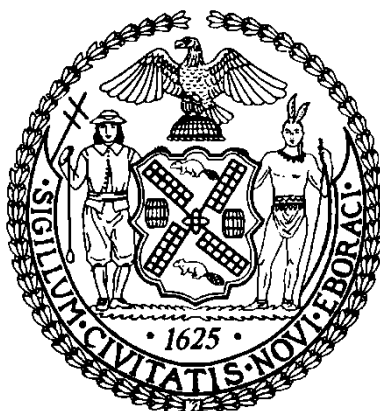


**CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER**

**John C. Liu  
COMPTROLLER**

**MANAGEMENT AUDIT**

**Tina Kim  
Deputy Comptroller for Audit**



**Audit Report on the Department of  
Education's Food Distribution  
Vendor Contracts**

*ME10-144A*

**December 13, 2011**



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
1 CENTRE STREET  
NEW YORK, N.Y. 10007-2341

John C. Liu  
COMPTROLLER

December 13, 2011

**To the Residents of the City of New York:**

My office has audited the adequacy of the Department of Education's (DOE) payment and contract management controls concerning the provision of food distribution services. We conduct audits such as this to determine whether City agencies are effectively monitoring contractors to ensure that funds allocated to the contract are appropriately spent and accounted for and that the terms of the contract are being met.

The audit found that DOE's payment and contract management controls over its procurement of food distribution services were insufficient. The audit identified weaknesses in the food delivery payment process and in the monitoring of food distributor performance. The weak controls resulted in unsupported payments to distributors, failure to receive prompt-payment discounts, and overpayments for donated food. Furthermore, there was insufficient documentation to support DOE's decisions concerning the imposition of liquidated damages for distributors' performance violations. Finally, DOE did not evaluate the performance of the food distribution vendors as required.

This audit recommends, among other things, that DOE: ensure that there is support for deliveries made by distributors before payments are processed; ensure that its vendor invoice verification and payment system properly distinguishes between purchased and donated food items; obtain sufficient documentation to support its decisions concerning the imposition of liquidated damages for distributors' performance violations; and evaluate vendor performance on a regular basis.

The results of the audit have been discussed with DOE officials, and their comments have been considered in preparing this report. Their complete written response is attached to this report.

If you have any questions concerning this report, please e-mail my audit bureau at [audit@Comptroller.nyc.gov](mailto:audit@Comptroller.nyc.gov).

Sincerely,

A handwritten signature in black ink, appearing to read "J. Liu".

John C. Liu

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*The City of New York  
Office of the Comptroller  
Management Audit*

**Audit Report on the Department of  
Education's Food Distribution  
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**AUDIT REPORT IN BRIEF**

This audit determined the adequacy of the Department of Education's (DOE) payment and contract management controls concerning the provision of food distribution services. Through a competitive bidding process, DOE entered into contracts with four food distribution vendors to procure and distribute about 550 food items to City schools. The contracts for Manhattan, Brooklyn, Queens, and Staten Island began on May 1, 2006, and have been renewed through August 31, 2012. The combined contract total is \$278,182,585 for this period. The contract for the Bronx started on August 4, 2004, and has been renewed through August 31, 2012, for a total amount of \$75,187,330.

DOE's Office of School Food and Nutrition Services (OSFNS) manages these contracts in an effort to ensure that students receive quality food at a reasonable cost. The food distribution contracts provide for the purchase, storage, and distribution of both donated and vendor-procured food. The New York State Office of General Services (OGS) delivers food donated by the U.S. Department of Agriculture and other organizations to the vendors' warehouses or, if necessary, to food manufacturers for processing. For non-donated food items, the food distributors purchase the goods from food manufacturers or suppliers. The food distribution vendor contracts stipulate that distributors must offer the items to DOE at specified manufacturer prices plus a mark-up to cover the costs of receiving, handling, warehousing, tracking, and delivering the food.

The primary scope of the audit was Fiscal Year 2010 (July 1, 2009, through June 30, 2010).

**Audit Findings and Conclusions**

DOE's payment and contract management controls over its procurement of food distribution services were insufficient. The audit identified weaknesses in the food delivery payment process and in the monitoring of food distributor performance.

The weak controls resulted in unsupported payments to distributors, failure to receive prompt-payment discounts, and overpayments for donated food. Our analysis of payments made to food distributors in Fiscal Year 2010 identified a total of about \$410,000 that should be recouped. (Payments to food distributors for deliveries to schools in Fiscal Year 2010 totaled \$113.9 million.)

This finding is the result of the focused testing we did for this audit and does not suggest that the remaining amount that DOE paid for food distribution services in Fiscal Year 2010 is fully supported and accurate.

In addition, DOE is not closely monitoring the prices charged by manufacturers/suppliers for the food items they provide to the distributors. As a result, DOE is hindered in identifying opportunities to negotiate with the distributors for lower food prices. Furthermore, there was insufficient documentation to support DOE's decisions concerning the imposition of liquidated damages for distributors' performance violations. Finally, DOE did not evaluate the performance of the food distribution vendors as required by the contracts and its own procurement manual.

### **Audit Recommendations**

To address these issues, the audit recommends, among other things, that DOE:

- Upgrade its vendor invoice verification and payment system, the Usage Basket System (Usage), so that it maintains complete payment information.
- Ensure that there is support for deliveries made by distributors before payments are processed.
- Ensure that Usage properly distinguishes between purchased and donated food items during the discount calculation process.
- Maintain a central inventory system that is linked to Usage and tracks in a timely manner the receipt of donated food by the distributors and the delivery of donated food to the schools.
- More closely monitor manufacturers'/suppliers' prices to identify opportunities to negotiate lower prices with the distributors.
- Obtain sufficient documentation to support its decisions concerning the imposition of liquidated damages for distributors' performance violations.
- Evaluate vendor performance on a regular basis as required by the contract and its own procurement manual.

### **Agency Response**

In their response, DOE officials agreed or partially agreed with 11 of the audit's 14 recommendations. Officials disagreed with our recommendations to upgrade Usage, ensure that Usage properly distinguishes between purchased and donated foods, and maintain a central inventory system that is linked to Usage.

## INTRODUCTION

### Background

The DOE provides primary and secondary education to over one million students in more than 1,600 schools. As part of its services, DOE provides over 850,000 meals each school day.

Through a competitive bidding process, DOE entered into contracts with four food distribution vendors to procure and distribute about 550 food items to City schools. The contracts for Manhattan, Brooklyn, Queens, and Staten Island began on May 1, 2006, and have been renewed through August 31, 2012. The combined contract total is \$278,182,584 for this period. The contract for the Bronx started on August 4, 2004, and has been renewed through August 31, 2012, for a total amount of \$75,187,330. See Table I for contract amounts by vendor.

**Table I**  
Food Distribution Contract Amounts by Vendor

Vendor Name	Borough Served	Bid #	Contract Amount
Teri Nichols	Manhattan	1C373	\$123,623,878
Teri Nichols	Brooklyn 1		
Metropolitan Foods, Inc. / Driscoll Foods	Queens	1C373	\$68,654,678
The Maramont Corporation	Brooklyn 2	1C373	\$66,372,296
Chef's Choice Food Dist.	Staten Island	1C373	\$19,531,732
<b>Total Contract Amount for Bid #1C373</b>			<b>\$278,182,584</b>
Metropolitan Foods, Inc./Driscoll Foods	Bronx	1C168	\$75,187,330
<b>Total Contract Amount for Bids #1C373 and #1C168</b>			<b>\$353,369,914</b>

OSFNS manages these contracts in an effort to ensure that students receive quality food at a reasonable cost. The food distribution contracts provide for the purchase, storage, and distribution of both donated and vendor-purchased food. OGS delivers food donated by the U.S. Department of Agriculture and other organizations to the vendors' warehouses or, if necessary, to food manufacturers for processing. For non-donated food items, the food distributors purchase the goods from food manufacturers or suppliers. OSFNS quality assurance inspectors visit the food distribution vendors' warehouses to ensure that food items are maintained as specified in the contract. The food distribution vendor contracts stipulate that distributors must offer the items to DOE at specified manufacturer prices plus a mark-up to cover the costs of receiving, handling, warehousing, tracking, and delivering the food.

School managers place food orders with the distributors. The deliveries that are made in response to these orders are checked by school personnel. In case there is food spoilage or a shortage or non-delivery of items, school personnel inform OSFNS, which is responsible for resolving the issue and assessing liquidated damages, if necessary. For each delivery, distributors submit signed receipts and invoices to OSFNS. OSFNS reviews the invoices and supporting

documentation and requests payments through the Financial Management System (FMS), the City's centralized accounting and budgeting system.

### **Objective**

The objective of the audit was to determine the adequacy of DOE payment and contract management controls concerning the provision of food distribution services.

### **Scope and Methodology Statement**

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The primary scope of the audit was Fiscal Year 2010 (July 1, 2009, through June 30, 2010). The primary focus of the audit was the appropriateness of DOE payments to the food distribution vendors. Please refer to the Detailed Scope and Methodology section at the end of this report for a discussion of the specific procedures followed and the tests conducted during this audit.

### **Discussion of Audit Results**

The matters covered in this report were discussed with DOE officials during and at the conclusion of this audit. A preliminary draft report was sent to DOE officials on September 28, 2011, and was discussed at an exit conference held on October 13, 2011. On October 26, 2011, we submitted this draft report to DOE officials with a request for comments. DOE officials provided a written response dated November 9, 2011. The audit makes 14 recommendations to DOE. In their response, DOE officials agreed or partially agreed with 11 recommendations. Officials disagreed with our recommendations to (1) upgrade Usage, (2) ensure that Usage properly distinguishes between purchased and donated foods, and (3) maintain a central inventory system that is linked to Usage.

The officials stated that "while [the] findings were quantitatively insignificant relative to the scale of our operations, several points raised were of interest and will provide us opportunities to further improve our operations." We disagree with DOE's comment regarding the significance of the findings. The purpose of our testing was to assess the payment and contract management controls employed by DOE over food distribution services, not to verify that all monies paid to vendors were appropriate. The dollar amount of the questioned costs is the result of the focused testing in selected areas that we conducted for this audit. The audit does not suggest that the remaining amount that DOE paid for food distribution services in Fiscal Year 2010 is fully supported and accurate.

The full text of the DOE response is included as an addendum to this report.

## FINDINGS AND RECOMMENDATIONS

DOE's payment and contract management controls concerning the provision of food distribution services were insufficient. The audit identified weaknesses in the food delivery payment process and in the monitoring of food distributor performance.

The weak controls resulted in unsupported payments to distributors, failure to receive prompt-payment discounts, and overpayments for donated food. Our analysis of payments made to food distributors in Fiscal Year 2010 identified a total of about \$410,000 that should be recouped. (Payments to food distributors for deliveries to schools in Fiscal Year 2010 totaled \$113.9 million.) This finding is the result of the focused testing we did for this audit and does not suggest that the remaining amount that DOE paid for food distribution services in Fiscal Year 2010 is fully supported and accurate. Table II summarizes the amounts that need to be recouped by DOE for Fiscal Year 2010 based on the results of our audit.

**Table II**  
Summary of Amounts to Be Recouped by DOE

<b>Category</b>	<b>Amount to be collected</b>
Unsupported payments	\$211,556
Discounts not obtained	\$155,896
Overpayments for donated food	\$42,692
<b>Total</b>	<b>\$410,144</b>

In addition, DOE is not closely monitoring the prices charged by manufacturers/suppliers for the food items they provide to the distributors. As a result, DOE is hindered in identifying opportunities to negotiate with the distributors for lower prices. Furthermore, there was insufficient documentation to support DOE's decisions concerning the imposition of liquidated damages for distributors' performance violations. Finally, DOE did not evaluate the performance of the food distribution vendors as required by the contracts and its own procurement manual.

### Weak Controls over Payment Process

#### **Payments to Distributors Not Substantiated**

DOE had weak controls over its food delivery payment process, which resulted in payments to distributors without adequate support. Consequently, in Fiscal Year 2010, DOE made \$211,556 in unsupported payments to the vendors.

To show its Fiscal Year 2010 payments, DOE provided a file from Usage that did not identify about \$2.436 million of the \$113.9 million in payments to food distributors that were shown in FMS. The file failed to capture two Final Weekly Statements (FWSs)—each of which summarized a distributor's invoices for a given week. The FWSs totaled about \$980,000. The file also failed to capture two food items (Corn Bread - Mini Loaf and Fresh Vegetables - Corn) for all four vendors and one item (Fresh Vegetables - Mediterranean Blend) for one vendor, for a total of



\$1.245 million. Although DOE subsequently provided us with the two missing FWSs and payment information about the three excluded food items, we have no assurance that this information was available in Usage when the Finance unit processed the related payments (totaling \$2.225 million). The remaining \$211,556 of the \$2.436 million in payments was not identified on the Usage file. An OSFNS official stated that the agency is working to address technical flaws in Usage that led to these payments not being identified in the system. DOE has not provided supporting documentation to demonstrate that deliveries relating to the \$211,556 in payments actually occurred.

### **Discount-for-prompt-payment Provision Not Consistently Enforced**

DOE did not receive \$155,896 in prompt-payment discounts it was due in Fiscal Year 2010.

The contract states:

The Department shall deduct two percent (2%) from the prices quoted herein (including delivery mark-ups) if payment is mailed within thirty (30) days from receipt of Invoice to Bill Paying Unit and acceptance of a delivery.

According to the contract, if the invoices are paid within 30 days of receipt, the discount should be applied to the full purchase and mark-up cost of distributor-purchased goods but only to the mark-up costs for donated food products. However, DOE has not consistently calculated the discount in accordance with the terms of the contract. To determine the amount of the discounts not recouped by DOE for the payments made to vendors in Fiscal Year 2010, we examined the Usage payment report for Fiscal Year 2010. (The purpose of this report is to provide information on the quantities and dollar amounts of all the items delivered to the schools.) Using this report, we calculated the discounts owed by the vendors for all of the deliveries made during Fiscal Year 2010 and found that DOE was owed a total of \$1.957 million in discounts. However, DOE only received a total of \$1.803 million, resulting in \$155,896 in discounts not having been received.

One cause of this problem appears to have been Usage not properly distinguishing between purchased and donated food items in the discount calculation process. As a result, DOE sometimes received partial discounts for purchased food when it should have received full discounts, and sometimes received full discounts for donated food when it should only have received partial discounts. To ensure that it receives the discounts it is due under the contract, DOE must ensure that Usage accurately distinguishes between purchased and donated food.

### **Inventory Controls Need Improvement**

#### ***Tracking of Donated Goods Delivered to the Schools***

DOE needs to improve its inventory controls concerning the donated food delivered to the schools. As a result of inventory control weaknesses, the donated goods inventory could not be fully accounted for. Donated food items were sometimes sold by vendors to DOE at purchased food prices and were sometimes paid for by DOE without clear evidence that they had been delivered.

In order to assess whether DOE was adequately tracking the donated goods that were delivered to the schools, we matched the quantities delivered to the schools according to the Distributor Order Inventory System (DOIS), the main DOE inventory tracking system, and the payment information (including quantities and amounts) on the Usage year-end report for Fiscal Year 2010.

OSFNS has two different inventory systems to track the donated goods inventory, DOIS and the Food Orders Inventory System (FOIS). DOIS tracks the donated goods at the distributors' warehouses based on Warehouse Receipt Tickets (WRTs) prepared by OSFNS inspectors, who inspect all donated goods delivered to the distributors' warehouses. The inventory information that is on these WRTs is entered into DOIS by OSFNS Inventory unit staff. The donated items are removed from the inventory based on emails or faxes regularly transmitted by the distributors detailing their deliveries of donated food. This information is also entered by Inventory unit staff into DOIS. FOIS is used by the OSFNS Finance unit to match the quantities of donated food that the distributors claim to have delivered to the schools to the quantity data on donated food that OSFNS inspectors entered in FOIS while they were at the distributors' warehouses. However, DOIS and FOIS do not interface. The OSFNS Inventory unit conducts quarterly physical inventory counts to try to reconcile DOIS and FOIS balances.

The Usage payment system is used by the Finance unit as a vendor invoice verification system. As part of the weekly billing process, distributors send food delivery information via email attachments to the Finance unit for uploading into Usage. Before payment, Usage interfaces with FOIS to match a distributor's quantities of donated goods as recorded in FOIS to the quantities the distributor delivered to the schools according to the uploaded data in Usage. This helps DOE determine the quantity of a donated item that should be paid for at the donated food price. Any additional deliveries of that food item are paid for, by default, at the purchase price. However, the Usage and FOIS systems do not communicate with DOIS. The fact that Usage does not interface with DOIS is of concern because DOIS is a newer system with more functionality than FOIS. DOIS also has more current information on food deliveries to the schools than FOIS. FOIS only obtains delivery information during the processing of payment requests.

Our analysis of all Fiscal Year 2010 donated food deliveries disclosed conflicting inventory data in Usage and DOIS and discrepancies between the quantities delivered to the schools and the quantities paid for by DOE. Some discrepancies involved donated items being sold to DOE at purchased-goods prices. Other discrepancies involved DOE paying distributors for donated food items when there was no clear evidence that the items had been delivered to the schools. Consequently, DOE appears to have overpaid food distributors a total of \$42,692 for donated goods for which DOE paid purchased-good prices (\$17,517) or paid for donated food items when there was no clear evidence that the items had been delivered to the schools (\$25,175). Table III shows the identified discrepancies.

**Table III**  
**Food Item Inventory Discrepancies**  
**by Vendor**

	Number of Donated Food Items with Inventory Discrepancies	Quantity of Donated Items Paid for at Distributor-Procured Prices	Quantity of Donated Items Paid for but Possibly Not Delivered	Overpayment due to Donated Items Being Paid for at Distributor-Procured Prices (A)	Payment for Donated Goods Possibly Not Delivered (B)	Total Overpayment to Vendor (A)+(B)
Vendor #1	18	41	86	\$961	\$897	\$1,858
Vendor #2	36	148	566	\$6,801	\$8,202	\$15,003
Vendor #3	22	289	541	\$4,808	\$7,989	\$12,797
Vendor #4	26	309	732	\$4,947	\$8,087	\$13,034
<b>Totals</b>	<b>102</b>	<b>787</b>	<b>1,925</b>	<b>\$17,517</b>	<b>\$25,175</b>	<b>\$42,692</b>

Because DOE has not maintained a fully reliable inventory system for tracking and reconciling donated food quantities delivered to the schools, DOE might be overpaying for donated food. DOE should maintain a central inventory system that is linked to Usage and updated in a timely manner to record the receipt of donated food by the distributors and the delivery of donated food to the schools. This would help reduce the risk of DOE overpaying for donated items or of paying for donated food that was not delivered to the schools at all.

***Tracking of Donated Goods Delivered to Manufacturers***

Our analysis disclosed that distributors have some control over whether they deliver donated or purchased food to the schools. Consequently, there is a risk that distributors could deliver more purchased goods than donated goods to the schools in an effort to increase their reimbursements.

Donated food items are either delivered to manufacturers for processing or to the distributors if the items do not need to be processed. When the schools order these items, distributors either deliver the food available in their warehouses or, if necessary, place an order with the manufacturers to process the food and deliver it to the distributors. The distributors are required to deliver donated food items to the schools before they deliver purchased goods. The school managers who place the orders and the school staff who receive the food are unable to determine whether the products delivered to the schools are donated or purchased goods. There is a risk that distributors could deliver purchased food available in their warehouses rather than order donated food that was available at the manufacturers.

DOE claims that it tracks donated food that is delivered to the manufacturers and does not pay a distributor at the purchased price level until all of a donated food item has been processed by the manufacturers and delivered to the distributors. However, we have no assurance that DOE knows at which point all of a donated food item has been delivered to the distributors because the agency has provided little evidence that it tracks the amount of donated food available at the

manufacturers throughout the year or that this information is used to prevent payments at the purchased price when donated food was available at the manufacturers. Although we found no evidence that food distributors are, in fact, delivering more purchased goods than donated goods to the schools in an effort to increase their reimbursements, we are concerned that DOE controls in this area appear to be insufficient to prevent this from happening.

Consequently, distributors could, if it were financially advantageous for them to do so, deliver purchased food items available in their warehouses when donated quantities of the same food item were available at the manufacturers. Although a distributor's mark-up charges would be the same whether the food item is donated or purchased, a distributor might realize a financial gain if it is able to purchase the food item from the manufacturer at a lower price than the one DOE has already agreed to pay the distributor. This could not happen with most donated food items because DOE negotiates the prices for these items directly with the manufacturers.<sup>1</sup> DOE should effectively track donated food to ensure that all of a donated food item at a manufacturer has been delivered to the distributor before the agency pays its distributor for this item at the purchased price.

### ***Delivery Receipts***

The OSFNS Finance unit processes distributor payments by comparing the quantities on the receiving reports to delivery information in Usage. However, DOE relies on receiving reports that are provided by the distributors rather than by the schools themselves. Although the receiving reports are purportedly signed by school officials, the reports would be more reliable if they were provided directly to OSFNS by the schools. This would reduce the risk that the receiving reports could be altered or signed by vendors in place of school personnel.

### **DOE Is Not Closely Monitoring Manufacturers'/Suppliers' Prices**

DOE is not closely monitoring the prices charged by manufacturers or suppliers for the food items they provide to the distributors in order to identify opportunities to negotiate with the distributors for lower prices.

According to the contract:

The New York City Department of Education reserves the right to request Voluntary Price Reductions in the event that any of the price(s) quoted are deemed high on the individual items or services. Voluntary Price Reductions are permitted both before and after award, as long as consented to by both parties.

Although prices are set at the time of the awarding of the contract and adjusted over time based on Producer Price Indexes,<sup>2</sup> it is important for DOE to monitor manufacturers'/suppliers' prices to determine whether there are opportunities to negotiate lower prices when the costs of certain food items decrease. Based on our comparison of manufacturer and distributor prices for a sample of 10 distributor-procured food items, we estimate that, in Fiscal Year 2010, the distributors charged DOE about \$77,000 more than the manufacturers/suppliers charged the distributors. For a

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<sup>1</sup> Approximately 24 percent of all food items are priced according to contracts OSFNS has with the manufacturers.

<sup>2</sup> The U.S. Bureau of Labor Statistics's Producer Price Indexes track prices of goods at the wholesale level.

total of 40 items (the same 10 items distributed by four different vendors), the distributors charged DOE higher prices than the manufacturers' prices for 20 of these items. For example, one distributor charged DOE \$75.98 per case for one item while the price it paid its manufacturer was \$60.84 per case. Another vendor charged DOE \$71.54 per case for the same item while the price it paid its manufacturer was \$61.38 per case. Table IV shows the differences between the distributors' prices and their manufacturers' prices.

**Table IV**  
**Comparison of Distributors' and Manufacturers' Prices**  
**for 10 Food Items\***

Item Code		BF F012	BF P129	BF P130	BF FS068	BF FS507	G 26010	G 19010	G 10036	PR D047	PR D083/ PR D058
Distributor #1	Manufacturer Price	20.01		47.50	40.52		50.15		39.95	60.84	26.40
	Distributor Price	21.37		49.73	43.28		50.63		43.11	75.98	38.79
Distributor #2	Manufacturer Price					17.28	49.90				
	Distributor Price					17.64	49.94				
Distributor #3	Manufacturer Price		47.50	47.50	43.28	17.28	50.15		39.45	60.48	
	Distributor Price		49.73	49.73	45.02	17.64	51.14/ 50.29		39.95	70.13 / 65.70	
Distributor #4	Manufacturer Price		47.50	47.50			50.15			61.38	
	Distributor Price		49.73	49.73			51.12			71.54	

\*Distributors' prices do not include mark-up prices.

Note: Blank boxes in the table indicate that the distributor's and manufacturer's prices were the same (for 10 of the 40 items), that the manufacturer's price exceeded the distributor's price (for seven of the 40 items), or that DOE was unable to obtain the manufacturers' invoices (for three of the 40 items).

According to DOE officials, brand analyses<sup>3</sup> are periodically done to monitor manufacturers'/suppliers' prices. However, according to evidence provided by DOE, the last brand analysis was performed in Fiscal Year 2008, and at that time only a few items were reviewed.

Had DOE been consistently monitoring manufacturers'/suppliers' prices, it would have been in a better position to negotiate lower prices with the distributors. If our analysis resulted in a significant difference for Fiscal Year 2010 for only 10 items per distributor, we can reasonably assume that a full review of the hundreds of remaining products would identify substantially more opportunities to negotiate lower prices and save DOE money.

DOE officials state that it is sometimes difficult to ask distributors to voluntarily reduce prices when the manufacturers'/suppliers' prices have fallen below the distributors' bid prices, since

<sup>3</sup> According to DOE, a brand analysis is a comparison of distributor and manufacturer prices for a sample of items to identify items for which the distributors are charging DOE more than the manufacturers' net prices. According to the contract: "Net cost is defined as delivered cost to awarded Vendor's distribution center, including all (less any) rebates, allowances, discounts, and incentives."

DOE will not increase its payments to distributors simply because the manufacturers' prices have risen above the distributors' bid prices. DOE also provided evidence that it periodically asks the distributors to identify opportunities for voluntary price reductions and that this approach has achieved some success. However, we believe that by more systematically collecting information on manufacturers'/suppliers' prices, DOE will be in a better position to negotiate fair food prices with the distributors during the course of their contracts.

### **Recommendations**

DOE should:

1. Upgrade Usage so that it maintains complete payment information.

**DOE Response:** "The DOE disagrees with the recommendation, as the referenced system does maintain complete payment support information while actual payment information is maintained in the Department's FAMIS system. There is no need to maintain payment information on multiple systems.

"We do review our processes and their supporting systems on an on-going basis to implement improvements as possible and appropriate. We will ensure that complete payment information is properly maintained by the respective units and will conduct periodic reconciliations by reviewing reports generated from the Usage System and FAMIS for data accuracy and consistency."

**Auditor Comment:** In the Background section of its response, DOE states that "the Usage system documents and maintains all entries (manual adjustments and system-generated transactions) in order for the Accounts Payable Unit to make accurate payment entries into FAMIS/FMS." However, the evidence indicates otherwise. As stated in the report, our review of Usage and FMS data identified about \$410,000 in payment discrepancies that is not supported in Usage and which DOE has not been able to explain (see DOE's response to Recommendations 3, 5, and 6).

Furthermore, because the payment information, including discount calculation, is processed in Usage and transferred into FAMIS and FMS, it is essential that Usage have complete payment information to assure proper payment to vendors. Therefore, we reaffirm our recommendation and maintain that Usage should be upgraded.

2. Ensure that there is proper support for deliveries made by distributors before payments are processed.

**DOE Response:** "DOE agrees with the recommendation, but notes that such support is already required before payments are processed. As already stated, we review processes and their supporting systems on an on-going basis to implement improvements. If discrepancies are discovered, we take corrective action and modify our processes and systems as appropriate."

**Auditor Comment:** As noted in our comment concerning DOE's response to Recommendation 1, based on our review of Usage and FMS data, our audit identified about \$410,000 in payment discrepancies that DOE has not been able to explain. Although DOE states that "support is already required before payments are processed," DOE was not able to provide supporting documentation for \$410,000 of its payments for food deliveries in Fiscal Year 2010, an indication that this requirement is not being adequately enforced.

3. Recoup the \$211,556 in unsupported payments to the vendors.

**DOE Response:** "DOE agrees that the referenced amount is not supported by the information provided to the audit team. Upon the auditors' provision of additional information after the preliminary draft exit conference, we were able to conduct further review of our records and have already begun the reconciliation process.

"... We are, therefore, reviewing Usage data for the full fiscal year only against FAMIS data for the corresponding period to determine if this is the source of the remaining discrepancies.

"We will take the necessary corrective action, including recoupment of overpayments, should it be concluded that overpayments were, in fact, made."

**Auditor Comment:** Based on our extensive analysis of this matter and on the numerous opportunities we provided to DOE to refute this finding, we continue to believe that the entire amount should be recouped by DOE.

4. Ensure that Usage properly distinguishes between purchased and donated food items during the discount calculation process.

**DOE Response:** "DOE disagrees with this recommendation as discounts are calculated on the basis of the total payment due. While distinguishing between purchased and donated food items is essential to calculating the total payment due (and our processes and systems properly support such calculations), once that amount is calculated, distinguishing between purchased and donated food items is entirely irrelevant to the calculation of the discounts referenced. Accordingly, no corrective action is required."

**Auditor Comment:** Usage does not calculate discounts based on the total amount due to a distributor but rather calculates the discount for each item based on whether the item is purchased or donated. In addition, we disagree with DOE's assertion that distinguishing between purchased and donated food items in Usage is irrelevant with regard to the discount calculation process. As we state in the report, DOE failed to recoup \$155,896 in discounts from the vendors, in part because Usage did not properly distinguish between purchased and donated food items. As a result, DOE sometimes received partial discounts for purchased food when it should have received full discounts, and sometimes received full discounts for donated food when it should only have received partial discounts. Therefore, we reaffirm this recommendation.

5. Recoup \$155,896 in discounts from the vendors.

**DOE Response:** “Although DOE agrees that the payment in the referenced amount is not supported by the information provided to the audit team, we currently are not prepared to agree with the recommendation for recoupment inasmuch as we have not concluded our own review of payment information. We have determined that from 7/10/2009 – 12/22/2009, the automated 2% prompt payment discount deduction feature in FAMIS was inoperable and manual prompt payment discounts had been made. We have initiated an internal audit to determine the source of the discrepancy identified by the auditors and will take the necessary corrective action, including recoupment of overpayments, should it be demonstrated that overpayments were, in fact, made.”

**Auditor Comment:** Based on our extensive analysis of this matter and on the numerous opportunities we provided to DOE to refute this finding, we continue to believe that the entire amount should be recouped by DOE.

6. Recoup \$42,692 for the donated goods for which DOE either paid purchased-good prices (\$17,517) or paid donated prices when there was no clear evidence that the items had been delivered to the schools (\$25,175).

**DOE Response:** “DOE agrees that the payment in the referenced amount is not supported by the information provided to the audit team, but cannot at this time agree with the amount recommended for recoupment until an internal audit determines the source of the discrepancies identified by the auditors. The DOE will take the necessary corrective action, including recoupment of overpayments, should it be demonstrated that overpayments were made, and, will enhance internal controls to ensure that transactions involving donated goods are properly entered and reconciled monthly.”

**Auditor Comment:** Based on our extensive analysis of this matter and on the numerous opportunities we provided to DOE to refute this finding, we continue to believe that the entire amount should be recouped by DOE.

7. Maintain a central inventory system that is linked to Usage and tracks in a timely manner the receipt of donated food by the distributors and the delivery of donated food to the schools.

**DOE Response:** “DOE disagrees with the recommendation, as our current processes and their supporting systems provide the functionality outlined and required, though not, as the report notes, in a single system. We are unconvinced that there is a significant benefit to be derived from a single system as recommended. Accordingly, no corrective action is required.”

**Auditor Comment:** As we explain in the report, DOE maintains two different inventory systems that do not interface. In addition, the system that has the most current food delivery information (i.e., DOIS) relies to a large extent on office staff manually entering data from Warehouse Receipt Tickets prepared by the inspectors and food delivery information faxed



by the distributors. Combining the two inventory systems into one that is linked to Usage and that relies less on the manual entering of data would help improve the accuracy of the food delivery information in Usage and the payments to distributors, thereby reducing the risk that inappropriate payments will occur. Therefore, we reaffirm this recommendation.

8. Track donated food at the manufacturers to ensure that as long as a donated food item is available at a manufacturer, the agency is only paying the donated food price for that item.

**DOE Response:** “DOE agrees with the recommendation and will implement a process to track the receipt of donated food from the time of its delivery to manufacturers through its delivery to our distributors to ensure that all donated food is utilized as efficiently as possible.”

9. Obtain and use receiving reports from the schools rather than from the distributors to verify delivery information in Usage.

**DOE Response:** “At present, payments are made on the basis of copies of receipts signed and submitted by School Food personnel, which are provided to our Accounts Payable Department by vendors. DOE will consider this recommendation and explore the logistics on how to implement such a complex project for over 1200 schools in a timely manner.”

10. More closely monitor manufacturers’/suppliers’ prices to identify opportunities to negotiate lower food prices with the distributors.

**DOE Response:** “DOE agrees with the recommendation, but does not agree to take ‘corrective action’ inasmuch as we already closely monitor manufacturers’/suppliers’ prices to identify opportunities to negotiate lower food prices with the distributors.

“Under Section 1.7 of the contract, ‘Distributor procured items must reflect the manufactures net invoice price for the first year thereafter all pricing will be contingent on the PPI adjustment or price reductions offered to the DOE.’ We rigorously adhere to this contract term. When the prices we pay to our distributors rise more rapidly than the prices our distributors pay to manufacturers, we cannot unilaterally reduce prices, but can, and do, request Voluntary Price Reductions of our vendors. In fact, evidence that this practice has resulted in savings to the DOE was presented to the auditors. Moreover, as the auditors are also aware, the DOE has the option to discontinue items when pricing has risen as a result of PPI adjustments, an option we have exercised when appropriate and will continue to do so.”

**Auditor Comment:** DOE provided little evidence that it is actively monitoring manufacturers’/suppliers’ prices to negotiate with the distributors for better prices. DOE primarily relies on the distributors to identify opportunities for price reductions.

## Inadequate Contract Management

### **Liquidated Damages Provision**

The contract allows DOE to assess liquidated damages for instances of non-compliance, such as non-deliveries of ordered food items or late or incomplete deliveries. The contract also specifies penalties associated with such violations. However, there was insufficient documentation to support DOE's decisions concerning the imposition of liquidated damages for distributors' performance violations.

As stated in the food distribution contracts, the normal procedure for handling non-compliance is for DOE to identify distributor violations and, if the non-compliance is not corrected within 24 hours, to impose liquidated damages. However, DOE rarely imposes liquidated damages. According to OSFNS officials, even if the non-compliance is not resolved within 24 hours, the violation can be waived if the distributor subsequently provides documentation showing that the imposition of liquidated damages would be inappropriate because the distributor was not at fault. For example, a distributor might be unable to deliver an ordered food item to a school on time because the manufacturer did not deliver the food item to the distributor in a timely manner.

According to data obtained from DOE, of the 83,852 orders placed with the distributors in Fiscal Year 2010, violations were assessed for 8,144 (9.7 percent) of them. The disposition of those violations, segregated by vendor, is shown in Table V.

**Table V**  
Disposition of Violations Issued in FY 2010

Distributor	Total Orders	Total Violations	Resolved within 24 hours	Not resolved within 24 hours	
				Liquidated Damages Imposed	Liquidated Damages Waived
Vendor #1	4,935	30	14	0	16
Vendor #2	24,154	436	363	0	73
Vendor #3	41,506	3,480	2,115	107	1,258
Vendor #4	13,257	4,198	3,049	85	1,064
<b>Totals</b>	<b>83,852</b>	<b>8,144</b>	<b>5,541</b>	<b>192</b>	<b>2,411</b>

DOE determined that 5,541 (68 percent) of the 8,144 violations were resolved within the 24-hour grace period and were, therefore, not subject to liquidated damages. Of the remaining 2,603 violations, DOE waived 2,411 (93 percent) of them and imposed liquidated damages for only 192 (7 percent) of them.

Regarding the waivers granted, we noted that there was a heavy reliance on assertions and documentation provided by the distributors in the processing of their requests for waivers. We found little evidence that OSFNS corroborates the evidence provided by distributors by contacting the schools. Additionally, our review of a limited number of waivers found inconsistencies in the

evidence provided. For example, some of the waivers were granted without any supporting documentation or explanation provided. For some, there was no indication (i.e., reviewer's initials) of who granted the waivers. In other instances, the waivers were granted even though the documentation provided by the distributors only confirms that the deliveries were made after the grace period. In one case we reviewed, a waiver was granted even though the distributor simply provided the original receiving report that showed that the food item had not been delivered.

To protect against the risk that waivers may be granted inappropriately, DOE should obtain corroborating evidence from the schools to determine whether the explanations provided by the distributors are valid. This would also help ensure that the distributors are meeting the performance standards of the contract and that liquidated damages are imposed when they are not.

On a related matter, when we reviewed a sample of 155 receiving reports, we noted that school personnel's signatures on 36 (23 percent) of them were undated. It is important that school personnel date their signatures on the receiving reports so that liquidated damages can be imposed for failure to deliver ordered food in a timely manner.

### **Required Performance Evaluations Not Conducted**

DOE did not evaluate the performance of the food distribution vendors as required by the contracts and its own procurement manual.

The contract provides for the evaluation of vendor performance. The contract states that "The Department will be tracking and managing repeated instances of non-compliance [such as late or incomplete deliveries]. ... The number of instances of non-compliance for each Distributor will be compared to the number of deliveries made in that same time period in order to generate a percentage." If this percentage exceeds 2.75 percent, a written corrective action plan should be required from the distributor. Additional steps should be taken if the percentage exceeds 3.25 percent or if the problem continues in subsequent time periods.

DOE provided some evidence that it calculated percentages relating to the vendors' violations and food deliveries; however, the percentages were not those envisioned by the contract. Instead of calculating the percentage of each distributor's deliveries for which there were violations, as specified in the contract, DOE calculated the percentage of each distributor's deliveries for which there were violations that led to the imposition of liquidated damages, which is a very small subset of all violations. However, delivering an order late is still a violation even if the item is delivered within the 24-hour grace period. Completing a late delivery within the grace period simply eliminates the possibility that liquidated damages can be imposed for the late delivery.

The violation percentages as calculated by DOE and as defined in the contract are shown in Table VI.

**Table VI**  
Distributors' Violation Percentages as per  
DOE and Contract Calculation Methods

<b>Column A</b>	<b>Column B</b>	<b>Column C</b>	<b>Column D</b>	<b>Column E</b>	<b>Column F</b>
<b>Distributor</b>	<b>Unwaived Violations*</b>	<b>Liquidated Damages Imposed (subset of Col. B)</b>	<b>Total Orders</b>	<b>Violation % as per DOE Calculation Method (Col. C/Col. D)</b>	<b>Violation % as per Contract Calculation Method (Col. B/Col. D)</b>
Vendor #1	14	0	4,935	0.00%	0.28%
Vendor #2	363	0	24,154	0.00%	1.50%
Vendor #3	2,222	107	41,506	0.26%	5.35%
Vendor #4	3,134	85	13,257	0.64%	23.64%
<b>Totals</b>	<b>5,733</b>	<b>192</b>	<b>83,852</b>	<b>0.23%</b>	<b>6.84%</b>

\*To be conservative, violations for which the payment of liquidated damages was waived are omitted.

As shown in the table above, the violation percentages for the four vendors in Fiscal Year 2010 as per DOE's method of calculation ranged from 0.0 percent to 0.64 percent. However, by the contract's method of calculation, the violation percentages ranged from 0.28 percent to 23.64 percent, the latter percentage presenting significant performance concerns. Additionally, to be conservative, we excluded waived violations from these calculations because some of them related to situations in which the distributor was not at fault, such as those situations in which a manufacturer was unable to deliver a food item to a distributor in a timely manner. Nevertheless, a number of waivers in the limited number we reviewed involved the distributor providing some evidence that the item was delivered late but within the grace period. In such situations, the violations are still warranted.

According to its Procurement Policy and Procedures manual, DOE is required to consider a contractor's performance when determining whether an existing contract should be renewed, extended, allowed to lapse, or terminated. Although requested, DOE provided us with no evidence that it formally evaluated vendor performance before renewing five food distribution vendor contracts in 2010.

By not properly evaluating vendor performance, DOE is not ensuring that vendors are effectively complying with the terms of their contracts. DOE also does not appear to be carefully reviewing vendor performance before it renews vendor contracts.

**Recommendations**

DOE should:

11. Obtain corroborating evidence from other sources (such as the schools or the manufacturers) before accepting distributors' arguments that their violations should be waived.

**DOE Response:** "We agree with the recommendation.

“That said, it is important that we clearly state our position which is that it is not the DOE’s objective to assess liquidated damages for late delivery of food, but to ensure, rather, that violations are cured and overall service is improved so that the schools receive the quantity and quality of food needed to serve students.

“As a point of further clarification, the contract allows a distributor to cure a violation for late delivery within twenty-four hours. Because our best interests are served by providing an incentive to get the food to where it is needed, we see the twenty-four hour cure provision as a positive. Further, as a matter of equity, the contract provides a mechanism whereby a violation can be waived if the distributor can demonstrate by providing a letter from the manufacturer that the late delivery was caused by the manufacturer, not the distributor.

“What the DOE is agreeing to do in response to the recommendation is improve its process for determining whether liquidated damages should be assessed by reviewing field personnel reports or verifying directly with the school or manufacturer whether there exist grounds for curing/waiving the violation.”

**Auditor Comment:** We do not dispute DOE’s position that its objective is to ensure that violations are cured and overall service is improved. However, the assessment of liquidated damages is a tool intended to assist DOE in achieving that objective. As indicated in the report, vendor #4 had 1,149 violations assessed against it that were subject to liquidated damages—DOE waived liquidated damages for 1,064 (93 percent) violations and assessed liquidated damages for only 85 (7 percent) of them. Meanwhile, this same vendor had violations issued for almost one-third (4,198)<sup>4</sup> of its 13,257 food orders. By limiting its utilization of liquidated damages, DOE may be likewise limiting its ability to ensure that its overall objectives regarding the delivery of food services are met.

12. Ensure that school personnel date their signatures on the receiving reports.

**DOE Response:** “DOE agrees with the recommendation since dated signatures are already required on receiving reports. We review personnel’s compliance with established procedures on an on-going basis and take corrective action when instances of non-compliance are identified. No further corrective action is required.”

**Auditor Comment:** Although school personnel may be required to date their signatures on receiving reports, our audit found that this requirement is not being adequately enforced. As we state in the report, when we reviewed a sample of 155 receiving reports, we noted that school personnel’s signatures on 36 (23 percent) of them were undated. Based on this result, we believe that further action in this area is required.

13. Evaluate vendor performance on a regular basis as required by the contract and its own procurement manual.

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<sup>4</sup> This figure includes 3,049 violations that were not subject to liquidated damages because they were reportedly resolved within 24 hours.

**DOE Response:** “DOE agrees with the recommendation inasmuch as vendor performance is already reviewed on a regular basis in accordance with the referenced contract and our own internal procedures. At present, we meet periodically with each vendor individually to review the vendor’s performance. More frequent meetings will occur on a case-by case-basis. We are in the process of improving our vendor performance review procedures in order to provide more detailed metrics on an on-going, rather than periodic, basis.

“Accordingly, no corrective action is required.”

**Auditor Comment:** DOE has provided no evidence in support of its assertion that it reviews vendor performance in accordance with the contract and its own internal procedures. As stated in the report, instead of calculating the percentage of each distributor’s deliveries for which there were violations, as specified in the contract, DOE calculated the percentage of each distributor’s deliveries for which there were violations that led to the imposition of liquidated damages, which is a very small subset of all violations. Furthermore, as also stated in the report, DOE provided us with no evidence that it formally evaluated vendor performance, as required by its own procedures, before renewing five food distribution vendor contracts in 2010. Based on these results, we believe that corrective action in this area is required.

## **Other Matter**

### **No Price Analysis Conducted**

DOE did not conduct an analysis to determine whether the contract prices it pays its food distribution vendors are fair and reasonable. DOE’s *Procurement Policy and Procedures* manual states that the agency “may use price analysis and/or cost analysis” in an effort to ensure that “the contract price is fair and reasonable.” Although such an analysis was not required, considering the high cost of these contracts, such an analysis would have been appropriate. This is especially so considering that, according to a contract analysis conducted by DOE in 2006, about 51 percent of the total dollar value of these contracts relates to the distributors’ mark-up charges (and, therefore, only 49 percent relates to the cost of the food itself).

For the five 2006 contracts, the mark-up prices as of April 15, 2010, ranged from \$4.66 to \$7.51 per case for more than four-fifths (83 percent) of the food items delivered by the distributors. Most of the prices in this range were recurring and applied to a wide variety of items without regard to the price of the item. For example, one distributor charged \$7.51 to deliver a case of “Beef – Gyro Strip” costing \$54.32 and the same \$7.51 amount to deliver a case of “Eggplant, Breaded” costing \$15.76. We also noted that for one-fifth of the items, the markup increased the price of the item by at least 50 percent; for about three-tenths of these items, the markup increased the price of the item by at least 100 percent.

School districts in some other localities pay the distributors a certain percentage of the cost of each food item they deliver rather than pay the same mark-up amounts for a wide variety of different items with different costs. DOE should survey school districts in other localities to review their methods for determining the appropriate prices to pay school food distributors. Although DOE

may ultimately conclude that the current pricing mechanism is appropriate, we still believe that it is worthwhile to conduct this type of price analysis considering the high percentage of DOE's food distribution costs relating to mark-up charges.

### **Recommendation**

14. DOE should conduct an analysis to determine whether the contract prices it pays its food distribution vendors are fair and reasonable.

**DOE Response:** "The Division of Contracts and Purchasing is responsible for preparing a price analysis at the time of bid evaluations.

"DOE agrees that a formal analysis should have been conducted. ... The annual cost of each awarded contract was over \$10 million and a formal price analysis should have been conducted. However, since the only place the bidder could include their profit margin was in the delivery mark up which the amount was under \$10 million and since this was a bid and there was competition (eight bidders participated) prices were validated as fair and reasonable.

"Additionally, research was conducted by Accenture, the DOE's contracted consulting firm, during the time of contract development. Based on the research done, the bid structure used was considered the most effective for our organization. In preparation for the new food distribution bid, the DOE will review how other large-scale educational systems engage similar vendors to determine if a better model exists."

**Auditor Comment:** Even if the delivery mark-up amounts for each contract were under \$10 million, it would have been in the best interest of DOE to conduct cost-price analyses to help ensure that it received fair and reasonable bids for these services.

## DETAILED SCOPE AND METHODOLOGY

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This audit was conducted in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

The primary scope of the audit was Fiscal Year 2010 (July 1, 2009, through June 30, 2010).

To gain an understanding of DOE's contracts with its school food distribution vendors, we interviewed DOE officials, conducted walk-throughs and observations of DOE units that manage these contracts, and reviewed the contracts and applicable policies and procedures.

We reviewed any available evaluations of distributor performance as well as the liquidated damages history for each distributor for Fiscal Years 2009 and 2010.

Furthermore, to review DOE controls over its payment process, we randomly selected and examined a sample of 25 voucher payments (totaling \$9.3 million) from a population of 408 voucher payments made to food distributors in Fiscal Year 2010. The number of vouchers reviewed for each distributor was proportionate to the total payments made to each distributor. We examined supporting documentation related to these voucher payments to determine whether the payments were accurate and properly approved. We also reviewed the delivery receipts for one day for each of two randomly selected distributors to determine whether they were signed and dated by the receivers at the schools.

To determine whether distributors were paid only for goods shipped to the schools, we compared the quantities of food items corresponding to the \$113.9 million in Fiscal Year 2010 payments to distributors to the quantities delivered to the schools during this period. To determine whether DOE consistently recouped the 2 percent prompt-payment discount from distributors' payments as required by the contract, we calculated the discounts the distributors owed DOE for the purchased and donated food delivered to the schools in Fiscal Year 2010. We then compared our calculated discount amounts to the discount amounts recouped by DOE according to FMS.

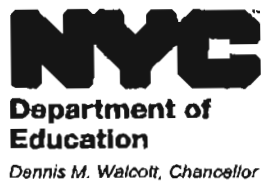
To evaluate controls over the donated-food inventory and to determine whether donated food was sold at donated—rather than purchased—food prices, we compared the quantities of donated food items delivered to the schools in Fiscal Year 2010 based on inventory records to the quantities paid for according to Usage.

To determine whether distributors were offering goods to DOE at the manufacturers' net costs, we selected 10 high-volume items and compared the distributors' prices as reflected on FWSs to the manufacturers' prices as reflected on the manufacturers' corresponding invoices.



To determine whether DOE provided us with a complete and accurate listing of all voucher payments for Fiscal Year 2010, we compared the listing of all voucher payments from DOE's Financial Accounting Management Information System (FAMIS) to a listing of such payments from FMS. FAMIS is used by DOE to process financial information and interfaces with FMS, which processes vendors' payments. We examined the listings for accuracy and consistency of amounts paid and discounts recouped.

The results of the above tests, several of which related to the entire population of Fiscal Year 2010 payments and a few of which related to samples that were not statistically projected to their respective populations, provide a reasonable basis for us to assess the adequacy of DOE's payment and contract management controls concerning the provision of food distribution services.



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November 9, 2011

Tina Kim  
Deputy Comptroller for Audits  
NYC Office of the Comptroller  
1 Centre Street, Room 1100  
New York, New York 10007-2341

Dear Ms. Kim

Breakfast. Lunch. Snack. Supper. Every school day, including summer months, during holidays, and weekends, in cafeterias and classrooms and afterschool program spaces, the New York City Department of Education Office of School Food and Nutrition Services provides low-cost meals that meet or exceed federal nutritional standards. On average, more than 224,000 breakfasts and 648,000 lunches are served to children each day of the school year. This enormous undertaking - the largest of any city in the country by far - requires the concerted efforts of a team comprised of chefs, food service managers, cooks and kitchen staff, administrators, technology staff, accountants and suppliers.

Within that latter group are four food distribution vendors tasked with acquisition of food products; warehousing; distribution services; program management; tracking inventory of donated commodities; and, creating and maintaining information technology systems that allow for and/or support online ordering, summary billing, and electronic invoicing, reporting and inventory management. During the period of the audit, Fiscal Year 2010, these vendors delivered food to over 1,200 separate locations around the City. In this time, School Food payments totaling \$186.7 million were processed of which over \$114 million were made to the four major food distributors within the 30 days of receipt of invoice to ensuring prompt payment discounts totaling \$2.4 million.

We welcomed the Comptroller's audit team and cooperated fully with their work. While their findings were quantitatively insignificant relative to the scale of our operations, several points raised were of interest and will provide us opportunities to further improve our operations.

Please find our responses to their recommendations attached.

Sincerely,

A handwritten signature in black ink, appearing to read "Eric Goldstein".

Eric Goldstein

Audit Report on the Department of Education  
Food Distribution Vendor Contracts  
ME10-144A

Office of SchoolFood Response to the NYC Comptroller

November 9, 2011

**Audit Title and Number: *Audit Report on the Department of Education Food Distribution Vendor Contracts ME10-144A***

## BACKGROUND

The Office of SchoolFood (OSF) manages the Department of Education's (DOE) food service program and is responsible for ensuring that safe, nutritious, and appetizing meals are available to New York City students. Select staff within OSF designs the breakfast, lunch, snacks and supper menus, selects the components and ingredients that make up each meal, and place orders with contracted distributors according to the required quantities. They also perform tests to ensure that the food provided under the Department's meal programs meet the highest health and taste standards.

OSF currently provides over 850,000 meals a day to schoolchildren within the five boroughs of New York City. Meals are currently provided at over 1200 locations each school year and over 1150 locations during the summer months. The Department and SchoolFood seek to increase participation by offering more nutritious and delicious breakfasts, lunches, snacks and suppers, and further develop healthy eating habits within the student body. The breadth of product purchased by the DOE for the Food Program includes frozen foods, fresh produce, snack, grocery and non-food related cafeteria items, dairy, and baked goods.

The scope of food distribution includes acquisition, storage, handling, distribution of food products (Frozen, Grocery and Produce) integration and distribution of donated goods and program management.

### Donated Commodities

Each year OSF accepts donated commodities from the New York State Office of General Services (OGS). Items accepted as Donated Commodities from OGS may include fresh produce, grocery, and frozen products.

There are two types of accepted donated commodities. *Donated items* which are finished products and require no processing are delivered by OGS to the Department's designated distributor warehouses for storage and distribution. Examples of donated product may include canned green beans or fresh pears. These products are shipped from the state to the distributor's warehouses based on a schedule determined by OSF. Distributors warehouse and deliver the donated commodities as requested by OSF throughout the year. OSF also accepts *raw donated product* from the state. This may include raw ground beef or whole raw chickens. This raw product is shipped directly to manufacturers for further processing into finished OSF specified items. Examples of donated processed items include broiled beef patties and breaded chicken nuggets. These processed items are then shipped to the Department's food distributors per their orders.

### Contract Direct Scope-

OSF has direct contracts with manufacturers for our high volume items. A majority of these items contain raw donated product which is accepted by the state (OGS) each year. For all donated processed items, manufactures are required to bid two prices. One price is for the commercial version (containing no donated product) and the second price is the donated version (contains raw donated product). Upon acceptance of raw donated commodities from OGS, the

**Audit Title and Number: *Audit Report on the Department of Education Food Distribution Vendor Contracts ME10-144A***

raw product is delivered directly to the DOE contracted manufacturer who in turn produces the donated version of the item (donated processed commodity). The distribution and ordering of all food and related items under these direct contracts are performed by our contracted food distributors. Distributors will place orders with the awarded vendor(s) of these Contract Direct bids at the contracted price(s), receive and warehouse the products, and deliver the items to the schools and locations within the Department.

Payments to Vendors

The Usage system documents and maintains all entries (manual adjustments and system-generated transactions) in order for the Accounts Payable Unit to make accurate payment entries into FAMIS/FMS. Contracted prices are entered into the Usage System by the Contract Management Unit. Electronic invoices are provided to Accounts Payable from vendors based on deliveries and are uploaded into Usage System.

Accounts Payable receives copies of the delivery receipts from the vendors signed by SchoolFood personnel confirming the items and volumes delivered to the school. Accounts Payable reviews the electronic invoices data against the signed delivery receipts and contacts SchoolFood personnel to reconcile discrepancies when applicable. The Final Weekly Statement is printed from the Usage System and submitted to Inventory Management Unit for a final reconciliation of donated product deliveries. If reconciliation is not required, Accounts Payable will process invoice. Accounts Payable will receive liquidated damages assessed to the vendor via the violations system and applicable charges are automatically deducted from the Final Weekly Statement which is then utilized to enter a payment transaction into FAMIS/FMS.

**Audit Title and Number: *Audit Report on the Department of Education Food Distribution Vendor Contracts ME10-144A***

The following pages contains the Department of Education's responses to the recommendations outlined in the NYC Comptroller's Audit Report on the Department of Education Food Distribution Vendor Contracts.

**Audit Title and Number: *Audit Report on the Department of Education Food Distribution Vendor Contracts ME10-144A***

**PAYMENTS TO DISTRIBUTORS NOT SUBSTANTIATED**

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**Recommendation 1**

***DOE should upgrade Usage so that it maintains complete payment information.***

**Corrective Action Response**

The DOE disagrees with the recommendation, as the referenced system does maintain complete payment support information while actual payment information is maintained in the Departments' FAMIS system. There is no need to maintain payment information on multiple systems.

We do review our processes and their supporting systems on an on-going basis to implement improvements as possible and appropriate. We will ensure that complete payment information is properly maintained by the respective units and will conduct periodic reconciliations by reviewing reports generated from the Usage System and FAMIS for data accuracy and consistency.

**Recommendation 2**

***DOE should ensure that there is proper support for deliveries made by distributors before payments are processed.***

**Corrective Action Response**

DOE agrees with the recommendation, but notes that such support is already required before payments are processed. As already stated, we review our processes and their supporting systems on an on-going basis to implement improvements. If discrepancies are discovered, we take corrective action and modify our processes and systems as appropriate.

**Recommendation 3**

***DOE should recoup the \$211,556 in unsupported payments to the vendors.***

**Corrective Action Response**

DOE agrees that the referenced amount is not supported by the information provided to the audit team. Upon the auditors' provision of additional information after the preliminary draft exit conference, we were able to conduct further review of our records and have already begun the reconciliation process.

Although it was not our intention to do so, it is likely that our response to the auditors' request for records created some confusion. The information that had been provided to auditors from the Usage system was for full weeks from the week ending 7/4/09 through the week ending 6/26/10. However, the payment information from FAMIS was for the fiscal year only, that is, 7/1/2009 – 6/30/2010. Accordingly, the Usage system data included information on deliveries from 6/28 – 30/2009 which were not part of the fiscal year and excluded information on deliveries from 6/27 – 30/2010, which were. We are, therefore, reviewing Usage data for the full fiscal year only

**Audit Title and Number: *Audit Report on the Department of Education Food Distribution Vendor Contracts ME10-144A***

against FAMIS data for the corresponding period to determine if this is the source of the remaining discrepancies.

We will take the necessary corrective actions, including recoupment of overpayments should it be concluded that overpayments were, in fact, made.

***Discount for Prompt Payment Provision Not Consistently Enforced***

**Recommendation 4**

***DOE should ensure that Usage properly distinguishes between purchased and donated food items during the discount calculation process.***

**Corrective Action Response**

DOE disagrees with this recommendation as discounts are calculated on the basis of the total payment due. While distinguishing between purchased and donated food items is essential to calculating the total payment due (and our processes and systems properly support such calculations) once that amount is calculated, distinguishing between purchased and donated food items is entirely irrelevant to the calculation of the discounts referenced. Accordingly, no corrective action is required.

**Recommendation 5**

***DOE should recoup the \$155,896 in discounts from the vendors.***

**Corrective Action Response**

Although DOE agrees that the payment in the referenced amount is not supported by the information provided to the audit team, we currently are not prepared to agree with the recommendation for recoupment inasmuch as we have not concluded our own review of payment information. We have determined that from 7/10/2009 – 12/22/2009, the automated 2% prompt payment discount deduction feature in FAMIS was inoperable and manual prompt payment discounts had been made. We have initiated an internal audit to determine the source of the discrepancy identified by the auditors and will take the necessary corrective action, including recoupment of overpayments, should it be demonstrated that overpayments were, in fact, made.



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**INVENTORY CONTROLS NEED IMPROVEMENT**

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**Tracking of Donated Goods Delivered to Schools**

**Recommendation 6**

*DOE should recoup the \$42,692 for the donated goods for which DOE either paid purchased-good process (\$17,517) or paid donated prices when there was no clear evidence that the items has been delivered to the schools (\$25,175).*

**Corrective Action Response**

DOE agrees that the payment in the referenced amount is not supported by the information provided to the audit team, but cannot at this time agree with the amount recommended for recoupment until an internal audit determines the source of the discrepancies identified by the auditors. The DOE will take the necessary corrective action, including recoupment of overpayments, should it be demonstrated that overpayments were made, and, will enhance internal controls to ensure that transactions involving donated goods<sup>1</sup> are properly entered and reconciled monthly.

**Recommendation 7**

*DOE should maintain a central inventory system that is linked to the Usage and track in a timely manner the receipt of donated food by the distributors and the delivery of the donated food to the schools.*

**Corrective Action Response**

DOE disagrees with the recommendation, as our current processes and their supporting system provided the functionality outlined and required, though not, as the report notes in a single system. We are unconvinced that there is a significant benefit to be derived from a single system as recommended. Accordingly, no corrective action is required.

**Tracking of Donated Goods Delivered to Manufacturers**

**Recommendation 8**

*DOE should track donated food at the manufacturers to ensure that as long as a donated food item is available at a manufacturer, the agency is only paying the donated food price for that item.*

**Corrective Action Response**

DOE agrees with the recommendation and will implement a process to track the receipt of donated food from the time of its delivery to manufacturers through its delivery to our distributors to ensure that all donated food is utilized as efficiently as possible.

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<sup>1</sup> The DOE has the ability under the contracts to allow distributors to deliver purchased items instead of donated items in special circumstances

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**Delivery Receipts**

**Recommendation 9**

*DOE should obtain and use receiving reports from the schools rather than from the distributors to verify delivery system information in Usage.*

**Corrective Action Response**

At present, payments are made on the basis of copies of receipts signed and submitted by SchoolFood personnel, which are provided to our Accounts Payable Department by vendors. DOE will consider this recommendation and explore the logistics on how to implement such a complex project for over 1200 schools in a timely manner.

**DOE IS NOT CLOSELY MONITORING MANUFACTURERS' /SUPPLIERS' PRICES**

**Recommendation 10**

*DOE should closely monitor manufacturers'/suppliers' prices to identify opportunities to negotiate lower food prices with the distributors.*

**Corrective Action Response**

DOE agrees with the recommendation, but does not agree to take "corrective action" inasmuch as we already closely monitor manufacturers'/suppliers' prices to identify opportunities to negotiate lower food prices with the distributors.

Under Section 1.7 of the contract, "Distributor procured items must reflect the manufactures net invoice price for the first year thereafter all pricing will be contingent on the PPI adjustment or price reductions offered to the DOE." We rigorously adhere to this contract term. When the prices we pay to our distributors rise more rapidly than the prices our distributors pay to manufacturers, we cannot unilaterally reduce prices, but can, and do, request Voluntary Price Reductions of our vendors. In fact, evidence that this practice has resulted in savings to the DOE was presented to the auditors. Moreover, as the auditors are also aware, the DOE has the option to discontinue items when pricing has risen as a result of PPI adjustments, an option we have exercised when appropriate and will continue to do so.

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**LIQUIDATED DAMAGES**

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**Recommendation 11**

***DOE should obtain corroborating evidence from other sources (such as the schools or the manufacturers) before accepting distributors' arguments that their violations should be waived.***

**Corrective Action Response**

We agree with the recommendation.

That said, it is important that we clearly state our position which is that it is not the DOE's objective to assess liquidated damages for late delivery of food, but to ensure, rather, that violations are cured and overall service is improved so that the schools receive the quantity and quality of food needed to serve students.

As a point of further clarification, the contract allows a distributor to cure a violation for late delivery within twenty-four hours. Because our best interests are served by providing an incentive to get the food to where it is needed, we see the twenty-four hour cure provision as a positive. Further, as a matter of equity, the contract provides a mechanism whereby a violation can be waived if the distributor can demonstrate by providing a letter from the manufacturer that the late delivery was caused by the manufacturer, not the distributor.

What the DOE is agreeing to do in response to the recommendation is improve its process for determining whether liquidated damages should be assessed by reviewing field personnel reports or verifying directly with the school or manufacturer whether there exist grounds for curing/waiving the violation.

**Recommendation 12**

***DOE should ensure that school personnel date their signatures on the receiving reports.***

**Corrective Action Response**

DOE agrees with the recommendation since dated signatures are already required on receiving reports. We review personnel's compliance with established procedures on an on-going basis and take corrective action when instances of non-compliance are identified. No further corrective action is required.

**Recommendation 13**

***DOE should evaluate vendor performance on a regular basis as required by the contract and its own procurement manual.***

**Corrective Action Response**

DOE agrees with the recommendation inasmuch as vendor performance is already reviewed on a regular basis in accordance with the referenced contract and our own internal procedures. At

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present, we meet periodically with each vendor individually to review the vendor's performance. More frequent meetings will occur on a case-by case-basis. We are in the process of improving our vendor performance review procedures in order to provide more detailed metrics on an on-going, rather than periodic, basis.

Accordingly, no corrective action is required.

**OTHER MATTER**

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**No price Analysis Conducted**

**Recommendation 14**

*DOE should conduct an analysis to determine whether the contract prices it pays its food distribution vendors are fair and reasonable.*

**Corrective Action Response**

The Division of Contracts and Purchasing is responsible for preparing a price analysis at the time of bid evaluations.

DOE agrees that a formal analysis should have been conducted. However, bidders were required to quote two prices - one for the product at the cost their suppliers were charging them<sup>2</sup> and a second adding a delivery mark up which would include their profit margin. Both quotes were tabulated together to determine the lowest responsive/responsible bidder. The annual cost of each awarded contract was over \$10 million and a formal price analysis should have been conducted. However, since the only place the bidder could include their profit margin was in the delivery mark up which the amount was under \$10 million and since this was a bid and there was competition (eight bidders participated) prices were validated as fair and reasonable.

Additionally research was conducted by Accenture, the DOE's contracted consulting firm, during the time of contract development. Based on the research done, the bid structure used was considered the most effective for our organization. In preparation for the new food distribution bid, the DOE will review how other large-scale educational systems engage similar vendors to determine if a better model exists

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<sup>2</sup> Bidders are required to show proof of supplier cost which can only be increased or decreased by the Producer Price Index.