



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



DATE: September 10, 2010

REPLY TO
ATTN OF: 27703-02-Hy (2)

TO: Julie Paradis
Administrator
Food and Nutrition Service

ATTN: Katherine Day
Director
Office of Internal Controls, Audits and Investigations

FROM: Gil H. Harden /s/ Rod DeSmet (for)
Assistant Inspector General
for Audit

SUBJECT: State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program – Use of EBT Management Reports

The American Recovery and Reinvestment Act of 2009¹ (Recovery Act) provided the Department of Agriculture (USDA) with \$28 billion in funding. Of this amount, \$19.8 billion was specifically allotted to the Food and Nutrition Service (FNS) to fund the 13.6 percent increase in benefits to participants in the Supplemental Nutrition Assistance Program (SNAP).² Congress, in enacting the Recovery Act, emphasized the need for accountability and transparency in the expenditure of funds. Further, 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.³ OMB issued additional guidance on April 3, 2009, to clarify existing requirements and establish additional steps that must 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 must take steps beyond standard practice to initiate the additional oversight mechanisms.⁴

SNAP provides nutrition assistance to approximately 40 million low-income individuals and families by supplementing their incomes with benefits to purchase food they need for healthy eating choices. FNS administers SNAP through a Federal-State partnership by which the Federal Government pays the full cost of recipient benefits, while the cost of administering the program

¹ Public Law 111-5, February 17, 2009.

² The potential amount of benefits to be funded through the Recovery Act increased when estimates were prepared for the fiscal year (FY) 2011 budget. According to FNS, the Recovery Act funding for SNAP is now estimated to total \$65.8 billion through FY 2019.

³ Office of Management and Budget Memorandum M-09-10.

⁴ Office of Management and Budget Memorandum M-09-15.

is shared 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. With regard to overall controls, SNAP regulations specify functional areas to be addressed by each State, but do not establish a standardized system of internal control at the State level. FNS' policy is to allow States the flexibility to establish control systems that meet the individual needs of each State. The States have the primary responsibility for monitoring recipients' compliance with program requirements, along with detecting and investigating cases of alleged intentional program violation.⁵ However, States are not responsible for monitoring program compliance by participating retailers; this function is performed by FNS' Compliance Branch.

The objectives of this audit are to assess FNS' oversight of State agencies' efforts to identify recipients fraudulently using their SNAP benefits, and to determine whether Recovery Act funds are expended in a manner that minimizes the risk of improper use. This is the second report to document the results of our assessment of FNS' oversight of the States' fraud detection units, and describes the need for FNS to provide guidance and oversight to States for the proactive use of EBT management reports in detecting and investigating cases of potential fraud. To accomplish our objectives, we conducted fieldwork at the FNS national office, the FNS Mid-Atlantic Regional Office, and the FNS Southeast Regional Office. Additionally, we visited the State offices in Florida and New Jersey, as well as five county offices in New Jersey. We conducted interviews with pertinent FNS and State officials, reviewed program regulations, analyzed EBT management reports, and assessed program policies, procedures, and internal controls relating to SNAP.

According to Federal regulations,⁶ each State is required to obtain EBT 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 detecting potentially fraudulent activities by SNAP recipients. In December 2007, the FNS national office issued guidance⁷ to the States related to their use of EBT management reports. However, this guidance did not include specific requirements as to how the State fraud detection units could make use of these reports to strengthen their fraud detection efforts. Further, they had not issued guidance on which reports could potentially be useful to various States, based on such factors as their organizational structure (e.g. centralized or county-based),⁸ or on the experiences of USDA investigative entities, such as the Office of Inspector General – Office of Investigations or FNS' Compliance Branch.

⁵ An intentional program violation is defined as any act violating the Food and Nutrition Act of 2008, SNAP regulations, or any State statute for the purpose of using, presenting, transferring, acquiring or receiving, possessing, or trafficking authorized EBT cards. This definition includes any act that constitutes making a false or misleading statement or concealing or withholding facts.

⁶ Title 7 C.F.R. 274.12(j)(2), January 1, 2009.

⁷ Electronic Benefits Transfer Request for Proposal (RFP) Guidance, December 19, 2007.

⁸ 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.

Although the States obtained the management reports, we found that neither State used the reports provided by their EBT processor to identify potentially fraudulent activities by SNAP recipients for investigation or other followup. Both FNS and State officials attributed this to the fact that FNS had not specifically required the States to use these reports. Officials at both levels noted that there are other tools, such as hotline complaints and referrals from outside sources, to assist the State fraud detection units in identifying potentially fraudulent activities by SNAP recipients. FNS officials consider the use of these reports to be another tool that could allow State fraud detection units the ability to conduct proactive operations to detect the deliberate misuse of SNAP benefits by recipients on an ongoing basis.

Our review of the EBT management reports from New Jersey and Florida disclosed several instances of questionable transactions that may indicate weak controls or potential recipient misuse of SNAP benefits. In total, we reviewed 18 EBT management reports between the two States, 5 reports in Florida, and 13 reports in New Jersey. In particular, we noted that six of the reports¹¹ detected a significant number of questionable transactions that could be indicative of fraudulent activity by recipients and/or retailers. Using these six reports, we identified a total of 2,634 questionable transactions, totaling over \$181,700. Our review of these six reports covered the period from August 2009 to October 2009.¹² The following are examples of our results:

- 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 requirements¹³ 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 benefits in another State. In New Jersey, we identified 312 questionable Out-of-State transactions, totaling approximately \$14,900 for 1 month. In Florida, we identified 1,934 questionable Out-of-State transactions in excess of \$83,000 for 1 month.¹⁴
- The Even-Dollar Transaction Report identifies unusual numbers of approved even-dollar SNAP transactions at specific retailer locations; these could be indicative of fraudulent activities, since retail transactions are typically not in whole dollar amounts. Our review of this report for New Jersey disclosed 196 questionable transactions, totaling approximately \$65,600 for 1 month. We were unable to review this management report in Florida because State officials had not considered the report useful and had instructed the EBT processor not to provide it.

⁹ New Jersey has contracted its EBT services to Affiliated Computer Services, while Florida has contracted its EBT services to JP Morgan Electronic Financial Services.

¹⁰ The term “outside sources” refers to individuals such as private citizens, other State officials, and/or other investigative entities.

¹¹ Of the six reports we reviewed, four reports were of SNAP recipient transactions from New Jersey and the remaining two reports were from Florida.

¹² The overall timeframe for our analysis covered 3 months unless otherwise noted. For some reports, we analyzed 1 month of data because of the complex design and format of the management reports.

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

¹⁴ When compiling this information, we eliminated Out-of-State participants who lived in areas adjacent to the State lines and might reasonably have made SNAP purchases in either New Jersey or Florida.

- The Excessive Return Transaction Report identifies transactions, in excess of thresholds¹⁵ 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 discounting of SNAP benefits for cash. In New Jersey, our analysis of this report disclosed 192 questionable excessive return transactions, totaling approximately \$18,200. We were unable to review this management report for the State of Florida because State officials had not requested this report to monitor recipient SNAP transactions.
- The Manual Transaction Report identifies all activity where retailers manually enter SNAP recipients' EBT card numbers into point-of-sale terminals.¹⁶ This management report is used to detect potentially fraudulent activities between a retailer and recipient where a large number of manual entries are processed by the retailer. Our review of this report in New Jersey disclosed 122 retailers that processed more than 400 manual transactions during the month of our review, totaling over \$4.4 million. These transactions represented 49 percent of these retailers' total SNAP transactions for the month. Our review in Florida disclosed another 15 retailers whose manual transactions totaled over \$155,000 for the month of our review.

We referred the questionable transactions to State officials in New Jersey and Florida for followup. At the time of our report, we had not received feedback from either State regarding these questionable transactions. However, during our site visit, New Jersey officials indicated that these reports, as designed, were time-consuming and ineffective in detecting the intentional misuse of SNAP benefits by recipients. We concluded that their concerns could be largely addressed by redesigning the reports to reflect data for individual counties - where the State's fraud detection units are based - rather than on a Statewide basis. Additionally, State officials in Florida had not utilized the management reports because they believed that their current process for detecting fraudulent activities - which emphasized investigations of retailers in specific areas of the State - was more effective.¹⁷ Although we concur that identifying fraudulent activities committed by retailers can also lead to the investigation and prosecution of individual recipients, we conclude that the State of Florida's existing process does not provide an effective means of identifying fraud in areas other than those selected for intensive retailer monitoring and investigations. Further, Florida's use of this process would not preclude the use of the management reports, which could disclose potentially fraudulent activities by SNAP recipients at a retailer location that they might not otherwise have targeted.

In prior OIG¹⁸ and Government Accountability Office¹⁹ reports, EBT management reports were cited as being useful in combating fraud within SNAP. Specifically, in June 2008, OIG's report on the State of Colorado's EBT system disclosed that this State, much like New Jersey and Florida, did not use the management reports being produced by its EBT processor to detect fraudulent activities by SNAP recipients. By reviewing the available reports, which included the

¹⁵ FNS officials stated retailers within each State cannot exceed processing of refunds beyond \$200.

¹⁶ A point-of-sale terminal is the equipment or system that is used to initiate electronic transactions from retailer locations.

¹⁷ Florida focused their attention on 3 of 21 circuits known to be trafficking areas. Circuits are defined as a set of counties comingled together to create individual sub-units of a regional area.

¹⁸ Audit Report 27099-68-Hy, Electronic Benefits Transfer System State of Colorado, June 2008.

¹⁹ GAO/RCED-00-61, Food Stamp Program, Better Use of Electronic Data Could Result in Disqualifying More Recipients Who Traffic Benefits, March 2000.

Out-of-State Activity report and the Even Dollar Transaction Report, we identified over \$2 million in questionable transactions between April 2006 and September 2006. Furthermore, we recommended that FNS require the Colorado State agency to strengthen its fraud detection activities, including “the assignment of responsibilities to State and county staff for periodic review and analysis of management reports to detect and follow up on suspicious and unusual food stamp transactions.” FNS officials agreed with this recommendation, and required the Colorado State agency to implement the recommendation. However, FNS did not extend this requirement to other States.

Without a method of proactive enforcement towards recipients, the ability of FNS and the States to ensure effective program integrity is reduced. We discussed this issue with FNS officials on June 1, 2010. Although FNS officials agreed with our findings and recommendations as presented, they contended that this issue pertains to their regular program operations and is not directly related to the expenditure of Recovery Act funds; therefore, they believed it should be handled through their normal reporting process, and not presented on the Recovery.gov website. Although we acknowledge the FNS officials’ concerns, we also note that the issue of recipient fraud affects the increased SNAP funding provided under the Recovery Act, as well as the agency’s normal SNAP funding; thus, it should be reported on the Recovery.gov website. Due to the heightened expectations for accountability and transparency of the Recovery Act, it is the agency’s responsibility to develop and implement additional measures beyond normal operations to ensure program integrity.

We recommend that FNS:

1. Provide guidance to States in identifying and assessing available EBT management reports to determine which could be most useful to each State’s fraud detection efforts.
2. Require that States implement procedures for the periodic review and analysis of management reports to detect and follow up on suspicious and unusual SNAP transactions.

Please provide a written response to this letter within 5 days, outlining your corrective actions. If you have any questions, please contact me at (202) 720-6945, or have a member of your staff contact Theresa Bulla, Director, Food and Marketing Division, at (202) 720-5907.

USDA'S

FOOD AND NUTRITION SERVICE

RESPONSE TO AUDIT REPORT



September 22, 2010

**United States
Department of
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Food and
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Service

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TO: Gil H. Harden
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SUBJECT: Food and Nutrition Service (FNS) Response to the Office of Inspector General (OIG) American Recovery and Reinvestment Act of 2009 (ARRA) Fast Report on Use of EBT Management Reports (OIG Audit No. 27703-2-HY)

The purpose of this memorandum is to respond to the Office of Inspector General's (OIG) *Fast Report* regarding State Fraud Detection Efforts for the Supplemental Nutrition Assistance Program (SNAP) – Use of EBT Management Reports, dated September 10, 2010. FNS supports OIG's objectives to ensure State agencies (SAs) are identifying recipients fraudulently using their SNAP benefits, and to determine whether Recovery Act funds are expended in a manner that minimizes the risk of improper use.

OIG's *Fast Report* asserts that, without a method of proactive enforcement towards recipients, the ability of FNS and the States to ensure effective program integrity is reduced. The report recommends that FNS:

1. Provide guidance to States in identifying and assessing available EBT management reports to determine which could be most useful to each State's fraud detection efforts; and
2. Require that States implement procedures for the periodic review and analysis of management reports to detect and follow up on suspicious and unusual SNAP transactions.

The audit recommendations above address an area that largely involves State prerogatives and resources. Specifically, States are required by Program regulations to pursue for potential legal remedies all activities which are identified as being potentially fraudulent. States have a number of reports and systems to assist them in this endeavor, but the process is time consuming and expensive. As a result, States must make determinations on whether to pursue trafficking/fraud cases based on those cases that are most likely to result in convictions. To do this, States have a variety of reports and other sources of information available to them upon which such decisions are based. FNS believes that requiring a specific report or method for this purpose may not necessarily result in more convictions/disqualifications or in a more efficient process, and that there is no documentation in the OIG report which would support this conclusion.

It is important to note here that the audit team looked at only two States, Florida and New Jersey. There is nothing in the audit report which would indicate that this limited experience is applicable nationwide. As such, FNS believes it is not prudent to mandate

new Program requirements nationally based on local findings. We would encourage the audit team to expand their work to include other States to determine whether requiring States to use specific EBT management reports would have an appreciable impact on fraud determinations and subsequent convictions and disqualifications.

In response to the report findings and recommendations, FNS will encourage all States to use EBT management reports to determine which could be useful in detecting and following up on suspicious SNAP transactions. Additionally, FNS will implement procedures, where appropriate, for the periodic review and analysis of such reports for this purpose.

If you would like to further discuss our position regarding your *Fast Report*, please contact the Program office at 703-305-2022.

Jessica Shahin /S/
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Supplemental Nutrition Assistance Program

cc: Jessica Shahin, SNAP
Laura Griffin, SNAP
Jane Duffield, SNAP
Katherine Day, FM
Mark Porter, GFPD

FNS: FM: GFPD:MPorter:9/22/10
File: OIG Fast Report Response-EBT Management Reports