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FOOD ASSISTANCE

Reducing Fraud and Abuse in  
the Food Stamp Program With  
Electronic Benefit Transfer  
Technologies

Statement for the Record by  
Robert A. Robinson, Associate Director,  
Food and Agriculture Issues,  
Resources, Community, and Economic  
Development Division



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Mr. Chairman and Members of the Committee:

We are pleased to have the opportunity to contribute to your hearings on fraud and abuse in federal food assistance programs. As you know, our current work on fraud and abuse in the Food Stamp Program is being done in response to a joint request from this Committee and the House Committee on Agriculture. We are examining the current coupon-based system of providing food assistance benefits and possible alternatives to the current system. The alternatives we are considering are (1) the use of electronic benefit transfer (EBT) technologies to deliver benefits, and (2) the option of providing direct cash to program recipients, referred to as "cash-out." The EBT applications we are reviewing are those that use some form of credit or debit card technology as a means of distributing benefits. Program recipients would access their benefits using their card and an individual personal identification number at special terminals in retail stores.

In view of the EBT Food Stamp Program legislation you proposed late last year, my statement will focus primarily on EBT's potential for reducing fraud and abuse. I must preface my comments, however, by saying that our work is not yet completed. We are currently in the process of reviewing and analyzing evaluation reports on U.S. Department of Agriculture (USDA) sponsored EBT demonstration projects, as well as interviewing project officials to obtain additional information on how the demonstrations fared. Our observations at this point are only preliminary; a great deal of analysis remains to be done.

In summary, we believe that EBT could reduce fraud and abuse in the Food Stamp Program, particularly fraud from counterfeiting and mail theft. However, it does not appear that EBT would have a major impact on reducing fraud and abuse that occur at the time recipients apply for food stamp coupons and states determine their eligibility and the amount of assistance to which they are entitled. Furthermore, while EBT has the potential to reduce the sale or trading of food stamps--known as trafficking--the amount of reduction that would result from using EBT is unclear at this time. Our review of EBT demonstration project reports also indicates that if EBT systems are put in place solely to distribute food stamp benefits, they could be more costly to the federal government than the current coupon-based system. EBT could be more cost-effective, however, if it were used in conjunction with other federal and state assistance programs, such as Aid to Families With Dependent Children and the Supplement Food Assistance Program for Women, Infants, and Children, to deliver a range of benefits. Several states have already moved in this direction. EBT's greatest benefit to the federal government is likely to be in the context of a combined approach to deliver multiple program benefits rather than as a mechanism for the Food Stamp Program only.

## MAGNITUDE OF THE FOOD STAMP PROGRAM

The Food Stamp Program is the largest food assistance program in the nation, and it has grown significantly in recent years. In fiscal year 1992, an average of about 26 million people received benefits each month--about 1 out of every 10 Americans. Almost \$20 billion in benefits was paid to these individuals--which represented about one-third of USDA's budget. Before discussing our observations on EBT, I would like to offer some comments regarding the extent of fraud and abuse in the Food Stamp Program.

## EXTENT OF FRAUD AND ABUSE IN THE FOOD STAMP PROGRAM

Fraud and abuse in the coupon-based Food Stamp Program can occur in four primary ways. First, when people apply for benefits, they may not be truthful about their economic situation and may thereby receive food stamps when they are not eligible, or receive more benefits than they are entitled to receive. Second, individuals can counterfeit food stamp coupons and use them to obtain food to which they are not entitled. Third, food stamp coupons delivered by mail can be stolen and used by unauthorized individuals. Food stamps stolen in the mail are normally replaced for the recipient. Fourth, recipients may misuse food stamp coupons by selling or trading them for cash or other items--referred to as trafficking--or buying nonfood items at retail grocery stores with their benefits. Also included in the trafficking category is retailers' misuse of food stamp coupons. For example, when food retailers receive food stamps through recipients' purchases of food, the retailers are supposed to redeem the stamps at banks or other financial institutions. These stamps are not to be used as cash. However, food retailers sometimes use the food stamps as cash to pay food wholesalers or for other purposes.

Eligibility fraud, counterfeiting, and food stamp mail theft have an immediate effect on program costs. While trafficking represents a fraudulent use of food stamps and a diversion of benefits from their intended purpose, controlling trafficking will not lead to reduced federal food stamp expenditures. An end to trafficking would undoubtedly enhance the program's effectiveness, but program expenditures would remain the same. Stamps issued to recipients that are subsequently sold or traded to unauthorized individuals are eventually redeemed by the U.S. Treasury at their face value. Indirectly, however, trafficking and the misuse of stamps can, and does, have an impact on federal expenditures. This manifests itself in the amount of money that is spent each year by federal and state authorities in policing the use of food stamps, investigating wrong-doing, and prosecuting those found to be defrauding or abusing the program.

Each category of abuse is discussed below. Also following is a discussion of the level of resources being devoted to detecting and investigating food stamp fraud.

### Eligibility Fraud

According to data provided by USDA's Food and Nutrition Service (FNS), in fiscal year 1992, about \$1.7 billion in food stamp overpayments were made to Food Stamp Program participants. While our analysis of why these overpayments occurred is continuing, FNS estimates that about 25 percent of the overpaid amount, or \$425 million, occurred because of recipient eligibility fraud. The remaining \$1.275 billion occurred because of legitimate recipient or state agency error, according to FNS. While the estimate of eligibility fraud exceeds \$400 million, claims against recipients to recover overpayments totaled only about \$32 million in fiscal year 1992. At this point in our review, we are not certain why there is such a wide variance between the FNS estimate of fraudulent overpayments and efforts to reclaim these funds.

### Counterfeiting

According to the U.S. Secret Service, counterfeiting of food stamp coupons 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 stamp coupons. The largest food stamp coupon denomination is \$10. In 1992, the Secret Service investigated only 65 food stamp counterfeiting cases. According to Secret Service and Federal Reserve information, from October of 1986 through January of 1992, the total amount of counterfeited food stamp coupons was approximately \$1.2 million.

### Mail Theft

As with counterfeiting, the theft of food stamps mailed out to program participants does not appear to be a major fraudulent activity in the Food Stamp Program. According to FNS, about \$6.1 billion of the \$20 billion in food stamp benefits issued in fiscal year 1992 was distributed through the mail. In that same fiscal year, FNS reported that about \$22.5 million in food stamp coupons was lost in the mail--less than one-half of one percent of the \$6.1 billion in benefits issued through the mail. How much of the \$22.5 million in mail loses was specifically theft is not known. According to information provided to us by the Postal Inspection Service, about 34,000 reports of food stamps being lost or stolen in the mail were received in fiscal year 1992.

### Food Stamp Trafficking and Use of Benefits for Nonfood Purchases

Based on our work to date, we have little doubt that food stamp trafficking and the use of food stamps for nonfood purchases is occurring. However, at this point, we have not identified any reliable data that document the extent of the problem. We have seen estimates suggesting that food stamp trafficking may account for as much as 10 percent of the benefits issued. If this is accurate, about \$2 billion of the almost \$20 billion in benefits issued in fiscal year 1992 would have been used illegally. However, determining precisely just how much trafficking is occurring and how often food stamps are being used for nonfood purchases would be an extraordinarily difficult and expensive effort. Doing so could require literally an army of investigators tracking a nationwide sample of program recipients for several months to determine how they used their food stamps.

### Cost of Detecting and Investigating Fraud and Abuse in the Coupon-Based System

Both state and federal authorities are engaged in efforts to combat fraud and abuse in the Food Stamp Program. With respect to the states, in fiscal year 1992, the 50 states spent \$83 million in conducting recipient antifraud investigations that qualified for reimbursement from federal funds. With these resources, the states conducted approximately 437,000 investigations and identified over 195,000 cases of fraud. States also spent their own funds on antifraud activities, but we have not quantified these amounts.

With respect to enforcement efforts conducted by federal agencies, in fiscal year 1992, the various agencies spent approximately \$15 million to investigate and combat the misuse of food stamps. These expenditures included the following:

- USDA's Office of Inspector General spent \$8.9 million investigating trafficking. These cases generally involve all forms of trafficking in food stamp coupons.
- FNS spent \$3.8 million on investigating food retail stores suspected of fraud. FNS generally limits its investigations to food store retailers suspected of buying food stamp coupons from program recipients for cash or selling nonfood items for food stamps.
- Postal Service investigators spent \$1.6 million investigating food stamps stolen from the mail.
- The Secret Service spent \$600,000 investigating food stamp trafficking and counterfeiting.

In addition, the Department of Justice undertakes investigations aimed at prosecuting food stamp trafficking and retailer fraud. We do not have any information on the amount being spent by the Department in pursuing the illegal use of food stamp coupons.

POTENTIAL FOR REDUCING FRAUD  
AND ABUSE WITH EBT

Our review to date indicates that EBT has the potential to reduce fraud and abuse in the Food Stamp Program. However, according to the data we have reviewed, the amount of potential reduction is not precisely quantifiable and would vary by the type of fraud or abuse. Some forms of fraud and abuse may not be affected at all, while others could be affected dramatically. For example, EBT appears to have little potential for reducing eligibility fraud. Our review of the project reports for the Reading, Pennsylvania; Albuquerque, New Mexico; and Ramsey County, Minnesota, EBT demonstrations indicates no change in the application and eligibility determination process used to determine participants' benefits from the current coupon-based system. Unless better ways of verifying applicant-supplied information prior to eligibility determination are established, individuals choosing to provide erroneous or incomplete information to the state agency can receive benefits to which they are not eligible, regardless of whether those benefits are disbursed as coupons, through an EBT card, or as cash.

EBT has significant potential to reduce fraud stemming from counterfeiting and postal theft. The need to have a personal identification number to use the EBT card to access an individual recipient's account would be a major deterrent to these types of fraudulent activities. EBT's potential to reduce the costs of food benefit theft could be dramatically affected, however, by decisions expected to be made soon by the Federal Reserve Board concerning regulations governing the liability of individuals using EBT cards. Under current Federal Reserve regulations, individuals using bank cards, such as ordinary credit cards, are liable for only \$50 in charges resulting from fraudulent use--for example, someone wrongfully using a lost or stolen credit card. A Federal Reserve decision is pending as to whether EBT cards used to provide federal benefits, such as food assistance, would be subject to the same liability as a bank card. If the liability applies, recipients could fraudulently report the loss of their EBT card and be able to have benefits replaced, subject to the \$50 liability. At the same time, other people could use the "lost" card (provided they had been given the personal identification number of the original recipient) and obtain benefits to which they are not entitled. We are told that the replacement of lost benefits would be the responsibility of the states and could greatly increase their costs.

With respect to trafficking, while we have found no data conclusively demonstrating that EBT will significantly reduce food stamp trafficking (some trafficking of EBT food stamp benefits has been documented in several states), the evaluations of current EBT demonstration projects showed that the project evaluators believe that trafficking and the use of benefits for nonfood items will decrease as the use of EBT increases. The evaluators, as well as FNS officials, believe that food stamp trafficking will decrease primarily because EBT provides an audit trail that links individual purchases to specific retailers, whereas coupons provide no such linkage. Furthermore, recipients will not be able to receive cash change when the value of a food purchase is less than the face value of an individual food stamp coupon, or combination of coupons. EBT will provide for an exact deduction of benefits from a recipient's benefit account and eliminate the need for cash change for the recipient--and thus eliminate the possibility of recipients using cash change from coupons for nonfood purchases. Security experts who evaluated the New Mexico and Minnesota demonstration projects expressed the opinion that EBT will reduce food stamp trafficking by as much as 50 percent. One state inspector general told us that, since EBT was implemented, he has seen a decrease of 10 to 15 percent in the number of referrals for food stamp fraud; however, he cautioned, as dishonest food stamp recipients and unscrupulous retailers learn more about the EBT system and its areas of vulnerability, trafficking may increase.

BIGGEST PAYOFF LIKELY IN USING  
EBT TO DELIVER BENEFITS OF MULTIPLE  
PUBLIC ASSISTANCE PROGRAMS

According to studies we have reviewed to date, using EBT to deliver food stamp benefits alone will be more costly than delivering benefits through the current coupon-based system. The Office of Technology Assessment (OTA), in its September 1993 report, Making Government Work: Electronic Delivery of Federal Services, also raises the issue of the cost effectiveness of EBT for a single-benefit program. OTA says that using EBT for multiple programs would be more cost-effective. In this regard, states that are moving toward EBT are using it as a means to combine the issuance of multiple benefits--not just for Food Stamp Program benefits. For example, Maryland, which operates an EBT system, has combined food stamps, Aid to Families With Dependent Children, General Assistance, and child support payments onto one card. This allows the state to take advantage of the economies of scale to reduce the cost of EBT to individual assistance programs. Other states are considering including refugee assistance; supplemental benefits for women, infants, and children; and medicaid benefits on their EBT systems.

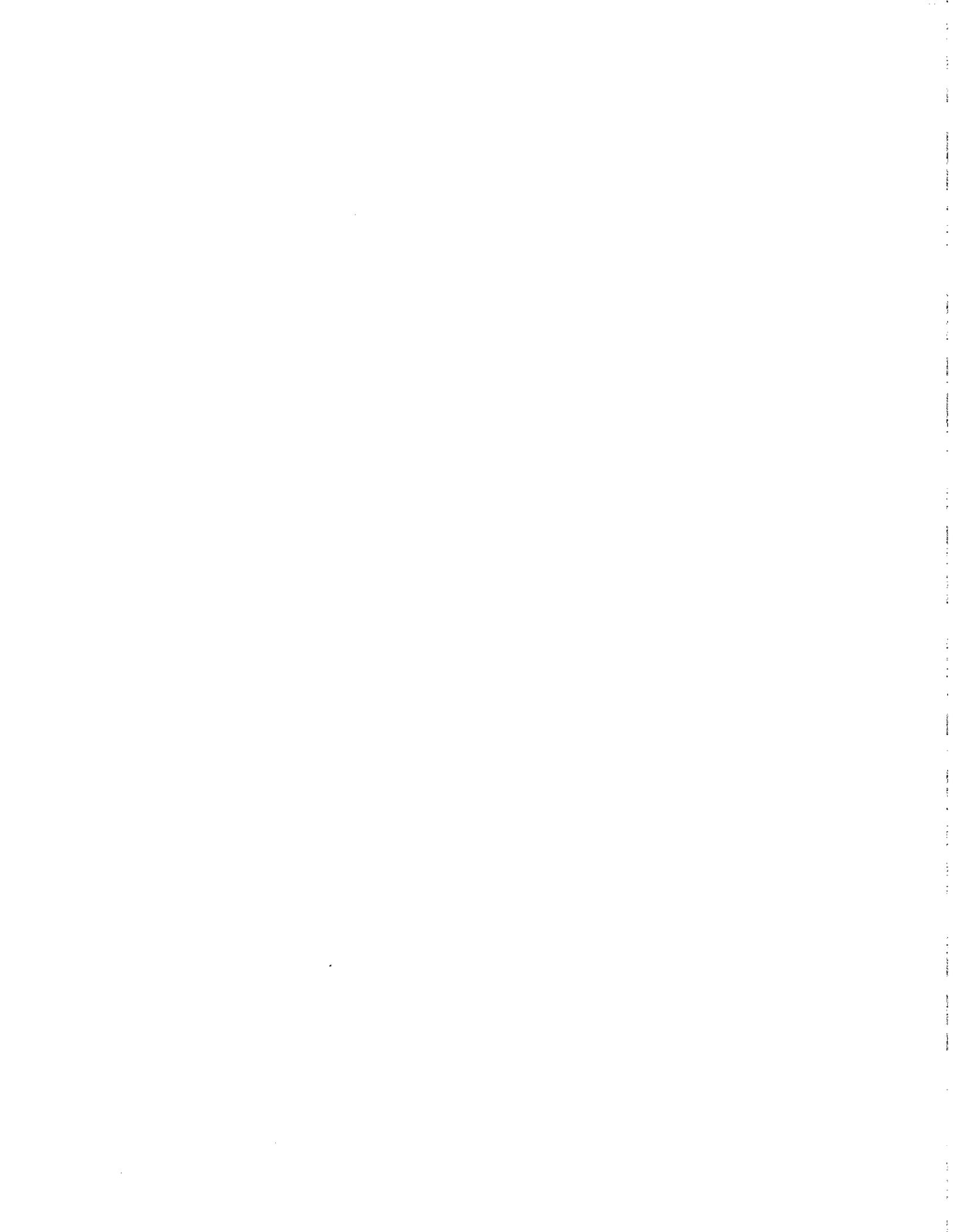
The June 1993 report of the Welfare Simplification and Coordination Advisory Committee contains recommendations directed

toward reforming the nation's welfare system that are consistent with a more broad-based application of EBT. The committee's primary recommendation is to replace the numerous federal programs that serve the needy with one, family-focused, client-oriented, comprehensive program. EBT could provide a cost-effective vehicle for distributing benefits under such a program. In the Food Stamp Fraud Reduction Act of 1993 (S.1664), which you introduced last November, you asked for a report that provided information on "the best approaches for maximizing the use of electronic benefits transfer systems for multiple Federal benefit programs so as to achieve the highest cost savings possible through the implementation of electronic benefits transfer systems." While EBT may have some benefit in reducing fraud and abuse in the Food Stamp Program, its greater pay-off may occur in the context of this larger application. In fact, it could be a starting point in efforts to restructure the federal welfare system.

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This concludes my prepared statement.

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