

GAO

Testimony

Before the Subcommittee on Department Operations,
Nutrition, and Foreign Agriculture, Committee on
Agriculture, House of Representatives

For Release
on Delivery
Expected at
10:00 a.m. EST
Thursday
October 30, 1997

FOOD ASSISTANCE

Reducing Food Stamp Benefit Overpayments and Trafficking

Statement of Robert A. Robinson, Director
Food and Agriculture Issues,
Resources, Community, and Economic
Development Division



Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss our work on fraud, waste, and abuse in the U.S. Department of Agriculture's (USDA) Food Stamp Program. The program is one of the nation's largest welfare programs and the largest single program administered by USDA. In fiscal year 1997, about \$21 billion in food stamps were provided to about 24 million recipients,¹ down slightly from recent years. Reviews by GAO, USDA's Office of Inspector General (OIG), and others have produced ample evidence that the system for delivering food stamps is vulnerable to, and is being victimized by, significant fraud, waste, and abuse.

Today, we will discuss fraud, waste, and abuse in the Food Stamp Program from three perspectives: (1) the nature and extent of the problem, (2) the roles and responsibilities of the major federal agencies involved in minimizing it, and (3) the potential of electronic benefits transfer (EBT)—a system of benefit delivery that replaces the traditional food stamp coupons with a debit card—to reduce it.

In summary, we found the following:

- Fraud, waste, and abuse in the Food Stamp Program takes two primary forms: (1) overpayments to food stamp recipients and (2) the use of food stamps to obtain cash or other non-food items—a process known as trafficking. According to USDA, in fiscal year 1996, the most current year for which data are available, about \$1.5 billion was paid out to individuals who either should not have received any food stamps at all or who received more than they were entitled to receive. These overpayments represented nearly 7 percent of the approximately \$22 billion in food stamps provided. Overpayments are caused by both inadvertent and intentional errors made by recipients and errors made by state caseworkers. In addition, program regulations specify that recipients use food stamps only to purchase food from authorized retailers. However, USDA has recently estimated that up to \$815 million in food stamps, approximately 4 percent of the food stamps issued, were traded for cash in fiscal year 1993 through retail stores participating in the program. Numerous retailers are caught each year paying food stamp recipients a discounted value of the stamps (for example, 70 cents on the dollar) and then redeeming the stamps at full face value from the government. There

¹For this testimony, food stamps refers to the benefits provided in the form of coupons or through electronic benefits transfer.

are no reliable data on the extent of trafficking that occurs before the food stamps are redeemed by an authorized retailer.

- USDA's Food and Consumer Service (FCS) administers the Food Stamp Program in partnership with the states. The states are responsible for the day-to-day operation of the program, including meeting with applicants and determining their eligibility and benefit levels. FCS provides nationwide criteria for determining eligibility for assistance and the amount of food stamps recipients are entitled to receive. It monitors the accuracy of state benefit determinations and operates a system of incentives and sanctions to encourage states to reduce the number of errors. FCS also approves retailers to participate in the program and monitors and investigates their activities to identify those potentially violating program regulations. The Department's OIG devotes a substantial share of its audit and investigative resources to identifying program irregularities, especially trafficking.
- EBT systems have the potential to reduce some aspects of the fraud, waste, and abuse in the Food Stamp Program but not others. By providing a clear "paper trail" of all food stamp transactions, EBT systems help reviewers identify trafficking activities and remove and/or prosecute retailers engaged in such activities. These systems also address problems associated with food stamp theft. Because EBT is a benefit delivery system, however, it cannot address the substantial problems associated with determining eligibility for food stamps or establishing benefit levels.

Nature and Extent of Fraud, Waste, and Abuse

The two main areas of fraud, waste, and abuse involve (1) overpayment of food stamp benefits and (2) trafficking.

Concerning the first area, overpayments occur when ineligible persons are provided food stamps and when eligible persons are provided more than they are entitled to receive. In 1996, for example, the states overpaid recipients an estimated \$1.5 billion—or 6.92 percent—of the approximately \$22 billion in food stamps issued. Overpayments occur for two reasons. First, recipients make errors, either inadvertent or intentional, in providing information to the state caseworker about the recipient household's size, income, assets, or other pertinent information needed to determine the household's eligibility and benefit level. Second, state caseworkers make errors in determining either an applicant's eligibility for food stamps or the appropriate level of benefits. According to 1996 data, recipient errors accounted for 57 percent of the overpayments—36 percent were unintentional errors and 21 percent were intentional. The remaining 43 percent of the overpayments were caused by caseworkers' errors. It should be noted that errors by participants and

caseworkers can also result in underpayments. FCS' data show that food stamp recipients were underpaid approximately \$518 million in fiscal year 1996.

In March 1997, we reported on one specific example of food stamp overpayments—payments involving violations of the federal regulations that prohibit inmates of correctional institutions from participating in the Food Stamp Program.² By matching automated food stamp and prison records in four states—California, Florida, New York, and Texas—we identified over 12,000 inmates who were included in the households receiving food stamps in fiscal year 1995. These households improperly collected an estimated \$3.5 million in food stamps. Subsequently, in August 1997, the Balanced Budget Act of 1997 (P. L. 105-33, Aug. 5, 1997) included a provision directing the states to ensure that individuals who are under federal, state, or local detention for more than 30 days are not participating in the Food Stamp Program. In response to a request from the Senate Committee on Agriculture, Nutrition, and Forestry, we are currently examining the potential for computer matching to identify other ineligible populations participating in the program.

With respect to trafficking—the second main area of fraud, waste and abuse—program regulations specify that participants must use food stamps only to purchase food items from the retailers authorized by FCS to accept food stamps. Once they receive them, authorized retailers are required to forward food stamps directly to financial institutions for redemption. However, numerous federal and state officials told us that food stamps have essentially become a second currency exchanged by some recipients for cash or non-food items. Trafficked food stamps may change hands several times, but all food stamps must eventually flow through an authorized retailer because only such a retailer can redeem food stamps for cash from the government. Numerous retailers are caught each year accepting food stamps from recipients, giving them a discounted value of the stamps in cash (for example, 70 cents on the dollar), and then redeeming the stamps at full face value from the government.

Data on the extent of trafficking between parties prior to reaching authorized retailers are unavailable. However, a 1995 FCS study³ estimated that up to \$815 million, or about 4 percent of the food stamps issued, was

²Food Stamps: Substantial Overpayments Result From Prisoners Counted as Household Members (GAO/RCED-97-54, Mar. 10, 1997).

³The Extent of Trafficking in the Food Stamp Program, U.S. Department of Agriculture, Food and Consumer Service, Aug. 19, 1995.

exchanged for cash by authorized retailers during fiscal year 1993. The study found that supermarkets, where over three-fourths of all food stamps are redeemed, have low trafficking rates compared with other types of retailers. The trafficking rate reported for publicly owned supermarkets (i.e., a company whose stock trades publicly) was less than 0.1 percent of food stamp redemptions, and the rate reported for privately owned supermarkets was 2.6 percent. By comparison, the trafficking rate for small, privately owned food retailers and privately owned retailers that do not stock a full line of food was 15.1 percent of the food stamps they redeemed.

Roles and Responsibilities of the Federal Agencies in Minimizing Fraud, Waste, and Abuse

The Food Stamp Program is administered by USDA's FCS in partnership with the states. FCS provides nationwide criteria for determining who is eligible for assistance and the amount of benefits recipients are entitled to receive. The states are responsible for the day-to-day operation of the program, including meeting with applicants and determining their eligibility and benefit levels. In making these decisions, state caseworkers rely on documentation provided by households and information obtained in interviews with the applicants. FCS is also responsible for authorizing retailers to redeem food stamps as well as for monitoring program compliance by the approximately 190,000 stores currently authorized to redeem food stamps. FCS and USDA's OIG are responsible for investigating retailers suspected of violating program regulations. The OIG performs all the criminal investigations of the Food Stamp Program conducted by USDA and coordinates investigative activities with other federal agencies. Others—such as the Federal Bureau of Investigation (FBI), the U.S. Postal Service, and the U.S. Secret Service—as well as the states assist in combatting fraud.

The Food Stamp Program's Quality Control (QC) System is FCS' primary tool for evaluating the states' performance in issuing benefits and determining the level of overpayments. Under the QC System, the states must review a sample of their household cases each year to determine the accuracy of the eligibility and benefit determinations made by state caseworkers and the extent of payment errors—both overpayments and underpayments. FCS reviews a subsample of each state's sample to ensure the accuracy of the states' efforts. FCS then determines the official error rate for each state and a national error rate. If an individual state's error rate exceeds the national error rate, FCS can sanction the state by requiring it to reimburse the federal government for a portion of the erroneous payments. On the other hand, states that have low error rates are eligible

for additional reimbursement from the federal government—referred to as enhanced funding.

According to USDA's data, overpayments in the Food Stamp Program have declined since 1993. At the national level, the overpayment error rate has decreased from 8.27 percent in fiscal year 1993 to 6.92 percent in fiscal year 1996. The 1996 overpayment error rate is the lowest level ever achieved in the program. Since 1995, FCS has increased its emphasis on achieving payment accuracy and has employed various initiatives to assist the states in reducing the number of errors. The Congress appropriated over \$3 million for these initiatives. Specifically, FCS' activities include sponsoring national, regional, and state conferences; providing direct technical assistance to the states; and facilitating the exchange of state information on effective strategies for determining accurate payments. As we reported in 1995,⁴ while technical assistance and related steps are undoubtedly useful, the single most critical factor in reducing overpayments is the commitment of the managers of the states' Food Stamp Programs to aggressively address the error rate problem.

Supplementing its efforts to help the states reduce errors, FCS has implemented a new strategy for conducting its sanction activities. Historically, for a variety of reasons, the states with high error rates paid little of the sanction penalties FCS imposed. Beginning in 1996, FCS reached agreement with some of these states regarding more than \$404 million in penalties owed for unacceptable error rates that occurred in fiscal years 1992 through 1996. FCS agreed to reduce this penalty to \$135 million and entered into settlement agreements with these states that establish performance goals tied to payment accuracy. Of the \$135 million sanction liability, the states are required to invest almost \$35 million in activities that directly lead to the reduction of their error rates. If a state meets its performance goals as set out in the agreement, its share of the remaining \$100 million liability will be waived. According to FCS, as a result of these settlements, the states are more actively engaged in activities to reduce errors, which should continue to have a positive effect on improving payment accuracy.

With respect to trafficking, our 1995 report stated that FCS' controls and procedures for authorizing and monitoring the retailers that participate in the Food Stamp Program did not deter or prevent retailers from trafficking in food stamps. Stores that did not meet eligibility criteria were being

⁴Food Assistance: Reducing Food Stamp Benefit Overpayments and Trafficking (GAO/RCED-95-198, June 23, 1995).

admitted to the program because the process for authorizing them was flawed. The single most effective deterrent to preventing ineligible retailers from being authorized is a preauthorization on-site visit. However, because of insufficient time or resources, FCS made few visits before authorizing stores to participate in the program. Furthermore, FCS' monitoring process was inadequate to detect authorized retailers that were violating program regulations. Reports on retailers' activities, such as total food sales and food stamp redemptions, were often untimely or inaccurate and of limited utility in identifying retailers' trafficking. In addition, we reported that FCS had only 46 investigators nationwide to conduct investigations of retailers suspected of trafficking or violating other program regulations.

Since our report, FCS has initiated several actions to reduce trafficking in the program. For example, FCS has contracted with a number of different companies to make 35,000 to 40,000 store visits by the end of fiscal year 1998. These visits will be made primarily to new stores requesting approval to participate in the program and to stores requesting reauthorization to participate in the program. In addition, FCS reports that it has improved its Store Tracking and Redemption System by, for example, developing a profile that enables FCS to better identify stores that may be trafficking in food stamps or selling ineligible items. The system also includes information on sanctions taken against the stores that violate program regulations. The system is used to screen all new applications for participation in the program in order to keep ineligible retailers from returning to the program during a period in which they are disqualified. The system is also used to monitor stores' redemptions and to identify retailers for investigation or other administrative actions. For the states using EBT systems, FCS has developed an automated system that identifies transaction patterns in EBT data that indicate trafficking violations.

In addition to FCS' oversight activities, USDA's OIG investigates retailers that illegally use food stamp benefits and coordinates its investigative activities with other federal and state agencies. For example, the OIG is currently looking at food stamp trafficking with state and local agencies in about 30 locations nationwide. The OIG has also taken an active role in monitoring and reviewing EBT systems and developing the automated system to analyze EBT data to identify fraud in the Food Stamp Program.

Outside of USDA, a number of federal investigative agencies also play a role in the process. For example, the FBI investigates criminal violations of USDA programs if the violation has involved bribery, organized crime, or

major fraud perpetrated by federal employees. The FBI focuses its investigations on links between food stamp trafficking and other criminal activities under the Bureau's jurisdiction, such as narcotics, terrorism, and white-collar crime. The U.S. Postal Inspection Service has primary responsibility for enforcing laws concerning property in the custody of the U.S. Postal Service. The Postal Inspection Service's main investigative focus for the Food Stamp Program is the theft of food stamps and EBT cards from the Postal Service's custody prior to receipt by the food stamp recipient. Finally, the U.S. Secret Service investigates food stamp counterfeiting and makes recommendations on security measures relating to EBT cards.

States are responsible for investigating and prosecuting individuals suspected of falsifying information in order to obtain food stamps and misusing their food stamps—such as selling their stamps for cash. States sometimes work with FCS or USDA's OIG to investigate retailers' fraud and abuse in the program. In an effort to supplement federal efforts to investigate retailers, FCS has used State Law Enforcement Bureau agreements. Under these agreements, FCS provides the states with food stamp coupons to use in conducting their own trafficking investigations. FCS has established agreements with 32 states, but only 10 states have conducted sustained efforts against food stamp trafficking.

Observations on the Use of Electronic Benefits Transfer Systems

Food stamp benefits have historically been distributed in the form of printed coupons. In Reading, Pennsylvania, in 1984, however, FCS piloted the use of an alternative delivery system—EBT. Since this pilot, there has been increasing interest in moving to EBT systems. Under such systems, recipients receive plastic debit cards to obtain their food stamps and pay for purchases through point-of-sale terminals installed at check-out counters in food stores. At the time of the purchase, recipients enter a personal identification number. The EBT computer then verifies that sufficient funds exist in the recipient's food stamp account, debits the purchase amount from the recipient's account, and credits it to the retailer's account. At the end of each business day, the authorized sales are totaled and funds are transferred electronically to the retailer's bank account. Currently, 11 states have implemented EBT systems statewide. Eight of these states deliver multiple program benefits with their EBT system, including other federal and state programs. Additionally, 16 states use EBT systems in selected counties. All the remaining states are in the process of implementing EBT systems. Collectively, EBT systems supply almost 20 percent of all food stamps.

By eliminating paper coupons that may be lost, sold without any record of the sale, or stolen, EBT systems can help cut back on food stamp fraud. EBT systems reduce the likelihood of benefit theft. Of most importance, however, EBT systems create an electronic record of each food stamp transaction, making it easier to identify and document instances where food stamp benefits are trafficked. EBT data include the following information on each transaction: the exact time of day, the amount, the recipient's identity, the store's identity, and the specific cash register in the store. Reviewers can use these data to identify suspicious transactions or transaction patterns. Since 1991, USDA's OIG has opened 234 cases involving food stamp trafficking as a result of analyzing EBT data. The stores involved in these cases redeemed over \$70 million in EBT food stamps, of which the OIG identified over \$27 million as being fraudulent.

The August 1996 Welfare Reform Act explicitly states that EBT data alone can be used as evidence to take action against retailers violating the Food Stamp Act. As a result, FCS can now use EBT data to levy administrative sanctions against retailers caught trafficking, such as permanently barring them from the program and imposing fiscal penalties, without the expense of criminal investigation and prosecution. The legislation also mandated nationwide implementation of EBT systems by October 1, 2002.

While EBT systems make a major contribution to reducing certain aspects of food stamp fraud, they will not eliminate all fraud. Even in states where EBT systems have been implemented statewide, trafficking is still occurring. In such cases, a store owner accepts a card, gives the recipient a discounted value of the benefits in the recipient's account in cash, then claims the full value of the benefits from the government. Furthermore, because EBT systems are simply another vehicle for distributing benefits, they cannot correct fraud, waste, and abuse that occurs during the process of determining eligibility and benefit levels. Unless better ways are found to verify applicant-supplied information and to avoid errors made by state caseworkers, individuals will continue to receive benefits to which they are not entitled, regardless of whether these benefits are distributed by coupon or EBT systems.

In addition, moving to EBT systems is not without costs. Substantial investments must be made in computer systems, point-of-sale terminals, and other hardware. FCS reported that initially EBT systems were more expensive to operate than conventional coupon systems. More recent estimates suggest that EBT systems have become more cost competitive.

EBT costs are expected to continue to diminish as the technology becomes more widely used.

In any event, however, as we reported in 1994⁵ and continue to believe today, EBT systems will likely be most cost effective if they are used to deliver food stamps in conjunction with other federal and state assistance programs such as Temporary Assistance to Needy Families and the Special Supplemental Nutrition Program for Women, Infants and Children. In this way, overhead costs can be spread across a larger program volume and serve the purposes of multiple programs.

Thank you again for the opportunity to appear before you today. We would be pleased to answer any questions you may have.

⁵Food Assistance: Potential Impacts of Alternative Systems for Delivering Food Stamp Program Benefits ([GAO/RCED-95-13](#), Dec. 16, 1994).

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

**U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013**

or visit:

**Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC**

**Orders may also be placed by calling (202) 512-6000
or by using fax number (202) 512-6061, or TDD (202) 512-2537.**

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested
