



U.S. Department of Agriculture



Office of Inspector General
Northeast Region

Audit Report

Food and Nutrition Service National Office Oversight of Electronic Benefits Transfer Operations

Report No. 27099-66-Hy
September 2006



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



September 28, 2006

REPLY TO

ATTN OF: 27099-66-Hy

TO: Roberto Salazar
Administrator
Food and Nutrition Service

ATTN: Lael Lubing
Director
Grants Management Division

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Food and Nutrition Service National Office Oversight of Electronic Benefits
Transfer Operations

This report presents the results of our audit of the Food and Nutrition Service's National Office Oversight of Electronic Benefits Transfer Operations. Your response to the official draft, dated September 28, 2006, is included as exhibit D. Excerpts of your response and the Office of Inspector General's position are incorporated into the Findings and Recommendations section of the report. Based on your response, we were able to reach management decision on Recommendations 1 and 2. Please follow your agency's internal procedures in forwarding documentation for final action to the Office of the Chief Financial Officer. Management decision for Recommendation 3 can be reached once you have provided us with the additional information outlined in the report section, OIG Position.

In accordance with Department Regulation 1720-1, please furnish a reply within 60 days describing the planned corrective action and the timeframe for implementing it for Recommendation 3. Please note that regulation requires management decision to be reached on all findings and recommendations within 6 months from report issuance.

We appreciate the courtesies and cooperation extended to us by members of your staff during this audit.

Executive Summary

Food and Nutrition Service National Office Oversight of Electronic Benefits Transfer Operations (Audit Report No. 27099-66-Hy)

Results in Brief

The Food Stamp Act of 1977, Public Law 88-525, authorized the Food and Nutrition Service (FNS) to experiment with alternative methods for the delivery of Food Stamp Program (FSP) benefits using electronic data processing and computer technology. With this authorization, FNS allowed State agencies to begin issuing FSP benefits using an Electronic Benefits Transfer (EBT) system. EBT is an electronic system that allows a recipient to authorize transfer of their government benefits from a Federal account to a retailer account to pay for products received. EBT has been implemented in all States since June 2004.

The Office of Inspector General (OIG) has monitored and audited implementation of EBT by FNS and States since its inception. We last issued a report on FNS national office oversight of EBT in January 2001. The objectives of this audit were to determine whether the FNS' corrective actions taken in response to prior EBT recommendations were adequate; whether FNS-approved waivers and EBT program changes made since our last audit were reasonable, properly implemented, and did not adversely affect EBT operations; and if oversight, related to EBT, was adequate.

We concluded that FNS' oversight of EBT operations was generally adequate. For example, we found that FNS-approved waivers and changes to the EBT program were reasonable, properly implemented, and did not adversely affect operations. EBT waivers relinquish rights given to EBT participants as prescribed in regulations.¹ These waivers cannot adversely affect the program or recipients nor can they increase the Federal cost of FSP EBT. In addition, FNS successfully implemented sections of the Farm Security and Rural Investment Act of 2002 related to EBT. Implementation of these sections was designed to help effectively deliver FSP benefits to clients when disasters occur, enhance current EBT issuance systems, increase FNS' controls over redemption, and increase FNS' flexibility to notify retailers of adverse actions. The national and Regional offices established appropriate roles, responsibilities, and lines of communication for oversight of EBT operations. However, despite FNS requirements to safeguard EBT systems, inadequate control over EBT system access by state agencies (e.g., improper use of user identification) remains a problem in the FSP. We also identified EBT trafficking,² through the illegal and

¹ Title 7 Code of Federal Regulations (C.F.R.) 274.12 January 1, 2005 and Title 7 C.F.R. 277.18 January 1, 2005.

² Individuals illegally selling their food benefits for cash.

unauthorized use of point of sale (POS) equipment as another weakness in the FSP.

In response to our prior recommendations,³ FNS agreed to strengthen procedures for reviewing and controlling access to State EBT systems. FNS directed States to conduct semiannual reviews of employee access and discussed the importance of these access reviews at EBT meetings in 2001. However, FNS does not independently confirm that States adequately controlled access to their EBT systems. As a result, unauthorized access to FSP benefits may not always be prevented or detected. We found system access deficiencies in seven State audits since the issuance of the last nationwide audit in January 2001. The scope of four of these audits (Texas, Michigan, New Mexico, and New Jersey) was subsequent to FNS' implementation of corrective actions agreed to in the 2001 audit.

Also, unscrupulous retailers have managed to circumvent the EBT security controls by fraudulently obtaining new equipment and/or illegally removing and using existing machines in unauthorized locations. Retailers obtained the new equipment by misrepresenting the need for replacement. This occurred because POS replacement procedures were inadequate to prevent certain retailers from fraudulently obtaining new POS equipment. Also, States were not required to consider including, in their Request for Proposal (RFP) to acquire EBT systems, equipment functionality and/or technological specifications that could prevent the illegal removal and unauthorized use of existing EBT POS equipment. As a result, the illegal and unauthorized use of EBT POS equipment impairs the integrity of the FSP.

Recommendations In Brief

We recommend that FNS require the Regional offices to revise their management evaluations of State EBT operations to include tests to determine if the States conducted proper system access reviews. We also recommend that FNS require States to implement, via the EBT contract, a formal process for use during EBT POS equipment replacement that would prevent retailers from fraudulently obtaining equipment. In addition, require States to consider including in their RFP to acquire EBT systems, requests for POS equipment functionality and/or technological specifications that could prevent the illegal removal and unauthorized use of the devices.⁴

³ Monitoring of the EBT System Development and Implementation, Evaluation Report No. 27801-03-Hy, September 1996 and FNS EBT System National Office Oversight, Audit Report No. 27099-11-Hy, January 2001.

⁴ FNS will not require this action via Federal regulations, however, as the final authority FNS' approval will depend on the State's consideration of fraud and theft controls during the RFP process.

Agency Response FNS agreed to all three report recommendations. We have incorporated FNS' response in the Findings and Recommendations section of this report, along with the OIG position. FNS' response is included as Exhibit D.

OIG Position Based on FNS' response, we were able to reach management decision on Recommendations 1 and 2. Management decision on Recommendation 3 can be reached once FNS has provided us with the additional information outlined in the report section, OIG Position.

Abbreviations Used in This Report

ADHS	Arkansas Department of Human Services
ALERT	Anti-fraud Locator using EBT Retailer Transactions
C.F.R.	Code of Federal Regulations
EBT	Electronic Benefits Transfer
EFS	Electronic Financial Services
FNS	Food and Nutrition Service
FSP	Food Stamp Program
FY	Fiscal Year
ID	Identification
ME	Management Evaluation
OIG	Office of Inspector General
OTDA	Office of Temporary and Disability Assistance
POS	Point of Sale
P.L.	Public Law
RFP	Request for Proposal
USDA	U.S. Department of Agriculture
WIC	Special Supplemental Program for Women, Infants and Children

Table of Contents

Executive Summary	i
Abbreviations Used in This Report.....	iv
Background and Objectives.....	1
Findings and Recommendations.....	4
Section 1. EBT System Access Controls Continue to Need Strengthening.....	4
Recommendation 1	5
Section 2. Controls to Safeguard EBT POS Equipment Need Strengthening.....	7
Recommendation 2	9
Recommendation 3	9
Scope and Methodology.....	11
Exhibit A – EBT Coalitions and Alliances.....	13
Exhibit B – Prior OIG Audits.....	14
Exhibit C – OIG Audit Recommendations.....	15
Exhibit D – Agency Response	21
Glossary of Terms	23

Background and Objectives

Background

The U.S. Department of Agriculture's (USDA) Food and Nutrition Service (FNS) administers the Food Stamp Program (FSP) which assists low-income households by increasing their ability to purchase food. Once a month, each participating household receives a benefit allotment determined by the number of individuals in the family, household income, and other related factors. Recipients can use the benefits to pay for food items at participating food retailers.

The Food Stamp Act of 1977, Public Law (P.L.) 88-525, authorized FNS to experiment with alternative methods for the delivery of FSP benefits using electronic data processing and computer technology. With this authorization, FNS allowed State agencies to begin issuing FSP benefits using an Electronic Benefits Transfer (EBT) system. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, P.L. 104-193, provided that all States⁵ must implement EBT systems before October 1, 2002, unless the requirement was waived. Additionally, the EBT Interoperability and Portability Act of 2000 mandated cost-effective portability of food stamp benefits across State borders by October 1, 2002.

The FSP is administered by FNS through a Federal-State partnership. The Federal Government pays the full cost of recipient benefits and shares the cost to administer the FSP with the States. Congress funds the FSP through direct appropriation. In Fiscal Year (FY) 2005, nearly \$29 billion in FSP benefits were issued through EBT systems.

Before EBT, the basic method of FSP benefit delivery was the food stamp coupon. EBT was developed to replace paper coupons with an electronic system. EBT systems provide computerized delivery of FSP benefits. Using plastic cards, much like a debit card along with a Personal Identification Number, recipients gain access to benefits through point of sale (POS) terminals located at approved food retailers.

FNS has established approval rules for the delivery of FSP benefits using EBT systems in Title 7 Code of Federal Regulations (C.F.R.) § 274.12, dated January 1, 2005, and for approving automated data processing systems in Title 7 C.F.R. § 277.18, dated January 1, 2005. FNS has issued a policy on the approval requirements for State development and implementation of EBT systems for the Women,

⁵ For purposes in this report, "States" will refer to all 50 U.S. States, Guam, Puerto Rico, Virgin Islands, and Washington D.C.

Infants and Children (WIC) program,⁶ but no specific regulations have been established for the delivery of WIC benefits using EBT systems. The FSP regulations specify functional areas to be addressed by the State agency but do not establish a standardized system of internal controls. FNS' policy is to allow the States the flexibility to establish control systems that meet the needs of the individual States.

Generally, States award contracts to private sector companies 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. However, the States remain financially liable to the Federal Government for actions of their EBT processors. As of February 2006, there were five prime EBT contractors plus three States who were acting as their own prime contractor. A prime contractor is the contractor selected by the State to oversee all EBT functions; however, the EBT processing function may be performed by another entity. Nearly two-thirds of all States have selected the same prime contractor, JP Morgan Electronic Financial Services (EFS). Additionally, there are four EBT coalitions/alliances, with 27 States participating (See Exhibit A). Coalitions provide the States with a number of advantages including allowing smaller States to gain a better negotiating position by combining with larger States to obtain contract prices and options, and the ability to share concerns, problems, solutions, lessons learned, etc.,.

The FNS National office is responsible for establishing all EBT policies and approving EBT system designs and EBT contracts. It maintains open communications with the States and the regional offices, monitors the financial reconciliation activity of the States, aids the Regional offices in crisis situations concerning daily EBT operations, responds to Congressional inquiries and letters and Web inquiries from the public, drafts guidance and regulations, and continues to develop the Anti-Fraud Locator using EBT Retailer Transactions (ALERT) system.

The seven Regional offices conduct management evaluations to ensure State compliance with Federal regulations and handle daily concerns arising from EBT operations at the State level.

The FNS national office and Regional offices share other responsibilities. They both ensure free and open competition among vendors, review all appropriate records pertaining to State EBT contracts, review test scripts and design documents for launch of a new system, attend national EBT conferences and workgroups, ensure that

⁶ Functional Requirements Document for a Model WIC System.

State limits on EBT-FSP funds are not exceeded, and continue development and monitoring of the Watch List.⁷

Objectives

The objectives of the audit were to determine whether: (1) actions taken by FNS on prior nationwide EBT recommendations were adequate, (2) FNS-approved waivers were reasonable and did not adversely affect EBT operations, (3) necessary changes to FNS regulations, policies, and forms have been completed and did not adversely affect EBT and non-EBT FSP operations, and (4) FNS national and Regional offices oversight, related to EBT, was adequate.

To accomplish these objectives, we reviewed 20 prior EBT audit recommendations, reviewed all current EBT waivers, interviewed pertinent FNS officials to receive information about changes in policies and procedures, and reviewed documents and conducted meetings with FNS officials to determine the adequacy of national office oversight.

⁷ A list of firms that may be violating the FSP.

Findings and Recommendations

Section 1. EBT System Access Controls Continue to Need Strengthening

Finding 1

In response to our prior recommendations,⁸ FNS agreed to strengthen procedures for reviewing and controlling access to State EBT systems. For example, FNS directed States to conduct semiannual reviews of employee access and discussed the importance of these access reviews at EBT meetings in 2001.⁹ These actions were not effective because FNS does not independently confirm that States adequately controlled access to their EBT systems. We identified weaknesses in controls over EBT system access in four States (i.e., Texas, Michigan, New Mexico, and New Jersey) subsequent to FNS' implementation of corrective actions. Accordingly, unauthorized access to FSP benefits may not be prevented or detected.

Federal regulations require States to protect the EBT system from theft and unauthorized use¹⁰ and also require States to conduct security reviews of EBT systems on a biennial basis.¹¹ Although, FSP regulations specify functional areas to be addressed, it is FNS' policy to allow States to develop specific controls to meet their needs.

We first reported that EBT system access procedures needed strengthening in our 1996 report. In response, FNS proposed to emphasize the importance of security in EBT systems to all States.

In January 2001, we reported that FNS' corrective actions were not sufficiently effective to address this system control weakness. We recommended that FNS require States to periodically review system access to identify individuals who no longer need access and to immediately delete their access. FNS did not concur with this recommendation. FNS did not believe regulating down to the level of periodic log-on identification (ID) reviews was necessary or appropriate. FNS instead proposed to write individually to State EBT managers directing them to tighten existing controls over EBT access by conducting semiannual reviews of employees with EBT access to determine if such access continued to be needed. In addition, FNS advised EBT managers to consult with their security managers about access reviews, added periodic access reviews as an agenda item for their January 2001 Regional EBT Coordinator conference call, and had

⁸ Monitoring of the EBT System Development and Implementation, Evaluation Report No. 27801-03-Hy, September 1996 and FNS EBT System National Office Oversight, Audit Report No. 27099-11-Hy, January 2001.

⁹ These meetings included FNS' January 2001 Regional EBT Coordinator conference call and Regional EBT user group meetings held in 2001.

¹⁰ Title 7 C.F.R. 274.12(i) (3)(v)(A) January 1, 2005 and Title 7 C.F.R. 277.18 (p) (2) (ii) (B) January 1, 2005.

¹¹ Title 7 C.F.R. 277.18 (p) (3) January 1, 2005.

the coordinators add this issue to all Regional EBT user's group meetings held in 2001.

The Office of Inspector General (OIG) performed 10 audits of State EBT systems since the release of the previous national oversight audit report in January 2001 (See Exhibit B). Seven of these audits (Washington D.C., New York, Arkansas, Michigan, Texas, New Mexico, and New Jersey) disclosed weaknesses in controls over EBT system access. Of these seven audits, four audits (Texas, Michigan, New Mexico, and New Jersey) disclosed weaknesses in controls over EBT system access and the scope of the review was subsequent to the June 2001 date when FNS reported that it had fully implemented actions to address the recommendations in our January 2001 report. These audits disclosed the following:

- Texas did not document requests for access to the EBT system nor did it conduct periodic reviews to determine if access granted to users remained appropriate.
- In Michigan, FSP caseworkers had unlimited access to the EBT issuance system and could independently change benefits for a recipient.
- New Jersey had no policies and procedures for removing system access for employees who have terminated employment or for employees who no longer had a continuing need for access.
- In New Mexico, some employees had the capability to access EBT systems that allow both the issuance of EBT benefits and EBT cards (access conflict). The audit also identified six employees with multiple user IDs.

We met with FNS officials regarding EBT system access weaknesses. FNS continued to believe that regulating down to the level of periodic logon ID reviews was not necessary or appropriate. They instead proposed to make system access reviews part of the Regional office management evaluation process in order to validate that States are appropriately controlling EBT system access.

Recommendation 1

Require the Regional offices to revise their management evaluations of State EBT operations to include tests to determine if the States periodically reviewed EBT system access to identify individuals who no longer needed access, identify individuals with multiple user IDs,

verify that the level of access granted was appropriate, and ensure that exceptions noted are corrected.

Agency Response.

We accept the finding and have taken steps to act on it. In the past, the FNS has issued management evaluation (ME) guidance to ensure that State EBT systems for the Food Stamp Program are secure and do not allow any of the above mentioned scenarios to occur. Although, system security was not included as part of the 2006 ME review elements, FNS has included it for 2007 as a result of this audit. FNS will be monitoring States' performance in this area.

OIG Position.

FNS officials informed us that the above described actions were incorporated into the ME guidance in August 2006. We accept FNS' management decision.

Section 2. Controls to Safeguard EBT POS Equipment Need Strengthening

Finding 2

EBT has changed the way that FNS combats fraud in the FSP. Because of the data available from the EBT system, there is an audit trail of transactions which was not available in the paper system. Using FSP transaction data from EBT systems, FNS successfully developed and implemented an automated system, ALERT, to manage the EBT data and assist in detecting fraud. In addition, FNS requires State agencies to protect EBT POS equipment from theft and unauthorized use and to establish computer hardware controls that ensure acceptance of data from authorized terminals only.

However, unscrupulous retailers have fraudulently obtained new equipment and/or illegally removed and used existing machines at unauthorized locations. Retailers obtained the new equipment by misrepresenting the need for replacement equipment. This occurred because EBT POS equipment replacement procedures were inadequate to prevent certain retailers from fraudulently obtaining additional equipment. Also, States were not required to consider including, in their Requests for Proposal (RFP) to acquire EBT systems, equipment functionality and/or technological specifications that could prevent the illegal removal and use of existing EBT POS equipment. As a result, food stamp benefits are at risk of improper use.

EBT trafficking via POS devices has been identified as far back as 1996. About \$395 million per year was diverted from food stamp benefits by trafficking between 1999 and 2002 (the most recent data available). From 1997 through the present, OIG Investigations identified over \$144 million in redemptions made by retailers under investigation for EBT trafficking in the Chicago area alone. In addition, the Chicago area investigations disclosed the first known instances where retailers fraudulently obtained and/or illegally removed and used the EBT POS devices. Specifically, OIG Investigations identified the following in Chicago, Illinois:

- A scheme whereby the subjects moved the authorized POS device to different locations so they could exchange cash for EBT benefits away from the authorized store. The individuals involved were ordered to pay \$29.1 million in restitution for defrauding the FSP from the fall of 1997 through August 2001.
- Thirty-one stores were collectively averaging \$2 million per month in trafficked benefits. OIG Investigations identified that most, but not all, of these stores had cloned machines or

duplicated machines obtained by misrepresenting the need for replacement.

- Through search warrants, 17 working EBT POS devices were recovered at 4 unauthorized EBT retailer locations.
- A store trafficked \$1.1 million in EBT benefits after the retailer shut down and boarded up the authorized location. The retailer continued to illegally traffic EBT-FSP benefits by using the POS device at an unauthorized location.¹²

FNS National office officials contended that OIG Investigations identified that the majority of EBT trafficking resulting from retailers fraudulently obtaining additional equipment and/or illegally removing and using existing POS devices remains localized in the Chicago, Illinois area. However, FNS and OIG agreed that this situation could occur anywhere in the country.

FNS officials conceded that the only regulatory requirement for replacing EBT POS equipment is a time limit to replace the equipment within 48 hours. FNS agreed that a process should be developed and used during equipment replacement that would prevent retailers from fraudulently obtaining additional EBT POS equipment. FNS could require that the process be part of the State EBT contracts.

During the course of fieldwork we suggested that at a minimum, the process should require a detailed explanation describing the need for replacement, proper identification of the device, and a visual inspection to determine if the equipment was tampered with in an effort to duplicate or clone the device. In addition, FNS proposed revising the existing procedure of assigning the replaced machine's terminal ID to the new machine. FNS proposed that the EBT processor disable the replaced machine's terminal ID and assign a new, unique terminal ID to the new machine.

FNS officials felt that it would be unfair to the States to require them to implement, via the EBT regulations or contracts, potentially expensive technologies or equipment functionality that would prevent retailers from illegally removing and using existing EBT POS devices. They contended that unscrupulous retailers will eventually find ways to circumvent the new controls. In addition, the controls may not be cost beneficial at this time or appropriate for a State that does not have this problem. However, FNS agreed with our proposal that they

¹² When FNS shuts a store down the authorization ID is also shut down. In this instance the retailer boarded up the store and relocated to an unauthorized location and continued to traffic benefits.

require requests for these technologies and equipment specifications in the RFP process. This way, each time the State entered into a new EBT contract, they would be required to obtain proposals and cost data on the latest technologies and equipment, yet retain the option to purchase only cost effective or otherwise acceptable options.

Recommendation 2

Require States to implement, via the EBT contract, a formal process for use during EBT POS equipment replacement that would prevent retailers from fraudulently obtaining equipment. At a minimum, the process should require a detailed explanation describing the need for replacement, proper identification of the device, assignment of unique terminal IDs, and a visual inspection to determine if the equipment was tampered with in an effort to duplicate or clone the device.

Agency Response

We agree with the finding and have taken steps to implement it. FNS regulations at C.F.R. 274.12(h) (3) (ii) (A) require that FNS accept transactions from authorized terminals only and that controls be in place such as terminal identifiers, and user and retailer identification codes. In order to ensure that States are complying with this regulatory requirement, FNS recently began providing specific language regarding POS device security for States to include in their RFP solicitations of EBT vendors. The specific language emphasizes the basic inventory procedures for EBT processors, which includes the de-activation of any government supplied equipment reported lost, stolen or in need of replacement as well as the assignment of unique terminal numbers for all government supplied equipment.

OIG Position

FNS officials informed us that they implemented the above described action in January 2006. We accept FNS' management decision.

Recommendation 3

Require States to consider including in their RFP's of EBT systems, POS equipment functionality and/or technological specifications that could prevent the illegal removal and unauthorized use of the devices.

Agency Response

As noted in Recommendation 2, FNS has begun working with States during the RFP process to include specific language to strengthen the

controls for POS device security. We will expand our efforts during the RFP review and approval process to encourage States to solicit methods for decreasing program fraud via the RFP. There are a variety of technologies that are coming onto the market to improve the security of electronic transactions; however, there may be cost and implementation limitations with such technologies. FNS will continue to monitor the effectiveness of new technologies and promote any which are successful and feasible for States to implement.

OIG Position

To achieve management decision, FNS needs to provide the specific actions they will engage in during the RFP review and approval process to encourage States to solicit methods for decreasing program fraud via the RFP and a date that these actions will be implemented.

Scope and Methodology

Fieldwork was performed at the FNS National office in Alexandria, Virginia, from October 2005, through February 2006. We audited FNS National office oversight of FSP EBT since January 2001 when we issued FNS EBT System National Office Oversight, Audit Report No. 27099-11-Hy.

We reviewed the following:

- Prior audit recommendations (see Exhibit C);
- Federal regulations, including changes since the January 2001 audit;
- Pending benefit files obtained from JP Morgan EFS;
- Regulation waivers;
- FNS guidance related to the expungement of benefits;
- Monitoring and communications between FNS and the States;
- Security issues;
- Status of implementation of EBT at farmer's markets;
- Other audits (see Exhibit B);
- Status of FSP and WIC EBT implementation;
- Methods of delivering EBT to farmer's markets;
- EBT waivers issued up to February 2006;
- FSP and WIC EBT guidance issued since the previous nationwide audit;
- Safeguarding POS Equipment;
- FSP EBT Report to Congress, issued 2003; and,
- The Extent of Trafficking in the Food Stamp Program Report, issued 2003

In addition, FNS provided us with a username and password to its EBT Partner Website. We downloaded the four RFPs issued between 2003 and 2005 to analyze efforts to standardize RFP language, price restructuring, and RFP restructuring. We also, downloaded the EBT Director's meeting notes to help us evaluate FNS' efforts to improve system security and provide communication with the States.

We reviewed all 291 current EBT waivers in FNS' FSP waiver database to determine if the waivers adversely affected EBT operations. We compared these waivers to the pertinent Federal regulations.

During the audit, we contacted and/or attended meetings with the following people to satisfy our audit objectives:

- FNS staff and officials;
- OIG Audit and Investigations staff;
- Other departmental OIG offices;
- Department of Justice officials;
- USDA Office of the General Counsel staff;
- The Director for the Illinois Logistics Information Network Program, EBT Unit

We attended a meeting held by FNS with EBT vendors and processors to discuss EBT POS control issues.

The audit was performed in accordance with Generally Accepted Government Auditing Standards.

Exhibit A – EBT Coalitions and Alliances

as of February 2006

Exhibit A – Page 1 of 1

STATES NOT IN A COALITION OR ALLIANCE		
NAME	PRIME CONTRACTOR	STATES
TWO-STATES COMBINED (1 PROJECT)	JP Morgan EFS	ND, SD
SINGLE STATES	JP Morgan EFS	CA, IN, LA, MI, NE, NM, OH, SC, WI, VA, VI
	Northrup Grumman	IL
	ACS	OK, MS, IA, MA, ME
	eFunds	OR, KS, MN, UT
	GM Group	PR
	Self	MT, TX, WY

COALITION AND ALLIANCE STATES		
NAME	PRIME CONTRACTOR	STATES
NORTHEAST COALITION OF STATES (NCS)	JP Morgan EFS	CT, NH, NY, RI, VT, (NY also participates in Mid-Atlantic Coalition)
SOUTHERN ALLIANCE OF STATES (SAS)	JP Morgan EFS	FL, GA, KY, TN
	ACS	AR
	eFunds	AL, MO, NC
WESTERN STATES EBT ALLIANCE (WSEA)	JP Morgan EFS	AK, AZ, CO, GU, HI, ID, NV, WA
MID-ATLANTIC REGIONAL COALITION (MARC)	JP Morgan EFS	WV, DC, MD, PA
	ACS	NJ
	eFunds	DE

<u>PRIME CONTRACTOR</u>	<u>NUMBER OF STATES</u>
JP Morgan EFS	34
eFunds	8
Self	3
ACS	7
Northrup Grumman	1
GM Group	1

Exhibit B – Prior OIG Audits

Exhibit B – Page 1 of 1

OIG Audits of State EBT Systems Since Prior Nationwide Audit		
State	Audit Number	Issuance Date
Washington	27099-14-SF	April 2001
Washington D.C.	27099-13-Hy	June 2001
Hawaii	27099-17-SF	September 2001
New York	27099-16-Hy	December 2001
Michigan	27099-23-Ch	July 2002
Arkansas	27099-11-Te	September 2002
Texas	27099-13-Te	June 2003
Nevada	27099-22-SF	September 2003
New Mexico	27099-18-Te	March 2004
New Jersey	27099-65-Hy	May 2004

Exhibit C – OIG Audit Recommendations

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
FNS EBT National Office Oversight, Report No. 27099-11-Hy (January 2001)		
No. 4 – Modify the time period, to a maximum of 30 days, States and EBT processors have for making corrections to FSP data.	OIG did not agree with FNS’ proposed action at the time of report issuance (January 2001). Management decision was reached on alternative corrective actions in March 2001. However, OIG has not performed audit work at an EBT processor since this report was issued.	Yes
No. 5 – Require State agencies to periodically review system access to identify those individuals who no longer have a need and immediately delete their access.	FNS did not concur with this recommendation. Instead FNS proposed writing individually to State EBT managers directing them to tighten existing controls over EBT access. However, OIG identified inadequate controls over EBT system access in subsequent audits.	No – See Findings and Recommendations Section 1
EBT System State of New York, Report No. 27099-16-Hy (December 2001)		
No. 6 – Direct the Office of Temporary and Disability Assistance (OTDA) to better utilize management reports in order to more effectively monitor the EBT system, especially the reports used to detect potential improper activity.	See No. 8 below.	Yes
No. 8 - Direct OTDA to obtain from Citicorp (now JP Morgan EFS) reports in an electronic data file format in order to more effectively monitor potential improper activity. These include Monthly Manual Transaction and ATM/POS Out-of-State Usage reports.	FNS’ responses to recommendations six and eight indicated that final action was contingent on the pending development of the State Fraud and Abuse Reporting System, targeted for August 2002.	Yes
No. 12 – Direct OTDA to develop written procedures to reinstate FSP benefits that are still available for use.	FNS’ response indicated final action was contingent on issuance of an administrative directive scheduled for January 2002.	Yes

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
Monitoring of EBT System in Michigan, Report No. 27099-23-Ch (August 2002)		
No. 1 – Require the State agency to develop controls that would ensure that the information in the EBT issuance system is reviewed and supported before a client is allowed access to their benefits.	To determine final action taken.	Yes
No. 5 – Work with the State agency to develop a time-phased action plan to document the purpose, distribution, and description of how the EBT management reports will be used by each division to manage the State agency’s EBT system.	To determine final action taken.	Yes
No. 6 – Work with the State agency to develop a time-phased action plan to ensure EBT client integrity.	To determine final action taken.	Yes
EBT System Development of Arkansas, Report No. 27099-11-Te (September 2002)		
No. 1 – Direct the Arkansas Department of Human Services (ADHS) to establish controls that require routine oversight of EBT system activities. The controls should include requirements for periodic review of management reports.	To determine final action taken.	Yes
No. 2 – Direct ADHS to complete the appropriate reconciliations in compliance with Federal regulations.	To determine final action taken.	Yes
No. 3 – Direct ADHS to establish controls to ensure that reconciliation procedures and FNS-46 procedures are current.	To determine final action taken.	Yes

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
EBT System Development State of New Mexico, Report No. 27099-18-Te (March 2004)		
No. 1 – Direct the State to determine which of the current authorizations needs to be removed and researched, including the \$555,521 identified, and make the appropriate accounting adjustments.	To determine final action taken.	Yes
No. 2 – Direct the State to establish written controls to ensure that authorizations that do not have EBT cards issued are timely (for example, within 60 days) removed from the pending file and researched.	To determine final action taken.	Yes
No. 3 – Direct the State, in consultation with FNS, to analyze the authorization process and determine if authorizations need to be sent to the processor before an EBT card is issued to the client. If so, modify the process before the next EBT contract is finalized.	To determine final action taken.	Yes
No. 4 – Take the necessary actions to: (a) bill the State for \$95,553 (or the applicable amount) in overpaid FSP fees from January 2002 to May 2003, and determine if other amounts need to be recovered for invoices approved after May 2003; and (b) establish written controls to ensure that future invoices comply with the approved fee schedule.	To determine final action taken.	Yes

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
<p>No. 7 – Direct the State to establish written controls to ensure that:</p> <p>7a – Help Desk functions are monitored.</p> <p>7b – A complaint resolution process is established that includes time periods for resolution.</p> <p>7c – Access to unissued EBT cards is limited to the least number of personnel.</p> <p>7d – A review of controls over unissued cards is included in the management evaluations that are performed at county offices.</p> <p>7e – EBT activities at Group Living Arrangement facilities are monitored during facility reviews.</p> <p>7f – Service agreements with the EBT processor are not allowed to expire.</p> <p>7g – Dormant accounts are reviewed to determine if additional benefits should be added to the account.</p> <p>7h – Appropriate reconciliations are performed on a daily basis.</p>	<p>Management Decision reached in September 2004, however, we had no evidence of final action as of January 2006. (recommendations 7a-7l)</p>	<p>Yes</p>

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
<p>7i – Training of State and county office EBT staffs are completed.</p> <p>7j – Procedure manual is developed for monitoring State office EBT operations.</p> <p>7k – The processor monitors retailer compliance with signed agreements.</p> <p>7l – Proper access to stored FSP coupons is established.</p>		
<p>No. 8 – Direct the State to establish written internal controls that ensure EBT corrective-action plan milestones are met.</p>	<p>To determine final action taken.</p>	<p>Yes</p>
<p>No. 9 – Review the State’s schedule of planned internal audits to determine if planned EBT audits are appropriate, considering the most recent A-133 Single Audit findings.</p>	<p>To determine final action taken.</p>	<p>Yes</p>
<p>No. 10 – Establish written internal controls to ensure that: (a) oversight of State EBT operations is appropriate and (b) State A-133 Single Audit Reports are reviewed at the appropriate levels of FNS management.</p>	<p>To determine final action taken.</p>	<p>Yes</p>

Prior Audit Recommendations	Reason for Follow-Up	Recommendation Effective (Y/N)
EBT System Development State of New Jersey, Report No. 27099-65-Hy (May 2004)		
No. 2 – Encourage the State agency to charge a fee when issuing excessive replacement cards to reduce the number of replacement cards issued, and lessen administrative costs incurred by the State and charged to the Federal Government.	The implementation date for New Jersey’s EBT replacement card fee as provided in their July 21, 2004 request for management decision was no longer valid because of a contract award delay. Management decision was reached in November 2004. The eFunds to ACS database conversion was scheduled for July 2005.	Yes



United States
Department of
Agriculture

Food and
Nutrition
Service

3101 Park
Center Drive

Alexandria, VA
22302-1500

SEP 28 2006

SUBJECT: OIG Audit 27099-66-HY: Oversight of Electronic Benefits Transfer (EBT) Operations

TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General

This memorandum is in response to the subject audit's findings and three recommendations. We concur with the findings and offer the following response:

Recommendation 1 – Require the regional offices to revise their management evaluations of State EBT operations to include tests to determine if the States periodically reviewed EBT system access to identify individuals who no longer needed access, identify individuals with multiple user ID's, verify that the level of access granted was appropriate, and ensure that exceptions noted are corrected.

We accept the finding and have taken steps to act on it. In the past, the Food and Nutrition Service (FNS) has issued management evaluation (ME) guidance to ensure that State EBT systems for the Food Stamp Program are secure and do not allow any of the above mentioned scenarios to occur. Although system security was not included as part of the 2006 ME review elements, FNS has included it for 2007 as a result of this audit. FNS will be monitoring States' performance in this area.

Recommendation 2 – Require States to implement, via the EBT contract, a formal process for use during EBT POS equipment replacement that would prevent retailers from fraudulently obtaining equipment. At a minimum, the process should require a detailed explanation describing the need for replacement, proper identification of the device, assignment of unique terminal ID's, and a visual inspection to determine if the equipment was tampered with in an effort to duplicate or clone the device.

We agree with the finding and have taken steps to implement it. FNS regulations at CFR 274.12(h) (3) (ii) (A) require that FNS accept transactions from authorized terminals only and that controls be in place such as terminal identifiers, and user and retailer identification codes. In order to ensure that States are complying with this regulatory requirement, FNS recently began providing specific language regarding Point-of-Sale (POS) device security for States to include in their Request for Proposal (RFP) solicitations of EBT vendors. The specific language emphasizes the basic inventory procedures for EBT processors, which includes the de-activation of any government supplied equipment reported lost, stolen or in need of replacement as well as the assignment of unique terminal numbers for all government supplied equipment.

AN EQUAL OPPORTUNITY EMPLOYER

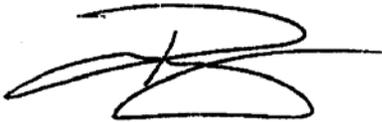
Robert W. Young
Page 2

During the RFP review and approval process, FNS will work with the States to ensure that their RFP contains such language. We will also expand on previous requests by asking EBT contractors to visually inspect terminals to determine if they have been tampered with.

Recommendation 3 – Require States to consider including in their RFPs of EBT systems, POS equipment functionality and/or technological specifications that could prevent the illegal removal and unauthorized use of the devices.

As noted above in Recommendation 2, FNS has begun working with States during the RFP process to include specific language to strengthen the controls for POS device security. We will expand our efforts during the RFP review and approval process to encourage States to solicit methods for decreasing Program fraud via the RFP. There are a variety of technologies that are coming onto the market to improve the security of electronic transactions; however, there may be cost and implementation limitations with such technologies. FNS will continue to monitor the effectiveness of new technologies and promote any which are successful and feasible for States to implement

Please feel free to contact me at 703-305-2062 or Jeff Cohen, Director, Benefit Redemption Division at 703-305-2434 if you wish to discuss our response.



Roberto Salazar
Administrator

Glossary of Terms

Anti-Fraud Locator using EBT Retailer Transactions (ALERT) – A system that enables USDA to identify patterns of non-compliance with FSP regulations and law evident from the electronic record of transactions that occur when people use their benefits.

Coalition/Alliance – Formed by States to establish uniform operating rules and guidelines for EBT to ensure interoperability.

Expungement Process – The State agency shall expunge (erase or strike out) benefits that have not been assessed by the household after a period of one year. Issuance reports shall reflect the adjustment to the State agency issuance totals to comply with monthly issuance reporting requirements.

Farmer's Markets – An open-air marketplace for farm products.

Prime Contractor – All EBT contracts are negotiated between a State and the prime contractor responsible for all aspects of performance of the contract, although prime contractors frequently use other firms as subcontractors for one or more of the various components of the contract requirements.

Terminal ID – A unique identifier that distinguishes one POS device from another.

Waiver – Intentional relinquishment of a right, claim, or privilege. FNS has the authority to approve requests from State agencies for waivers of regulatory requirements.

