



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

Monitoring of the Electronic Benefit Transfer
System in Michigan



Report No.
27099-0023-CH
AUGUST 2002



UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Midwest Region
111 North Canal Street - Suite 1130
Chicago, IL 60606-7295



DATE: August 21, 2002

REPLY TO
ATTN. OF: 27099-23-Ch

SUBJECT: Monitoring of the Electronic Benefit Transfer (EBT) System in Michigan

TO: Theodore O. Bell
Regional Administrator
Food and Nutrition Service
77 West Jackson Boulevard, 20th Floor
Chicago, IL 60604

This report presents the results of our audit of the Food and Nutrition Service's Monitoring of the Electronic Benefit Transfer (EBT) System in Michigan. Your August 7, 2002, response to the draft report is included as exhibit B with excerpts and the Office of Inspector General's position incorporated into the relevant sections of the report.

Based on the response from your office we have reached management decision for Recommendation Nos. 2, 3, 5, 6, 7, and 8. Correspondence regarding final actions should be addressed to the Office of the Chief Financial Officer. Management decisions have not been reached for Recommendation Nos. 1, and 4. Management decisions on these recommendations can be reached once you have provided us with the additional information outlined in the report section, OIG Position.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation of those recommendations 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. If you have any questions, please have a member of your staff contact John W. Pepper, Assistant Regional Inspector General, at 312-353-4910.

/s/
EDWARD R. KRIVUS
Regional Inspector General

EXECUTIVE SUMMARY

FOOD AND NUTRITION SERVICE FOOD STAMP PROGRAM MONITORING OF THE ELECTRONIC BENEFIT TRANSFER SYSTEM IN MICHIGAN

REPORT NO. 27099-0023-CH

RESULTS IN BRIEF

This audit report presents the results of our audit of the electronic benefit transfer (EBT) system for the Food Stamp Program in Michigan. Our objective was to assess the regional office's and State agency's oversight of the EBT system, the adequacy of EBT system internal controls, and compliance with laws and regulations. We found inadequate controls over the process of updating benefits prior to issuance, and as a result, there is reduced assurance that only authorized benefits are available on the EBT system. Internal controls were also an issue regarding system security. We found that three former employees of the State agency still had an active logon identification, without a clear explanation as to why this occurred. With former employees still having access to the EBT system, the integrity of the entire system is compromised.

Our audit also disclosed the lack of oversight by the State agency, since it did not have a permanent process to monitor its EBT system. Although the EBT system went statewide on July 1, 2001, the State agency has not yet decided which of the processor reports would be needed to effectively manage the EBT system. In addition, the Food and Nutrition Service (FNS) regional office had not provided oversight to ensure that a system was established or a timeframe when the process would be implemented. FNS also lacked oversight in ensuring that the State agency complied with the requirements listed in a waiver allowing the cash-out of food stamp benefits. The cash-out was allowed when a client moved to a State whose system was not interoperable with Michigan's; however, nearly 50 percent of all cash-outs, that occurred from June through December 2001 were in interoperable States.

KEY RECOMMENDATIONS

We recommended that the FNS Midwest Regional Office ensure that the State agency develops controls to ensure that the information in the EBT issuance system is reviewed and supported before a client is allowed access to their benefits.

The State agency should be required to rescind access to its EBT system for the cited unauthorized users and amend its process for verifying and deleting EBT system access in a timely manner. FNS should work with the State agency to develop a time-phased action plan to document how the EBT management reports will be used by each division to manage the State agency's EBT system. Finally, FNS should review the waiver on cash-outs and determine whether the waiver should be extended and for what period.

AGENCY RESPONSE

In its response to the official draft, dated August 31, 2002, FNS agreed with the findings and recommendations except for Recommendation No. 1, in which agency officials stated that it believed the State agency has the organizational structure in place to ensure proper division of responsibility. We have incorporated applicable portions of the FNS response, along with our position, within the Findings and Recommendations section of the report. The FNS response, with attachments, is included in its entirety as exhibit B of the audit report

OIG POSITION

Based on FNS response, we have reached management decisions on Recommendation Nos. 2, 3, 5, 6, 7, and 8. Management decisions on the remaining recommendations can be reached once FNS has provided us with the additional information outlined in the report section, OIG Position. For Recommendation No. 1, we requested an additional response citing the proposed corrective actions to be taken along with their associated timeframes.

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INTRODUCTION

BACKGROUND

The U.S. Department of Agriculture Food and Nutrition Service (FNS) administers the Food Stamp Program (FSP). The FSP assists low-income households by increasing their ability to purchase food. The basic method of FSP benefit delivery is the electronic benefits transfer (EBT) system. Once a month, each participating household receives a supply of coupons determined by the number of people in the family, household income, and other related factors. Recipients can use the EBT to pay for food items at approved food retailers.

The FSP is a Federal-State partnership with the Federal Government paying the full cost of recipient benefits. The Federal Government also pays at least half of the expenses incurred by the States to administer the program. FNS field offices authorize retailer participation in the FSP.

The Food Stamp Act of 1977, Public Law 88-525, authorized FNS to experiment with alternative methods for the delivery of FSP benefits using electronic data processing and computer technology. The Act allowed, with proper oversight, FNS to issue waivers of any part of the Act to State agencies in support of pilot projects that would improve the administration and effectiveness of the FSP in delivering nutrition-related benefits.

The EBT system provides benefit access through automated teller machines¹ and point-of-service terminals located at approved retailers. It replaces the paper-based coupon delivery system with an electronic system. In June 1999, the State of Michigan Department of Family Independence Agency signed a contract with Citicorp Services, Inc., to implement a pilot EBT system in Jackson County, Michigan. The contract included a provision to expand to a statewide system, which was achieved in July 2001.

Michigan uses an on-line (magnetic card) EBT system. On-line systems use the existing card technology developed by financial institutions and credit card companies. The State agency provides a plastic benefit card to

¹ The use of EBT allows States to deliver FSP and other benefits through the same system; however, recipients cannot use automated teller machines to receive FSP benefits in the form of cash, unless the State agency converts those benefits through an approved FNS waiver.

each FSP household. The card has a magnetic strip containing basic information to make food purchases. At an authorized FSP retailer, the recipient presents the card and enters a personal identification number into a point-of-service terminal. The terminal communicates with a central database that maintains recipient account balance information, which has been transferred from Michigan's FSP certification system. The central database verifies the amount of benefits available, authorizes the transaction, and deducts the purchase amount from the household's account. The system also calculates the cumulative FSP sales for each retailer and authorizes payment electronically to the retailers' bank accounts daily. Citicorp learns of changes in authorized retailers through access to the Retailer EBT Data Exchange system maintained by FNS.

OBJECTIVES

The objectives of this audit were to assess the FNS regional office's oversight of and the adequacy of Michigan's EBT internal controls for the FSP. Specifically, we identified the internal controls that were established in key operational areas, performed tests to determine if the controls were operating as designed, and provided an assessment on the adequacy of prescribed controls.

SCOPE

This audit is part of a nationwide effort in the continuing monitoring of a State EBT system. This audit of Michigan's EBT system was conducted at the FNS Midwest Regional Office in Chicago, Illinois; the Michigan Family Independence Agency in Lansing, Michigan; and 5 Michigan local offices in Wayne County (Detroit Metro area) and Kent County (Grand Rapids, Michigan). During fiscal year 2001, the State agency issued over \$504 million in food stamp benefits of \$15 billion issued nationwide. Since the EBT system has expanded statewide, it has about 641,000 recipients and 5,445 retailers. We conducted our fieldwork from November 2001 through February 2002. Our audit coverage was generally from the time the EBT system was implemented statewide in July 2001, through current operations. We expanded audit coverage in certain areas, as indicated in the report.

We conducted the audit in accordance with Government Auditing Standards established by the Comptroller General of the United States.

METHODOLOGY

To accomplish our audit objectives, we: (1) Reviewed EBT policies, program procedures, and pertinent correspondence at the FNS Midwest Regional Office and the Michigan State agency, (2) interviewed responsible FNS personnel, and State agency officials managing the EBT project; and (3) analyzed the State

agency's controls, including the procedures for controlling access to the EBT system. At the five local offices, we reviewed EBT policies and procedures for the certification and issuance of FSP benefits, procedures for the issuance of EBT cards, and procedures used when clients selected their personal identification numbers.

FINDINGS AND RECOMMENDATIONS

| | |
|------------------|--|
| CHAPTER 1 | STATE AGENCY NEEDS TO IMPROVE ACCESS CONTROLS OVER EBT SYSTEM |
|------------------|--|

The State agency needs to improve its controls over the EBT system. Controls over the certification and issuance of FSP benefits need to be enhanced, logon access for FSP employees needs to be rescinded promptly after they resign or transfer to another department, and the State agency, with assistance from FNS, needs to develop a plan as to how management reports provided by the EBT processor will be distributed and used to monitor the program. Developing and maintaining good internal controls over the EBT system will deter system abuses and the issuance of unauthorized benefits.

FINDING NO. 1

UNLIMITED ACCESS TO EBT SYSTEM MAY AFFECT CLIENTS' BENEFITS

FSP caseworkers have unlimited access to the EBT issuance system and can independently change benefits for a recipient. Controls are inadequate to prevent caseworkers from making fraudulent changes to a recipient's food stamp benefits and sending those changes to the EBT issuance system. As a result, there is reduced

assurance that FSP benefits are correct and are properly supported.

Federal regulations require that in order to safeguard certification and issuance records from unauthorized creation or tampering, the State agency shall establish an organizational structure which divides the responsibility for eligibility determinations and coupon issuance among certification, data management, and issuance units. The certification unit shall be responsible for the determination of household eligibility and the creation of records and documents to authorize the issuance of coupons to eligible households. The data management unit, in response to input from the certification unit, shall create and maintain the household issuance record master file on cards, computer discs, tapes, or similar memory devices. The issuance unit shall provide certified households with the authorized allotments².

² 7 CFR 272.4 (c)(1) dated January 1, 2001.

We reviewed casefiles at five local offices and determined that the FSP benefits shown in the issuance system were not supported by documentation in the certification casefiles for 4 of the 112 recipients we reviewed. Once a certification worker enters a password, current procedures allow them to independently modify eligibility data in the State's computerized recipient certification system. When the enter button is keyed into the certification system, the EBT issuance system is automatically updated to reflect the revised benefits. Except for a very small sample of cases reviewed by local office supervisors, there were no second party reviews of certification data entered prior to the issuance system being updated. As a result, there is reduced assurance that only authorized FSP benefits are available on the EBT system.

Although we found that there were adequate controls in establishing a new food stamp case, there were only minimal controls once a recipient is assigned a caseworker. At the local office, caseworkers interview clients and collect and review documentation that supports the certification level as entered into the State agency's certification system. The caseworkers enter the certification system through their password and can update a client's data including number of household members, household expense, and income directly into the certification system. A change in any of these data fields can affect a client's benefit amount. That is why there needs to be a control to prevent a caseworker from autonomously entering data into the certification system that instantly transmits to the EBT issuance system.

The State agency's current review procedures require local office supervisors to review a minimum sample of 4 cases per caseworker per month. However, one of the five local offices we visited selected only new cases for review. These procedures provide little assurance that food stamp cases with a change in benefits will be selected and reviewed to ensure that any changes to a recipient's benefits are legitimate, either before or after they become available in the EBT system. The lack of controls was further evidenced by our review of casefiles at the 5 local offices. We found that 4 of the 112 casefiles we reviewed did not support the EBT benefit level, and therefore these clients received unsupported FSP benefits. Local officials could not explain why the cases had an issuance amount greater than the supporting documents in the casefile.

At two of the local offices, officials were unable to provide two casefiles we had selected for review. They later provided the two missing casefiles, which they told us were located at other local offices. Without the casefile being physically located at the office where the benefits were certified and issued, a caseworker or supervisor would be unable to ensure that the food stamp benefits provided were adequately supported. This presents

further support that controls were needed to ensure a food stamp recipient's issuance amount is supported and that there be adequate separation of responsibilities between the certification and issuance systems.

The need for controls to ensure food stamp benefits are supported by credible documents is highlighted in an OIG Investigation Report of a case in another State. The report described how a caseworker, during the re-certification of a client (an undercover police officer), solicited a bribe in exchange for fraudulently increasing the client's benefits. The caseworker agreed to falsify an increase in monthly expenses thereby increasing the recipient's food stamp allotment.

The State agency's current process of having supervisors review four cases per caseworker per month is not enough to ensure EBT issuance matches supporting documentation. By definition, an internal control should ensure that a particular objective is met: In this instance, there should be a control to ensure that the issuance amount is properly supported by documentation in the casefile. In light of this definition, the current control of reviewing a certain number of cases per month, even if performed diligently, would not ensure completion of the intended objective. The State agency needs to develop control techniques between the establishment of benefits on the State's certification system and when those benefits are made available on the EBT system. All controls developed should meet the objective of ensuring that all adjustments made to client benefits are supported by credible evidence.

RECOMMENDATION NO. 1

Require the State agency to develop controls that would ensure that the information in the EBT issuance system is reviewed and supported before a client is allowed access to their benefits.

Agency Response

In its response, FNS stated that it does not agree with our recommendation and believes that the State agency has the organizational structure required by 7 CFR 272.4 (c)(1). This regulation requires the division of responsibility for eligibility determinations and benefit issuance among certification, data management, and issuance units. The caseworker at the State agency's local office determines eligibility and benefits, but on a daily basis, the information is sent electronically to the EBT issuance system for access by the food stamp

clients. In addition, a caseworker is not authorized to issue an EBT card since that is a function of the local agency's fiscal unit staff. Although FNS acknowledges that there is a risk of a caseworker entering incorrect or fraudulent data affecting a food stamp client's benefits, that risk is mitigated by the local agency's quality control procedures.

OIG Position

We agree that the State agency's current structure does physically separate both eligibility and benefits issuance, but there still is a risk that food stamp benefit levels may not be supported by documentation. This has been proven by FNS reporting on the State agency's consistently high error rate in determining benefit levels. It only appears that there is a division of responsibility between the State agency's certification and the EBT issuance systems. If a case is not selected for review, then the data entered into the certification system is the same as the benefits made available in the EBT issuance system. In addition, the State agency's quality control procedure, of reviewing four cases per caseworker per month, is not enough to ensure EBT issuance matches supporting documentation. In addition, as noted in this report, one of the State's local agencies only selected new cases to review. Therefore, the benefits could be improperly increased in an established case file without the possibility of that case being selected for review.

A time delay between a caseworker entering data in the certification system before being sent to the issuance system does not ensure the accuracy or authenticity of the data. A caseworker would still be able to enter fraudulent household data, thereby raising food stamp benefits, and that benefit will be available to the client after the daily electronic transfer. Both FNS and the State agency have a large investment in both the EBT issuance and certification systems, which could be used to ensure supportable food stamp benefit claims. In order to reach management decision, FNS needs to provide a description of the controls developed and a specific timeframe as to when those controls will be in place.

FINDING NO. 2

SECURITY PROCEDURES AND CONTROLS NEED IMPROVEMENT

The State agency's security procedures over the EBT system allowed former employees access to that system. Current EBT system security procedures place too much reliance on departmental supervisors notifying the security staff when a person no longer needs access, and the EBT processor rescinding unauthorized users' access in a timely manner. As a result, three former employees still had access to the EBT system thereby placing the entire system at risk of improper access and data manipulation.

Federal regulations require that State and local agencies be responsible for the security of all automated data processing operational systems involved in the administration of the FSP³. However, our review of the State agency's security procedures disclosed that several steps were involved to add or remove EBT system access. Failure of a control at any step renders the entire control system ineffective in removing system access in a timely manner. Regardless of which control failed, the fact remains that with former employees still having access to the EBT system, the entire system has been compromised.

The State agency's procedure to add or delete access to the EBT system is to have an employee's supervisor fill out and sign a request form and submit the form to the State agency's system security staff. The employee's job title determines the level of access to the system. The security staff reviews each form for completeness and supervisory approval and then forwards the form to the processor for appropriate action. After the processor has added or deleted user identification access for the employee, it sends a confirmation back to the State agency. The State agency cannot access the processor's system to add or delete an employee's access, or even to monitor the current access listing. This entire process may take days, or even weeks, since the State agency must wait for confirmation from the processor before the security staff is assured that access had been provided or removed.

At the local offices, the primary control for ensuring that former employees no longer have access to the EBT system rests with the EBT coordinator. The coordinator must prepare a form requesting that former employees' access to the EBT system be rescinded; that form is then to be forwarded to the State's security staff. However, we found that EBT coordinators did not always submit the forms to have EBT access deleted for employees who no longer require access. At one local office, we asked for a list of employees currently authorized to access the EBT system. When we reviewed the list, we found one person listed whose employment with the State agency had ended 6 months previously. (Note: Even though this primary control failed, the secondary control discussed in the next paragraph deleted that person's access.) When we asked the EBT coordinator why she had not requested that the former employee's access be rescinded, she stated that she did not even think about it. Although this is the primary control in removing EBT system access, State security staff admitted that local office staff does not always submit the necessary forms.

³ 7 CFR 277.18 (p) (1), dated January 1, 2001.

Without the local office notification, the security staff must rely on secondary controls to prevent unauthorized access. One of the secondary controls consists of specific queries to help detect unauthorized EBT system access. The State agency's system security staff run queries against the State agency's human resources and payroll systems to help identify employees who no longer needed EBT system access. The query against the human resources system is done monthly and identifies employees who have departed (left the State's employ), retired, or been laid off. The results are compared to the EBT system access listing, and if they find employees who have separated per human resources but still have EBT access, they notify the processor to remove that person's access. However, performing a query a month or more after access should have been denied is not an effective control. We performed a similar query by reviewing one month's listing of 791 State agency personnel that had EBT access to the human resource list of personnel that have left the State's employ in the past year. We found that 3 of the 791 still had active logon identification for EBT access even though they no longer worked for the State agency.

The monthly query run against former employees does not take into account employees that transferred to another State position and no longer need EBT system access. To review these possible breaches to system security, the State agency staff performs another query using the payroll system data, which is supposed to identify inter-agency transfers. However, this query is performed once per quarter, so a transferred employee could have active logon identification for up to 3 months before it is discovered. In addition, security staff do not have a query that will show intra-agency transfers, so if an employee changed jobs within the agency, and did not require continued access, security staff would not know to make the deletion unless the employee's supervisor submitted the written request. As noted above, the security system controls are ineffective in identifying and promptly removing EBT system access.

Better coordination between the State's security staff and the EBT processor would help guard the system against unauthorized access. The State agency's current procedures and controls allow the EBT system to be accessed by unauthorized persons. The entire process over EBT system security should be reviewed and amended to ensure that system access is by authorized personnel only. The procedures should include a limited timeframe between the moment a person no longer needs EBT system access and their access being cancelled. The State agency needs a system where they could monitor or delete a person's system access at least on a daily basis.

RECOMMENDATION NO. 2

Require the State agency to revoke system access for the three former employees we identified as having unauthorized access.

Agency Response

In its response, FNS stated that it agreed with our recommendation and have asked the State agency to provide confirmation that system access, by three former employees, has been revoked.

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to OCFO as evidence that system access has been removed for the three former agency employees cited in the report.

RECOMMENDATION NO. 3

Require the State agency to amend its process for adding and deleting EBT system access to ensure that access is by authorized employees only. Also, ensure that the additions and deletions are performed in a timely manner.

Agency Response

In its response, FNS agreed with our recommendation and requested the State agency to provide the corrective actions it will implement to improve its process for adding and deleting EBT system user access.

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to OCFO that the corrective actions will prevent unauthorized EBT system access and not rely solely on backup controls to remove unauthorized user access. FNS also needs to ensure that the State agency's response includes a specific date for implementation.

RECOMMENDATION NO. 4

Until a permanent and efficient system is operational, require the State agency to review its EBT processor contract to ensure the processor is meeting its requirement in adding and especially deleting a person's EBT system access in a timely manner.

Agency Response

In its response, FNS agreed with our recommendation and requested the State agency to provide documentation to support that its EBT contractor had been reminded of its contractual obligation to timely add or remove EBT system user access.

OIG Position

To reach management decision, FNS needs to provide us with the controls the State agency will use to ensure the EBT contractor meets its contractual obligations in maintaining EBT system access by authorized users only.

FINDING NO. 3

STATE AGENCY NEEDS TO ESTABLISH PERMANENT PROCEDURES TO ADEQUATELY MANAGE ITS EBT SYSTEMS

The State agency does not have a permanent process for monitoring its FSP through the use of reports provided by its EBT processor, nor does it have a written policy on identifying potential fraud cases for referral to proper authorities. The State agency has not decided which of the processor-generated reports would be needed to effectively manage the delivery of FSP benefits through its EBT

system. Adding to this indecision was the lack of oversight or guidance by the FNS regional office in ensuring that a system was established or a timeframe when the process would be implemented. As a result, the State agency was unable to effectively manage its EBT system to ensure compliance with FSP requirements.

Federal regulations require that the State shall ensure that the EBT system provides reports that enable it to properly manage the system.⁴ Regulations also require the establishment and operation of fraud

⁴ 7 CFR 274.12 (k) (2) dated January 1, 2001.

detection units that will detect, investigate, and assist in the prosecution of program fraud. States shall have a written procedure for systematically identifying and referring fraud cases for investigation⁵.

EBT was implemented statewide on July 1, 2001, but the State agency has yet to establish a permanent system to monitor system activity. The FNS regional office provided little guidance for the State agency's establishment of an EBT monitoring system. Although the State agency installed a new EBT management team at the start of statewide operation, they have yet to establish timeframes as to when a management and fraud detection system would be implemented. Without procedures to monitor the EBT system or to detect possible fraudulent activity, there is reduced assurance of the system's effectiveness and compliance with program requirements.

The processor provides the State agency with management reports that detail various EBT activities. These reports are transmitted to the State agency's data center electronically, either daily or monthly, and provide financial, operational, fraud, performance, and security data. The data center controls the flow of all reports and ensures the personnel identified on the distribution list receive their reports timely. Since statewide implementation of EBT, the State agency's new management team has been meeting on a regular basis to review and analyze all EBT management reports. However, after several months of reviews, the State agency neither has a permanent system to ensure the appropriate personnel receive the reports nor determined whether those reports are being used to manage the EBT system.

Although the State agency's data center was distributing reports to appropriate divisions, the State agency's Office of Inspector General (OIG) division was not using this information. This division received reports on potential fraud; however, there was no evidence that it used these reports to identify suspicious activity. Although OIG personnel stated that they reviewed the reports, our review of the manual transaction reports that the OIG division received did not indicate that anything was reviewed or that any action was taken. There were no markings, notes, or spreadsheets made available as evidence that the report was ever reviewed. Furthermore, manual transaction usage reports for July and October 2001 were not provided to the State's OIG division.

A State OIG official stated that they are still working on profiling techniques for monitoring and identifying unauthorized manual transactions. This was the main reason given why the State's OIG division refused to provide us a

⁵ 7 CFR 272.4 (h) dated January 1, 2001.

copy of its draft policies and procedures. Federal regulations require State agencies to establish and operate fraud detection units, with written procedures, which systematically identify and refer potential fraud cases for investigation⁶.

An FNS regional official stated that they have not issued any guidance to States relating to management reports. The State agency would benefit from FNS guidance in the development of procedures for using the reports provided by the processor to manage the EBT system. With FNS' knowledge of other State systems and monitoring procedures and its association with processors, it could provide samples of best practices and alternatives for States to follow in managing their EBT systems.

The State agency's evaluation of the processor's management reports has been an ongoing process, but it needs to set timeframes for when this review process will be completed. The State agency needs to have a permanent system in place to monitor the EBT system through the use of EBT processor management reports. The State agency also needs to establish written procedures on fraud detection as soon as possible, so that potential fraud cases can be handled in a systematic manner and not be overlooked.

RECOMMENDATION NO. 5

Work with the State agency to develop a time-phased action plan to document the purpose, distribution, and description of how the EBT management reports will be used by each division to manage the State agency's EBT system.

Agency Response

In its response, FNS stated that it forwarded a list of EBT system reports that the State agency must receive to properly monitor the FNS regulatory requirements covering EBT operations. In addition, FNS notified the State agency that other reports may be needed to monitor EBT waivers and managing the EBT contract. FNS requested the State agency to respond as to when the reports will be received and who will be responsible for reviewing the EBT contractor reports.

⁶ 7 CFR 272.4 (h) dated January 1, 2001.

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to OCFO that FNS received the State agency's plan to use EBT system reports to monitor EBT operations and when that plan will be implemented.

RECOMMENDATION NO. 6

Work with the State agency to develop a time-phased action plan to ensure EBT client integrity.

Agency Response

In its response, FNS concurred with our recommendation, and in conjunction with the State agency, it had developed a client integrity plan. On July 25, 2002, FNS sent a memorandum of understanding to the State agency for signature. The memorandum of understanding details the responsibility of both FNS and the State agency in ensuring food stamp client integrity

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to the OCFO that the memorandum of understanding on the client integrity plan with the State agency is signed, implemented, and monitored for effectiveness.

FINDING NO. 4

The FNS regional office did not ensure that the State agency complied with the terms of the waiver that allowed the State agency to convert food stamp benefits to cash. This occurred because the FNS regional office did not indicate the time period when the waiver was in effect, nor require the State agency to report on the status of the cash-outs made. Although the FNS regional office initially required data relating to cash-outs, it decided that the data it received was not useful in monitoring the State agency's activities. As a result, FNS regional officials were unaware that, within a 7-month period, the State agency cashed out over \$68,000 in food stamp benefits in direct violation of the FNS waiver.

The Food Stamp Act of 1977 states that an experimental project, which can only be conducted by waiving requirements of The Act, must include an evaluation to determine the effects of the project⁷. The Act also states, that for an experimental project requiring a waiver, a project is considered impermissible if it is not limited to a specific time period⁸. FNS did not adhere to these two provisions when it granted the Michigan State agency a waiver from Food Stamp Act provisions that allowed the State agency to convert the remaining EBT food stamp benefits in a household's account to cash when the household moved to a State that was not interoperable with Michigan.

An interoperable State is one that belongs to and follows the Quest operating system. The Quest operating rules allow States to issue benefits using their own EBT card, but allow a recipient to use these benefits in another State operated under these same rules. There are⁹ 30 States that are interoperable with Michigan's EBT system. When FNS issued the cash-out waiver, it was clear that Michigan was not to cash-out any FSP benefits when recipients moved to an interoperable State.

The State agency requested that FNS waive the prohibition that food stamp benefits not be converted to cash, and on March 6, 1996, FNS

⁷ Section 17 (b) (1) (B) (i) (II) (b) (1) (A) of the Food Stamp Act of 1977, as amended 1996.

⁸ Section 17 (b) (1) (B) (iv) (V) of the Food Stamp Act of 1977, as amended 1996.

⁹ Some of these States may not yet be interoperable Statewide. See footnote for exhibit A.

approved a waiver of the cash-out requirements, but with several stipulations. One of the stipulations being that these cash-outs should not be done if the State to which the household was moving had interoperability with Michigan's EBT system. FNS further stipulated in the waiver that the State agency must submit quarterly and annual reports to FNS that included the number of households and dollar amount in those cash conversions. An FNS regional official stated that after they received the reports on cash-out activity, they determined that the reports were not useful and quit requiring the State agency to submit them.

The Act also required that any waiver issued would have to specify a time period it would be in effect. Neither the State agency's waiver request nor the subsequent approval of that request by FNS stipulated a time period. An FNS official told us that the waiver would expire when the State agency's current EBT processor contract expired in 2006. Later, he told us that States that had the waiver approved before the August 1996 deadline, with FNS' approval, could be able to continue to use it for subsequent contracts. Provided FNS continues to approve the waiver, Michigan would be able to cash-out food stamp benefits indefinitely.

The FNS cash-out waiver became effective July 1, 2001, when Michigan began statewide EBT implementation. To determine whether the State agency was adhering to the conditions of the FNS waiver, we reviewed a State agency report of all FSP recipients that cashed out their benefits from July 1, 2001, through December 31, 2001, their address of record, and the amount of FSP benefits cashed out. During that 6-month period, the State agency cashed out FSP benefits for a total of 521 recipients. In direct violation of the FNS waiver, 236 of the 521 FSP recipients were allowed to cash-out \$62,590 in FSP benefits: 194 had moved to another location within Michigan and 42 had moved to an interoperable State. In June 2001, prior to the effective date of the waiver, the State agency converted \$5,702 worth of FSP benefits to cash for 22 recipients. In total, 258 food stamp recipients received \$68,292 in cash instead of having those benefits transferred via EBT to their new residence. (See exhibit A.) Had the FNS regional office reviewed the same report we reviewed, it too could have confirmed that the State agency was not complying with the terms of the waiver.

According to The Act, all States will be required to have completed the installation of their EBT systems and all systems must be interoperable by October 2002. However, until nationwide interoperability is achieved, FNS needs to perform annual reviews to determine whether this waiver to cash-out benefits should be maintained. Until this waiver is rescinded, FNS needs to obtain feedback from the State agency in order to

adequately monitor the State agency's use of the waiver. An FNS regional official defended their use of the waiver by stating that without a guarantee of benefit portability, cash conversion is the best way to ensure that clients are able to use their benefits. However, this does not relieve FNS of its responsibility for ensuring that the State agency complies with the terms of the waiver.

RECOMMENDATION NO. 7

Determine what information is necessary to assure that the Michigan State agency complies with the waiver to cash-out food stamp benefits (waiver number 960040), and obtain this information on a quarterly and annual basis.

Agency Response

In its response, FNS agreed with our recommendation and requested that the State agency provide documentation that it reminded its local agencies that a food stamp client leaving the State may have their benefits cashed-out only when a client moves to a non-interoperable State. FNS requested that the State agency notify them which quarterly and annual reports will be made available to FNS in order to determine if a food stamp client's benefits were cashed-out appropriately. The State agency reports must be submitted to FNS starting with the quarter ending September 30, 2002.

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to OCFO that the State agency notified its local agencies about the restrictions to EBT cash-outs and FNS has received the State agency reports on cash-out activity.

RECOMMENDATION NO. 8

Review the State's quarterly and annual reports on cash-outs, and at least annually, determine whether the waiver should be extended and for what period.

Agency Response

In its response, FNS concurred with our recommendation and stated it will review, at least annually, the State agency's quarterly and annual reports of food stamp benefits that were cashed-out. Beginning no later than December 30, 2002, FNS will monitor the State agency's use of the cash-out waiver and will determine whether the waiver should be extended and for what period.

OIG Position

We accept FNS' management decision. For Final Action, provide documentation to OCFO that you have reviewed the State agency's reports on its cash-out activity.

EXHIBIT A – VALUE OF FOOD STAMP BENEFITS IMPROPERLY CONVERTED TO CASH

| STATES WITH INTEROPERABLE EBT SYSTEMS¹⁰ | NUMBER OF FOOD STAMP RECIPIENTS | VALUE OF FOOD STAMP BENEFITS CONVERTED TO CASH |
|---|--|---|
| Alabama | 1 | \$355 |
| Arizona | 4 | 387 |
| Arkansas | 3 | 473 |
| Florida | 18 | 5,055 |
| Georgia | 2 | 700 |
| Kentucky | 4 | 640 |
| Maryland | 1 | 312 |
| Michigan | 194 | 52,690 |
| Minnesota | 1 | 372 |
| New York | 3 | 522 |
| North Carolina | 2 | 324 |
| Washington | 2 | 630 |
| Wisconsin | 1 | 130 |
| Subtotal | 236 | \$62,590 |
| Total Cash-Outs in June 2001 (prior to FNS waiver) | 22 | \$5,702 |
| GRAND TOTAL | 258 | \$68,292 |

¹⁰ Three States, Idaho, Tennessee, and Virginia are interoperable with Michigan's EBT System but have not yet provided Statewide access. Eight recipients from these States cashed-out their benefits totaling \$1507.

EXHIBIT B- FNS RESPONSE TO THE DRAFT REPORT



United States
Department of
Agriculture

Food and
Nutrition
Service

Midwest Region

Edward R. Krivus, Regional Director for Audit
Office of the Inspector General
Midwest Regional Office
111 North Canal Street, Suite 1130
Chicago, IL. 60606-7295

August 7, 2002

Dear Mr. Krivus:

77 W. Jackson Blvd.
20th Floor
Chicago, IL
60604-3511

We have received the Official Draft Report 27099-0023-Ch, "Monitoring of the Electronic Benefit Transfer System in Michigan" We address each recommendation below.

Recommendation 1: Require the State agency (SA) to develop controls that would ensure that the information in the EBT issuance system is reviewed and supported before a client is allowed access to their benefits.

FNS does not agree with this recommendation.

FNS believes that the State agency has the organizational structure required by 7 CFR 272.4(c)(1) that divides the responsibility for eligibility determinations and benefit issuance among certification, data management, and issuance units. Local office caseworkers in Michigan are responsible for collecting information from food stamp applicants and for determining household eligibility by entering household information into the State agency's (SA) eligibility system. This is an inherent function of food stamp caseworkers. However, the SA has implemented a separation of duties as required by program regulations. Specifically, the EBT system is not instantly updated to reflect the eligibility information entered by caseworkers. The SA sends electronic files containing the demographic and benefit information for participating households to the State's EBT system contactor through a batch process. This batch transmission of demographic and benefit information is managed by SA information technology staff. Food stamp caseworkers are not involved in the transmission of these files, nor the validation that the number of records were successfully transmitted and posted by the EBT contactor. Finally, food stamp caseworkers do not have the required EBT system access to issue an EBT card. Local office fiscal unit staffs, not caseworkers, perform the issuance of EBT cards over-the-counter in local offices. As a result, a caseworker could not create a new food stamp case or change an existing food stamp case on the eligibility system and then independently issue an EBT card for this household over-the-counter in the local office. FNS recognizes that this is a primary function of caseworkers to enter household information into the SA eligibility system and, as a result, there is a risk that caseworkers could enter incorrect or fraudulent information that may ultimately affects a household's benefit level. However, Quality Control procedures are in place to mitigate this risk. In addition, the SA is responsible for monitoring and addressing instances of deliberate fraud such as those that were referenced as occurring in another State.

Recommendation 2: Require the SA to revoke system access for the three former employees we identified as having unauthorized access.

FNS agrees with this recommendation.

We have asked the SA to confirm that they have revoked system access for the three former employees identified by OIG in the audit.

Estimated completion date is August 31, 2002.

Recommendation 3: Require the SA to amend its process for adding and deleting EBT system access to ensure that access is by authorized employees only. Also, ensure that the additions and deletions are performed in a timely manner.

FNS agrees with this recommendation.

We have asked the SA to provide us with corrective action to improve its process for adding and deleting EBT system users to ensure that only authorized users have access to the system.

Estimated completion date is November 30, 2002.

Recommendation 4: Until a permanent and efficient system is operational, require the SA to review its EBT processor contract to ensure the processor is meeting its requirement in adding and especially deleting a person's EBT system in a timely manner.

FNS agrees with this recommendation.

We have asked the SA to provide us documentation showing that they have advised the EBT contactor of its contractual obligation the timely addition and deletion of EBT system users.

Estimated completion date is November 30, 2002.

Recommendation 5: Work with the SA to develop a time-phased action plan to document the purpose, distribution, and description of how the EBT management reports will be used by each division to manage the SA's EBT system.

FNS agrees with this recommendation.

We have forwarded to the SA a listing of reports that FIA must receive and review in order to monitor the FNS regulatory requirements covering EBT system operations. We have also identified reports that will enable FIA to monitor areas covered by EBT waivers. Finally, we have identified reports that will enable FIA to manage/monitor contractor performance.

We have informed the SA that the listing is not to be considered exclusive and does not preclude the SA from receiving and reviewing other reports the SA deems necessary to manage the EBT contract. We asked that we be notified when they will begin receiving the reports and who will be responsible for reviewing the reports.

Estimated date of completion is November 30, 2002.

Recommendation 6: Work with the SA to develop a time-phased action plan to ensure EBT client integrity.

FNS agrees with this recommendation.

We have been working with the SA to address EBT client integrity in Michigan. We have sent the SA the final time-phased action plan covering these procedures for signature.

Estimated completion date is November 30, 2002.

Recommendation 7: Determine what information is necessary to assure that the Michigan SA complies with the waiver to cash-out food stamp benefits (waiver number 960040), and obtain this information on a quarterly and annual basis.

FNS agrees with this recommendation.

We have asked the SA to provide us with documentation that they have reminded local agencies that clients leaving Michigan should only have remaining EBT benefits cashed-out when they are moving to a State which is not interoperable with the Michigan EBT system. Also FIA must identify which reports will be made available to FNS on a quarterly and annual basis that will enable us to compare the benefits that have been cashed-out for EBT conversion with the State that client has moved to in order to determine if a client was cashed-out appropriately. We asked that the SA provide us with an example of the reports. The reports should be submitted to FNS on a quarterly basis beginning with the quarter ending September 30, 2002.

Estimated completion date November 30, 2002.

Recommendation 8: Review the State's quarterly and annual reports on cash-outs, and at least annually, determine whether the waiver should be extended and for what period.

FNS agrees with this recommendation.

We will review the State's quarterly and annual reports on cash-outs at least annually, and will determine whether the waiver should be extended and for what period upon receipt of the SA's reports.

Estimated completion date December 30, 2002.

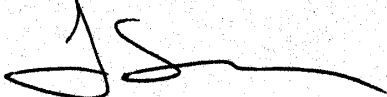
Edward Krivus

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FNS agrees with exhibit A – Value of food stamp benefits improperly converted to cash, in the audit report.

If you have any questions, please contact me at (312) 353-8239 or e-mail me at frank.suchy@fns.usda.gov.

Sincerely,



FRANK SUCHY
Chief
Fiscal/State Systems
Financial Management

cc: Tim English, Chief, FSP

Informational copies of this report have been distributed to:

Agency Liaison Officer

General Accounting Office (1)

Office of Management and Budget (1)

Office of the Chief Financial Officer

Director, Planning and Accountability Division (1)

OIG Headquarters

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