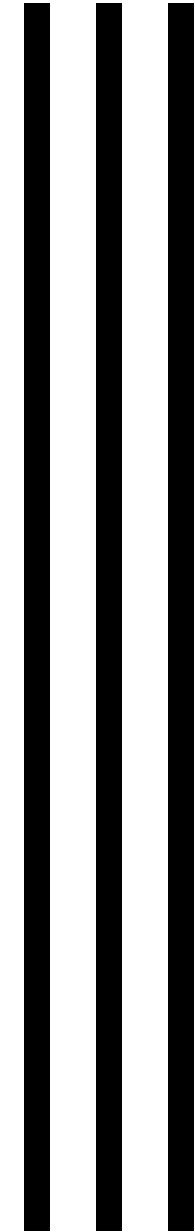




U.S. Department of Agriculture  
Office of Inspector General  
Northeast Region  
Audit Report

FOOD AND NUTRITION SERVICE  
ELECTRONIC BENEFITS  
TRANSFER SYSTEM  
NATIONAL OFFICE OVERSIGHT



**Audit Report No.  
27099-11-Hy  
January 2001**



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: January 24, 2001

REPLY TO  
ATTN OF: 27099-11-Hy

SUBJECT: Electronic Benefits Transfer System – National Office Oversight

TO: George A. Braley  
Acting Administrator  
Food and Nutrition Service

ATTN: Lou Pastura  
Director  
Grants Management Division

This report presents the results of the subject audit. The Food and Nutrition Service's (FNS) December 21, 2000, response to the official draft report is included as Exhibit D with excerpts and the Office of Inspector General's (OIG) position incorporated into the Findings and Recommendations section of the report.

We concur with the agency's management decision for Recommendation Nos. 1, 2, 3, and 5. We do not agree with FNS' management decision for Recommendation No. 4 and request additional action as outlined in the OIG Position.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned and the timeframe for implementing the corrective actions on the recommendation for which management decision has not yet been reached. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the cooperation and assistance provided the OIG staff during the audit.

/s/

JAMES R. EBBITT  
Assistant Inspector General  
for Audit

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# EXECUTIVE SUMMARY

## ELECTRONIC BENEFITS TRANSFER SYSTEM NATIONAL OFFICE OVERSIGHT AUDIT REPORT NO. 27099-11-HY

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### RESULTS IN BRIEF

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The overall objective of this audit was to provide an evaluation of the adequacy of established Electronic Benefits Transfer (EBT) system controls and an assessment on whether controls function as designed. We identified internal controls established in key operational areas, included tests to ensure controls were in place and operated as designed, and assessed the adequacy of prescribed controls.

Actions taken by Food and Nutrition Service (FNS) on the prior nationwide EBT audit recommendations, Monitoring of the EBT System Development and Implementation, Evaluation No. 27801-03-Hy, dated September 1996, were generally adequate. FNS approved waivers and made necessary changes to FNS regulations, policies, and forms to facilitate implementation of EBT. To address, in part, continuing problems identified in Office of Inspector General (OIG) audit reports related to issuance data reported to FNS by States, FNS implemented, in fiscal year (FY) 1999, EBT reconciliation guidance for State Agencies (SAs).

As required by the Welfare Reform Act, FNS is working to ensure that all States implement a system to deliver Food Stamp Program (FSP) benefits by FY 2002. FNS continues to work with States to improve EBT by assuring that retailers are entered into, or removed from, the EBT systems timely and accurately through the use of the Retailer Electronic Data Exchange (REDE); as well as working with States to allow access to program benefits, nationwide. FNS has also provided technical assistance to States in implementing EBT. Between the period October 1984 and January 2001, 42 SAs implemented EBT systems to deliver FSP benefits.

Overall, State EBT systems are functioning as prescribed in 7 Code of Federal Regulations (CFR) §274.12. However, as EBT continues to expand nationwide, FNS needs to strengthen controls over EBT benefit data reported to FNS and access controls to EBT systems at States. Specifically,

- Obligations at fiscal year end are not accurately reflected in FNS' accounting records because FNS' methodology, used in the fiscal year integrity calculation, for reporting redemptions is flawed. FNS reduces

the current year's food stamp issuance by the amount of benefits reported by States as expunged. Benefits are no longer available for use and are required to be expunged when they have not been accessed for one year, unless a waiver has been approved for a shorter duration. FNS' methodology results in current year's obligations of food stamp benefits being understated and prior year's obligations remaining in the accounting system when they are no longer available to recipients.

- States have not always reported the proper amount of expunged food stamp benefits within the required timeframes nor has FNS adequately monitored reported expungement data for reasonableness. We identified 22 States who reported an unreasonable amount of expunged benefits or who reported no expunged benefits in FY 1999. States reported more than \$61.7 million of FSP benefits as expunged in FY 1999. As a result, obligations for food stamp benefits, for FY 1999, were overstated by \$2.5 million in FNS' accounting system.
- We reported in OIG audit report, The Implementation of the AMA System, Audit No. 27099-04-Hy, dated September 1997, that the Account Management Agent (AMA) system design permits the EBT processor to adjust issuance without obtaining State approval. FNS subsequently required EBT processors to utilize batch processing to minimize the number and amount of necessary adjustments. Batch processing is when batches of transactions are accumulated and processed as a group, electronically. However, batch processing does not prevent the EBT processor from posting unauthorized adjustments to the AMA system. Additionally, the EBT processor has an excessive amount of time to make corrections to previously reported issuance data. FNS policy allows States to report corrections to EBT issuance for 90 days, the same time period allowed for food coupons. In the coupon environment, 90 days was a reasonable length of time because issuance information had to be collected from numerous field sites and then the data compiled and verified by the State, all of which took an extensive amount of time. EBT is an automated process and a reconciliation of daily issuance is required to be performed. As a result of the design of AMA, EBT processors can gain access to a larger amount of Federal funds than authorized by the State. We reported this vulnerability in our prior audits on FNS' financial statements.
- Procedures for reviewing access to State EBT systems continue to need strengthening. This problem was also identified in the prior nationwide EBT report, Evaluation No. 27801-03-Hy. FNS' actions to improve this control weakness have not been effective. We subsequently reported in seven State audit reports that user's last access to the system had not

been adequately monitored nor were terminated employees' access to the EBT system always removed. We identified more than 180 individuals whose access to a State EBT system should be removed because their job duties had changed or they were no longer employed by the State. As a result, unauthorized access to FSP benefits may not be prevented or detected.

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## **KEY RECOMMENDATIONS**

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We recommend that FNS modify the existing manual fiscal year integrity calculation; implement a system to review reported expungement data; expedite the implementation of an enhancement to AMA that requires prior approval by the State of all processor-initiated adjustments; modify the time period, to a maximum of 30 days, that States and EBT processors have for making corrections to FSP issuance data; and require the SA to periodically review system access and identify those individuals who no longer have a need and immediately delete their access.

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## **AGENCY RESPONSE**

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FNS officials generally agreed with the audit recommendations. They suggested modification to two recommendations. FNS proposed writing to each State EBT manager and FSP director, directing them to tighten existing controls over EBT access, by conducting semi-annual reviews of employee access and by raising the level of awareness regarding the importance of reviewing system access, rather than regulating down to the level of periodic logon ID review. FNS also proposed allowing EBT processors 60 days, rather than the recommended 30 days, for modifying corrections to FSP issuance.

FNS also believes that the General Comment, to develop program regulations in the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) program for EBT systems, was premature considering that there are currently only three operational WIC program EBT pilots and they do not have sufficient knowledge concerning needed system requirements.

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## OIG POSITION

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OIG generally agreed with FNS' proposed actions for implementing the audit recommendations. We agree with FNS' suggested change for improving EBT system access controls. We do not agree with FNS' proposal, of allowing the EBT processor 60 days to modify corrections to FSP issuance. EBT is an automated process and FNS has recommended to States and EBT processors to reconcile daily issuance activity on at least a weekly basis, therefore, we continue to believe that 30 days is more than sufficient time to make necessary corrections to issuance data without excessive FNS involvement.

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# INTRODUCTION

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## BACKGROUND

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The U.S. Department of Agriculture (USDA) Food and Nutrition Service (FNS) administers the Food Stamp Program (FSP) and Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) program. Currently, FNS is pursuing electronic benefits transfer (EBT) implementation for the FSP nationwide, and in three States for the WIC program. There are an additional nine States pursuing EBT for the delivery of WIC program benefits for the near future.

FNS administers the FSP through a Federal-State partnership. The FSP assists low-income households by increasing their ability to purchase food. Once a month, each participating household receives a benefit allotment determined by the number of family members, household income, and other related factors. Recipients can redeem the benefits for food items at authorized food retailers. The Federal Government pays the full cost of recipient benefits and shares the cost to administer the FSP with the States.

The WIC program provides nutritious supplemental foods, nutrition education, and health care referrals at no cost to low-income, pregnant, postpartum, and breastfeeding women, infants, and children up to their fifth birthday, who are determined to be at nutritional risk. The WIC program makes grants to participating State agencies (SA) that in turn distribute the funds to participating local agencies. State and local agencies use WIC program funds to pay the costs of specified supplemental foods and administrative costs.

In the past, the basic method of FSP benefit delivery was the food stamp coupon. The Food Stamp Act of 1977 as amended, Public Law 88-525, authorized FNS to experiment with alternative methods for the delivery of FSP benefits using electronic data processing. In the mid-1980's, a computerized version of food stamp delivery, the EBT system, was developed to replace paper coupons. Using a plastic card similar to a debit card, recipients gain access to benefits through point-of-sale terminals located at approved food retailers. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (also referred to as the Welfare Reform Act), Public Law 104-193, required that by October 1, 2002, all States must implement an EBT system for FSP benefit delivery.

The FNS National Office was designated by the Federal EBT Task Force as the lead Federal agency for approving State EBT system applications and issuing EBT policy. FNS has established rules for the delivery of FSP benefits using EBT systems in Title 7, Code of Federal Regulations (CFR) §274.12 and for approving automated data processing systems in Title 7 CFR §277.18. The FSP regulations specify functional areas to be addressed by the SA but do not establish a standardized system of internal controls. FNS' policy is to allow the States the flexibility to establish control systems that meet the needs of the individual States. No specific regulations have been established for the delivery of WIC program benefits using EBT systems, although, FNS has issued a policy on the approval and development of WIC program EBT systems.

Generally, States award contracts to private sector companies to develop and operate its EBT systems. However, States remain financially liable to the Federal Government for the actions of its EBT processors. These companies are usually financial institutions or other organizations that already handle electronic funds transfer activities. As of January 2001, there were six prime EBT contractors plus one State who is acting as the prime EBT contractor (the contractor selected by the State to oversee all EBT functions; EBT processing functions may be performed by another company.) Sixty-five percent of all SAs have selected the same prime contractor, Citibank. (See exhibit B.)

As of January 2001, 41 States and the District of Columbia used EBT systems to deliver FSP benefits, 38 of which operated statewide. Additionally, two of these States have operational off-line EBT systems. (See exhibit A.) Nationwide, there are four consortiums with 30 States participating. (See exhibit B.) Consortiums provide the States with a number of advantages, which include: smaller States gaining a better negotiating position by combining with larger States to obtain contract prices and options, and because of the commonality of the EBT contractor they can share concerns, problems, solutions, and lessons learned. Conversely, smaller States, in a consortium, may be at a disadvantage because they do not always have the bargaining power of a larger State, especially, for State specific issues.

FNS oversight of the implementation of the State EBT system is performed by the assigned FSP account executive at the FNS National Office. Account executives are involved in the approval of State planning documents and contracts; and coordinate acceptance testing and implementation of the EBT system. The national office has contracted with Booz-Allen & Hamilton to provide technical assistance in reviewing individual State EBT system's programming and testing. FNS National Office financial management is responsible for monitoring reconciliation activity as required by the Account

Management Agent (AMA) system contract. This includes daily reconciliation of the Agency Financial Management System (AFMS) and AMA system data, and oversight of State's reconciliation of issuance and redemption data to EBT processor reported data. The regional offices are responsible for handling daily EBT operational issues with the States. This includes resolving problems related to card issuance, receipt of EBT data from processors, payment reconciliation with the Automated Standard Application for Payments (ASAP) system and oversight of State EBT operations.

FNS' management of FSP funds involves several automated systems, including AFMS, AMA and ASAP systems. These systems support FSP data that is generated at the SA and the EBT processor. FNS established AFMS as its accounting system and the AMA system to improve the monitoring and management of FSP funds delivered via EBT. ASAP is a centralized system developed by the U.S. Department of the Treasury for the request and delivery of Federal funds, which FNS uses to pay FSP and WIC program benefits to States or their EBT contractors. Additionally, FNS also utilizes three other computer systems: the Store Tracking, Authorization and Redemption Subsystem to record and monitor FSP redemption data; the Retailer EBT Data Exchange (REDE), to facilitate the exchange of FSP retailer data between FNS and the EBT processors; and the Anti-fraud Locator for EBT Retailer Transactions system, to monitor retailers' EBT transactions for potential fraud activity in the FSP.

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## **OBJECTIVES**

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The overall objective of this audit was to provide an evaluation of the adequacy of established controls and an assessment of whether the controls function as designed. The audit

(1) Identified internal controls established in key operational areas, (2) included tests to ensure controls are in place and operated as designed, and (3) provided an assessment on the adequacy of prescribed controls. The specific objectives at the FNS National Office were to determine whether: (1) Actions taken by FNS on prior nationwide EBT audit recommendations were adequate; (2) FNS approved waivers adversely affected EBT operations; (3) necessary changes to FNS regulations; policies, and forms have been completed and do not adversely affect EBT and non-EBT operations; and (4) FNS National and Regional Office oversight related to EBT is adequate.

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## **SCOPE**

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The audit was conducted in accordance with generally accepted Government Auditing Standards. Fieldwork was performed at the FNS National Office in Alexandria, Virginia. As part of this nationwide audit, we also reviewed State EBT systems operating

in 14 States and issued individual reports. (See exhibit C.) The results of the individual State reports were rolled-up into this report. These States were judgmentally selected for audit. We based our selection on those States who had been operating an EBT system the longest or who had the highest EBT issuance within each Office of Inspector General (OIG) region. In Fiscal Year (FY) 1999, FSP benefits totaled almost \$16 billion with approximately 60 percent of these benefits being delivered through EBT. Our sampled States delivered over \$3.3 billion, or 36 percent of the total FSP benefits delivered via EBT in FY 1999. In FY 1999, WIC program benefits totaled \$2.8 billion. Wyoming, the only State delivering WIC program EBT benefits in FY 1999, issued approximately \$3.7 million in benefits. We conducted our national office fieldwork from February 1999 through August 2000. Regional and State office fieldwork was performed during the period December 1995 through August 1999.

We evaluated FNS National Office oversight and the administration and management of the EBT system. The audit also assessed the adequacy and operation of internal controls to ensure that controls were established in key operational areas in State EBT systems. The operational areas of State systems we reviewed included: reconciliations of FSP issuance data, help desk operations, fraud detection, use of EBT management reports, access to and security over the EBT system, and interstate transactions.

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## **METHODOLOGY**

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To accomplish our audit objectives, we: (1) interviewed responsible FNS, SAs, EBT processor, and Federal Reserve Bank (FRB) personnel; (2) reviewed applicable laws and regulations, FSP and WIC program EBT policies and procedures, and pertinent correspondence and management reports from FNS, SAs, and an EBT processor; and (3) reviewed AMA issuance and ASAP payment data reported to AFMS.

At SAs we identified, tested, and assessed internal controls established in key operational areas, including: training; EBT cards and personal identification numbers; returned EBT cards; help desk operations; EBT and third-party processor contract provisions; use of point-of-sale terminals; fee structure; access to the EBT system; FSP benefit issuance and redemption processes; use of manual transactions; reconciliations between State, EBT processor, and Federal information systems; use of management reports; out-of-State transactions; expunging of FSP benefits; and the use of EBT benefits in group living arrangements.

Overall, EBT systems are functioning as prescribed in 7 CFR §274.12. EBT system management deficiencies were noted in the individual State reports in the following areas: EBT security, access, separation of duties, FSP issuance data, oversight, and system design. In all of these areas except for system access and errors in reporting issuance data the weaknesses were State specific and would not require FNS to revise or establish procedures or processes.

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## FINDINGS AND RECOMMENDATIONS

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<b>CHAPTER 1</b>	<b>CONTROL ISSUES AFFECTING FNS' REPORTING OF EBT BENEFIT DATA</b>
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Actions taken by FNS on the prior nationwide EBT audit recommendations, Monitoring of the EBT System Development and Implementation, Evaluation No. 27801-03-Hy, dated September 1996, were generally adequate. FNS approved waivers and made necessary changes to FNS policies and forms to facilitate implementation of EBT. To address, in part, continuing problems related to issuance data reported to FNS that were identified in prior OIG audit reports, FNS implemented in FY 1999, EBT reconciliation guidance for SAs. This guidance will help FNS ensure that data included in their financial statements is supported and reliable.

In September 1997 we issued a report, "The Implementation of the AMA System, Audit No. 27099-04-Hy, which noted that FNS' AMA system design provided inaccurate budgetary accounting because it allowed prior fiscal year funds to be used for current year expenditures. We reported that FNS violated appropriation law by reporting the use of FY 1996 appropriations for FY 1997 expenses. The AMA system supports management of FSP benefits delivered by State EBT systems and is operated by the FRB. FNS properly records obligations in the year they are issued against the current year's appropriation. However, EBT processors report and the AMA system records expenditures (redemptions), by posting them against the prior year's obligations until they are depleted and then against the current year's obligations, regardless of what fiscal year's obligation they actually relate to. As a result, FNS must perform a manual calculation to properly reflect outstanding obligations at fiscal year end. FNS stated changes to the existing States EBT and AMA systems would be too costly and instead they would propose language in the FY 1999 appropriation bill that would permit the agency to fully liquidate prior year's FSP obligations before charging expenditures to the current year, similar to food stamp coupons, which lose their identify as to fiscal year of issuance. However, EBT through the AMA system, provides FNS with proper funds control capability; benefit issuance and redemption can be tracked by fiscal year of issuance. In the interim, FNS and OIG agreed that FNS would perform a manual calculation to accurately report EBT costs incurred in the current year. FNS was unsuccessful in incorporating language into the Food Stamp Act to exempt them from being required to record EBT FSP benefit costs against the year

of obligation. In our FY 1999 FNS Financial Statements Audit Report No. 27401-17-Hy, dated February 2000, we reported that corrective actions have not been completed and the problem continues to exist. We recommended that FNS conduct a cost-benefit analysis to determine whether AMA and State EBT systems enhancements would be feasible and continue to perform the manual calculation if system enhancements cannot be implemented.

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## **FINDING NO. 1**

### **FISCAL YEAR INTEGRITY CALCULATION FOR FSP EXPENDITURE REPORTING NEEDS MODIFICATION**

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Obligations at fiscal year end are not accurately reflected in FNS' accounting records because FNS' methodology for reporting redemptions is flawed. FNS reduces the current year's food stamp issuance by the amount of benefits reported by States as expunged. As a result, current year's obligations of food stamp benefits are understated and prior year's obligations remain in the accounting system when they are

no longer available to recipients.

FNS accounts for the expungement of benefits incorrectly. EBT benefits are required to be expunged when they have not been accessed by recipients within the required timeframes and are no longer available for use. FNS records all reported expunged benefits against the current year's obligation, rather than the actual obligation. In FY 1999, more than \$61.7 million or almost one percent of total FY 1998 EBT issuance was expunged against current benefits rather than prior year's outstanding obligations. FNS regulations require the SA to expunge benefits that have not been accessed by the household after a period of one year.<sup>1</sup> However, 14 States, which operate on-line systems, have approved waivers that allow them to expunge benefits less than a year after issuance. These States reported approximately 16 percent or \$9.9 million of the total amount of benefits expunged in FY 1999. In addition, the two States, Ohio and Wyoming, who operate off-line systems expunge benefits after 3 months. Off-line benefits not posted to an EBT card expire similar to an ATP card. By using the current methodology, prior year's obligations remain in FNS' accounting system even when they are no longer available for use by the recipient. Benefits expunged should be recorded against the oldest outstanding obligations remaining in AFMS.

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## **RECOMMENDATION NO. 1**

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Modify the existing manual fiscal year integrity calculation to ensure that expungements are posted against the oldest remaining fiscal year obligation.

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<sup>1</sup> 7 CFR Part 274.12(f)(7)(ii), dated January 1, 1996

## **FNS Response**

FNS concurs with this recommendation. FNS has modified the existing manual fiscal year integrity calculation, effective September 30, 2000. The calculation for FY's 1999 and 2000 now applies expunged benefits against the oldest remaining fiscal year obligation. Additionally, FNS is continuing to pursue the incorporation of language into the Food Stamp Act that would exempt FNS from recording EBT FSP benefit costs against the year of obligation. If they are successful, this change will take effect in FY 2002.

## **OIG Position**

We concur with FNS' proposed management decision.

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### **FINDING NO. 2**

#### **OVERSIGHT OF REPORTED EXPUNGED BENEFITS NEEDS IMPROVEMENT**

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States have not always reported the proper amount of expunged food stamp benefits within the required timeframes nor has FNS adequately monitored expungement data for reasonableness. We identified 22 States who reported an unreasonable amount or no expunged FSP benefits in FY 1999. EBT processors reported more than \$61.7 million of

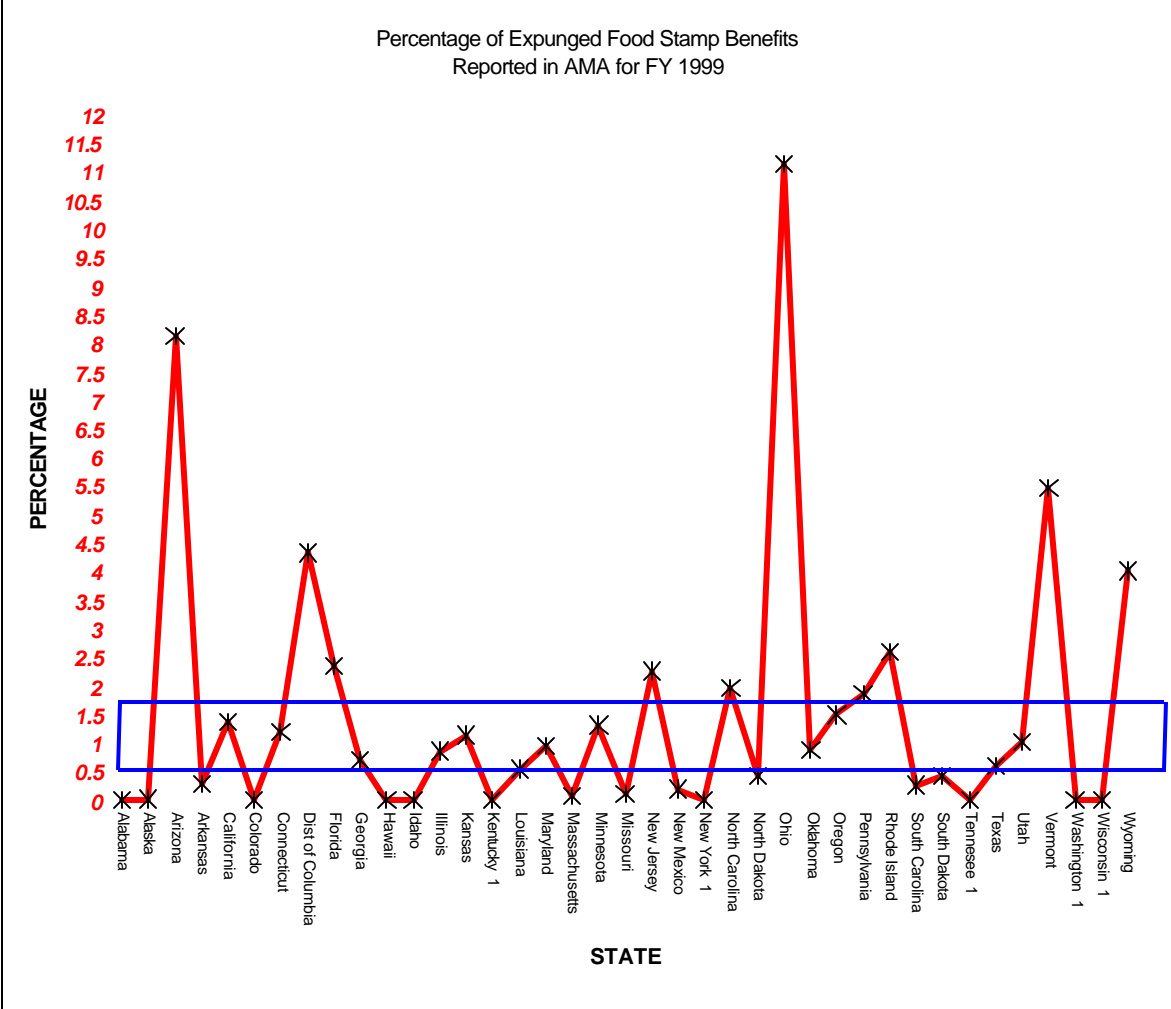
State expunged FSP benefits through the AMA system to FNS in FY 1999. Expungement data reduces obligations recorded in FNS' accounting system, AFMS. As a result, the FSP FY 1998 obligations balance, as of September 30, 1999, in FNS' accounting system was overstated by \$2.5 million.

Food stamp regulations require States to expunge benefits that have not been accessed for at least one year, unless a waiver has been approved. FNS has approved waivers allowing 14 States, who operate on-line EBT systems to expunge benefits within a shorter time period, 3 to 9 months. Additionally, EBT processors use different approaches to expunge benefits. For example, some EBT processors only expunge benefit amounts that have not been accessed for the authorized period, while two EBT processors, Citibank and Transactive, expunge all benefits in a recipient account when all or part of the balance has not been accessed for the authorized period. The States who use these two processors must have a system in place to track those benefits still eligible for use if a recipient requests reinstatement. We will be evaluating this tracking process in subsequent State EBT audits.

Based on historical knowledge, FNS has determined that approximately one percent of all FSP benefits are not redeemed. We expected reported expungement amounts to fall into the range of one-half to one and one-half



percent of total FSP benefits issued. Using the above indicated percentage range, we compared FY 1998 FSP benefit issuance data to FY 1999 expunged benefit data and identified several States who reported an unreasonable amount of expunged benefits or reported no expunged benefits in FY 1999. Included in this assessment were all States who issued benefits in FY 1999, five of whom we did not expect any benefits to be expunged because they were not operating an EBT system for at least one year. We identified twelve States who understated expungement by almost \$15 million (two who did not report expunged benefits and the other ten who reported an inadequate amount), while an additional ten States over reported expunged benefits by more than \$17.5 million. Of the two States that did not expunge benefits in FY 1999, only one has begun to report expungements in FY 2000.



1 - State was not expected to have expunged FSP benefits because they were in operation less than one year.

FNS regulations require State agencies to expunge benefits that are not accessed by the household after a period of one year unless a waiver is

approved for a shorter duration.<sup>2</sup> FNS officials stated that they did not review reported expunged benefits for reasonableness or ensure that the State or its EBT processor was expunging FSP benefits.

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## **RECOMMENDATION NO. 2**

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Implement a system to review reported expungement data for reasonableness.

### **FNS Response**

FNS concurs with this recommendation. FNS will evaluate monthly AMA summary data for each State agency to track and monitor reported expungements for reasonableness. They will contact States whose expungement patterns fall outside the one-half to one and one-half percent of total EBT FSP benefits issued to determine the circumstances surrounding their expungement pattern. FNS will take the appropriate action to correct any deficiencies with the State agency. FNS is currently developing internal procedures for this systematic review. These procedures will be implemented by February 1, 2001 and will be retroactive for expungement activity beginning October 1, 2000.

### **OIG Position**

We concur with FNS' proposed management decision.

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## **FINDING NO. 3**

### **TIMEFRAMES AND CONTROLS FOR EBT PROCESSOR ADJUSTMENTS NEED IMPROVEMENT**

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FNS implemented batch processing to minimize discrepancies between State issuance data and AMA system data. These discrepancies were caused by keypunch errors, as well as untimely entry of daily issuance data and other processor adjustments. However, this process does not correct a system vulnerability we previously reported that allows the EBT

processor the ability to make unauthorized adjustments to State issuance data. We reported this control weakness in our prior audit, The Implementation of the AMA System, Audit No. 27099-04-Hy, as well as prior FNS financial statements audits. In addition, the EBT processor has an excessive amount of time to make corrections to previously reported issuance data, increasing system vulnerability. FNS policy allows States to report corrections to EBT issuance for 90 days, the same time period allowed for food coupons. As a result, EBT processors can enter issuance information in the AMA system without State knowledge or approval and gain access to a larger amount of Federal funds than authorized by the State.

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<sup>2</sup> 7 CFR 274.12(f)(7)(ii), dated January 1, 1996

We reported in the prior AMA report that the AMA system design permits the EBT processors to adjust previously submitted issuance information without obtaining State approval. During our subsequent State EBT audits we identified one EBT processor who made at least four adjustments to FSP issuance data in two States, totaling about \$1.7 million, in FYs 1998 and 1999 without obtaining prior approval from FNS or the SA.

Beginning in May 1999, States are required to periodically perform a reconciliation of daily issuance activity reported to the EBT processor and AMA systems. FNS recommends that this reconciliation be performed at least weekly. However, this reconciliation does not prevent unauthorized adjustments from being posted to the AMA system but it will timely identify any unauthorized adjustments after the fact.

The Joint Financial Management Improvement Program's (JFMIP) Core Financial System Requirements, dated February 1999, established standard requirements for a Federal agency's integrated financial management system. This includes security, internal controls, data stewardship, and system architecture elements. JFMIP is a joint and cooperative undertaking within the Federal government to improve financial management practices in government.

As a result of our AMA system audit, FNS agreed to implement a batch-processing enhancement to the AMA system as the first step in eliminating the need for entering data on-line. Also, batch processing will significantly minimize the need for entering backdated issuance (issuance that is posted after the effective date). Batch processing is where batches of transactions are accumulated and processed as a group, electronically. Currently, batch processing has been implemented by three of the four largest EBT processors in 34 SAs, representing 78 percent of total EBT issuance in FY 2000. Eight States have not implemented batch processing: Two States utilize Transactive, an EBT processor who is leaving the EBT arena; three States who utilize an older platform at Citibank; and three States who are still deciding whether to implement batch processing.

Batch processing does not prevent the EBT processor from entering issuance data into AMA without the State's knowledge or approval. It minimizes erroneous data being entered into the AMA system but does not prevent processor-initiated adjustments. FNS proposed to amend the AMA system design, as a result of our prior AMA audit, to prohibit the entry of processor-initiated manual adjustments without prior State approval. At the exit conference, FNS officials informed OIG that this enhancement is expected to be implemented in January 2001.

The timeframe allowed by FNS policy for States and the EBT processors to report corrections to EBT issuance is excessive and also increases the systems' vulnerability for error. EBT processors can report corrections to issuance up to 90 days, without prior approval from FNS or the SA. This appears to be an excessive time period. This policy is also applicable to the issuance of food coupons. In the coupon environment, 90 days was a reasonable length of time because issuance information had to be collected from numerous field sites and then the data had to be compiled and verified by the State, all of which took an extensive amount of time. EBT is an automated process and a reconciliation of daily issuance is required to be performed. Based on our review of AMA reported issuance data, corrections are generally made within the next calendar month. States and EBT processors should be required to submit corrections of FSP issuance data within a maximum of 30 days after the reporting month ends.

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**RECOMMENDATION NO. 3**

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Expedite the implementation of an enhancement to AMA that requires prior approval by the State of all processor-initiated adjustments.

**FNS Response**

FNS concurs with this recommendation. We have tasked the FRB to modify its AMA system to require prior approval by the State agency of all processor-initiated adjustments that are not processed via the batch process. This enhancement is scheduled to be implemented on January 1, 2001.

**OIG Position**

We concur with FNS' proposed management decision.

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**RECOMMENDATION NO. 4**

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Modify the time period, to a maximum of 30 days, States and EBT processors have for making corrections to FSP issuance data.

**FNS Response**

FNS concurs with the recommendation; however, the switch to "batch" issuance has extended the time many State agencies need to reconcile. Although State agencies continue to reconcile daily activity, many State agencies need several days worth of issuance activity from the EBT processor to validate against issuance data on the State agencies' systems. The main reason for this is that "batch" issuances are often spread over many days. In some instances, issuances may be spread 20 days or more.

FNS requested that the maximum be reduced to 60 days, as State agencies and EBT processors will need an appropriate amount of time to make adjustments, if and when, variances are noted. If FNS were to reduce the maximum to 30 days, the level of FNS involvement in routine adjustments would most likely increase tremendously. We prefer to leave this responsibility with the State agencies, and continue to focus our involvement on the “exception basis.”

### **OIG Position**

We do not agree with FNS’ proposed corrective action. Timely reporting of issuance adjustments is critical to FNS’ financial statements reporting process. Since EBT is an automated process and FNS has recommended that States and the EBT processor reconcile daily issuance activity on at least a weekly basis, we continue to believe that 30 days after the month ends is more than sufficient time to make necessary corrections without significantly increasing FNS involvement. Additionally, FNS EBT reconciliation guidance procedures issued in FY 1999, state that on a daily basis the State should ensure that the EBT processor and the State issuance files match, and rejected records, and unapplied benefits (benefits that cannot be matched to an active account) that are placed in a pending file are reported by the EBT processor on a daily basis to the State. If this information is provided timely, reconciliation of daily issuance activity should be readily performed. To reach management decision FNS needs to provide documented data that supports the need for a 60-day period.

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**FINDING NO. 4**

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Procedures for reviewing access to State EBT systems continue to need strengthening; this problem was also identified in the prior nationwide EBT report, Evaluation

No. 27801-03-Hy. FNS' corrective actions were not effective to address this system control weakness. User's last access to the system had not been adequately monitored nor was terminated employees' access to the EBT system always removed. As a result, unauthorized access to FSP benefits may not be prevented or detected.

As a part of State EBT system audits we evaluated certification standards for handling sensitive data, securing the confidentiality of recipient data, pre-employment screening of staff operating the EBT system, rules of conduct and training for handling privacy data, as well as procedures followed for authorizing and reviewing requests for access, and periodically reviewing the need for continued access. We also reviewed and assessed Statement of Auditing Standards (SAS) 70, Processing of Transactions by Service Organizations, reports to identify control weaknesses and subsequent corrective actions at the EBT processor.

We reported in the prior nationwide EBT report that EBT system access procedures needed strengthening. In response to our audit recommendation FNS issued instructions, in March 1997, to SAs. The instructions included limiting access to the EBT system, division of responsibilities among those with access, and periodic review of EBT access. These instructions were only for the States to *consider* (emphasis added) when implementing access controls. Since issuance of the previous nationwide EBT report, OIG has reported that seven additional States' controls over access to the EBT system needed improvement.

In many instances there was no periodic review of EBT system users to determine whether access was still needed. Additionally, login IDs for terminated employees were not deleted from the EBT system. Individuals had access to the system that were either no longer employed by the SA or whose duties had changed and who had no reason for continued access. We identified during our State EBT audits, more than 180 individuals whose access to State EBT systems should have been removed. We did not, however, identify any unauthorized access. We also noted that in some cases this occurred because States were not being provided with a report, as required by the EBT contracts, which showed the last system access date for each authorized user.

FNS regulations state that the SA is responsible for protecting equipment used in food stamp data processing systems from unauthorized use. Regulations also require the SA to establish appropriate procedures to protect FSP data and equipment from theft and unauthorized use but they do not specifically require the SA to periodically review system access.

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**RECOMMENDATION NO. 5**

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Require SAs to periodically review system access to identify those individuals who no longer have a need and immediately delete their access.

**FNS Response**

FNS does not concur with this recommendation. FNS does not believe regulating down to the level of periodic log-on ID reviews is necessary or appropriate. Current regulations require procedures be established and followed in the area of system access. FNS believes that during EBT implementation access needs may be overestimated and then not reviewed until operations are Statewide, and EBT security is fully absorbed into the overall State agency security program. With the responsibilities for security shared between EBT and State agency security managers, there may be temporary failures to address details. FNS believes all of these factors contribute to State agencies failing to perfectly limit EBT system access.

For management decision, FNS proposes to write individually to State EBT managers, with copies to the State FSP Directors, by January 31, 2001. Their letters will direct the EBT managers to tighten existing controls over EBT access by conducting at least semiannual reviews of employees with EBT access to determine if such access continues to be needed. FNS will also advise EBT managers to consult with their State security managers about access reviews of their EBT systems to be certain about roles, procedures, and reports. In addition, FNS will add the periodic access reviews as an agenda item at their next Regional EBT Coordinator conference call which is currently scheduled for January 4, 2001. FNS will have the coordinators plan to add this issue to all Regional EBT Users' Group meetings held during FY 2001.

**OIG Position**

We agree with FNS' proposed management decision.

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## GENERAL COMMENTS

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Implementation of EBT in the WIC program continues to expand. During FY 2000, one State, Wyoming, was completing migration to a statewide EBT system for both FSP and the WIC program. Another two States were piloting an EBT system for the delivery of WIC program benefits, while an additional nine States were in various stages of planning the implementation of an EBT system for delivering WIC program benefits. FNS, however, has not established specific regulations for the delivery of WIC program benefits using an EBT system. FNS has issued a policy on the approval requirements for State development and implementation of EBT systems for the WIC program. This policy does not establish rules for the delivery of WIC program benefits nor system requirements. It addresses the agency's EBT vision for the WIC program, the need to partner with other programs, funding for EBT systems, EBT system approval policy, and EBT system functional guidelines. Proposed WIC program regulations for food delivery systems recognizes that FNS needs to modify regulatory provisions as EBT continues to expand nationwide.

The Administrative Procedures Act of 1946, as revised, requires agencies to follow certain procedures when issuing guidance, rules, or required procedures to be followed by a third-party. This includes rules designed to implement, interpret, or prescribe law or policy or describe the organization, procedure, or practice requirements of an agency.

FNS has not published regulations for States to follow in implementing an EBT system for the delivery of WIC program benefits because they believe existing program regulations are sufficient. EBT is a method of benefit delivery and FNS believes sufficient program requirements are already outlined in the regulations regarding benefit delivery. Also, they have issued a policy memorandum that they believe provides the necessary information for the States to follow when implementing an EBT system. Additionally, FNS does not want to regulate a technical process.

Informal discussions with the Office of General Counsel staff disclosed that if an agency is implementing a new aspect of a program and the rights and obligations of third-parties are impacted, a fee is charged, or the third-party must submit certain documents, then there is substantive impact and the agency should probably provide notice of the policy or regulations for public comment. Policy does not have the force and effect of law and would not be enforceable through the courts. If FNS is only prescribing policy and they are only making a policy statement (which OGC indicated FNS is most likely



doing), then a regulation would not be required. However, the best solution is for FNS to issue regulations that address what the State plan should include and what FNS will approve.

We suggest FNS begin the process to develop program regulations that spell-out the SA requirements for implementing an EBT system for the delivery of WIC program benefits, as they have for the FSP, so that SAs know specifically what is required.

In their response to our official draft report, FNS believes the above suggestion is premature considering the WIC program currently has only three operational EBT pilot systems. At the present time, they do not believe FNS has sufficient knowledge concerning needed system requirements to develop regulations for an evolving system whose needs are not yet fully known. During their continuing course of pilot implementation and evaluation, FNS will determine if EBT is a feasible and viable alternative for WIC program benefit delivery. As the future of WIC program EBT becomes more defined, FNS will continue to evaluate the need to regulate the electronic delivery of WIC program benefits. We continue to believe that FNS needs to begin developing program regulations, as this process is a lengthy one, in order to ensure that States will not implement EBT systems that may not meet regulatory requirements.

**EXHIBIT A - EBT PROJECT STATUS  
JANUARY 2001**

- **Currently thirty-nine States and the District of Columbia use on-line EBT systems to deliver FSP benefits, 36 systems including the District of Columbia are statewide:**

- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>○ Alabama – Statewide</li> <li>○ Alaska – Statewide</li> <li>○ Arizona – Statewide</li> <li>○ Arkansas – Statewide</li> <li>○ California - San Bernadino and San Diego Counties</li> <li>○ Colorado – Statewide</li> <li>○ Connecticut – Statewide</li> <li>○ District of Columbia – Districtwide</li> <li>○ Florida – Statewide</li> <li>○ Georgia – Statewide</li> <li>○ Hawaii – Statewide</li> <li>○ Idaho – Statewide</li> <li>○ Illinois – Statewide</li> <li>○ Iowa - Linn County (Cedar Rapids)</li> <li>○ Kansas – Statewide</li> <li>○ Kentucky – Statewide</li> <li>○ Louisiana – Statewide</li> <li>○ Maryland – Statewide</li> <li>○ Massachusetts – Statewide</li> <li>○ Minnesota – Statewide</li> </ul> | <ul style="list-style-type: none"> <li>○ Michigan – expanding Statewide</li> <li>○ Missouri – Statewide</li> <li>○ New Hampshire – Statewide</li> <li>○ New Jersey – Statewide</li> <li>○ New Mexico – Statewide</li> <br/> <li>○ New York – New York City</li> <li>○ North Carolina – Statewide</li> <li>○ North Dakota – Statewide</li> <li>○ Oklahoma – Statewide</li> <li>○ Oregon – Statewide</li> <li>○ Pennsylvania – Statewide</li> <li>○ Rhode Island – Statewide</li> <li>○ South Carolina – Statewide</li> <li>○ South Dakota – Statewide</li> <br/> <li>○ Tennessee – Statewide</li> <li>○ Texas – Statewide</li> <li>○ Utah – Statewide</li> <li>○ Vermont – Statewide</li> <li>○ Washington – Statewide</li> <li>○ Wisconsin – Statewide</li> </ul> |
|--|---|

- **Two States have operational off-line EBT systems:**
  - Ohio - Statewide
  - Wyoming – FSP Statewide, WIC expanding Statewide

**EXHIBIT B – EBT COALITIONS AND ALLIANCES  
JANUARY 2001**

**COALITION AND ALLIANCE STATES**

<b>NAME</b>	<b>PRIME CONTRACTOR</b>	<b>STATES</b>
NORTHEAST COALITION	Citibank	CT, ME, MA, NH, NY, RI, VT (NY also participates in Mid-Atlantic Coalition)
SOUTHERN ALLIANCE	Citibank	AL, AR, FL, GA, KY, MO, NC, TN, WV (WV also participates in Mid-Atlantic Coalition)
WESTERN ALLIANCE	Citibank	AK, AZ, CO, HI, ID, NV, WA
MID-ATLANTIC REGIONAL COALITION	Citibank	MD, OH, PA, VA
	Lockheed	DC
	e Funds	NJ
	None Selected	DE

**STATES NOT IN A COALITION OR ALLIANCE**

<b>NAME</b>	<b>PRIME CONTRACTOR</b>	<b>STATES</b>
TWO-STATES COMBINED (1 PROJECT)	Citibank	ND, SD
SINGLE STATES	Citibank	IN, MI, NM, SC, WI
	Transactive	IL
	e Funds	KS, LA, MN, OR, UT
	Lockheed	OK
	Iowa Transfer System	IA
	Self Prime Contractor	TX
	Stored Value	WY
	None Selected	CA <sup>3</sup> , MS, MT, NE

<b>TOTAL:</b>	<b><u>PRIME CONTRACTOR</u></b>	<b><u>NUMBER OF STATES</u></b>
	Citibank	34
	e Funds	6
	Lockheed	2
	Transactive	1
	Stored Value	1
	Iowa Transfer System	1
	Self Prime Contractor	1
	None Selected	5

<sup>3</sup> Two counties in California are currently utilizing Deluxe Data as their processor, State expects to award a contract in February 2001.

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**EXHIBIT C – OIG AUDITS COMPLETED**  
**OCTOBER 1, 1996 – MARCH 31, 2000**

<b>STATE</b>	<b>AUDIT NUMBER</b>	<b>ISSUANCE DATE</b>
Alabama	27601-05-At	September 1998
Colorado	27801-04-KC	September 1999
Illinois	27099-11-Ch	September 1997
Illinois	27099-15-Ch	March 1999
Kansas	27801-02-KC	November 1998
Louisiana	27801-05-Te	March 2000
Massachusetts	27099-06-Hy	March 1999
Minnesota	27099-18-Ch	September 1999
Missouri	27801-03-KC	July 1999
New Mexico	27099-06-Te	March 1997
Ohio	27099-06-Ch	December 1996
Oklahoma	27801-03-Te	September 1998
Oregon	27801-03-SF	September 1999
Wyoming	27002-04-KC	January 1997

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# EXHIBIT D – FNS NATIONAL OFFICE RESPONSE TO DRAFT REPORT

Page 1 of 3



DEC 21 2000

United States  
Department of  
Agriculture

Food and  
Nutrition  
Service

3101 Park  
Center Drive

Alexandria, VA  
22302-1500

**SUBJECT:** Food and Nutrition Service Electronic Benefits Transfer System National Office Oversight, Office of Inspector General (OIG) Audit Report No. 27099-11-Hy

**TO:** James R. Ebbitt  
Assistant Inspector General for Audit  
Office of Inspector General

Thank you for the opportunity to comment on the draft report. As we noted at our exit conference, we agree with many of the OIG's conclusions and recommendations. In order to reach management decision on this audit, we are proposing corrective action for each audit recommendation in the subject audit. A restatement of the recommendations, and our response, follows:

**Recommendation 1:** Modify the existing manual fiscal year integrity calculation to ensure that expungements are posted against the oldest remaining fiscal year obligation.

**FNS response:** FNS concurs with this recommendation. FNS has modified the existing manual fiscal year integrity calculation effective September 30, 2000. The calculation for fiscal years (FY) 1999 and 2000 now applies expunged benefits against the oldest remaining fiscal year obligation. Additionally, FNS is continuing to pursue the incorporation of language into the Food Stamp Act that would exempt FNS from recording EBT Food Stamp Program (FSP) benefit costs against the year of obligation. If we are successful, this change will take effect in FY 2002.

**Recommendation 2:** Implement a system to review reported expungement data for reasonableness.

**FNS response:** FNS concurs with this recommendation. FNS will evaluate monthly Account Management Agent (AMA) summary data for each State agency to track and monitor reported expungements for reasonableness. We will contact States whose expungement patterns fall outside the one-half to one and one-half percent of total EBT FSP benefits issued to determine the circumstances surrounding their expungement pattern. FNS will take the appropriate action to correct any deficiencies with the State agency. FNS is currently developing internal procedures for this systematic review. These procedures will be implemented by February 1, 2001 and will be retroactive for expungement activity beginning 10-1-00.

**Recommendation 3:** Expedite the implementation of an enhancement to AMA that requires prior approval by the State of all processor-initiated adjustments.

James R. Ebbitt

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**FNS response:** FNS concurs with this recommendation. We have tasked the Federal Reserve Bank to modify its AMA system to require prior approval by the State agency of all processor-initiated adjustments that are not processed via the batch process. This enhancement is scheduled to be implemented on January 1, 2001.

**Recommendation 4:** Modify the time period, to a maximum of 30 days, States and EBT processors have for making corrections to FSP issuance data.

**FNS response:** FNS concurs with the recommendation; however, the switch to "batch" issuance has extended the time many State agencies need to reconcile. Although State agencies continue to reconcile daily activity, many State agencies need several days worth of issuance activity from the EBT processor to validate against issuance data on the State agencies' systems. The main reason for this is that "batch" issuances are often spread over many days. In some instances, issuances may be spread 20 days or more.

FNS is requesting that the maximum be reduced to 60 days, as State agencies and EBT processors will need an appropriate amount of time to make adjustments, if and when, variances are noted. If we were to reduce the maximum to 30 days, the level of FNS involvement in routine adjustments would most likely increase tremendously. We prefer to leave this responsibility with the State agencies, and continue to focus our involvement on the "exception basis."

**Recommendation 5:** Require SAs to periodically review system access to identify those individuals who no longer have a need and immediately delete their access.

**FNS response:** FNS does not concur with this recommendation. We do not believe regulating down to the level of periodic log-on ID reviews is necessary or appropriate. Current regulations require procedures be established and followed in the area of system access. We think State agencies are willing to cooperate without having a regulatory requirement; however, their circumstances at the time of our notice prevented them from recognizing or addressing this issue fully.

During EBT implementation, State agencies face an enormous task with limited, even shorthanded, staff. Access needs may be overestimated and then not reviewed until operations are statewide, everything and everyone involved settles down, and EBT security is fully absorbed into the overall State agency security program. With the responsibilities for security shared between EBT and State agency security managers, there may be temporary failures to address details. EBT changes the way State agencies do business in this area, as well as many others, and adds another complexity to security matters. We believe all these factors contribute to State agencies failing to perfectly limit EBT system access. We do not believe that State agencies chose to ignore our March 1997 notice. Of the State audits used as the basis for this finding, we note that three were

James R. Ebbitt

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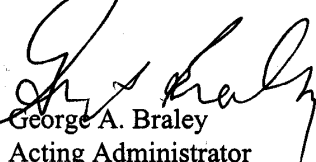
completed before we sent our notice in March 1997. Only one State agency cited for this finding had a fully implemented EBT system at the time we provided our notice. Most of the State agencies cited had no pilots and one was rolling out their system. While some State agencies have not been as diligent as they should be, there has been absolutely no indication of abuse in this area. Nevertheless, we agree with OIG that additional follow-up in this area is warranted.

For management decision, we are proposing to write individually to State EBT managers, with copies to the State FSP Directors, by January 31, 2000. Our letters will direct the

EBT managers to tighten existing controls over EBT access by conducting at least semi-annual reviews of employees with EBT access to determine if such access continues to be needed. We will also advise EBT managers to consult with their State security managers about access reviews of their EBT systems to be certain about roles, procedures, and reports. In addition, we will add the periodic access reviews as an agenda item to our next Regional EBT Coordinator conference call which is currently scheduled for January 4, 2001. We will have the coordinators plan to add this issue to all Regional EBT Users' Group meetings held during FY 2001.

**General Comments:** In the General Comments Section of the report (page 16) OIG suggests that "FNS begin the process to develop program regulations that spell-out the State agencies' requirements for implementing an EBT system for the delivery of WIC program benefits, as they have for the FSP, so that State agencies know specifically what is required." We believe the suggestion is premature considering WIC currently has only three operational EBT pilot systems. At the present time, we do not believe we have sufficient knowledge concerning needed system requirements to develop regulations for an evolving system whose needs are not yet fully known. During our continuing course of pilot implementation and evaluation, FNS will determine if EBT is a feasible and viable alternative for WIC benefit delivery. As the future of WIC EBT becomes more defined, we will continue to evaluate the need to regulate the electronic delivery of WIC benefits.

Once again, we appreciate the opportunity to comment. Please contact Lou Pastura if you have any questions concerning our proposed corrective actions.



George A. Braley  
Acting Administrator

cc: Bonny O'Neil, FSP  
Ron Vogel, SNP  
Gary Maupin, FM

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# ABBREVIATIONS

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AFMS	
Agency Financial Management System .....	3
AMA	
Account Management Agent .....	ii
ASAP	
Automated Standard Application for Payments.....	3
CFR	
Code of Federal Regulations .....	i
EBT	
Electronic Benefits Transfer.....	i
FNS	
Food and Nutrition Service .....	i
FRB	
Federal Reserve Bank .....	4
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