



U.S. Department of Agriculture

Office of Inspector General



Summary of Nationwide Electronic Benefits Transfer Operations

Audit Report 27099-71-Hy
January 2010



U.S. Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: January 26, 2010

REPLY TO

ATTN OF: 27099-71-HY

TO: Julie Paradis
Administrator
Food and Nutrition Service

ATTN: Lael Lubing
Director
Grants Management Division

FROM: Tracy LaPoint /s/
Acting Assistant Inspector General
for Audit

SUBJECT: Summary of Nationwide Electronic Benefits Transfer (EBT) Operations

Summary

We conducted our audit, in part, to evaluate retailer verification controls over EBT transactions processed through third party processors (TPP). Although we found that the Food and Nutrition Service (FNS) generally had adequate controls over these processes, we did note one area in which we believe that the agency's control could be strengthened. In reviewing Special Nutrition Assistance Program (SNAP) transactions at three TPPs for October 2008, we identified a small number of instances in which retailers redeemed SNAP benefits using incorrect store authorization numbers. Most of these instances involved either chain stores that incorrectly assigned the same authorization number to more than one of their stores, or input errors made by TPPs. Although FNS regulations require that the retailer authorization number accompanying each SNAP transaction be matched to the agency's database of authorized retailers, this control does not identify cases where otherwise valid authorization numbers are used by retailers other than those to whom they were assigned. FNS' current policy is to deal with these situations on a case-by-case basis as they occur. However, this weakness does carry the potential for program misuse. The items we identified were not material enough to justify a formal recommendation. However, FNS has agreed to take actions to address these issues. FNS plans to work with the EBT community to ensure the proper retailer authorization number is used and, if necessary, updated with accurate information in a timely manner.

We also conducted our audit to determine if FNS officials took corrective actions in response to our prior recommendations related to nationwide control deficiencies identified in EBT audits performed since 2006 (see Exhibit A). We found that FNS implemented these recommendations

as intended. In addition, we evaluated whether FNS or State agencies monitored the financial viability of the EBT prime processors upon whom they depend to process SNAP transactions, so that actions could be taken to ensure the continuation of SNAP operations if one or more of the prime processors were to become insolvent. We found that although FNS defers primarily to States, the three States we contacted did have contingency plans to replace prime processors if necessary.

Background

FNS administers SNAP through Federal-State partnerships to assist low income households to purchase food. Participating households receive monthly benefits to pay for food at participating authorized food retailers. Approximately \$34.6 billion in SNAP benefits were issued in 2008 to over 12.7 million households for use at more than 175,000 authorized retailers. The Office of Inspector General (OIG) has monitored and audited the implementation of EBT for SNAP by FNS and States since April 1995.

Generally, States award contracts to private sector companies, referred to as prime processors, to develop and operate their EBT systems. These companies are usually financial institutions or other organizations that already handle debit and credit card systems or electronic funds transfer activities. In addition, EBT processing functions may also be handled by other companies that operate existing electronic funds transfer networks. These companies, referred to as third party processors (TPP), generally contract with retailers who wish to handle other types of electronic transactions besides SNAP. To process SNAP transactions, each TPP must enter into an agreement with one of the prime processors which permits the TPP's point-of-sale terminals at retail stores to accept EBT transactions. At the time of our audit there were seven prime processors,¹ and we identified 22 TPPs operating in the SNAP.² Each State remains financially liable to FNS for the actions of their EBT processors, including TPPs.

To become an authorized retailer, a store owner submits an application to FNS. FNS reviews all applications for accuracy, conducts a background check for past SNAP history, and evaluates the store for eligibility. For the application to be approved, FNS checks its database of retailers to determine if the applicant has been disqualified from participating in the SNAP Program. While the application is being processed, an FNS representative may visit the store to verify information. If the information is verified and/or the application is approved, FNS authorizes the store to participate and issues a permit to the retailer. The permit includes a unique 7-digit FNS authorization number and certifies that the owner and business location are granted approval to accept and redeem SNAP benefits according to program requirements. The authorization number is used in each SNAP transaction to identify the retailer. The permit is non-transferable and is voided by changes involving ownership, location, or the name of business. A retailer could also lose their permit due to inactivity. FNS routinely monitors retailer activity and conducts a reauthorization of each authorized store at least once every five years.

¹ Affiliated Computer Services, eFunds, JPMorgan Electronic Financial Services, Northrop Grumman, and Evertec are prime processors. Texas and Montana act as their own prime processors.

² FNS could not provide us with the total number of TPPs operating in the SNAP.

Objectives

Our objectives were to (1) assess whether FNS addressed nationwide control deficiencies identified since 2006, (2) evaluate retailer verification controls over EBT transactions processed through third party processors, and (3) assess whether SNAP officials monitor the financial viability of EBT prime processors if one or more of the States' prime processors were to become insolvent.

Details: FNS Controls to Ensure Accurate Retailer Authorization Numbers Could Be Strengthened

Our analysis of October 2008 settlement data³ for approximately 60,000 retailers disclosed that 34 retailers processed over \$1.1 million in SNAP benefits using FNS authorization numbers that were actually assigned to other retailers. Although FNS regulations require that the FNS authorization number accompanying each SNAP transaction be matched to the agency's database of authorized retailers, this control did not identify these instances because the authorization numbers used were valid numbers in the database. Although we identified no instances of fraud, this weakness could allow the redemption of SNAP benefits by unauthorized individuals or businesses.

FNS is directly responsible for managing retailer participation, which includes ensuring that only currently authorized retailers transact benefits. FNS collaborates with States, which hold contracts with EBT prime processors. FNS also conveys retailer authorization information from the Retailer EBT Data Exchange (REDE) file directly to the prime processors. The prime processors use the FNS REDE file to ensure that only authorized retailers are able to pass SNAP transactions through the system. The prime processors use the data to prevent disqualified or withdrawn retailers from participating in the program.⁴ In addition, each State agency is responsible for ensuring that their EBT processor verifies the FNS retailer authorization numbers for all transactions against the National REDE file.⁵ Retailers, such as supermarkets that do not want to use State-issued point-of-sale devices because they transact more than SNAP benefits, can transact SNAP benefits through a TPP. The State's EBT prime processor contracts with TPPs, who then relay their EBT SNAP transactions – including FNS store authorization numbers and transaction amounts – to the prime processor. The prime processor transmits the SNAP reimbursements to the TPP, who in turn reimburses each retailer with whom it contracts.

While conducting a 2008 audit of California's EBT system,⁶ we found that TPPs under contract with the State's prime processor may not have established controls to check the validity of FNS retailer authorization numbers. As part of our current audit, we assessed the risk associated with this potential lack of controls. We selected three prime processors for review and obtained SNAP settlement data for October 2008 from three of their TPPs. For each of the approximately 60,000 SNAP retailers that participated with the selected TPPs that month, we matched the FNS

³ This data, provided by the selected TPPs, included the total amounts of SNAP redemptions paid to individual retailers by the TPPs for October 2008. It also included the name, address, and FNS authorization number for each retailer.

⁴ 7 C.F.R. 274.12(e)(4).

⁵ 7 C.F.R. 274.12(h)(10)(v).

⁶ Report No. 27099-35-SF, *FNS' Continued Monitoring of EBT Operations – State of California Department of Social Services*, December 2008

authorization number, the name of the retailer, and the retailer's address to the FNS REDE file to verify the retailer's authenticity.

In this review we found that 2 TPPs processed transactions totaling \$1.1 million for 34 retailers using FNS authorization numbers that belonged to other retailers. Most of these were chain stores where either the TPP entered the number incorrectly, or corporate administrative personnel for the chain stores reported the same FNS authorization number to the TPP for multiple stores. According to TPP representatives, this occurs because chain store administrative personnel did not always realize that each store had a unique FNS authorization number. For example, one large retailer had three different stores, each of which had their own corporate merchant number⁷ and FNS retailer authorization number. However, the TPP incorrectly used the authorization number for one of the stores to process transactions for all three. This situation, if uncorrected, could in the long term prompt FNS to revoke the authorizations for the other two retailers due to inactivity.

Another example involved two stores using the same FNS authorization number. These stores transacted \$58,424 and \$26,854, respectively. FNS researched this case and found that there was a change in ownership that was not reported to FNS. The new owner should have applied to FNS for approval to accept and redeem SNAP benefits while the old owner should have reported the sale of the store to FNS.

These situations were typical of the issues in the other cases. We worked closely with FNS Benefits Redemption Division officials to resolve these issues, and also coordinated with various officials of prime processors and TPPs. In addition, we discussed the 34 cases with OIG's investigative staff who also conducted follow-up work. Based on this work, OIG did not detect any fraudulent activity.

TPP personnel we interviewed stated that when a retailer applies for the TPP's services and submits an FNS retailer authorization number, they are not required to verify that either the retailer itself or the supplied authorization number is valid. FNS officials stated that there had not been a history of fraudulent activity associated with one retailer's use of another's authorization number, and that they had tended to deal with occurrences on a case-by-case basis as they arose. However, without a mechanism to reliably verify the retailer's authenticity there is reduced assurance that either FNS, State agencies, or EBT processors would become aware of such activity were it to occur.

The items we identified were not material enough to justify a formal recommendation. However, FNS officials agreed that action needed to be taken to address this weakness. As a result, they proposed to work with the EBT community and strongly encourage the TPPs to (1) use the REDE file to validate FNS authorization numbers at the time retailers apply for their services; (2) establish a process for cross-checking FNS authorization numbers against each retailer's merchant identification number so that a single authorization number cannot be used by multiple retailers; and (3) to resolve these issues within a set time period.

No further response to this report is required.

⁷ The corporate merchant number is assigned by the TPP in their own unique store numbering system and it is distinct from the FNS authorization number.

Scope and Methodology

We performed our audit at the FNS Headquarters in Alexandria, Virginia and at one prime processor's office in Austin, Texas. To evaluate the adequacy of FNS' implementation of EBT operations on a national basis, we conducted interviews of FNS officials, examined documentation, analyzed data, reviewed FNS policies and procedures, and reviewed OIG audit reports issued since 2006 (see Exhibit A). Our assessment of FNS' corrective actions on nationwide control deficiencies focused on prior audit recommendations concerning system security, EBT equipment safeguards, unapplied benefits,⁸ and State refund controls.

Our evaluation of retailer verification controls reviewed operations of FNS' Benefit Redemption Division, EBT prime processors, and TPPs for a one-month period. We selected EBT transactions from October 2008 because it marked the start of our fieldwork and we expected data would be readily available. For our review, we selected the three prime processors that had the most EBT contracts with State agencies. The selected prime processors had a total of 50 contracts. We obtained and analyzed complete settlement data for three TPPs. The data represented about 30 percent of the retailer settlement totals reported by prime processors for October 2008. We conducted follow-up interviews with FNS, prime processors, TPPs, and OIG investigations and made written inquiries as necessary to complete our analyses.

Due to the economic downturn in 2009, we expanded our audit coverage to assess SNAP officials' monitoring of the financial viability of EBT prime processors and the potential impact on EBT operations. We interviewed FNS National office officials and State agency officials from Maryland, New York, and Wisconsin about their monitoring of the financial viability of their EBT prime processors.

The audit was performed in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁸ Transactions that cannot be applied to a specific household EBT benefit record.

Exhibit A: EBT Audits Since 2006

Prior Audit	Nationwide EBT System Deficiency Identified	Deficiencies Identified	Recommendation Implemented (Yes or No)
FNS EBT National Office Oversight - Report No. 27099-66-Hy - September 2006	Yes	Controls over EBT systems access and controls to safeguard EBT POS equipment needed strengthening.	Yes
FNS JPMorgan EFS' Oversight - Report No. 27099-69-Hy - September 2007	Yes	Controls over unapplied benefits and State refunds needed strengthening.	Yes
Electronic Benefits Transfer System State of Colorado - Report No. 27099-68-Hy - June 2008	No	Management and oversight by the State agency needed to be improved, but no EBT system deficiencies were noted.	Not Applicable.
FNS' Continued Monitoring of EBT Operations – State of California Department of Social Service – Report No. 27099-35-SF - December 2008	No	No deficiencies identified.	

For prior OIG EBT audits since 2006, Exhibit A shows whether the audit identified nationwide EBT system deficiencies. It describes the deficiencies identified during the audit, and whether or not the recommendations to correct the deficiencies were implemented.

Informational copies of this report have been distributed to:

Administrator, FNS, Attn: Agency Liaison Officer (8)

Director, Civil Rights (1)

Office of Management and Budget (1)

Government Accountability Office (1)

Office of the Chief Financial Officer (1)

Director, Planning and Accountability Division (1)