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**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 THE BUDGET

ON

FRAUD, WASTE, AND ABUSE  
IN MANDATORY SPENDING PROGRAMS

July 9, 2003



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Thank you, Mr. Chairman and members of the committee. I am pleased to be here to provide testimony about the Office of Inspector General's (OIG) perspective on fraud, waste, and abuse in mandatory programs administered by the U.S. Department of Agriculture (USDA).

**BACKGROUND**

USDA's Office of Inspector General has over forty years of service within the Department and as such has a long history of identifying fraud, waste and abuse in USDA's programs. Although our tools and techniques have changed over the years, our purpose remains the same: to perform audits and investigations of the Department's more than 300 programs and operations, recommend policies and actions to promote economy and efficiency, and prevent and detect fraud, waste, and abuse in

these programs and operations. We have been actively involved in auditing and investigating the major USDA mandatory programs: food assistance programs and farm programs (including conservation) and crop insurance programs. We take as our motto and our purpose, “Ensuring the integrity of American Agriculture.” In forty years, we have seen many changes in the Department’s programs, just as we have seen many changes in the nature of the schemes and devices we encounter, and the program abuse and mismanagement we find.

### **Improper Payments**

Allow me to say from the outset that while OIG has a long history in identifying fraud, waste, and abuse in USDA programs, quantifying the extent of these offenses is extremely difficult. In the case of fraud in particular, people do not commit it with the idea that it will be discovered. Consequently, a reliable estimate is difficult to obtain. Both Congress and the Administration recognize the importance of reducing waste in Government programs. As you know, one of the initiatives of the President’s Management Agenda is to reduce erroneous (improper) payments. An erroneous payment is any payment that should not have been made, or that was made in an incorrect amount, to an ineligible recipient, or for an ineligible service. The 2002 Improper Payments Information Act now requires agencies to identify programs vulnerable to improper payments, estimate the extent of these erroneous payments, and develop a plan to prevent such errors. This new requirement will be a significant management challenge to Federal agencies, including USDA. Successful implementation will require a strong internal control structure, to include management commitment and the necessary

resources, quality control processes, and information systems to prevent, detect, and measure the extent of erroneous payments. Ultimately, the goal will be to design internal control systems to detect and prevent improper payments before they “go out the door.”

Within USDA, the only agency that currently has a statistically based quality control program in place to measure the extent of improper payments is the Food and Nutrition Service (FNS). This program measures both over- and under-payments of Food Stamp Program benefits by State administering agencies, albeit “after the fact.” A key component of FNS’ program is to provide a system of incentives and penalties to encourage State administering agencies to lower their error rates and ensure that eligible individuals receive the proper amount of program benefits. OIG recognizes the importance of preventing improper payments and has recently initiated a review to assess the progress of select agencies in implementing this new mandated requirement.

Over the past several years, OIG has been requested to identify the top management challenges facing the Department. Among other things, we considered OIG’s experience in finding fraud, waste, and abuse in the program and the nature of the program that might make it vulnerable to fraud, waste or abuse. USDA has about 70 mandatory spending programs (see Exhibit A). For FY 2003, these mandatory programs amounted to approximately \$67.8 billion, or 64 percent of the USDA’s total estimated program dollar level. Today, we will focus our testimony on those programs that comprise a significant portion of USDA’s program levels, in both dollars and participants, and that contain OIG-identified management challenges for USDA. The programs I will address are the major food assistance programs (Food Stamp and National School Lunch and

Breakfast Programs); farm programs (including conservation); and crop insurance programs. Between fiscal years (FY) 1996 and 2002, OIG conducted 509 audits and 3,492 investigations in these programs; our audits identified about \$751 million in questioned costs and \$466 million in potential program savings in these programs, and our investigations resulted in over \$497 million in monetary results.

### **FOOD ASSISTANCE PROGRAMS**

FNS administers the food assistance programs of USDA. These programs include the Food Stamp Program, the National School Lunch and School Breakfast Programs, among others. The program goals are to provide access to a more nutritious diet for people with low incomes, to encourage better eating habits among the nation's children, and to stabilize farm prices by distributing surplus foods.

#### **Food Stamp Program**

The Food Stamp Program is the Nation's principal nutrition assistance program. FNS administers the program in cooperation with State agencies. Households apply for benefits at State or local welfare offices. Those offices certify the households' eligibility to participate and issue the benefits. Eligibility is generally based on the household's level of income and other resources of the applicant, including bank accounts and real estate. In FY 2002 just over \$18 billion in food stamps was issued to an average 8.2 million households. FNS funds the entire cost of program benefits and shares in the State agencies' administrative costs. The program provides monthly program allotments to households in the form of paper coupons or in the form of electronic benefits transfer

(EBT) systems cards, which function much like bank debit cards. Food stamp benefits provided via coupons and EBT cards can be redeemed at authorized retailers. FNS began pilot implementation of EBT to provide food stamp benefits in 1984. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Welfare Reform) mandated all States to implement EBT for food stamps by October 2002. As of July 2003, FNS reported 52 of 53 State Agencies have operational systems with 48 being operational State- or district-wide. FNS now estimates that about 91 percent of participating households receive food stamp benefits through EBT systems, which is about 91 percent of the total issuances.

Retailers apply to FNS for authorization to accept food stamps at their establishments, including supermarkets, corner grocery stores, convenience stores, and farmers' markets. To qualify for authorization, a retailer must stock an ample variety of staple foods including breads, dairy products, fruits and vegetables, and meats.

### **Retailer Abuses**

Fraud and abuse in the Food Stamp Program generally occurs when individuals sell their benefits for cash in violation of the intent of the Program as well as the law. This practice, known as trafficking, diverts food stamps away from their purpose. Curbing the incidence of trafficking by retailers and individuals remains an area of significant mutual concern for FNS and OIG. FNS' latest estimate for trafficking was published in March 2000 (FNS is planning to issue a revised estimate this summer). The report used data from FNS investigations of authorized retailers and disclosed that stores trafficked over

\$650 million each year during the period 1996 through 1998. This amounted to 3 ½ cents of every food stamp dollar issued. The advent of EBT has not prevented fraud from occurring; the scheme of trafficking has not changed yet the method has. Specifically, trafficking of food stamp benefits has moved from the street to the stores. Our investigations now focus almost solely on the retailers because they are the only ones who can redeem food benefits for cash from the government using paper coupons or households' EBT cards. EBT systems do, however, provide an electronic record of transactions and make it easier to identify stores that may be trafficking. The systems also identify the households whose benefits were trafficked, something that was not possible under the coupon system.

Since the FNS-authorized retailer is the key to redemption of program benefits, OIG has been concerned about the legitimacy and eligibility of these authorized retailers. We have testified in the past about our work in this area and the need for agency on-site reviews to determine if a retailer should be authorized or remain eligible for reauthorization. In 1995, we performed a review of retailer eligibility entitled "Food Stamp Program, Store Eligibility Task Force." At that time, we visited over 5,000 authorized retailers and identified over 850 stores that were obviously not eligible to participate and another 450 stores whose eligibility was questionable. These stores had minimal or no staple foods, were out of business, or did not exist. FNS had not routinely conducted onsite preauthorization visits and had accepted the information provided on the store's application without verification. While FNS could require stores to be periodically reauthorized, site visits were not a requirement of the reauthorization

process. We recommended that routine onsite visits be incorporated into both the application and reauthorization processes. In response to OIG's concerns, FNS contracted with outside vendors to make the visits and provide FNS with specific information to be used in the authorization and reauthorization process. The contractors were required to complete a checklist of food inventory and take representative photographs of each retailer's operation. We have reviewed this system and concluded that it is working. At the time of our initial review of retailer eligibility in 1995, there were about 208,000 authorized retailers. At the end of FY 2002, with increased onsite monitoring resulting in better information and more critical assessments, that number has now been reduced to 146,000. This being said, our ongoing investigations indicate FNS must remain vigilant in identifying and addressing problem retailers.

As previously mentioned, EBT systems provide an electronic record of individual transactions. Because FNS has a reliable quality control system in place to detect erroneous payments due to errors in determining recipient eligibility, OIG audits over the past five years have been directed to evaluating State and EBT processor controls to ensure that EBT systems can accurately and reliably issue, account for, and report Food Stamp Program data. Our audits have shown that these EBT systems are working. Analyses of EBT data have proven invaluable in targeting retailers whose activities are questionable. With the majority of food stamp benefits now being issued through EBT systems, the focus needs to remain on using this data to better target problem retailers and refining analyses as problem retailers change their techniques to avoid detection.

In fact, we focus our investigative efforts on retailer trafficking in an attempt to stem both the retailer's illegal gains and the recipient's illegal use of food stamp benefits. For the period FYs 1996 through 2002, we have conducted 2,540 food stamp related investigations. Of the investigations, 2,238 were retailer related, and of those, 491 involved trafficking with EBT benefits. Our food stamp related investigations for the past 7 years have resulted in 2,969 indictments, 2,740 convictions, and over \$264 million in monetary results.

One example of our investigative work involved a joint investigation with the Internal Revenue Service of four food stores owned by family members in the Fort Worth, Texas area. We found that from the period December 1996 through April 1999, the defendants' efforts in a food stamp trafficking scheme resulted in government losses exceeding \$1.3 million. Part of the scheme involved trafficking food stamps through one authorized retail store via manual transaction over the telephone of another store. The owner of one store would call the owner of a second store and provide him with an EBT card number and associated PIN. The owner at the second location would enter the information into the point of sale (POS) device to complete the transaction. POS devices are terminals used to transact EBT benefits. Through our efforts five family members and several other store employees were convicted and received sentences ranging from 8 to 46 months in prison. They were charged with violations of food stamp EBT trafficking and conspiracy. These individuals were also ordered to pay over \$1.3 million in restitution for the Government's losses.

We have recently identified a fraudulent scheme that while rare, appears to be growing in the Food Stamp Program. We noticed that authorized retailers are moving their POS devices to an unauthorized location, such as an unauthorized store or apartment, for trafficking purposes. We learned through investigation that unauthorized stores take possession of EBT POS devices, which are then used to conduct fraudulent transactions. Additionally, we found that stores work in concert with other unauthorized stores to further the scheme. We have met with FNS on this issue, and are working together to consider ways to prevent this activity from occurring. Factors such as cost, however, have been identified as potential impediments to some solutions.

The nature of the food stamp program and the large amount of money that it provides to recipients creates the potential for laundered monies to be transferred overseas, where it is not always possible to track how the funds are used. We have noticed trends in our food stamp trafficking investigations where such activity occurs. In fact, the elements of money laundering and overseas transfers led to our participation in the Federal Joint Terrorism Task Force (JTTF) and Operation Green Quest, which is a national project to target money transfer businesses sending funds overseas to terrorist groups.

In one such investigation we uncovered a network of grocery stores, a wholesale distributing company and a video store, all owned by the same individuals that purchased food stamps and other program benefits for cash. The primary source of the trafficking occurred at the video store, which was located a few storefronts away from a food stamp issuance center. The video store would receive cash from one of the grocery stores,

owned by the defendants, and use it to purchase food stamps and other program benefits. The video store would then provide the illegally obtained food stamps and other program benefits to the grocery store, which in turn redeemed the stamps or provided them to another authorized grocery store for redemption. Due to the large volume of food stamps and other program benefits, which needed to be redeemed, many authorized grocery stores were involved in the network, so that the fraud would go undetected. Through this investigation we discovered that approximately \$1 million was transferred overseas. Two of the owners who pled guilty to food stamp fraud have fled the country and remain in a fugitive status. Additionally, the courts have entered a judgment against the storeowners in an amount exceeding \$71 million.

We currently have active investigations with most of the 44 local JTTFs, and have an OIG representative serving on the National JTTF.

FNS has the ability to take administrative action against authorized retailers using its own analysis of EBT data. FNS may also conduct retailer compliance investigations and take administrative action against retailers who violate the food stamp regulations. Such administrative actions include temporarily or permanently disqualifying retailers and their owners from participating in the program. In those instances when an FNS compliance investigation uncovers a retailer trafficking in food stamps, FNS promptly notifies OIG concerning the potential for a criminal investigation. Since FY 1996, OIG has opened 1,159 food stamp trafficking investigations based on FNS referrals.

An excellent example of an OIG investigation based on an FNS Compliance referral involves a matter in Philadelphia. Through a joint investigation with FNS Compliance and the U.S. Secret Service, we found that over an 18-month period, the two owners of an authorized store fraudulently redeemed \$1.3 million in food stamp EBT benefits. Both owners were convicted of fraud. One was sentenced to 9 months incarceration, 3 years probation, and ordered to pay \$1.3 million in restitution. The other was sentenced to 6 months home detention, 5 years probation, and ordered to pay \$1.3 million in restitution. Additionally, one of the owners agreed to cooperate and testify against the food stamp recipients who sold him their food stamp benefits. Thus far, the owner has identified about 3,000 recipients; over 2,000 of them have been notified that they will be removed from the food stamp rolls. The State of Pennsylvania has also indicted over 120 recipients in this matter.

### **Improper Payments**

Eligibility for the Food Stamp Program is generally based on household income and other resources of the applicant, including 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 to become eligible to participate. Since 1974, FNS has measured payment accuracy using a statistical sampling system called the Quality Control (QC) system. Each State conducts monthly reviews of a statistical sample of households to measure payment accuracy (overpayments and underpayments) and the correctness of decisions to deny benefits. Between FYs 1993 and 2001, the national annual error rates have fluctuated between

10.81 percent and 8.66 percent, which include both over- and underpayments. For FY 2001, the total erroneous payments were about \$1.3 billion, with about \$1 billion in overissuances and about \$340 million in underissuances. Total issuances for FY 2001 were about \$15.5 billion. OIG considers the significance of these errors to be material to the Food Stamp Program.

FNS' analyses of the error rates for FY 2000 (the latest year published) shows that 54 percent of the dollar errors were attributed to the certifying agency, while about 46 percent were attributed to the households. The single biggest factor is determining or reporting income, which makes up almost 52 percent of the errors. This is followed by deductions from the household's gross income, which makes up about 28 percent of the errors.

Our investigations have found that some recipients deliberately misrepresent their financial status, household income and composition, to obtain program benefits. Through this misreporting of information, individuals are certified as qualifying for food stamp benefits when, in fact, they do not. In a recent investigation worked jointly with the FBI, Immigration and Naturalization Service, Secret Service, Bureau of Alcohol, Tobacco, and Firearms, and two other Federal OIG offices, we found that an individual's personal finances and assets were inconsistent with those claimed on his food stamp and welfare applications. The investigation revealed that the individual provided false information in order to obtain credit cards, social security numbers, and alien registration documents. The individual was found guilty on several counts, including unlawful acquisition of food

stamp benefits. He was sentenced to 30 months in prison and ordered to pay restitution in the amount of \$41,805.

We note that the Food Stamp Reauthorization Act of 2002 contains provisions to simplify the definitions of income, utility allowances, housing costs, resources, and determining deductions. These provisions of the Act became effective October 1, 2002 and FNS plans to publish regulations to implement the Act as soon as possible. While one would expect these provisions to result in fewer certification errors, the determining factor will be how well FNS and the States implement the provisions and then make any adjustments based on QC results. The QC results will not be available until FY 2004 data are tested.

At the time of OIG's audit in 1997, entitled "Reinvestment of Food Stamp Penalties," it was thought that the high error rates were attributable to large increases in participation without a corresponding increase in State certification personnel. However, between 1995 and 2001 there was a significant decline in the number of participating households and a 34 percent decrease in program outlays. Yet the error rate for the same period only declined by 11 percent, which indicates that error rates are not directly linked to participation levels.

Reducing the error rate, and thus the corresponding program losses, needs to remain an area of focus for FNS. This emphasis is supported by the Under Secretary for Food, Nutrition and Consumer Services, who noted in his FY 2003 budget hearings that the Department's focus will be to deal with States with the most serious problems and

consistently high error rates. In line with the Under Secretary's statement, 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 (Farm Bill) made substantial changes to FNS' quality control system. Effective for FY 2003, the reforms raise this 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 two 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 rates and FNS' ability to encourage corrective actions by State administering agencies may not be known until FY 2005. We plan to monitor the implementation of these program changes.

### **Fugitive Felons Made Ineligible to Receive Food Stamp Program Benefits**

In 1996, Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, generally known as the Welfare Reform Act. In the Act, Congress recognized that certain people are not eligible for food stamps. The Act made felony fugitives ineligible to receive food stamp benefits. Additionally, this law allows the matching of law enforcement felony fugitive files with social service agencies' food stamp recipient records. To implement the law, OIG created "Operation Talon." This initiative capitalized on the provision of the Act that declared individuals ineligible to receive Food Stamp Program benefits who are "...fleeing to avoid prosecution, custody,

or confinement after conviction.” The provision also authorized State agencies to provide the addresses of food stamp recipients to any Federal, State, or local law enforcement officer for official purposes. Operation Talon was commenced in conjunction with other law enforcement agencies across the United States to locate and apprehend fugitives who may be illegally receiving food stamp benefits. It was designed to carry out the intent of Congress by:

- removing ineligible fugitive felons from Food Stamp Program rolls, thereby reducing program outlays;
- removing fugitive felons from the streets in order to make our communities safer; and
- demonstrating to States how to carry out the statutory provisions on a continuing basis.

Since its inception in early 1997, Operation Talon has resulted in 8,793 arrests. Serious crimes perpetrated by those arrested include homicide-related offenses, such as murder attempted murder, and manslaughter; sex offenses, such as child molestation, rape, and attempted rape; kidnapping/abduction; assault; robbery; and drugs/narcotics violations. An example of an Operation Talon arrest involved an individual wanted for murder in Southern New Jersey. The individual and two others were 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 in the Bronx, which was at the address he

reported in his food stamp application.

As successful as this initiative is, I unfortunately cannot provide the cost savings brought about by these operations. Since the States determine eligibility, they are the ones who are best positioned to make such determinations. For example, New Jersey has developed a formula for estimating costs avoided. To date, New Jersey estimates cost avoidance (program benefits now available for eligible recipients) of \$1.9 million since the inception of Talon in 1996. It is difficult, however, for most States to determine cost savings because even though fugitives are removed from the food stamp eligibility roles, they may be only one member in an entire household that continues to be eligible.

### **National School Lunch and School Breakfast Programs**

The National School Lunch and School Breakfast Programs are administered by FNS through State educational agencies. The programs are designed to provide children with access to nutritious meals away from home and to improve their diets. Schools are eligible for reimbursement from FNS for all meals served that meet program requirements, with meals served free or at a reduced-price receiving additional reimbursement. For FY 2003, FNS estimates that National School Lunch Program outlays will be about \$5.8 billion with the School Breakfast Program approaching \$1.7 billion. Both programs share common eligibility requirements for free and reduced-price meals. In FY 2002, almost 58 percent of the National School Lunch meals were served free or at a reduced-price, with the School Breakfast Program serving almost 83 percent of its meals as free or reduced-price. Eligibility for free and reduced-price

meals is based on household income with households submitting applications at the beginning of the school year to their local school food authority. To test whether households correctly report their income, school food authorities are required to sample applications to verify the reported income.

In August 1997, OIG issued a report entitled “National School Lunch Program Verification of Applications in Illinois.” We reported that while school food authorities generally followed regulations in conducting income verifications, they did not expand their sampling when high error rates were found. Overall, Illinois had a 19 percent error rate comprised of households underreporting income (about 9 percent) or failing to respond to verification requests (about 10 percent). This meant that \$31.2 million, of the \$165.1 million Illinois received in 1 year for free and reduced-price meals, was potentially paid out for households that were not eligible. As part of the verification process, school food authorities are required to reduce or terminate benefits when the verification does not confirm the accuracy of the child’s eligibility. OIG recommended that FNS establish a threshold for the maximum percentage of errors allowable during the verification process and require additional sampling when that percentage is exceeded. OIG further recommended that States be required to monitor school food authority verification efforts and follow-up to assure additional testing was undertaken where needed. FNS did not initially agree to make regulatory changes based only on our findings in Illinois, but subsequently revised this position when information it gathered on additional States showed an average error rate of 26 percent.

OIG's review, "National School Lunch Program Operations in New York City," issued in September 2002, further confirmed the severity of the problem. For school year 1998/1999, in which New York City received \$204 million in FNS reimbursement, the school food authority's testing of households' applications showed about 55 percent of those sampled underreported income (about 23 percent) or did not respond to verification requests (about 32 percent), with the error rate climbing to 59.5 percent in school year 1999/2000, 65.1 percent in school year 2000/2001, and 69.5 percent in 2001/2002. Furthermore, the New York City school food authority did not always adjust its claims for reimbursement based on the verification results, as required.

The Department has acknowledged that eligibility determinations and verification in the National School Lunch and School Breakfast Programs is an issue that needs to be addressed for program integrity. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony before the House Appropriations Subcommittee on Agriculture, Rural Development, Food and Drug, and Related Agencies in March 2002, that the recent U.S. Census shows 27 percent more students are certified for free or reduced-price meals than the Census data itself would suggest are eligible. Since National School Lunch and School Breakfast Program reimbursements are estimated to reach \$7.5 billion during FY 2003, in response to these concerns, FNS has published a proposed rule requiring schools to report on the results of their verification reviews to the State agency. In turn, State agencies would consolidate the data and report to FNS. FNS also currently has pilot projects underway in 22 school food authorities in 16 States to assess three different options to address the verification process and the current high error

rate. The first option requires households that are not eligible for free meals, by virtue of being eligible for Food Stamp Program or Temporary Assistance for Needy Family benefits, to provide upfront documentation of household income with their application. The second option requires school food authorities to expand verification sampling if the initial tests showed an error rate exceeding 25 percent. The third option requires school food authorities to verify direct certifications, namely those who reported receiving Food Stamp Program or Temporary Assistance for Needy Families benefits. The pilots are to be completed at the end of school year 2002/2003.

FNS and OIG both agree that the eligibility determination and verification process is a management challenge that must be addressed to reduce fraud, waste, and abuse in FNS programs. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony before the Senate Committee on Agriculture, Nutrition and Forestry in April 2003 that problems with school meals certification have worsened over time and that the Department has been working to develop and test policy changes that improve accuracy but do not deter eligible children from participation in the programs. Options being pursued by the Department include requiring direct certification for free meals through the Food Stamp Program, enhancing verification of applications by drawing samples early in the school year and expanding the verification sample, requiring a robust effort to follow up with those who do not respond to verification requests, streamlining the process by requiring a single application, and initiating a series of projects to test alternatives for certifying and verifying applicant information (including computer matching of wage data).

Another area in the National School Lunch and Breakfast Programs prone to fraud, waste, or abuse involves local school food authority contracts with food service providers. OIG is working with FNS to address cost reductions in the form of contract discounts, rebates, and allowances. Federal cost principals require that such benefits accrue to the program. However, the Office of Management and Budget has recently determined that Federal cost principles do not apply to local contracts with food service management companies. FNS is pursuing regulatory action to address this problem. Our investigations have also identified schemes by food service providers to inflate expense claims. One large food service provider agreed to pay \$325,000, in order to settle a lawsuit brought in regards to inflated National School Lunch Program claims. In its billings to several school districts, this firm inflated flat rate labor costs for employee-related expenses and claimed for insurance expenses that had not been incurred.

### **CROP INSURANCE AND FARM PROGRAMS**

We believe the Department confronts the same challenges in administering these two program areas, since they are closely related, interdependent, and prone to the same types of abuse. When Congress enacted the Agricultural Risk Protection Act of 2000 (ARPA), it mandated the Risk Management Agency (RMA) and Farm Service Agency (FSA) to work together to strengthen their programs and to better serve American farmers and ranchers.

Federal crop insurance programs are delivered through private insurance companies under the oversight of the Federal Crop Insurance Corporation and RMA. Today's crop insurance programs help farmers survive depressed market prices and major crop losses through market-based risk management solutions. At the same time, the farm programs administered by FSA serve to stabilize farm income, help farmers conserve land and water resources, provide credit to new or disadvantaged farmers and ranchers, and help farm operations recover from the effects of disaster. For the five FYs 1998 through 2002, the average value of all financial assistance provided to the public by RMA, FSA, and NRCS (actual program levels) were \$2.432 billion, \$32.073 billion, and \$1.426 billion respectively. Over those 5 years, RMA's, FSA's, and NRCS' combined program levels ranged from 28 to 45 percent of USDA's annual budget.

While OIG has observed the general nature of fraud, waste, and abuse in crop insurance and farm programs, the overall magnitude of these problems is unknown. Fraud is commonly perpetrated through false certification of one or more of the basic data elements essential for determining program eligibility and amounts of benefits. In RMA cases, the scheme typically involves a conspiracy between an insurance company representative and a producer. For example, in one investigation it was determined that a producer who was also employed as an insurance agent paid employees of his insurance company to assist him in setting up sham farming operations. These sham operations enabled the individual to receive over \$5.9 million in ineligible payments from FSA and RMA. The individual was also able to use the sham operations to offset his sizable insurance profits and file false income tax returns. This individual was convicted on

money laundering, conspiracy, false statements, aiding and abetting, false tax returns, mail fraud, and wire fraud. The individual was sentenced to 60 months incarceration, 3 years supervised release, \$1,800 special assessment, \$13,800 towards cost of prosecution, and forfeiture of \$5.8 million.

Abuse is more subjective and occurs when a participant's actions defeat the intent of the program although no law, regulation, or contract provision is actually violated. Waste, on the other hand, occurs when there are flaws in the program design. These program design flaws or weaknesses inevitably invite abuse by the program participants – what we refer to as “moral hazards.” For example, our September 2002 audit report, “RMA Viability of Fall Watermelons in Texas and Their Inclusion in the 1999 Watermelon Insurance Pilot Program,” showed RMA's internal policy approval process was not adequate to preclude the issuance of a crop insurance policy on crops that were not viable. Specifically, RMA offered a policy covering fall watermelon crops in South Texas although such crops ran a high risk of failure. This pilot program presented producers with a significant opportunity for monetary gain since the crop insurance indemnities substantially exceeded the producers' input costs. In response to the policy offering, producers significantly increased their acreage devoted to fall watermelons. In South Texas alone, annual fall watermelon acreage jumped from its pre-1999 level of about 1,000 acres to nearly 27,000 acres for 1999. The fall watermelon pilot program in Texas culminated in the expenditure of \$21.2 million in insurance indemnities (44 percent of all watermelon claims nationwide in 1999). RMA discontinued the program effective for the 2000 crop year, and we observed a corresponding decrease in

fall watermelon acreage for that year. In this case, we found that RMA had adequate procedures in place for reviewing and approving pilot programs, however, these procedures were not closely followed. We recommended that the RMA consider holding the responsible officials accountable for their actions. We are still waiting for a response from RMA.

### **Actions Taken to Eliminate or Reduce Problems**

The crop insurance and farm programs use the same basic data to compute program benefits. Such data include acreage, crop, location, production, and shares, all of which are generally self-certified by the program participants. The insurance companies and FSA, however, separately collect the data from producers in different formats. OIG believes common data should be shared between the agencies and programs, as well as the responsibility to ensure the integrity of the data.

### **Agricultural Risk Protection Act of 2000 (ARPA)**

Fundamental differences in FSA and RMA definitions and program procedures sometimes give the appearance there are discrepancies in the data. For example, RMA and FSA have different definitions for common pieces of land: RMA identifies land by “units,” while FSA “farms” are composed of “tracts” which may further be broken into individual “fields.” RMA units cannot be directly equated to FSA farms, tracts, or fields.

ARPA requires RMA and FSA to annually reconcile information received from producers and to identify and address any apparent discrepancies. To further improve

program compliance and integrity, ARPA requires FSA to assist RMA in ongoing monitoring of crop insurance programs and requires RMA to consult with state FSA committees on policies and plans for insurance offered in the state. In addition, ARPA requires RMA to make full use of data warehousing and data mining technologies to identify anomalies in the crop insurance programs.

OIG reviewed the 2001 crop year data reconciliation process and found that FSA was able to resolve about 250,000 (52 percent) of the 480,000 data records unmatched between RMA and FSA. We believe significant additional action is still needed by RMA to resolve the remaining discrepancies. Most of the discrepancies can be attributed to differences in RMA's and FSA's definitions of the basic data necessary to compute benefits and in how they collect and record such data. Until these differences are resolved, we believe neither of these agencies will be able to effectively and efficiently implement the data reconciliation process and, therefore, meet its intended goal of reducing improper payments. We plan to issue our audit report, "USDA Implementation of the Agricultural Risk Protection Act of 2000," in September 2003. In FY 2004, we plan to continue monitoring the agencies' implementation of ARPA. Our planned work includes emphasis on RMA's use of information provided through data mining.

During the past 7 fiscal years, we conducted 655 investigations related to FSA mandatory programs, involving unauthorized disposition of property mortgaged to the government, fraud by warehouse operators, false statements by commodities producers and exporters, and false statements by borrowers in order to obtain more or greater dollar value loans or

debt write-downs to those which they are actually entitled. These investigations have resulted in 310 indictments, 306 convictions and \$116.1 million in monetary results. For this same period we conducted 154 investigations related to RMA mandatory programs, which have resulted in 49 indictments, 43 convictions, and \$22 million in monetary results. We believe a more effective data reconciliation and data mining process could detect potentially fraudulent actions and/or abuse by program participants and, thereby, mutually benefit both RMA and FSA.

### **Existing Quality Control Systems**

Because the crop insurance and farm programs fundamentally rely upon producers' self-certifications to determine eligibility for benefits, the agencies have in place a number of differing internal control systems to evaluate participant compliance with program provisions. For example, there exists within each FSA program specific compliance or spot check requirements. FSA regards such compliance reviews as collateral duties to be performed by FSA county office employees. FSA also has in place a County Operations Review Program (CORP). CORP was implemented in 1986, based upon an OIG audit that determined existing internal control processes did not meet the requirements of the Federal Managers' Financial Integrity Act (FMFIA) or the internal control guidelines established by the Office of Management and Budget (OMB). For FY 2002, there were 74 county operations reviewers (COR) positions approved nationwide for FSA. The COR position is a full-time position used exclusively for county office internal control functions.

The current internal review systems were developed independently of each other in response to known problems and without consideration of whether the reviews would be cost effective or the extent of the problems measurable. In addition, there has been no concerted effort to coordinate the conduct of the multiple reviews or to communicate the results to officials responsible for other programs that may be affected.

To evaluate overall program integrity and compliance, RMA uses a system that consists largely of insurance company internal reviews and periodic RMA verifications. Given its resources, RMA must continue to rely on this approach in partnership with the insurance companies. In our March 2002 audit report, "Risk Management Agency Monitoring of RMA's Implementation of Manual 14 Reviews/Quality Control Review System," we reported RMA continues to struggle to develop and implement a reliable QC system capable of evaluating private sector delivery of Federal crop insurance programs. RMA's stated commitment to QC has not answered basic policy questions, including what constitutes an error, the amount of improper payments made, and whether program delivery should be assessed at the national or at the insurance company level. We continue to monitor RMA's actions to implement our recommendations.

In general, RMA's and FSA's QC systems rely on judgmental sampling and are not designed to estimate the magnitude of fraud, waste, and abuse in the programs.

Statistical sampling is the only reasonable way to review large populations in an objective and unbiased manner. Statistical sampling is objective and defensible; it provides the means to estimate the sample size and sample error; it saves time and

money; it has a proven scientific basis; and it generally yields results that have high visibility and impact. We are aware of only one RMA internal review designed to use a statistical sample. We believe the agencies must move toward standardized statistical sampling in order to estimate annual amounts of improper payments as required by the Improper Payments Information Act of 2002.

The Department's conservation programs fall under the jurisdiction of FSA or the Natural Resources Conservation Service (NRCS). In some of these programs, such as the Conservation Reserve Program, FSA administers the program and NRCS provides technical assistance to the farmers. In other programs, such as the Wetlands Reserve Program, NRCS both administers the program and provides the technical assistance. For most programs, NRCS is responsible for monitoring the farmers' implementation of the conservation practices they agreed to. Farmers need to comply with the conservation provisions of their agreements with FSA or NRCS to remain eligible for farm program benefits. NRCS monitors this compliance through status reviews. The tracts it selects for these reviews are taken partly from a random sample and partly from referrals it gets from FSA, its own field offices, public complainants, or other sources. If NRCS finds that a farmer did not comply with the appropriate agreements, it may waive the noncompliance, recommend penalties, or ask FSA to withhold farm program benefits. In the past, NRCS has reported generally around a 98-percent rate of farmers' compliance with the conservation provisions.

We recently evaluated the performance of the status reviews (that is, compliance reviews) in one State in response to a whistleblower complaint. In our September 2002 report,

“NRCS – Compliance With Highly Erodible Land Provisions,” we pointed out a number of ways NRCS could strengthen its status reviews: clarify its handbook procedures, seek better coordination with FSA, perform more timely status review field visits, and require better reporting by the field offices of the results of the status reviews. The General Accounting Office’s recently issued report, “USDA Needs to Better Ensure Protection of Highly Erodible Cropland and Wetlands,” raised similar concerns. It pointed out that in the process of selecting sample tracts for review, NRCS disproportionately emphasizes tracts (e.g., permanent rangelands) where the conservation compliance provisions may not be applicable. Since these tracts provide little potential for noncompliance, the status reviews that include them result in inflated compliance rates. GAO reported that for crop years 2000 and 2001, only 5 percent of all tracts selected for compliance review resulted in waivers or violations. And of those tracts with violations, over 60 percent of these cases from 1993 through 2001 were waived when the farmers appealed their cases to FSA. For FY 2004, we plan to evaluate NRCS’ compliance rates by verifying, through a statistical sample of tracts, that conservation provisions have been properly implemented.

### **RMA Data Acceptance System**

Crop insurance program benefits are based on information provided by the producers to the insurance companies. The insurance companies enter the data into their information technology (IT) systems and then download it to RMA, where the data purportedly first undergo a series of IT edit checks or validations to ensure the data are complete and accurate. Once the data are cleared through this electronic information processing

application, known as the Data Acceptance System (DAS), RMA's crop insurance database is updated.

For the 2001 crop year, we found RMA did not have documentation to describe all current DAS edits, users, and reports. We were unable to determine the internal controls in place to evaluate the quality of data downloaded to RMA from the insurance companies. Further, we discovered any updated or changed data overwrites and completely replaces any corresponding pre-existing data in RMA's crop insurance database. Thus, the audit trail or history of changes is effectively eliminated. Finally, the crop insurance database and RMA's accounting system do not interface with one another. Instead, RMA uses the database values at monthly cutoff dates to generate a monthly accounting report for each insurance company. These reports are sent to the companies for review and attestation and are ultimately signed and returned to RMA. RMA manually compares the current month's cumulative amounts to the prior month's cumulative amounts for each insurance company, and RMA accountants enter the calculated differences into the automated accounting system to make payments to or demand refunds from the individual insurance companies. RMA's current system makes it impossible to verify financial events at the transaction level and does not comply with Federal financial management and financial systems requirements. Our report on "Risk Management Agency Survey of Data Acceptance System Processing Controls" is scheduled to be issued in September 2003. We plan to do additional reviews of DAS, particularly testing the validity of the data including any changes to the database.

### **Common Computing Environment and Geographic Information Systems**

The Department of Agriculture Reorganization Act of 1994 authorized the reorganization and modernization of USDA to achieve greater efficiency, effectiveness, and economy in program delivery. One major component of this effort targeted USDA's county-based agencies (FSA, the Natural Resources Conservation Service (NRCS), and the agencies in the Rural Development mission area). A key element under USDA's modernization initiative is the development of a common computing environment (CCE) to enable the county-based agencies to share data among themselves. USDA began implementation of the CCE in 1998 and plans to complete its installation in FY 2004.

Another component of the modernization initiative is implementation of Geographic Information Systems (GIS) and Global Positioning Systems (GPS) technology. GIS and GPS will allow the county-based agencies, and other USDA agencies, to electronically analyze data on land and crops. GIS is a computer-based tool for mapping and analyzing geographic information. GPS is an accompanying technology that can be integrated with GIS for even greater analysis of real world information. GPS data layers, ortho-photography, soils layers, public land survey data, and many other data layers can be placed atop one another inside of one GIS project. FSA plans to use the geo-spatial data and tools to improve assessment of crop conditions and producer compliance with FSA programs, as well as to maintain and share farm records and maps digitally with other agencies as appropriate. Based on our discussions with RMA compliance staff, such geo-spatial data and tools have allowed them to closely and timely monitor crop conditions

and producer compliance, particularly in situations where they have received complaints or their reviews indicate potential problems.

In our investigations, we have benefited from this modern technology by utilizing satellite imagery technology for crop identification and comparison during growing seasons. Specifically, thermal image technology has been used to determine acreage amount and whether or not a crop was planted, as well as the type of crop planted. Although this technology can be extremely useful in our audits and investigations, upfront costs, to include personnel expertise and training, are unknown at this time.

### **Penalties**

RMA and FSA distinguish between participant errors and agency errors in the programs. In cases of participant error, RMA and FSA generally demand refunds of overpayments, but greater leniency is afforded in cases of agency error, including cases of misaction or misinformation. Further, there are legislated disparities in RMA's and FSA's handling of agency errors. For example, FSA's Finality Rule waives repayment after 90 days unless the participant had reason to know the payment was made in error. If the participant is not notified within 90 days of the county committee's approval of the request that a potential overpayment may have occurred, FSA is precluded from recovering overpayments resulting from agency errors. Since recovery is moot, a reviewer is discouraged from actively seeking and identifying overpayments that could be the result of agency waste. In our August 2002 report, "FSA – Limited California Cooperative Insolvency Payment Program – Tri Valley Growers," we found agency errors in

approximately 20 percent of the program payments. Early on in the review, we raised these concerns to FSA who, in turn, notified participants of the potential payment problems. Fortunately, because of these notifications, FSA was able to issue bills of collections to recover these overpayments.

In contrast, ARPA provides a 3-year period for the recovery of improper payments attributed to an insurance company's error. To adequately enforce program compliance and integrity, remedies should be consistent across agency lines and for similar violations.

### **SUMMATION**

You have asked us here today to talk about our experiences in auditing and investigating fraud, waste, and abuse within USDA mandatory programs. In each of the mandatory spending programs I have discussed here today, much has been done by the USDA agencies and Congress to address inherent weaknesses and vulnerabilities within USDA's programs.

In regards to the Food Stamp Program, FNS has a long history of identifying erroneous payments, as well as working with State Administering agencies to lower error rates.

What impact the recent legislative reforms will have on FNS' ability to continue to effect positive changes in State error rates will not be known for some time. We will continue to monitor this process. Also, both FNS and State Administering Agencies need to remain focused on using data available from EBT systems to target problem retailers and

ensure program integrity. The eligibility issues in the National School Lunch and Breakfast Programs are more complicated and we would encourage the Congress to work with FNS to find a solution that will minimize erroneous payments and yet not deter those eligible from receiving program benefits.

We believe the recent legislative initiatives for the farm and crop insurance programs, if effectively implemented, should have a positive impact on program administration and integrity. Key to effective implementation of this legislation is the development of common data reporting requirements (i.e., definitions for common pieces of land), which will facilitate more effective data reconciliation and data mining to detect improper payments.

Overall, I see the Department's challenge in implementing the 2002 Improper Payments Information Act as a critical action item in the identification and prevention of erroneous payments. For USDA to be successful in reducing erroneous payments in its spectrum of programs, there must be management commitment, inter-and intra-agency coordination, adequate information systems and quality control processes, and effective enforcement actions. Each of these areas is an interrelated element of an effective and efficient internal control system to reduce fraud, waste, and abuse.

Commitment is the driving force of any system of internal controls: management (and Congress) must be willing to commit the necessary resources to the task of preventing and detecting errors and irregularities. Internal controls should not be secondary

considerations or collateral duties. Program compliance and integrity must be impressed throughout the cultural climate as an integral part of program delivery.

In the last decade, Congress has done much to mandate and encourage a coordinated Departmental approach to program delivery. To create a seamless interagency team approach to program integrity, the Department must encourage individual agencies and employees to work across organizational lines to share information and coordinate compliance and data mining activities which may affect multiple programs, both inter- and intra-agency.

Integrated and collaborative information technology should also be a fundamental part of the Department's efforts to improve program compliance and integrity. Information technology is a means to pool the Department's limited resources to compare data throughout the Department and to identify and target anomalies for further analysis.

Finally, a system of internal controls does nothing to discourage or deter fraud, waste, and abuse unless participants and USDA employees are held accountable for errors and irregularities. The Department must work to ensure penalties are consistently and fully enforced across agency lines. We will continue working with the Department and its agencies to strengthen their programs and to identify areas where cost avoidance and savings can be achieved. This concludes my statement, Mr. Chairman. I would be happy to answer any questions that you may have.

UNITED STATES DEPARTMENT OF AGRICULTURE

MANDATORY PROGRAMS	2003 BUDGET (Dollars in Millions)
Cooperative Research, Education, and Extension Service	
Initiative for future agricultural and food systems	0
Animal and Plant Health Inspection Service	
Agricultural quarantine inspection	152
Agricultural Marketing Service	
Grading activities	120
Section 32	1,213
Perishable agricultural commodities activities	8
Marketing agreements and orders	15
Natural Resources Conservation Service	
Watershed rehabilitation program	0
Wetlands reserve program	273
Conservation security program	4
Farmland protection program	72
Grassland reserve program	70
Environmental quality incentives program	599
Ground and surface water conservation program	54
Wildlife habitat incentives program	21
Biomass research and development	14
Farm Service Agency	
Conservation reserve program	1,883
Dairy indemnity program	0
Commodity Credit Corporation	18,749
Direct payments	
Counter-cyclical payments	
Nonrecourse marketing assistance loans	
Loan deficiency payments	
Payment in lieu of deficiency payments for grazed acreage	
Peanut programs	
Milk price support programs	
National dairy market loss payments	
Sugar program	
Sugar storage facility loan program	
Noninsured crop assistance program	
Disposal of surplus commodities	

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MANDATORY PROGRAMS	2003 BUDGET (Dollars in Millions)
Bioenergy program	
Disaster related activities:	
Assistance for livestock producers	
Market loss assistance for apple producers	
Market loss assistance for onion producers	
Commercial fisheries failure	
Tree assistance program	
Risk Management Agency	
Crop insurance program	3,082
Foreign Agricultural Service	
Export credit guarantees	4,225
Short-term guarantees (GSM-102)	
Intermediate-term guarantees (GSM-103)	
Supplier credit guarantees	
Facilities financing guarantees	
Market development programs	
Market access program	110
Foreign market development cooperator program	35
Technical assistance for specialty crops program	2
Export subsidy programs	
Export enhancement program	28
Dairy export incentive program	36
Bill Emerson humanitarian trust	
International food for education program	100
Rural Development	
Rural community advancement program	0
National Sheep Industry Improvement Center	1
Rural strategic investment program	0
Rural Housing Service	
Rural firefighters and emergency personnel grant program	0
Rural Utilities Service	
Rural broadband access	20
Rural Business-Cooperative Service	
Value-added agricultural product market development grants	40
Renewable energy systems and energy efficiency improvements	23

UNITED STATES DEPARTMENT OF AGRICULTURE

MANDATORY PROGRAMS	2003 BUDGET (Dollars in Millions)
Rural business investment program	0
Food and Nutrition Service	
Food stamp program	26,233
Employment and training program	
Consolidated block grant for Puerto Rico and American Samoa	
Food distribution on Indian reservations	
Community food projects	
Child nutrition programs	10,573
School lunch program	
School breakfast program	
Child and adult care food program	
Summer food service program	
State administrative expenses	
Nutrition education and training	
Special milk program	
WIC farmers' market program	0
Senior farmers market program	15
Forest Service	
Forest land enhancement program	20
Departmental direction and administration	
Biodiesel fuel education program	2
Total Mandatory Programs	67,792
USDA Total Program Level (2003 Estimate)	106,694
USDA Mandatory Programs as a Percent of USDA Total Programs	63.54%