

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL

STATEMENT OF PHYLLIS K. FONG
INSPECTOR GENERAL

Before the

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON AGRICULTURE
Subcommittee on Department Operations,
Oversight, Nutrition, and Forestry

ON

RECENT CHANGES TO THE FOOD STAMP PROGRAM

July 24, 2003



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Good afternoon, Mr. Chairman, and members of the committee. I appreciate the opportunity to testify regarding how well the Food Stamp Program is doing, how changes introduced through the 2002 Farm Bill have affected the program, and how the program might continue to improve.

Considering the size of the Food Stamp Program (over \$18 billion of benefits issued in fiscal year (FY) 2002), the program is working reasonably well. While FNS has worked diligently with States to reduce errors in issuing program benefits, there is always room for improvement. The recent changes made in the Farm Bill were, in fact, designed to improve program administration; these changes were made to provide the States flexibility in administering the program, improve access to program benefits, simplify program eligibility requirements, and enhance program integrity. The impact of these changes, however, will not be known for some time.

The OIG has a long history in identifying fraud, waste, and abuse in USDA programs. OIG and the Food and Nutrition Service (FNS) have an excellent working relationship; our staffs have worked collaboratively to improve program integrity and to identify

improvements needed in program administration, particularly as FNS moved forward to implement the delivery of food stamp benefits through electronic benefits transfer (EBT) systems. FNS has taken positive actions to implement many of our recommendations and we look forward to working with them as these new legislative initiatives are fully implemented.

After a brief overview of the Food Stamp Program, I will address three challenges facing FNS in its administration and management of the Food Stamp Program. One of these challenges will be to fully implement the Improper Payments Act and President's Management Agenda initiative of reducing improper (erroneous) payments. FNS is the only USDA agency that has had a statistically based quality control program (limited to its Food Stamp Program) in place to measure the extent of improper payments. FNS' challenge will be to continue to work with States to minimize and/or prevent erroneous payments before "they go out the door." Another challenge that is more difficult to address is fraud; unscrupulous parties can always find ways to circumvent existing controls. We will continue to work with FNS to strengthen program integrity through our audits and investigations. Finally, while FNS is very close to successful implementation of EBT systems in all States, one of the largest States (in terms of program benefits issued) still needs to come "on-line". I will also update you on "Operation Talon." This initiative was put in place by OIG as a result of the Welfare Reform Act of 1996 to locate and apprehend fugitives who were illegally receiving food stamp benefits, thereby ensuring that program benefits go to those who are truly in need.

Food Stamp Program

The Food Stamp Program provides monthly allotments to households in the form of paper coupons or electronic benefits transfer (EBT) cards, which work like ATM cards at authorized retailers. People apply for benefits at State or local (e.g., county) welfare offices that certify eligibility based on a household's level of income and other resources. FNS funds the benefits and administers the program in cooperation with State agencies. In 2002, an average of 8.2 million households received just over \$18 billion in food stamp benefits.

Electronic Benefits Transfer (EBT) Systems

FNS has been at the forefront of developing and implementing electronic delivery of program benefits through EBT. In 1984, FNS began pilot implementation of EBT systems to deliver food stamp benefits and was the first Federal agency to publish standards for EBT systems. FNS now estimates that about 91 percent of the participating households receive food stamp benefits, representing 91 percent of the total program benefits issued, through EBT systems. The 1996 Welfare Reform Act mandated that all States use EBT systems by October 2002. As of July 2003, 47 systems are up and running State-wide and in the District of Columbia and the Virgin Islands. California, Delaware, Iowa, and Guam have EBT systems only in some county or local areas. FNS' challenge will be to work with State and county administrators to complete final EBT implementation.

Since 1986, OIG has actively monitored and reviewed EBT system development and deployment by FNS, as well as EBT implementation in 28 States. Our audits were designed to determine whether controls were in place and working to ensure that EBT systems could timely and accurately provide and account for program benefits. We also evaluated whether EBT program data was being used as a management tool to monitor and effectively administer the Food Stamp Program. FNS has consistently reacted positively to our recommendations and has worked with the States to address any weaknesses or vulnerabilities we have identified. Overall, we have found that EBT systems are doing what they are designed to do – to provide effective electronic delivery and accountability of program benefits. However, more can be done in analyzing EBT data to identify questionable transactions that may be indicators of potential fraud and/or misuse of program benefits. EBT systems provide an electronic transaction record, making it easier to identify problem retailers and recipients, something that was not possible under the paper coupon system. We will continue to audit EBT systems as issues emerge or when new State contracts with EBT processors are awarded.

Our audits have also identified computer (IT) security concerns at States relating to access controls over EBT systems. We found that States did not always have controls in place to remove access to EBT systems when employee duties or employment status changed. Those States we reviewed took immediate action on our recommendations to reduce this vulnerability. We have also found that even when employees have been authorized access to EBT systems, food stamp caseworkers (those State and/or county employees responsible for determining the eligibility of households for food stamp

benefits) sometime use their access to commit fraud in return for financial kickbacks. In some of our investigations, we found caseworkers used their EBT access to make unauthorized payments to ineligible individuals. One caseworker issued over \$80,000 in food stamps and benefits to 2 fictitious families; those fictitious families supposedly had 13 family members. The caseworker admitted using the food stamp benefits to purchase food for herself and her family. The caseworker and a co-conspirator pled guilty to theft and embezzlement of public monies, as well as unlawful possession of food stamps. These individuals were sentenced to 21 months in jail and ordered to pay restitution.

Retailer Abuses

Fraud and abuse in the Food Stamp Program generally occur when individuals sell their benefits for a fraction of its face value. Known as trafficking, this practice remains an area of significant mutual concern for FNS and OIG. FNS has recently estimated that between 1999 and 2002 authorized retailers trafficked over \$395 million each year, or 2½ cents of every food stamp dollar issued. This estimate was made using data from FNS compliance investigations of authorized retailers.

The advent of EBT has not prevented fraud from occurring –food stamp trafficking has just moved primarily from the street to the store. Since only authorized retailers can redeem program benefits, OIG has been concerned about the legitimacy and eligibility of these retailers to participate in the Food Stamp Program. We have testified in the past about the need for on-site reviews to determine if a retailer should be authorized or reauthorized to participate. In a 1995 review of retailer eligibility entitled “Food Stamp

Program, Store Eligibility Task Force,” we visited over 5,000 authorized stores and found more than 850 that should have been ineligible and another 450 whose eligibility was questionable. These stores had minimal or no staple foods, were out of business, or, at the time of our review, did not exist. FNS had routinely authorized stores to participate based solely on information submitted by the retailers in their application. Site visits were not a requirement for either authorization or reauthorization. For both processes, we recommended that FNS conduct routine onsite visits prior to approval.

In response to OIG’s review, FNS hired outside firms to verify retailer information through onsite visits. FNS required the contractors to complete a food inventory checklist and to take photographs of each store’s layout. We reviewed this process and found it to be effective in determining those retailers eligible for participation in the program. When we began reviewing retailer eligibility in 1995, there were about 208,000 authorized retailers. At the end of FY 2002, through on-site monitoring and critical assessments, that number had been reduced to 146,000. FNS must remain vigilant in identifying and addressing problem retailers.

As previously mentioned, EBT systems provide data that can help identify questionable transactions and retailers by providing an electronic record of individual transactions. With the majority of food stamp benefits now being issued through EBT systems, OIG’s focus needs to remain on using this data to identify problem retailers and refining analyses as problem retailers change their techniques to avoid detection. Between 1996 and 2002, we conducted 2,235 food stamp retailer-related investigations. Over the past 7

years, our investigations in the Food Stamp Program have resulted in 2,969 indictments, 2,740 convictions, and over \$264 million in monetary judgments. The overwhelming majority of these results are attributed to retailer cases.

FNS can also take administrative action against authorized stores that violate food stamp regulations using its own analyses of EBT data. These actions include temporarily or permanently disqualifying stores and owners. When an FNS compliance investigation uncovers a trafficking operation, FNS alerts OIG about a potential criminal investigation. Since FY 1996, OIG has opened 1,159 trafficking investigations based on FNS referrals.

One example of an OIG investigation based on an FNS referral happened in Philadelphia. Through a joint investigation with FNS Compliance and the U.S. Secret Service, we found two owners of an authorized store had fraudulently redeemed \$1.3 million in EBT benefits. These individuals were sentenced to either prison or home detention and ordered to pay \$1.3 million in restitution. In addition, one of the owners agreed to testify against the food stamp recipients who sold him their benefits. So far, the owner has identified about 3,000 recipients; 2,000 of them have been notified they will be removed from the food stamp rolls. The State of Pennsylvania has also indicted over 120 recipients in this matter.

Over the last few years, we have investigated a number of food stamp trafficking cases involving the transfer of monies overseas. As a result of these cases, which often involve a large amount of money, we are participating in Federal Joint Terrorism Task Forces

(JTTF) around the country, as well as Operation Green Quest (a national project to identify mechanisms used to transfer funds overseas to terrorist groups). An OIG representative serves on the National JTTF, and we currently have active investigations with many of the 44 local JTTFs.

In one overseas transfer case, we uncovered a network of stores owned by individuals who trafficked in food stamp benefits. Most of the trafficking occurred at a video store located a few storefronts away from a food stamp issuance center. The video store would get cash from another store in the scheme and use the money to buy food stamps from people who had just received them. The video store would turn around and give the illegally obtained food stamps to an authorized retailer for redemption. Due to the large volume of benefits fraudulently collected, many authorized retailers had to be involved in the network so that FNS would not be tipped off by evidence that one store was redeeming too many food stamps. During this investigation, we discovered that approximately \$1 million was transferred overseas. Two of the retailers, who pled guilty and were issued a court judgment against them of over \$71 million, have fled the country.

Improper Payments

Eligibility for the Food Stamp Program is generally based on an applicant's household income and other resources such as bank accounts and real estate. Certain deductions are allowed from a household's gross income including dependent care, shelter, medical, and child support payments. Applicants must provide proof of income in order to participate.

Since 1974, FNS has measured payment accuracy using a statistical sampling system called the Quality Control (QC) system.

Every month, each State reviews a sample of households receiving food stamp benefits and those denied benefits, to measure payment accuracy (overpayments and underpayments) and the correctness of decisions to deny benefits. Between fiscal years 1993 and 2002, the national annual error rates have fluctuated between 10.81 percent and 8.26 percent. For fiscal year 2002, out of about \$18.2 billion in total issuances, about \$1.5 billion was erroneous (approximately \$1.1 billion was over issued and \$384 million was under issued).

FNS' analyses of the causes of such error rates for fiscal year 2000 (the latest year the results of such analyses were published) show that 54 percent of the dollar errors were the fault of the certifying agency while the rest were attributed to the food stamp recipients. Determining or reporting income makes up over half of the errors—the biggest factor. Deductions from the household's gross income are the next most prone to error at about 28 percent.

We note that the Food Stamp Reauthorization Act of 2002 contains provisions to simplify the definitions of income, utility allowances, housing costs, resources, and deductions. These provisions became effective October 1, 2002, and FNS plans to publish corresponding regulations as soon as possible. While one would expect these provisions to result in fewer certification errors, it will depend on how well FNS and the States implement them. We will not know whether these changes will impact the error rate

until FY 2004 data is tested and FNS analyzes and reports the QC results, which should occur in mid-FY 2005.

Although one would expect that high error rates in payment accuracy are caused by large increases in participation without corresponding increases in State certification personnel, we found this not to be the case. Between 1995 and 2001, the number of participating households declined significantly, with a 34 percent decrease in program outlays. Yet, the error rate for that period only declined 11 percent. This indicates that error rates are not directly linked to participation levels.

Reducing the error rate, and corresponding program losses, has remained an area of focus for FNS. The Under Secretary for Food, Nutrition and Consumer Services, stated in his FY 2003 budget hearing that the Department will focus on States with the most serious problems and the highest error rates. The Department has recently fined California, Michigan, and Wisconsin, the three States with the highest error rates for 2002.

The current law imposes QC liabilities each year a State's payment error rate is above the national average. Recent legislation (2002 Farm Bill) made substantial changes to FNS' quality control system. Effective for FY 2003, the reforms raise this error rate threshold so that States are not penalized unless there is a 95 percent probability that their error rate exceeds 105 percent of the national average for 2 consecutive years. The law also contains various provisions for waiving penalties and provides bonuses for high performance. The impact of these changes on the payment accuracy rate and FNS'

ability to encourage corrective actions by State administering agencies may not be known until FY 2005. We plan to monitor implementation of these program changes and their impact on FNS' ability to encourage actions by States to reduce their error rates.

Operation Talon: Fugitive Felons Made Ineligible To Receive Food Stamp Benefits

The 1996 Welfare Reform Act made felony fugitives ineligible for food stamps. This law allows for comparing law enforcement fugitive felony information with food stamp recipient records. Under this provision, OIG created "Operation Talon" in conjunction with other law enforcement agencies across the United States to locate and apprehend fugitives illegally receiving program benefits.

Since its inception in early 1997, Operation Talon has resulted in 8,793 arrests, simultaneously getting many dangerous criminals off the welfare rolls and off the streets. Serious crimes perpetrated by those arrested include homicide offenses, sex offenses, kidnapping, assault, robbery, and narcotics. For example, Operation Talon identified an individual who, along with two others, was alleged to have executed a victim as part of a cocaine distribution conspiracy. OIG agents and detectives from the New Jersey State Police, the New York State Police, and the New York City Police Department apprehended the individual at the address he reported on his food stamp application.

Since they determine food stamp eligibility, individual States are best positioned to estimate how much money Operation Talon has saved. It is difficult, however, for most States to determine cost savings because, even though a fugitive is removed from

eligibility, there may be other people in that household who receive benefits. New Jersey, which has developed a formula for approximating savings, estimates that \$1.9 million has been saved since 1996 in that State.

CONCLUSION

You asked me here today to talk about my view of the Food Stamp Program and how it can do better. The Food Stamp Program is working reasonably well, but it faces three major challenges – two systemic and one criminal.

There will always be people looking for ways to take advantage of the system. Food stamp traffickers will continue their attempts to defraud the program. As I have made clear in this testimony, however, transaction records provided by the EBT system make it easier to catch even the cleverest swindlers. FNS and States must continue to use this data to better manage and administer the Food Stamp Program to identify questionable transactions and remove those who abuse the program from participation.

The second challenge, as I see it, is for FNS to continue its success in lowering the payment accuracy error rate, as well as to put control processes in place to prevent erroneous payments from being made in the first place. Although this rate has come down since FY 1993, the magnitude of erroneous payments, over \$1.5 billion, is still material to the overall program. FNS must continue on its path of working with States to develop and implement action plans to reduce the high error rates.

The third challenge is getting all States to fully implement EBT systems. FNS has made great progress, but three States still do not have statewide systems in place even though the mandated deadline has passed. One of those States, California, is the largest in terms of benefits issued.

Finally, OIG is concerned that, on the surface, the recent changes made in the 2002 Farm Bill may have weakened FNS' QC process and its ability to encourage States to reduce their error rates. The impact of these changes, however, will not be known until the first 3-year cycle of determining the penalties to be assessed and bonuses to be paid to the States has been completed.

OIG will continue to work collaboratively with FNS through our audits and investigations to improve program administration, as well as its integrity. Our audit work during the next year will continue to focus on FNS and State implementation of EBT systems. We will also monitor the impact of the recent legislative changes to its quality control system and error rate reduction activities. In terms of our investigative activities, we will continue to work with FNS to identify and pursue prosecution of those who violate the Food Stamp law.

This concludes my statement. I would be pleased to entertain any questions the committee may have.