

October 2006

# FOOD STAMP TRAFFICKING

## FNS Could Enhance Program Integrity by Better Targeting Stores Likely to Traffic and Increasing Penalties



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Accountability · Integrity · Reliability

# Highlights

Highlights of [GAO-07-53](#), a report to congressional committees

## Why GAO Did This Study

Every year, food stamp recipients exchange hundreds of millions of dollars in benefits for cash instead of food with retailers across the country, a practice known as trafficking. From 2000 to 2005, the Food Stamp Program has grown from \$15 billion to \$29 billion in benefits. During this period of time, the U.S. Department of Agriculture's (USDA) Food and Nutrition Service (FNS) replaced paper food stamp coupons with electronic benefit transfer (EBT) cards that work much like a debit card at the grocery checkout counter. Given these program changes and continuing retailer fraud, GAO was asked to provide information on (1) what is known about the extent and nature of retailer food stamp trafficking, (2) the efforts of federal agencies to combat such trafficking, and (3) program vulnerabilities. To do this, GAO interviewed agency officials, visited 10 field offices, conducted case file reviews, and analyzed data from the FNS retailer database.

## What GAO Recommends

To reduce program vulnerabilities, GAO recommends that FNS take additional steps to target and provide early oversight of stores most likely to traffic; develop a strategy to increase penalties for trafficking, working with the USDA Inspector General as needed; and promote state efforts to pursue recipients suspected of trafficking. FNS generally agreed with findings, conclusions and recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-07-53](http://www.gao.gov/cgi-bin/getrpt?GAO-07-53).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Sigurd Nilsen at (202) 512-7215 or [nilsens@gao.gov](mailto:nilsens@gao.gov).

## FOOD STAMP TRAFFICKING

### FNS Could Enhance Program Integrity by Better Targeting Stores Likely to Traffic and Increasing Penalties

#### What GAO Found

FNS's estimates suggest trafficking declined between 1995 and 2005 from 3.8 cents per dollar of benefits redeemed to 1.0 cent, resulting in an estimated \$241 million in food stamps trafficked in 2005. The rate of trafficking in small grocery and convenience stores is 7.6 cents per dollar, significantly higher than the rate for large stores, where it is estimated to be 0.2 cents per dollar. In addition, the use of EBT cards has changed the way some benefits are trafficked, for example eliminating middlemen who used to collect and redeem large amounts of paper coupons from program participants willing to sell them.

FNS has taken advantage of EBT data to improve its ability to detect and disqualify trafficking retailers, while law enforcement agencies have conducted a decreasing number of investigations. Cases using only EBT transaction data now account for more than half of trafficking disqualifications, supplementing traditional, but more time-consuming, undercover investigations. Other federal entities, such as the USDA's Inspector General and the U.S. Secret Service, have reduced the number of traffickers they pursue in recent years and focused their efforts on high-impact cases. This has resulted in fewer cases referred for federal prosecution and fewer federal convictions for retailer trafficking.

Despite FNS progress, the program remains vulnerable because retailers can enter the program intending to traffic, often without fear of severe criminal penalties. FNS authorizes some stores with limited food supplies so that low-income participants in areas with few supermarkets have access to food, but may not inspect these stores again for 5 years unless there is some indication of a problem. Oversight of early operations is important because newly authorized retailers can quickly ramp up the amount of benefits they traffic. One location that FNS disqualified for trafficking redeemed almost \$650,000 in 9 months. In addition, FNS has not conducted analyses to identify high risk areas and to target its limited compliance-monitoring resources. Furthermore, disqualification, FNS's most severe penalty, may not be a sufficient deterrent, and FNS must rely upon others for prosecution. Finally, states' failing to pursue trafficking recipients leaves a pool of recipients willing to traffic when a disqualified store reopens.

#### This Disqualified Store, with Its Limited Counter Area and Single Cash Register, Redeemed Over \$190,000 of Food Stamp Benefits in One Month



Source: FNS.

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### Abbreviations

EBT	Electronic Benefits Transfer
FNS	Food and Nutrition Service
OIG	Office of the Inspector General
PRWORA	Personal Responsibility and Work Opportunity Reconciliation Act of 1996
USDA	U.S. Department of Agriculture

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United States Government Accountability Office  
Washington, DC 20548

October 13, 2006

The Honorable Saxby Chambliss  
Chairman  
The Honorable Tom Harkin  
Ranking Democratic Member  
Committee on Agriculture, Nutrition, and Forestry  
United States Senate

The Honorable Collin C. Peterson  
Ranking Minority Member  
Committee on Agriculture  
House of Representatives

The Honorable Gil Gutknecht  
Chairman  
The Honorable Joe Baca  
Ranking Minority Member  
Subcommittee on Department Operations,  
Oversight, Dairy, Nutrition and Forestry  
Committee on Agriculture  
House of Representatives

Every year, food stamp recipients exchange hundreds of millions of dollars in benefits for cash instead of food with authorized retailers across the country, a practice known as trafficking. In a typical trafficking situation, a retailer gives a food stamp recipient a discounted amount of cash—commonly 50 cents on the dollar—in exchange for food stamp benefits and pockets the difference. By trafficking, retailers commit fraud and undermine the primary purpose of the program, which is to help provide food to low-income individuals and families. Recipients who traffic deprive themselves and their families of the intended nutritional benefits.

In recent years, the Food Stamp Program has grown tremendously. From 2000 to 2005, the program—administered by the Food and Nutrition Service (FNS) of the U.S. Department of Agriculture (USDA), in partnership with the states—has grown from \$15 billion in benefits provided to 17 million individuals to \$29 billion in benefits to nearly 26 million individuals. Almost one in every 12 Americans participates in the program. During this period of time, FNS and the states completed

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replacing paper food stamp coupons with electronic benefit transfer (EBT) cards that work much like a debit card at the grocery checkout counter. This EBT transaction provides a wealth of new electronic information to FNS officials, who are responsible for monitoring food stamp retailers and sanctioning those who traffic. Given these major changes in the program and continued concern about retailer fraud and abuse, you asked us to provide information on (1) what is known about the extent and nature of retailer food stamp trafficking, (2) the efforts of federal agencies to combat such trafficking, and (3) the program vulnerabilities that continue to exist.

To report on what is known about the extent of trafficking, we used four FNS estimates of food stamp trafficking. The four estimates, which were the best available data on this subject, covered the calendar years 1993, 1996 to 1998, 1999 to 2002, and 2002 to 2005.<sup>1</sup> The methodology FNS used to develop these estimates has some limitations; the estimates do not provide a precise measure of food stamp trafficking.<sup>2</sup> However, they can be used to provide an indication of the magnitude of food stamp trafficking and the change in the rate over time.<sup>3</sup>

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<sup>1</sup> U.S. Department of Agriculture, Office of Analysis and Evaluation, *The Extent of Trafficking in the Food Stamp Program* (August 1995); *The Extent of Trafficking in the Food Stamp Program: An Update* (March 2000); *The Extent of Trafficking in the Food Stamp Program: 1999-2002* (July 2003); and *The Extent of Trafficking in the Food Stamp Program: 2002-2005* (September 2006).

<sup>2</sup> For example, FNS did not randomly select a sample of retailers to produce its estimates. Instead, it selected those retailers who had been investigated for trafficking and used this group to analyze and calculate the trafficking rate. FNS believes its trafficking estimates likely overstate the amount of dollars diverted by trafficking because FNS based its estimates on retailers already suspected of trafficking. However, it is possible that trafficking occurs among stores outside of the pool of suspected traffickers. To the extent that this occurs, FNS' estimates could understate actual trafficking. Also, this approach does not ensure that each retailer has a known probability of being selected in the sample, which undermines the ability to statistically generalize to a larger population.

<sup>3</sup> FNS used a relatively consistent method for each estimate; however, to improve its 1999-2002 estimate, FNS included retailers suspected of trafficking and disqualified on the basis of certain EBT transactions. To be more reflective of all its trafficking-related activities, for its 2002-2005 estimate, FNS used a number of additional data sources. These sources include closed cases on FNS's Watch List and retailers investigated by the OIG, the U.S. Department of Justice, the states, and other entities. While the additional data sources in the most recent estimate provide a broader range of trafficking investigations, this adjustment could also contribute to a lower estimate as the Watch List, for example, contains retailers that demonstrate a lesser level of suspicious behavior than retailers used for prior estimates.

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To understand the nature of trafficking, assess the efforts to combat it, and identify continued program vulnerabilities, we conducted interviews with the following program stakeholders: officials from FNS headquarters and regional offices; other officials responsible for investigating food stamp trafficking including the USDA's Office of the Inspector General (OIG) and the U.S. Secret Service; food stamp advocates and researchers; officials from industry associations and EBT contractors; and officials from selected state law enforcement bureaus. In addition, we obtained relevant information from the state audit, comptroller, and treasurer community. We selected and visited 10 FNS field offices (Chicago, Ill.; Dallas, Tex.; Denver, Colo.; Detroit, Mich.; Los Angeles, Calif.; New York, N.Y.; Portland, Ore.; Sacramento, Calif.; Tallahassee, Fla and Towson, Md.) located in the seven FNS regions. We selected these offices to achieve variation in geographical distribution, the ages of the states' EBT systems, and the number of stores that were disqualified from participating in the program for trafficking. At each office, we conducted semistructured interviews with FNS officials and used a case file review tool to review nonprobability samples of files for 163 retailers that were disqualified for trafficking in fiscal year 2005. We also interviewed officials from seven of the states where we made our field office visits.

In addition, to identify efforts to combat trafficking, we analyzed FNS's authorized retailer database, the Store Tracking and Redemption System, to determine the number of permanent trafficking disqualifications by store address, to calculate the time between a store's initial authorization and its first disqualification for fiscal years 1996 through 2005, and to determine the number of sanction actions that had been taken against a retailer leading up to the retailer's being permanently disqualified. To ensure the accuracy of the FNS data we analyzed, we interviewed agency officials to identify and resolve any inconsistencies that could affect our work. In addition, we reviewed documentation on how these data were gathered and maintained. Based on the collective information from our assessment, we determined the data are sufficiently reliable for enhancing our understanding of continuing program vulnerabilities and agency efforts in combating trafficking. We conducted our work between July 2005 and June 2006 in accordance with generally accepted government auditing standards.

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## Results in Brief

FNS estimates that about 1.0 cent per dollar of benefits redeemed in 2005 were trafficked; this trafficking usually occurred in small convenience and grocery stores and often, we found, between store owners and food stamp recipients with whom they were familiar. The national rate of food stamp trafficking declined from about 3.8 cents per dollar of benefits redeemed in 1993 to about 1.0 cent per dollar during the years 2002 to 2005. However, even at that lower rate, FNS estimates that about \$241 million in food stamp benefits would have been trafficked annually in those years. The rate of trafficking in small stores remains higher—an estimated 7.6 cents per dollar—than the rate for large stores—an estimated 0.2 cents per dollar. Since the nationwide implementation of EBT, the way some food stamp benefits are trafficked has changed. Previously, in addition to trafficking conducted directly between store owners and recipients, middlemen purchased large numbers of food stamp coupons at a discounted rate directly from recipients and then exchanged the coupons for cash from a retailer. EBT has largely eliminated the middleman. Retailers now must have the recipients' EBT card and personal identification number to conduct a trafficking transaction and are likely to limit their trafficking transactions to people from their neighborhood or with whom they are familiar.

FNS has taken advantage of EBT and other new technology to improve its ability to detect trafficking and disqualify retailers who traffic, while law enforcement agencies have investigated and referred for prosecution a decreasing number of traffickers, instead focusing their efforts on fewer high-impact investigations. To pursue traffickers, FNS traditionally sent its undercover investigators into stores to attempt to traffic benefits. Now, EBT transaction data allow FNS to act on cases based solely on suspicious transaction patterns. For these cases, FNS applies established criteria to its data to identify individual stores with exceptional patterns of EBT transactions for that store's particular type of retail operation. Cases using EBT data can be prepared in the office relatively quickly and now account for more of the 841 retailers that were permanently disqualified for trafficking in fiscal year 2005 than undercover investigations. However, undercover investigations still play an important role when EBT transaction data are insufficient to build a case against a retailer suspected of food stamp trafficking. In addition, retailer trafficking investigations by other federal entities, such as USDA's Inspector General and the U.S. Secret Service, have declined in recent years, resulting in fewer referrals for prosecutions of retailers that traffic. For example, the number of trafficking investigations opened by the Inspector General declined from 179 in 2000 to 77 in 2005, and the number of investigations it referred for prosecution to the Department of Justice declined as well. Ultimately, the



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number of federal convictions for retailer trafficking has also declined. Federal law enforcement officials told us that they are increasingly focused on high-impact investigations, such as those focused on large-scale trafficking or involving other criminal activity.

Despite the progress FNS has made in combating retailer trafficking, the Food Stamp Program remains vulnerable because retailers can enter the program intending to traffic and do so, often without fear of severe criminal penalties, as the declining number of investigations referred for prosecution suggests. FNS field office officials told us their first priority is getting stores into the program to ensure needy people have access to food, and therefore they sometimes authorize stores that stock limited food supplies but meet the minimum requirements in areas with few larger grocery stores. However, once authorized, some dishonest retailers do not maintain adequate food stock and focus more on trafficking food stamp benefits than on selling groceries, according to FNS officials, and 5 years may pass before FNS checks the stock again unless there is an indication of a problem with the store. In addition, while EBT has aided FNS's monitoring ability, some retailers have adapted their behaviors to avoid detection and found new ways to exploit the EBT technology. For instance, individuals can obtain point-of-sale machines and conduct illegal food stamp transactions in unauthorized stores or apartments. Yet, despite dwindling staff resources, FNS has not conducted the analyses to identify high risk areas and to target their compliance-monitoring resources to the areas of highest risk. Furthermore, current FNS food-stamp-trafficking penalties may not be sufficient to deter traffickers, because the most severe penalty most traffickers face is disqualification from the program and FNS must rely upon others for prosecution. Finally, if recipients suspected of trafficking are not investigated by the states, it may leave a pool of recipients ready and willing to traffic their benefits as soon as a disqualified store reopens under new management.

To reduce program vulnerabilities and help FNS better target its limited compliance-monitoring resources, we are making recommendations to the Secretary of the Department of Agriculture to require FNS to develop additional criteria to identify stores most likely to traffic, use these criteria to conduct risk assessments, and provide more targeted and early oversight of stores determined most likely to engage in trafficking. Also, we are recommending that FNS work to develop a strategy to increase the penalties for trafficking, working with the Inspector General as needed. In addition, we are recommending steps to promote state efforts to pursue recipients suspected of trafficking. The Department of Agriculture officials generally agreed with our findings, conclusions, and recommendations but

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noted they believe they do have a strategy for targeting resources through their use of EBT transaction data to identify suspicious transaction patterns. We believe that FNS has made good progress in its use of EBT transaction data; however, it is now at a point where it can begin to formulate more sophisticated analyses.

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## Background

The federal Food Stamp Program is intended to help low-income individuals and families obtain a more nutritious diet by supplementing their income with benefits to purchase nutritious food such as meat, dairy, fruits, and vegetables, but not items such as soap, tobacco, or alcohol. The Food and Nutrition Service (FNS) pays the full cost of food stamp benefits and shares the states' administrative costs—with FNS usually paying approximately 50 percent—and is responsible for promulgating program regulations and ensuring that state officials administer the program in compliance with program rules.<sup>4</sup> The states administer the program by determining whether households meet the program's income and asset requirements, calculating monthly benefits for qualified households, and issuing benefits to participants on an electronic benefits card.

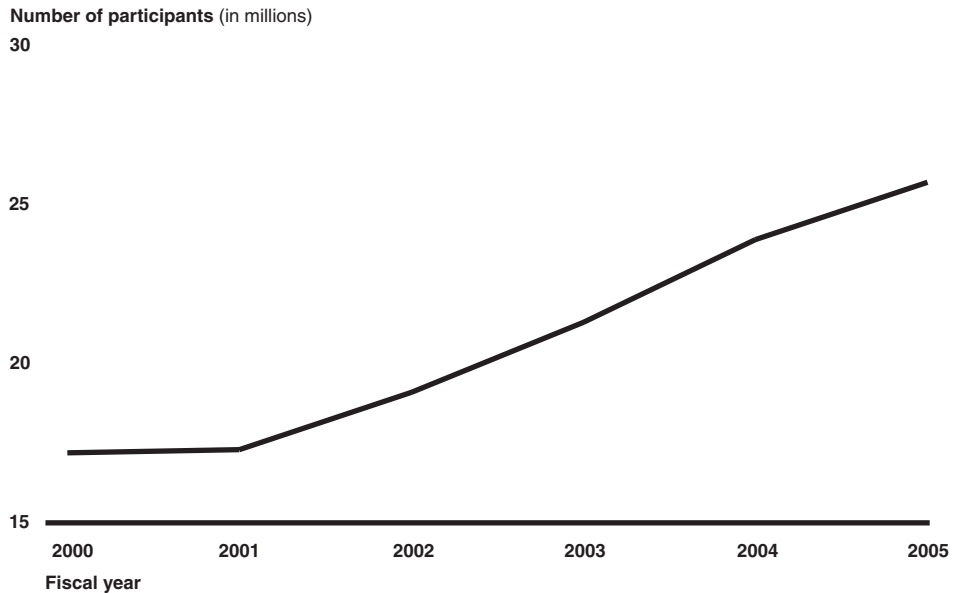
In fiscal year 2005, the Food Stamp Program issued almost \$28.6 billion in benefits to about 25.7 million individuals participating in the program, and the maximum monthly food stamp benefit for a household of four living in the continental United States was \$506. As shown in figure 1, the increase in the average monthly participation of food stamp recipients in 2005 continues a recent upward trend in the number of people receiving benefits.

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<sup>4</sup> Reimbursements for food stamp administrative costs in 44 states are adjusted each year to subtract certain food stamp administrative costs that have already been factored into these states' TANF grants. As a result, these states receive less than 50 percent of their administrative costs. See GAO, *Food Stamp Program: States Face Reduced Federal Reimbursement for Administrative Costs*, RCED/AIMD-99-231 (Washington D.C.: July 23, 1999)

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**Figure 1: Food Stamp Participation Has Increased Since Fiscal Year 2000**



Source: FNS.

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## Retailer Authorization

Retailers are the front line for determining which goods can be purchased and for ensuring the integrity of the food stamp transaction. FNS operates 44 field offices throughout the country, and they have the primary responsibility for authorizing retailers to participate in the Food Stamp Program. To become an authorized retailer, a store must offer on a continuing basis a variety of foods in each of the four staple food categories—meats, poultry or fish; breads or cereals; vegetables or fruits; and dairy products—or 50 percent of its sales must be in a staple group such as meat or bakery items. However, the regulations do not specify how many food items retailers should stock. The store owner submits an application and includes forms of identification such as copies of the owner’s Social Security card, driver’s license, business license, liquor license, and alien resident card. The FNS field office program specialist then checks the applicant’s Social Security number against FNS’s database of retailers, the Store Tracking and Redemption System, to see if the applicant has previously been sanctioned in the Food Stamp Program. The application also collects information on the type of business, store hours, number of employees, number of cash registers, the types of staple foods offered, and the estimated annual amount of gross sales and eligible food stamp sales.

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If the application is complete, most field offices will forward a request to the private contractor employed by FNS to conduct on-site inspections that verify the information in the application and provide additional information for the approval process. The contractor visits the store and submits a map of the store layout, the inspection form, and photographs of the outside and inside of the store and its inventory. The contractor reports information on the type of store and its location, access to parking, the number of cash registers and EBT point-of-sale devices,<sup>5</sup> whether shopping carts or baskets are available, and the availability of nonfood stock and services offered, such as liquor, tobacco, gasoline, check cashing, and lottery tickets. As part of the inspection, the contractor also evaluates the general store conditions and notes problems—such as empty coolers and shelves, dusty cans and expired or outdated foods—that could indicate that this may not be a viable grocery operation. Upon receiving favorable information from the contractor, the FNS program specialist authorizes the store to participate in the Food Stamp Program for 5 years. Unless a problem arises with the store, it typically would not be re-inspected until it applies for reauthorization.

At the end of fiscal year 2005, more than 160,000 retailers were authorized to accept food stamp benefits. During the fiscal year, almost 24,000 new stores were authorized, 30,000 were reauthorized and almost 17,000 left the program, most for voluntary reasons.<sup>6</sup> As shown in table 1, supermarkets account for only about 22 percent of the authorized stores but redeem the lion's share of food stamp benefits. FNS defines a supermarket as a store with \$2 million of gross sales, three or more cash registers, and coded as a supermarket on its food stamp application.

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<sup>5</sup> Point-of-sale devices or terminals read the recipient identification information from the magnetic strip on the back of the food stamp EBT card. That information, along with the amount of the purchase, would be sent to the state's EBT contractor for approval of the transaction.

<sup>6</sup> Voluntary reasons include changes in store ownership, changes in the nature of the store, or store closings. Involuntary reasons include the store no longer meets the basic eligibility requirements for authorization or the store had no redemption activity.

**Table 1: Percentage of Authorized Stores and Food Stamp Redemptions by Store Category for Fiscal Year 2005**

Type of firm	Percentage of total authorized firms	Percentage of total food stamp dollars redeemed
Supermarkets	22.34	86.44
Grocery stores	21.59	6.57
Convenience stores	19.95	1.86
Combination stores <sup>a</sup>	22.17	1.95
All other stores <sup>b</sup>	12.31	2.97
Meal services <sup>c</sup>	1.64	.21

Source: FNS data.

<sup>a</sup>This category includes stores such as grocery/gas, grocery/bar, grocery/restaurant, and grocery/merchandise.

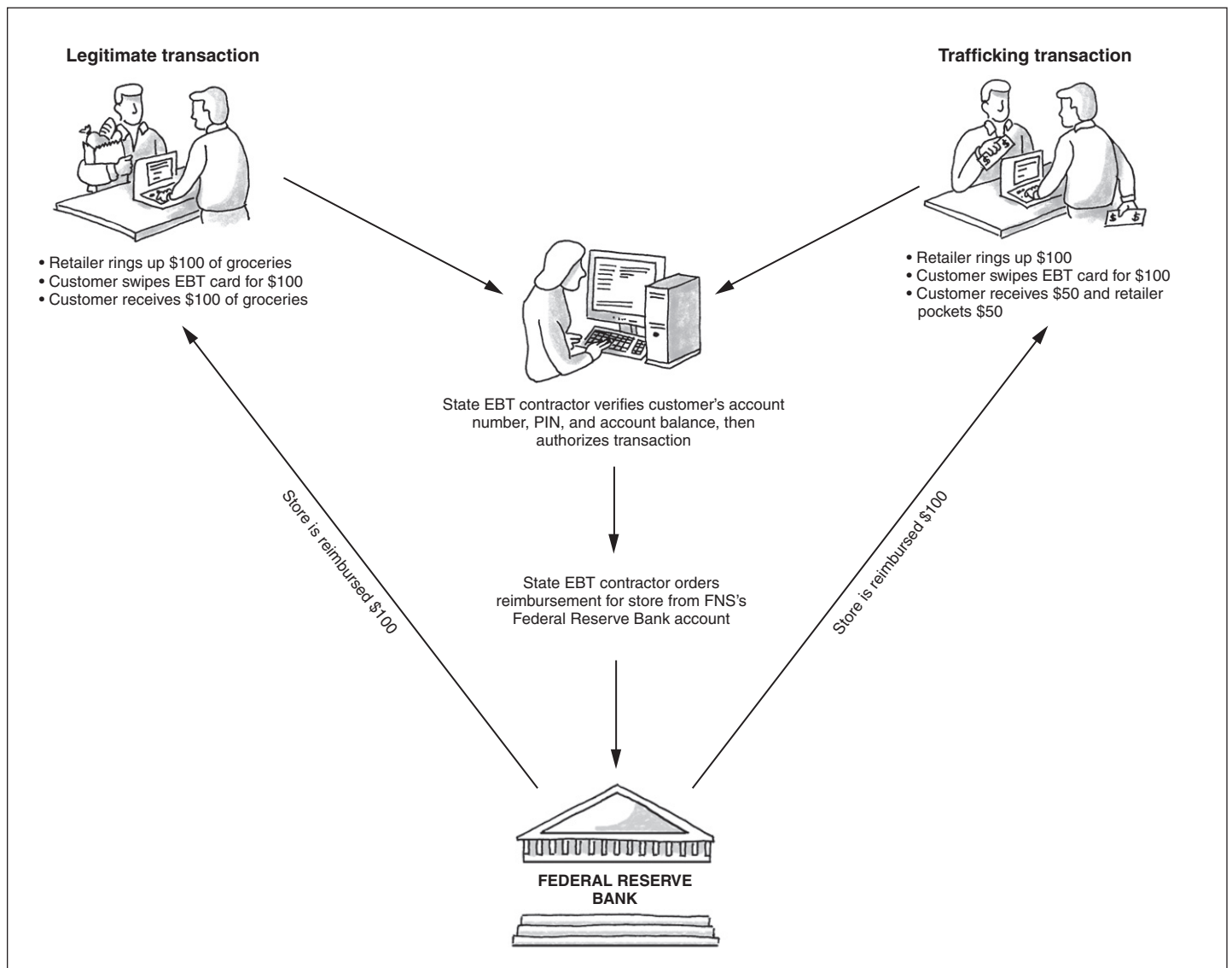
<sup>b</sup>This category includes farmers markets, produce stands, wholesalers, co-located retailers, drug stores, specialty food stores, health/natural food stores, non-profit food-buying co-ops, military commissaries, and delivery routes.

<sup>c</sup>This category includes drug and alcohol treatment centers, group homes, and communal dining facilities or meals on wheels for seniors.

## Use of EBT and Trafficking

Prior to EBT, recipients used highly negotiable food stamp coupons to pay for allowable foods. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), however, required each state agency to implement an EBT system to electronically distribute food stamp benefits, and the last state completed its implementation in fiscal year 2004. Under the EBT system, food stamp recipients receive an EBT card imprinted with their name and a personal account number, and food stamp benefits are automatically credited to the recipients' accounts once a month. As shown on the left in figure 2, in a legitimate food stamp transaction, recipients run their EBT card, which works much like a debit card, through an electronic point-of-sale machine at the grocery checkout counter, and enter their secret personal identification number to access their food stamp accounts and to authorize the transfer of food stamp benefits from a federal account to the retailer's account to pay for the eligible food items. The legitimate transaction contrasts with a trafficking transaction portrayed on the right, in which recipients swipe their EBT card, but instead of buying groceries, they receive a discounted amount of cash and the retailer pockets the difference.

**Figure 2: Legitimate Food Stamp Transaction Compared to Trafficking Transaction**



Source: GAO.

## Monitoring, Investigating, and Prosecuting Retailer Fraud

In addition to approving retailers to participate in the program, FNS has the primary responsibility for monitoring their compliance with requirements and administratively disqualifying those who are found to have trafficked food stamp benefits. FNS headquarters officials collect and monitor EBT transaction data to detect suspicious patterns of transactions

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by retailers. They then send any leads to FNS program specialists in the field office who either work the cases themselves or refer them to undercover investigators in the Retailer Investigations Branch to pursue by attempting to traffic food stamps for cash.

FNS notifies the USDA's Office of the Inspector General (OIG) before the field office specialist or undercover investigator develops a case, and the OIG may choose to open an investigation on this case on its own for possible criminal prosecution. The OIG may also work with the US Secret Service, the Federal Bureau of Investigation, or other agencies to investigate retailers for criminal prosecution.<sup>7</sup> Secret Service officials told us they have a memorandum of understanding with the USDA that allows them to initiate food-stamp-trafficking investigations on their own, provided they notify the OIG of all the investigations in which an authorized retailer is targeted.

When trafficking is proved, FNS penalizes the store owners, usually by permanent program disqualification but in limited circumstances they may receive civil money penalties.<sup>8</sup> Store owners who sell ineligible goods but do not traffic are generally subject to a 1-year temporary program disqualification.<sup>9</sup> If a field office specialist finds that a retailer has trafficked, the specialist sends a letter to the retailer detailing the charges and the intended penalty. If the Retailer Investigations Branch succeeds in trafficking food stamps with a retailer, it first refers the case to the OIG, which then decides whether it will investigate the case further for possible prosecution by the US Attorney's office or by state and local prosecutors or refer the case back to the FNS field office to complete the disqualification action.

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<sup>7</sup> The Secret Service was originally given authority to participate in food stamp investigations because food stamps were considered the same as currency, and the Secret Service is responsible for investigating currency violations such as counterfeiting. With the move to EBT, Secret Service authority derives from the use of an EBT card as an access device to commit fraud.

<sup>8</sup> If the retailer had taken proper measures and can prove he was not involved in the trafficking, rather than permanent disqualification, FNS may impose a civil money penalty. Civil money penalties may also be imposed against disqualified owners who sell their stores before the expiration of the disqualification period, because they have not completed their program suspension penalty.

<sup>9</sup> FNS officials said it is more common for a store to receive a 6-month temporary disqualification because they are unable to determine whether the ineligible goods were sold by the store owner or a store employee.

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The retailer may attempt to rebut the charges, but if the retailer does not respond or cannot provide a reasonable explanation for the specific charges, then a letter is sent executing the program disqualification. The retailer may appeal the decision, first to the Administrative Review Branch at FNS headquarters and later to the appropriate federal district court.

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### Monitoring, Investigating, and Prosecuting Recipient Fraud

In addition to administering the day-to-day operation of the Food Stamp Program, states also have the primary responsibility for monitoring recipients' compliance with the program's requirements and investigating any case of alleged intentional program violation. This includes cases of ineligible persons attempting to obtain food stamps or applicants deliberately providing false information in an attempt to receive more benefits than they should as well as cases in which recipients traffic their food stamp benefits. States must ensure that appropriate cases are acted upon, either through administrative disqualification hearings or referral to a court of appropriate jurisdiction, in accordance with the procedures outlined in the Food Stamp Program regulations.

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### FNS Estimates Suggest That the Rate of Food Stamp Trafficking Has Declined and That It Occurs More Frequently in Smaller Stores

FNS estimates that the rate of food stamp trafficking was 1.0 cent on the dollar for calendar years 2002 to 2005. Overall, the estimated rate of trafficking at small stores is much higher than the estimated rate for supermarkets and large groceries, which redeem most food stamp benefits. Furthermore, the implementation of EBT eliminated the role of the middleman by requiring personal identification numbers each time the EBT card is used.

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### FNS Reports That the Rate of Food Stamp Trafficking Declined between 1995 and 2005

FNS's most recent estimate suggests that the food-stamp-trafficking rate was 1.0 cent on the dollar for calendar years 2002 to 2005 and that this rate and the total estimated benefits trafficked have declined in recent years. FNS' first trafficking study in 1995 estimated that about 3.8 cents of every dollar of food stamp benefits issued was trafficked in 1993. As shown in table 2, subsequent FNS studies estimated that this trafficking rate continued to decline.



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**Table 2: FNS Estimates Suggest That the Trafficking Rate Has Declined**

Millions of dollars

Calendar year period	Estimated trafficking rate percentage	Food stamp benefits issued annually	Estimated amount of benefits trafficked annually
1993	3.8	21,100	812
1996-1998	3.5	19,627 <sup>a</sup>	657
1999-2002	2.5	16,139 <sup>a</sup>	393
2002-2005	1.0	23,213 <sup>a</sup>	241

Source: FNS studies and GAO calculation.

<sup>a</sup>FNS reported that they annualized redemption data over the period of the study but did not provide the annualized figures. We calculated the three- and four-year average of benefits redeemed for comparative purposes.

The trafficking exchange rate that retailers offer for food stamp benefits can vary from place to place. While retailers generally offer recipients about 50 cents for each dollar of benefits, in New York City we were told by an FNS undercover investigator that the exchange rate is about 70 cents, and in a few locations, some retailers will exchange one dollar of cash for one dollar of benefits as an accommodation to the food stamp recipient.

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## Most Trafficking Still Occurs in Small Stores

FNS studies suggest that small convenience and grocery stores continue to be the most common sites for trafficking. Small stores, including small grocery, convenience, specialty, and gas/grocery stores have an estimated trafficking rate of 7.6 cents per dollar. In contrast, supermarkets and large grocery stores have an estimated rate of 0.2 cents per dollar. However, because supermarkets account for the lion's share of food stamp benefit redemptions, even at this lower rate, over \$49 million of benefits may have been trafficked in supermarkets and large grocery stores in fiscal year 2005. Most FNS field officials we interviewed told us these findings reflected their experience. They characterized a typical trafficking case at their field office occurring at a convenience, small grocery, or gas/grocery store located in an urban area where the store owner traffics with familiar neighborhood food stamp recipients.

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## EBT Has Changed How Food Stamps Are Trafficked

The nationwide implementation of EBT has changed the way some food stamp benefits are trafficked. Previously, in addition to trafficking conducted directly between store owners and recipients, middlemen could wait around public assistance offices or subsidized housing complexes to purchase large numbers of food stamp coupons at a discounted rate directly from recipients. The coupons might also change hands among multiple middlemen, with each taking a cut, before ultimately being exchanged for cash from a willing retailer. Field office officials told us that EBT has largely eliminated the middleman because retailers must now have the recipients' EBT card and personal identification number to conduct a trafficking transaction. As a result, some recipients have adapted their trafficking behavior to the new EBT environment. For example, one field office official told us that some food stamp recipients now stand outside of stores offering to loan their EBT cards to shoppers entering the store. In this situation, the shopper would purchase groceries using the card and return it and a discounted amount of cash to the recipient upon leaving the store. During our field office visit to Tallahassee, a GAO analyst was approached in his hotel parking lot by a would-be trafficker offering such a transaction.

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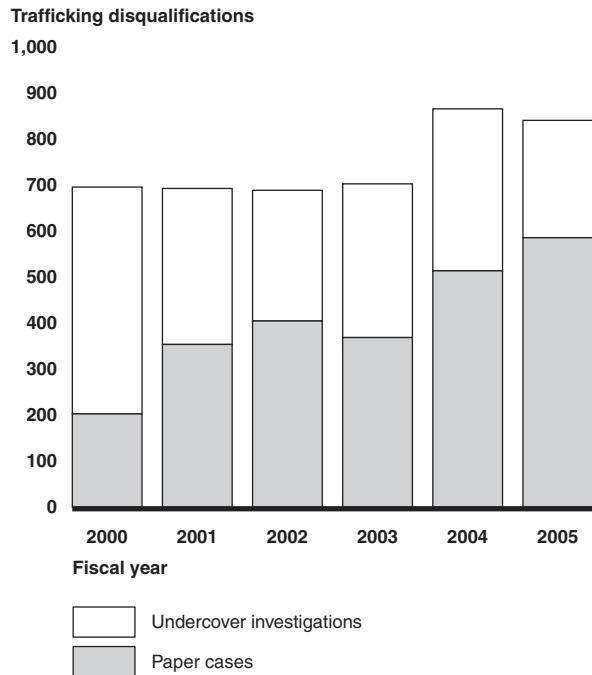
## FNS Has Taken Advantage of New EBT Data to Improve Retailer Monitoring, While Other Federal Entities Have Focused on Fewer, High-Impact Investigations

FNS has taken advantage of new technology to improve its monitoring and sanctioning of food stamp retailers, but other federal agencies' have been investigating and prosecuting fewer traffickers. With the implementation of EBT, FNS has supplemented its traditional undercover investigations by the Retailer Investigations Branch with cases developed by analyzing EBT transaction data. These EBT cases now account for more than half of the permanent disqualifications by FNS (see fig. 3 below).<sup>10</sup> Although the number of trafficking disqualifications based on undercover investigations has declined, these investigations continue to play a key role in combating trafficking. However, as FNS's ability to detect trafficking has improved, the number of suspected traffickers investigated by other federal entities, such as the USDA Inspector General and the U.S. Secret Service have declined. These entities have focused more on a smaller number of high-impact investigations. As a result, retailers who traffic are less likely to face severe penalties or prosecution.

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<sup>10</sup> According to FNS officials, at least 90 percent of non-Retailer Investigations Branch trafficking disqualifications result from paper cases. Other disqualifications may result from the OIG and state law enforcement investigations.

**Figure 3: As Trafficking Disqualifications Based on EBT Data Have Increased, Those Based on Undercover Investigations Have Decreased**



Source: FNS.

## EBT Has Provided FNS with Powerful New Tools to Supplement Traditional Retailer Trafficking Investigations

The nationwide implementation of EBT has given FNS powerful new tools to supplement its traditional undercover investigations of retailers suspected of trafficking food stamp benefits. FNS traditionally sent its investigators into stores numerous times over a period of months to attempt to traffic benefits. However, PRWORA gave FNS the authority to charge retailers with trafficking in cases based solely on EBT transaction evidence, called “paper cases.” A major advantage of paper cases is that they can be prepared relatively quickly and without multiple store visits. These paper cases accounted for the majority of FNS’s 841 trafficking disqualifications in fiscal year 2005.

As part of the monitoring process, FNS collects each month’s food stamp transaction data from the states’ EBT processors and adds the data to its EBT transaction database for analysis. Six months’ worth of EBT

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transactions—about 500 million—are available on line.<sup>11</sup> Information on the amount of the transaction is reported. Information on the items being purchased is not available through EBT. The system scans these data to flag transactions or sets of transactions that fit a certain set of criteria defined by established patterns of fraudulent activity. The system then generates a monthly “Watch List” of retailers with suspicious transaction patterns incongruent with a store’s particular type of retail operation.<sup>12</sup>

The Watch List is sent out to the responsible FNS field office for follow-up. In the field offices, program specialists begin their work on paper cases by reviewing the Watch List and leads from other sources, such as the state food stamp agency, the state EBT processors, and law enforcement agencies. Using experience with the retailers in the area, program specialists may determine that suspicious transactions for some retailers are explainable. In such cases, the specialist may take no further action or schedule a later review of the store’s transactions. In cases for which they cannot explain the suspicious transactions, program specialists determine which retailers they will pursue as paper cases. If the program specialist is unable to develop a paper case, the case may be referred to the Retailer Investigations Branch for an undercover investigation.

After deciding to open a paper case, FNS obtains clearance from the OIG to pursue the case, and then the program specialist uses FNS data and a variety of other resources to gather evidence. Program specialists generally use 3 months of EBT data to show suspicious patterns. In the case files we reviewed, charge letters typically contained hundreds of examples of suspicious transactions, although FNS guidance does not specify the number of transactions necessary to support a case. Specialists also review FNS historical data on retailers to check for such things as prior program violations.<sup>13</sup> In addition, these specialists obtain more current transaction data as well as information on recipients suspected of trafficking with the retailer, through state Food Stamp Program databases. Many specialists supplement these data with online resources, such as

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<sup>11</sup> FNS has retained archives of all state EBT transaction data from the beginning of each state’s EBT system, and if program specialists request older data, FNS can e-mail it to the field office within hours.

<sup>12</sup> Although FNS’s EBT transaction data system analyzes all transaction data, large stores are not included on Watch Lists, because FNS’s data show that large stores are rarely involved in trafficking.

<sup>13</sup> Additional historical data can be requested by field office staff as necessary.

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mapping software to identify suspicious shopping patterns. Program specialists can also consult the photos taken at the time of authorization to assess whether conditions in the store support the volume of food stamp redemptions claimed. Figure 4 shows the limited counter space and the single cash register of a store that claimed food stamp redemptions of almost \$200,000 per month and was later disqualified for trafficking. Such information enables the program specialists to corroborate conclusions they have drawn based on patterns in the EBT transaction data.

**Figure 4: Limited Counter Area and Single Cash Register of a Store Disqualified for Trafficking**



Source: FNS.

In addition, most program specialists in the offices we visited told us they also visit the store once before charging a retailer with trafficking. Some store visits allow the program specialist to check for possible explanations for the suspicious transaction patterns, while others corroborate the suspicion that the stores are in business to traffic. For example, during one store visit, program specialists found cans of food on the shelves with thick layers of dust, many items that had passed their expiration dates, and jars of spaghetti sauce so old that the contents had separated.

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The store owner may attempt to rebut the charges. For example, a store owner may claim to have extended credit to recipients so they could purchase food until they received their next month's food stamp benefits, and the high-dollar transactions were repayment of the credit. Although extending credit is also a violation of program rules, it carries a lesser penalty—temporary disqualification—than trafficking. If the owner is unable to rebut the charges, and the program specialist disqualifies the store, the store owner may appeal to the Administrative Review Branch. In 2005, about 6 percent of the permanent disqualifications were modified or reversed by the branch.

The length of time between a new store's authorization and its first disqualification has decreased over the last 10 years. Stores that received a temporary or permanent disqualification in 1996 had been open an average of about 8.7 years, but by 2005, that average had dropped to 6.3 years. Two factors may have contributed to this 28 percent decrease in length of time between authorization and disqualification: improved FNS monitoring of the program and use of EBT transaction data or more store owners who begin to traffic food stamps sooner. The officer-in-charge of the Chicago field office believes that in her area an increasing number of store owners are trafficking immediately after authorization. We analyzed FNS's authorized retailer data for stores in the Chicago area and found that the average time between authorization and a store's first temporary or permanent disqualification dropped by nearly half. In 1996, it took a Chicago store about 5 years to receive a term or permanent disqualification, and in 2005, it was just 2.6 years.

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### Investigations by the Retailer Investigations Branch Account for Fewer Trafficking Disqualifications, but Still Play a Key Role in Combating Trafficking

The number of Retailer Investigations Branch undercover trafficking investigations has declined, but these investigations are often used in cases where EBT data alone are not enough to prove a retailer is trafficking. The investigators initiate cases based on requests from FNS field offices, their own review of the Watch List, or leads from state or local law enforcement agencies. Like the paper case process, FNS consults with the OIG before opening a case. To build a case, the investigators make undercover visits to the store to determine whether the retailer is selling ineligible goods or trafficking food stamps. If a retailer sells the investigator ineligible goods but does not traffic, the resulting temporary disqualification from the program for selling ineligibles can create a deterrent effect on the disqualified store owner, other store owners, and trafficking recipients, because such penalties often become known in the community.

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Personal safety can be a concern for investigators. One investigator told us that there are some stores, especially in urban areas, where it would be dangerous to attempt an undercover investigation.

Although cases in which the Retailer Investigations Branch finds trafficking are routinely referred to the OIG for possible prosecution, in most cases the OIG returns the case to the field office for administrative disqualification. As with paper cases, the field office sends a charge letter, detailing the dates on which the retailer sold ineligible or trafficked food stamp benefits, and the retailer may attempt to rebut the charges. Once disqualified, the retailer can appeal the penalty to the Administrative Review Branch. If no violation is found, the Retailer Investigations Branch refers the case to the field office to determine whether to continue investigating.

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### OIG and Other Federal Entities Are Conducting Fewer Retailer Trafficking Investigations and Fewer Retailers Are Prosecuted

In recent years, the USDA OIG has opened a decreasing number of food-stamp-trafficking investigations and has focused on high-impact investigations. In 2000, the OIG opened 179 trafficking investigations, while in 2005 it opened 77. According to OIG, this has occurred both because of a lack of resources—the number of OIG investigators has dropped by 28 percent since 1997—and because the OIG has focused its resources on high-impact investigations such as those with large-scale trafficking, those involving other criminal activity, or those involving possible terrorist connections since September 11, 2001. In addition, OIG officials told us that it can take up to 5 years to investigate and prosecute a store owner, and the process of developing an investigation for prosecution further strains limited resources.

Other federal agencies are also conducting fewer retailer food stamp trafficking investigations. The US Secret Service used to take on investigations when large amounts of food stamp coupons were being trafficked. However, its involvement in retailer trafficking investigations is rare because the Secret Service finds that large trafficking investigations are less common since the implementation of EBT. EBT cards typically only have a few hundred dollars of benefits each month, so it takes many transactions for a dishonest store owner to traffic a large amount of money. However, in large trafficking investigations or those where a retailer is believed to be diverting profits from trafficking to terrorist causes, the Secret Service or the FBI might work with the OIG and other agencies on a sting operation or a joint task force. For example, the OIG and FBI worked jointly with state and local law enforcement authorities in Florida on an investigation involving store owners who were ordered to

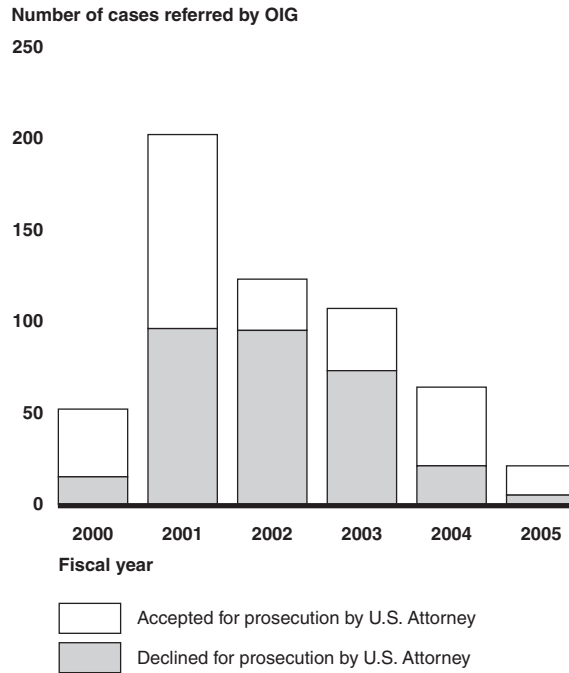
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pay \$2.6 million in restitution to the USDA and went to prison after pleading guilty to trafficking over \$3 million in food stamp benefits. OIG officials told us they were actively conducting task force investigations with other federal, state and local law enforcement authorities. If an investigation is accepted and developed for prosecution by a law enforcement entity, there is still no guarantee that the trafficker will be prosecuted. Most US Attorneys' offices will not prosecute a retailer unless a great deal of money is involved, although the threshold varies from one region to another, according to federal law enforcement officials. Thus, prosecuting the store owners is a challenge.

Figure 5 shows a decline in recent years in the number of investigations deemed serious enough to be referred by the OIG to the US Attorney for prosecution, down from 202 in fiscal year 2001 to 21 in 2005. These data illustrate the relatively small number of store owners who have faced prosecution for trafficking in recent years, particularly in light of the 841 owners who were disqualified in fiscal year 2005. These data also show that the proportion of investigations accepted by the US Attorney for prosecution has been increasing in recent years. OIG officials told us they believe they are better targeting investigations for referral.



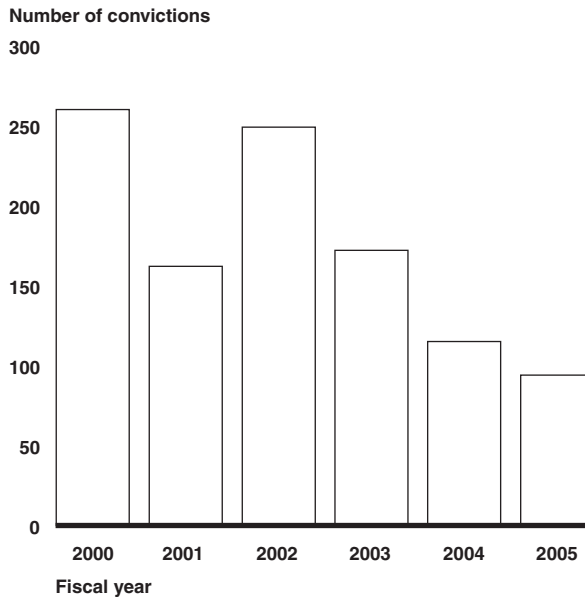
**Figure 5: Trafficking Investigations Referred to the US Attorney and Accepted for Prosecution for Fiscal Years 2000 to 2005**



Source: USDA OIG.

With fewer retailers prosecuted, the number of convictions has also declined. Because of the length of time it takes to prosecute a case, there is a lag between the time when a trafficking investigation is accepted by the US Attorney for prosecution and the time when a retailer is convicted. Thus, it is not possible to compare the figures for investigations accepted for prosecution and those resulting in convictions in the same year. However, as shown in figure 6, the number of convictions resulting from investigations by the OIG has declined from 260 in 2000 to 94 in 2005.

**Figure 6: Fiscal Year Totals for Trafficking Convictions Resulting from OIG Investigations**



Source: USDA OIG.

Note: Convictions are for retail store owners and employees and not for stores; some stores have multiple owners.

## Despite the Progress That Has Been Made against Trafficking, Vulnerabilities Still Exist in the Program

Despite the declining FNS estimates of retailer trafficking, retailers can still enter the program intending to traffic and do so, often without fear of severe criminal penalties. Minimal food stock requirements for authorization and a lack of FNS oversight of contractor inspections may allow dishonest retailers into the program, and delays in access to transaction data may allow retailers to traffic large amounts for several months undetected. In addition, some retailers have adapted their trafficking behaviors to avoid detection while others have found new ways to exploit the EBT technology. FNS does not yet have an overall strategy to target its monitoring resources to high risk areas. Moreover, the available FNS penalties for trafficking may not be sufficient to deter retailers from trafficking, and the states' lack of focus on recipient trafficking can also facilitate trafficking.

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## Minimal Requirements for Authorization and Lack of Oversight of Contractor Inspections May Allow Corrupt Retailers into the Program

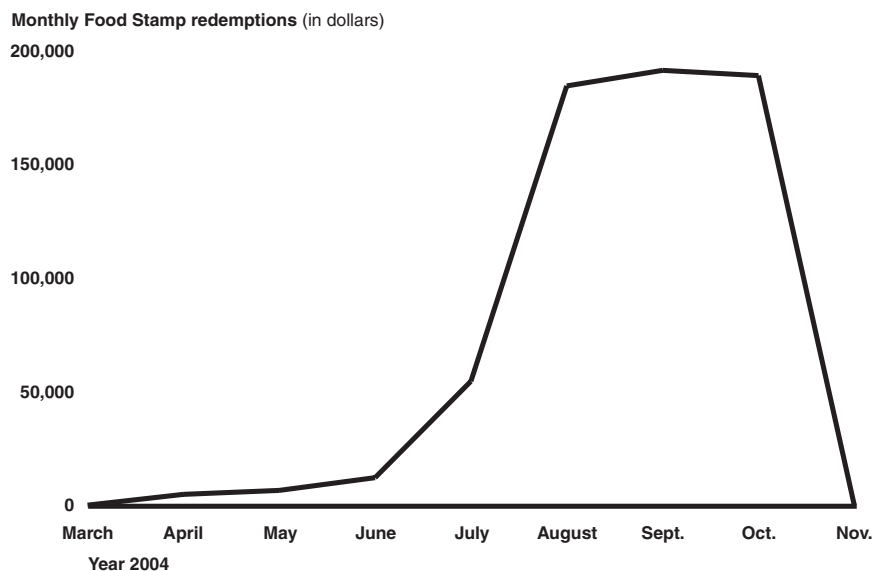
Minimal food stock requirements may allow corrupt retailers to enter the program, yet their stocks will not likely be checked for 5 years absent the indication of a problem. FNS field office officials told us their first priority is getting stores into the program to ensure needy people have access to food. In part because large grocery stores are sometimes scarce in urban, low-income areas, officials may allow stores with minimal food stock that meet the minimum FNS requirements to become authorized food stamp retailers. Officials told us that when a retailer only stocks small quantities of eligible food items, such as just a few cans of one kind of vegetable, it is often an indication of the intent to traffic. However, FNS regulations do not specify the amount of food items that would constitute sufficient stock. The officer-in-charge of a large urban field office expressed frustration with this lack of specificity. Many authorized stores in her area are gas-and-grocery combinations or convenience stores and some of these stores stock only one item from each required food group. However, she said the field office cannot deny these stores authorization based upon minimal food stock because, in her experience, the denial would be overturned if appealed. Another official at an FNS regional office told us about a store that was denied authorization in that region. According to this official, the denial was overturned by the Administrative Review Branch when the reviewing officer determined that a single can of corn sufficed as one of the three different products required in the fruit or vegetable food group. In addition, Secret Service officials said that some merchants quickly learn that they do not need to restock their stores to continue to redeem food stamps because stores aren't routinely checked for 5 years unless there is some indication of a problem with the store. Staff in one of the 10 FNS field offices we visited told us that they have to authorize some retailers who seem suspicious, but they perform post-authorization visits of these stores to ensure they are legitimate.

During the authorization process, FNS field offices rely on contractors to inspect stores to ensure they meet program requirements, but FNS does not independently verify the inspectors' reports. The inspector provides the final check that a store exists, it has food in each of the required food groups, and the information provided on the application for authorization to become a food stamp retailer is correct. However, at one field office, a contract inspector was submitting false reports, allowing dishonest retailers into the program.

Oversight of retailers' entry into the program and early operations is important because newly authorized retailers can quickly ramp up the amount of food stamps they traffic, and there is no limit on the value of food stamps a retailer can redeem in 1 month. At one field office location

where retailers are often innovative in their trafficking schemes, FNS officials noticed that some retailers quickly escalated their trafficking within 2 to 3 months after their initial authorization. As shown in figure 7, one disqualified retailer’s case file we reviewed at that field office showed the store went from \$500 in monthly food stamp redemptions to almost \$200,000 within 6 months. Redemption activity dropped precipitously after the trafficking charge letter was sent to the retailer in late October. In its application for food stamp authorization, this retailer estimated he would have \$180,000 of total annual food sales, yet the retailer was redeeming more than that each month in food stamp benefits before being caught in a Retailer Investigations Branch investigation.

**Figure 7: Food Stamp Redemptions of a Newly Authorized Store Disqualified for Trafficking**



Source: GAO analysis of FNS case file.

### Delays in Access to Transaction Data Allow Trafficking to Continue for Months Undetected

Although EBT implementation provides FNS with valuable transaction data to identify potential trafficking, an FNS headquarters official said monitoring and identification of traffickers will be improved once program specialists have faster access to transaction data to detect suspicious ramp-up activity. Currently, FNS receives each state’s EBT transaction data monthly on disk from the states’ EBT contractors. Using this process, the program specialists would not be aware of a retailer’s rapid ramp-up activity until they had 2 months’ worth of transaction data, in the third month after the retailer’s authorization. Then, following the normal case

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development process, a charge letter would not be sent to the store until the fourth month, leading to possible disqualification in the fifth month. According to this official, as retailers learned that FNS would eventually discover them by analyzing their EBT transactions, they responded by ramping up their trafficking activity more quickly to make a quick profit before FNS could take action.

FNS officials told us they believe that the solution to combating rapid ramp-up trafficking is for FNS to receive EBT transaction data daily. FNS systems could then monitor the data more quickly and produce daily reports of rapidly increasing amounts of retailer transactions called “spike reports.” In order for FNS to receive so much data on a daily basis, it is working on building large data pipelines from the states’ EBT processors and developing its ability to manage that data before the end of this year. In the interim, FNS is piloting the use of spike reports using monthly data.

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## Retailers Are Developing New Trafficking Schemes under EBT

As some retailers have become familiar with FNS’s monitoring techniques, they have adapted their trafficking patterns to avoid detection. Unlike those who quickly ramp up their trafficking behavior for quick profit before detection through FNS monitoring, other retailers have adjusted to EBT monitoring by manipulating trafficking transactions to prevent detection by FNS analysis of transaction patterns. One field official said that there is a large network of trafficking retailers in her field office area that dissects the charge letters sent to traffickers to determine what analyses FNS conducts and to teach other retailers how to elude detection. Secret Service officials confirmed the existence of fraud networks in this area and said that one ringleader will recruit, encourage, and reward an entire family and the friends of that family for trafficking food stamp benefits.

Some retailers have also found new ways to exploit the EBT technology and continue to traffic. In her July 2003 testimony, the USDA Inspector General reported that her office had recently identified a fraudulent scheme that, while rare, appeared to be growing in the Food Stamp Program.<sup>14</sup> The OIG noticed that some authorized retailers were moving their point-of-sale terminals to an unauthorized location, such as an unauthorized store or apartment, for trafficking purposes. In its

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<sup>14</sup> U.S. Congress, House Committee on the Budget, *Fraud, Waste and Abuse in Mandatory Spending Programs* (July 9, 2003).

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Semiannual Report to Congress for the first half of fiscal year 2004, the OIG reports that four individuals moved the authorized terminals to different locations in Chicago so they could exchange cash for food stamp benefits away from the authorized stores and possible detection. This allowed them to conduct a large number of transactions one after another. These individuals had been sentenced to serve from 15 to 57 months in prison and ordered to pay \$29.1 million in restitution for defrauding the Food Stamp Program in this way from the fall of 1997 through August 2001. OIG headquarters officials told us that moving authorized and unauthorized terminals remains a significant area of concern because of the large volume of money that could be redeemed quickly.

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### FNS Has Not Taken the Next Steps to Target Its Monitoring Resources to High Risk Areas

FNS has not taken the steps to ensure that it identifies those areas or stores that are at highest risk for trafficking so that it can allocate its resources accordingly. FNS has made good use of EBT transaction data to produce its Watch List to identify suspicious transaction patterns and target certain stores. It has also established task forces of undercover investigators when it identifies geographic areas needing additional coverage. However, it is now at a point where it can begin to formulate more sophisticated analyses to identify high risk areas and target its resources. For example, certain states have a disproportionate share of the disqualified stores compared with the number of food stamp recipients in their states, yet it is not clear whether these numbers indicate that trafficking is more common in those states or whether FNS program specialists and investigators have engaged in more intensive pursuit of traffickers in those areas. Our analysis of FNS's database of retailers showed that of the 9,808 stores permanently disqualified from the Food Stamp Program, about 35 percent were in just 4 states: New York, Illinois, Texas, and Florida, and yet about 26 percent of food stamp recipients lived in those states. However, FNS headquarters officials did not know the number of program specialists in the field offices in these states who devote a portion of their time to monitoring food stamp transactions and initiating paper cases.<sup>15</sup> Moreover, FNS officials believe there are probably other areas of the country where trafficking is occurring that may warrant further attention or additional resources, such as California, where fewer than 5 percent of all permanent store disqualifications occurred and about 8 percent of food stamp recipients live. However, FNS officials have not

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<sup>15</sup> Program specialists also devote time to other duties, but the range and extent of other duties vary from field office to field office.

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yet developed a clear strategy or criteria to systematically identify those areas and reallocate resources in response.

In addition, some retailers and store locations have a history of program violations that lead up to permanent disqualifications, but FNS did not have a system in place to ensure these stores were quickly targeted for heightened attention. Our analysis showed that, of the 9,808 stores that had been permanently disqualified from the program, about 90 percent were disqualified for their first detected offense. However, 9.4 percent of the disqualified retailers had shown early indications of problems before being disqualified. About 4.3 percent of these retailers had received a civil money penalty, 4.3 percent had received a warning letter for program violations, and 0.8 percent had received a temporary disqualification.<sup>16,17</sup> Most of these stores were small and may present a higher risk of future trafficking than others, yet FNS does not necessarily target them for speedy attention.

Further, some store locations may be at risk of trafficking because a series of different owners had trafficked there. After an owner was disqualified, field office officials told us the store would reopen under new owners who continued to traffic with the store's clientele. One field office official would like to be able to bar these repeat store locations, while another suggested a 90-day waiting period before a new owner of a disqualified store location could qualify as an authorized food stamp retailer. As table 3 shows, our analysis of FNS's database of retailers found that about 174, or 1.8 percent, of the store addresses had a series of different owners over time who had been permanently disqualified for trafficking at that same location, totaling 369 separate disqualifications. In one case, a store in the District of Columbia had 10 different owners who were each disqualified for trafficking, consuming FNS's limited compliance-monitoring resources.

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<sup>16</sup> Civil money penalties may be imposed against a store in lieu of disqualification. FNS collected almost \$1.7 million in civil money penalties in fiscal year 2005.

<sup>17</sup> Warning letters are sent for lesser violations of program regulations such as charging food stamp recipients higher prices than other customers or when the evidence is too limited to warrant a disqualification. Temporary disqualifications are generally for selling ineligible goods such as paper plates, tobacco or alcohol or providing credit to food stamp recipients.

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**Table 3: Some Store Locations Have Had Multiple Retailers That Engaged in Trafficking**

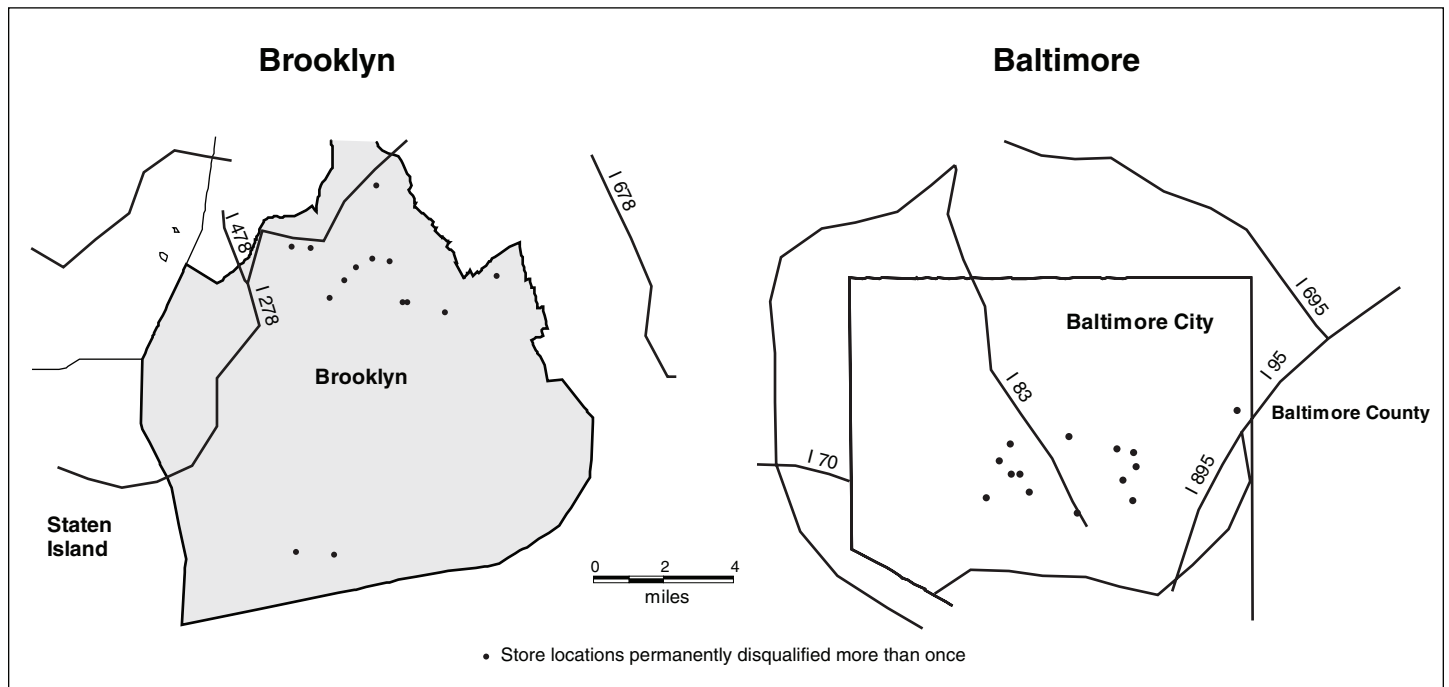
<b>Number of different owners at same address disqualified</b>	<b>Number of disqualified addresses</b>
2	162
3	10
5	1
10	1
<b>Total</b>	<b>174</b>

Source: GAO analysis of FNS data.

Our analysis of the data on these stores with multiple disqualified owners indicates that FNS officials found this type of trafficking in a handful of cities and states. Almost 60 percent of repeat store locations were in six states and 44 percent were in 8 cities, often concentrated in small areas. For example, as figure 8 shows, 14 repeat store locations were clustered in downtown areas of both Brooklyn and Baltimore. However, it is not clear whether these data indicate heightened efforts of compliance staff or whether trafficking is more common in these areas. Regardless, early monitoring of high-risk locations when stores change hands could be an efficient use of resources.



**Figure 8: Map of Stores Repeatedly Disqualified for Trafficking in Brooklyn and Baltimore**



Source: GAO analysis of FNS data.

Efficient use of resources is particularly important because available compliance-monitoring resources have decreased in recent years. As the importance of paper cases has grown, the compliance-monitoring workload has gradually shifted to field office program specialists at a time when overall program resources have dwindled. Officials said the number of field investigators and field staff nationwide, which includes program specialists, has declined over the last 10 years.

### Available FNS Penalties May Not Deter Traffickers

FNS penalties alone may not be sufficient to deter traffickers. The most severe FNS penalty that most traffickers face is disqualification from the program, and FNS must rely on other entities to conduct investigations that could lead to prosecution. For example, in the food-stamp-trafficking ramp-up case previously cited, this retailer redeemed almost \$650,000 of food stamps over the course of 9 months before being disqualified from the program in November 2004. As of August 2006, there was no active investigation of this retailer.

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Because of the time it takes to develop an investigation for prosecution and the costs associated with doing so, a natural tension exists between the goal of disqualifying a retailer as quickly as possible to prevent further trafficking and seeking prosecution of the retailer to recover losses and deter other traffickers. One FNS field office official said it can take months or even years to investigate a case for prosecution and in the meantime the store continues to traffic. FNS can disqualify a retailer relatively quickly—thereby saving federal dollars from misuse—compared with the time OIG needs to investigate a case for referral for prosecution. However, if prosecution is successful, a retailer’s assets and profits from trafficking can be seized, providing a potential deterrent to others considering trafficking.

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### States’ Lack of Focus on Recipient Trafficking Can Facilitate Vendor Trafficking

Paper cases often identify recipients suspected to have trafficked their food stamp benefits with a dishonest retailer, and some FNS field offices send a list of those recipients to the appropriate state. In response, some states actively pursue and disqualify these recipients.<sup>18</sup> For example, Illinois has used these lists to disqualify more than 3,000 of the almost 20,000 suspected recipients referred to them since 1999 through FNS retailer investigations. In addition to pursuing recipients who are suspected of trafficking, one state told us it uses some recipients charged with trafficking to gather evidence against retailers.

However, FNS field offices do not always send lists of suspected individual traffickers to states or counties administering the program, and not all states investigate the individuals on these lists. Officials from four FNS field offices we visited said they don’t send the list of recipients suspected of trafficking to the states or counties administering the program. Other field office officials said they send the lists to their states, but they are not acted upon because states do not have the resources to conduct investigations into recipients who may be trafficking. FNS headquarters officials also believe that not many states are acting on the lists they receive because it is difficult and potentially costly to prove individual cases of recipient trafficking. One field office official said that store owners represent only half of the problem and that states could do more

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<sup>18</sup> The states are responsible for conducting a hearing for recipients caught trafficking. A recipient who is found to have trafficked faces disqualification from the Food Stamp Program: 12 months for a first offense, 24 months for a second offense, and permanently for a third offense.

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to address trafficking. If states could reduce recipients' trafficking, it would curb retailer trafficking as well.

Instead of focusing on food stamp recipients who traffic their benefits, states are using their resources to focus on recipients who improperly collect benefits, according to FNS officials.<sup>19</sup> The current incentive structure for the states includes performance bonuses to reward states for correcting payment errors and reducing error rates. In addition, states are penalized financially if their error rates reach a specific threshold for 2 years in a row.<sup>20</sup> States that do investigate recipient traffickers can keep 35 percent of any monies they recover; however, it may be difficult to recover the funds, and the amount recovered may be minimal. When a state proves a recipient has trafficked, the recipient can no longer receive benefits, but other members of the family can. States can try to recover some of the benefits trafficked by deducting a set amount from the family benefits each month. However, pursuing recipients who traffic can be costly and time-consuming.<sup>21</sup> Taken together, these factors can result in states' choosing to focus on improper benefit payments rather than recipient trafficking. This inaction by some states allows recipients suspected of trafficking to continue the practice, and such inaction also leaves a pool of recipients ready and willing to traffic their benefits as soon as a disqualified store reopens under new management. In fact, California field office staffs have begun to track suspected trafficking recipients from a disqualified store to a new store, where they begin exhibiting the same patterns.

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<sup>19</sup> In fiscal year 2004, states reported that they completed almost 746,000 food stamp fraud investigations resulting in over 55,000 recipient disqualification determinations. They do not, however, report the number of cases involving recipients who trafficked versus the number who obtained benefits fraudulently.

<sup>20</sup> States are penalized when there is a 95 percent statistical probability that their error rates exceeds 105 percent of the national average for 2 consecutive years. The penalty is equal to 10 percent of the cost of errors above 6 percent. For more information, see GAO, *Food Stamp Program: States Have Made Progress Reducing Payment Errors, and Further Challenges Remain*, GAO-05-245 (Washington, D.C.: May 5, 2005).

<sup>21</sup> In addition, the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, reduced the administrative reimbursement for all investigations and prosecutions from 75 to 50 percent.

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## Conclusions

In the Food Stamp Program, stores are the frontline for ensuring that recipients use food stamps to purchase appropriate food items, and these stores operate with no day-to-day oversight. Although the vast majority of stores do not traffic food stamp benefits, each year millions of dollars of program benefits that were awarded to provide food to needy individuals and families are trafficked. FNS, using EBT data, has made significant progress in taking advantage of new opportunities to monitor and disqualify traffickers. However, because store owners can begin trafficking as soon as they are authorized to participate in the program, pocketing large sums of cash for months before FNS can detect potentially suspicious transaction patterns, early monitoring and detection are critical to curbing larger losses to the program. FNS has at its fingertips a wealth of information that could help it develop additional criteria to target certain stores or geographic areas for early or more heightened monitoring, including the presence of low food stocks, the location of repeat offender stores, areas of recipient trafficking, and areas with evidence of organized fraudulent activity. FNS's loss of monitoring staff in recent years magnifies the need to ensure that compliance-monitoring resources are focused on those stores and geographic areas at greatest risk of trafficking. A more focused effort to target and disqualify these stores could help FNS meet its continuing challenge of ensuring that stores are available and operating in areas of high need while still maintaining program integrity.

Yet, as EBT has limited the amount of benefits that can be trafficked at one time, there is less chance the retailer or the recipient will be prosecuted. There is no easy solution to this lack of deterrence. Law enforcement agencies are making decisions to efficiently use their resources by targeting larger or more critical cases. And FNS currently does not have authority to impose stiffer penalties on retailers other than program disqualification or in limited situations, civil money penalties in lieu of disqualification. Food stamp trafficking will continue to be lucrative for retailers as long as the potential rewards outweigh the penalties and there are recipients willing to exchange their benefits for cash and resources are not used for investigations and penalizing recipients.

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## Recommendations

We recommend that the Secretary of the Department of Agriculture direct FNS to take the following five actions.

To help ensure that its limited compliance-monitoring resources are used efficiently, FNS should

- 
- develop additional criteria to help identify stores most likely to traffic and their locations; conduct risk assessments, using compliance and other data, to systematically identify stores and areas that meet these criteria; and allocate resources accordingly, and
  - provide more targeted and early oversight of stores that meet these criteria, such as conducting early monitoring or follow-up inspections.

To provide further deterrence for trafficking, FNS should

- develop a strategy to increase the penalties for trafficking, working with the OIG as needed. If these penalties entail additional authority, consider developing legislative proposals for program reauthorization in 2007.

To promote state efforts to pursue recipients suspected of trafficking and thereby reduce the pool of recipient traffickers, FNS should:

- ensure that FNS field offices report to states those recipients who are suspected of trafficking with disqualified retailers, and
- revisit the incentive structure to incorporate additional provisions to encourage states to investigate and take action against recipients who traffic.

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## Agency Comments

We provided a draft of this report to the U.S. Department of Agriculture and the U.S. Secret Service for review and comment. On September 5, 2006, FNS officials provided us with their oral comments. The officials generally agreed with our findings, conclusions, and recommendations. However, FNS officials raised a concern regarding our recommendations on more efficient use of their compliance-monitoring resources. They stated they believe they do have a strategy for targeting resources through their use of the Watch List, which helps them identify suspicious transaction patterns and target certain stores, combined with their ability to establish task forces of investigators when they identify geographic areas needing additional coverage. We believe that FNS has made good progress in its use of EBT transaction data; however, it is now at a point where it can begin to formulate more sophisticated analyses. For example, these analyses could combine EBT transaction data with other available data, such as information on stores with minimal inventory and stores with a past history of trafficking, to develop criteria to better and more quickly identify stores at risk of trafficking. In addition, FNS could also take advantage of more sophisticated analysis tools, such as certain mapping programs to better identify those areas where trafficking is more

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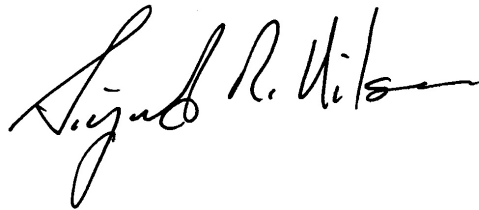
prevalent. Finally, to increase the likelihood of success, FNS will need to combine the expertise of its field investigators and its program specialists and then allocate these resources to monitor those stores at the greatest risk of trafficking. FNS and OIG officials also provided technical comments, which we incorporated where appropriate.

The U.S. Secret Service did not provide us with formal comments but told us it concurred with the findings in our report and that it agreed with our recommendation that additional work needs to be done to increase existing penalties for trafficking.

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We are sending copies of this report to the Secretary of Agriculture, appropriate congressional committees, and other interested parties. We will also make copies available to others upon request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions regarding this report, please contact me at (202) 512-7215 or [nilsens@gao.gov](mailto:nilsens@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributors to this report are listed in appendix I.



Sigurd R. Nilsen  
Director, Education, Workforce,  
and Income Security Issues

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# Appendix I: GAO Contact and Staff Acknowledgments

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## GAO Contact

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## Staff Acknowledgments

In addition to the contact named above, Kay Brown, Assistant Director; Gloria Hernandezsaunders; Kevin Jackson; Kevin Kumanga, Analyst-in-Charge; Crystal Lazcano; Jesus Moreno; Phil Reiff; Ramon Rodriguez; Eden Savino; Dan Schwimer; Vanessa Taylor; Rachael Valliere; and Jill Yost.

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*Food Stamp Program: Steps Have Been Taken to Increase Participation of Working Families, but Better Tracking of Efforts Is Needed.* [GAO-04-346](#). Washington, D.C.: March 5, 2004.

*Financial Management: Coordinated Approach Needed to Address the Government's Improper Payments Problems.* [GAO-02-749](#). Washington, D.C.: August 9, 2002.

*Food Stamp Program: States' Use of Options and Waivers to Improve Program Administration and Promote Access.* [GAO-02-409](#). Washington, D.C.: February 22, 2002.

*Executive Guide: Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations.* [GAO-02-69G](#). Washington, D.C.: October 2001.

*Food Stamp Program: States Seek to Reduce Payment Errors and Program Complexity.* [GAO-01-272](#). Washington D.C.: January 19, 2001.

*Food Stamp Program: Better Use of Electronic Data Could Result in Disqualifying More Recipients Who Traffick Benefits.* [GAO/RCED-00-61](#). Washington D.C.: March 7, 2000.

*Food Assistance: Reducing the Trafficking of Food Stamp Benefits.* [GAO/T-RCED-00-250](#). Washington D.C.: July 19, 2000.

*Food Stamp Program: Information on Trafficking Food Stamp Benefits.* [GAO/RCED-98-77](#). Washington D.C.: March 26, 1998.



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