U.S. Department of Agriculture

Office of Inspector General
Southeast Region

Audit Report

Special Supplemental Nutrition Program for Women, Infants, and Children, Puerto Rico

Report No. 27004-4-At
May 2007

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Southeast Region - Audit
401 West Peachtree Street, Suite 2328
Atlanta, Georgia 30308
TEL: 404-730-3210 FAX: 404-730-3221

May 24, 2007

REPLY TO
ATTN OF: 27004-4-At

TO: Yvette Jackson
Regional Administrator
Food and Nutrition Service – Mid-Atlantic Region

ATTN: Catherine Lueck
Director of Financial Management

FROM: Raymond G. Poland /S/
Regional Inspector General

SUBJECT: Food and Nutrition Service, Special Supplemental Nutrition Program for Women, Infants, and Children, Puerto Rico

This report presents the results of the subject audit. Your response dated May 9, 2007, to the draft report is included in exhibit B, with excerpts and the Office of Inspector General's position incorporated into the relevant Findings and Recommendations section of the report. Based on your responses, we have accepted management decision on all recommendations in the report.

Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer. Final action on the management decisions should be completed within 1 year of the date of this report to preclude being listed in the Department's Performance and Accountability Report.

We appreciate the cooperation and assistance provided by you and your staff during this audit.

Executive Summary

Special Supplemental Nutrition Program for Women, Infants, and Children, Puerto Rico (Audit Report No. 27004-4-At)

Results in Brief

The Food and Nutrition Service (FNS) administers the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). WIC programs are designed to improve the nutrition of women and children by providing wholesome foods and other nutrition-related services. Similar State programs serve participants in all 50 States, as well as U.S. territories, including Puerto Rico. The FNS Mid-Atlantic Region is responsible for overseeing the Puerto Rico WIC activities. The Puerto Rico Health Department is the State agency (SA) responsible for administering Puerto Rico's WIC—a program that, in fiscal year (FY) 2006, served 203,134 participants for total costs of $163.2 million in food and $36 million for nutrition service administration (NSA) costs. The Office of Inspector General (OIG) initiated this audit to evaluate FNS' management controls (1) for overseeing how the SA manages the WIC program, as well as the SA controls for authorization and oversight of WIC vendors[1] and (2) over the infant formula cost containment program[2].

We reviewed WIC vendor management operations for FYs 2004 and 2005, evaluated FNS' and the SA monitoring activities from FYs 2000 to 2005, and visited 6 of 51 "WIC-only" vendors. We concluded that control weaknesses exist at both FNS and the SA.

FNS reviews a portion of Puerto Rico's WIC program annually and the entire program is covered on a 3-year cycle. Over the past cycle, FNS reported a total of 38 weaknesses in different aspects of the program's operations. FNS had not been able to resolve 25 of these weaknesses; 8 of which related to our audit scope (as shown in exhibit A, some weaknesses were reported multiple times). FNS officials explained that, unlike in other States, the core management positions in Puerto Rico's WIC program were political appointments that changed each time the governing party changed. These positions were thus continually being filled with new officials—some of whom were not familiar with the program—thereby, delaying implementation of needed corrective actions. The following major issues we noted during this audit are also reflected in six of the eight weaknesses FNS noted during its reviews. Specifically, the SA failed to:

- Fully reconcile food instruments issued to participants since FY 2000. The SA did not have adequate controls in place to ensure the validity of food instruments redeemed that could not be matched to enrollment records. SA officials authorized the bank to redeem and pay food

[1] For an explanation of the different sorts of WIC vendors, see Background.
[2] As required by Title 7, *Code of Federal Regulations* (CFR), section 246.16(a).

instruments even when the instruments were not listed as issued by the clinics because they assumed the clinics were having computer transmission problems. However, the SA did not request an exception report of these instruments to research and validate at a later time. Therefore, the SA did not follow up on at least 11,939 of these food instruments totaling $335,148 from May 2005 through October 2006. This compromised the integrity of the reconciliation process.

- Monitor WIC vendors in order to ensure they comply with all relevant program regulations. Federal regulations require that SAs perform both routine monitoring and compliance investigations; but Puerto Rico had completed only routine monitoring from FY 2000 to FY 2006. Compliance investigations include both compliance buys and inventory audits; however, the SA had only conducted compliance buys from December 2004 through May 2006 and had just begun inventory audits in June 2006.

Further, FNS learned while conducting its management reviews that the SA had not excluded products that had tested nutritionally deficient from its list of approved WIC products. The SA did not take appropriate steps in August 2003 to inform vendors that 33 products were suspended from the program because they had failed nutritional tests. The SA had no assurance that participants were receiving products that met Federal nutritional requirements. Moreover, without finalizing a list of approved products, the SA could not authorize new vendor agreements that had expired in September 2003. In November 2006 the SA interim WIC Director approved a new list of WIC products after the products passed new nutritional testing and the SA confirmed the products met Federal nutritional requirements. The new list of approved products was submitted to vendors for price bids under the new vendor cost containment program.

Although FNS reported these problems to the SA between FYs 2000 and 2004, we found that the SA had not taken satisfactory steps to correct them. FNS, however, chose not to invoke its statutory authority to withhold NSA funds. FNS officials stated that withholding NSA funds would harm program participation. Consequently, FNS repeatedly postponed deadlines and allowed new officials time to learn the program and to consider remedies for identified problems, but the officials kept changing and the problems continued.

We acknowledge the dilemma FNS faces when dealing with the high turnover among SA officials. During the course of our audit, when we questioned program decisions, we often found that important decisions were made by officials who had left the program. An official currently holding a position could not always explain why the decision in question was made. We concluded that this lack of continuity in key positions is one of the

greatest obstacles to improving Puerto Rico's WIC program. However, FNS' decision to not apply sanctions serves to decrease the urgency with which SA officials deal with identified program weaknesses. FNS should work with the SA to improve stability of WIC program management by requiring a time-phased corrective action plan that determines the actions that will be taken to assign permanent staff to key program positions and/or responsibilities. FNS should invoke its statutory authority to enforce sanctions if corrective actions are not implemented.

In addition to those WIC program weaknesses FNS had already identified, we identified two other problems:

- The SA compromised the vendors' bidding process by releasing the consumption factor of products to vendors prior to bids being accepted. The consumption factor shows the quantity of each particular food item that is prescribed on food instruments to the program participants. Thus, the released consumption factor information allowed vendors to calculate their bid prices in ways that increased food costs and was disadvantageous to the program by overpricing high consumption food items and underpricing low consumption food items. In addition, the SA did not take into consideration these factors that impacted the bid prices when authorizing vendors. Rather, the SA simply added the total amount for each product as the total package bid, giving no consideration to the quantity of each item that participants would actually consume. In September 2006, FNS approved a vendor cost containment measurement plan submitted by the SA that includes setting maximum allowable prices. If properly implemented, the plan should correct this situation.

- The SA violated regulations[3] when they condoned the use of in-store credits. The WIC Vendor Division Manager and investigators within that unit admitted they were aware that vendors were keeping "milk registers", which was a system of informal in-store credits and that this practice violated the regulations. We found vendors were not always providing participants with all the food items allotted to them, yet they redeemed the entire value of the food instruments. In five of six "WIC-only" stores we visited, we observed that vendors were maintaining "milk registers." When participants redeemed all their food instruments at once, they were taking home fewer commodities than specified, and were instead carrying credit balances on these "milk registers." All registers reviewed disclosed participants had outstanding, and growing, balances of milk not delivered each month. Thus, vendors were reimbursed for milk that ultimately may never be delivered to participants. We were unable to quantify the total amount of milk that was reimbursed but undelivered because the informal registers kept by

[3] 7 CFR, section 246.12(h)(3)(ii).

vendors did not include sufficient detailed information. For example, many of the registers listed only a first name without the associated last name. The SA Vendor Division officials stated that this practice was justifiable because they concluded the number of half gallons prescribed to participants were excessive even though these guidelines were established by nutritionists. However, FNS officials stated that the milk prescribed to participants was in accordance with Federal regulations and that the SA should enforce the proper redemption of food instruments. After we discussed this condition with SA officials, they sent a letter in August 2005 to vendors prohibiting "milk registers" and reminding them of possible penalties if they do not deliver all products when food instruments are redeemed. However, the SA had not improved monitoring controls over vendors to determine if this practice continues to exist.

FNS should work with the SA to establish a process in which corrective actions continue during changes in top management and hold the SA accountable for correcting all identified program weaknesses. If FNS finds that the SA does not correct these problems, the agency should invoke its statutory authority to withhold NSA funds.

Our evaluation of the management controls over the infant-formula cost containment program did not identify any reportable issues, and therefore, resulted in no recommended actions. We did not review the new vendor cost containment program that was authorized by the Reauthorization Act of 2004, and made effective by FNS in November 2005. The SA had just recently submitted and received approval from FNS of their cost containment plan in October 2006.

Recommendations in Brief

Require the SA to develop a corrective action plan to correct all unresolved identified program weaknesses and establish a timeframe to accomplish them, including making a determination as to whether a full-time or equivalent administrator be assigned for the program.

As part of the corrective action plan, require the SA to (1) research and validate food instruments paid but not listed in the SA's system as being issued by clinics; (2) monitor vendors in accordance with Federal regulations; (3) remove from list of authorized foods, any products that comes to the SA attention has failed a nutritional test and verify during vendor monitoring visits that it is not being provided to participants; (4) ensure that the new vendor cost containment implementation plan approved by FNS in October 2006 is implemented; and (5) include tests in its routine monitoring, compliance buys and inventory audits to determine if any forms of in-store credit, including "milk registers" are being used by vendors.

Agency Response In its May 9, 2007, written response to the draft report, FNS Regional Office officials agreed with the report's 12 recommendations. We have incorporated excerpts from FNS' response in the Findings and Recommendations section of this report, along with the OIG position. FNS' response is included as exhibit B.

OIG Position Based on FNS' response, we were able to reach management decision on all of the report's 12 recommendations.

Abbreviations Used in This Report

AMS	Agricultural Marketing Service
CFR	Code of Federal Regulations
FDA	Food and Drug Administration
FNS	Food and Nutrition Service
FY	Fiscal Year
NSA	Nutrition Service Administration
OIG	Office of Inspector General
SA	State Agency
SENA	Selección Efectiva de Negocios Autorizados (Effective Selection of Authorized Vendors)
USDA	U.S. Department of Agriculture
WIC	Women, Infants, and Children

Table of Contents

Executive Summary ..... **i**

Abbreviations Used in This Report ..... **vi**

Background and Objectives **1**

Findings and Recommendations **4**

Section 1. FNS Should Require the SA to Correct Identified Program Weaknesses **4**

Finding 1 FNS Did Not Impose Sanctions When the SA Failed to Correct Problems 4
Recommendation 1 7
Recommendation 2 7

Section 2. The SA Should Improve Controls Over Vendors **8**

Finding 2 The SA Has Not Fully Reconciled WIC Food Instruments 9
Recommendation 3 10
Recommendation 4 11
Finding 3 The SA Controls Over Vendor Monitoring is Deficient 11
Recommendation 5 14
Recommendation 6 14
Finding 4 The SA Should Require Vendors to Provide Participants With All Products Listed on Their Food Instruments 14
Recommendation 7 17
Recommendation 8 18
Recommendation 9 18
Finding 5 The SA Did Not Exclude Products With Nutritional Deficiencies 19
Recommendation 10 21
Recommendation 11 21
Finding 6 The SA Needs to Improve its Vendor Selection Process 22
Recommendation 12 24

Scope and Methodology **25**

Exhibit A – Outstanding Issues Reported by FNS in the Management Evaluation Report **27**
Exhibit B – Agency Response **28**

Background and Objectives

Background

The Food and Nutrition Service (FNS), an agency of the U.S. Department of Agriculture (USDA), administers nutritional programs in partnership with cooperating State agencies (SA). FNS is responsible for most of the nation's nutritional assistance programs, including the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).[4] WIC was established to improve the nutrition of low-income pregnant, postpartum, and breastfeeding women; infants and children up to age 5 who are at nutritional risk. Under this program, participants are provided healthy foods, nutrition education, immunizations, and access to other social and health programs.

WIC Program Administration

Nationwide, WIC operates through 2,200 local agencies, 9,000 clinic sites, 50 State health departments, and 33 Indian Tribal organizations. In addition to the 50 States, WIC programs exist in American Samoa, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands. The FNS Mid-Atlantic Region is responsible for the oversight of WIC in Puerto Rico, while the Puerto Rico Health Department is the SA responsible for administering Puerto Rico's WIC program and manages the WIC program in Puerto Rico through a central office in San Juan, 7 regional offices and 102 clinics located throughout the island.

WIC is a Federal grant program, for which Congress authorizes a specific amount of funding each year for program operations. In fiscal year (FY) 2006, Puerto Rico served 203,134 WIC participants for a total cost of $163.2 million in food and $36 million in nutrition service administration (NSA) costs.

Redemption of Food Instruments

WIC participants are approved a monthly food package of specific food items that participants can obtain at retail stores in exchange for WIC food checks or instruments. These food packages are designed for infants or children of different ages, or for women who are pregnant or breast feeding. Each food instrument specifies the food package authorized and maximum dollar amount the WIC vendor can claim. In Puerto Rico, participants receive a WIC food instrument generated at the local clinics and may redeem them at any of the 735 authorized retail stores. Retail stores then submit the redeemed food instruments to the SA for reimbursement. Redeemed food instruments list the products purchased by the WIC participants and the prices charged at the retail stores. The SA is required to account for the disposition of all food

[4] Public Law 92-433 Supplement, "Child Nutrition Act of 1966," dated September 26, 1972.

instruments in a process which FNS defines as the one-on-one reconciliation. In this process, the SA identifies each instrument as either validly issued, lost, stolen, expired, duplicated, or not matching valid enrollment and issuance records.

Since 1996, "WIC-only" stores—vendors accepting only WIC food instruments as payment—have proliferated nationwide. These stores have become popular with WIC participants because they receive convenient service without the stigma sometimes experienced at the checkout registers of full-service retail stores. However, prices at most "WIC-only" stores are usually higher than the prices at full-service retail stores. In some cases, "WIC-only" vendors are pricing products at or near the maximum value allowed by the WIC program.

In FY 2005, Congress passed a law to restrict the number of vendors expecting to receive more than 50 percent of their annual revenue from the sale of supplemental foods obtained with WIC food instruments. Congress allowed the Secretary of Agriculture to authorize new "WIC-only" vendors only if they were necessary to assure participant access to program benefits.[5]

As of September 30, 2004, Puerto Rico had 735 authorized WIC retailers, of which 51 were "WIC-only" stores. Puerto Rico has also witnessed the creation of a new type of store called, "Baby Food Center Stores." Although these stores are "WIC-only" in the sense that they predominately cater to WIC participants, these stores also carry other products and attract other customers. So, while these stores operate as "WIC-only," they also sell other products which cannot be purchased with WIC food instruments.

Infant Formula Cost Containment

SAs are required by law to have competitive bid infant formula rebate contracts with infant formula manufacturers for the WIC program. These contracts stipulate that the State agrees to provide one brand of infant formula, and in return, the manufacturer gives the SAs a rebate for each can of infant formula purchased by WIC participants. The reduced food costs resulting from these agreements allow the State to serve more eligible families.

Vendor Cost Containment

In the Reauthorization Act of 2004, Congress asked FNS to establish a vendor cost containment program to compel SAs to achieve lower food costs. The Act requires SAs to implement a vendor peer group with distinct competitive prices and allowable reimbursement levels. In addition, the Act

[5] "Consolidated Appropriations Act 2005," dated December 8, 2004.

establishes limitations on how the SA can authorize vendors which generate more than 50 percent of their annual income selling supplemental foods to WIC participants.

Objectives

Our audit objectives were to (1) evaluate FNS' management controls for overseeing how the SA manages the WIC program; (2) evaluate management controls over the authorization and oversight of WIC stores in Puerto Rico; and (3) evaluate how the SA has managed the Infant Formula Rebate System.

Findings and Recommendations

Section 1. FNS Should Require the SA to Correct Identified Program Weaknesses

We found that FNS has implemented an effective management evaluation system for identifying WIC program weaknesses. From FY 2000 to 2004, FNS identified 38 weaknesses in the SA operations. Although FNS reported these weaknesses in management evaluation reviews, recommended corrective actions to the SA, and maintained continuous written and verbal communication with the SA, its efforts to compel the SA to correct weaknesses were hindered by frequent turnover in key WIC management positions. As a result, the SA did not correct 25[6] of the 38 identified weaknesses. Eight of these 25 program weaknesses related to food instruments and vendor management (see exhibit A).

Because the program weaknesses are long standing, FNS should work more aggressively with the SA to develop a feasible plan for correcting all identified program weaknesses. If the SA fails to comply with this action plan, FNS should enforce sanctions by invoking its authority to withhold NSA funds.

Finding 1 — FNS Did Not Impose Sanctions When the SA Failed to Correct Problems

Although the SA had not corrected 25 of the 38 weaknesses reported in the management evaluations performed from FY 2000 through 2004, FNS did not have a plan to impose sanctions by withholding NSA funds from the SA. FNS maintained frequent communication with SA officials, through weekly conference calls, meetings, e-mails, and memos, in order to correct issues reported. FNS officials explained that they granted the SA repeated extensions for completing its corrective actions because successful implementation of long-term, sustained corrective action was hampered by high turnover in the SA's administrative personnel, vacancies not being filled timely in permanent program management, and the implementation of a new information system.[7] In addition, FNS officials explained they only withhold NSA funds when it is determined that the SA mismanaged the program or monetary loss is identified. Moreover, FNS officials stated their reluctance to impose sanctions in Puerto Rico resulted from their experience in the early 1990s, when imposing sanctions caused the SA to curtail its services and thereby cut program participation. We maintain that FNS' unwillingness to

[6] Of the 25 uncorrected weaknesses, 2 were identified in FY 2000; 5 were identified in FY 2002; 15 were identified in FY 2003; and 3 were identified in FY 2004.
[7] The implementation of this new information system is discussed at length in Findings 2 and 3.

impose sanctions meant that there was little incentive for the SA to promptly resolve these problems. Thus, FNS chose not to utilize a control created to help ensure effectiveness and efficiency in the WIC program.

FNS established a management evaluation system to assess the accomplishment of WIC program objectives. Federal regulations state, if FNS determines through a management evaluation or other means that during a fiscal year the SA has failed, without good cause, to demonstrate efficient and effective administration of its program, or has failed to comply with its correction action plan, FNS may withhold up to 100 percent of NSA funds for that fiscal year.[8] However, FNS did not withhold any NSA funds when the SA repeatedly failed to comply with their corrective action plans.

FNS was conducting annual management evaluations of selected components[9] of Puerto Rico's WIC program; completing a review of the entire program on a 3-year cycle. These evaluations were effective in identifying a number of problems. From FY 2000 through 2004, FNS completed 11 management evaluations and reported 38 weaknesses in different aspects of the WIC operations. Despite FNS sending numerous letters to the SA to follow up on the reported weaknesses, the SA was unresponsive and FNS was unable to close 25[10] of these weaknesses. In particular, the SA had not corrected eight weaknesses related to food instruments and vendor management activities, including the following.

- In FYs 2000 and 2003, FNS reported that the SA was not conducting the one-on-one reconciliation of all food instruments. Without this one-on-one reconciliation, the agency could not account for the final disposition of all food instruments (see exhibit A).

- In FY 2003, FNS reported that the SA was not exercising adequate oversight of its vendors. Without adequate oversight, SA officials cannot be certain that vendors are abiding by program regulations. The high number of violations uncovered by the SA's 2005 compliance buys[11] demonstrated the SA's pressing need to comply with Federal compliance investigation requirements (see Finding 3).

Further, in FY 2003, FNS learned while conducting its management reviews that the SA knew some juices prescribed to WIC participants did not meet Federal nutritional requirements. However, FNS was unaware that the SA did not notify vendors and participants of the situation. We inquired why the SA had not notified vendors and participants, but because of SA staff turnover, no current officials knew why. The SA is in the process of entering into an

[8] Title 7, *Code of Federal Regulations* (CFR), section 246.19(a)(2).
[9] Management evaluations are performed for different aspects of the program, including: vendor management, food and caseload management, information systems and food delivery.
[10] As shown in exhibit A, FNS has reported several weaknesses multiple times, and keeps all recommendations open until they are corrected.
[11] A compliance buy is when a contractor performs covert onsite investigations of vendors by posing as participants and redeeming food instruments.

agreement with the University of Puerto Rico to test products and require manufacturers to provide certification from the university confirming the nutritional values of the products. Though the SA has taken these steps towards determining which products meet Federal standards, that work has not yet been completed. As a result, the nutritional quality of products reaching program participants is still in doubt (see Finding 5).

FNS officials explained that they have met with Puerto Rico officials on numerous occasions in the past 5 years to resolve outstanding weaknesses; however, their efforts have been hindered by continuous personnel turnover in key WIC positions. Several important management positions[12] in the SA have changed from two to six times in the past 5 years—three individuals have served as WIC Director since 1999, and the position has been filled by an acting official since November 2004. The current interim Director is working part-time for the program because he divides his time in WIC with his responsibilities as legal advisor for the Secretary of the Puerto Rico Health Department. Regulations require a full-time, or equivalent, administrator be assigned to the program[13]. Unlike other States where this is a career position, the WIC Director in Puerto Rico is a political appointee who changes as the governing party changes. FNS stated that not only were the SA officials continuously changing, but so were other positions vital to ensuring that statutory requirements are met.

Due to this high personnel turnover, FNS officials are continuously training and providing technical support to WIC management and other key positions in order to update new appointees on issues affecting the WIC program. FNS believes that new appointees deserve some time to understand and attempt to correct problems before FNS imposes sanctions, especially since some appointees lack experience or knowledge in the field.

OIG recognizes that timely completion of corrective action has been more difficult because of these personnel changes; however, this is a recurring scenario over many years and WIC now issues over $160 million of benefits yearly in Puerto Rico. It is therefore imperative that the agency resolve identified program weaknesses as promptly as possible. We concluded that FNS should coordinate with SA officials to establish feasible dates for the completion of all outstanding corrective actions. At the same time, FNS should invoke its authority to withhold NSA funds if the SA does not complete corrective action plans by agreed-upon dates. FNS should also pursue with the SA what actions can be taken to ensure reasonable stability in WIC program management, including assigning permanent State staff to key positions and/or responsibilities.

[12] Management positions such as: WIC Director, Financial Manager Information System Manager, and Vendor Manager.
[13] 7 CFR 246.3

Correction of the control weaknesses reported by FNS, such as lack of reconciliation of food instruments and monitoring of vendors, would prevent monetary losses. However, allowing the SA to continuously extend the completion dates for their corrective action plans has instead diminished the agency's urgency to improve conditions. We concluded that FNS must take steps to correct these problems and to hold the SA accountable for the effective and efficient implementation of its program.

Recommendation 1

Establish timeframes for the SA to implement corrective actions for all unresolved issues identified in FNS management evaluations. If corrective actions are not taken by the SA, FNS shall implement the sanctioning provisions defined in 7 CFR 246.19.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation and will send the State agency a letter requiring a corrective action plan including timeframes for resolving all unresolved issues identified in FNS management evaluations. This letter will detail the penalties and sanctions FNS may apply, in accordance with WIC Regulations, should the corrective action plan not be implemented by the specified due dates. FNS will issue the corrective action plan request letter within 60 days of the official release of the audit. Final action will occur when FNS determines the State agency submitted an approvable corrective action plan with reasonable timeframes as per our agreement with OIG.

OIG Position. We accept management decision for this recommendation.

Recommendation 2

Require the SA to assign a full-time, or equivalent, administrator for the program as required by Federal regulation 7 CFR 246.3.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this as an action plan item in the corrective action plan addressed in Recommendation 1.

OIG Position. We accept management decision for this recommendation.

The SA's continuous disregard of key Federal regulations jeopardized the effectiveness of the management controls and accountability of program funds. By not following controls in the Federal regulations, the SA increased food costs, thus impacting the number of WIC participants that could participate in the program. We found the SA:

- Did not fully reconcile food instruments issued since FY 2000, because the SA failed to request an exception report from its computer contractor to identify those redeemed and paid food instruments without the instruments being listed as issued by clinics. The SA allowed the bank to pay instruments not listed as issued in the clinics' instrument listings, as we found that the SA could not assure the authenticity of at least 11,939 food instruments totaling $335,148 redeemed between May 2005 and October 2006.

- Did not perform compliance investigations, including: compliance buys and inventory audits since FY 2000. In the past, these monitoring activities allowed the SA to identify many vendors violating program requirements.

- Did not exclude products with nutritional deficiencies from its list of approved WIC products. Moreover, by not finalizing a current list of approved products, the SA could not authorize new vendor agreements. These agreements had expired in September 2003.

- Used a bidding system to establish prices for program products that was flawed and subject to manipulation; and did not ensure the program received the most competitive prices because it allowed vendors to bid high prices on high consumption products.

- Violated regulations when they condoned the use of in-store credits. We found vendors were not always providing participants with all food allotted to them, yet vendors redeemed the entire value of the food instruments. In five of six "WIC-only" stores we visited, we observed that vendors were maintaining "milk registers." When participants redeemed their food instruments, all at once, they were taking home fewer commodities than specified, and were instead carrying balances on these "milk registers." All registers reviewed disclosed participants had outstanding balances of milk not delivered each month. We were unable to quantify the total amount of milk that was reimbursed but undelivered because the informal registers kept by vendors did not include sufficient detailed information. For example, first names were used without the associated last names.

The SA should include corrective action for these problems in the overall plan it develops in collaboration with FNS.

Finding 2 The SA Has Not Fully Reconciled WIC Food Instruments

The SA did not have adequate controls in place to ensure the validity of food instruments redeemed that could not be matched to enrollment records. SA officials authorized the bank to redeem and pay food instruments even when the instruments were not listed as issued by the clinics because they assumed the clinics were having computer transmission problems. However, the SA did not request an exception report of these instruments to research and validate at a later time. Since May 2005, a computer contractor, on their own initiative, started tracking these instruments and recorded 11,939 food instruments, totaling $335,148, as redeemed from May 2005 to October 2006 without being validated against enrollment records.

Federal regulations[14] require the SA to design and implement a system to review food instruments submitted by vendors for redemption to ensure compliance with applicable price limitations and detect questionable food instruments. This review must examine either all or a representative sample of the food instruments and may be done before or after the SA makes payments on the food instruments. WIC policy Memorandum 2002-1[15] clarified the Federal regulations and required the SA to actually match redeemed food instruments with valid issuance and enrollment records as part of the food instrument disposition process. Further, FNS has the authority to establish a claim against any SA that has not taken appropriate followup action on all redeemed instruments that cannot be matched against valid enrollment and issuance records[16].

On a daily basis, local clinics issue food instruments to participants. Each clinic then transmits to the SA a file listing the instruments it has issued. When these instruments are redeemed, the SA uses the file to determine whether the instruments were issued at certified clinics and to validate enrollment. If a vendor attempts to redeem an instrument not included on the WIC list, it will be rejected. However, because some clinics experienced difficulties when electronically transmitting their files (usually caused by poor telecommunications infrastructure and electrical blackouts), the SA's list did not always contain all food instruments issued by certified clinics. Consequently, the SA had to ask the clinics to retransmit information or send backups to the computer contractor. Meanwhile, the SA also instructed banks

[14] 7 CFR 246.12(k)
[15] Revision 1 – Clarification of WIC Food Delivery Systems Final Rule Questions and Answers
[16] 7 CFR 246.23(a)(4)

to process payments even when the instrument was not listed as valid on the SA's issuance list. From May 1, 2005, through October 31, 2006, the contractor processed payments for 11,939 unverified food instruments totaling $335,148. The computer contractor stated the SA did not request an exception report for these redemptions. Therefore, the contractor started tracking these payments in 2005 because the staff suspected somebody would question these redemptions. In October 2006, we confirmed that the SA continues to pay instruments without validating its issuance with clinics. Although, the SA is currently working with FNS to address backup plans for their telecommunication issues; the staff had not addressed nor requested an exception report to validate these payments. We concluded that the SA's system was not functioning as designed and should be improved to verify that all food instruments are validly issued.

SA officials stated they had not conducted the complete one-on-one reconciliation since the agency acquired the new computer system in FY 2000. FNS confirmed this statement, in its management evaluation reports for FY 2000 and 2003, when it reported the SA had not been conducting the one-on-one reconciliation. SA officials stated at that time the reconciliation could not be performed because they had not requested a reconciliation module when the computer system was purchased in FY 2000. In April 2006, FNS sent a letter to the SA to request an update on the reconciliation process. The SA did not send a written reply, but met with FNS officials in Puerto Rico and stated that corrective action had not been implemented. SA officials informed FNS that to correct the reconciliation issue, they would need to make a change order for their current computer contract. The computer contractor has recently submitted a proposal for the reconciliation module to the SA for review.

When discussing this audit result, FNS officials agreed its management evaluation reports were confusing because they intended to report the SA was not validating exceptions identified during the redemption process, such as instruments paid without enrollment records confirmed, instead of concluding the SA was not reconciling instruments at all. FNS officials explained the SA was validating and verifying a large portion of food instruments during the redemption process; because it matched most instruments processed for payment to its enrollment records.

Recommendation 3

Require the SA to request an exception report listing all food instruments paid for which issuance could not be confirmed. Develop and implement procedures to research and validate on a monthly basis all these instruments.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS also reported that on March 6, 2007, the SA submitted to FNS a proposal for a Check Reconciliation Report and Exception Payments Report. The SA confirmed, on April 24, 2007, its agreement to request these reports and develop related implementation procedures.

OIG Position. We accept management decision for this recommendation.

Recommendation 4

If the SA cannot provide a reasonable explanation for the disposition of food instruments issued, FNS should establish a claim as required in 7 CFR 246.23 (a) (4).

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS will also advise the SA that a claim will be assessed for unmatched food instruments that have not been investigated.

OIG Position. We accept management decision for this recommendation.

Finding 3 The SA Controls Over Vendor Monitoring is Deficient

The SA has not conducted compliance investigations, such as compliance buys and inventory audits as required by regulations, since FY 2000. From FY 2000 until June 2006, inventory audits were not performed because the SA's new computer system did not have the capabilities to retrieve data needed to perform the audits, and staff was unavailable to perform these audits due to other priorities. Continuous changes in SA management allowed the condition to remain unresolved. Although FNS directed the SA to correct this condition, it did not impose sanctions when corrective actions were not implemented. When a computer programming problem was corrected in the summer of 2005, the SA did not have staff available to conduct the audits. In June 2006, the SA selected 20 vendors to begin conducting inventory audits; however, the SA has not yet reported any results. Further, compliance buys were not performed from FY 2000 until December 2004, because according

to a SA official, the high turnover of personnel resulted in the expiration of the contractor's agreement. The compliance buys were discontinued again in May 2006 when the SA's contract expired. Without completing all types of oversight activities, the SA cannot be certain that vendors are complying with program requirements.

Federal regulations require State agencies to design and implement a system to monitor its vendors for compliance with program requirements.[17] Monitoring visits include two types of oversight—routine monitoring and compliance investigations, which includes inventory audits and compliance buys. These monitoring visits serve distinct purposes and are designed to provide broad assurance that vendors are complying with all relevant program regulations.

- The SA is required to conduct routine monitoring visits on a minimum of 5 percent of the number of vendors authorized by the SA. When conducting routine monitoring reviews, SA representatives select vendors for review based on criteria established in the State Plan and identify themselves to vendors during the investigation. Since vendors are aware when investigators are conducting their routine monitoring, they are less likely to violate regulations during their visits. The purpose of this review is for the SA to obtain an overall understanding of how the program is functioning.

- The SA is required to conduct compliance investigations on all high-risk vendors up to a 5-percent minimum; if fewer of the authorized vendors are identified as high risk, the SA must randomly select additional vendors. A compliance investigation includes both compliance buys and inventory audits. When conducting compliance buys, contractors perform covert onsite investigations of vendors by posing as participants and redeeming food instruments. The purpose of this review is to provide assurance that vendors' actual practices correspond to regulations. Because vendors are likely to recognize WIC employees, compliance investigations are conducted by contractors. When conducting inventory audits, the State internal auditors examine vendors' food invoices and other proofs of purchase. The purpose of this review is to determine whether vendors purchased sufficient quantities of foods to provide participants the quantities of food redeemed by the vendor during a given period.

Together, these types of monitoring are meant to provide the best possible assurance that vendors are following all WIC program requirements. We found, however, that although the SA had a system to conduct routine

[17] 7 CFR, section 246.12(j).

monitoring of 5 percent of its vendors, it has not met the compliance investigations requirements.

- *Compliance buys*—FNS reported in FY 2003 that the agency had not performed any compliance buys[18] since FY 2001. In its report, FNS required that compliance buys begin promptly, but the SA did not begin conducting these buys until December 2004, after approving a contract needed to conduct compliance buys. The SA again citied the continuous changes in WIC's management (mentioned in Finding 1) as its reason for not timely approving the contract. Since then the SA has recommended disqualifying 8 of the 15 (53 percent) stores investigated.[19] The contractor reported that these vendors were allowing participants to purchase unauthorized products and were redeeming participants' food instruments before their first use date, among other program violations. However, we found that this contract expired in May 2006. Thus, the SA discontinued compliance buys and did not indicate when this would be restarted. FNS was not aware of this because they had not conducted a management review of this program area since August 2003.

- *Inventory audits*—Inventory audits had not been performed since June 1997. SA officials stated the new WIC computer system could not issue reports with redemption information needed for the inventory audits. This occurred because the SA did not request such capabilities when the computer system was acquired in 2000. In the summer of 2005, the computer contractor corrected the problem and was able to issue reports; however, the internal auditors could not conduct the inventory audits because they had other priorities and conflicting schedules. In June 2006, the SA selected 20 vendors to start conducting inventory audits. These audits are covering infant formulas and cereals because of the high cost and trafficking vulnerability. SA officials requested documentation from the 20 vendors and are currently waiting for some vendors to deliver the information while analyzing the information received from others. The SA has not yet reported any results from these inventory audits. When the SA performed these reviews in earlier years, the results indicated that vendors were violating program requirements. In FY 1995, for example, the SA internal auditors performed inventory audits of 495 authorized stores — their reviews disclosed that 299 stores (60 percent) were violating program requirements.

We concluded that FNS must take steps to ensure that all of the oversight activities required by Federal regulations are completed promptly, regularly, and thoroughly, and that sanctions are enforced against vendors violating program regulations.

[18] FNS did not report any information about inventory audits.
[19] As of October 2006, none of these stores had been disqualified.

Recommendation 5

Require the SA to perform and complete compliance investigations, up to 5-percent minimum of all high risk vendors, including compliance buys and/or inventory audits, in accordance with Federal regulations. If the SA fails to complete these investigations, require the SA to include this noncompliance in its corrective action plan and apply corrective action as stated in Recommendation 1.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS also reported that on April 24, 2007, the SA advised it had begun action to procure a contractor to perform compliance investigations; and that it will also establish internal procedures to conduct such investigations until a contract for these services is in place.

OIG Position. We accept management decision for this recommendation.

Recommendation 6

Require the SA to incorporate store owners with numerous violations of program regulations as part of the criteria for selection of high-risk vendors.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS will require the SA to identify store owners with numerous violations as part of the criteria for selection of high-risk vendors. FNS reported that on April 24, 2007, the SA agreed to implement this request.

OIG Position. We accept management decision for this recommendation.

Finding 4 — The SA Should Require Vendors to Provide Participants With All Products Listed on Their Food Instruments

Five of the six "WIC-only" vendors reviewed allowed participants to fully redeem their food instruments, take only a portion of their products, and carry

an informal credit account balance from which they could draw later. In violation of Federal regulations and WIC program requirements, vendors were redeeming food instruments and charging the SA for goods that participants had not yet received or may not receive at all. Though this system of in-store credit was referred to as a "milk register," it was also used to carry balances for products other than fresh milk. Even though they knew it was against regulations, the SA condoned the vendors' practice of keeping "milk registers", believing it justifiable considering the large amount of fresh milk that was prescribed to WIC participants and the associated difficulties in transporting the milk to the recipients' residence and storing it. However, FNS officials stated that the milk prescribed to participants was in accordance with Federal regulations and that the SA should enforce the proper redemption of food instruments. We were unable to quantify the total amount of milk for which vendors received reimbursement but did not deliver because the informal registers vendors kept did not include sufficient detailed information, such as first names being used without the associated last names. After we discussed this condition with SA officials, they sent a letter in August 2005 to vendors prohibiting "milk registers" and reminding them of possible penalties if they do not deliver all products when food instruments are redeemed. However, the SA has not improved monitoring controls over vendors to determine if this prohibited practice continued. As a result, vendors redeemed food instruments and received reimbursement for products that had not yet been provided to WIC participants.

We noted that from October 1, 2004, through June 30, 2005, the six sample vendors redeemed more than $10.5 million for fresh milk. Thus, we attempted to verify whether the vendors' redemption matched their inventory levels. We compared WIC vendors' fresh milk invoices to their claims for redemption to determine the amount of milk not delivered to WIC participants. We found that the quantity of milk vendors purchased was similar to the quantity they reported as redeemed in the WIC program. This would suggest that vendors had not delivered to WIC participants all the fresh milk purchased because these stores sold milk to non-WIC customers as well. Also, participants were carrying balances on the "milk registers." Since our review disclosed that the milk reported as redeemed matched milk purchased (even with the "milk registers"), we concluded that the vendors were claiming for reimbursement milk that had not yet been received by program participants.

Federal regulations state that vendors may not, in exchange for WIC food instruments, provide unauthorized food items, non-food items, cash, or credit (including rain checks).[20] The SA's agreement states that vendors are to provide participants all the food products listed on the checks or exchange instruments upon presentation of the check or exchange instruments. If

[20] 7 CFR, section 246.12(h)(3)ii.

vendors display a pattern of charging for supplemental food that participants do not receive, they may be suspended from the program for 3 years.[21]

We obtained copies of 23 "milk registers" for 5 of the 6 vendors reviewed,[22] and learned that participants did not obtain all food items on the redeemed food instruments assigned to them and vendors were keeping a running balance of participants' fresh milk that remained undelivered.[23] For example, one register showed that a participant's guardian was increasing its register by 28 half gallons of fresh milk each month from two participants and carried a balance of 68 half gallons not delivered as of June 29, 2005, for a total value of $146.20.

SA officials knew that vendors kept "milk registers", and that this practice violated Federal regulations. They were also aware this was an ongoing practice for the last 6 years mostly in small retail and "WIC-only" stores. However, State officials stated that they were not aware that other items – such as cereals, juices, and other products that did not pose transportation problems – were added to participants' balances on vendors' "milk registers". SA officials condoned the practice, believing it was justifiable because some participants' monthly food packages contained too much fresh milk for purchase at one time. One monthly food package, for example, includes 14 half gallons of fresh milk each month;[24] however, such packages are divided into several food instruments. In this case, the participant would receive three instruments, two with five half gallons of fresh milk and one with four. Although State officials claimed that participants were instructed to redeem just one instrument at a time, they were also aware this requirement was not enforced and was not followed; and, as we observed, participants often redeemed all the month's instruments[25] on the same day.[26] State officials also justified this practice on the grounds that participants might not always have transportation to go to a store several times a month. We noted, however, that participants who carried balances on their "milk registers" often made several trips to the store each month to draw upon their balance.

[21] 7 CFR, section 246.12(l)(1)iii(E).
[22] The sixth vendor claimed he did not maintain "milk registers"; when we reviewed the report listing the food instruments redeemed at that store, however, we learned that the store was redeeming consecutive instruments on the same day. Likewise, we observed the vendor's employee deliver milk to WIC recipients without collecting payment. Given the quantities of products involved, this fact strongly suggests that "milk registers" were being maintained at that store.
[23] The quality of these registers varied. Some were very detailed and required participants' signatures, while others were little more than a running total. It was impossible to trace the transaction on these "milk registers" to the redemption of food instruments, as cards often listed a guardian's name and not the WIC participant. However, since these registers were obtained from a "WIC-only" store, it was reasonable to conclude that they belonged to WIC participants. In addition, we also observed participants using the "milk registers".
[24] Some SA officials believed this quantity of milk was too much; however, the nutritionist prescriptions met the requirements specified in 7 CFR, section 246.10(c)(5)(vi).
[25] Participants are issued two to three consecutively numbered instruments for each month.
[26] Vendors often deposited their food instruments on a daily basis, and frequently deposited consecutive instruments on the same day. Because participants are issued consecutively numbered food instruments, this fact suggests that the same participant is redeeming multiple instruments on the same day.

We understand participants cannot reasonably be expected to store 14 half gallons of fresh milk at a time, however, "milk registers" are not an acceptable solution. "Milk registers" violate Federal regulations and WIC program requirements because they are, in fact, a form of in-store credit. They result in vendors being paid for milk they may never provide to participants. Participants are not required to take the entire month's allotment of fresh milk with them all at once—they receive several food instruments a month and quantities of fresh milk are reasonably divided between these instruments.

When we brought the existence of "milk registers" to FNS' attention, agency officials were unaware vendors had been offering participants in-store credit or that the SA had condoned the practice as FNS does not visit vendors during their management reviews. FNS stated their role is to oversee and evaluate program operations, not to conduct compliance activities. FNS agreed that "milk registers" or any other system of in-store credit violates Federal regulations, creates the potential for abuse, and should be discontinued.

After we discussed this finding with State officials, they sent a letter on August 8, 2005, to vendors prohibiting "milk registers" and reminding them of possible penalties if they do not deliver all the products to participants when food instruments are redeemed. However, the SA has not developed a process to identify and evaluate consecutive food instruments, including fresh milk, that are redeemed the same day to identify vendors and/or participants that are potentially violating program regulations. Therefore, we concluded that the SA must improve how it monitors vendors. In particular, the SA should check for "milk registers" or other systems of in-store credit, as part of the routine monitoring and compliance buys it performs when monitoring vendors (see Finding 3). In addition, the SA should include fresh milk as a food item verified in the inventory audits.

Recommendation 7

Require the SA to include in its routine monitoring of vendors, tests to verify that all foods—including fresh milk—are being delivered to participants when they redeem food instruments, and steps to determine if any forms of in-store credits are being utilized by vendors and enforce the related penalties and sanctions.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS also reported that on April 24, 2007, the SA advised it had sent a letter

> informing vendors to "cease and desist" using milk registers. The SA also agreed to include monitoring procedures in its compliance investigations and routine monitoring visits.

OIG Position. We accept management decision for this recommendation.

Recommendation 8

Require the SA to develop and implement a process to identify the same day redemption of consecutive food instruments that include fresh milk; determine who violated the program's food delivery requirements and enforce the related penalties and sanctions.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. Also, FNS reported that on April 24, 2007, the SA agreed to develop and implement a process to identify same day redemption of consecutive food instruments that include fresh milk. The SA will determine who violated the program's food delivery requirements and enforce the related penalties and sanctions.

OIG Position. We accept management decision for this recommendation.

Recommendation 9

Require the SA to include the verification of fresh milk redemptions when conducting compliance buys and inventory audits.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. Also, FNS reported that on April 24, 2007, the SA agreed to revise their compliance buy and inventory audit procedures to include the verification of fresh milk redemptions.

OIG Position. We accept management decision for this recommendation.

Finding 5 The SA Did Not Exclude Products With Nutritional Deficiencies

Since August 2003, the SA was aware that 33 products prescribed to participants failed to meet Federal nutritional requirements. State officials did not take appropriate steps to inform vendors that these products were suspended from the program and to ensure that vendors stopped selling these products. Due to the rapid turnover in critical management positions described in Finding 1, we were unable to speak to the officials who could explain why vendors were not notified about the failed products. Current "acting" management officials could not explain the lack of notification but informed us that they were taking active steps to remedy this problem, including creating a new list of approved products and informing vendors of what products do not meet Federal standards. Until these steps are completed, the State has no assurance that participants are receiving products that meet Federal nutritional requirements. Moreover, until the list of products is approved, the program continues to operate with vendors agreements that expired in September 2003. New vendor agreements cannot be executed until the list of products used in food instruments are approved.

Federal regulations require that foods dispensed as part of the WIC program contain nutrients beneficial for pregnant, breastfeeding and postpartum women, as well as infants and children.[27] Those regulations set forth the nutrients needed in each food authorized.[28] For example, for infants between 4 and 12 months, juices must contain 30 milligrams of vitamin C per every 100 milliliters; dry cereals must have a minimum of 28 milligrams of iron per 100 grams, and not more than 21.2 grams of sucrose and other sugars per 100 grams. SAs are responsible for identifying foods that meet program requirements.[29] Although WIC food instruments identify the type of food item authorized, i.e., juice, they do not identify a specific brand since the SA may authorize more than one brand of a food item.

After responding to a hotline complaint, the Food and Drug Administration (FDA) informed the SA in 2002 that six flavors of juices from two manufacturers approved for the WIC program had failed its nutritional tests and were incorrectly labeled. FDA informed the SA of these test results so that the SA could evaluate manufacturers participating in the program and ensure that their products met Federal standards. In response to this letter, the SA requested USDA's Agricultural Marketing Service (AMS) to conduct nutritional testing of WIC-approved products to identify any that were not in compliance with the regulations. In June 2003, the SA signed a memorandum

[27] 7 CFR, section 246.2.
[28] 7 CFR, section 246.10(c).
[29] 7 CFR, section 246.10(b)(1).

of understanding with AMS to test current products, as well as to begin continuous monitoring of approved products. Their goal was to ensure that all products reaching WIC participants met Federal nutritional standards.

In FY 2003, the SA was also due to update its list of approved products as part of renewing vendors' contracts.[30] Given FDA's concerns, the SA established a committee to oversee this process, ensure that product selection was unbiased, and verify that products were correctly tested. Manufacturers who wished to have their products included on WIC's list were required to submit their products along with AMS' certification that these products met Federal nutritional standards. According to AMS' tests, 33 products failed to meet these standards.[31] AMS officials stated some products failed the first test; however, passed the second test after the SA granted them an appeal right.[32] The SA had originally given manufacturers the right to appeal this decision up to three times; however, the SA legal advisors decided that its appeals process was flawed because it could not allow the SA to overrule decisions made by AMS. After seeking and receiving legal advice concerning this issue, the SA stopped the committee's work by halting the appeals, canceling the selection process, and disbanding the committee. Products that had failed AMS' tests—many of which were already on WIC's prior list—were thus left to be stocked on vendors' shelves and sold to participants since WIC vendors were not informed that the failed products were suspended from the program.

In 2004, the SA established a second committee to revise WIC's list of approved products. Once again, manufacturers who wished to have their products included were required to submit their products for consideration in the program after they had been tested by AMS. This second committee prepared a list of approved products in August 2004, based on AMS' testing results. Although the SA informed all manufacturers failing these tests that their products were suspended from the program, the SA again did not inform vendors participating in the program that these products were no longer eligible for distribution to WIC participants. Again, due to the rapid turnover of staff discussed in Finding 1, current officials could not explain why a notification to vendors was not sent. Consequently, the SA has no assurance that vendors discontinued distributing these products to participants. Moreover, FNS Regional and SA officials stated the WIC program staff lacked the authority to withdraw products from the shelves, but they do have the authority to eliminate brands of products from their list of approved products. Also, they could not withhold funds from vendors since the food instruments do not list brands delivered to participants.

[30] WIC updates this list every 3 years when vendors' agreements are renewed. The list includes the brands authorized per food, which is information not included in the food instruments.
[31] The total number of products tested for nutritional value is unknown since neither the SA nor AMS kept records with the information.
[32] Although the same brands were tested, new "batches" of products were tested for the second test.

The SA concluded that the list of authorized products developed by the 2004 committee was incomplete. Because manufacturers did not submit applications for all products needed in the WIC program, the committee could not select products for all categories. The SA thus decided to merge their complete list of products approved prior to 2001 with the incomplete list of products approved in 2004. However, this combined list will include products that had failed previous tests. Once the lists are combined, the SA plans to ask the University of Puerto Rico to test products on the merged list. Because juices tend to be the products with the most failed nutrition tests, they would be the primary focus of these tests.

The SA approved a new list of products on November 8, 2006. The SA Acting Director stated that they would begin the selection of vendors and renewal of expired agreements on November 9, 2006. According to the vendor cost containment measurement plan, the selection of vendors should be completed by December 30, 2006.

Recommendation 10

Require the SA to remove products from the authorized food list when it comes to its attention that the product has failed a nutritional test.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. Also, FNS reported that on April 24, 2007, the SA agreed to provide FNS with a policy regarding the removal of products from the authorized food list when the SA learns that the products have failed nutritional tests.

OIG Position. We accept management decision for this recommendation.

Recommendation 11

Require the SA to include during monitoring visits and compliance investigations, a requirement to verify that products suspended from the program are not being provided to participants.

Agency Response. FNS stated in its May 9, 2007, response:

> FNS concurs with this recommendation. FNS will include this requirement as an action plan item in the corrective action plan addressed in Recommendation 1. FNS will require the forms used by the SA during monitoring visits and compliance

investigations include the verification that products suspended from the program are not being provided to participants. Also, FNS reported that on April 24, 2007, the SA agreed to revise their current procedures.

OIG Position. We accept management decision for this recommendation.

Finding 6 The SA Needs to Improve its Vendor Selection Process

We found that the SA compromised the vendors' bidding process by releasing the consumption factor of products to vendors prior to bids being accepted. The consumption factor shows the quantity of each particular food item that is prescribed on food instruments to the program participants. Thus, the released consumption factor information allowed vendors to calculate their bid prices in ways that increased food costs and was disadvantageous to the program by overpricing high consumption food items and underpricing low consumption food items. In addition, the SA did not take into consideration these factors that impacted the bid prices when authorizing vendors. Rather, the SA simply added the total amount for each product as the total package bid, giving no consideration to the quantity of each item that participants would actually consume. Allowing vendors access to this information meant that they could—potentially—arrange the bidding process so that they could sell high consumption factor items at a high price and greater profit. Current SA officials could not explain why the decision was made to release this information, as the officials who made this decision have left the agency (see Finding 1). In September 2006, FNS approved a vendor cost containment measurement plan submitted by the SA that includes setting maximum allowable prices. If properly implemented, the plan should correct this situation.

In 1995, the SA implemented a selection process known as Selección Efectiva de Negocios Autorizados[33] (SENA), to address vendors charging exorbitant prices for WIC authorized products. SENA required vendors to bid a price for individual products authorized in the program and submit a total price for the list. The program then selected vendors whose total price—calculated as the sum of all the individual products—was economical to the program. Selected vendors were obligated to charge the prices bid throughout the duration of their agreement.

According to FNS officials, SENA worked well during the selection of vendors from 1996 through 2000. We found, however, that when the last

[33] English translation is Effective Selection of Authorized Vendors.

bidding process was conducted in 2001[34], the SA compromised SENA by releasing information on the consumption factor of each product. This information allowed vendors to establish higher bid prices for heavily consumed products and lower prices on lesser used products. FNS officials had noted the high cost of food in Puerto Rico and were concerned that problems with the vendor bidding process might be causing the high costs. However, FNS staff stated that since no other State used SENA to compare bidding information they were not able to confirm their suspicions with the vendor bidding process. This was an issue limited to Puerto Rico. Current SA officials were unaware of actions taken by prior SA officials. We determined the SA controls over the vendor bidding process were not adequate to ensure that the program received the best possible prices.

In 2001, vendors learned the SA selected bids, not based on the prices of individual goods,[35] but rather on the sum of the entire list. With such a system, vendors could offset high bids on high demand products with low bids on low demand products. When the bids for each product are tallied, the overall bid can still appear low, even as the prices for some items are quite high. Additionally, by publishing these factors, the SA unknowingly provided vendors with data they could use to manipulate the bidding process. All program commodities are not consumed equally. Some commodities such as juice and dried cereal are consumed frequently; others, such as tuna, are consumed less frequently. Consumption factors indicate the frequency that program participants would be purchasing products on the lists. Since vendors are now aware of this system and know their bids will be selected on the total price of all products, the SA bidding process is vulnerable to abuse.

Further compounding the consumption factor problem, we also found the SA bidding system was not designed to detect and reject unusually high or low bid prices. The computer contractor staff explained the SA had not established those controls in the computer system. Further, current SA staff confirmed they had never used reports which compared vendors' prices against the island's average price. As a result, the SA approved a vendor who bid $130.64 for the list of products while also approving another vendor who bid $306.28 for the same list of products. In fact, a vendor was approved even though it bid $28 for a box of dry cereal when the island-wide average price for similar boxes of cereal was just $2.40. Although OIG believes that this bid was a mistake,[36] the SA accepted this bid and authorized this vendor to charge the program $28 per box of dried cereal sold to program participants. Since the computer system did not have controls in place to exclude bids higher than a maximum allowable price per product, the error was never identified and corrected. Since food instruments are redeemed based on the

[34] Since the SA had not been able to finalize the list of authorized products (See Finding 4) which is needed to request bids from vendors, the SA had not requested new bids since 2001. The bid prices have remained the same except for SA authorized increases due to inflation.
[35] Vendors' bid prices represent the amount the SA will be reimbursing for the foods delivered to participants.
[36] When vendors bid on cereal under this program, they bid per ounce on two 10 oz. boxes of cereal. Had the vendor bid $.28 per ounce, that bid would have been within a reasonable range for this product. However, this vendor bid $2.8 per ounce. We have no evidence to suggest that this was not an error.

total value of the foods listed in the instruments, we were unable to determine if this vendor charged the program $28 per box of cereal since multiple products are grouped together and the vendor charges by total check amount.

In June 2004, Congress enacted Public Law 108-265 to contain vendors' costs, requiring the SA to establish distinctive competitive prices and allowable reimbursement levels based on vendor peer groups. On September 27, 2006, the SA submitted to FNS a Vendor Cost Containment Measurement Plan which described how the SA computed a statewide supplemental food average price for all authorized food products. The maximum allowable reimbursement level was to be calculated using shelf prices collected from a random sample of 139 vendors. In addition, the SA will be grouping vendors into peer groups (geographical areas comparable group) for the authorization and selection process. FNS approved the proposed plan on October 4, 2006, and the SA began implementation of the plan in November 2006.

Recommendation 12

Ensure prompt and proper implementation of the SA Vendor Cost Containment Implementation Plan approved by FNS in October 2006.

Agency Response. FNS stated in its May 9, 2007, response:

> On December 28, 2006, the SA confirmed that full implementation had occurred of the FNS approved Vendor Cost Containment plan. The SA made policy and procedure changes to reflect changes in accordance with provisions of Public Law 108-265. FNS noted the approved plan was in effect on December 29, 2006, and is being utilized for the selection process. The completion of the vendor selection process is currently underway, and all plan requirements will be met.

OIG Position. We accept management decision for this recommendation.

Scope and Methodology

Audit fieldwork was performed from April to October 2006, at the FNS Mid-Atlantic Regional Office, Robbinsville, New Jersey; the FNS Caribbean Area Office, San Juan, Puerto Rico; and the WIC SA, San Juan, Puerto Rico.

We assessed WIC vendor management operations during FYs 2004 through 2005. The SA food costs were $143.5 million in FY 2004, and $146.3 million in FY 2005. To assess their oversight of the WIC program operations, we evaluated FNS' and the SA monitoring activities from FY 2000 through FY 2005. We were unable to review implementation of the new vendor cost containment provisions enacted by the Reauthorization Act of 2004 because the SA submitted and obtained approval of their cost containment plan from FNS in October 2006 which was after our audit fieldwork. To assess the infant formula cost containment program, we (1) reviewed the SA selection process of the formula company, (2) reviewed how the SA processed the rebate forms, and (3) validated infant formula on the rebate forms to purchases of infant formula listed on the vendors' invoices.

To assess the SA activities, we judgmentally selected 6 of 51 "WIC-only" vendors. Vendors were selected based on the value of the food instruments they redeemed in the third quarter of FY 2005. We selected five vendors from top 25 municipalities with the largest redemption of food instruments and one vendor was selected in a small rural municipality. We expanded our scope to assess the SA's controls over the authorization and monitoring of all WIC stores after we determined that the controls for the "WIC-only" stores were the same for all types of stores.

To accomplish our objectives, the audit included interviews with FNS, SA personnel, and others as deemed necessary. In addition, we:

- reviewed legislation, program regulations, guidance, policies, and procedures as applicable to the WIC vendor management and infant formula cost containment program;

- reviewed external and internal audit reports, financial reports, and performance reports;

- reviewed copies of WIC vendors' agreements, food instruments redemption reports and vendors' invoices to assess authorization, and activities of WIC vendors;

- interviewed the computer contractor and bank officials to assess how food instruments were redeemed; and

- visited 6 of 51 WIC vendors classified as “WIC-only” or Baby Food Centers to ensure vendors were maintaining minimum inventories and dispatched products in accordance with program requirements and we found no material exceptions. We also reviewed food instruments on hand to ensure they were handled in accordance with regulations. During our vendor visits, we also reviewed infant formula invoices and rebates to ensure that invoices listed the same formula as the rebate forms.

This audit was conducted in accordance with generally accepted government auditing standards. Accordingly, it included such tests of FNS’ monitoring of the SA operations and other auditing procedures necessary to accomplish our audit objectives.

Exhibit A – Outstanding Issues Reported by FNS in the Management Evaluation Report

Reporting year	Area	Issues Outstanding	Number of findings outstanding
2000	Food Funds & Caseload Management	Absence of one-on-one reconciliation.	1
2003	Food Funds & Caseload Management	Absence of one-on-one reconciliation.	1
2003	Nutrition Services	Establish a plan to limit the use of non-contract infant formula.	1
2003	Information System	Validation of information in the system's reports.	1
2003	Vendor Management	Compliance buys not being conducted.	1
2003	Food Delivery	No formal system to review food instruments; absence of one-on-one reconciliation; and the need to develop a contingency plan to handle the power outages.	3
TOTAL			**8**

USDA

United States Department of Agriculture

Food and Nutrition Service

Mid-Atlantic Region

300 Corporate Blvd
Robbinsville, NJ
08691-1598

Date: MAY - 9 2007

Re:

Subject: **Response to Official Draft Audit Report #27004-4-At: Special Supplemental Nutrition Program for Women, Infants, and Children, Puerto Rico**

To: Raymond G. Poland
Regional Inspector General

This memorandum presents our response to the recommendations in the subject audit report. Our response reflects discussions and agreements made with the Puerto Rico WIC State agency during our April 24, 2007, teleconference call.

Thank you for the opportunity to comment on the draft audit report. If you have any questions, please do not hesitate to contact me at (609) 259-5025.

Yvette S. Jackson

YVETTE S. JACKSON
Regional Administrator
Mid-Atlantic Region

Attachment

Response to Draft Audit Report #27004-4-At

Recommendation 1: Establish timeframes for the State agency to implement corrective actions for all unresolved issues identified in FNS management evaluations. If corrective actions are not taken by the State agency, FNS shall implement the sanctioning provisions defined in 7 CFR 246.19.

FNS Response: FNS concurs with this recommendation and will send the State agency a letter requiring a corrective action plan including timeframes for resolving all unresolved issues identified in FNS management evaluations. The letter will detail the penalties and sanctions FNS may apply, in accordance with WIC Regulations, should the corrective action plan not be implemented by the specified due dates. FNS will issue the corrective action plan request letter within 60 days of the official release of the audit. Final action will occur when FNS determines the State agency submitted an approvable corrective action plan with reasonable timeframes as per our agreement with OIG.

We request management decision based on the above planned action.

Recommendation 2: Require the State agency to assign a full-time, or equivalent, administrator for the program as required by Federal regulation 7 CFR 246.3.

FNS Response: FNS concurs with this recommendation and as agreed with OIG will include this as an action plan item in the corrective action plan addressed in Recommendation 1.

We request management decision based on the above planned action.

Recommendation 3: Require the State agency to request an exception report listing all food instruments paid for which issuance could not be confirmed. Develop and implement procedures to research and validate on a monthly basis all these instruments.

Recommendation 4: If the State agency cannot provide a reasonable explanation for the disposition of food instruments issued, FNS should establish a claim as required in 7 CFR 246.23(a)(4).

FNS Response: FNS concurs with these recommendations and will include these requirements in the letter issued to the PR WIC State agency noted in Recommendation 1. FNS will also advise the State agency that a claim will be assessed for unmatched food instruments that have not been investigated.

The State agency already submitted a copy of a computer change request proposal for a Check Reconciliation Report and Exception Payments Report to FNS on March 6, 2007. During the April 24, 2007 teleconference call, the State agency confirmed its agreement to request the exception report and develop and implement the related procedures for

following up on the exceptions. Final action will occur when the State agency provides evidence that the exception report, documenting follow up actions, has been implemented. If FNS determines that the PR WIC State agency has not adequately followed-up on the exception report, a claim will be assessed.

We request management decision based on the above planned action.

Recommendation 5: Require the State agency to perform and complete compliance investigations, up to 5 percent minimum of all high-risk vendors, including compliance buys and/or inventory audits, in accordance with Federal regulations. If the State agency fails to complete these investigations, require the State agency to include this noncompliance in its corrective action plan and apply corrective action as stated in Recommendation 1.

FNS Response: FNS concurs with this recommendation. In the letter issued 60 days after release of the final audit, FNS will require a corrective action plan be developed by the Puerto Rico Department of Health (noted in Recommendation 1) with timeframes for performing and completing compliance investigations and/or inventory audits on a minimum of 5 percent of all high-risk vendors in accordance with Federal regulations. The letter will detail the penalties and sanctions FNS may apply should the corrective action plan not be implemented by the specified due dates.

The State agency advised during the April 24, 2007, teleconference that it had begun action to procure a contractor to perform compliance investigations. The State agency also advised that it will establish internal procedures for conducting compliance investigations until such time as a contract for investigative services is in place.

We request management decision based on the above planned action.

Recommendation 6: Require the State agency to incorporate store owners with numerous violations of program regulations as part of the criteria for selection of high-risk vendors.

FNS Response: FNS concurs with this recommendation. In the letter issued 60 days after release of the final audit, FNS will require the State agency to identify store owners with numerous violations of program regulations as part of the criteria for selection of high-risk vendors and use this information to target compliance investigations.

During the April 24, 2007, teleconference, the State agency agreed to implement high-risk vendor identification procedures that include store owners with numerous violations and use this information when conducting compliance investigations as required in Recommendation 5.

We request management decision based on the above planned action.

Recommendation 7: Require the State agency to include in its routine monitoring of vendors tests to verify that all foods, including fresh milk, are being delivered to participants when they redeem food instruments; and steps to determine if any forms of in-store credits are being utilized by vendors and enforce the related penalties and sanctions.

FNS Response: FNS concurs with this recommendation and will include these requirements in the letter issued to the PR WIC State agency noted in Recommendation 1.

During the April 24, 2007, teleconference, the State agency advised that it had sent all vendors a letter informing them to "cease and desist" using milk registers. The State agency also agreed: 1) to revise its routine monitoring forms to include tests verifying that all foods are being delivered to participants when they redeem their food instruments; 2) to include steps to determine if any forms of in-store credits are being utilized by vendors; 3) to monitor fresh milk registers during compliance investigations (Recommendation 5); and 4) enforce the related penalties and sanctions.

We request management decision based on the above planned action.

Recommendation 8: Require the State agency to develop and implement a process to identify the same day redemption of consecutive food instruments that include fresh milk; determine who violated the program's food delivery requirements and enforce the related penalties and sanctions.

FNS Response: FNS concurs with this recommendation and will include these requirements in the letter issued to the PR WIC State agency noted in Recommendation 1.

During the April 24, 2007, teleconference, the State agency agreed to revise an existing computer report or request a new report that will provide information on same day redemption of consecutive food instruments. It also agreed to develop and implement a process to identify the same day redemption of consecutive food instruments that include fresh milk; determine who violated the program's food delivery requirements; and enforce the related penalties and sanctions.

We request management decision based on the above planned action.

Recommendation 9: Require the State agency to include the verification of fresh milk redemptions when conducting compliance buys and inventory audits.

FNS Response: FNS concurs with this recommendation and will include this requirement in the letter issued to the PR WIC State agency noted in Recommendation 1.

During the April 24, 2007, teleconference call, the State agency agreed to revise their compliance buy and inventory audit procedures (Recommendation 5) to include the verification of fresh milk redemptions.

We request management decision based on the above planned action.

Recommendation 10: Require the State agency to remove products from the authorized food list when it comes to its attention that the product has failed a nutritional test.

FNS Response: FNS concurs with this recommendation and will include this requirement in the letter issued to the PR WIC State agency noted in Recommendation 1.

In a December 14, 2006, letter, the Puerto Rico WIC Program advised FNS that all juices listed complied with required nutritional test however not all juices had required labels. In a March 7, 2007, letter to the Puerto Rico WIC Program, FNS recommended that immediate action be taken to remove juices with inaccurate labels from the list of eligible juices. On May 8, 2007, the State agency provided FNS with a revised authorized food list that had all inaccurately labeled juices removed.

During the April 24, 2007, teleconference, the State agency agreed to provide FNS with a policy regarding the removal of products from the authorized food list when the State agency learns that the products have failed nutritional tests.

We request management decision based on the above planned action.

Recommendation 11: Require the State agency to include during monitoring visits and compliance investigations, a requirement to verify that products suspended from the program are not being provided to participants.

FNS Response: FNS concurs with this recommendation. In the letter issued to the PR WIC State agency noted in Recommendation 1, FNS will require the forms used by the State agency during monitoring visits and compliance investigations include the verification that products suspended from the program are not being provided to participants.

During the April 24, 2007, teleconference, the State agency agreed to revise its routine monitoring and compliance investigation procedures to include this verification.

We request management decision based on the above planned action.

Finding 12: Ensure prompt and proper implementation of the State agency Vendor Cost Containment Implementation Plan approved by FNS in October 2006.

FNS Response: On December 28, 2006, Puerto Rico WIC confirmed that full implementation of its FNS-approved Vendor Cost Containment Plan had occurred. The State agency made policy and procedure changes reflecting provisions of Public Law 108-265 and submitted the t-test indicating it had achieved cost neutrality. On December 29, 2006, FNS certified the State agency's vendor cost containment system in accordance with section 246.12(g)(4)(vi) of the WIC Vendor Cost Containment Interim Rule. On December 29, 2006, FNS also noted that the Puerto Rico WIC vendor selection process was in effect as described in the FNS-approved cost containment plan and is being utilized for the selection process. Upon completion of the vendor selection process currently underway, all requirements of the Implementation Plan will be met.

We request management decision based on the above planned action.

Informational copies of this report have been distributed to:

Regional Administrator, FNSRO (6)
Agency Liaison Officer (3)
Government Accountability Office (1)
Office of the Chief Financial Officer (1)
    Director, Planning and Accountability Division
Office of Management and Budget (1)