

**FOOD SERVICE MANAGEMENT CONTRACTS:  
ARE CONTRACTORS OVERCHARGING THE GOVERNMENT?**

**Senate Homeland Security and Governmental Affairs Ad Hoc Subcommittee on  
Contracting Oversight**

October 5, 2011

Chairman Claire McCaskill

Opening Statement

Today's hearing focuses on how the government buys food. Every day, the government provides meals to our soldiers at home and overseas, veterans, government employees, and to our children through the National School Lunch Program. Every year, billions of taxpayer dollars are paid to the food service contractors who supply the food for dining facilities on military bases, ships and on the battle field, as well as at government buildings, hospitals, and schools.

When food service contractors buy food for the government they get rebates from manufactures, suppliers, and vendors. In their simplest form, rebates often are based on volume purchases that contractors make from food manufacturers and distributors. For example, a contractor may order several cases of cereal from a food manufacturer, for which it will receive a rebate in the form of a discounted price or a cash payment from the manufacturer. In cost-reimbursable contracts, the contractor will then submit invoices for its food purchases to the contracting agency. The problem is that the invoice price may not include the rebates received from the manufacturer or distributor, so that the agency then pays the full amount of the invoice and the contractor pockets the difference. When contractors buy food with the taxpayers' money, they shouldn't get to keep the change.

Recently, reports of fraud and other abuses on food service contracts have snowballed. Last July, the New York Attorney General's Office announced a \$20 million settlement with Sodexo, one of the largest food service management contractors in the world, regarding allegations that the company failed to pass along rebates it had received through its contracts with the New York public schools participating in the national school lunch program.

In September 2010, the Department of Justice announced a \$30 million settlement with U.S. Foodservice, another major contractor, based on allegations that it had overcharged the government by inflating food prices on contracts with the Defense Department and the Veterans Administration.

The Department of Justice also has a major case pending against Public Warehousing Company, now known as Agility, based in part on allegations that PWC submitted false information, manipulated prices, and overcharged the government for food and related services under its contract to supply food to the military in Iraq.

This June, the Department of Agriculture's Inspector General announced that it would be conducting its third audit of food service management contracts in the last decade. Both of its previous audits, conducted in 2002 and 2005, found serious problems with companies overcharging schools by withholding rebates.

The message that these reports and investigations send is clear: we're not doing enough to ensure that the government isn't getting cheated.

With increased scrutiny of rebate withholding, contractors have turned to new practices in order to avoid passing rebates on to the government or to pad their profits. One such method is to simply call the rebate another name, such as “marketing incentives” or “vendor consideration.”

What’s more, it seems obvious that the problem is even more widespread. For example, some companies have said that their accounting practices prevent them from accounting for the rebates owed to individual clients. And even if the company is giving the government the rebates that may be attributable for the individual contract, there is no way for the government to recoup the overall rebates that may be attributable to discounts based on purchases made by an entire federal agency or the federal government overall.

We’re here today to learn from some of the nation’s experts on this issue how contractors can manipulate their prices and invoices. We will discuss barriers to effective oversight of these contracts, including the complexity of the contractors’ relationships with their vendors and suppliers and the ambiguities in federal regulations relating to rebates. We will also discuss whether the practices that they have seen are exceptions or part of a pattern of fraud on these types of contracts across the federal government.

In this time of belt-tightening, we need to be more careful than ever to ensure that taxpayer dollars aren’t being wasted – particularly because every dollar that is lost through rebate schemes is a dollar we cannot use to feed our soldiers and children.

I thank the witnesses for being here today and I look forward to their testimony.