If the state fails to force repayment of misappropriations or refunds due from food service accounts, the federal government collects the unpaid amount from CDE. Over the past two decades, the department has had to pay the USDA more than \$3 million that it could not recoup from food service accounts. Those bad debts often involved agencies, such as child or adult care centers, which had gone out of business.



## Oversight Gaps

For much of the past decade, the Los Angeles Unified School District ignored internal warnings from its food service directors, top administrators and ultimately its inspector general that the district was illegally misappropriating millions of dollars in cafeteria funds.

By the time state officials stepped in and ordered the district to stop, more than \$158 million had been improperly charged against the fund over a six-year period, according to the district's inspector general and the State Controller's Office.

The \$158 million, however, did not cover all of the misappropriations. It represented just six of 11 years of improper or unsupported charges that dated back to 1999, according to the inspector general and others. During that span, the district's cafeteria fund transitioned from a healthy surplus to deep annual deficits.

How did that happen? And how did similar misappropriations go unnoticed at other districts, typically until someone complained to state or federal officials?

Some of the answers can be found in a regulatory scheme decreed by the federal government, but carried out by a small team of state examiners who are outnumbered and easily outmaneuvered by school officials who know when they are coming and what they will be looking for.

The collaborative approach is designed to assist more than punish, and places greater emphasis on nutritional standards than financial compliance. As a result, for those who want to violate strict federal rules on what cafeteria funds may be used for, the system offers ample opportunities.

### **Most food service programs self-supporting, independent operations**

School food services are largely independent operations that depend on federal and state meal subsidies for most of their income. They are

required by federal law to be nonprofits and the goal at most districts is that food services be self-supporting.

As an indication of their unique standing, school cafeterias are regulated by the U.S. Department of Agriculture, not the U.S. Department of Education. The federal government pays the California Department of Education (CDE) to monitor and periodically review the meal programs. State and federal auditing requirements extend to cafeteria funds, but with little guidance or information about the unique spending restrictions that apply, CDE officials and others said. The state Department of Education has pushed the federal government to include that information in its audit guide, so far without success.

“A lot of CPAs don’t know everything they need to know about cafeteria funds,” said Christine Kavooras, a manager and 17-year veteran of CDE’s Nutrition Services Division. “They focus on the academic world of a district, not the nutrition side, and they don’t know how restrictive this is.”

Dennis Barrett, a former food service director at L.A. Unified and several other large school districts over the past 42 years, said the lack of auditing is the most obvious weakness in the regulation of student meal programs. Barrett said he has been unable to persuade USDA administrators to make a simple rule change that might remedy that.

“All you have to do is add one sentence and it will correct everything,” he said. “It is already federal statute that a school district must be audited by an external auditing firm every year. All you have to do is require that the cafeteria fund must be audited, as part as of the external audit, for compliance with state and federal regulations.”

The USDA conducts little if any direct oversight to spot check the state’s supervision of meal programs. And efforts by the Legislature to ease the spending restrictions have created conflicting state and federal rules and may have encouraged violations of the federal regulations, which prevail in such conflicts.

### **Small state oversight team**

School meal programs up and down the state are monitored by a 58-person oversight team in CDE’s Nutrition Services Division. The team has struggled to complete a daunting workload that starts with periodic reviews of nearly 3,000 school districts and other operations that serve meals, such as youth and adult day care homes. That workload figures to increase dramatically, by perhaps as much as 40 percent, when the Healthy Hunger-Free Kids Act of 2010 is fully implemented.

That new federal law will attempt, among other things, to tighten and improve oversight. A five-year review cycle for schools will be shortened to three years perhaps later this year, but more likely in 2014, according to CDE officials. That means the federal government will expect the state to review food service programs once every three years, rather than the current five-year interval.

The Department of Education, however, has not completed all of the required reviews in any five-year cycle for more than a decade – since 2001, the department disclosed. The department attributed the chronic failure to inadequate staffing.

To address the added workload the Healthy Hunger-Free Kids Act will bring, the department requested and was granted 10 additional positions. The department believes it ultimately may need twice that many new positions to meet its responsibilities under the new law.

The ability to secure adequate staffing for the oversight team has been complicated, if not frustrated, by a bifurcated funding and approval process for new positions. Although 98 percent of the oversight team's funding comes from the federal government, CDE must persuade an always skeptical state Department of Finance to approve new positions.

### **Coordinated reviews rather than surprise inspections**

Rather than unannounced inspections, like health departments do, the Department of Education conducts what are known as Coordinated Review Efforts, or CREs, of food service operations. As the name implies, the reviews are coordinated with schools, which are told in advance when the state is coming, what sites it will examine and what documents it wants to see.

“They give you all the parameters ahead of time. You know the questions and you know which school sites they are going to,” said Jan Monforte, a veteran food service director and former president of the California School Nutrition Association, a professional organization for food service directors.

Monforte said she has heard others brag about taking steps, such as transferring strong managers to schools selected for a state review, to improve their district's results. Her description of the process was confirmed by another experienced food service director as well as a CDE official, who explained that the existing procedure reflects federal policy.

“If they're going to tell me where they're going to go, I'm going to make

sure that site is 100 percent compliant,” said Lynette Rock, food service director at Torrance Unified School District and incoming president of the nutrition association.

In contrast, federal guidelines require CDE to conduct unannounced inspections of adult and child day care centers and to do much more thorough financial reviews of their food programs every year, said David Jang, manager of the program integrity unit in CDE’s Nutrition Services Division.

### **Incomplete records reviewed largely by nutritionists, not auditors**

While CDE’s oversight arm operates under a five-year review cycle, federal rules require districts to maintain records going back only three years, unless they are in the process of correcting previous violations.

The three-year limit on records retention has given districts two years during every five-year cycle in which they can be fairly certain no one from the state will ask to see their cafeteria books. That two-year gap will be closed when the new three-year review cycle takes effect this year, or in 2014.

As a matter of policy, CDE does not go back more than three years in investigations involving food service financial records and it does not always go back that far.

In the case of Santa Ana Unified School District, CDE’s auditors reviewed three years of records for one finding, but only one year of records for another that involved the same basic violation – failure to document the hours of employees who spend only a portion of their shift on cafeteria-related work. The result was a \$1.7 million disallowance for activity supervisors over three years and a \$668,000 disallowance for custodians and others for a single year. Santa Ana is contesting the state’s findings.

The state’s field examiners who conduct the coordinated reviews are instructed to look at only a single year’s records. Only if they see something that appears irregular or suspicious are the department’s auditors called in, and that does not always happen. At San Diego Unified, a coordinated review completed in May flagged \$3.3 million in unsupported custodial costs and \$952,000 in unallowable utility charges. The charges represented steep increases that began three years earlier, which district officials had publicly acknowledged. But CDE did not decide to send in auditors to review the two earlier years until the district



challenged the findings. The district contends that any improper charges can be written off as partial repayment of an \$18 million general fund loan to the food services operation.

Reflecting a greater emphasis on nutritional standards, most of CDE's field examiners are dietitians or nutritionists. Few, if any, have financial training. The job specifications are set by the State Personnel Board, said Sandip Kaur, director of the Nutrition Services Division.

Despite the recent increase in cafeteria fund misappropriations, federal officials said they have no plans to order California and other states to place more financial expertise on the front lines.

"The state oversees the program, so the state is accountable for the fiscal activities that happen in the district, period," said Ronna Bach, regional director of special nutrition programs for the USDA. "How they oversee those, how they meet that expectation, that's up to them."

The USDA evaluates the state's oversight through a review of records and reports compiled every year. But the federal government does not independently review school districts to measure the effectiveness of the state's scrutiny, federal officials said.

One federal regulation may actually discourage state enforcement actions. The rule requires the state to force repayment of disallowed charges that it identifies. When it doesn't, the USDA bills the state for any uncollected funds. That policy has cost the state more than \$3 million that it could not recover from agencies, such as care homes that had closed. It also produced warnings from federal officials more than a decade ago that CDE could lose its federal oversight funding – currently \$30 million – if the state did not improve collections of debts owed by meal providers.

### **Mixed messages and conflicting rules**

Twice in the past decade, the Legislature has enacted measures that appeared to grant school districts permission to use cafeteria fund surpluses for other pressing needs. In both cases – AB 1754 in 2003 and SB 1067 of 2008 – the state Department of Education scrambled to warn districts that state law could not pre-empt the strict federal rules that limit what the money may be used for.

"While the intent of SB 1067 is to allow districts to access *surplus* fund balances for other district purposes, **districts participating in federal school nutrition programs have minimal flexibility when utilizing cafeteria funds,**" CDE warned with the added emphasis in a July

2008 bulletin to districts statewide. “SB 1067 does not override the requirements of federal regulations that govern the use of cafeteria funds.” At least two other state laws, embedded in the California Education Code, also conflict with federal guidelines.

Education Code Section 38092 permits cafeteria fund revenue sharing with associated student bodies. Federal regulations no longer permit such revenue sharing with student groups.

Education Code Section 38102 authorizes districts to establish cafeteria equipment funds with reserves from their meal programs. The USDA does not recognize such accounts and strictly limits cafeteria fund surpluses to three months average expenditures of the program.

“There is a lot of Education Code that is permissive and districts jump on that,” CDE’s Kavooras said. “The Legislature wants to provide schools more flexibility, but they don’t really have it and nobody wants to listen to that.”

## Overview of Cafeteria Fund Misuse

As financial pressures intensify, some California school districts are illegally misappropriating millions of dollars from restricted cafeteria funds intended to feed the state's poorest children.

In perhaps the biggest such case in the nation, the Los Angeles Unified School District recently agreed to repay more than \$158 million that it had charged against its food service program over a six-year period. The district, the nation's second largest, continued to assess unsubstantiated and excessive charges to its cafeteria fund for more than a decade, despite repeated internal warnings that it was violating state and federal law, the Senate Office of Oversight and Outcomes found.

The California Department of Education, which oversees federal meal programs in the state, recently notified two more big urban districts – San Diego Unified, the state's second largest, and Santa Ana Unified, the sixth largest – that it has found similar misappropriations and unallowable charges in their records. The state has ordered San Diego to repay \$4.5 million and Santa Ana, \$2.7 million. Both districts are challenging the state's findings.

The state earlier forced Oxnard Union High School District to repay \$5.6 million, Baldwin Park Unified to repay \$3.1 million, Compton Unified to repay more than \$1.2 million, Centinela Valley to repay \$500,000 and San Francisco Unified to repay \$369,000. A half-dozen smaller districts were ordered to repay lesser amounts.

Not included on the list of more recent cases is a \$2 million settlement the state reached with Long Beach Unified in 2006 for charges dating back to 2003. The settlement, which resolved a pending appeal of the state's findings, cut in half the amount CDE initially ordered the district to return to its cafeteria fund.

## **Federal government pays for most of the state's student meal subsidies**

All of the funds in question come largely from \$2 billion a year in federal payments that California receives for the National School Lunch, School Breakfast, snack and other student meal programs. The state provides another \$145 million a year in subsidies. The combined funds deliver an average 2.4 million free and reduced price lunches every day to low-income students.

For many of these poor children, experts say the school meals are often the only nutritious meals they may receive in a given day.

“From my point of view, they are literally taking food out of the mouths of kids,” said Richard Zeiger, chief deputy state superintendent of public instruction. “They say, ‘Well we can do it cheaper.’ I say you should do it better.”

Federal rules enforced by the state require schools that participate in subsidized meal programs to maintain nonprofit cafeteria operations whose revenues are “used only for the operation or improvement of such food service.” That means school districts can charge utility, custodial, maintenance, supply and other related costs to cafeteria funds. But those charges must be documented according to federal guidelines designed to ensure that only necessary costs associated with food services are billed to cafeteria accounts.

To minimize the temptation to use cafeteria funds as rainy-day reserves, federal rules limit surpluses to three months average expenditures.

## **Misappropriations typically attempt to cover other school costs**

The misappropriations examined in this report are not diversions for personal gain. Rather, they are typically attempts by administrators to shift a greater share of a district's personnel, utility and other costs to flush cafeteria accounts. Some charges were clearly improper. Los Angeles Unified used cafeteria funds to buy lawn sprinklers and to pay salaries of employees at the district's television station, two former district officials disclosed. Auditors also found that L.A. Unified and other districts charged their cafeteria funds twice for some expenses.

Districts are quick to portray the state's questions about their cafeteria funds as complex disputes over accounting methodologies for charges,

such as custodial and utility expenses, that clearly benefit their meal programs.

But CDE officials, who enforce rules interpreted in consultation with the federal government, say districts are using unallowable practices, such as estimating and extrapolating charges, that do not reflect actual, cafeteria-related costs and enable them to pad allowable expenses.

“Those districts (found in violation) never said that they did not know what they were supposed to do,” said Sandip Kaur, director of CDE’s Nutrition Services Division. “They did not say that it was a training or staff turnover issue. They insisted that what they did should be okay and we should accept it as being okay.”

Districts feel the federal regulations are too restrictive, and the requirements too difficult and cumbersome to follow, Kaur added.

“Every one of them has argued that ‘we should be able to do this,’” Zeiger said. “My answer to that is, ‘Well maybe you should. But the law doesn’t let you and neither do we.’”

Most of the recent investigations and repayment orders have occurred in the past two years. The spurt appears to reflect a desperate search for budgetary relief after years of belt-tightening. But it also may portend a larger problem that has flourished with little notice under an obliging oversight system.

### **Whistleblowers expose most of the improper expenditures**

Most of the recent cases of cafeteria fund misuse have resulted from complaints or tips, not from the state’s periodic reviews of food service programs or independent annual audits required of most school districts. In addition, officials at several districts that have been ordered to repay millions of dollars in alleged misappropriations insist they have done nothing that districts all over the state are not doing.

Against that backdrop, CDE officials acknowledged the misappropriations uncovered so far may be only a small sample of what is going on statewide.

“We don’t know how big the problem is,” Zeiger said. “I’d like to think that most people are doing it right. I’m sure that anybody who gets caught, one of their defenses is going to be, ‘Everybody is doing this,’ and I don’t know how true that is.”

In defending their districts, two school business officers acknowledged witnessing cafeteria fund abuse at other districts.

“I’m very sympathetic,” said Wayne Oetken, former interim chief financial officer at San Diego Unified. “I’ve seen certain superintendents over the years try to make a raid on the cafeteria fund.”

“I know that there are abuses of cafeteria funds,” said Ron Hacker, assistant superintendent for business services at Centinela Valley Union High School District. “I’ve worked in four school districts and I’ve seen attempts to use Fund 13 (the cafeteria fund) as a cash cow... In no way, shape or form was Centinela attempting to do that.”

Centinela disputed the state’s determination, but ultimately agreed to repay \$430,000 that CDE said had been transferred improperly from its cafeteria fund plus another \$72,000 for disallowed personnel costs.

### **Food service directors fear consequences of speaking out**

Several food service directors, including one who was fired after she began trying to clean up improper cafeteria fund charges and other problems at Santa Ana Unified, said illegal diversions of student meal funds are on the rise as a result of the intense budget pressures of recent years. The trend has forced some food service directors to weigh whether to remain silent or risk the peril of speaking out.

“People have strong feelings about districts just taking their money, and they don’t have any support,” said Margan Holloway, president of the California School Nutrition Association and director of student nutrition services at Tamalpais Union High School District. “You’re one person and you often don’t have anybody else on your side.”

Lynette Rock, president-elect of the nutrition association and the food service director at Torrance Unified, said districts “are looking for any way to generate revenues so they don’t have to lay people off. So I understand why they’re doing it. Is it legal? No. I’m just fortunate to be in a district that doesn’t do that.”

Rock said some food service directors have been warned not to say anything about improper charges to cafeteria accounts.

“Those districts that are doing it illegally are playing hard ball with it,” she said. “They say, ‘You want to contact the state and let them know that we’re cheating? That’s fine. How long do you want your job?’”

Another food service director, Geoffrey Monsour of Baldwin Park Unified, filed a lawsuit against that district in November, alleging that he was harassed and retaliated against after he told state officials the district was using cafeteria funds for impermissible purposes.

Baldwin Park's troubles date back to 2007, when the district transferred \$1.6 million from its cafeteria account to a building fund that financed construction, including cafeteria improvements, at six schools. Federal regulations, the state noted, expressly forbid using cafeteria funds for building construction.

Baldwin Park returned the \$1.6 million but later had its meal payments suspended before it agreed to repay another \$1.5 million in disallowed charges in 2011. The district returned the funds to its cafeteria account but continues to dispute the state's findings.

### **Nutritional standards primary focus of state oversight**

Weaknesses in the state's oversight system stem in part from a greater emphasis on monitoring nutritional standards than financial integrity. The system of checks also is a collaborative process designed to help districts as much or more than it enforces and punishes.

The state's field examiners, those who conduct periodic reviews of the food service operations, are dietitians and nutritionists with little, if any, auditing or financial training. The CDE's auditors have been called in only when field examiners see something that raises a concern during what the department described as an often cursory review of the finances.

That has changed in recent months. In June, CDE moved to expand the role of its Audits & Investigations Division in the regular reviews. The department's auditors also will for the first time help train the field staff who do the reviews.

Those reviews have been conducted once every five years. But districts are required to maintain only three years of financial records, leaving two years in every five-year cycle that state auditors cannot review. Compounding that regulatory void, CDE has not completed all of the school and other food programs up for review in any five-year cycle since 2001, according to the department.

New federal regulations will soon cut the review cycle from five to three years, although it's unknown whether the department will receive enough additional staffing to handle what looks to be potentially a 40 percent workload increase.

Most districts are audited annually by an independent, outside firm. But those audits often do not include cafeteria accounts and not all auditors are knowledgeable of the complex rules that apply, CDE officials said. State and federal audit guides also provide no guidance on what may and may not be charged to cafeteria funds, something CDE has attempted to remedy without success.

The oversight gaps may explain why most of the cases the state has investigated in recent years have resulted from complaints or informants, not the state's scrutiny.

Los Angeles Unified evaded state detection for at least a decade. During that time, the district was warned repeatedly by its own inspector general and top administrators that it was misappropriating cafeteria funds. The district commissioned several reports, which confirmed the inspector general's findings, yet continued to assign improper charges to its cafeteria fund until 2010, when the state stepped in after being alerted by a district employee.

The district agreed to repay \$158 million, plus more than \$1 million in interest. The amount was developed from disallowed charges identified in audits done by the district's inspector general and the State Controller's Office. Los Angeles Unified did not have to repay years of earlier improper charges that were noted but not audited by the inspector general.

Paradoxically, the district's repayment will not result in any net increase to its beleaguered cafeteria fund, which has been running a deficit that ballooned to nearly \$79 million in the 2011-12 school year. Because the district's general fund must cover the food services deficit, CDE allowed Los Angeles Unified to apply the ongoing general fund subsidy to the amount owed – \$158 million plus interest. As a result, the district has been able to write off \$120 million of the debt to date.

### **Intentional misappropriations a federal crime**

Under federal law, "willful misapplication" of cafeteria funds is a crime, punishable by up to a \$25,000 fine and five years in prison. Yet, federal officials said they were unaware of any school officials ever prosecuted for intentionally diverting cafeteria funds to cover other district expenses.

The Federal Bureau of Investigation and federal prosecutors declined to file criminal charges when employees were caught padding meal counts at Oxnard Union High School District from 2005 to 2008. The fraud resulted in \$5.6 million in overcharges.



“After learning that no one financially profited from inflating the meal count numbers except the school district, the FBI closed their case file,” stated an investigative summary compiled by the USDA’s Office of Inspector General.

In the Oxnard case, federal meal reimbursements shot up 53 percent in a single year, yet set off no alarms at the state or federal level. The inflated meal counts began shortly after the state had completed a regular review and, thus, was not scheduled to return for another five years.

The fraudulent counts continued until a distraught district employee called a federal whistleblower hotline, according to the USDA inspector general’s report. The informant disclosed that cafeteria supervisors were gaming the system, claiming meal counts that were just below a threshold that they knew would catch the state’s attention.

“The food service director told (the informant) that if the school district reports meals under the 93 percent national attendance (rate) for each school site, CDE will not question and investigate the meal counts reported,” an internal CDE email stated at the time.

The Oxnard food service director was correct. Yet, nearly five years after the case was uncovered, neither the state nor the federal government has initiated any oversight changes that would catch a similar, conspicuous spike in meal counts or make the audit trigger any less predictable, a CDE official said.



## Case Studies

### **LOS ANGELES UNIFIED: Despite repeated warnings, district misappropriated cafeteria funds for years**

Not long after Michael Eugene joined the Los Angeles Unified School District as its new business manager in July 2002, he discovered the district was rapidly burning through what had once been a healthy, \$97 million surplus in its cafeteria fund.

As he pored over the revenues and expenses, Eugene found that the account was being drained by illegal misappropriations, including double charges in some cases for the same expenses. Despite strict rules on what food service funds can be used for, the district's top administrators were using the revenue to help balance an ever-strained budget, to cover more than the program's share of costs in some areas and unrelated expenses in others.

Five employees with the district's television station, a disproportionate share of financial managers and items such as lawn sprinklers were being billed to the cafeteria fund, Eugene and others said.

In April 2003, Eugene detailed the situation in an internal memo to then-Chief Financial Officer Joseph Zeronian. The district, Eugene wrote, needed to "eliminate inappropriate charges," "reconcile direct and allocated charges to ensure no duplicate charges exist" and take several other steps to bring food service expenditures into compliance with federal law.

Eugene's memo failed to accomplish what he had hoped. But it sounded one of the earliest in a series of internal warnings that the district was misappropriating millions of dollars from its food service program. The warnings continued for another six years, until late 2009, when the state stepped in after it was alerted by a district employee.

Subsequent negotiations between the district and the California Department of Education (CDE) produced an agreement in March

2011, in which the district agreed to repay \$109.8 million, plus more than \$1 million interest, for illegal or disallowed charges against its cafeteria fund between 2005 and 2008. The district also agreed to repay disallowed charges for two later years –2008-09 and 09-10 – that would be determined by the State Controller’s Office. The controller’s audit, finalized in August, rejected another \$48.3 million in charges to the cafeteria fund. The state allowed Los Angeles Unified to repay the combined \$158 million by crediting its growing general fund subsidy of food services to the debt. As a result, the district already has been able to write off nearly \$120 million of the balance due.

Los Angeles Unified is the nation’s second largest school district with 656,000 students. Its food service program serves 109 million meals a year with an annual budget of more than \$325 million. Most of that, nearly \$240 million in the 2011-12 school year, came from federal and state meal subsidies.

Although the district and state reached a settlement, district officials continue to dispute some of the disallowed charges, the CDE’s interpretations of applicable rules and some of the controller’s findings. However, most of the misappropriations and disallowed charges also were flagged by Eugene, the district’s inspector general and private consultants hired by the district.

Eugene’s 2003 memo was followed by:

- *A September 2006 audit by LAUSD’s Office of Inspector General that found the district’s chief financial officer had for six years used an outdated expense allocation methodology as the basis for assigning charges to the cafeteria fund.*

The audit was requested by Eugene, who said he had difficulty getting anyone above him to act on the improper charges. “I believed the district had a compliance issue with federal law that was not being addressed,” he said.

The OIG found that the district’s food services branch lacked documentation required to substantiate charges and was not able to monitor charges for financial managers and supervisory aides. A survey of 80 administrative positions directly funded by the food service program found only 20 of those employees spending all of their time on cafeteria-related work. Some said they were doing little, if any, cafeteria-related work.

The OIG also noted that the cafeteria fund was covering half the salaries of 136 financial managers with none of the required documentation to show how much of their daily work involved food services.

- *A March 2007 study of the district's food services operation that included many of the same warnings issued six months earlier by the inspector general.*

The 154-page report by Evergreen Solutions, a firm hired by the district, noted that the Business Services office had identified nearly \$9.4 million in salaries paid from the cafeteria account for employees outside food services.

“State and federal regulations,” the report cautioned, “do not allow districts to charge to food service funds the costs of any employees who are not actively engaged in supporting the food service program. For employees outside the food services operation who are charged to the food services fund, regulations require time and effort documentation at least semi-annually.”

- *A June 2007 report by B. Sackin & Associates that was ordered by the district to review the findings of the 2006 OIG audit.*

Sackin is a child nutrition and school meals consultant. The firm's report focused on employees outside of food services who were being paid with cafeteria funds. It also included an extensive review of the relevant federal and state regulations.

The findings were blunt: “In general, the district is out of compliance with federal and state laws that require accurate accounting of charges made by a district against the food service program,” the report declared.

The report cited “clear violations” of federal law and said that, for 21 Personnel Commission positions paid for by food services, the system for assigning expenses “appears to be based more on identifying sources of income than allocating costs fairly.”

For 50 finance positions, the report said there was “no ongoing assessment of time and effort and assignment of positions to be paid for by food services. This became evident when a programmer stated that he hadn't worked on food service tasks for almost two years.”

- *A second OIG audit, issued in August 2009, which found that few of the violations and problems identified in the 2006 OIG audit had been remedied.*

“Our audit found that the duties, responsibilities and accountability for the use of cafeteria funds had not been clearly established,” the inspector general wrote. The district’s top financial officers “did not have written policies and procedures related to the appropriate allocation and recording of cafeteria charges.”

The lack of established procedures and accounting methodologies “increased the potential of double-charging, resulted in unjustified and unreasonable charges to the cafeteria fund” as well as “charges to the cafeteria fund for central administrative services that were disproportionate to the benefit received by the food services program,” the inspector general stated.

Some district offices were unaware that they received funding from the cafeteria account and “some of those offices stated that none of their employees were performing tasks for the food services program,” the inspector general found.

“Finally, because of the ongoing and unresolved issue of the cafeteria fund allocations, funding was not consistently available for necessary improvements and has negatively impacted the overall quality of the food services program,” the inspector general concluded.

- *A third OIG audit, completed just three months later in November 2009, which stated some maintenance and operations charges to the Cafeteria Fund “may not be substantiated, resulting in violation of federal and/or state regulations.”*

The audit went on to note that the cafeteria fund also “may have been overcharged for services due to duplication of claims or unreasonably high amounts of time claimed for services provided.”

In addition to the improper charges, Los Angeles Unified had earlier agreed to repay \$11 million that had been transferred from its cafeteria fund to its general fund. The transfer, over four years starting in 2001, had been questioned by the district’s external auditors and the state Department of Education, according to an internal department email.

But the far more extensive problems identified by the OIG were not otherwise detected by CDE. The OIG issues its reports to the school

board and superintendent. It is not obligated to report findings to the state, but the audits are public documents available on the district's website.

Eugene, who is now the chief operations officer of Orange County (Florida) Public Schools, said his efforts to persuade Los Angeles Unified to eliminate improper charges were hampered by frequent turnover among the district's top administrators. In seven years at Los Angeles Unified, Eugene said he worked for five chief financial officers.

"Starting and restarting the discussion about appropriate charges to the fund was a challenge because of the number of times that position turned over," he said. "And this isn't an easy discussion to have within a district. In order to really make a systemic fix ... you have to cut things out of your general fund."

The OIG audits traced the improper charges back as far as the 1999-2000 school year. But the inspector general did not attempt to gather or analyze any records before the 2005-06 school year, and CDE did not want to do any independent audits of the period in question. As a result, the district did not have to review or repay any cafeteria fund charges for the five school years before 2005-06.

Federal guidelines, enforced by the state, require districts to retain such records for only three years. Thus, absent the OIG's audits, Los Angeles Unified would have had to account for and repay just three years of improper charges, rather than the six years covered in the 2011 settlement with the state.

Los Angeles Unified is the only district in the state that has an inspector general. The district was required to establish an OIG by state legislation enacted in response to allegations of mismanagement involving the proposed \$200 million Belmont Learning Center, a downtown high school project the district attempted to build in the late 1990s on a site that turned out to be contaminated with toxic waste. The OIG mandate will sunset on Jan. 1, 2015, unless it is extended.

In addition to the impact of the improper charges, Los Angeles Unified's food service program has struggled to absorb more than \$35 million a year in added benefit and salary costs the school board approved in 2007, when it extended health benefits to part-time food service workers. The cafeteria fund ran up a \$27 million deficit the following year, and has operated in the red ever since, with the annual deficit reaching \$78.6 million last year, according to Megan Reilly, the district's chief financial officer.

Eighteen months after the benefit increase, in January 2009, Los Angeles Unified held a news conference and issued a press release that warned the district “may run out of money to feed hungry children” because of a potential shortfall in state meal subsidies. The release, promoting a bill to increase student meal funding, was headlined “Cafeteria Fund Cash Flow May Leave Neediest LAUSD Students Hungry.”

In August 2011, four years after approving the benefit package for part-time cafeteria workers, the district asked CDE for a \$70 million advance to cover food service costs at the start of the new school year. After the department balked, the district withdrew the request. The state had denied a similar request two years earlier.

Dennis Barrett, a food services veteran who has run big-city programs in Texas, Nevada and Colorado, said he recognized the improper cafeteria fund charges shortly after he became Los Angeles Unified’s food services director in January 2007. A month into the job, Barrett said he raised the issue during a meeting with the district’s superintendent and other top administrators.

“I said if things do not change ... someone in this building could go to the federal penitentiary,” Barrett recalled.

He was alluding to a federal law that provides penalties of up to five years in prison and a \$25,000 fine for the “willful misapplication” of cafeteria funds. Barrett said his warning prompted the district to order the Evergreen report, a study that warned millions of dollars in salaries were being charged improperly to food services.

Both Barrett and Eugene said the financial drain on the cafeteria account compromised the district’s food services. The district was forced to rely more on processed rather than fresh foods, Eugene said. They were able to increase the number of high school students eating a cafeteria lunch from 17 percent to almost 40 percent, but it stalled there and has since declined to 34 percent. The district’s participation rate for students eligible for subsidized lunches ranged from 51 percent to 60.3 percent over six years ending in 2010-11, well below statewide averages of 71 percent to 74.5 percent during the same span, according to data compiled by CDE.

“Throughout the seven years that I was there, it just seemed like we were chasing our tail,” Eugene said. “There was more discussion about how the district should charge the fund as opposed to really investing that money back into the program to improve the quality of meals and the physical environment for kids eating the meals.”



CFO Reilly, who joined the district in late 2007, acknowledged that LAUSD should have corrected the problems years ago. But Reilly said the district found it difficult to get CDE to sign off on an acceptable accounting methodology for the disputed charges. She also said the district continues to believe it should have been allowed to charge some reasonable expense for utility and other costs, which were completely disallowed.

“The district has worked very hard with CDE to make sure and correct everything,” Reilly said. “We may have our differences of opinion, but I think we basically knew we had an outdated methodology that needed to be updated.”

The 2011 settlement agreement between the district and the state included detailed definitions of the charges that could be assessed to the cafeteria fund and the required documentation.

### **OXNARD UNION HIGH SCHOOL DISTRICT: Inflated meal counts went undetected for more than three years**

Late in the summer of 2008, officials at Oxnard Union High School District learned that they had a multimillion-dollar case of student meal fraud on their hands. A district accountant, troubled by several years of inflated meal counts, disclosed the illegal charges when he filed a stress claim for worker’s compensation.

The accountant also alerted state and federal authorities, who would join a district investigation already in progress. An accounting firm hired by the district estimated the overcharges at \$6.6 million. But, because at least half of the district’s meal count records were missing, the state later reduced the overcharge to \$5.6 million spanning three school years starting in 2005-06, and a few months of a fourth, 2008-09.

Oxnard Union operates high schools with 16,000 students in three cities, Oxnard, Camarillo and Port Hueneme. Investigators determined that each of the district’s six traditional and two alternative high schools was overstating subsidized meal counts, up to an extra 700 meals a day at some campuses. More than 4 million extra meals were claimed over the three-plus years, according to a report prepared for the district by the accounting firm, Vicenti, Lloyd & Stutzman.

The whistleblower told authorities he first noticed the irregularities after he had been with the district for about nine months. He said he initially

reported the situation to the food service director.

“The food service director told (the whistleblower) that if the school district reports meals under the 93 percent national attendance (rate) for each school site, CDE will not question and investigate the meal counts reported for each site,” an internal CDE email stated. The whistleblower said each school was reporting meal counts of 85 percent to 90 percent of enrollment.

The inflated counts began shortly after the state completed a routine periodic review of the district’s food service program in 2005. Those reviews are conducted every five years, which meant the state’s examiners would not be expected back until 2010, at the earliest.

Nonetheless, district, state and federal officials missed a clear sign that something was awry at Oxnard Union. In a single year – 2005-06 – the district’s federal payments under the National School Lunch Program jumped nearly 53 percent, from \$2.8 million to \$4.3 million. Enrollment had been flat and, despite the sharp increase in the number of meals reported served, the district’s food costs declined.

As a result of the padded meal counts, federal and state meal subsidies provided an unexpected surplus in the district’s cafeteria fund. The subsidy payments are approved and processed by CDE, which receives detailed monthly reports that support each request for federal and state meal reimbursements.

“These variances and high fund balances were significant and unusual and should have drawn the attention of those responsible for the oversight and accounting,” the Vicenti report stated.

The report also found that the district failed to follow up on several earlier disclosures about the inflated counts, including one relayed to management by the district’s auditors in early 2008.

The state’s five-year review cycle will soon be reduced to three years under new federal guidelines. But the known audit trigger – the meal count threshold that district employees knew would prompt a state review – has not been revised and neither state nor federal officials have made any changes that would send an automatic alert when a district’s subsidized meal payments jump by a conspicuous amount, as they did in Oxnard. Although the federal government provides most of the meal subsidies, all of the money flows through the state Department of Education, which administers and monitors meal programs for the U.S. Department of Agriculture.

District officials and investigators said most of the padded reimbursements were spent on the food services program, although some \$350,000 was missing, along with records that might show what happened to the money.

Jack Parham, the district's attorney at the time, said district officials believed there was criminal action involved but could not prove it. The USDA's inspector general and the Federal Bureau of Investigation declined to pursue criminal charges because investigators said they could find no evidence that anyone benefitted personally from the inflated meal payments. The prosecutors' decision was discretionary. The federal statute that provides up to five years in prison and a \$25,000 fine for willful misappropriation of cafeteria funds does not require evidence that funds were diverted for personal use.

The district later appealed the \$5.6 million balance owed and asked the state to reduce the amount to \$3.4 million. The state, noting that it has no authority to reduce such debts owed to the federal government, rejected the appeal. The last installment on the \$5.6 million was paid last year.

### **SANTA ANA UNIFIED: Troubled food service program ran up a \$16 million surplus as staff vacancy rate exceeded 20 percent**

There were unmistakable signs of trouble in Santa Ana Unified's food service program long before the state ordered the district in July 2012 to repay \$2.4 million that auditors concluded had been improperly charged to its cafeteria fund.

Two years earlier, the food service director had been fired for, among other reasons, allowing what an arbitrator called "a rather astonishing hostile work environment" to exist in the district's central kitchen. Employees there regularly engaged in "sexual horseplay," including simulated intercourse or "humping," grabbing each other's genitals and viewing pornography on cell phones, according to the arbitrator's findings outlined in a recommendation to uphold the dismissal.

A subsequent assessment by an accounting firm hired by the district identified multiple problems, including 59 vacancies representing 21 percent of the authorized staff, failure to seek competitive bids for supplies and lax financial controls that resulted in "a cash shortage that appears to be caused by more than human error."

With some 57,000 students, Santa Ana is the state's sixth largest school district. More than 80 percent of the students are eligible for free or reduced-price meals. As a result, the district's food services depend heavily on federal meal subsidies, which provided \$24.9 million, or 79 percent, of the program's revenues in the 2010-11 school year. State subsidies accounted for another \$2.1 million, or 7 percent of the food service budget.

The \$2.4 million in disallowed charges included more than \$1.7 million for "activity supervisors," employees who monitor students during meals, and nearly \$670,000 for custodial, security, warehouse, maintenance and groundskeeper employees. The state has since asked the district to repay another \$300,000 for a roof project that was improperly charged to the cafeteria account.

In a conspicuous departure, CDE auditors reviewed records for and disallowed only a single year of charges associated with the custodial, security, warehouse, maintenance and groundskeeper employees. For the activity supervisors, the auditors added up charges from three years of records, the maximum amount districts are required to retain.

The Department of Education also found that Santa Ana Unified had squirreled away a \$16 million surplus in its cafeteria account. The reserve is more than double what federal law allows for what is supposed to be a nonprofit operation.

As a result of the bloated surplus, the state recently rejected the district's application for a \$1.2 million grant, similar to others it has received in the past, for fresh fruits and vegetables. The department suggested the district instead use its cafeteria surplus to buy fresh fruits and vegetables for students.

State auditors also found that the district had failed to collect more than \$100,000 that students owed for meals and was not charging enough for adult meals, two more violations of state and federal laws.

The Department of Education did not act on allegations that the district had not solicited competitive bids or secured contracts for any of its major food service suppliers, as required by law. The district's own accountants had raised the same issue in a report issued two years earlier. State law requires competitive bids and contracts for school cafeteria purchases that exceed \$81,000 a year. The federal threshold is \$150,000, but federal rules require agencies to adhere to the state threshold, if it is lower.

Michael Bishop, a deputy superintendent who supervises Santa Ana's

food services, said the district went to bid on “everything” required to be competitively bid for its food services operation. But, in response to a Public Records Act request from the Senate Oversight Office, the district provided only two contracts, both of which had been “piggybacked” or borrowed from other agencies that solicited the bids, negotiated the terms and executed the agreements. One contract was for frozen foods. The other was for distribution of USDA commodities.

The district’s food service operation purchases more than \$13 million a year in food and other supplies. It has exceeded the contracting threshold for purchases from Driftwood Dairy, US Foodservice, Best Contracting Services, Loewy Enterprises/Sunrise Produce and A&R Wholesale Distributors, according to recent, board-approved payments that the Senate Oversight Office found.

Bishop said one of those payments, \$300,978 to Best Contracting Services, was for a roof replacement project. State investigators had advised the district that a roof project is an impermissible use of cafeteria funds. That amount will also have to be repaid.

The district has taken steps to correct some of the problems identified by the state, but has challenged the \$2.4 million in disallowed charges for salaries and benefits of the activity supervisors, custodians, maintenance workers and others who work only part of their shifts on cafeteria-related tasks.

State auditors said the district failed to maintain work logs required to substantiate workers’ time actually spent on cafeteria-related activities. For the activity supervisors’ salaries and benefits, which represent \$1.7 million of the disallowed charges, the district based the charges on “estimated percentages of time worked by only a selected number” of employees, the auditors found.

As part of a standard, five-year review cycle, CDE had examined Santa Ana’s food services program in 2006 and 2011. After both visits, the district was cited for cafeteria surpluses that exceeded the federal limit – three months average expenses of the program. But neither review discovered any of the disallowed charges later flagged by CDE auditors. Those findings resulted from a complaint filed by Jan Monforte, who succeeded Mary Lou Romero, the food service director who was fired in 2010.

Monforte, a former president of the California School Nutrition Association, served nearly a year as the district’s food service director before she was fired without warning or explanation in October 2011,

two days before her one-year anniversary, when she would have cleared probation.

After she was dismissed, Monforte told CDE that Bishop and other Santa Ana administrators viewed the food service department, with its \$16 million surplus, as a “cash cow” that could be used “even when the expense under discussion was not an allowable charge.”

She told CDE about charges made without proper documentation for the activity supervisors, and the absence of contracts for the \$13 million worth of food and supplies purchased every year for the district’s cafeterias. She reported that the food services program had been required to provide free meals, in violation of federal law, for school board members and administrators.

Although the cafeteria fund was being charged more than \$700,000 a year for custodians and maintenance workers, Monforte said many of the cafeteria sites were cited “routinely” by the Orange County health department for unsanitary conditions.

“In some of the cafeterias, they had to keep old-fashioned mouse traps around the edges of the kitchen,” Monforte said. “When you get to the point where you have to do that, things have gone out of control.”

A review of health department records over the past four years showed many campuses were frequently cited for minor health code violations, such as deteriorated floors, holes in walls and debris around equipment. The records also included 22 health code violations for cockroaches and rodents at 15 campuses and the central kitchen. A rodent infestation prompted the county to order the closure of a Godinez High snack bar in the fall of 2011.

Michael Haller, program manager for Orange County’s food protection program, said the number and types of health code violations at Santa Ana Unified schools did not stand out from other school systems in the county.

“We get a smattering of closures throughout all the districts,” Haller said. “If we did see a district that would tend to trend higher than any of the others, that would have been brought to my attention.”

As the illegal surplus continued to grow by more than \$2 million a year, Monforte said she had difficulty persuading the district to fill the many vacancies that hampered the food service operation. Just weeks before she was dismissed, Monforte also had advised the district’s principals and

administration that they needed to compile work logs, known as personal activity reports, for the activity supervisors.

In a Sept. 28, 2011, memo distributed district wide, Monforte warned – as state auditors later affirmed – that the work logs were required “to be compliant with federal and state requirements.”

She had warned in an earlier memo that the free meals for board members and administrators were not permitted and that prices charged for adult meals could no longer be subsidized by the cafeteria account.

In his criticism of CDE’s findings, Bishop repeatedly cited an “absence of guidance” from the state. In response to such criticism, which other districts also expressed, CDE officials point to numerous bulletins that the department has issued on the rules as well as regular seminars that it conducts on what is and is not permitted.

Monforte said she understood the rules and was trying to bring the district into compliance when she was fired.

Bishop refused to discuss any of Monforte’s allegations. He said the district does need to increase staffing in its food services program. Of the \$16 million surplus, he said: “We run a very profitable program. We have high utilization ... high reimbursement.” One of the federal government’s basic rules is that food services that accept federal subsidies operate as nonprofit programs.

Bishop said the reserves also have grown because the district has been unable to charge all allowable expenses to the program. For example, the rules permit charging only a fraction of utility costs, unless kitchens have individual meters, which most do not.

“I think it’s interpretation,” Bishop said. “When you look at the narrowest interpretation of anything, you can exclude just about anything you want.”

### **BALDWIN PARK UNIFIED: Long impasse with the state ends with agreement to increase spending on fresh fruits and vegetables**

In May 2012, Baldwin Park Superintendent Mark Skvarna signed a settlement agreement committing his district to repay \$1.5 million that the California Department of Education determined had been misappropriated from the district’s cafeteria fund.

The settlement brought to an end almost six years of bitter disagreement between the district and CDE, although some of the fallout continues in a lawsuit that Baldwin Park's food services director filed in November against Skvarna and the district.

Nearly 60 percent of Baldwin Park Unified's more than 20,000 students qualify for free or reduced-price meals. Of more than \$8.3 million in revenue generated by the food service program in 2011-12, nearly 80 percent, or \$6.7 million, came from federal reimbursements. The state provided \$568,000, or 7 percent of the revenue.

In the lawsuit, attorneys for food service director Geoffrey Monsour allege that he was subjected to harassment and retaliation for objecting to "improper and illegal" uses of the district's cafeteria funds. Monsour has been on paid leave since December 2011.

The lawsuit alleges that Skvarna used millions of dollars in cafeteria funds "that were required by state and/or federal laws and regulations to be spent for specific childhood nutrition programs ... for other impermissible purposes, such as making up shortfalls in the general fund."

Monsour's attorney, Zachary Shepard, said the food service director warned Skvarna in 2005 that money the district wanted to use for cafeteria construction could not be used for that purpose.

Skvarna said Monsour never made such a statement to him. The superintendent declined to discuss the allegations in the lawsuit, but said he continues to believe all of the charges against the cafeteria fund were appropriate and legal. Monsour, he said, "was never mistreated, abused or anything else. He was just asked questions and I don't think he liked to be questioned."

In 2006, during a periodic review by the state Department of Education, the district was cited for transferring \$1.6 million from its cafeteria fund to its building fund for remodeling and other construction work done at six schools, including cafeterias at each campus. State officials said they received a tip from a district employee about the \$1.6 million transfer.

Federal regulations expressly prohibit the use of cafeteria funds for construction of buildings. The district's National School Lunch Program agreement, a contract required to participate in the program, also states that "program revenues shall not be used for purchasing land, or for acquiring or constructing buildings."

The district also was cited for carrying an excess surplus in its cafeteria



fund. Federal rules limit net cafeteria fund reserves to no more than three months average expenditures of a food program. Baldwin Park's \$2 million reserve exceeded that threshold by nearly \$500,000, CDE concluded. The district challenged the state's findings and Skvarna said he still believes the state was wrong.

"It was basically a remove and replace operation," the superintendent said. "We weren't expanding any kitchens and, my understanding of federal standards is that has always been allowable."

Nonetheless, in November 2006, the district returned the \$1.6 million to its cafeteria fund. Six months later, the district also submitted to the state a required five-year plan to reduce the surplus.

Less than two years later, during a follow-up review, CDE discovered that Baldwin Park had transferred another \$1.5 million from its cafeteria fund to its general fund. Most of that money, \$982,000, was charged for custodial services in cafeterias and kitchens dating back to the 2004-05 school year. (District officials said food services had not been charged for any janitorial or utility costs for at least eight years.) Another \$383,000 represented interest overpayments to the cafeteria fund, according to the district.

The state rejected the charges on a number of grounds. Recouping unclaimed expenses from previous years is not permitted, the custodial charges were not properly documented and the combined charges had not been approved, as required, in the five-year plan to spend down the surplus. Only CDE "has the specific authority to approve" expenditures to reduce excess cafeteria fund surpluses, the state said.

Baldwin Park disagreed and refused to repay the funds. Skvarna threatened to sue the state. The Department of Education offered to bring in the State Controller's Office or the Department of Finance to do an independent audit of Baldwin Park's cafeteria account. Skvarna declined because he said the state refused to allow the district to use cafeteria funds to pay for any audit. No lawsuit was ever filed.

With no movement after nearly three years of impasse, CDE suspended Baldwin Park's meal reimbursements, roughly \$700,000 a month, in May 2011. When the district appealed once more, CDE again offered to submit the dispute to a "neutral third party," such as the Controller's Office. Instead, Baldwin Park agreed to settle.

"They stopped my money," Skvarna said. "I could have done a lot of things, but I can't do anything if I can't feed kids."

By then, after the suspended meal payments were restored, Baldwin Park's cafeteria fund surplus had grown to \$6.5 million. A new five-year plan requires the district to spend most of the surplus on equipment and improvements for the food services program, including \$2.7 million for salad bars, fresh fruits and vegetables.

Skvarna said the surplus-reduction plan will force the district to redo a lot of work that was recently done and replace equipment that is relatively new or doesn't need to be replaced. Federal guidelines offer several options to reduce an excess cafeteria fund surplus. Schools districts may improve the food service operation and the meals provided, reduce lunch prices or accept reduced reimbursements for free and reduced-price meals.

Skvarna said his district was singled out for accounting practices, particularly the failure to keep timesheets documenting hours spent on cafeteria-related work, that are widely used by districts throughout the state.

"I have great sympathy for (those who complain about) keeping track of everybody's hours," said Richard Zeiger, chief deputy state superintendent of public instruction. "We have to do that here. We track everybody's hours to see if they can write something off to a federal program, everybody, thousands of people, every single hour."

### **SAN DIEGO UNIFIED: State cites faulty accounting and double-billing for costs**

In May 2012, the California Department of Education notified San Diego Unified, the state's second largest school district, that it had improperly charged nearly \$4.5 million in custodial and utility charges to its cafeteria fund.

The department's findings reflected a review of only one school year, 2010-11, even though a district administrator had publicly stated that the questionable charges dated back three years. The state has since expanded its review to include all three years.

District officials are contesting the findings. Pending a more extensive analysis, they say that any disallowed charges can be deducted from an outstanding \$18 million general fund loan to the food services operation. The state's review was expanded in part to determine whether the district can document that loan.

More than 65 percent of San Diego Unified's 131,000 students qualify for free and reduced-price meals. As a result, federal subsidies provided \$44.2 million, or nearly 79 percent, of the \$55.8 million that the district's cafeterias generated in the 2011-12 school year. The state provided another \$3.9 million or 7 percent of the revenue.

The origin of the San Diego Unified case distinguishes it from most of the other cafeteria fund investigations the state has opened in recent years. Rather than a tip or complaint about budgetary sleight of hand, CDE disallowed the \$4.5 million in charges after a standard state review done once every five years.

The department said San Diego Unified failed to document a sharp increase – from \$188,000 to \$3.3 million a year – in custodial time and charges assigned to the cafeteria fund. In addition, the department said the school district failed to substantiate nearly \$1.2 million in utility costs charged to the cafeteria fund. The district also double-charged some of those utility expenses as both direct and indirect costs to the fund, CDE said.

District officials acknowledge that, with rapidly shrinking reserves, they were searching for ways to relieve pressure on the general fund. Assigning food services its fair share of custodial and utility costs was not only legal, they said, but something the district should have done long ago.

“It has caused the district to do belt tightening and assign costs out to provide relief for the general fund, wherever and whenever possible,” said Wayne Oetken, former interim chief financial officer. “But there was no attempt on the part of the district to make a claim that was inappropriate or not allowed.”

To assess its options, the district four years ago commissioned a study by The Portolan Group, a school consulting firm. Portolan's 2009 report, “Opportunities for Economic Improvement (in) Food Service Operations,” identified steps the district could take to improve both its food services and its precarious finances. One of those recommendations was to increase custodial charges to the cafeteria fund.

Philip Stover, the district's deputy superintendent of business, worked for Portolan at the time and headed the team that did the study. He said the district had not charged food services for much custodial time because the program was operating in the red and could not afford it.

But, with increased sales and acceptance of subsidized meals driven by food service improvements, the district was able to begin

charging the cafeteria fund for custodial services. Following Portolan's recommendation, the charges were based on a detailed time study that assigned two, four and six hours of custodial time per day to elementary, middle and high schools, respectively.

The study calculated total annual custodial costs of \$2.6 million for food services. The district already was assigning \$188,000 a year in custodial costs to the cafeteria fund for breakfast cleanup. When the district executed the consultant's recommendation, it raised the custodial charge to the cafeteria fund to \$3.3 million in 2009-10 and 2010-11, and \$3.6 million in 2011-12.

But the district had a problem. Federal and state guidelines do not permit the use of time studies, unless approved in advance by the federal government, to calculate chargeable hours of employees, like custodians, who spend only a portion of their day on food service duties, CDE stated.

Stover said the recommended accounting methodology was based on the extensive experience of his Portolan team, which had worked with more than 150 school districts across the nation. He said his team did not run the methodology by anyone at CDE.

In a summary of the state's findings, a CDE examiner reminded the district of a department PowerPoint presentation entitled, "Cafeteria Funds, the Do's and Don'ts. What Districts and Agencies Need to Know About Managing Their Food Service Funds." Slides in the PowerPoint, which the department uses in frequent seminars for school district employees, identified improper charges like those assessed at San Diego Unified. The summary also cited a U.S. Department of Agriculture policy memo and a CDE bulletin to school districts that offered additional guidance on allowable food service charges.

Nonetheless, Debbie Foster, San Diego Unified's budget operations director, said the district's outside auditor signed off on the disputed charges. State education officials say there is no cafeteria fund guidance in the state or federal audit guides and some auditors are unaware of the strict rules on how the money can be used.

District officials continue to maintain the charges were fully justified, but have agreed to repay the disallowed charges, if necessary. This district also is working with CDE to develop a tracking and accounting system that complies with federal and state law.

In a Sept. 27, 2012, letter to CDE, San Diego Superintendent William Kowba said the district "clearly understands that the methodology used"

to substantiate the utility and custodial charges does “not meet program requirements.” However, he added, since the charges “were incurred as direct support of the program, it is our hope that some acceptable validation process can be identified which will enable the district to charge the food service program for all or a portion thereof.”

Foster said the district has an award-winning food service operation that has not been hurt by the disallowed charges and continues to attract increased student participation.

“We have an incredible child nutrition program,” she said. “So we just want to be appropriate in the way we are recording expenses and move forward.”



## Recommendations

During research for this report, weaknesses and gaps in the oversight system for student meal funds were acknowledged by officials at the California Department of Education, who monitor subsidized meal programs for the federal government, as well as school administrators who must comply with the rules. Enforcement appears to be difficult for all involved and the temptation to use restricted meal funds for other pressing needs can be great. The following recommendations were developed by the Senate Office of Oversight and Outcomes and include worthy proposals suggested by those who participated in the preparation of this report:

- The California Department of Education should conduct an assessment of its food services workload and staffing needs and request sufficient federal funding to hire enough personnel to carry out the state's oversight responsibilities.
- The state Education Audit Appeals Panel should include in the state audit guide for K-12 local education agencies clear and comprehensive guidance on what school districts may and may not do with funds in cafeteria accounts. The Education Audit Appeals Panel should require annual audits to review cafeteria fund expenditures for compliance with state and federal rules.
- The state Department of Education should prepare simplified guidelines, such as those included in the Los Angeles Unified School District settlement agreement with the state, that address most of the common acceptable and unacceptable charges to cafeteria accounts.
- The state Department of Education should announce and publicize enforcement actions for misappropriation of cafeteria funds, to create an ongoing discussion of the rules and to encourage compliance.
- The Legislature should consider extending the three-year requirement to maintain financial records to perhaps five or 10

years to discourage creative accounting. Many records now are prepared electronically and can easily and inexpensively be stored electronically.

- The Legislature should consider adopting legislation that mirrors federal regulations and guidance to prohibit charges to cafeteria funds for expenses incurred in prior years, and any recouping of direct or indirect charges that were never charged during the appropriate fiscal year.
- The Legislature should consider requiring school districts to give food service directors access to all financial records involving student nutrition programs.
- The Legislature should consider repealing sections of the Education Code that conflict with federal law or regulations. Those sections include:

EC Section 38102, which authorizes the establishment of cafeteria equipment accounts which the USDA does not permit and which some school districts use to hide money.

EC Section 38092, which authorizes cafeteria fund revenue sharing with associated student bodies. Federal law does not permit such revenue sharing.

- The Legislature should consider eliminating or extending the Jan. 1, 2015, sunset date in EC Section 35400 for Los Angeles Unified's Office of Inspector General. The OIG documented LAUSD's decade-long misappropriation of cafeteria funds and has amassed an impressive body of work since it was established in response to outrage over the district's attempt to build a new downtown school on expensive property that later turned out to be contaminated.



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