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TO: Audrey Rowe
Administrator
Food and Nutrition Service

ATTN: Mark Porter
Acting Director
Office of Internal Controls, Audits and Investigations

FROM: Gil H. Harden
Assistant Inspector General
for Audit

SUBJECT: State Fraud Detection Efforts for the Supplemental Nutrition Assistance
Program (SNAP)

This report presents the results of our audit of State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program. Your response to the official draft report, dated, December 15, 2011, is included in its entirety in the audit report, with excerpts and the Office of Inspector General's position incorporated into the relevant sections of the report. Based on the written response, we have accepted management decision for all recommendations in the report, and no further response to us is necessary.

Please note that Departmental Regulation 1720-1 requires final action to be reached on all recommendations within 1 year of management decision to avoid being listed in the Department's annual Performance and Accountability Report. Please follow your office's internal procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions.

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State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program

Executive Summary

The Supplemental Nutrition Assistance Program (SNAP) helps 42 million low-income individuals and families to purchase food they need for healthy eating choices by supplementing their incomes with benefits through the use of an electronic benefits transfer (EBT) system. On February 17, 2009, Congress enacted and the President signed into law the American Recovery and Reinvestment Act (Recovery Act) of 2009,¹ to promote economic recovery and assist those most impacted by the economic downturn. The Recovery Act provided the Department of Agriculture (USDA) with \$28 billion in funding. Of this amount, the Recovery Act increased the amount of SNAP benefits by 13.6 percent² and provided \$290.5 million in funding for State Administrative Expenses to handle the anticipated increase in SNAP caseloads. As part of the Recovery Act, Congress emphasized the need for accountability and transparency in the expenditure of funds. Accordingly, the Office of Inspector General (OIG) initiated this audit to assess the effectiveness of the State fraud detection efforts for SNAP. We also followed up on six recommendations we made in prior OIG reports³ that dealt with the fraud detection units (see exhibit A). We found that Food and Nutrition Service (FNS) fully implemented our recommendations that the Colorado Department of Human Services (CDHS) establish a fraud unit, and that both CDHS and New York's Office of Temporary and Disability Assistance (OTDA) strengthen their use of EBT management reports to detect and follow up on suspicious and unusual SNAP transactions.

In our previous audit, OTDA determined that the management reports provided by its current EBT processor were unreliable; therefore, it elected to use the EBT transaction data from the State Fraud and Abuse Reporting system extract file, which would allow the agency to detect improper EBT activity. Further, FNS is working with CDHS to reach an agreement on how its fraud detection units can best use the EBT data available to identify, investigate, and disqualify recipients involved in trafficking SNAP benefits.

Overall, we focused our audit efforts in two States, New Jersey and Florida, to assess FNS' oversight of the States' efforts to target recipients who fraudulently use their SNAP benefits. This entailed ensuring that (1) proper internal control procedures were established, (2) participants properly complied with program requirements, and (3) effective compliance operations were established. We identified two issues relating to the States' fraud detection efforts:

¹ Public Law 111-5.

² The potential amount of benefits to be funded through the Recovery Act increased when estimates were prepared for the (FY) 2011 budget. According to FNS, the Recovery Act funding for SNAP is now estimated to total over \$65 billion through FY 2019.

³ Audit Report 27099-68-Hy, "Electronic Benefits Transfer System - State of Colorado," June 2008, and Audit Report 27099-16-Hy, "Electronic Benefits Transfer System - State of New York," December 2001.

- FNS did not require the States to use the management reports provided by their EBT processors; thus, neither State we visited was using these reports to identify potentially fraudulent activities by SNAP recipients for investigation or other follow up. In the course of our audit we identified over 2,600 questionable transactions using these reports, totaling over \$181,700 for a 1-month period.
- FNS did not establish an effective review process to periodically assess the States' fraud detection efforts. The States' management evaluation (ME) reviews did not address the efficiency and functioning of the fraud detection units. Instead, FNS relied upon the information collected by the States and reported in FNS' annual State Activity Report (SAR), which we found to be of questionable accuracy in some cases. For instance, we noted that New Jersey State agency officials could not substantiate some of the information they reported to FNS. Although the State agency reported to FNS the issuance of 14 waivers where clients signed disqualification consent agreements,⁴ county reports to the State showed that 125 of these waivers were issued. State officials could not explain this discrepancy.

FNS has a management control structure in place that does not sufficiently assess the effectiveness of the States' fraud detection efforts. By addressing these concerns, FNS could put in place a more robust control environment for assessing the States' fraud detection efforts and for targeting recipients that are fraudulently using their SNAP benefits.

This report consolidates the audit results from our two Fast Reports dated July 12, 2010, and September 10, 2010. In its responses to the Fast Reports, FNS generally agreed with the findings and recommendations, but believed that they were not necessarily applicable nationwide. However, past audits⁵ have noted similar issues regarding the effectiveness of States' SNAP fraud detection efforts, including not using available EBT management reports. Therefore, we believe the issues are not merely isolated cases. Addressing these issues nationwide⁶ could assist other States in ensuring that effective internal controls are in place to identify potentially fraudulent activities by SNAP recipients

Recommendation Summary

FNS should establish and provide guidance to States in identifying and assessing available EBT management reports to determine which reports could be most useful to each State's fraud detection units. Furthermore, FNS needs to encourage States to utilize the EBT management reports in detecting fraudulent activities and in following up on SNAP transactions that could be indicative of fraudulent activities. FNS should require States to implement procedures for the periodic review and analysis of management reports to detect and follow up on questionable SNAP transactions. FNS should perform reviews as needed to determine the extent to which an

⁴ This reflects the number of cases where individuals waived their rights to a hearing and did not contest the disqualification period.

⁵ Audit Report 27099-68-Hy, "Electronic Benefits Transfer System State of Colorado," June 2008, and Audit Report 27099-16-Hy, "Electronic Benefits Transfer System State of New York," December 2001.

⁶ The recommendations from these two reports were directed only at the States where they were performed, and were therefore not implemented on a nationwide basis.

assessment of State fraud detection efforts may be compromised by inaccurate information provided by the States, and take corrective actions as necessary. FNS should also include as part of their ME review process an assessment of the States' fraud detection units.

Agency Response

In their response dated December 15, 2011, FNS officials agreed with the findings and recommendations as presented in this report. We have incorporated portions of the FNS response, along with our position, in the applicable sections of this report. FNS' response to the official draft report is included in its entirety at the end of this report.

OIG Position

Based on FNS' response, we have reached management decisions on all recommendations in this report.

Background and Objectives

Background

The Food and Nutrition Service (FNS), an agency within the Department of Agriculture (USDA), administers nutrition assistance programs to provide children and needy families with better access to food and a more healthful diet. The Supplemental Nutrition Assistance Program (SNAP) is used to assist low-income individuals and families in obtaining a more nutritious diet by supplementing their incomes with benefits to purchase food they need for healthy eating choices. SNAP is administered by FNS through a Federal-State partnership in which USDA pays the full cost of recipient benefits, and shares the cost to administer SNAP with the States. Further, States distribute recipient benefits through an Electronic Benefits Transfer (EBT) system, in which the recipient authorizes the transfer of benefits from a Federal account to a retailer account to pay for products purchased. In fiscal year (FY) 2011, FNS disbursed over \$71.8 billion in SNAP benefits that were used by an average of 46 million participants nationwide.

In response to the economic downturn, Congress passed the Recovery Act, which the President signed into law on February 17, 2009. The Recovery Act increased the amount of SNAP benefits by 13.6 percent⁷ for food allotments over a 5-year period for SNAP and \$290.5 million in additional administrative expenses to handle the increasing caseloads.⁸ In order to meet the accountability objectives of the Recovery Act, FNS was provided \$4.5 million in administrative expense funds to perform necessary management and oversight, monitor program integrity, and evaluate the effect of payments made under the related sections of the Recovery Act.

Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of the funds. On February 18, 2009, the Office of Management and Budget (OMB) issued initial guidance that required Federal agencies to establish rigorous internal controls, oversight mechanisms, and other approaches to meet the accountability objectives of the Recovery Act.⁹ OMB issued additional guidance on April 3, 2009, to clarify existing requirements and establish additional steps that were to be taken to facilitate the accountability and transparency objectives of the Recovery Act. Moreover, OMB emphasized that due to the unique implementation risks of the Recovery Act, agencies were to take steps beyond their standard practice in initiating the additional oversight mechanisms.¹⁰ According to guidance issued by the Secretary of Agriculture, agencies were to develop transparent, merit-based criteria to guide their discretion in committing, obligating, and expending funds under the Recovery Act.

⁷ The potential amount of benefits to be funded through the Recovery Act increased when estimates were prepared for the (FY) 2011 budget. According to FNS, the Recovery Act funding for SNAP is now estimated to total over \$65 billion through FY 2019.

⁸ The Recovery Act provided USDA with a total of \$28 billion in funding for a number of program areas to assist in achieving the purposes of the Recovery Act.

⁹ Office of Management and Budget Memorandum M-09-10.

¹⁰ Office of Management and Budget Memorandum M-09-15.

SNAP regulations specify functional areas to be addressed by the States; however, the regulations do not establish standardized internal controls at the State level. FNS policy is to allow the States the flexibility to establish internal controls that meet the needs of each individual State. In addition to administering the day-to-day program operations, State agencies have the primary responsibility for monitoring recipients' compliance with program requirements and for detecting and investigating cases of alleged intentional program violation.¹¹ FNS' Compliance Branch is charged with monitoring program compliance by participating retailers. Federal regulations¹² require States to establish and operate fraud detection units in all areas in which 5,000 or more households participate in SNAP. The functions of fraud detection may be performed by persons not employed by the State. For instance, the Florida State agency contracted its fraud detection efforts to the Florida Department of Law Enforcement, while the State agency in New Jersey established separate fraud detection units within each of its county offices. Thus, the State agency provides oversight for each of the individual county fraud detection units. Each fraud detection unit is responsible for detecting and investigating any case of alleged intentional program violation committed by SNAP recipients.

Federal regulations¹³ require each State to obtain EBT management reports from its contracted EBT processor to assist it with program management, operations, and performance of SNAP operations. Each State can request the EBT processor to provide additional reports specifically designed to assist in detecting potentially fraudulent activities by SNAP recipients. However, due to the high cost associated with obtaining this information from the EBT processors and the resulting impact on the overall cost of program operations, the FNS national office also instructed States to limit their requests to only those reports they actually intend to review and analyze.

In the past, the Office of Inspector General (OIG) found instances of ineffective controls over EBT systems. OIG's previous audits determined whether FNS had established effective controls over EBT systems and whether FNS' oversight of the States' EBT system operations was adequate. OIG reports addressed the need for fraud detection units and indicated that the States were not utilizing the EBT management reports to identify, investigate, and disqualify recipients involved in trafficking¹⁴ SNAP benefits. For example, in June 2008, we reported that the Colorado Department of Human Services (CDHS) did not establish required fraud detection units; further, we could not find support that CDHS used available EBT management reports to monitor SNAP program operations for improper activity.¹⁵ Likewise, in December 2001, we

¹¹ Intentional program violation is defined as any act violating the Food and Nutrition Act, SNAP regulations, or any State statute for the purpose of using, presenting, transferring, acquiring, receiving, possessing, or trafficking authorization cards. Also, an intentional program violation is any act that constitutes making a false or misleading statement or concealing or withholding facts.

¹² Title 7 Code of Federal Regulations (CFR) §272.4 (g) (4), January 1, 2009.

¹³ Title 7 CFR §274.12 (j) (2), January 1, 2009.

¹⁴ Food stamp trafficking is the buying and selling of food stamp benefits for cash or items not authorized under the Food Stamp Act of 1977. This occurs when retailers and recipients violate the Food Stamp Program by accepting and selling food stamp benefits for cash at less than par value or by purchasing unauthorized items such as tobacco and alcohol, etc.

¹⁵ Audit Report 27099-68-Hy, Electronic Benefits Transfer System State of Colorado, June 2008.

reported that New York's Office of Temporary and Disability Assistance (OTDA) needed to improve its controls over EBT management reports.¹⁶

Objectives

The objectives of this audit were to assess FNS' oversight of the State agencies' efforts to identify recipients fraudulently using their SNAP benefits. Specifically, our audit objectives were to ensure that: (1) proper internal control procedures were established, (2) participants properly complied with program requirements, and (3) effective compliance operations were established. We also determined whether FNS took appropriate and timely actions to implement prior OIG audit recommendations.

¹⁶ Audit Report 27099-16-Hy, Electronic Benefits Transfer System State of New York, December 2001.

Section 1: FNS Needs to Strengthen Its Fraud Detection Efforts

Finding 1: EBT System Management Reports Need to Be Better Utilized

The two States we visited did not use the management reports provided by the EBT processors¹⁷ to identify potentially fraudulent activities by SNAP recipients for investigation or other follow up. Both FNS and State officials attributed this to the fact that FNS had not specifically required the States to use these reports, and because they believed there were other tools available such as outside referrals¹⁸ to assist the States' fraud detection activities. However, using the available EBT management reports for both States over a 3-month period,¹⁹ we identified over 2,600 questionable and previously-undetected SNAP transactions totaling over \$181,700, which could potentially represent instances of recipient fraudulent activity. Additionally, we found \$4.5 million in manual transactions²⁰ which likewise could be at a higher risk for potential fraudulent activity. By not using these management reports, which every EBT processor is required to provide, State fraud detection units have reduced assurance of being able to proactively detect instances of recipient fraud that are not otherwise reported through such means as referrals and hotline complaints.

Federal regulations²¹ require each State to obtain EBT system management reports from their contracted EBT processors. These reports are intended to assist the States with program management, operations, and performance. Additionally, each State can request the EBT processor to provide reports specifically designed to assist in the detection of potentially fraudulent activities by SNAP recipients. The EBT management reports are tools that allow State fraud detection units to conduct proactive operations to detect the deliberate misuse of SNAP benefits by recipients.

Our review of the EBT management reports from New Jersey and Florida disclosed several instances of questionable transactions that indicate potential recipient misuse of SNAP benefits. From each State, we selected the reports denoted as "fraud" reports provided by the EBT processors, in addition to other EBT management reports that OIG used in prior audits²² that

¹⁷ The State of New Jersey contracted its EBT services to Affiliated Computer Services and the State of Florida contracted its EBT services to JP Morgan Electronic Financial Services.

¹⁸ The term "outside referrals" refers to individuals such as private citizens, other State officials, and/or other investigative entities who refer SNAP recipients for investigation.

¹⁹ The overall timeframe for our analysis covered 3 months unless otherwise noted. For some reports, we analyzed one month of data because of the complex design and format of the management reports.

²⁰ A manual transaction is an off-line food stamp transaction. The recipient purchases are authorized without telecommunication between the point of sale device and EBT system. The retailer manually enters the recipient's information.

²¹ Title 7 CFR §274.12(j) (2), January 1, 2009.

²² Audit Report 27099-68-Hy, Electronic Benefits Transfer System State of Colorado, June 2008; Audit Report 27099-16-Hy, Electronic Benefits Transfer System State of New York, December 2001; Audit Report 27099-0023-Ch, Monitoring of the Electronic Benefit Transfer System in Michigan, August 2002; Audit Report 27099-11-Te, Electronic Benefit Transfer System Development State of Arkansas, September 2002; and Audit Report 27099-69-Hy, JPMorgan EFS' Oversight of EBT Operations, September 2007.

resulted in identifying fraudulent activities. In total, we reviewed 18²³ management reports: 5 reports from the State of Florida and 13 reports from the State of New Jersey (see exhibit B). From six of these reports,²⁴ we identified the questionable or potentially fraudulent transactions discussed below:

- The Out-of-State Activity Report identifies SNAP recipients who redeem the majority, if not all, of their benefits at retailers located outside the State in which they reside. Federal requirements²⁵ allow a recipient to move out of State without reporting an address change; however, the Out-of-State Activity Report could be a useful tool for identifying recipients who might be receiving duplicate benefits in another State during the same period and have not reported their change in residence. In New Jersey, we identified 312 questionable out-of-State transactions, totaling \$14,900, for 1 month. In Florida, we identified 1,934 questionable out-of-State transactions, in excess of \$83,000, for 1 month.
- The Even-Dollar Transaction Report identifies unusual numbers of approved even-dollar SNAP transactions processed at retailer locations. These transactions could be indicative of fraudulent activities, since retail transactions are typically not in whole dollar amounts. Our review of this report in New Jersey disclosed 196 questionable transactions, totaling over \$65,600, for 1 month. We were unable to review this particular EBT management report in Florida because State officials had not considered the report useful and had instructed the EBT processor not to provide it.
- The Excessive Return Transaction Report²⁶ identifies transactions in excess of thresholds established by the States, which involve refunds by retailers to SNAP recipients. Its purpose is to identify instances where refund transactions may be used to conceal the discounting²⁷ of SNAP benefits for cash. In New Jersey our analysis disclosed 192 questionable excessive return transactions totaling approximately \$18,200. We were unable to review this particular EBT management report in Florida because officials did not request the report from its EBT processor.
- The Manual Transaction Report is used to identify all activity where retailers manually enter SNAP recipients' EBT card numbers into point-of-sale (POS) terminals.²⁸ This management report is used to detect potentially fraudulent activities between a retailer and recipient where large numbers of manual entries are processed by the retailer. Our review of this report in New Jersey disclosed 122 retailers that processed more than

²³ All of these reports were different, except for the Out-of-State Activity and Manual Transaction Reports which were available for both States.

²⁴ Of the six reports we reviewed, four reports were of SNAP recipient transactions from New Jersey and the remaining two reports were from Florida.

²⁵ Simplified reporting requirements under the Farm Security and Rural Investment Act of 2002, Public Law 107-171, enacted May 13, 2002.

²⁶ For the Excessive Return Transaction Report, we reviewed and analyzed the information for additional months outside of our stated timeframes because of an active investigation being conducted by the Office of Inspector General – Office of Investigations. This report was available to one of two States reviewed.

²⁷ Exchanging SNAP benefits for cash at less than face value.

²⁸ A point-of-sale terminal is the equipment or system that is used to initiate electronic transactions from retailer locations.

400 manual transactions each during the month of our review, totaling over \$4.4 million. These transactions represented 49 percent of the retailers' total SNAP transactions for the month. Additionally, our review in Florida disclosed another 15 retailers whose manual transactions totaled over \$155,000 for the month of our review. In total, the two State reports disclosed 137 retailers that manually processed over \$4.5 million in SNAP benefits from recipients.

Officials in New Jersey stated that the EBT management reports, as designed, were time-consuming to review and analyze, and ineffective in detecting the intentional misuse of SNAP benefits by recipients. These concerns were largely due to the fact that the State's county-based fraud detection units had difficulty in adapting the existing Statewide reports for their use; this concern, we believe, could be addressed by requesting that the reports' format be changed to reflect information at the county level. Officials from Florida likewise had not utilized the management reports because they believed that their current process for detecting fraudulent activities—which emphasized investigation of retailers in specific areas of the State—was more effective.²⁹ However, these reviews did not identify the more than 2,500 questionable transactions that we found by reviewing the EBT management reports.

Although the FNS national office issued guidance³⁰ to the States in December 2007 regarding the EBT management reports, this guidance did not include specific requirements for State fraud detection units to use the reports to strengthen their fraud detection efforts. In addition, FNS has not provided guidance to assist the States in determining which of the available EBT management reports could be useful to individual States based on their particular organizational structures (e.g. centralized or county-based). FNS officials stated that it is up to the States to determine the best methods to use in their fraud detection efforts, and stated that there are other tools such as hotline complaints and outside referrals that are available to assist the State fraud detection units in identifying fraudulent activities.

By not adopting a proactive approach to recipient fraud detection—such as that provided by the EBT management reports—Federal and State officials could be potentially unaware of the extent to which SNAP recipient fraud may exist within each State. In prior OIG³¹ and Government Accountability Office (GAO)³² reports, EBT management reports were noted as being useful in combating fraud within SNAP. Specifically, OIG's report on the State of Colorado's EBT system disclosed that this State, much like the two States we visited in this audit, did not use the management reports produced by its EBT processor to detect the potential misuse of recipient benefits. By reviewing the available reports, including the Out-of-State Activity Report and the Even-Dollar Transaction Report, we identified over \$2 million in questionable transactions between April and September 2006. In that report, OIG recommended that FNS require Colorado to strengthen its fraud detection activities, including the assignment of responsibilities to State and county staff for periodic review and analysis of management reports

²⁹ Based on the prior experience of the fraud detection unit, the State officials focused their attention on 3 of 21 circuits known to be trafficking areas. Circuits are multiple counties within specific areas within the State.

³⁰ Electronic Benefits Transfer Request for Proposal (RFP) Guidance, December 19, 2007.

³¹ Audit Report 27099-68-Hy, Electronic Benefits Transfer System State of Colorado, June 2008.

³² GAO/RCED-00-61, Food Stamp Program, Better Use of Electronic Data Could Result in Disqualifying More Recipients Who Traffic Benefits, March 2000.

to detect and follow up on suspicious and unusual SNAP transactions. (See exhibit A.) FNS officials agreed with this recommendation and required the Colorado State agency to implement the recommendation.

We reported our concern regarding States not using EBT management reports to FNS through a Fast Report in September 2010 and made the following recommendations.

Recommendation 1

Provide guidance to States in identifying and assessing available EBT management reports to determine which could be useful to State fraud detection efforts.

Agency Response

In their response dated December 15, 2010, FNS officials stated that the agency continues to emphasize to States in meetings and other forums the importance of working with their EBT processors to determine the best data available to help with fraud detection. Often it is not the pre-packaged canned reports, but other ad-hoc or specially developed reports that would be most helpful. States often have internal reports and data mining tools that are also extremely useful in fraud detection efforts. Most States now require data warehouses and use those for internal fraud analysis rather than paper reports. FNS encourages electronic fraud analysis methods and continued to work with the States to re-design their approach, based on 15 years of experience using the ALERT system, to develop more effective methods for client fraud detection. In discussions surrounding the EBT RFP procurement process, FNS encouraged the States to:

- Include contract language that allows the State to set parameters to focus on the more egregious problems and require the contractor to change parameters upon request at no cost;
- re-organize and re-sort the content to identify higher-value fraud cases as opposed to the current categorization method that typically relies on case number, FNS retailer number, date, or time;
- add new reports to address issues like high-volume card replacements;
- expand data warehouse functionality to allow analysis or reports to cover client activity over multiple months; and
- require standard and ad hoc data warehouse analysis tools for State fraud investigators.

FNS officials also agreed to document this advice with a more formal communication to the States by March 31, 2012.

OIG Position

We accept FNS' management decision.

Recommendation 2

Encourage States to utilize the EBT management reports in detecting fraudulent activities by SNAP recipients and in following up on SNAP transactions that appear to be questionable. FNS should also implement procedures requiring States to periodically review and analyze the effectiveness of the EBT management reports for detecting fraudulent activities.

Agency Response

In their response dated December 15, 2011, FNS officials stated that they had issued a policy memo to the States, dated October 14, 2011, conveying the expectation that States would use FNS-provided data on retailer disqualifications to further investigate suspicious recipient EBT transactions, which are included with the information the States receive. Management Evaluation targets for FY 2012 include recipient integrity issues, particularly State fraud unit activities including use of EBT and other appropriate data to identify potential recipient fraud. In addition, FNS has developed an online document library on the FNS SNAP Partner Website for sharing policies and best practices related to recipient integrity with the State agencies.

OIG Position

We accept FNS' management decision.

Finding 2: FNS Needs to Strengthen Its Oversight of State Fraud Detection Units

FNS did not establish an effective process to periodically assess the States' fraud detection efforts. FNS officials relied on management evaluation (ME) reviews and other sources of information. However, the ME review process does not address fraud detection activities. Also, we found the other sources of information used to monitor fraud detection to be inaccurate in some instances. Without reliable controls that periodically verify State-reported data on recipient fraud detection activities, FNS' ability to assess program risks and improve SNAP integrity and efficiency is jeopardized.

In FNS' Recovery Act Plan,³³ FNS officials stated that the Recovery Act requires an unprecedented level of transparency, oversight, and accountability to ensure that funds are used according to the Act's requirements.³⁴ According to the plan, FNS officials would rely on ME reviews, financial management reviews, and quality control reviews to provide oversight of Recovery Act funds. These reviews were also used prior to the Recovery Act to assess program risk and to improve the integrity of program benefits. The ME review process covers specific

³³ United States Department of Agriculture Food and Nutrition Service, American Recovery and Reinvestment Act Plan, dated May 13, 2009.

³⁴ The Recovery Act did not provide specific funding for State Fraud Activities; however, we assessed these controls because the Recovery Act included a 13.6 percent increase in benefits to SNAP participants.

program target areas³⁵ approved by FNS' national office to measure compliance with policies, procedures, and standards of timeliness as mandated by program regulations. These reviews are performed by both the FNS regional offices and the States. States have the option to include additional target areas for review as they deem necessary to ensure that FNS programs operate efficiently and effectively. According to Federal regulations,³⁶ each State is required to establish and operate internal fraud detection units in all areas in which 5,000 or more households participate in SNAP. Each fraud detection unit is responsible for detecting, investigating, and assisting in the prosecution of program fraud committed by SNAP recipients.

During our assessment, we found that although both States had functioning fraud detection units, as required by regulations, FNS officials did not review their efficiency. Our review in New Jersey and Florida disclosed that only New Jersey included reviews of its fraud detection unit as a supplemental target area in its ME reviews; however, rather than assessing the effectiveness of fraud detection efforts, these reviews were limited to ensuring that salaries attributed to each fraud investigator were solely for the purpose of performing fraud-related activities. As a result, ME reviews in these States were not being used as a tool to evaluate the States' fraud detection units' efficiency and effectiveness in accomplishing their assigned mission.

According to an FNS official, reviews to determine the efficiency and effectiveness of States' fraud detection units were not considered necessary because the annual State Activity Report (SAR)³⁷ was sufficient to ensure that States devoted adequate resources to fraud detection. FNS primarily relied upon this reported information to assess the effectiveness of the States' fraud detection units each year. However, we found that the information within these reports, most notably the Program Activity Statement (FNS-366B), was unreliable.³⁸

We reviewed the FY 2008 and FY 2009 FNS-366B reports from both States we visited. The State of New Jersey conducted its SNAP operations at the county level, with the State providing management oversight. For this State, we found differences between the information reported to FNS on the FNS-366B's by the State agency and the information reported to the State agency by the county offices.³⁹ For example, we noted that in FY 2009 New Jersey county offices reported to the State agency the issuance of 125 waivers where clients signed disqualification consent agreements.⁴⁰ However, we found that State officials incorrectly reported the issuance of only 14 of these waivers to FNS on the FNS-366B's. Similarly, our review of the FY 2008

³⁵ Target areas are identified by FNS as critical program areas to be monitored by the States during the subsequent fiscal year for the successful operation of SNAP nationwide.

³⁶ Title 7 CFR, §272.4 (g) (4), January 1, 2009.

³⁷ The SAR is a compilation of both State-reported data and data calculated from information provided by the States, such as participation rates, investigations, prosecutions, disqualifications, and claims. FNS' national office prepares the SAR from information reported by each State in the Program and Budget Summary Statement Part B – Program Activity Statement (FNS-366B) report. This report summarizes each States' SNAP activity annually.

³⁸ The FNS-366B is used by States to report information on SNAP operations, such as participation rates, investigations, prosecutions, disqualifications, and claims. This information is used to produce the SAR which FNS officials rely upon to assess the effectiveness of States' fraud detection units.

³⁹ Each State has the option to administer SNAP operations on either a Statewide or county-level basis. States that elect to administer their SNAP operations at the county level act as oversight at the State level.

⁴⁰ Disqualification consent agreements reflect the number of cases where individuals waived their right to a hearing, but did not contest the disqualification period.

information disclosed that the county offices reported 131 instances where decisions rendered during the administrative hearing process were upheld; however, State officials incorrectly reported only 18 to FNS. We conducted visits to five county offices and found that some information could not be validated because of inadequate record keeping. According to State officials, the State agency does not require supporting documentation to be submitted by county offices to validate the information reported. When we questioned State agency officials on the differences between what the county offices reported to the State agency and what the State agency reported to FNS, these officials could not explain the discrepancies.

During our visit to Florida, we found that non-SNAP cash benefits were reported on the FNS-366B.⁴¹ According to a State official, the inclusion of non-SNAP benefits on the FNS-366B was incorrect; however, the error went unnoticed until we raised the question. Further, the State official attributed the error in part to the continued use of outdated guidance, which required the inclusion of cash benefits in one section of the FNS-366B report. The updated guidance, issued on November 30, 2007, dispensed with the reporting requirements for cash benefits, yet the Florida officials continued to include cash benefits.

Other than the ME reviews and the SAR, FNS has not implemented methods for assessing the effectiveness of States' fraud detection efforts. In our Fast Report 27703-02-Hy (1), dated July 12, 2010, we recommended that FNS identify and implement a process for periodically assessing the States' fraud detection units. In addition, we are recommending that States' fraud detection units be assessed as part of the ME process.

Recommendation 3

Perform reviews as needed to determine the extent to which FNS' assessment of States' fraud detection efforts is compromised by the absence of ME reviews of the effectiveness of State fraud detection efforts and by inaccurate information provided by the States on SAR reports. Take corrective actions as necessary.

Agency Response

In their response, dated December 15, 2011, FNS officials stated that Management Evaluation targets for FY 2012, as communicated to the FNS regional offices in a memo dated August 18, 2011, included recipient integrity issues, particularly State fraud unit activities. Through the ME process, FNS will work with States to ensure appropriate corrective actions are in place when findings occur. FNS expects to complete these actions by September 30, 2012.

OIG Position

We accept FNS' management decision.

⁴¹ Non-SNAP cash benefits are provided through the Temporary Assistance for Needy Families program, which is a Department of Health and Human Services program administered by the State.

Recommendation 4

Include as part of the ME review process an assessment of the States' fraud detection units.

Agency Response

In their response dated December 15, 2011, agency officials stated that an FNS work group, including national and regional office staff, is currently revising and updating standardized ME review module focused on State fraud detection units. The work group expects to complete its work so that the regional offices can test and implement the module by March 31, 2012.

OIG Position

We accept FNS' management decision.

Scope and Methodology

We performed our audit fieldwork from April 2009 through May 2011 at the FNS Headquarters in Alexandria, Virginia; two FNS regional offices in Robbinsville, New Jersey, and Atlanta, Georgia; two FNS State agencies in Trenton, New Jersey, and Tallahassee, Florida; and five county offices in New Jersey.

To accomplish our objectives, we conducted interviews with FNS and State officials; reviewed program regulations; analyzed EBT management reports; and assessed program policies, procedures, and internal controls relating to SNAP. We also assessed the implementation of selected recommendations made from two prior OIG reports related to the scope of this audit. However, we did not review the EBT systems or assess the integrity of the data in the system as information system controls were not part of our audit objective.

We selected three States to review the effectiveness of the States' efforts in detecting fraudulent activities by SNAP recipients. However, after we completed the fieldwork from the first two States, we determined that we did not need to complete the final State to meet our audit objectives. The results from our first two States—that FNS lacks adequate oversight of its States' fraud detection units—were similar to the issues disclosed in a prior audit.⁴²

We judgmentally selected the States and the applicable FNS regional offices based on our analysis of the FY 2007 payment error rate data compiled by FNS; current information was not available at the time of our review. The States we selected met one of the following criteria: highest total overpayment error rate, second lowest overpayment error rate, and total issuance.

To assess the effectiveness of the State fraud detection units, we visited the fraud unit in Tallahassee, Florida, and judgmentally selected five county offices in New Jersey to conduct on-site reviews.⁴³ To judgmentally select the county offices for our review, we based our analysis on current SNAP household data maintained by the State.⁴⁴ We judgmentally selected 5 of 21 (25 percent) county offices to represent each class of project area (small, medium, and large).⁴⁵ We reviewed and evaluated supporting documentation for the program and both FNS and State oversight of fraud detection activities. In addition, we reviewed and analyzed a total of 18 EBT management reports for calendar years 2009 and 2010 to determine the States' efforts in detecting suspected fraudulent recipient activities. (See exhibit B.)

⁴²We did not visit one State and its applicable regional office located in Dallas, Texas, because of consistent issues as identified in the previous two States visited. Further, a prior audit - "Electronic Benefits Transfer System State of Colorado," Audit Report 27099-68-Hy - disclosed discrepancies of the same nature.

⁴³ The State of New Jersey has elected to operate a fraud detection unit within each county office in its State.

⁴⁴ New Jersey Department of Human Services – Number of Participating Households, Person, Adults and Children by County, dated June 2009. The State of New Jersey contained 21 counties in total.

⁴⁵ The three classes of project areas are defined according to the monthly total caseload of active participants. A small project area is defined as having 2,000 or fewer participants. A medium project area is defined as having 2,001 to 15,000 participants. A large project area is defined as having more than 15,000 participants. We selected two large county offices, two medium county offices, and one small county office.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Abbreviations

ATM.....	Automated Teller Machine
CDHS.....	Colorado Department of Human Services
CFR.....	Code of Federal Regulations
EBT.....	Electronic Benefits Transfer
FNS.....	Food and Nutrition Service
FY.....	Fiscal Year
GAO.....	Government Accountability Office
HHS.....	U.S. Department of Health and Human Services
ME.....	Management Evaluation
OIG.....	Office of Inspector General
OMB.....	Office of Management and Budget
OTDA.....	Office of Temporary and Disability Assistance
POS.....	Point-of-Sale
SAR.....	State Activity Report
SNAP.....	Supplemental Nutrition Assistance Program
USDA.....	U.S. Department of Agriculture

Exhibit A: Implementation of Prior Audit Recommendations

This exhibit addresses the complete implementation of select recommendations provided in Audit Report 27099-68-Hy, “Electronic Benefits Transfer System - State of Colorado, dated June 2008,” and Audit Report 27099-16-Hy, “Electronic Benefits Transfer System - State of New York, dated December 2001.”

No.	Prior Audit Recommendation (Audit Report 27099-68-Hy)	Corrective Action Implemented
7	Direct CDHS to develop and implement internal control procedures that require routine oversight of EBT system activities for SNAP. The controls should include the assignment of responsibilities to State and county staff for periodic review and analysis of management reports to detect and follow up on unusual SNAP transactions.	Yes
8	Require that CDHS establish fraud detection units to detect, investigate, and assist in the prosecution of recipient SNAP trafficking and periodically report the results of their activities to FNS’ Mountain Plains Regional Office.	Yes
9	Work with CDHS to reach an agreement on how fraud detection unit(s) can best use the EBT data now available to identify, investigate, and disqualify recipients involved in trafficking.	Yes
10	Establish an action plan with specific milestone dates to periodically perform a review to assess CDHS’ compliance with Federal SNAP requirements for fraud detection and initiate corrective actions for any deficiencies identified.	Yes
	Prior Audit Recommendations (Audit Report 27099-16-Hy)	
6	Direct OTDA to better utilize management reports in order to more effectively monitor the EBT system, especially the reports used to detect potential improper activity.	Yes
8	Direct OTDA to obtain from Citicorp EFS reports in an electronic data file format in order to more effectively monitor potential improper activity. These include monthly manual transaction usage and automated teller machine (ATM)/POS Out-of-State Usage reports.	Yes

Exhibit B: EBT Management Reports Reviewed

This exhibit identifies the EBT management reports we reviewed for the States of New Jersey and Florida. We included the name of the report, and its intended purpose, as defined by the respective States.

New Jersey

Name of Report	Description
Even Dollar Transaction Report	This monthly transaction report identifies monthly approved, even dollar SNAP transactions over a State-defined amount.
Exceeded PIN Attempts Report	This report contains a list of the recipients' accounts that exceed the State-defined number of invalid PIN attempts for a specific time period. The State of New Jersey has selected 5 invalid PINs as their threshold for followup.
Excessive Return Transaction Report	This monthly report identifies approved SNAP transactions over a State defined amount.
Manual Card Entry Report	This monthly report identifies approved SNAP transactions where the recipient's personal activity number was manually entered into the POS terminal at the retailer location.
Retailer Manual Entry Summary	This report provides a summary of the count and amount of manually-entered transactions performed by a retailer if the number of manually-entered transactions reaches a State-defined threshold.
Out-of-State Activity Report	A monthly transaction report of all recipient transactions occurring outside of the State
After Hours Report	This monthly report identifies transactions occurring between the hours of 2am and 5am EST.
Full FS Balance Withdrawal Report	This monthly report identifies transactions in which the full authorized SNAP amount is withdrawn in one transaction.
Multiple Withdrawals Within 1Hour Report	This monthly report lists approved SNAP withdrawals made by the same personal activity number within a defined timeframe.
Refund Activity Report	This report details at a benefit authorization level the refunds that have occurred.
Excessive Dollar Transaction Report	This monthly report identifies retailers with at least 5 approved SNAP transactions in a month over a State-defined amount.

Exhibit B: EBT Management Reports Reviewed

Transactions Attempted on Invalid Cards	This monthly report identifies transactions performed against cards with a status other than “Active.”
Retailer Adjustment Report	This report identifies retailer adjustments made to the retailer’s account.

Florida

Name of Report	Description
Daily Manual Authorization Report	This report identifies all active, expired, released, or new hold manual authorization (vouchers) for the day.
Production Logon Report	This report provides a listing of approved users and their level of access.
ATM/POS Out-of-State Usage Report	This report provides the information of recipients that have three or more out-of-State transactions within 60 days.
Lost/Damaged/Stolen Card Report	This report provides a total for the amount of cards lost, damaged, stolen, compromised, unauthorized, household, or other.
Manual Transactions Report	This report lists all manual authorization (voucher) transaction activity for the month.

**USDA'S
FOOD AND NUTRITION SERVICE
RESPONSE TO AUDIT REPORT**



**United States
Department of
Agriculture**

Food and
Nutrition
Service

3101 Park
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Alexandria, VA
22302-1500

DATE: December 15, 2011

AUDIT
NUMBER: 27703-02-HY

TO: Gil H. Harden
Assistant Inspector General for Audit

FROM: Audrey Rowe /S/
Administrator
Food and Nutrition Service

SUBJECT: State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program (SNAP)

This letter responds to the official draft report for audit report number 27703-02-HY, State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program (SNAP). Specifically, the Food and Nutrition Service (FNS) is responding to the four recommendations within the report.

OIG Recommendation 1:

Provide guidance to States in identifying and assessing available EBT management reports to determine which could be useful to State fraud detection efforts.

Food and Nutrition Service Response:

FNS takes program integrity very seriously. FNS continues to emphasize to States in meetings and other forums the importance of working with their EBT processors to determine the best data available to help with fraud detection. Often it is not the pre-packaged canned reports, but other ad-hoc or specially developed reports that would be most helpful. States often have internal reports and data mining tools that are also extremely useful in fraud detection efforts. Most States now require data warehouses and use those for internal fraud analysis rather than paper reports. FNS encourages electronic fraud analysis methods and continues to work with the States to re-design their approach, based on our 15 year experience using the ALERT system, to develop more effective methods for client fraud detection. In discussions surrounding the EBT RFP procurement process, FNS encourages the States to:

- include contract language that allows the State to set parameters to focus on the more egregious problems and require the contractor to change parameters upon request at no cost;

- re-organize and re-sort the content to identify higher value fraud cases as opposed to the current categorization method that typically relies on case number, FNS retailer number, date, or time;
- add new reports to address issues like high volume card replacements;
- expand their data warehouse functionality to allow analysis or reports to cover client activity over multiple months;
- and to require standard and ad hoc data warehouse analysis tools for State fraud investigators.

FNS will be documenting this advice with a more formal communication to States in early 2012.

On October 14, 2011, FNS issued a policy memo stating FNS' expectation that States will use the results of FNS retailer disqualification actions to investigate and penalize recipients for trafficking. The policy memo provided guidance regarding the use of data that FNS provides to States documenting retailer disqualifications as a potent source of evidence in recipient trafficking cases. FNS shares information with States regarding retail stores found guilty of trafficking SNAP benefits and therefore permanently disqualified from participation in the SNAP. FNS provides the States copies of letters notifying retailers of their disqualification from SNAP and the data/evidence supporting the disqualification. The data and other information FNS shares with States contain household transactions that FNS has determined meet patterns indicative of trafficking. FNS expects States to use this information to determine which recipient cases need further investigation.

Under Secretary Concannon sent a letter to all State SNAP commissioners on June 21, 2011, reiterating the critical importance of integrity, encouraging all States to be even more active and vigilant in this area, including the use of available data. On November 15, 2011, Under Secretary Concannon also sent a letter to all State Governors highlighting recent initiatives by FNS to help States combat fraud and to express FNS' continued commitment to work with States to strengthen Program integrity.

FNS developed an online document library on the FNS SNAP Partner Web site for sharing with State agencies policies and best practices related to recipient integrity.

Estimated Completion Date: March 31, 2012

OIG Recommendation 2:

Encourage States to utilize the EBT Management Reports in detecting fraudulent activities by SNAP recipients and in following up on SNAP transactions that appear to be questionable. FNS should also implement procedures requiring States to periodically review and analyze the effectiveness of the EBT management reports for detecting fraudulent activities.

Food and Nutrition Service Response:

See full response to Recommendation 1 above. FNS continues to emphasize to States in meetings and other forums, the importance of working with their EBT processors to determine the best data available to help with fraud detection. Often it is not the pre-packaged canned reports, but other ad-hoc or specially developed reports that are needed. States often have internal reports and data mining tools that are also extremely useful in fraud detection efforts.

FNS issued a policy memo on October 14, 2011, conveying the expectation that States use FNS provided data on retailer disqualifications to further investigate suspicious recipient EBT transactions, which are included with the information the States receive. Management Evaluation (ME) targets for FY 2012 include recipient integrity issues, particularly State fraud unit activities including use of EBT and other appropriate data to identify potential recipient fraud.

Furthermore, Under Secretary Concannon sent a letter to all State SNAP commissioners on June 21, 2011, reiterating the critical importance of integrity, encouraging all State to be even more active and vigilant in this area, including the use of available data. On November 15, 2011, Under Secretary Concannon also sent a letter to all State Governors highlighting recent initiatives by FNS to help States combat fraud and to express FNS' continued commitment to work with States to strengthen Program integrity.

FNS developed an online document library on the FNS SNAP Partner Web site for sharing with State agencies policies and best practices related to recipient integrity.

Completion Date: October 14, 2011**OIG Recommendation 3:**

Perform reviews as needed to determine the extent to which FNS' assessment of States' fraud detection efforts is compromised by the absence of Management Evaluation (ME) reviews of the effectiveness of State fraud detection efforts and by inaccurate information provided by the States SAR reports. Take corrective actions as necessary.

Food and Nutrition Service Response:

FNS agrees with the recommendation that reviews of State fraud detections be conducted. Towards that end, ME targets for FY 2012, as communicated to the FNS regional offices in a memo dated August 18, 2011, include recipient integrity issues, particularly State fraud unit activities. Through the ME process, FNS will work with States to ensure appropriate corrective actions are in place when findings occur.

Estimated Completion Date: September 30, 2012

OIG Recommendation 4:

Include as part of their ME review process an assessment of the State's fraud detection unit.

Food and Nutrition Service Response:

FNS agrees with this recommendation. An FNS work group, including national and regional office staff, is currently revising and updating a standardized ME review module focused on State fraud detection units. The work group expects to complete its work so that the regional offices can test and implement the module during the second quarter of FY 2012.

Estimated Completion Date: March 31, 2012

Informational copies of this report have been distributed to:

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