



SEC. 206 OF HEALTHY, HUNGER-FREE KIDS ACT FAILS TO PROTECT NSLP FUNDS IN SOME DISTRICTS

Proxy formula is not adequate for protecting federal school meal funds in districts with higher labor costs for their competitive food programs.

Background: Data from the USDA Meal Cost Study showed that in many districts, revenues from competitive food sales are not covering the full cost associated with competitive food programs. The federal reimbursement for school meals and student meal payments are not intended to be used to offset any costs associated with the procurement and sale of competitive foods. Nevertheless, because districts have limited resources outside of school meal revenue, it is likely that a significant amount of the losses associated with CF are, in fact, being paid with revenues intended to be used for federally subsidized school meals (National School Lunch and Breakfast Programs, “NSLP” and “SBP”). The Healthy, Hunger-Free Kids Act of 2010 (“the Act”) includes a provision (Section 206) designed to prevent revenues associated with federally subsidized school meals from being used to subsidize competitive foods.

The most effective way to ensure revenues for school meals are not being diverted to offset losses in competitive food programs would be for districts to conduct cost accounting of both their federal meal programs and competitive food operations and be prohibited from using federal funds to offset losses in or otherwise support competitive food sales. However, stakeholders and policymakers were concerned that requiring cost accounting might be too burdensome and difficult for many districts.

To resolve this dilemma, the Healthy, Hunger-Free Kids Act of 2010 contains a proxy accounting formula that districts are required to meet starting in school year 2011-2012. Note that the legislation refers to competitive foods as “non-program foods” but in this report, the more traditional term “competitive foods” is used.

$$\frac{\text{Competitive Food Program Revenue}}{\text{Total Revenue}} \geq \frac{\text{Competitive Food Program Food Cost}}{\text{Total Food Costs}}$$

To calculate this formula, districts must track the *food* costs associated with competitive foods but do not have to track labor costs and keep separate accounting for each program. The report language explaining this provision states, “The method [formula] set forth in this section to make this determination is intended to ease the potential administrative burden that separate accounting could entail.” (Senate Report 111-178)

The formula is based on two assumptions: (1) If competitive foods generate adequate revenue, federal funds will not be used to subsidize competitive food programs. (2) For the purpose of the formula, food costs are a reasonably accurate proxy for the cost of food *and* labor. The first assumption seems a reasonable assertion. The second, however, does not hold up in practice, as shown in our analysis below.

The proxy formula falls short of intent: The formula will *not* prevent federal funds from subsidizing competitive foods in districts where labor costs associated with competitive foods are higher than for the federal school meals, as illustrated in the examples at the end of this report. In those districts, millions of dollars could still drain from the federal program into the competitive food program. This is a violation of the National School Lunch Act's requirement that NSLP funds be used only for NSLP meals (see Kavanagh, C., *Flunking Lunch*, p. 45-46) and is contrary to congressional intent.

Why would districts have higher labor costs for competitive food sales? Some competitive food programs can require significantly more labor hours, more skilled labor and more management time than federal school meal programs. The resulting higher labor costs for competitive food would not be taken into account by the new formula, rendering it ineffective.

For example, in districts where both programs are offered, the federally subsidized meals are typically served out of a central location, most often a cafeteria. Food options are limited. Competitive foods, however, may be sold at various locations throughout the school—kiosks or pull up windows situated in hallways, gathering places, and outdoors. Such multiple locations result in a labor hour-to-revenue hour ratio that is much higher than in the federal meal programs. For example, there may be three employees working the NSLP meals (one of whom oversees both the federal and competitive food programs), but at least five employees selling a smaller quantity of competitive food.

The second labor factor to consider is the classification of the employees in each program. If the competitive food entrees are cooked from scratch at each school site, those employees would typically be classified at a higher hourly rate than an NSLP employee who is handing out pre-plated food and who is not certified to cook or handle raw food.

The third factor is that some directors have reported spending a disproportionate amount of central office time running their competitive food programs compared to their federal meal programs. This can happen when competitive food programs offer more variety or require scratch cooking. More variety takes more time to order and track. Sometimes individual schools request special competitive food offerings to meet student preferences, requiring even more central office time. This is likely to become more significant as districts start allocating time to ensure competitive foods meet the new federal nutrition standards.

Policy Recommendation to the USDA: The USDA does not have the authority to change the formula in the new law. However, it could better fulfill the intent of the provision by taking the following steps.

- Ensure that state agencies and districts understand the intent of Section 206—federally subsidized school meal funds should not be diverted to cover losses in competitive food sales;
- Offer guidance that includes profiles identifying the type of district where the formula may not be adequate to meet the intent of the law (see examples above) to raise awareness that in such situations more attention may be necessary by district foodservice directors and state reviewers to protect the NSLP funds, and
- Measure the formula’s effectiveness in the next Meal Cost Study and communicate the results with the appropriate Congressional committees.

DESCRIPTION OF CHART

The districts in this chart are fictitious. They have a basic profile of serving 20,000-25,000 NSLP meals a day alongside a sizable competitive food program. None of the schools serve breakfast. Revenues and food costs for their NSLP are the same as are their competitive food revenue. They also have similar ratios of free, reduced-price and paid participation and charge similar fees for paid meals. NSLP meals are preplated, provided by an outside vendor.

District A: Baseline district. This district has even distribution of labor and food costs for producing NSLP and competitive food meals. Competitive foods, which are limited to uncooked items, are sold only in the cafeteria. This district complies with the formula in Section 206, showing that revenues from NSLP are not supporting CF.

District B: This district is different from District A only in that they sell competitive food from numerous locations in addition to the cafeteria at each of their 25 high schools. The district could comply with the formula while still covering its competitive food deficit of \$750,000 with NSLP revenues.

District C: This district differs from District A in several ways. Overall, its labor rates are lower. However, its competitive food labor costs are higher because they scratch cook two competitive food entrees at their 25 high schools daily. The cooks are paid at a much higher rate than the employees who hand out pre-plated NSLP meals. In addition to selling competitive food entrees in the cafeteria, they also sell snacks at numerous kiosks located throughout each high school.

District D: This is a district consisting of only high schools. It scratch cooks five competitive food entrees at each school daily. competitive food snacks are sold in cafeterias and at kiosks and pull-up windows situated throughout the schools—in hallways and outside. The competitive food snack items are less expensive for the district to sell because it does not offer some of the lower profit items offered in District A. A staff person at the main office is dedicated solely to managing the competitive food system, from food ordering to staff management, whereas the NSLP food is managed by a director who oversees both the NSLP and competitive food programs. The district could comply with the formula while still covering its competitive food deficit of \$2,000,000 with NSLP revenues.

Analysis of Section 206 of the Healthy, Hunger-Free Kids Act of 2010

Examples of the formula's ineffectiveness in preventing diversion of NSLP funds to cover losses in competitive food (CF) sales when competitive food labor costs are high relative to the NSLP.

	<u>District A</u>	<u>District B</u>	<u>District C</u>	<u>District D</u>
NSLP food	\$4,500,000	\$4,500,000	\$4,500,000	\$4,500,000
NSLP labor	<u>\$4,500,000</u>	<u>\$4,500,000</u>	<u>\$3,750,000</u>	<u>\$3,250,000</u>
NSLP total costs	\$9,000,000	\$9,000,000	\$8,250,000	\$7,750,000
NSLP total revenue	\$9,750,000	\$9,750,000	\$9,750,000	\$9,750,000
CF food costs	\$3,000,000	\$3,000,000	\$3,000,000	\$2,500,000
CF labor costs	<u>\$3,000,000</u>	<u>\$3,750,000</u>	<u>\$4,500,000</u>	<u>\$5,500,000</u>
CF total costs	\$6,000,000	\$6,750,000	\$7,500,000	\$8,000,000
CF total revenue	\$6,000,000	\$6,000,000	\$6,000,000	\$6,000,000
Total Revenue	\$15,000,000	\$15,750,000	\$15,750,000	\$16,000,000
CF Deficit	\$0.00	(\$750,000)	(\$1,500,000)	(\$2,000,000)

Current formula in section 206

*all numbers rounded to tenths, unless otherwise indicated

$$\frac{\text{CF Revenue}}{\text{Total Revenue}} \geq \frac{\text{CF Food Costs}}{\text{Total Food Costs}}$$

CF Rev/Total Rev	0.4	0.4	0.4	0.4
CF Food/Total Food Costs	0.4	0.4	0.4	0.4
Ratio [law requires # >=1.0]	1.0	1.0	1.0	1.1

Formula including labor costs

*all numbers rounded to tenths, unless otherwise indicated

$$\frac{\text{CF Revenue}}{\text{Total Revenue}} \geq \frac{\text{Total CF Food \& Labor Costs}}{\text{Total Food \& Labor Costs}}$$

CF Revenues/Total Revenue	.4	.38	.4	.4
Total CF Food & Labor Costs/Total Food & Labor Costs	.4	.43	.5	.5
Ratio [# < 1 indicates proxy formula failure]	1.0	.9	.8	.8