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FOOD ASSISTANCE

Potential Impacts of Alternative Systems for Delivering Food Stamp Program Benefits





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General Accounting Office
Washington, D.C. 20548

**Resources, Community, and
Economic Development Division**

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Congressional Committees

This report responds to your request for information on fraud, waste, and abuse in the Food Stamp Program and the potential of two alternative benefit delivery systems—electronic benefits transfer and cash-out—to reduce fraud, waste, and abuse in the current coupon-based Program. This report also examines the impact that these alternatives would have on (1) the costs of administering the Program, (2) the number of participants in the Program, and (3) the assurance that benefits are used to purchase food. A separate, more detailed report on the fraud, waste, and abuse that occurs during the process for determining applicants' eligibility and benefits, together with a more detailed examination of the processes used to approve and monitor retail stores allowed to redeem food stamps, will be provided early next year.

As arranged with your offices, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the appropriate House and Senate committees and subcommittees; interested Members of Congress; the Secretaries of Agriculture and the Treasury; the Director of the U.S. Secret Service; the Postmaster General; the Director, Office of Management and Budget; and other interested parties. We will make copies available to others upon request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who can be reached at (202) 512-5138 if you or your staff have any questions. Major contributors to this report are listed in appendix VII.

Sincerely yours,

A handwritten signature in black ink, reading "Keith O. Fultz". The signature is stylized with a large, flowing "K" and a prominent "F".

Keith O. Fultz
Assistant Comptroller General

B-256367

List of Committees

The Honorable Patrick J. Leahy
Chairman

The Honorable Richard G. Lugar
Ranking Minority Member
Committee on Agriculture, Nutrition
and Forestry
United States Senate

The Honorable E (Kika) de la Garza
Chairman

The Honorable Pat Roberts
Ranking Minority Member
Committee on Agriculture
House of Representatives

Executive Summary

Purpose

The Food Stamp Program is one of the nation's largest welfare programs, currently providing benefits to about 1 out of every 10 Americans. In fiscal year 1993, federal costs for the Program were almost \$24.8 billion. Because of the Program's rising cost and vulnerability to fraud, waste, and abuse, the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition and Forestry asked GAO to examine two alternatives to the current coupon-based system for delivering benefits—(1) the use of electronic fund transfer technologies, referred to as electronic benefits transfer, and (2) the distribution of benefits by check, referred to as cash-out. GAO was also asked to examine the effects that these alternatives might have on the Program's administrative costs, the number of participants in the Program, and the assurance that benefits are actually used for food.

Background

The Program is administered by the U.S. Department of Agriculture's (USDA) Food and Consumer Service (FCS) in partnership with the states. FCS provides nationwide criteria for determining who is eligible for assistance and how much in benefits each participant is entitled to receive. The states are responsible for the day-to-day administration of the Program at the local levels. The federal government pays all of the costs of providing benefits and shares with the states in the costs of administering the Program.

GAO's review focused on FCS-sponsored electronic benefits transfer and cash-out demonstration projects. In analyzing fraud, waste, and abuse, GAO focused on the (1) overpayments that occur during the eligibility and benefit determination process, (2) illegal use of benefits after they are issued, (3) counterfeiting of food stamps, and (4) theft of coupons from the mail.

Results in Brief

Both the electronic benefits transfer and cash-out alternatives can reduce certain types of fraud, waste, and abuse that occur in the currently used coupon system for delivering benefits, but the reductions possible under the two alternatives have not been quantified under FCS' demonstration projects. Neither alternative will reduce the overpayment of benefits—which was about \$1.8 billion in 1993—that occurs from fraud, waste, and abuse in the process for determining eligibility and benefits. Administratively, cash-out is the least expensive of the three systems for delivering benefits. Whether electronic benefits transfer will be less expensive to administer than the coupon system is unclear on the basis of

demonstrations to date. Also, the popularly held assumption that electronic benefits transfer and cash-out will increase participation in the Program has not been substantiated in the demonstrations. With regard to the Program's objective of ensuring that benefits are actually used to purchase food, the electronic benefits transfer system appears superior to both the coupon and cash-out systems.

Currently, momentum is building to implement a new federal electronic benefits delivery system that would provide government benefits and payments for a host of federal and state programs. In GAO's opinion, the future value and utility of electronic benefits transfer are in the larger arena of a multi-program benefit delivery mechanism instead of in a system for delivering food assistance benefits alone.

GAO Analysis

Electronic Benefits Transfer and Cash-Out Can Reduce but Not Eliminate Fraud, Waste, and Abuse

There is ample evidence that the current coupon-based Program is vulnerable to fraud, waste, and abuse; however, it is not possible to determine precisely how much is lost each year as a result. FCS' estimates show that for the 6-year period covering fiscal years 1988-93, \$7.44 billion in benefits was issued to ineligible households and to households who received more benefits than they should have. About \$1.78 billion, or 24 percent of the overissued benefits, was given to individuals who intentionally provided inaccurate information when seeking benefits. The remaining \$5.66 billion in overpayments occurred because of recipients' unintentional errors in providing eligibility information or state agency caseworkers' errors in determining applicants' eligibility and benefit levels. GAO's review of electronic benefits transfer and cash-out projects found that the process for determining applicants' eligibility and benefits was the same as that used in the coupon-based system. Thus, overpayments due to fraudulent, abusive, or wasteful behaviors in this part of the Program will likely continue under electronic benefits transfer or cash-out.

Available law enforcement evidence indicates that a considerable number of the food stamps issued each year are sold or traded for illegal items—referred to as trafficking—thereby diverting food assistance benefits from their intended use. Because of the nature of this misuse, there is no practical way to precisely estimate the dollar value of trafficked

food stamps. Pronouncements that about 10 percent of food stamp benefits—about \$2 billion—are used illegally each year have been widely reported in the media, but GAO could not find evidence to corroborate this estimate. Under the electronic benefits transfer alternative, the need for a debit card and a personal identification number to gain access to benefits makes the redemption of trafficked or stolen benefits more difficult and should reduce this type of fraud and abuse. But such reductions have yet to be quantitatively demonstrated. In fact, trafficking continues to occur at electronic benefits transfer demonstration projects. Cash-out eliminates trafficking altogether, since participants are given cash instead of coupons, but there is no guarantee that recipients will not abuse the Program by using their benefits for nonfood purchases. It should be noted that trafficking does not directly affect the costs of providing benefits because illegally used coupons are redeemed only for their face value by the U.S. Treasury. But efforts to combat trafficking do affect the Program's administrative costs, which can be extensive.

Although losses to the Program due to the counterfeiting of food stamp coupons and mail theft are not significant, electronic benefits transfer and cash-out could significantly reduce the fraud and abuse that occur when food stamps are stolen from the mail and used by unauthorized persons.

Cash-Out Reduces Administrative Costs

Three of the cash-out demonstrations compared the administrative costs of providing benefits under cash-out with those under the coupon system and found that administrative costs were reduced for all three demonstrations. Although not projectable nationwide, GAO's analysis of the projects' reports shows that reductions in federal and state administrative costs at the three cash-out projects ranged from 31 to 62 percent. The cost savings were primarily attributable to eliminating the need to print, control, and manage coupons. The cash-out option would also eliminate millions of dollars spent each year in authorizing and monitoring retail stores participating in the Program and in investigating food stamp trafficking. The administrative costs of electronic benefits transfer, however, remain unclear. GAO found that when the system's startup costs are considered, the costs of delivering benefits at three of the five electronic benefits transfer projects exceeded the costs of the coupon-based systems they replaced.

Complicating the electronic benefits transfer cost equation is the Federal Reserve Board's February 28, 1994, rule that electronic benefits transfer users should be afforded the same consumer protection for lost or stolen

benefit cards as is provided to bank card users. This rule could shift the responsibility for participants' losses of benefits exceeding \$50 from participants to the states. Consequently, millions of dollars could be added to states' costs once the rule becomes mandatory on March 1, 1997.

Participation in the Program Has Not Increased Under Alternatives

A large number of people are eligible for food stamps but do not apply for benefits. Some believe that if food stamp coupons are replaced with another benefit delivery system, more eligible people will apply for benefits, which would lead to an increase in the Program's benefit costs. Although this may be a popular assumption, GAO found no evidence that participation in the Program increased because of electronic benefits transfer or cash-out.

Electronic Benefits Transfer Is Best for Ensuring That Benefits Are Used for Food

Electronic benefits transfer increases the likelihood that participants will actually use food assistance benefits to purchase food when compared with the coupon system. This is because electronic benefits transfer requires a personal identification number and a debit card to use one's benefits, thus making the redemption of stolen or trafficked benefits more difficult. Also, electronic benefits transfer allows for deducting the exact amount of the food purchases from benefits, thereby eliminating the need to provide participants with cash change (of up to 99 cents) under the coupon system, which could be used for nonfood purposes. However, evidence does not precisely measure the impact on this goal of the Program. Cashing-out food stamp benefits completely severs the link between benefits and food purchases and is likely to result in a decrease in the amount of benefits that participants spend on food. Reductions in food expenditures were noted at three of the four cash-out demonstrations. However, because of the wide variation in reductions at the three projects, the precise impact is difficult to quantify.

Momentum for Electronic Benefits Transfer Is Growing

Nine states now operate electronic benefits transfer projects or systems, and over 25 other states have electronic benefits transfer activities under way. Those involved in these demonstrations—financial institutions, food retailers, and recipients—prefer this system over coupons. In May 1994, the Federal Electronic Benefits Transfer Task Force issued its plan for a nationwide electronic benefits transfer system for delivering not only food stamp benefits but also other direct federal and state cash benefits. The report assumes a sharing of implementation costs between the government and the private sector and estimates the federal share to be

about \$83 million. Once implemented, the Task Force projects annual federal savings of \$195 million.

GAO's February 2, 1994, testimony presented to the Senate Committee on Agriculture, Nutrition and Forestry concluded that if electronic benefits transfer systems are implemented solely to distribute food program benefits, they could be more costly than the current coupon-based system. GAO further stated, and continues to believe, that the greatest utility and value for electronic benefits transfer is in an expanded system that provides for the delivery of multiple government program benefits.

Recommendations

This report contains no recommendations.

Agency Comments

USDA, in written comments, asked that GAO clarify the treatment of several issues in the report. Specifically, USDA asked that GAO make it clear that (1) there is no evidence to corroborate the estimates of food stamp trafficking, (2) neither the electronic benefits transfer nor the cash-out alternative will reduce errors in the overpayment of benefits, (3) cash-out will not ensure that benefits are used for food, and (4) cost-effectiveness was not an objective of early electronic benefits transfer demonstrations. Also, USDA provided information on its recent initiatives to reduce the overpayment of benefits. GAO used this additional information to clarify the report where appropriate and update its information. The U.S. Secret Service, in written comments, and the U.S. Postal Service, in oral comments, generally agreed with GAO's analysis and conclusions.

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Abbreviations

AFDC	Aid to Families with Dependent Children
ASSETS	Alabama Avenues to Self-Sufficiency through Employment and Training Services
EBT	electronic benefits transfer
FCS	Food and Consumer Service
FIP	Family Independence Program
GAO	General Accounting Office
OIG	Office of Inspector General
OTA	Office of Technology Assessment
PIN	personal identification number
POS	point-of-sale
SSI	Supplemental Security Income
USDA	U.S. Department of Agriculture

Introduction

The Food Stamp Program provides monthly benefits to millions of financially needy households who meet specific income, asset, and employment-related eligibility requirements.¹ With federal expenditures of \$24.8 billion and an average monthly caseload of 27 million individuals in fiscal year 1993, the Food Stamp Program ranks as one of the nation's largest social welfare programs and is by far the largest food assistance program.

Numerous reports have been issued on fraud, waste, and abuse in the Program since its beginning over 30 years ago. Fraud, waste, and abuse issues generally have centered on food stamp recipients who (1) receive benefits when they are not eligible, (2) receive more benefits than warranted, or (3) use their benefits for nonfood purchases. In recent years, concern has heightened regarding the vulnerabilities of the current coupon-based system of delivering benefits as well as the current system's efficiency and effectiveness. In recognition of these concerns, the U.S. Department of Agriculture's (USDA) Food and Consumer Service (FCS),² with congressional approval, and in cooperation with various states, has been testing and evaluating variations of two alternative systems for delivering benefits. The two alternatives focus on (1) the use of electronic fund transfer systems—referred to as electronic benefit transfer (EBT)—which use some form of debit card to deliver benefits and (2) the use of direct cash payments to recipients in the form of a check—referred to as “cash-out.”

Food Stamp Program's Administration

The Food Stamp Program is administered by FCS in partnership with state and local governments. Initiated as a pilot program in 1961 and made permanent in 1964, the initial goals of the Program were to boost needy families' food-purchasing power and assist the ailing agricultural economy. The goals of the Program have shifted over the years, however, and today the Program's primary goal is to increase low-income households' food-purchasing power and, by extension, the nutritional quality of their diets. At the same time, however, the goal of ensuring that benefits are used to purchase food—and only food—remains a basic tenet of the Program.

¹The basic food stamp beneficiary unit is the household. A food stamp household can either be an individual living alone or a group of individuals living together who customarily purchase food and prepare meals together. Unrelated co-residents and certain related co-residents may apply and be treated as separate households if they purchase food and prepare meals separately.

²Prior to USDA's October 1994 reorganization, the Food and Nutrition Service was the name of the USDA organization responsible for administering food assistance programs. As part of the reorganization, the Food and Nutrition Service was renamed the Food and Consumer Service.

The Program provides more assistance than all the other 13 USDA food assistance programs combined. Most of the people who benefit from food stamps are children or the elderly. In fiscal year 1992, the latest fiscal year for which complete data are available, 59 percent of those receiving food stamps were children under 18 and elderly participants age 60 or over. Furthermore, nearly 40 percent of the recipients' households had monthly incomes below 50 percent of the federal poverty standards, and 80 percent had no earned income.

Federal Role

The federal government funds all of the Program's benefits and shares with the states in the administrative costs of distributing benefits to eligible households. With regard to administrative expenses, the federal government pays all the costs for printing and distributing food stamp coupons to the states and for destroying the coupons after they are used. In addition, the federal government generally pays 50 percent of the costs incurred by states in administering the Program. These state costs include certifying households for eligibility, distributing benefits, and conducting quality control activities. In fiscal year 1993, the federal government spent \$1.8 billion on administration and oversight of the Program.

As part of its management responsibilities, FCS promulgates the Program's regulations and provides technical assistance to states. It also is responsible for oversight of the Program. In this regard, FCS monitors retailers that are authorized to redeem food stamp coupons to ensure that they comply with the Program's regulations. Retailers suspected of abusing the Program are referred to FCS' Compliance Branch for investigation. In addition to FCS' retailer-related oversight activities, USDA's Office of Inspector General (OIG) investigates individuals and retailers involved in misusing food stamp coupons. FCS has also established a Quality Control System to monitor the accuracy of states' and local authorities' data in determining the eligibility and benefit levels of the households applying for and receiving food stamps.

State Role

States have primary responsibility for the day-to-day administration of the Program. Generally, a state agency operates the Program either directly or by delegating these responsibilities to local governments, usually counties. Using nationwide eligibility criteria provided by FCS, state and local caseworkers evaluate each food stamp application to determine a household's eligibility and to ensure that the proper level of benefits is

authorized. Food stamp coupons are issued to recipients in person or by mail.

The states also share in responsibilities regarding the Program's integrity. Specifically, they are responsible for investigating and prosecuting individuals suspected of falsifying information on the number of people in their household or their economic situation to obtain food stamps. States often work with FCS or the OIG in investigating abuse in the Program.

Prior GAO and OIG Reports

In the past, we and the OIG have reported on fraud, waste, and abuse in the Program. Since 1977, we have completed over 50 reviews of the Food Stamp Program and recommended a number of corrective actions to reduce fraud, waste, and abuse. In 1977, we reported that the federal government was losing over half a billion dollars annually because of overissued food stamp benefits.³ Again in 1983 and 1986, we pointed out that waste and abuse in the Program was costing billions of dollars.⁴

The OIG has devoted even more time and resources to auditing and investigating the Program. Since 1979, the OIG has completed more than 440 audits of the Program and devoted a significant amount of investigative resources to fraud and abuse in the Program. According to the OIG, the Program is targeted for audits and investigations because of the large dollar amounts involved and the opportunities for waste and abuse at all points in the system. In fiscal year 1993, more than 40 percent of the OIG's audit and investigative efforts were devoted to the Program.

Objectives, Scope, and Methodology

The Chairmen and Ranking Minority Members of the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition and Forestry asked us to examine two possible alternative systems for delivering food stamp benefits—EBT and cash-out. Specifically, they asked us to assess whether these alternatives might reduce fraud, waste, and abuse in the Program. They also asked us to assess what effect the alternatives might have on the costs of administering the Program, participation in the Program, and the Program's goal of ensuring that food stamp benefits are actually used to purchase food.

³The Food Stamp Program: Overissued Benefits Not Recovered and Fraud Not Punished (CED-77-112, July 18, 1977).

⁴Need for Greater Efforts to Recover Cost of Food Stamps Obtained Through Error or Fraud (RCED-83-40, Feb. 4, 1983) and Benefit Overpayments: Recoveries Could Be Increased in the Food Stamp Program and AFDC Programs (GAO/RCED-86-17, Mar. 14, 1986).

In conducting our review, we first focused on the current coupon-based Program to develop a baseline by which we could compare the current Program with the two alternatives we were asked to evaluate. In pursuing this objective, we determined how the coupon-based Program operated and gathered information on the Program's administrative costs, participation in the Program, and the goals of the Program. To accomplish these tasks, we interviewed officials from USDA's FCS and OIG and seven state/local agencies responsible for operating the Food Stamp Program. The agencies visited were the Alabama Department of Human Resources; Maryland Department of Human Resources; Montgomery County (Dayton, Ohio) Department of Human Services; New Mexico Department of Human Services; Pennsylvania Department of Public Welfare; San Diego County, California, Department of Social Services; and Vermont Department of Social Welfare. These state agencies were selected because they were also involved in either EBT or cash-out demonstrations as a means of delivering food stamp benefits. We also reviewed pertinent documents and reports from the above-listed agencies as well as our own reports and reports from the Congressional Research Service to identify the strengths and weaknesses of the coupon-based system.

Next, we assessed the Program's vulnerability to fraud, waste, and abuse, and gathered information on the extent of fraud, waste, and abuse occurring in the Program. Our approach was to assess fraud, waste, and abuse in four basic areas: (1) the eligibility and benefit determination process, (2) the use of benefits for nonfood purposes, (3) the counterfeiting of food stamp coupons, and (4) the theft or loss of coupons in the mail. In making our assessment, we reviewed FCS' Financial Managers Financial Integrity Act reports for fiscal years 1990-93 and held discussions with FCS and state agency officials. We also reviewed prior GAO reports and reports by USDA's OIG concerning weaknesses in the coupon-based Program. In addition, to the extent possible, we gathered information on the time and expense that USDA and other federal agencies, such as the U.S. Secret Service and the U.S. Postal Inspection Service, spend on investigating fraud and abuse in the coupon-based Program.

We relied on data from FCS' Food Stamp Program Quality Control System to estimate the amount of fraud, waste, and abuse that occurs at the time that state or local government officials determine the eligibility of applicants and the benefits to which they are entitled. The Program's state and local officials are responsible for determining when a household provides fraudulent information during the eligibility and benefits determination process—or when other inadvertent errors in this process

lead to overpayments to applicants. These judgments are based on imprecise criteria, thus, there is room for differing conclusions by the countless number of officials in the Program across the nation. Because of this imprecision, FCS officials expressed questions about the reliability of the data for determining the specific amount of overpayments that can be attributed to fraud. While perhaps not perfect, these data are the most comprehensive available at the current time.

We were unable to accurately estimate the total amount of food stamp benefits that are traded for cash or other items by recipients or used for nonfood purchases—referred to as trafficking—because data necessary for making such an estimate were not available from FCS or the OIG. We did discuss the extent of food stamp trafficking with agents from the Secret Service, Postal Inspection Service, OIG, FCS' Compliance Branch, and state agencies.

Information on food stamp coupon counterfeiting was obtained from Secret Service officials, and information on the theft or loss of coupons in the U.S. mail was obtained from U.S. Postal Service officials.

Our second objective was to evaluate the EBT alternative against the current coupon-based system. In examining EBT as an alternative delivery method, we relied heavily on FCS contractors' evaluations of five USDA-approved EBT demonstration projects. These evaluation reports have certain statistical limitations that preclude making broad-based or nationwide projections from the results of the projects, but again they provide the best information currently available on EBT. We also visited four EBT demonstration projects located in Maryland, New Mexico, Ohio, and Pennsylvania and interviewed the state agency officials responsible for operating the projects. In addition, we interviewed an official from the Department of the Treasury's Financial Management Service and reviewed reports on EBT and electronic funds transfer.

We also obtained information on the Federal Reserve's Electronic Funds Transfer regulation (Regulation E), which has applicability to the EBT system for delivering food stamp benefits. Regulation E provides consumers with limited financial protection against the unauthorized use of their bank credit cards. We obtained the Federal Reserve Board's final rule that the EBT system will be subject to the provisions of Regulation E, some of the comments received on the proposed rule, and a report by a private contractor on the applicability and costs of applying Regulation E prepared for the Treasury Department. We also reviewed the Office of

Technology Assessment's report on the feasibility of delivering a range of social services with EBT and discussed the implications of using EBT with a principal analyst of the report. Finally, we reviewed the Federal Electronic Benefits Transfer Task Force's implementation plan for a nationwide EBT system that was done in response to a National Performance Review initiative.

Our third objective was to examine cash-out as an alternative to food stamp coupons. We again relied heavily on FCS contractors' evaluations of four demonstration projects—two in Alabama; one in San Diego, California; and one in Washington State. We visited officials of the two Alabama projects and the San Diego project. As with the EBT projects, because of their limited scope, nationwide projections cannot be made from the results of the cash-out demonstrations. Although they do not have cash-out demonstration projects, some states have been authorized to provide limited cash food assistance benefits in emergency situations and also to provide cash food assistance to persons aged 65 or older that receive Supplemental Security Income. As part of our review, we visited Vermont, which is one of these states, to obtain information on this type of cash-out program. Because these programs are limited to specific groups of individuals or specific types of situations, we did not consider these cash-out programs in our analysis. We also interviewed officials from FCS and the Treasury Department to obtain their views on the use of cash-out.

To obtain additional views on the EBT and cash-out alternatives, we interviewed members of, and obtained and reviewed documents from, several associations that have an interest in the Food Stamp Program. These associations include the National Association of Convenience Stores, the Food Marketing Institute, the National Grocers Association, and the American Public Welfare Association. Finally, in assessing the possible effects that cash-out or EBT might have on food stamp fraud, we interviewed officials from the Secret Service, Postal Inspection Service, USDA's OIG, and state and/or local law enforcement personnel from New Mexico, Ohio, and Pennsylvania.

We conducted our review from June 1993 through November 1994. Our work was performed in accordance with generally accepted government auditing standards. We obtained written agency comments from USDA and the U.S. Secret Service on a draft of this report which appear, with our evaluation, in appendixes V and VI, respectively. Oral comments were provided on the draft by the Postal Service.

The balance of this report is organized as follows. Chapter 2 discusses the current coupon-based system, chapter 3 discusses the EBT alternative in comparison to the current coupon-based system, chapter 4 discusses the cash-out alternative, and overall observations and conclusions on the three systems are presented in chapter 5. Finally, a detailed comparison of the three benefit delivery systems can be found in appendixes I-IV.

Food Stamp Program's Current Vulnerabilities, Costs, and Participation Levels

Fraud, waste, and abuse occur in the coupon-based Food Stamp Program in a number of ways, but the full extent of wrongdoing and wasteful practices cannot be precisely calculated. The overissuance of benefits alone resulting from fraudulent eligibility and benefit claims, applicants' inadvertent errors, and erroneous processing errors committed by state welfare case workers was estimated to be about \$1.8 billion in fiscal year 1993. In addition, a large, but unquantifiable amount of coupons was sold for cash or used for nonfood purchases by food stamp recipients. Additional losses occurred when coupons were stolen from the mail or counterfeited. Administrative costs for the Program are also substantial. The federal government and states are currently spending over \$2 billion each year to administer the Food Stamp Program, much of which is directed toward policing the Program.

Although the Food Stamp Program is one of the nation's most responsive welfare programs, currently serving about 1 out of every 10 Americans, an undetermined number of those eligible for benefits do not apply for assistance—some estimates suggest that millions are forgoing assistance.

The Coupon-Based System Is Vulnerable to Fraud, Waste, and Abuse

As indicated in chapter 1, fraud, waste, and abuse in the Food Stamp Program generally occur in four basic ways as follows:

- The Program's applicants receive benefits to which they are not entitled because of weaknesses in the eligibility and benefits determination process.
- Participants in the Program use benefits for nonfood purposes.
- Food stamp coupons are counterfeited and used by unauthorized individuals.
- Food stamp coupons are stolen in the mail and used by unauthorized individuals.

Each of these fraudulent, wasteful, or abusive practices is discussed below.

Weaknesses in the Eligibility and Benefit Determination Process Result in Billions of Dollars in Losses

To qualify for food stamps, applicants must meet certain eligibility requirements and provide proof of household income and family composition. States' food stamp officials evaluate each household's application to determine eligibility and to issue the proper level of benefits. Despite these precautions, significant overpayments occur when ineligible persons are provided benefits and when eligible persons are

provided more than they are entitled to receive. According to information from FCS' Food Stamp Program Quality Control System, during the 6-year period from fiscal year 1988 through fiscal year 1993, states made approximately \$7.4 billion in food stamp overpayments to the Program's recipients.

Why Overpayments Occur

Food Stamp Program overpayments related to the eligibility and benefit determination process result from (1) state agencies' errors, (2) inadvertent errors by recipients, and (3) intentional violations by recipients. A state agency error is an error made by a state agency's food stamp official while taking an application for food stamps from a potential participant or in determining the level of benefits for a participant. This usually occurs when the state official makes a mathematical error, does not correctly apply the regulations, or does not get the necessary information to make a correct determination. An inadvertent Program recipient error occurs when a recipient unintentionally provides incorrect information about his/her financial or family situation during the initial application process or after a client is in the Program. Inadvertent errors made by recipients in applying for food stamp benefits as well as errors made by state agency officials are not considered to be fraudulent or abusive behavior. However, they do result in a waste of benefits and, furthermore, increase the Program's costs.

An overissuance of food stamps that occurs because a recipient has intentionally provided inaccurate or incomplete information on the composition of the household or its economic situation is an intentional Program violation. Such a violation often means that a recipient has defrauded the Food Stamp Program. Investigations have disclosed elaborate schemes involving false documents, fictitious identities, and even fraud by state welfare system employees who create "ghost" recipients and pocket the benefits. However, when a recipient is suspected of intentionally violating the Program's regulations and rules, current law requires that due process must be followed, including an administrative disqualification hearing before the resulting overpayment is classified as fraud.

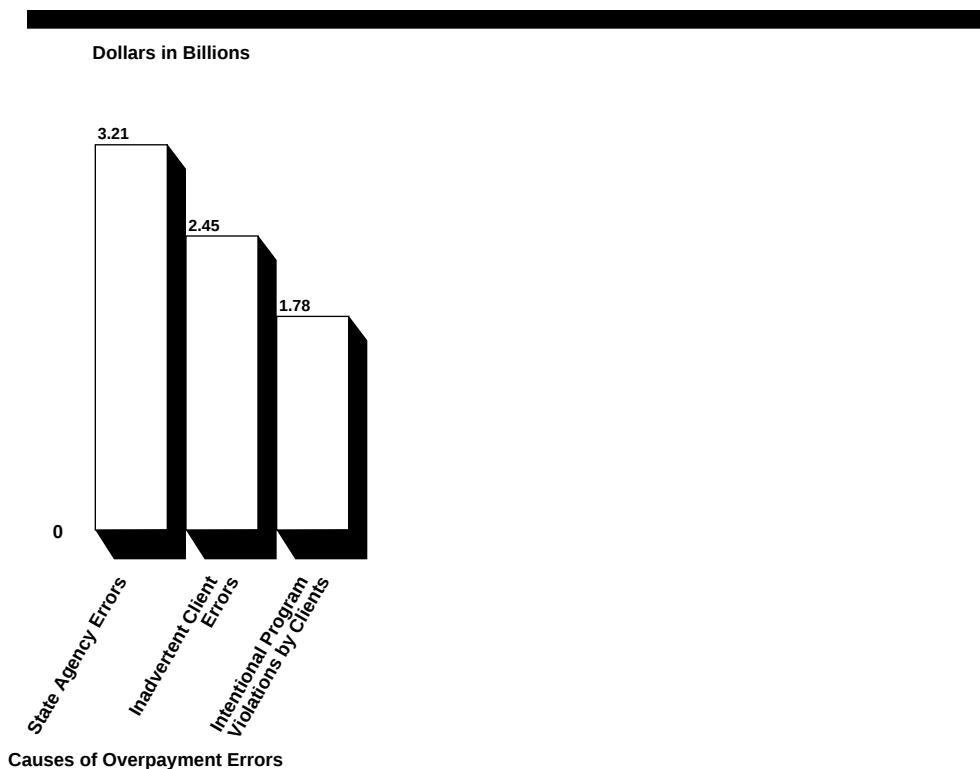
Losses Result From Overpayments

Through its Quality Control System, FCS monitors states' performance in determining applicants' eligibility and benefit levels for food stamp assistance. Under the Quality Control System, states are required to perform in-depth reviews of a sample of the eligibility and benefit determinations made by their case workers to test the accuracy of the determinations, which include both overpayments and underpayments to

recipients. The states' error rate findings are provided to FCS. FCS then reviews a sample of each state's subsample to ensure the quality of the states' efforts. After disagreements with the states' reported error rates are resolved, FCS determines the official error rate on the basis of a projection of the states' samples. If a state's error rate exceeds permissible tolerances, then the state is required to reimburse the federal government for a portion of the overpayments.

Our review of the Quality Control System's data for fiscal years 1988-93 shows that states made an estimated \$7.4 billion in food stamp overpayments during the 6-year period. FCS' Quality Control System also estimates the cause of the overpayments by the type of overpayment error. Figure 2.1 compares the amount of overpayments by cause category, namely, state agencies' errors, recipients' inadvertent errors, and recipients' intentional violations. As can be seen, state agencies' errors account for most of the overpayments—\$3.21 billion (43 percent). Intentional violations account for the least amount of overpayments—\$1.78 billion (24 percent).

Figure 2.1: Causes and Dollar Amounts of Food Stamp Program's Overpayments Estimated by FCS' Quality Control System, Fiscal Years 1988-1993



As discussed above, the overpayment estimates are based on projections of the Quality Control System's data and not on actual overpayments. In discussing these estimates with FCS officials, they believed that the Quality Control System's information is appropriate for estimating the amount of benefit overpayments that occur, but they have reservations about using the information to estimate the amount of overpayments because of the specific causes of overpayments discussed above. FCS officials cautioned us that making judgments on whether incorrect information provided by participants is intentional or unintentional is a subjective decision that is made by state or local officials. Because of the subjective nature of these decisions, the conclusions reached can vary widely among these officials.

In commenting on a draft of this report, FCS described recent actions being taken in an attempt to reduce overpayments. These actions include the following:

- Establishing a FCS headquarters core group to work exclusively on the development and coordination of issues relating to the accuracy of payments.
- Holding a national conference with the states to discuss the overpayment issue and to underscore FCS' commitment to reducing the overpayment of benefits. (The conference was held on Nov. 16-17, 1994, at which time, the FCS Administrator asked for at least a 1-percentage point reduction in the national overpayment error rate during the next year.)
- Committing \$1 million to error reduction activities.
- Taking a number of aggressive actions to encourage applicants to provide accurate information about household circumstances when applying for benefits.

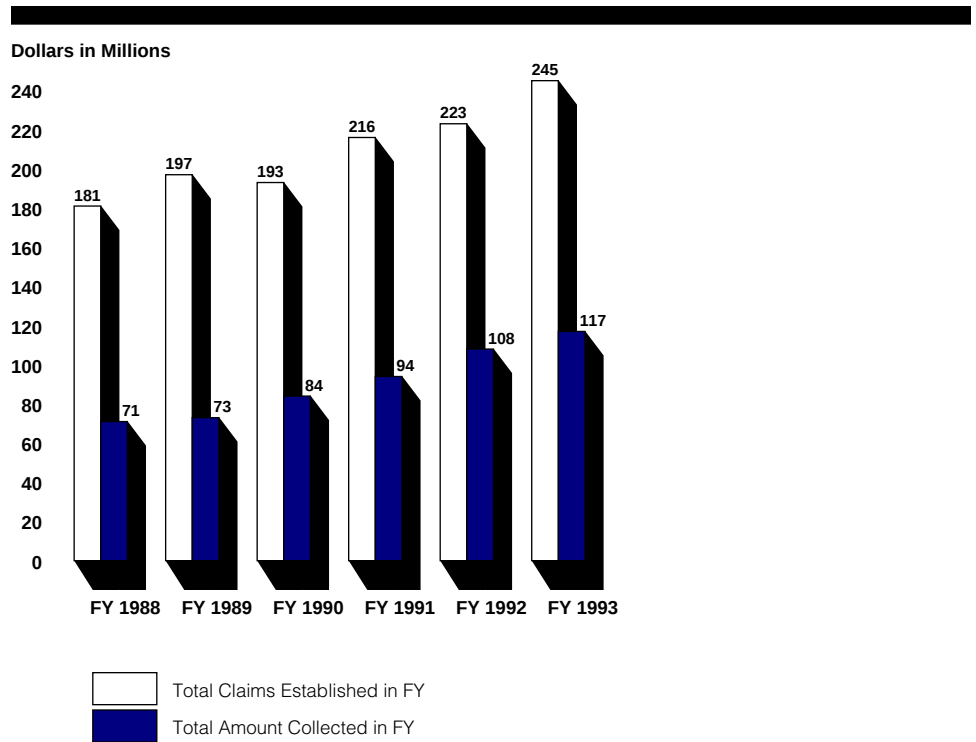
Claims Are Not Established for a Majority of Overpayments

FCS' regulations require states to establish a claim for all overpayments that they identify regardless of the cause. However, our analysis of states' claims data established for fiscal years 1988-93 shows that claims are established for only a small portion of the overpayments that are estimated by FCS' Quality Control System.

This is largely true because there is a wide disparity between FCS' overpayment estimates and actual overpayments identified by states as a by-product of normal day-to-day operations of the Program. States are able to identify and pursue only a small portion of the overpayment cases that is statistically estimated to occur. Consequently, projected overpayments substantially exceed the amount of claims established. For fiscal years 1988 through 1993, the states established approximately \$1.25 billion in claims out of the more than \$7.4 billion in food stamp benefit overpayments estimated by FCS to have been made.

The amount of claims actually collected by the states is lower still. For fiscal years 1988 through 1993, states collected about \$548 million in overpayments, about 44 percent of the dollar value in claims established during this time frame. Figure 2.2 compares the states' collections with all claims.

Figure 2.2: Overpayment Claims and Collections for the Food Stamp Program, Fiscal Years 1988-93



While we did not assess why states collect such a small percentage of overpayments, a separate GAO review is currently examining the state agencies' effectiveness in recovering overpayments for the Food Stamp Program and other social welfare programs. A separate report on the results of this review is expected to be issued early next year.

Program's Benefits Used for Nonfood Purchases

Regulations for the Program specify that participants must use food stamp benefits only to purchase food items from food store retailers authorized by FCS to accept food stamp coupons. Furthermore, food stamp retailers are to forward the coupons directly to financial institutions for redemption. In general, the sale or trading of food stamp coupons by food stamp recipients for nonfood items or cash is referred to as "trafficking." In some cases, food store retailers that accept food stamps will use the coupons as currency for their own purposes rather than redeem them at financial institutions. This illegal practice is also categorized as trafficking.

Federal and state officials involved in policing the Program told us that food stamp trafficking is widespread and involves a significant amount of food assistance benefits. Numerous federal and state officials also told us that food stamp coupons are essentially a second currency that is often openly traded on the streets. According to the OIG's Semiannual Report to Congress in fiscal year 1990 (the most recent information available on trafficking), FCS estimated that of the 220,000 food stores authorized to accept food stamp coupons, about 53,000 (24 percent) may be selling nonfood items for food stamps, and over 3,200 retailers may be exchanging food stamps for cash. That is, the recipient sells his/her coupons to the food store—instead of using them to purchase food—below the value of the food stamps. The retailer then redeems the coupons at a financial institution for full value, thereby making a profit on the transaction.

However, neither FCS nor the OIG has an accurate estimate of the amount of trafficking in food stamps. Estimates suggesting that food stamp trafficking may run as high as 10 percent of the benefits issued annually—about \$2 billion—have been widely reported in the media, but we were unable to corroborate this estimate with USDA or any other officials responsible for policing the Program.

FCS has identified the participation of authorized retailers in illegal transactions involving the exchange of food stamp coupons for cash, drugs, weapons, and other ineligible items as a high-risk area and a material weakness in its Federal Managers' Financial Integrity Act Report for fiscal years 1990 through 1993. Although FCS is undertaking numerous initiatives to establish controls over trafficking, FCS has concluded that it cannot completely eliminate this activity. Completed improvements include new procedures and policies to improve investigative efforts. Many of the planned actions to reduce trafficking are associated with using EBT technologies rather than coupons to provide benefits to recipients.

Precisely determining how much trafficking is occurring would be an extraordinarily difficult and expensive effort. Such an effort would require an army of investigators to track a nationwide sample of food stamp recipients for several months to determine how they used their coupons. Because of the resource requirements and expense to do so, we did not attempt to estimate the amount of trafficking that occurs in the Program.

Although not considered to be trafficking or an illegal activity, some participants use the cash change they receive when they make purchases with coupons to then buy nonfood items. Retailers are permitted to return up to 99 cents in cash change for a food stamp coupon purchase. Although the Program's regulations do not restrict recipients from using cash change, purchasing nonfood items with this cash change is considered a diversion of benefits from their intended purpose. FCS does not collect data on the amount of such diversion occurring in the Program. However, an FCS contractor's evaluation of EBT demonstration projects estimated that just over one-half of 1 percent of coupon benefits was diverted to nonfood purchases in the locations where the projects took place.¹ If this were the case across the Program, about \$123 million of the \$23 billion in food assistance benefits may have been diverted to nonfood items in fiscal year 1993 as a result of cash change nationwide.

Counterfeiting of Food Stamp Coupons Is Not a Major Threat

Based on available evidence, counterfeiting does not pose a major threat to the Program. According to the Secret Service, counterfeiting of food stamps is not a major problem because people with the skills necessary to be successful counterfeiters generally devote their energies to counterfeiting currency of higher denominations than food stamps, which have a maximum denomination of \$10. In 1993, the Secret Service investigated 96 food stamp counterfeiting cases. According to information from the Secret Service and Federal Reserve System, from October of 1986 through January of 1992, the total amount of counterfeited food stamp coupons was approximately \$1.2 million.

Some Food Stamps Are Stolen in the Mail

As with counterfeiting, the theft of food stamp coupons mailed out to participants does not appear to cause significant losses of benefits. For fiscal year 1993, almost \$6.3 billion in food stamps was issued through the mail. The states reported \$23.9 million in mail losses—or about 0.4 percent of the total value of stamps mailed to recipients. According to information provided to us by the U.S. Postal Inspection Service, the Service received 30,226 reports of food stamps that were lost or stolen in the mail in fiscal year 1993. The Postal Inspection Service initiated 79 separate criminal investigations in response to these reported losses.

Although not appearing to be a major problem, USDA's OIG recently issued a report showing that the systems of internal control used by state agencies

¹The Impacts of the State-Initiated EBT Demonstrations on the Food Stamp Program, Abt Associates, Inc., June 1993.

and contractors in distributing food stamps through the mail are generally not adequate to ensure the physical security of food stamps.² The control weaknesses include (1) inadequate physical security over food coupon inventories, (2) insecure methods used to transport envelopes containing food coupons to the Postal Service, and (3) inadequate controls over undeliverable coupons returned by mail to the Postal Service. The OIG did not find any actual cases of mail theft in its audit. The report did state, however, that part of the \$23.9 million in mail theft in fiscal year 1993 may have resulted because of the weaknesses noted in the OIG's report.

Federal Costs for Administering and Policing Food Stamp Program Exceed \$1 Billion

While FCS provides overall oversight of the Program, the day-to-day responsibility for administering it rests largely with the states. However, the federal government shares these state costs roughly on a 50-percent cost-sharing basis. In fiscal year 1993, the federal government spent nearly \$1.8 billion to administer the Program. As shown in table 2.1, most of these expenditures (about \$1.5 billion) involved federal reimbursements to the states. The remainder covered federal oversight costs, including the expenses of detecting and pursuing fraud, waste, and abuse.

Table 2.1: Federal Administrative Costs for the Food Stamp Program, Fiscal Year 1993

In millions	
USDA's costs	Cost
FCS' costs to administer program	
Oversight of program	\$58.0
Production and printing of food stamps	71.0
Monitoring of retailers	4.0
Other program costs	18.0
Reimbursement to states	
Administration of program	1,463.0
Employment and training efforts	167.0
Office of Inspector General	10.5
Other federal agencies	
Secret Service	0.5
Postal Service	1.6
Total federal costs	\$1,793.6

Of the \$1.8 billion in total federal cost, \$113 million, or 6 percent, was spent in combating fraud and abuse. Most of the federal policing costs (\$97 million) involved reimbursements of state costs to conduct antifraud

²Distribution of Food Coupons Through Direct Mail Issuance (OIG, No. 27600-0012, Mar. 1994).

investigations of recipients. Using this money, the states conducted over 543,000 investigations of individuals who were suspected of defrauding the Food Stamp Program. In addition, FCS' Compliance Branch spent \$4 million in monitoring and investigating retail food stores. The Compliance Branch investigated 4,644 food retailers in fiscal year 1993 and disqualified 842 of them.

USDA's OIG, the Postal Inspection Service, and the Secret Service are also involved in policing the Program. As shown in table 2.1, the OIG spent over \$10 million in fiscal year 1993 on audits and investigations of the Program. About 90 percent of the OIG's money, or \$9.4 million, was spent in investigating food stamp fraud and abuse—this represented more than 40 percent of the OIG's total investigative resources in fiscal year 1993. While the Postal Inspection Service and Secret Service do not spend nearly as much as the OIG, collectively, they spent over \$2 million in investigating food stamp fraud and abuse in fiscal year 1993.

All Who Are Eligible Do Not Apply for Food Stamps

The Food Stamp Program is very responsive to changes in the economy, and participation has expanded substantially in the past 2 years. Currently, the Program provides assistance to more than 1 in 10 Americans. The average monthly participation during fiscal year 1993 was 27 million—up 1.6 million from fiscal year 1992. Although the Program provides benefits to more people than any other food assistance program, there are still millions of persons eligible for food stamps that do not apply for benefits for various reasons.

The precise numbers of those eligible for food stamp benefits who do not participate in the Program are not available. However, an FCS study published in 1992 estimated that 60 percent of eligible households participate.³ By applying this participation rate to the actual number of participating households in fiscal year 1993, we calculated that approximately 7 million eligible households may not be participating in the Program.

According to a 1988 Congressional Budget Office report, certain demographic groups are more likely to participate in the Food Stamp Program than others.⁴ The report showed that eligible households with children had higher-than-average participation rates (between 59 percent

³Participation in the Food Stamp Program: A Multivariate Analysis, Mathematica Policy Research, Inc., Mar. 1992.

⁴The Food Stamp Program: Eligibility and Participation, Congressional Budget Office, Nov. 1988.

and 81 percent). In contrast, participation rates for households with elderly members were lower, at 34 to 44 percent. Households without children or elderly members had still lower participation rates. Participation rates for this group ranged from 24 to 39 percent.

Another study we reviewed discussed the impediments to participation in one state.⁵ On the basis of this study, all eligible persons do not obtain food stamps for several reasons. The barriers to participation include

- the Program's complex rules and the sheer volume of rule and procedural changes that "force clients through hoops" and make administration difficult,
- the lack of information about the Program, and
- negative public attitudes toward food stamp users.

⁵The Food Stamp Program in Minnesota, *Barriers to Participation and Outreach Strategies*, Minnesota Food Education and Resource Center, Apr. 5, 1994.

The Benefits of EBT as an Alternative to Food Stamp Coupons Are Not Clearly Established

EBT has certain advantages as an alternative to the coupon-based system, but it will not eliminate fraud, waste, and abuse in the Food Stamp Program. Although EBT has the potential to reduce some forms of fraud, waste, and abuse, demonstrations to date suggest that problems are continuing. For example, like all other issuance systems, EBT will have no effect on the errors committed during the eligibility and benefits determination process. One major antifraud advantage of EBT is that it allows FCS to determine where recipients actually use their benefits, which FCS is unable to do under the current coupon-based system. Hopefully, this would dissuade recipients from selling or trading their food assistance benefits to unscrupulous food retailers. Another advantage is that EBT eliminates the need to provide recipients with cash change from food coupon purchases—thus, increasing the probability that benefits will be used only for food purchases. However, EBT may not be cost-effective, especially with the Federal Reserve Board’s recent regulation requiring that EBT users be provided with consumer liability protection. Evaluations to date indicate no increase in participation in the Program due to EBT.

How EBT Differs From the Coupon-Based System

The EBT system for delivering food stamp benefits differs from the current coupon-based system in that EBT uses automated financial transaction processing and debit card access technologies to electronically deliver food stamp benefits. Rather than receiving coupons, recipients use plastic debit cards, similar to bank debit cards, to access their food stamp benefits through point-of-sale (POS) terminals installed at check-out counters in food stores. In most cases, the POS terminals access a central computer that maintains information on each recipient’s food stamp account. At the time of purchase, the recipient inserts the plastic card into the POS terminal and keys in a personal identification number (PIN). The amount of the benefits to be drawn is keyed into the terminal, and an electronic message is sent to an EBT central computer facility. The EBT computer verifies that sufficient funds exist in the account and returns an on-line authorization message to the inquirer. Once the purchase is authorized, the amount is debited from the recipient’s account and credited to the retailer’s system account. At the end of each business day, retailers’ authorized EBT sales are totaled, and funds are transferred electronically to retailers’ bank account. An alternative to this type of EBT system used in some locations is the so-called off-line, or “smart card” system. In these systems, benefit information is stored on the card itself, thus eliminating the need to access an EBT central computer with each purchase.

Eight states currently have an operational on-line EBT system, and one state has an operational off-line system. The first EBT demonstration began in 1984 in Reading, Pennsylvania, and included only food stamps. Two more demonstrations became operational in 1991—in Ramsey County, Minnesota, and Albuquerque, New Mexico; these demonstrations integrated the delivery of electronic benefits between the Program and other assistance programs, such as Aid to Families with Dependent Children (AFDC). Operations began in March 1992 for an off-line EBT demonstration in Dayton, Ohio. The state of Maryland implemented an EBT project in the Park Circle District of Baltimore in 1989, and expanded the system statewide by May 1993. Maryland's EBT system also combines several assistance programs including food stamps, AFDC, and public assistance for adults. The state was evaluating the system's impact at the time of our field work. These five systems were included in our review. Four additional on-line systems were not included in our review because they had just started operations and would not have been far enough along in implementation to have produced evaluative information for our analysis. One of these systems, which was started in April 1993, is in Linn County, Iowa; another system, in Camden, New Jersey, became operational in January 1994. The latest two projects were initiated in Texas in October 1994 and in South Carolina in November 1994.

EBT Will Not Eliminate Fraud, Waste, and Abuse in the Food Stamp Program

EBT offers the potential to reduce some but not all fraud, waste, and abuse in the Food Stamp Program, especially not that which occurs during the eligibility and benefit determination process. Also, the extent to which EBT will reduce trafficking is not clear on the basis of the demonstration projects' results to date. Counterfeiting has not been a problem with EBT, and EBT has reduced the vulnerability of the Program to mail theft.

EBT Has Little Potential to Reduce Fraud, Waste, and Abuse During the Eligibility and Benefit Determination Process

Because EBT is simply another vehicle for distributing food stamp benefits, it will not affect fraud, waste, and abuse occurring during the eligibility and benefit determination process. Our review of the project evaluation reports for the Albuquerque, New Mexico; Maryland; Ramsey County, Minnesota; and Reading, Pennsylvania, EBT systems found that no changes had been made in the application processes used to determine eligibility in the Program and food assistance benefit levels. Unless better ways of verifying applicant-supplied information and avoiding errors made by state agencies' case workers are established prior to the eligibility and benefit determination decisions, individuals will continue to receive benefits to which they are not entitled regardless of whether these benefits are

distributed by coupon or EBT. Consequently, food stamp overpayments, which appear to account for the largest amount of quantifiable fraud, waste, and abuse in the Program, will most likely continue to occur at a level comparable to that experienced under the current coupon-based system.

Evidence on the Extent That EBT Will Reduce Food Stamp Trafficking and Related Fraud Schemes Is Inconclusive

According to USDA's OIG, FCS, and some state officials, EBT has the potential to significantly reduce food stamp trafficking as well as other forms of the loss and diversion of benefits. They believe that two key attributes of the EBT process make this reduction likely. First, EBT provides an audit trail that links individual purchases to specific retailers. Unlike food stamp coupons, every EBT transaction is recorded to properly debit the beneficiary's food assistance account and credit retailers' accounts. This makes it possible to identify where recipients redeem their food stamp benefits. Thus, if a retailer is found to be trafficking food stamps, it is easy to determine which recipients use the retailer and which recipients may be using their benefits for nonfood purchases. Because EBT transactions can be traced to individual recipients and retailers, Food Stamp Program officials believe potential traffickers will be less likely to sell, trade, or use their benefits for other purposes. Second, redeeming benefits obtained from participants through fraudulent activities is more difficult with EBT because the redemption process for participants is different from that for the coupon-based system. Under the coupon system, a person merely presents coupons to a food retailer to pay for food purchases. Under EBT, traffickers have to know the recipients' PIN and have access to a POS terminal in order to use food stamp benefits.

While Food Stamp Program officials are confident that EBT will reduce trafficking, they could only provide estimates instead of tangible, quantifiable evidence of reductions for the demonstrations we examined. For example, security experts evaluating the New Mexico and Ramsey County, Minnesota, demonstration projects believe EBT will reduce benefit trafficking by 50 percent. Experts evaluating Maryland's EBT project estimated a reduction in trafficking of 10 percent.

Not everyone believes EBT will reduce trafficking. Secret Service agents that we interviewed believe retailers that purchase food stamp coupons will also traffic EBT benefits. In addition, they expressed concern that newer and perhaps more expensive types of fraud may occur with EBT, such as cases where individuals obtain welfare benefits through computer fraud, unauthorized retailers fraudulently obtain POS terminals that accept

EBT cards, or individuals counterfeit EBT cards. USDA's OIG officials also expressed the concern that with EBT, the potential exists for large fraud losses by use of a computer, particularly by transferring or debiting funds from the system at some point.

Clearly, EBT has not eliminated the problem of trafficking. It is occurring at several locations where an EBT system has replaced the coupon-based food stamp system. Both state investigative agencies and USDA's OIG have identified cases of the trafficking of benefits provided through an EBT system. For example, during the OIG's first major fraud investigation involving EBT in Reading, Pennsylvania, the OIG found that a small sandwich shop conducted over \$151,000 in fraudulent EBT transactions over a 2-year period. These transactions accounted for 76 percent of the shop's total EBT dollar volume, and 173 food stamp recipients were convicted for illegally selling their benefits. More recently, a food retailer in Reading was permanently disqualified from the Program for trafficking food stamp benefits totaling approximately \$200,000. During this investigation, OIG agents found that the retail establishment had illegally obtained 79 EBT cards along with the recipients' PINs.

A New Mexico State OIG official told us that food stamp trafficking is occurring at that project as well. His office recently found an individual who was purchasing EBT cards from the homeless and selling the food stamp benefits at two food stores. The amount of benefits involved was approximately \$60,000. Furthermore, another state OIG official said that although his office had seen a 10- to 15-percent reduction in the number of food stamp fraud referrals received since EBT has been operating, he believes that trafficking will increase as recipients and individuals who purchase food stamp benefits learn more about the EBT system. In Dayton, Ohio, FCS Compliance Branch undercover agents identified five stores that were exchanging cash for food stamp benefits on EBT cards. However, 10 stores were willing to traffic coupons but not electronic benefits. USDA's OIG is continuing this fraud investigation because of the high dollar amount of trafficking.

In addition to trafficking, other types of fraud and abuse have occurred at the EBT demonstration projects that we visited. For example, state OIG officials in New Mexico told us about various schemes used to defraud the EBT system. In one scheme, the retailer defrauded recipients by "double swiping" their EBT cards during sales transactions, thereby obtaining additional credits from the cards. In Maryland, a state official provided examples of other types of EBT fraud that had been uncovered. These

included instances where a recipient's relatives or friends (who knew the card holder's PIN) stole benefits and state employees fraudulently obtained EBT cards and used the benefits.

Although EBT provides an audit trail to facilitate the detection of food stamp trafficking and fraud, it may not be used to its full advantage. For example, one state official responsible for directing an EBT system said his state does not have the necessary resources to use the data from the system in conducting investigations of fraud. Furthermore, USDA's OIG officials also expressed concern that FCS is not adequately using transaction data available from the EBT systems to identify and track fraud and abuse.

In discussing this issue with Food Stamp Program officials at the close of our study, we were told that FCS is currently working with a contractor and USDA's OIG on a plan to use EBT data from all states to create a national data bank. These data will then be the basis for exception reports that target retailers likely to be engaged in trafficking. FCS officials said that these exception reports will also be shared with other federal agencies such as the Secret Service and with state enforcement authorities.

Instances of Counterfeiting EBT Cards to Date Are Not Known

As with food stamp coupons, the counterfeiting of EBT cards is not a demonstrated problem. But according to Secret Service agents, the potential does exist for individuals to counterfeit EBT cards. For example, one agent said retailers can obtain enough information from POS terminals to counterfeit a recipient's EBT card and fraudulently obtain benefits. However, to date, there are no reported instances of counterfeiting of the EBT cards in any of the operational projects and, according to an evaluation report of two EBT projects, such counterfeiting is not likely.

In commenting on a draft of this report, the Secret Service reaffirmed that the counterfeiting of EBT cards is currently not a problem. However, they cautioned that EBT cards could become more attractive to counterfeiters if multiple social program benefits are placed on each card. This would raise the amount of benefits being placed on cards and could increase the likelihood of counterfeiting.

Mail Theft of Food Stamp Benefits Is Substantially Reduced With EBT

Mail theft of food stamp coupons is not high, but some mail theft losses do occur. EBT has the potential to reduce this problem even further. For example, in Bernalillo County, New Mexico, where coupons were replaced

by EBT, approximately \$22 million in food stamp coupons was issued by mail between October 1989 and July 1990. Mail losses for that time period were approximately \$170,000, or 0.77 percent of the value of the food stamps issued via the mail. Under New Mexico's EBT program, food stamp recipients do not receive any of their monthly benefits through the mail. Rather, the recipients attend a training session at which time they learn how to use the EBT system, select a PIN, and receive their cards. Once they have the EBT card, monthly benefits are posted to their accounts electronically. Thus, the potential for losses due to mail theft is substantially reduced, if not eliminated, with EBT.

In commenting on a draft of this report, a Postal Inspection Service official said that it may not be practical for all recipients to visit a food stamp office to obtain an EBT card—especially those that are handicapped. In such cases, it may be necessary to deliver the EBT card by mail. Should this be the case, there is the possibility that the cards could be stolen from the mail. The Postal Inspection Service official suggested that a card activation system, such as that used by some credit card companies, could be used to activate EBT cards that may be mailed to recipients. According to him, this would reduce the potential for card theft through the mail. Under a card activation system, a mailed EBT card would not be activated until the recipient called one of the Program's offices and provided specific personal information to an official, who would then activate the card.

Application of Federal Reserve Board's Electronic Funds Transfer Regulation Could Result in Increased EBT Fraud and Abuse

While EBT has the potential to reduce fraud, waste, and abuse in some respects, there is concern that it may generate a new kind of fraud. EBT demonstration projects implemented to date have not been subject to the consumer protection provisions provided to electronic funds transfer users under the Federal Reserve Board's Regulation E. This regulation implements the Electronic Funds Transfer Act of 1978, which establishes the basic rights, liabilities, and responsibilities of consumers who use electronic funds transfer systems and the financial institutions that offer these services. Regulation E provides that consumers who properly report the loss of an electronic card are liable for no more than \$50 of the fraudulent charges on a stolen card.

The Federal Reserve Board's final rule applying Regulation E to EBT systems became effective on February 28, 1994; however, implementation is being delayed until March 1, 1997. Under the Board's final rule, recipients will be liable for up to \$50 if the EBT card is lost or stolen. USDA

officials told us that under the Program's current regulations, the Department's position is that the states will be liable for losses that exceed the \$50 liability limit—but this is an unresolved question. By contrast, under the current coupon-based system, neither the states nor FCS is responsible for replacing recipients' lost or stolen benefits once they have been received.

According to FCS, Regulation E substantially reduces a recipient's responsibility for EBT card and PIN protection and makes it possible for recipients to report false losses to receive additional benefits. FCS believes Regulation E introduces an opportunity for additional abuse of the Program under EBT that is not present under the coupon-based system.

In November 1993, at the request of the Vice President's National Performance Review, an interagency task force was formed to develop an implementation plan to support the rapid development of a nationwide system for delivering government benefits. In its May 1994 report, the Federal Task Force presented its plan for a nationwide EBT system. The Task Force, in its report, also recognized that Regulation E could impose a large, unfunded liability on the states.¹

During the next 3 years, the federal government will evaluate the potential costs and impacts of Regulation E on EBT. The plan is to develop administrative procedures for resolving disputes that arise when unauthorized persons use EBT cards to obtain benefits.

Cost Competitiveness of EBT Remains Uncertain

Whether EBT will reduce federal and state costs to deliver food stamp benefits is not certain. Our analyses of the five EBT project evaluation reports showed considerable variation in the costs of providing benefits via EBT. Moreover, future changes to EBT (e.g., the application of Regulation E) will certainly affect the cost of EBT to the states and, perhaps, even the federal government if it is decided that the federal government should share in the liability costs covered by Regulation E. While the federal and state cost impacts have been mixed, all five demonstration projects show that EBT is less costly for recipients, retailers, and financial institutions.

¹Creating a Benefits Delivery System That Works Better and Costs Less: An Implementation Plan For Nationwide EBT, Federal EBT Task Force, May 1994.

Federal and State Costs Are Uncertain

Our review of the evaluation reports' cost comparisons between the five EBT systems and the coupon systems they replaced shows that three of the EBT systems were less expensive to the federal and state governments. The cost comparisons are shown in table 3.1.

Table 3.1: Costs to Deliver Food Stamp Benefits Via EBT Versus Coupon-Based Systems—Per Household, Per Month

Costs	Reading, Pa.	New Mexico	Ramsey County, Minn.	Dayton, Ohio	Maryland
Coupon costs	\$2.74	\$4.04	\$4.53	\$2.89	\$4.70 ^a
EBT costs	9.14	3.07	4.38	8.21	3.92
Difference	+\$6.40	−\$0.97	−\$0.15	+\$5.32	−\$0.78

^aMaryland's EBT system provides benefits for the Food Stamp Program as well as four other welfare programs. The costs per case-month for Maryland represent only the Food Stamp Program's allocation of the EBT costs.

Source: FCS Project Evaluation Reports.

The cost comparisons shown in table 3.1 do not, however, include design, development, and implementation costs for the EBT systems. These costs are significant. For example, the cost of the New Mexico system totaled \$1.58 million, and the cost of the Ramsey County, Minnesota, and Reading, Pennsylvania, systems each totaled \$2.1 million. The EBT start-up costs in Maryland and Dayton, Ohio, were even higher—costing \$7 million and \$3.4 million, respectively.

For our cost comparison analyses, we included the startup costs for the EBT systems to show the total amount of resources necessary to develop, implement, and operate the systems. For our analysis, we amortized these costs over a 7-year time frame. We used a 7-year time frame in order to be consistent with FCS regulations implementing the requirement in the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624) that the federal costs of providing food assistance benefits through EBT systems should not exceed the federal costs of providing benefits through the coupon-systems they replace. We then added these costs to the EBT systems' costs shown in the evaluation reports and recalculated the difference between the coupon and EBT systems' costs. The results of our analyses, as shown in table 3.2, indicate that

- Ramsey County's EBT cost was more—not less—than the cost of the coupon-based system it replaced,
- the EBT cost savings at the Maryland and New Mexico projects are less than shown in the evaluation reports, and

- the additional cost of delivering benefits via EBT at the Dayton and Reading projects is greater than that shown in the reports.

Table 3.2: GAO Calculated Costs to Deliver Food Stamp Benefits Via EBT and Compared Them With Coupon-Based Systems' Costs—Per Household, Per Month

Costs	Reading, Pa.	New Mexico	Ramsey County, Minn.	Dayton, Ohio	Maryland
Coupon costs	\$2.74	\$4.04	\$4.53	\$2.89	\$4.70 ^b
EBT costs	13.92 ^a	3.60	5.45	11.93	4.09
Difference	+\$11.18	−\$0.44	+\$0.92	+\$9.04	−\$0.61

Note: Start-up costs for EBT systems are included.

^aA Pennsylvania state official told us that the EBT cost has been reduced significantly and in 1993 was \$2.77 per case-month.

^bThe costs per case-month for Maryland include only the Food Stamp Program's share of the EBT costs.

As indicated earlier, the federal statute authorizing EBT issuance of food stamp benefits requires that such systems must be cost neutral to the federal government. FCS' implementing regulations were issued in 1992 subsequent to the start of the five EBT demonstration projects we reviewed. Thus, the cost analyses for these projects do not reflect the cost comparison methodology provided for in the regulations. Projects started subsequent to the regulations, however, must comply with the cost neutrality requirement, which requires that capital expenditures and other normal startup costs be included in the cost analysis. According to FCS, expanding EBT to include more food stamp recipients, providing multi-program benefits such as AFDC and other welfare program payments on an EBT card, and integrating EBT with existing commercial financial fund transfer systems will reduce EBT's operating costs. However, replicating these systems on a nationwide basis or even at another location will not be easy. For example, the New Mexico EBT system's evaluation report points out that it cannot be taken for granted that EBT systems in other locations will be as cost-effective as New Mexico's system. The evaluation report states that many factors affect the likelihood of a cost-effective EBT system, since coupon issuance costs vary substantially from one location to another. The cost-effectiveness of the system would vary depending on (1) the efficiency of training participants in the use of EBT cards, (2) the amount of fees and other charges paid to the EBT system's operator, (3) the extent to which POS network costs are shared with retailers and third-party networks, and (4) the amount of EBT project management and support costs.

According to a recent Office of Technology Assessment (OTA) report,² many important EBT cost-related questions remain unanswered. The report also outlines new opportunities for cost-sharing and partnership between the federal and state governments and the need for the private sector to help offset and defray some of the start-up costs associated with EBT. OTA estimates that it will cost between \$160 million and \$520 million to implement a nationwide EBT system for delivering multiple program benefits and that annual operating costs could be as high as \$1.04 billion. OTA believes that EBT will ultimately save money in the delivery of multiple benefits if the Program's enrollment and disbursement processes are streamlined. An OTA analyst told us that by integrating social service programs into one EBT system, fewer federal resources would be required to oversee and monitor the programs.

OTA's notion of combining benefits provided through a number of federal programs with a single EBT system is reflected in the implementation plan developed by the National Performance Review Federal EBT Task Force. The plan identifies 12 federal and state programs that could use EBT to replace current paper delivery methods for making government payments. The Task Force's report plan calls for full implementation of EBT nationwide by 1999 and estimates federal savings of \$195 million annually by reducing paper costs associated with current delivery systems. The implementation plan calls for a sharing of the costs to implement EBT among federal and state governments, food retailers, and financial institutions. The Task Force estimates the total federal share to implement EBT to be about \$83 million.

Regulation E May
Adversely Affect Federal
and State EBT
Administrative Costs

In our analyses, we did not factor in the costs of Federal Reserve Regulation E, which we discussed earlier in this chapter. The regulation could add several hundred million dollars annually to states' EBT costs. None of the FCS demonstration projects considered the effects of this regulation because it was not applicable when the projects were initiated.

Compliance with Regulation E implies incorporating a number of new factors in EBT systems' cost estimates, such as the direct cost of replacing benefits, administration of a Regulation E compliance program, claim processing and investigation, card replacement, and other costs. Hard data on these costs are generally unavailable, since EBT programs have previously been exempt from compliance with Regulation E.

²Making Government Work: Electronic Delivery of Federal Services, Office of Technology Assessment, Sept. 1993.

The only formal study of the effects of Regulation E on EBT was completed by the Department of the Treasury's Financial Management Service in 1993.³ The report, which was conducted by contractors, found that costs for complying with Regulation E may exceed any cost savings of providing benefits through EBT. For example, cost estimates for complying with Regulation E ranged from \$69 million to \$464 million per year for the Food Stamp Program alone, and these estimates do not include indirect costs, such as antifraud enforcement. For EBT systems that provide multiple-program benefits such as AFDC and state general assistance, the cost estimates of Regulation E are much higher, ranging from \$122 million to \$827 million per year.

State EBT providers have voiced concern about their liability for unauthorized transfers, particularly those related to recipients' negligence and fraud. Given the fraud in the paper-based delivery system, states fear that the cost of applying Regulation E to EBT programs will exceed the advantages of providing benefits electronically.

USDA recommended that Regulation E not be applied to EBT systems, contending that Regulation E would increase the cost of delivering food stamp benefits to the point where EBT might not be economically feasible. FCS is committed to testing an EBT system in accordance with Regulation E to determine how it will affect states' liability. According to an FCS official, FCS needs to determine (1) what claims should be paid because not all losses have to be automatically replaced and (2) what administrative procedures can be put in place to limit losses. FCS expects that some of the losses will be due to fraud and some to recipients who improperly handle their cards.

Costs to Recipients Are Less With EBT

According to the evaluation reports of all five EBT projects, the EBT systems reduce the costs for recipients to participate in the Program. The cost reductions ranged from 46 percent at the Ramsey County, Minnesota, project to 88 percent at the Reading, Pennsylvania, project.

These cost reductions are achieved in several ways. Under the current Program, recipients incur some time and money costs to collect their food stamps. These costs include those associated with visiting a welfare office to pick up their food stamp benefits. Under EBT, recipients would not incur these costs after their initial visit to pick up their EBT card.

³Implications of Regulation E in Electronic Benefit Transfer Programs, Aug. 31, 1993. U.S. Department of Treasury, Financial Management Service.

The evaluations also reported that recipients were less likely to lose their benefits to theft when they were provided through EBT. Under the current system, coupons that are lost or stolen after being received by a recipient are not usually replaced; therefore, the recipient must bear this cost. With EBT, however, the likelihood of such losses to the recipient is less because an EBT card thief would also need a PIN to access the recipient's benefits. In addition, if the recipient reports the card as lost or stolen, the account is put on hold. Consequently, the probability of lost benefits, and the associated cost to recipients from lost benefits is less with EBT.

Costs to Retailers Are Less With EBT

According to the EBT evaluation reports, EBT also reduced retailers' costs to participate in the Program. Retailers' estimated participation costs were reduced by less than 1 percent at the Maryland project. At the other four projects, however, the costs reductions were greater—ranging from 20 percent at the Ramsey County, Minnesota, project to 38 percent at the Dayton, Ohio, project. These savings resulted primarily from a decrease in the time and resources spent in collecting, handling, and reconciling food stamp coupons. The Food Marketing Institute recently published a study that corroborates the evaluation reports.⁴ The study shows that the retailer's average cost in accepting EBT payments is \$0.1497 per transaction whereas the average cost of a food stamp transaction is \$0.1630.

Retailers' costs under EBT systems could increase, however, if retailers pay to acquire the POS terminals. At the five demonstration sites, the POS terminals were installed in retail stores at no cost to the retailers. Current law prohibits state agencies from requiring food retailers to purchase equipment or incur other costs as a condition of participation in EBT systems. However, the Federal Electronics Benefit Transfer Task Force, in its May 1994 report, suggests that expanding EBT nationwide would require a sharing of costs between government and industry and recommends that retailers finance the costs of POS terminals.

OTA also raised concerns that under the current law, retailers are not encouraged to share the cost of EBT. According to an OTA analyst, food retailers would stand to benefit from EBT, and therefore, the federal government should encourage them to invest in such a system. According to a nonprofit food retailer association, if the POS terminals could accommodate both food stamp and nonfood stamp customers, then the retailers would be willing to purchase the terminals, since this would

⁴Benchmarking Comparative Payment Methods: Costs and Case Studies, Food Marketing Institute, 1994.

benefit all their customers. However, the costs associated with the purchasing of POS terminals by retailers are not known at this time nor is the impact that these costs would have on retailers' costs under future EBT systems.

Costs to Financial Institutions Are Less With EBT

A shift to EBT would also generate a substantial reduction in costs to financial institutions that process food stamp coupons redeemed by retailers. Local banks would realize the majority of the cost reduction, since EBT would eliminate expensive coupon redemption activities. Currently, bank personnel must (1) count the coupons numerous times to verify totals, (2) complete internal ledger and transmittal forms to transport coupon deposits to the appropriate operations area of the bank, (3) endorse each coupon with a bank stamp, (4) organize the coupons into bundles, (5) complete a coupon deposit document identifying the bank and the total value of the coupons for the Federal Reserve Bank, and (6) deliver the coupons and forms to the Federal Reserve Bank. According to EBT evaluation reports, local bank costs were completely eliminated at two projects and reduced by 90 percent or more at the three other projects. Costs incurred by Federal Reserve Banks are also reduced under EBT but by a smaller margin than that for local banks.

EBT Has Not Affected Participation in the Program

Providing food stamp benefits through EBT has apparently not had any impact on participation in the Program. According to FCS, measuring EBT's impact on participation is challenging at best. Since EBT is being introduced while many other changes such as economic shifts and changes in requirements for eligibility in the Program may be occurring, it is necessary to control for the influence of these factors. One approach is to compare changes in participation levels for an area with EBT with participation levels in comparable areas without EBT. This kind of analysis was conducted for one EBT evaluation, and there was no evidence of any impact on participation from EBT. Another EBT evaluation report found no serious evidence that EBT systems had affected participation in any way.

Stating that EBT has not caused participation to increase or decrease, seven FCS and three state agency officials that we interviewed corroborated these findings. Some of these officials said that changes in participation rates are caused primarily by changes in the economy, rather than the way in which benefits are delivered, such as EBT.

EBT Could Result in the Use of More Benefits for Food Purchases

When recipients purchase nonfood items with cash change from food stamp purchases, it undermines the Program's objective of increasing the food-purchasing power of recipients. EBT provides for an exact deduction of benefits from a recipient's benefit account, eliminates the need for cash change, and thus eliminates the possibility that recipients will use the change for nonfood purchases.

The EBT evaluation reports we reviewed showed that a small amount of benefits were being diverted from food purchases as the result of cash change. For example, in New Mexico and Ramsey County, Minnesota, the evaluation report estimated that about 0.54 percent of coupon benefits in both sites were diverted to nonfood items with cash change. It is important to note, however, that these estimates are based on economic assumptions and not actual results. Although quantifiable data on the amount of diversion in the coupon-based system are not available, all of the state agency personnel and FCS officials that we interviewed believed that recipients will spend more of their monthly benefits on food when provided through EBT.

Cash-Out Reduces the Program's Costs but Provides No Assurance That Benefits Will Be Used for Food Purchases

The cash-out alternative to the current coupon-based system would eliminate trafficking but not all fraud, waste, and abuse in the Food Stamp Program. Providing food stamp recipients with cash benefits in lieu of coupons can save millions of dollars in costs for federal, state, and local governments. Federal savings would accrue from eliminating the administrative costs to maintain a coupon currency and from reduced spending to combat coupon-related fraud and waste. State and local governments would save through more efficient food assistance distribution activities. Concurrent with these savings, however, is the loss of assurance that food assistance dollars are actually spent for food. Also, contrary to popular assumption, it does not appear that participation by eligible households increased at any of the cash-out projects as a direct result of providing benefits in the form of cash rather than coupons.

How Cash-Out Differs From the Coupon-Based System

Under cash-out, state agencies provide eligible individuals with benefits in the form of state or U.S. Treasury checks. Recipients may transact these checks at any financial institution for cash and may then use the cash to make food purchases at any retailer they choose, rather than at only those stores that receive FCS' approval to accept food stamp coupons.

A call for a program of widespread experiments in welfare policy in the 1980s led FCS to approve four demonstration projects to evaluate the effects of replacing food stamps with cash assistance. The four projects were (1) the Alabama Avenues to Self-Sufficiency through Employment and Training Services (ASSETS) project, (2) the Alabama "Pure" Cash-Out Demonstration, (3) the San Diego Food Stamp Cash-Out Demonstration, and (4) the Washington State Family Independence Program (FIP) project. Table 4.1 provides an overview of the projects.

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Table 4.1: Overview of FCS' Cash-Out Demonstrations

Category	Alabama "Pure"	Alabama ASSETS	San Diego, Calif.	Washington State FIP
Programs affected	Food Stamp Program only	Food Stamp Program and AFDC	Food Stamp Program only	Food Stamp Program, AFDC, and Medicaid
Percentage of food stamp caseload cashed out	4 percent of caseload in 12 counties	100 percent of caseload in 3 counties	20 percent of caseload in first year, 100 percent thereafter	Five welfare offices selected statewide
Project's duration	8 months (May 1990 to Jan. 1991)	4 years (May 1990 to Apr. 1994)	6 years, 3 months (July 1989 to Oct. 1995)	5 years (July 1988 to June 1993)
Project's evaluation covered				
Administrative costs	Yes	No	Yes	Yes
Food expenditures	Yes	Yes	Yes	Yes
Other expenditures	Yes	Yes	Yes	Yes
Recipients' adequacy of food supply	Yes	Yes	Yes	Yes
Participation	No	No	Yes	No
Cash-out effects on retailers	No	Yes	Yes	No

In the Alabama "Pure" and San Diego Cash-out Demonstrations, providing cash assistance for food was the only change to the Program that was introduced and evaluated. However, the other demonstrations—Alabama ASSETS and Washington State FIP—introduced other welfare reform initiatives concurrent with cash-out. For example, the Alabama ASSETS demonstration consolidated two separately administered programs—Food Stamp Program and Aid to Families With Dependent Children—by standardizing some eligibility requirements and providing a single cash grant. The Washington State FIP combined the Food Stamp Program, AFDC, and Medicaid into one grant program with benefits for the first two programs combined into one check for participants. The four demonstrations also varied considerably in terms of geographic location, degree of urbanization, and caseload demographics.

In addition to these major demonstration projects, seven states have been given limited authorization to issue food stamp benefits in the form of cash rather than coupons in specific situations. Minnesota and Vermont distribute cash for the initial month of expedited food assistance because their systems cannot issue food stamp coupons within the required time frame.¹ Vermont along with Utah and some counties in Minnesota, Ohio,

¹In emergency situations, the Program's regulations call for benefits to be issued under less stringent verification standards and within 5 days of initial application rather than 30 days.

Oregon, New York, and Virginia also provide food stamp benefits in the form of cash to persons who are age 65 or older and receive Supplemental Security Income. These areas began providing cash benefits as part of FCS' first cash-out demonstration, conducted from April 1980 through the summer of 1981. The Congress extended the cash benefits for these states beyond the demonstration period and has since reauthorized them on two occasions through October 1, 1995.

According to FCS, additional states have received approval to provide cash in lieu of coupons on a limited basis as part of a state welfare reform initiative. Under these demonstrations, states will be testing new approaches to welfare, including the consolidation of the Food Stamp and AFDC programs. These states are Colorado, Minnesota, Missouri, New York, Oregon, Pennsylvania, Utah, and Wisconsin. Evaluation data on the effects of cash-out are not yet available on these projects. FCS is also reviewing cash-out proposals in eight other states.

The 1995 Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act (P.L. 103-330) limits USDA to no more than 25 cash-out projects, and the total participation in these projects cannot exceed 3 percent of the estimated national household level of participation in the Program. According to FCS, as of October 1994, 18 cash-out projects had been approved.

Cash-Out Will Eliminate Food Stamp Trafficking but Not Other Kinds of Fraud, Waste, and Abuse

The cash-out alternative to the current coupon-based system would eliminate one type of food stamp fraud and abuse—trafficking—but it will not eliminate all fraud, waste, and abuse in the Program. Eligibility fraud, waste, and abuse will remain unchanged, but mail theft and counterfeiting will remain minimal.

Eligibility and Benefit Determination Fraud and Waste Would Not Be Reduced

As with EBT, simply providing food stamp benefits in cash instead of coupons will not reduce the overpayments that occur each year because of fraud, waste, and abuse in the eligibility and benefits determination process. Once again, this is because changing the method of delivering benefits does not modify the eligibility and benefits determination processes used by the states. Unless better ways of verifying applicant-supplied information prior to the time that eligibility and benefit determinations are made, individuals choosing to provide erroneous or

incomplete information can receive benefits to which they are not eligible, regardless of whether the benefits are disbursed as coupons or as cash.

**Trafficking Would Be
Eliminated**

Cash-out will inherently eliminate food stamp trafficking. The illegal bartering of food stamp coupons—either by recipients or food retailers—ceases to be a problem, since the benefits are issued in cash. Although trafficking would be eliminated with a cash-out system, there is no guarantee that cash benefits would be used to purchase food. That is, recipients who use their benefits for other than food purchases would still be abusing the Food Stamp Program. The potential use of cash benefits for nonfood purchases is also discussed in a later section of this chapter.

**Mail Theft Would Remain
Minimal**

Mail theft under cash-out was evaluated in the San Diego and Alabama “Pure” demonstration projects. The San Diego evaluation indicated that the cash-out system was less vulnerable to losses than the coupon-based system. Under this demonstration project, food stamp benefits lost through mail theft decreased from approximately \$22,000 to \$1,000 per month, or 95 percent, after food stamp coupons were replaced with cash benefits. Furthermore, the evaluation found that although checks can be lost or stolen from the mail, misuse of the benefits is more difficult because personal identification is generally required to cash a check. No identification is required to redeem food stamp coupons. Additionally, the Treasury Department and states can place a stop-payment order on checks reported stolen but not on food stamp coupons.

In contrast, the evaluation for the Alabama “Pure” project found more losses from mail theft when food stamps were cashed-out; however, the theft losses remained small—only 12 of 16,737 checks were stolen and fraudulently cashed. The total loss in benefits was \$2,285, and as is generally the case, losses resulting from forged checks are usually borne by the institutions that cashed the checks—not the federal or state governments.

**Counterfeiting Losses
Would Be Minimal**

Since food stamp coupons are eliminated under the cash-out approach, any counterfeiting of food stamp benefits would occur in the form of counterfeited state- or perhaps U.S. Treasury- issued checks. On the basis of information supplied by the Secret Service, the counterfeiting of Treasury Department checks is not widespread, but the relatively few occurrences represent a sizable dollar value. In fiscal year 1993, the Secret

Service discovered that 58 Treasury Department checks valued at \$9.4 million had been counterfeited and cashed. An additional 37 counterfeit checks valued at \$11.9 million were seized by the Secret Service before they were cashed. Since most household food assistance benefits are relatively small in dollar value, it would not seem that food assistance checks would be a target for counterfeiters.

Cash-Out Will Reduce Administrative Costs

Replacing food stamp coupons with cash could significantly reduce the Program's overall administrative costs both at the federal and state or local levels. The cost impact on retailers, banks, and food stamp recipients is, however, uncertain.

Federal and State Costs Are Reduced

Three of the four cash-out project evaluations compared administrative costs for cash-out with those of the coupon-based systems they replaced and identified savings in all three locations. As shown in table 4.2, the estimated cost savings per case month ranged from \$1.02 to \$2.35. The \$1.02 reduction at the Alabama "Pure" project represents an approximate 50-percent reduction in the joint federal/state cost to administer the Program, the \$1.70 reduction at San Diego represents a 62-percent reduction in administrative costs, and the \$2.35 in the Washington State demonstration represents a 31-percent reduction in administrative cost. The fourth evaluation—Alabama ASSETS—did not assess the effect that cash-out had on the Program's administrative costs.

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Table 4.2: Estimated Federal, State, and Local Government Cash-Out Savings—Per Household, Per Month

Category	Alabama "Pure"	San Diego County	Washington State
Federal-level issuance savings			
Coupon printing	\$0.180	\$0.180	\$0.18
Coupon storage and transportation	.020	.020	.02
Federal Reserve fees	.170	.170	.17
Authorizing and monitoring of retail stores	.140	.140	.14
Subtotal	.510	.510	.51^a
Federal/state reimbursement savings ^b			
1/2 state/county issuance savings	.255	.595	.92
Total federal savings	.765	1.105	1.43
State/county unreimbursed savings	.255	.595	.92
Total savings	\$1.020	\$1.70	\$2.35^c

^aThe Washington State study's report did not include an estimate for the reduction in federal administrative costs. According to FCS officials, the federal administrative cost reductions in the Alabama and San Diego projects are reasonable estimates to use in the Washington State analysis.

^bStates are reimbursed for at least one-half of their administrative costs for distributing food assistance.

^cThe Washington State project's cost analysis represents only the Food Stamp Program's costs associated with the project.

Table 4.2 also illustrates that much of the administrative cost savings achieved through cash-out accrued to the federal government. In fact, the federal administrative cost reductions ranged from 35 to 68 percent at the three cash-out projects. As indicated, these savings resulted primarily by eliminating the costs associated with printing and redeeming food stamp coupons and authorizing and monitoring retail food stores and by reducing the costs reimbursed to the states. On the other hand, the state and local governments' administrative cost reductions ranged from 26 to 54 percent at the three projects. These savings occurred for a number of reasons, including the elimination of processing and reporting requirements associated with issuing food stamp coupons. Also, cash-out freed welfare office personnel from coupon inventory management activities, such as the daily reconciliation, ordering, receipt, and tallying of coupons.

In addition to reducing administrative costs, cash-out can save the federal government at least part of the millions of dollars spent annually in policing the Program. Since cash-out would eliminate food stamp

trafficking, the money spent on investigating trafficking could be saved or redirected to more productive uses.

**Costs to Retailers, Banks,
and Recipients Are
Uncertain With Cash-Out**

Unlike the EBT project's evaluations, the cash-out project's evaluations did not fully address the cost impacts that cash-out would have on retailers, financial institutions, or food stamp recipients. Absent such an analysis, we have drawn on information from other sources, including the EBT evaluations, to provide a limited assessment of what cost impacts cash-out might have on these groups.

**Retailers' Costs Should
Decrease**

The EBT project's evaluations show that the major costs to retailers under the coupon-based system result from labor-intensive activities, such as collecting and separating the coupons by denomination; accounting for, bundling, and endorsing the coupons; and then forwarding them to a financial institution for cash redemption.

Under the cash-out alternative, only checks would be involved in the redemption process, thus the time involved in collecting, accounting for, and forwarding deposits to the bank could be reduced, which would reduce the retailer's costs. The reduction would vary by retailer.

A recently released Food Marketing Institute report shows that cash payments are less expensive for food retailers to transact than any other form of payment. The study found that the average cost to retailers for accepting food stamp coupons as a method of payment is \$0.163. By contrast, the average cost of a cash transaction is \$0.0716—less than half the cost of a food stamp coupon transaction. (Cash is also about half the cost of an EBT transaction.) However, the study also found that the average cost for accepting a check as a method of payment is \$0.4256—significantly higher than both food stamps and cash. Thus, if a food stamp recipient pays for food purchases with a check, a retailer's cost could be more than the cost of accepting food stamps. But if the recipient cashes the benefit check at a bank or some other entity and then uses cash for food purchases, the retailer's cost would be less.

**Cost Impacts on Banks
Uncertain**

As discussed in chapter 3, the EBT project's evaluations show that the elimination of food stamp coupons resulted in a reduction of costs for financial institutions. The majority of these savings occurred because labor-intensive activities such as counting, endorsing, and bundling loose coupons for forwarding to the Federal Reserve were reduced or

eliminated under EBT. These same savings would occur under a cash-out system.

However, under a cash-out system, the processes associated with redeeming food stamp coupons would be replaced with those associated with accepting and processing food assistance benefit checks. The banks' costs associated with processing these checks would have to be considered in calculating the net savings to commercial banks in changing from a coupon system to a cash-out system. However, the Federal Reserve does not have specific information on the resources or amount of time that commercial banks spend in processing checks or food stamp coupons. Therefore, a direct comparison of the two is not possible.

Effects on Recipients Is Difficult to Project

The effects that cash-out would have on food stamp recipients is also not entirely clear. On the one hand, three of the four evaluations of cash-out projects show that most recipients did not have to pay a check-cashing fee when they redeemed their benefits. Also, in all four locations, researchers found that recipients preferred cash to food stamp coupons because of increased flexibility in purchasing decisions.

On the other hand, because purchases made with food stamp coupons are not subject to sales tax, recipients in the 20 states that impose such a tax could see a decrease in the purchasing power of their benefits if food stamp benefits were cashed-out and purchases were made with cash. To avoid reducing recipients' food purchasing power, those states that tax food purchases are currently required to increase food assistance allotments to households in order to compensate or offset the sales tax that households would have to pay when using their benefits. These states would recoup the money they provided when the food assistance benefits were actually used, but the states would have to budget for the money and provide it up-front.

For some states, providing this one-time, up-front funding may be difficult and a disincentive for providing cash food stamp benefits. Recently, for example, in seeking FCS' approval to continue the ASSETS project for 2 years, Alabama officials elected to return to a coupon-based system. The state could not afford the \$2.4 million up-front funding necessary to increase cash food assistance benefits to offset the impact of the state sales tax.

Cash-Out Has Not Affected Participation in the Program

Cash-out supporters argue that the overt identification of food stamp recipients when using coupons to buy food is a stigma that discourages many who are eligible from participating in the Program. The coupon system's supporters maintain that the coupon system is needed to ensure that benefits are actually used to purchase food. Also, there is concern that the cash-out system will result in increased participation and drive up benefit costs. However, we found no evidence that participation in the Food Stamp Program increased because benefits were cashed-out.

The San Diego County project's evaluation was the only evaluation that formally assessed the effects on participation of introducing cash assistance, and it identified no significant impact resulting from replacing food stamp coupons with cash. While San Diego County's food stamp caseload did in fact increase by 27 percent during the first 2 years of cash assistance, this increase was attributed to factors such as poor economic conditions—not to cash-out.

Likewise, although they prepared no formal evaluation, Alabama officials responsible for operating the Program told us that the increased participation they experienced during cash-out most likely occurred because of simplified public assistance rules and poor economic conditions. An Alabama ASSETS project official said that an initial influx of homeless applicants occurred with cash-out but subsided to normal levels once the project's work and training requirements for food assistance were widely publicized.

Cash-Out May Reduce Food Expenditures

Extremely different outcomes resulted from the recent cash-out demonstrations' analysis of households' food expenditures. At one extreme, the evaluation of the Alabama ASSETS project identified an 18-percent decline in food expenditures by cash recipients. In contrast, researchers in the other Alabama project found virtually no change in the value of household food purchases resulting from the switch from coupons to cash. Findings in the San Diego County and Washington State demonstrations fell between the Alabama extremes. The San Diego study identified what researchers termed a "small" but statistically significant downward impact of about 5-percent on household food expenditures. Similarly, Washington State researchers identified a 12-percent drop in the dollar value of household food purchases by cash recipients. These different results make it difficult to precisely quantify cash-out's overall effect on households' food expenditures. In discussing this point with FCS officials, they agreed that it would be difficult to quantify the impact that

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cash-out would have on food purchases on the basis of these demonstrations. However, they did point out that three of the studies showed a decline in food expenditures, which strongly suggests that cash-out would lead to some decrease in food expenditures.

Observations and Conclusions

While both the EBT and cash-out alternatives offer certain advantages over the coupon-based system for delivering food stamp benefits, neither of the two has a clear-cut advantage over the current system. Currently, there is momentum to change from the current system to EBT. The EBT system being advocated, however, is a broad-based application that envisions providing benefits for a number of federal and state programs in addition to food stamp benefits.

No One System Has a Clear Advantage

Both EBT and cash-out show promise for reducing certain types of fraud, waste, and abuse that plague the coupon-based system. However, as shown in appendix I, neither will reduce the nearly \$1.8 billion in estimated overpayments resulting from fraud, waste, and abuse that occur during the eligibility and benefit determination process. EBT has the potential to reduce, but not eliminate, trafficking; however, the reduction has not been demonstrated in quantifiable terms. Cash-out offers the best opportunity for reducing the illegal use of food stamp benefits because it eliminates trafficking.

Administratively, cash-out is clearly the least expensive of the three systems as a means for delivering benefits. It is unclear from the demonstrations to date whether EBT is less expensive to administer than the coupon system. Two major EBT cost issues remain to be resolved: (1) the administrative cost of expanding the system nationwide and (2) the potential liability costs that would result from the application of Federal Reserve Regulation E to EBT systems. From a cost standpoint, EBT reduced costs for retailers, financial institutions, and recipients. Such reductions were less clear under cash-out, and recipients' costs could increase because of requirements to pay state and local sales taxes at the time they use their benefits. A comparison of the administrative costs of the three systems—coupon, EBT, and cash-out—is shown at appendix II.

On the basis of demonstrations, neither EBT or cash-out plays a significant role in an individual's decision to apply for food assistance. Therefore, the number of people participating in the Program is not likely to increase or decrease by any measurable number if the current coupon-based system is replaced with either alternative. (See app. III for a comparison between systems.)

With regard to the Program's objective of ensuring that food assistance benefits are actually used to purchase food, the EBT and cash-out demonstrations have not provided conclusive evidence to determine if

either system would be more effective than the current coupon system. However, EBT does increase the likelihood that participants will use benefits for food. On the other hand, cash-out severs the link between food stamps and actual food purchases and may lead some recipients to spend less on food purchases. (See app. IV for a comparison between systems.)

Prospects for Change

Between the EBT and cash-out alternatives, EBT currently has wider acceptance as a possible replacement for the coupon-based system, including support from the Congress and USDA. This wide support of EBT seems to center on the replacement of outmoded government disbursement systems through the use of modern electronic banking technology. However, some state and local agencies remain interested in replacing food stamp coupons with cash benefits.

Momentum for EBT Is Building

The momentum to replace the paper-based, government-funded benefit systems with EBT is building. The movement toward EBT has been strongly endorsed by the Secretary of Agriculture, who is encouraging states to pursue EBT for delivering food stamp benefits. Currently, nine states operate EBT systems, and the Treasury Department is demonstrating the use of EBT for direct federal programs in Houston and Dallas, Texas. All parties involved in USDA's EBT demonstrations—financial institutions, food retailers, and food stamp recipients—prefer EBT over food stamp coupons. Furthermore, over 30 additional states are anticipating implementation of EBT systems for delivering government-funded benefits.

Interest in EBT has heightened recently. For example, the Chairman of the Senate Agriculture, Nutrition and Forestry Committee introduced Senate bill 1646, the Food Stamp Fraud Reduction Act of 1993. The bill would mandate EBT for the Food Stamp Program and eliminate food stamp coupons nationwide (with certain exceptions) within 3 years from enactment. In May 1994, the Federal EBT Task Force issued its recommended implementation plan to the Vice President for a nationwide EBT system for delivering government-funded benefits, including food stamps, AFDC, certain direct federal cash benefit programs, and some state general assistance programs. As indicated earlier in this report, the Task Force concluded that the development and implementation of EBT will require a sharing of costs between government and the private sector—with the federal share of the investment estimated to be about \$83 million. After the infrastructure has been developed and the EBT

system is in place, savings are expected to accrue from combining multiple program benefits on a single magnetic stripe card. Annual federal savings of \$195 million are projected.

Cash-Out Has Less Support

Cash-out has never had much of a constituency. However, recipients in the FCS cash-out demonstration projects preferred cash benefits to coupons, and state and local officials expressed support for continuing cash food stamp assistance. Officials in Alabama and San Diego County prefer the cash-out system to coupons because it is easier to administer, permits efficiencies through the combining of food stamp operations with other public assistance activities, and allows caseworkers to concentrate on eligibility decisions rather than maintaining accountability over food stamp coupons.

San Diego County requested and received FCS' approval to continue providing food stamp benefits via cash until October 1995. In addition, other states have recently requested approval to cash-out for at least part of their food stamp recipients. As indicated in chapter 4, 18 states have now been authorized to proceed with cash-out demonstrations. A number of these states—for example, Colorado, Oregon, and Pennsylvania—have requested authority to provide cash food assistance as part of broad reform efforts combining food stamp benefits with other public assistance, such as AFDC and child care benefits. South Carolina has sought approval to provide cash food stamp benefits to Supplemental Security Income recipients.

Use of EBT for Food Stamps Should Be Linked With the Delivery of Other Welfare Benefits

As discussed in chapter 3, many important questions concerning the cost-effectiveness of EBT remain unanswered, especially using EBT for a single-benefit program. Both OTA and the Federal EBT Task Force reports found that the greatest payoff for EBT is likely to come from combining multiple-benefit programs into one system. In this vein, states that are using EBT to deliver food stamps and other welfare program benefits may be laying the foundation for reforming the nation's system for delivering welfare benefits.

In our February 2, 1994, statement-for-the-record testimony presented to the Senate Committee on Agriculture, Nutrition and Forestry, we concluded that if EBT systems were put in place solely to distribute food program benefits, they could be more costly to the federal government

than the current coupon-based system.¹ We further stated that EBT could be more cost-effective if it were used in conjunction with other federal and state assistance programs. We continue to believe that the greatest utility for EBT is an expanded system that provides for the delivery of multiple government-program benefits.

Agency Comments and Our Evaluation

USDA, in written comments, asked that we clarify discussions in the report regarding the lack of evidence to support estimates of food stamp trafficking, the fact that benefit overpayment errors would be basically the same under any of the three issuance systems, the inability of cash-out to ensure that benefits are used for food, and the cost effectiveness of electronic benefits transfer. Also, USDA provided information on its recent initiatives to reduce the overpayment of benefits. USDA also provided a number of technical comments to improve the clarity and currency of information contained in the report. We have included the additional information provided by USDA in the report where appropriate. The U.S. Secret Service, in written comments, and the U.S Postal Service, in oral comments, generally agreed with our analysis and conclusions.

¹Food Assistance: Reducing Fraud, Waste, and Abuse in the Food Stamp Program with Electronic Benefit Transfer Technologies (GAO/T-RCED-94-125, Feb. 2, 1994).

Comparison of Fraud, Waste, and Abuse Under the Coupon-Based System and the EBT and Cash-Out Alternatives

Fraud, waste, and abuse category	Coupon-based system	EBT option	Cash-out option
Eligibility and benefit determination process	\$1.8 billion in overpayments was estimated in FY 1993.	Overpayments would not be reduced because no changes are made in the eligibility/benefit determination process.	Overpayments would not be reduced because no changes are made in the eligibility/benefit determination process
Trafficking	Accurate, reliable data are not available to document the amount of food stamp trafficking that is occurring.	EBT has the potential to reduce trafficking, but the effects have not been quantified in the demonstration projects. Trafficking in EBT cards has been found at three demonstration projects.	Trafficking would be eliminated because recipients would be given checks rather than coupons or an EBT card.
Counterfeiting	\$1.2 million in counterfeited food stamps occurred from October 1986 through January 1992. Not viewed as a problem.	Potential exists, but no cases have been reported to date.	Counterfeiting of checks providing benefits is possible.
Mail theft	\$23.9 million in losses occurred in FY 1993—less than 1/2 of 1 percent of total dollar amount of stamps issued by mail.	Mail theft would be reduced if recipients receive their EBT card in person rather than through the mail. Also, thieves cannot use an EBT card without the recipient's PIN.	Mail theft would be reduced because identification is needed to cash a state or U.S. Treasury check.

Legend

EBT = electronic benefit transfer.

FY = fiscal year.

PIN = personal identification number.

Comparison of Administrative Costs Under the Coupon-Based System and the EBT and Cash-Out Alternatives

Administrative costs category	Coupon-based system	EBT option	Cash-out option
Federal Costs	\$1.8 billion in FY 1993. Includes federal reimbursement to states (\$1.46 billion) as well as USDA's and other federal agencies' costs associated with policing the program.	It is unclear if costs would be reduced on the basis of the results of the demonstration projects	Costs were reduced from \$0.76 to \$1.43 per case month (35- to 68-percent reduction) at cash-out demonstration sites.
States' costs	\$1.46 billion minimum estimated on the basis of 50/50 cost share with federal government.	It is unclear if costs would be reduced on the basis of the results of the demonstration projects.	Costs were reduced from \$0.26 to \$0.92 per case month (26- to 54-percent reduction) at cash-out demonstration projects.
Retailers' costs	Retailers' coupon cost estimates ranged from \$17.83 to \$46.05 per \$1,000 in coupon redemptions at EBT demonstration sites prior to converting to EBT.	Retailers' cost reductions ranged from \$3.98 to \$9.52 per \$1,000 in coupon redemptions at EBT demonstration sites.	Retailers' costs were not evaluated. It is not clear if check-handling costs would be less than food stamp-handling costs.
Financial institutions' costs	Cost estimates ranged from \$3.29 to \$5.52 per \$1,000 in coupon redemptions at EBT sites prior to converting to EBT.	Cost reductions ranged from \$3.19 to \$5.63 per \$1,000 in coupon redemptions at EBT demonstration sites.	Costs were not evaluated. It is not clear if check-handling costs would be less than food stamp-handling costs.
Recipients' costs	Costs estimated to range from \$3.03 to \$13.39 per household per month at sites prior to converting to EBT.	Recipients' costs were reduced from \$1.29 to \$10.87 per household per month at EBT demonstration sites.	Recipients' costs were not evaluated. Check-cashing fees could be more than costs under the coupon program. Loss of sales tax exemption, unless mitigated by states, would also increase costs.

Legend

EBT = electronic benefit transfer.

FY = fiscal year.

USDA = U.S. Department of Agriculture.

Comparison of Recipients' Participation Under the Coupon-Based System and the EBT and Cash-Out Alternatives

Participation category	Participation	Dollar value of benefits paid to recipients
Coupon-based system	Participation averaged 27 million per month in FY 1993.	Approximately \$23 billion in benefits was provided in FY 1993.
EBT	Demonstration projects showed no increase in participation as a result of introducing EBT.	No increase occurred, since there was no increase in the number of recipients after the introduction of EBT.
Cash-out option	The only demonstration project that evaluated participation showed no increase as a result of introducing cash-out.	No increase occurred because no increase in participation occurred at the one project that evaluated participation when cash-out was introduced.

Legend

EBT = electronic benefit transfer.

FY = fiscal year.

Comparison of Use of Benefits for Food Under the Coupon-Based System With Use Under EBT and the Cash-Out Alternatives

System	Trafficking	Cash change
Coupon-based system	Coupons are being used for nonfood purchases. No concrete estimate exists of the amount of coupons not used to purchase food.	Cash change is provided to recipients for coupon purchases and used for nonfood purchases. Change ranged from \$1.83 to \$2.01 per case per month at two sites prior to its conversion to EBT.
EBT option	EBT could reduce use of benefits for nonfood items; however, this has not been demonstrated under the EBT projects.	No cash change is provided under EBT system. EBT demonstration project's studies predict additional 1/2 of 1 percent of benefits will be used for food purchases.
Cash-out option	Cash-out would lessen the assurance that benefits are used for food purchases. One cash-out project suggested a reduction of 10 percent. However, cash-out would give beneficiaries more flexibility to choose where they wish to shop and could result in increased buying power for the benefits they receive.	There is less assurance under cash-out that benefits are used for food.

Legend
EBT = electronic benefit transfer.

Comments From the U.S. Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States
Department of
Agriculture

Food and
Nutrition
Service

3101 Park Center Drive
Alexandria, VA 22302

NOV 30 1994

John W. Harman, Director
Food and Agriculture Issues
Resources, Community and Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Harman:

We have reviewed the draft report, FOOD ASSISTANCE: Potential Impacts of Alternative Systems for Delivering FSP Benefits. Under separate cover, we provided technical comments to the draft report to James Fowler. The purpose of this letter is to provide formal Agency comments apart from technical and editorial detail included in our earlier response.

Examining the three main areas of benefit delivery under discussion in the report and evaluating the impact of these systems for emphasis in diverse areas is an ambitious undertaking. We recognize how difficult it is to summarize the impact of these three areas comprehensively in a few pages. We appreciate GAO's support of the Agency's efforts to move toward Electronic Benefit Transfer (EBT) System as indicated in this draft report and in GAO's earlier testimony on the subject.

Nonetheless we would like to comment on several key areas of this report.

Statements Concerning A \$2 Billion Misuse of Food Coupons Are Misleading

On page 4, the current draft states, "Some have estimated that over \$2 billion in food stamps are used illegally each year." GAO subsequently admits that it could not find any evidence to support this figure as the level of Program trafficking. Food Stamp trafficking, whether committed by the retailer or the recipient, is by its very nature an illegal and covert action. Consequently, there are no data to support the \$2 billion as a figure representing the Program benefits diverted to Food Stamp trafficking.

The Agency is concerned that, despite the disclaimer, the inclusion of an unsupported and unattributed amount in the report will lend this figure unwarranted creditability. It is possible that this figure was provided to GAO through misunderstanding of other Program information. If such is the case, we would like the opportunity to be able to resolve any confusion to the respondent or to GAO through this report.

See comment 1.

John W. Harman, Director

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See comment 2.

GAO Should Avoid the Misperception that Alternate Forms of Issuance Can Reduce Certification Errors

It is frequently stated throughout the report, that as an alternative to the present food stamp coupon issuance system, EBT and cash-out will not reduce certification fraud. The reader is left with the impression that the alternative issuance systems are somehow deficient in that they do not do more to combat this form of Program loss. The point that seems to be lost throughout the discussion is that the eligibility criteria and the process for determining benefit levels remain unchanged under any of the issuance systems studied by the GAO. The current coupon system, EBT systems and cash-out systems all rely on a standard certification process set by statute and Program regulations. Errors in the application of these regulations or client misrepresentation of economic circumstances are the cause of the loss and not the form of that the benefit issuance takes.

We believe that the report should not unintentionally emphasize that the issuance systems studied fail to combat certification fraud. As methods of issuance, these systems have no direct applicability to reducing the incidence of certification error and certification fraud. This needs to be stated more directly in the several areas of the report where this is mentioned.

FCS Is Committed to Reducing Losses At Certification

In order to combat certification fraud, FCS has undertaken a comprehensive payment accuracy initiative which will involve commitment of effort and resources at all levels of responsibility. At FCS headquarters, a core team has been created to work exclusively on development and coordination of payment accuracy issues.

On November 16 and 17, FCS held a national conference to discuss the problems of management and accuracy in the Food Stamp Program with State Commissioners and other high level State and Federal officials. This conference underscored the Administration's commitment to enhancing program integrity into the Food Stamp Program.

FCS will perform data analysis and undertake initiatives to assist States in developing payment accuracy strategies. As a part of the FY 1995 budget allocation for error reduction, FCS will set aside \$1 million for error reduction activities in addition to approximately \$379,000 in funding for State Exchange Program. The State Exchange Program provides funds that allow State and local agencies to travel to other localities to observe and share proven methods to reduce certification and issuance errors.

See comment 3.

John W. Harman, Director

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In addition, FCS is taking a number of aggressive actions to improve collection of recipient claims in order to encourage applicants to provide accurate information about household circumstances and thereby reduce errors made during the certification process. Some of these actions include participation in the Federal Income Tax Refund Offset program and a test of the Federal salary offset to be initiated in the coming fiscal year.

Cash-Out Does Not Eliminate the Root Problems Associated With Coupon Trafficking

Although we recognize that GAO does discuss limitations in benefit delivery through cash-out, throughout the report GAO states that cash-out eliminates coupon trafficking. Because clients receive Program benefits in the form of cash payments under cash-out, the issue of the "illegality" of the conversion of benefits presented through coupon or EBT systems is eliminated.

The root problem of recipient trafficking in the Food Stamp Program is the diversion of benefits away from the intended Program objective of providing food and nutritional support to low-income households. Individuals who discount food coupons or EBT benefits for cash do so with an intent to obtain the cash for purposes other than the purchase of food. The direct provision of cash under cash-out provides a greater opportunity for that diversion. Analysis of food purchasing practices in the Agency's Cash-out demonstrations supports the view that there is a greater diversion of benefits away from food purchases. The fundamental loss from trafficking is the diversion of benefits away from the stated objectives of the program, not the "illegality of the action."

In several places in this report, GAO does conclude that there is a greater risk that benefits will be diverted away from food purchases under cash-out. FCS believes that the loss in nutritional support under trafficking in coupon-based and EBT systems to be similar to the loss associated through the use of cash provided under cash-out for nonfood purchases.

GAO is correct in its assessment that the administrative costs of investigation and prosecuting "trafficking" are eliminated under cash-out, although, by error, those costs are overstated in the draft version of this report. We believe that GAO has included the much larger costs associated investigating and prosecuting Food Stamp applicant certification fraud in its numbers on trafficking.

See comment 4.

See comment 5.

John W. Harman, Director

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**GAO Should Modify Its Observations on Cost Effectiveness of the
Five EBT Demonstrations Studied In This Report**

When presenting the overall cost-effectiveness of the Agency's five EBT demonstrations, the GAO concludes that three of these systems are not cost-effective. This observation is misleading, because two of the three projects cited (Pennsylvania and Ohio) were technology feasibility tests and were not expected, while under test, to be cost-effective. Both demonstrations were designed to be "food stamp" only tests operating on a very small scale. The conditions under which they were established are not the conditions under which current demonstrations are being authorized. We would appreciate consideration of report modifications in this area.

In several places in this Report, GAO indicates that the costs associated with EBT reductions in fraud and benefit diversion have not been quantified. In fact, all EBT evaluations provide specific cost estimates associated with fraud and loss in the coupon and EBT systems under consideration. It would be more accurate to state that for some components of fraud, these estimates are based on expert judgements rather than records documenting actual experience or that these estimates apply specifically to the systems under evaluation and may not be generalizable.

Under separate cover, we provided James Fowler with a comprehensive listing of observations which we have termed "technical comments". Included among the technical comments are specific page references in your report where some of the concerns noted above can be addressed.

Our Office of Inspector General has also advised us that they have nothing to add or modify with respect to the issues presented in this report that relate to their operations.

We appreciate the opportunity provided by GAO to provide comments to the Draft Report. Please let us know if we may be of assistance in preparing the final report.

Sincerely,



William E. Ludwig
Administrator

The following are GAO's comments on the U.S. Department of Agriculture's letter dated November 30, 1994.

GAO Comments

1. As we stated in our report, we could not find any evidence to corroborate the widely reported estimates of food stamp trafficking. However, because this estimate is widely cited in discussions of food stamp fraud, we believe it should be addressed in our report.
2. We agree with USDA that neither the electronic benefit transfer (EBT) or cash-out alternatives will affect the fraud, waste, and abuse that occur during the participant eligibility and benefit determination process. Each of the three benefit distribution systems retains the same eligibility and benefit determination process. We have clearly made this point in the report.
3. We have revised the report to recognize USDA's recent initiatives to reduce the overpayment of benefits.
4. USDA points out that although not illegal, under cash-out, there is a greater likelihood that benefits would be used for nonfood purchases, which runs counter to the purpose of the program. We have revised the report to clarify our treatment of this issue.
5. In chapter 2 of the report, we indicated that in fiscal year 1993, the federal government spent about \$113 million to combat fraud, waste, and abuse in the current coupon-based system of delivering benefits. This includes the cost of investigating eligibility fraud as well as the costs of investigating both retailers' and participants' trafficking. Under cash-out, the cost of investigating trafficking would be eliminated. In a draft of the report, we mistakenly implied that the full \$113 million in policing costs would be eliminated under the cash-out option. Only the portion of the policing costs associated with trafficking would be eliminated. Data are not available to precisely calculate this portion of the policing cost; however, available information demonstrates that these costs total in the millions. We have revised the report accordingly to clarify this point.
6. Our report recognizes that the Maryland demonstration has been the only statewide application of EBT. We agree that the other four projects, including the Ohio and Pennsylvania projects, were limited-scale applications and note this in our report. We also state that the cost-effectiveness of these applications could change as they are expanded

to include more participants. In our view, cost information was important at all the limited-scale demonstrations regardless of whether they were intended to measure the cost-effectiveness of the projects. We believe our report fairly portrays the purpose and cost experience of the EBT demonstrations.

7. We believe our report accurately identifies where estimates are based on quantitative data and where estimates are based on professional opinions.

8. USDA provided a number of technical suggestions and corrections to improve the clarity and accuracy of the report. We have incorporated these changes in the report as we deemed appropriate.

Comments From the U.S. Secret Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
UNITED STATES SECRET SERVICE

SEP 13 1994

Mr. John W. Harman
Director, Food and
Agriculture Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Harman:

I am in receipt of your August 24, 1994, correspondence which was directed to Secretary Lloyd M. Bentsen. The correspondence addresses the General Accounting Office (GAO) draft report entitled "Food Assistance: Potential Impacts of Alternative Systems for Delivering Food Stamp Program Benefits," which compares three optional benefit delivery systems; Food Stamp Coupons (FSC), Electronic Benefits Transfer (EBT) Cards and the Cash-out program. The report, in part, cites information provided by U.S. Secret Service Special Agents on security issues associated with the delivery of food assistance benefits and invites comments from the Secret Service on our activities mentioned in the report.

The Secret Service is authorized to investigate fraud in the Food Stamp program and the counterfeiting of Food Stamp Coupons thru Title 18, USC 3056. This section charges the Secret Service, in part, as a law enforcement agency within the Department of Treasury, with the enforcement of criminal laws relating to obligations and securities of the United States. Food Stamp Coupons are defined as an "obligation or other security" of the United States under Title 18, USC Section 8. The Secret Service investigates Food Stamp Trafficking fraud jointly with the U.S. Department of Agriculture Office of Inspector General in accordance with the Food Stamp Act of 1977, as amended in Title 7, USC 2011-2032. In addition, the Secret Service investigates Food Stamp Coupon counterfeiting pursuant to Title 18, USC, Sections 471, 472, and 473, all of which are criminal statutes associated with counterfeiting. Based on the Secret Service's expertise and historical knowledge of FSC trafficking and counterfeiting, our agents assessed for the GAO the possible affects that Cash-out or EBT may have on current food stamp fraud. These comments were chronicled in the aforementioned GAO report.

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In response to your invitation, the Secret Service would like to reaffirm the information our agents previously provided to GAO regarding the secure delivery of food assistance funds. In addition, we will address other areas concerning the secure delivery of food assistance funds and other government entitlements. These observations are based not only on the Secret Service's experience in investigating Food Stamp Coupon trafficking and counterfeiting, but also on investigating false applications and access device fraud as it applies to EBT trafficking and counterfeiting.

The Secret Service is the primary federal agency charged with enforcement of Title 18, USC 1029, (Fraud and Related Activities In Connection To Access Devices). This jurisdiction tasks the Secret Service with investigating the fraudulent use of any access device to obtain money, goods or services. The account number on an EBT card is defined as an access device; therefore the fraudulent use of that number may be investigated by the Secret Service. We feel that our expertise investigating access device fraud in the commercial credit and debit card industries uniquely qualifies the Secret Service to offer advice concerning the potential for fraud in government EBT systems.

The Secret Service has the following comments and recommendations concerning security issues associated with the food assistance delivery options addressed by the GAO draft report.

Chapter one of the GAO report assesses the current Food Stamp Program's vulnerability to fraud, waste, and abuse and lists four categories of these vulnerabilities. Listed below are the four GAO categories and the Secret Service's response to those problems.

1. "The Program's applicants receive benefits to which they are not entitled because of weaknesses in the eligibility and benefits determination process."

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The report goes on to explain this weakness in the eligibility and benefits determination process causes overpayments of \$5.6 billion per year and that these overpayments occur because of state agency error, inadvertent program recipient error and intentional program violation. Of these three areas of concern, the Secret Service has identified "intentional program violations" as a systemic problem which can be significantly impacted.

Intentional program violations occur in part, in the initial application for benefits. The possibility of ineligible applicants obtaining additional benefits by utilizing multiple false identities is of considerable concern. The Secret Service has noted in our ongoing investigations into commercial credit and debit card fraud, the ability of criminals to develop multiple identities when applying for cash, goods, and services. These investigations have identified sophisticated false identification and application schemes to obtain fraudulent credit and debit card accounts which are eventually compromised for high dollar amounts.

Although no false application statistics are available on fraudulent applications in the current food stamp program, commercially Visa and Mastercard report combined losses of over \$28 million in 1993, due to false applications. While fraudulent applications represent only 2.8 percent of their losses due to fraud, statistics show that this problem has grown more than 33 percent during the past 2 years.

The Secret Service believes that of all of the security problems associated with the delivery of government benefits, whether they are delivered via Food Stamp Coupons, EBT cards, Cash-out programs or by other means, the potential fraudulent application problem should be an enforcement focal point. This is true particularly if EBT cards are selected as the delivery system for not only food benefits but also other government entitlement programs. The dollar amount associated with multiple benefits on one EBT card would make fraudulent EBT applications more attractive to criminals currently using their skills in producing false identification to fraudulently apply for the more lucrative commercial credit card.

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Fraud by recipients applying for multiple benefits by use of false identities can be curtailed by verification of the true recipient in the application phase of the food benefits issuance program. To link the true identity of the applicant to one set of benefits and to prevent the applicant from filing multiple applications for benefits, biometrics should be considered. Biometrics is a distinctive means of individual identification, such as photographs and fingerprints. For application verification purposes, fingerprint identification would offer the greatest advantage.

State of the art technology in fingerprint identification is available in the Automated Fingerprint Identification System (AFIS). Use of this computer system to positively identify applicants would require that recipients be fingerprinted at the time of their application for benefits. This fingerprinting establishes a permanent identity of the applicant. AFIS compares the fingerprints of all benefit applicants with the fingerprints of all other recipients on file thereby identifying anyone attempting to apply for multiple benefits with false identification information or documents. AFIS is currently successfully being utilized in the Los Angeles County Welfare System to verify the identity of all applicants and defeat fraudulent application schemes.

The Secret Service has concluded that due to the known ability of criminals to produce false identification and use it to fraudulently obtain cash, goods, and services on a large scale in the commercial credit card industry, the potential exists for using these same schemes to fraudulently obtain food assistance delivery and other government benefits. Implementation of AFIS in the application and issuance phase of the FSC, EBT, or Cash-out systems, could defeat these schemes and significantly affect the \$1.35 billion in fraud that GAO associates with intentional program violations.

See comment 1.

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2. "Participants in the Program use benefits for nonfood purposes"

Food Stamp Coupon Program regulations specify that participants must use food stamp benefits only to purchase food items from food store retailers authorized by FNS to accept FSC's. The sale or trading of FSC's by food stamp recipients for nonfood items or cash is referred to as "trafficking." This occurs when recipients sell their FSC's to brokers for a discounted amount with the broker in turn selling the FSC's to collusive merchants or the recipient selling the FSC's directly to the collusive merchants for a discounted amount. In either scenario, the merchant then redeems the FSC's for full face value.

The GAO report states that numerous FSC Program officials relate trafficking is widespread and involves a significant amount of food assistance benefits with FSC's essentially used as a second currency, often openly traded in the streets. GAO reports that 24 percent of the Food and Nutrition Service's 220,000 authorized stores sell nonfood items and 3200 retailers exchange FSC's for cash rather than food. It is quite probable this assessment is in the low range regarding FSC trafficking as Secret Service investigators have found that FSC trafficking is widespread in all areas of the country.

With regard to the FSC Program's objective of ensuring that benefits are actually used to purchase food, the Secret Service agrees with the GAO's findings that EBT appears superior to both the FSC and Cash-out systems. The Secret Service has found this to be the case in current pilot EBT programs for two reasons. First, EBT systems require a Personal Identification Number (PIN), be used by the recipient in conjunction with the EBT card when redeeming the card for purchases. This requirement may significantly reduce trafficking because this system is usually defeated only with the recipients' cooperation in compromising the PIN. The current FSC system provides no avenue to link the coupons to the recipient which in turn allows the recipient to sell the FSC's to traffickers without being identified.

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Secondly, EBT computer profiling programs developed by law enforcement officials that flag suspicious EBT transactions are being used to target collusive merchants for trafficking investigations. This profiling enhances law enforcement officials' ability in identifying collusive merchant fraud. In contrast, investigators are only able to identify FSC trafficking merchants by developing informants and making undercover sales to those merchants, a time consuming and costly method of investigation. Cash-out programs provide no method of determining if food assistance benefits are used to purchase food items.

To summarize, the PIN somewhat ensures that the EBT card is used by the recipient for purchases and computer profiling further assists in attempting to ensure that merchants accept the card for only authorized purchases.

Despite the advantages EBT systems have over FSC and Cash-out systems to ensure benefits are used for authorized food purchases; no system will guarantee that benefits are used for the purchase of food items. However, additional methods could be employed in EBT systems in an attempt to ensure authorized purchases are made. The use of scanners at the Point of Sale (POS) terminal would ensure that only food items are purchased if the scanners are programmed to accept only the authorized items. Another possibility involves the use of AFIS scanners at the POS terminal to help ensure only the intended benefit recipient is using the EBT card for the purchase.

The Secret Service concurs with the GAO report's conclusion that an EBT system offers the potential to reduce some, but not all fraud, waste and abuse in the Food Stamp Program. The ways in which EBT may reduce trafficking by use of the PIN and identifying collusive merchants by use of computer profiling has been clearly demonstrated in the current EBT pilot projects. However, further security methods should be implemented to ensure that food benefits funds are actually redeemed for food purchases by the intended recipient. Emphasis on recipient integrity in both the application and redemption process must also be enhanced.

See comment 2.

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See comment 3.

3. "Counterfeiting of Food Stamp Coupons Is Not A Major Threat"

The Secret Service reaffirms their statement reported by GAO that counterfeiting of Food Stamps is not a major threat because people with the skills necessary to be successful counterfeiters generally devote their energies to counterfeiting currency of higher denominations more than food stamps, which have a maximum denomination of \$10. The Secret Service does however, recognize the potential for large scale counterfeiting of EBT cards. This is true particularly if EBT cards are chosen as the delivery system for not only food benefits but all other government entitlement programs. As previously stated, the high dollar amounts associated with multiple benefits on one EBT card would make counterfeit EBT cards more attractive to criminals who currently use their card counterfeiting skills to produce the more lucrative commercial credit card. Although there is no cost effective way to produce an EBT card that is immune to counterfeiting, the Secret Service believes the use of security features currently found in commercial credit cards can deter large scale counterfeiting. Security features currently used include: a stamped hologram foil, signature panel, fine line printing graphics, watermark technology, and encoded biometric identifiers. In addition, the use of PIN's in conjunction with card use will serve as a further safeguard against counterfeiting.

4. "The theft or loss of coupons in the mail"

The Secret Service does not investigate the theft or loss of FSC's from the mail. However, the Secret Service agrees with the GAO's conclusion that EBT cards would be less susceptible to compromise than FSC's in that regard. EBT cards require the use of a PIN to negotiate the card benefits, thereby making it difficult for criminals to obtain both the card and PIN. In contrast, stolen FSC's are more easily redeemed by criminals.

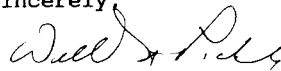
-8-

The above listed four categories of opportunities for fraud, waste, and abuse in the delivery of food stamp assistance benefits address known criminal activities that affect the security of the three delivery systems. The Secret Service maintains that whatever system is selected to deliver benefits, it must address the problem of applicant verification in order to ensure that legitimate recipients are receiving only their appropriate benefits. Failure to use the available technology to defeat fraud in the initial application phase of the benefit delivery program will open the entire system to fraud and abuse.

In conclusion, the Secret Service agrees with the GAO that of the three studied benefit delivery systems, EBT provides the most potential to reduce waste, fraud, and abuse, because of features that make EBT transactions more easily traced and audit trails which more readily identify collusive merchants. However, the Secret Service maintains that applicant verification in the initial phase of an EBT program and further safeguards should be implemented.

We acknowledge that a variety of entities, with their respective priorities, play a role in the design and implementation of any food stamp program system(s). We recommend that whichever program(s) is/are under consideration, security safeguards be evaluated on an ongoing basis. In that way, systemic and enforcement enhancements may be properly integrated, remembering that the goals of such a program and those of law enforcement are not mutually exclusive. We welcome the opportunity to be involved in any such initiative; believing that we can make a contribution.

Sincerely,



William H. Pickle
Executive Assistant
to the Director
(Congressional Affairs)

The following are GAO's comments on the U.S. Secret Service's letter dated September 13, 1994.

GAO Comments

1. The Secret Service makes reference to an Automated Fingerprint Identification System that could be used to reduce fraud by applicants. This automated computer system, according to the Secret Service, has been used in the Los Angeles (California) County Welfare system to verify the identity of welfare applicants and defeat fraudulent application schemes. Our review focused on the broader issues of fraud, waste, and abuse and not necessarily on technologies for detecting wrongdoing. Thus, this automated system and its application were outside the scope of our review and are not addressed in this report.
2. The use of point-of-sale scanners was also outside the scope of our review.
3. We have modified the report to reflect the Secret Service's comment that EBT cards could become attractive to counterfeiters, should the number of programs and dollar amount of benefits on the cards increase.

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