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REPORT BY THE

Comptroller General

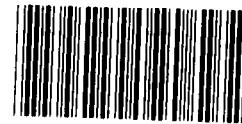
OF THE UNITED STATES

Regulation Of Retailers Authorized To Accept Food Stamps Should Be Strengthened

The Department of Agriculture's Food and Nutrition Service has unnecessarily authorized some retailers to accept food stamps even though they sold only token amounts of staple foods. This weakens the primary control for channeling food stamp use to staple foods needed for an economical nutritious diet and seems inconsistent with the legislation requiring that only retailers advancing program objectives be authorized. Agriculture believes that the Food Stamp Act of 1977 will result in improvements in this regard.

Food stamp redemption controls need strengthening. Data the Service uses for routinely monitoring 270,000 retailers is unreliable, and independent controls to make sure that commercial banks are accepting food stamps only as permitted do not exist.

The Department has been unable to adequately identify, and impose timely and effective penalties against, retailers not adhering to the law and program regulations.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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The Honorable W. Henson Moore
House of Representatives

Dear Mr. Moore:

This report discusses weaknesses in authorizing and regulating retailers participating in the food stamp program and the Food Stamp Act of 1977's potential impact on the program. We made our review in response to a request by you and several other Committee on Agriculture members.

As agreed with your office, we are furnishing copies of this report to the request letter's cosigners as well as to the Secretary of Agriculture and the Chairmen of the House Committee on Government Operations, the Senate Committee on Governmental Affairs, the House and Senate Committees on Appropriations, the House Committee on Agriculture, and the Senate Committee on Agriculture, Nutrition and Forestry. Copies are also being sent to interested Members of Congress and other interested parties. Copies will also be available to other parties on request.

Sincerely yours,

A handwritten signature in cursive script, reading "James R. Heath".

Comptroller General
of the United States

D I G E S T

The authorization and regulation of retailers who accept food stamps, also called coupons, need improvement so that people eligible to use the coupons will be encouraged to buy the staple foods most needed in their diets.

The Department of Agriculture and its Food and Nutrition Service should authorize only retailers that can advance program objectives, more effectively monitor and control coupon use and redemption, and better investigate and resolve retailer violations.

Service criteria for authorizing retailers are not clear. Firms such as pastry shops, gas stations, and taverns which sell only limited amounts of staple foods have been unnecessarily approved. Authorizing such firms weakens achievement of the program's objective of encouraging recipients to buy the staple foods needed to provide economical nutritious diets. (See p. 9.)

The Food Stamp Act of 1977 contains provisions to tighten the retailer authorization process. If Service regulations, which will implement this legislation in early 1979 contain specific criteria, they could keep out firms not advancing program objectives. (See p. 14.)

NEED FOR MORE EFFECTIVE MONITORING AND
CONTROL OF COUPON REDEMPTIONS

Service monitoring and controlling coupon redemptions by retailers, wholesalers, and banks have been extensive, but not as effective as possible because:

- The computerized system for monitoring retailers on a recurring basis uses unreliable data. This requires valuable staff time to resolve "false

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alarms" and allows possible violations to go undetected. (See p. 18.)

--No mechanism exists to ensure that commercial banks are submitting to Federal Reserve Banks only food coupons they acquired in accordance with the regulations. (See p. 19.)

--Coupon redemptions for approximately 4,100 wholesalers in the program are not adequately controlled to ensure that only properly acquired coupons are redeemed. However, the number of wholesalers in the program may be reduced under the 1977 legislation. (See p. 22.)

In 1977 the Service reorganized its field operations. Between 1976 and 1977, the number of employees assigned to retailer monitoring was reduced from 859 to 496 and the number of retailers and wholesalers increased several thousand. Because fewer Service employees are now available for monitoring coupon redemptions, effective in-place controls to achieve compliance with program regulations and minimize abuses are even more important. (See p. 15.)

NEED FOR MORE TIMELY AND EFFECTIVE
INVESTIGATION AND RESOLUTION OF
SUSPECTED VIOLATIONS

The Service has had difficulty identifying, and imposing timely and effective penalties against, firms not adhering to program regulations because:

--The Department's Office of Investigation usually had higher priority work and was unable to promptly initiate Service-requested investigations of suspected violators. (See p. 26.)

--Investigators often had difficulty proving that violations had occurred. (See p. 27.)

--After receiving investigation reports Service field offices took a long time to process cases and impose penalties. (See p. 27.)

--The administrative review process was time consuming. (See p. 29.)

--Administrative review officers may consider unrelated factors and events occurring after a violation, possibly reducing or overturning a retailer's previous penalty. (See p. 34.)

GAO's analysis of 1,038 investigations conducted in five States--California, Louisiana, Michigan, Pennsylvania, and New Jersey--showed that an average of 426 days elapsed between identifying suspected violators and final action. Meanwhile, retailers involved were allowed to continue accepting food coupons. (See p. 25.)

Penalties imposed on violators are minor in many cases--especially when penalties are reduced during administrative appeals or imposed through criminal prosecutions. (See p. 31.)

Before January 1977 the Department's Office of Investigation had complete responsibility for investigating firms suspected of violating program regulations. In January 1977 the Service established a compliance branch responsible for routine retailer investigations. The Office of Investigation is still responsible for investigating felony-level transactions. Although the compliance branch had limited success in 1977, GAO believes this approach can work successfully if improvements are made. (See p. 36.)

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

The Secretary of Agriculture should direct the Administrator, Food and Nutrition Service, to:

- Establish specific criteria for authorizing retailers.
- Take a series of actions to improve monitoring of retailers and wholesalers and control of the food coupon redemption process.
- Institute guidelines for and improve the monitoring of Service administrative reviews of penalties against firms violating program regulations.
- Designate additional administrative review officers until cases can be reviewed expeditiously.

- Reduce the compliance branch's work backlog and make the branch responsible for all investigations where criminal prosecution appears unlikely.
- In cooperation with the Attorney General, periodically review the guidelines for referring violators to the Department of Justice to ensure that all cases are handled in a reasonable and timely manner. (See p. 40.)

The President has proposed eliminating the food stamp program as part of a reform of the Nation's welfare system. If such a proposal is adopted, GAO recommendations would not be applicable.

AGENCY COMMENTS

The Department of Agriculture generally agreed to either adopt or consider GAO's recommendations or it proposed its own actions to solve the problems. (See p. 41.)

The Department of Justice said that GAO's conclusions and recommendations generally complement its position relating to fraud in Federal programs. (See p. 47.)

C o n t e n t s

	<u>Page</u>
DIGEST	i
CHAPTER	
1 INTRODUCTION	1
Scope of review	2
2 IMPORTANCE OF THE AUTHORIZATION AND SURVEILLANCE OF RETAILERS AND BANKS TO FOOD STAMP PROGRAM SUCCESS	4
3 AUTHORIZING RETAILERS THAT DO NOT ADVANCE PROGRAM OBJECTIVES	8
Weaknesses in criteria for authorizing retailers	9
Recent events affecting authorization criteria	14
4 NEED FOR MORE EFFECTIVE MONITORING AND CONTROL OF COUPON REDEMPTIONS	15
System for monitoring and control- ling redemptions is unreliable	15
Problems in monitoring retailer redemptions made through whole- salers	22
5 NEED FOR MORE TIMELY AND EFFECTIVE INVESTIGATION AND RESOLUTION OF SUSPECTED VIOLATIONS	23
How violations are discovered and handled	24
Delays in obtaining investigations	25
Low success rate of investigations	26
Delays in administrative process of disqualification	27
Penalties imposed do not seem to provide an effective deterrent	31
Changes in investigative responsibility	36

		<u>Page</u>
6	CONCLUSIONS AND RECOMMENDATIONS	40
	Conclusions	40
	Recommendations to the Secretary of Agriculture	40
	Agency comments and our evaluation	41
APPENDIX		
I	Letter dated September 25, 1978, from the Department of Agriculture	48
II	Letter dated November 1, 1978, from the Department of Justice	59

CHAPTER 1

INTRODUCTION

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The food stamp program, authorized by the Food Stamp Act of 1964 (7 U.S.C. 2011 et seq.), was designed to help low-income households obtain more nutritionally adequate diets by supplementing their food budgets. The program is administered nationally by the Food and Nutrition Service, Department of Agriculture. State and local welfare agencies administer the program locally. The Service has issued regulations and instructions which are intended to assure that recipients of food stamps, also called coupons, use their increased purchasing power to buy the staple foods most needed in their diets.

Under the program participating households certified eligible by State welfare agencies are issued coupons which may be exchanged for eligible food at Service-authorized retailers. The 1964 act defined a retail food store as "an establishment, including a recognized department thereof, or a house-to-house trade route, which sells food to households for home consumption."

Authorized retailers may accept food coupons only for food products for human consumption, and not for such things as alcoholic beverages and tobacco. Retailers redeem the coupons at commercial banks directly or through wholesalers. These banks in turn forward the coupons to Federal Reserve Banks which credit the redeeming banks and destroy the coupons.

There are about 270,000 retailers authorized to accept food coupons. During fiscal year 1977 the retailers accepted over \$8 billion in coupons and redeemed them at commercial banks and wholesale firms.

The food stamp program has grown from 2.9 million participants receiving about \$600 million in food coupons in fiscal year 1969, to an estimated 17.1 million participants receiving \$8.3 billion in food coupons in fiscal year 1977.

The Service's administrative responsibilities are carried out by its 7 regional offices and 96 field offices throughout the United States, Puerto Rico, and Guam. Before January 1977 the Department's Office of Investigation had complete responsibility for investigating firms suspected of violating program regulations. In January 1977 the Service established a compliance branch responsible for routine investigations of firms authorized to accept food coupons. The Office of

Investigation, which is part of the Department's Office of the Inspector General, is still responsible for investigating felony-level transactions and trafficking in coupons.

The size and high cost of the program, together with extensive publicity given to program abuses, have caused much public and congressional concern about its administration. Congressman W. Henson Moore requested us to investigate the program's administration in light of testimony furnished to the House Committee on Agriculture which indicated that, in Louisiana, widespread abuse of the program was occurring at the retailer level and that program objectives were not being achieved.

The President has proposed reforming the Nation's welfare system by combining the food stamp program, the supplemental security income program, and the aid to families with dependent children program. Under this proposal there would be a single cash payment to each eligible household, food coupons would be eliminated, and there would be no restrictions on how the cash payment would be used.

If this or a similar proposal is enacted, there will be no need to authorize or regulate retailers for food stamp purposes, and the recommendations in this report would not be applicable. However, it is uncertain if, or when, the President's proposal will be enacted. In view of this uncertainty and the seriousness of the problems identified, we believe our recommendations should be acted upon unless, before this can be done, elimination of food coupons becomes imminent.

SCOPE OF REVIEW

We made our review in California, Louisiana, Michigan, Pennsylvania, and New Jersey, which account for about 22 percent of the Nation's food stamp recipients and about 21 percent of the authorized retailers.

We evaluated the Service's regional and field office procedures for authorizing retailers, examined the field offices' system for monitoring coupon redemption, and reviewed the investigative and administrative processes involved in identifying abuses by and assessing penalties against wholesalers and retailers.

We also obtained information from the Service's and the Office of Investigation's headquarters in Washington, D.C.; the Federal Reserve System; and the Service's computer center

in Minneapolis. We also visited four of the Office of Investigation's seven regional offices and numerous retail firms and commercial banks in the five States.

The time periods our work covers varied for the different program operations reviewed and are included in the report where pertinent. The Food Stamp Act of 1977 (Public Law 95-113, 91 Stat. 958) was enacted after most of our fieldwork was conducted; the probable effects of this legislation and the regulations and instructions for implementing it are discussed in the various sections of the report.

CHAPTER 2

IMPORTANCE OF THE AUTHORIZATION AND SURVEILLANCE OF RETAILERS AND BANKS TO FOOD STAMP PROGRAM SUCCESS

The food stamp program's basic aim is to provide low-income households the opportunity to purchase a low-cost, more nutritionally adequate diet. To further this objective, the Department of Agriculture has issued regulations and instructions which are intended to assure that coupon recipients use their increased purchasing power to buy the staple foods most needed in their diets. The success of the food stamp program depends to a large measure on the

- authorization of only those retailers that carry a wide selection of staple foods and offer the opportunity for recipients to obtain a low-cost nutritionally adequate diet and thereby advance the program's purpose;
- effective monitoring of coupon redemptions by retailers, wholesalers, and banks to ensure adherence to program regulations; and
- extent to which prompt investigations and case dispositions are made regarding those suspected of violating program regulations and the effectiveness of sanctions against firms that abuse the program.

Although most authorized retailers may advance the program's purpose and closely adhere to the law and program regulations, the Service should make all reasonable efforts to identify and take action against those that do not. The participation of retailers that do not advance program objectives or follow program regulations and the abuses such retailers invite, undermine public confidence in the effectiveness of the food stamp program. Also, lack of action to eliminate such retailers from the program invites further abuses and encourages other retailers to violate program requirements.

The discretionary authority, as well as the responsibility, for authorizing retailers on a selective basis is vested in the Department of Agriculture by the Food Stamp Act of 1964, as amended. In charging the Department with the program's administration, the 1964 act stated:

"All practicable efforts shall be made in the administration of the food stamp program to insure that participants use their food purchasing power to obtain those staple foods most needed in their diets, * * *."

To ensure achievement of this congressional aim, program legislation provides for authorizing only those firms "whose participation will effectuate the purpose of the food stamp program." Moreover, to confirm the Department's ability to limit authorization to only those firms whose participation is consistent with the program's objectives, the legislation further requires consideration of the following factors in determining the qualifications of retail firms:

- Nature and extent of the applicant's food business.
- The volume of coupon business the applicant may reasonably be expected to do.
- The applicant's business integrity and reputation.

The legislation and program regulations state that other factors may also be considered.

Thus, in establishing the food stamp program, the Congress clearly intended that not all retailers selling food merchandise be automatically eligible to participate. If participation of all retailers were indeed automatic, there would be no need for, and no meaning to, the selective criteria for approval of participating retailers, as set forth in the legislation.

The program's legislative history shows that the Congress intended food coupons to be used for staple foods requiring substantial home preparation. The Congress has repeatedly considered legislative provisions to prohibit the use of coupons for nonstaple and ready-to-eat foods but decided not to enact most of these provisions because they would be impractical to administer. Instead, the Congress adopted the authorization process as a control for channeling food coupons to those retailers capable of advancing the program's purpose.

The Congress reaffirmed in the Food Stamp Act of 1977 its intent that coupons be used for staple foods. In an effort to tighten the authorization criteria and make it clear that certain types of retailers already authorized to accept food coupons should have their authorizations terminated, the Congress retained the 1964 act's basic definition

of a retail food store but added the requirement that an authorized retailer's sales of staple foods be at least 50 percent of its total food sales. The wording of the 1977 act and related legislative history allows considerable flexibility for promulgating regulations and procedures for authorizing stores.

The 1977 act also eliminated the requirement that most households participating in the food stamp program pay for their coupons. Previously the value of the coupons was always greater than the amount of cash paid by recipients. The difference between the two amounts was called the bonus value.

Under the 1977 act, instead of paying a certain amount of cash, recipients will receive the bonus value of their coupons at no cost. This change will reduce the amount of coupons most households receive and increase the cash they have available. The act's basic purpose of improving the nutrition of low-income households remains the same.

Because the total coupon value most households receive will be less, it is extremely important to encourage recipients to use their coupons to obtain nutritious staple foods if the act's basic purpose (improved nutrition) is to be achieved. Accordingly, we believe it is now very important to tighten the criteria for retailers permitted to accept food coupons, as recommended in this report.

In addition to authorizing only those retailers that sell the staple foods needed by food stamp recipients, it is important that the Service monitor those retailers' coupon redemptions to ensure that they accept the coupons only for eligible foods. If retailers accept coupons for items other than food or exchange coupons for cash, then the program's objective is being defeated and the law is being violated.

Another essential element in the monitoring and control system relates to properly redeeming food coupons. Any coupons obtained or used illegally eventually must be converted to cash at face value. This conversion would have to include a Federal Reserve Bank and a commercial bank; it may or may not involve an authorized wholesaler or retailer. Accordingly, controls over the redemption process are an essential tool in attempting to prevent illegal use of food coupons or promptly detecting such illegal use if it occurs.

The investigation of firms suspected of violating program regulations and the process of imposing administrative and/or criminal penalties against those found guilty is another important control. Prompt action against abusers is necessary

to protect the program from further harm and to encourage voluntary compliance by authorized firms.

The following chapters discuss how these important functions have been carried out and how they can be improved.

CHAPTER 3

AUTHORIZING RETAILERS THAT DO

NOT ADVANCE PROGRAM OBJECTIVES

The Food and Nutrition Service regulations and criteria for authorizing retailers to accept food coupons have not assured that only those retailers capable of advancing program objectives were authorized. The regulations have not been precise and definitive and, therefore, have been stretched to authorize retailers of questionable value to the program. Such retailers include pastry shops; doughnut shops; coffee, tea, and spice merchants; and other firms, such as gas stations and liquor stores, selling only token amounts of staple foods. Their authorization weakened the primary control for channeling food coupon use to sources where the recipients would be encouraged to buy the staple foods needed to provide economical, nutritious diets.

The Food Stamp Act of 1977, scheduled for implementations in early 1979, contains provisions to tighten the retailer authorization process. However, for the law to have maximum effectiveness, the Service's instructions for implementing it (and the regulations recently issued pursuant to it) need to be specific enough to encourage sound and consistent judgments by Service personnel.

It was not practicable for us to accumulate data in such a way that we could project our results nationwide, or even statewide in the States where we made our review. Even though we could not determine the exact magnitude of the problem, we believe that the weaknesses in the Service's criteria constitute a systemic problem which needs correction.

The food stamp program's general thrust is to help low-income households. However, Service criteria for determining what retail establishments should be authorized to accept food coupons and the other program segments related to regulating food retailers have not provided for direct consideration of recipients' needs. The Service's regulations and instructions and their administration have been oriented strongly toward authorizing most retailers seeking authorization unless they totally fail to meet basic legal requirements. Especially in marginal cases of compliance with basic criteria, it would have been appropriate to consider whether a retailer's authorization is needed to serve the nutritional needs of food coupon recipients living nearby. The Service issued regulations on September 22, 1978, which provide for considering recipients' needs in approving retailers in the future.

Instructions on how to consider this and other criteria for evaluating retailers had not been issued at the time this report was being finalized. (See p. 14.)

WEAKNESSES IN CRITERIA FOR
AUTHORIZING RETAILERS

The Service's most important criteria for authorizing retailers deal with the retailer's nature and the extent of its eligible food business. Service instructions indicate that the intent of the criteria is to authorize only those retailers that carry the staple foods most needed in the diets of low-income households. However, as shown on pages 10 through 13, the specific criteria applicable to the various types of retailers which might seek authorization are not precise and definitive and thus (1) do not promote uniform judgments by field personnel in borderline cases and (2) allow authorization of firms which do not seem to advance program objectives.

Staple foods have been considered to be those eligible foods which are most needed in the diets of eligible households, such as 1/

milk	salt	tea
butter	pepper	cocoa
cheese	flour	meat
margarine	honey	poultry
lard	lunch meat	bread
eggs	vegetables	fruits
fish	molasses	vegetable and
cereals	coffee	fruit juices
peanut butter	sugar	

At two Service field offices, we asked food program specialists to help us identify retailers which primarily sold nonfood items and whose stock of staple foods might make their authorizations questionable if the criteria were strictly applied. Of the hundreds of retailers identified, we visited

1/In the Food Stamp Act of 1977, staple foods are defined as those food items intended for home preparation and consumption, including meat, poultry, fish, bread, cereals, fruits, vegetables, and dairy products. Accessory food items, such as coffee, tea, cocoa, carbonated and uncarbonated drinks, candy, condiments, and spices are not to be considered as staple foods for qualifying retail food stores for program participation.

44 in Louisiana and Pennsylvania. We also examined selected files pertaining to authorizations of these and other retailers in Louisiana, Pennsylvania, California, Michigan, and New Jersey and the Service's instructions to field personnel for evaluating applications for authorization. On the basis of our examinations and visits, we believe that 24 of the 44 retailers we visited and many other retailers in the five States whose files we examined should not have been authorized.

The Service's instructions state that the nature of the retailer's business may rule out participation in the program, even though it sells some eligible items. Several types of firms are described in the instructions with general guidelines as to whether they should be authorized. Examples of these guidelines and our observations on the criteria's specificity are discussed below.

Retail trade routes

The instructions state that a retail trade route whose primary business is the sale of eligible foods, such as milk, bread, and other staple items, should be authorized the same as any other retail food business. Where the firm's primary business is in other than staple foods, however, the instructions state:

"the application should be reviewed fully in the same manner as with a general store. * * * A route should not be authorized unless its food stock includes staple foods. Where the primary merchandise carried consists of ineligible items, the application to participate should be denied."

The instructions do not define, in quantitative terms, what level of stock constitutes primary business. No specific number of eligible items are required, nor are any other definitive guidelines established for evaluating the applicant firms.

Some retail trade routes have been authorized although their primary business was selling ineligible items. For example, a New Orleans area firm operated door-to-door in residential neighborhoods, offering merchandise to its customers for delivery in 2 weeks. The firm issued a catalog which allowed customers to shop in their homes for such items as scales, massagers, furniture, watches, bedspreads, fans, and numerous other nonfood articles. In addition, the firm provided a grocery list of the following food items: coffee, tea, fruit cakes, cookies, candy, instant

mashed potatoes, drink mixes, spices, and flavorings. The grocery list also included nonfood items, such as health and beauty aids and household cleaning supplies.

A Service district manager in Louisiana attempted to get the firm's authorization revoked in September 1973. Excerpts from his recommendations follow:

"I sincerely believe the tremendous number of items now carried and offered for sale to food stamp recipients as customers of this firm vastly outweighs the few eligible items offered. Certainly the few eligible items cannot offer anything like a reasonable diet to low-income families, * * *.

"I contend that this firm has no legitimate reason to be authorized to accept food stamps. Failure to authorize this firm should not be detrimental to food stamp recipients. If this retailer is to remain authorized then there is no legitimate reason to not authorize every little snack shop in the country as they sell an equal amount of eligible items and certainly far less ineligibles."

Service headquarters officials did not accept the district manager's recommendation because the Service's Administrator had determined that the routes met program requirements although the firm's food sales were mainly coffee and tea.

Because the firm's primary merchandise consisted of ineligible items, a strict interpretation of the Service's criteria should have resulted in a denial of the application. Since the criteria were not precise, however, Service headquarters was able to stretch them to approve this firm.

Retail food stores combined
with gas stations

The instructions state that these firms must handle at least a few staple food items and that applications should be reviewed very carefully if the firms' primary business is selling gasoline and other automotive products. In such cases,

"an individual determination must be made as to whether the extent of the retail food business is sufficient in relation to the total business or as an absolute dollar value to effectuate the purpose of the program and whether the food business includes the sale of staple foods."

The instructions do not define "sufficient" in relation to the amount of retail food business needed to qualify for authorization and do not refer to the needs of food stamp recipients in the area. As a result of these loosely worded instructions, some firms selling primarily gasoline and other automotive products have been authorized.

For example, a combination gas station and convenience store authorized in Pennsylvania had two gasoline pumps which accounted for an estimated 75 percent of total sales of \$48,000 a month. In addition to gas and oil, other ineligible items included children's novelties, pet supplies, magazines, paper products, and carpet cleaning equipment for rent. The store part of the business also carried eligible food items, such as milk and other dairy products and small quantities of canned goods and bread. There were no fresh meats, vegetables, or fruits. The manager estimated that monthly sales of eligible food items totaled \$8,000. Thus over 83 percent of the retailer's business was in ineligible items. There were other firms nearby with similar operating hours which carried a full line of staple foods, making authorization of this retailer unnecessary to serve food stamp program participants.

Retail groceries combined with bars,
taverns, or liquor stores

Service instructions state:

"The Officer in charge must exercise care in determining whether stores which combine a bar, tavern or liquor store with a retail grocery business should be authorized. Stores falling into this category which submit applications to participate in the program must be judged on the basis of their business as a whole. To be approved * * * such a business must have a recognized food department, the stock of which includes staple food for home preparation. In those cases where the store is primarily a bar, tavern, or liquor store handling only a very small number of staple items, the application should be denied."

The instructions do not describe the variety or quantities of staple foods required, or what constitutes a "very small number." Also, they do not clearly indicate whether sales, or merely stock on hand, should be considered.

Such vagueness permits the authorization of stores that are of questionable value to the program. For example, a combination beer-wine-liquor store was authorized in Michigan, although only about 10 percent of the store's floor area was used for food items, mainly bread, milk, luncheon meats, and party foods (potato chips, crackers, and canned hors d'oeuvres). There were several large supermarkets nearby. The officer-in-charge of the Service field office recommended denial of this firm in June 1976, but an administrative review by the Service overturned the denial in August 1976 although the firm's primary business was selling liquor.

Bakeries and pastry shops

Service instructions describe bakeries and pastry shops as stores which specialize in selling baked goods and state that such firms may be authorized if they sell bread or other staple foods for home consumption as a regular part of their business.

The instructions do not define regular part of their business and no quantitative criteria have been established to permit various field offices to make uniform judgments. We found some pastry shops authorized that sold mostly wedding and birthday cakes and only token amounts of bread and milk, while some doughnut shops that also sold bread and milk were denied authorization. Other doughnut shops were approved.

A retailer operating a chain of 39 pastry shops in the New Orleans area was authorized to participate in the program. We visited four of the shops and found that they offered almost exclusively pastry items, such as cakes, pies, cookies, and confectioneries. The only staple foods in three shops were small amounts of bread and milk and these shops were near large supermarkets. The fourth shop, located inside a huge supermarket, carried no staple items.

These shops' stocks of staple foods were insignificant parts of their overall business; apparently the basis for their authorization was that they sold bread and milk (staple foods for home consumption) as a regular part of their business. More specific criteria in Service instructions might have resulted in uniform disapproval of pastry and doughnut shops which had only small amounts of staple foods when other stores with a wide variety of staple foods were nearby.

RECENT EVENTS AFFECTING
AUTHORIZATION CRITERIA

During our review, new food stamp legislation was enacted (the Food Stamp Act of 1977) and on September 22, 1978, the Service issued regulations implementing major portions of this legislation. The regulations provide that retailers whose primary business is selling food for home preparation and consumption will generally be approved if staple food items constitute more than half of their food sales. The regulations are scheduled for implementation in early 1979.

A firm whose primary business is not the sale of food for home preparation and consumption will be approved if it has a recognized grocery department in which staple food items constitute more than half of the food sales. In evaluating such a firm, the Service will also consider the availability of other authorized retailers in the area and the amount of staple food sales compared with the firm's other business.

These regulations, if properly implemented, could help prevent or eliminate participation by retailers such as those we identified as not advancing the program's purpose, depending on the Service's judgment in individual cases. As previously discussed, inappropriate judgments were permitted by regulations and instructions that were not specific enough. Implementing instructions for the new regulations need to be specific enough to encourage sound and consistent judgments by Service personnel.

For example, clear instructions will be needed on how to determine whether a firm's primary business is the sale of food for home consumption. The instructions should spell out how staple food sales should compare to other business and how to determine if other authorized retailers are close enough to make a store's authorization unnecessary.

If the Service keeps out of the program retailers whose primary business is not the sale of food for home consumption--except those whose participation is needed because there are no other authorized retailers nearby--and whose staple food sales are less than 50 percent of their total food sales, only those firms which advance program objectives should be retained.

CHAPTER 4

NEED FOR MORE EFFECTIVE MONITORING AND CONTROL OF COUPON REDEMPTIONS

Service monitoring of coupon redemptions should be improved because

- the data being used as a basis for monitoring approximately 270,000 retailers on a recurring basis is unreliable,
- there is no mechanism to ensure that commercial banks are submitting only legally acquired or properly accepted food coupons to the Federal Reserve Bank, and
- the coupon redemptions of approximately 4,100 wholesalers in the program are not subject to adequate controls to ensure that only properly acquired coupons are redeemed from properly authorized retailers.

The Service's nationwide coupon redemption monitoring activities have been quite extensive, involving major computer operations and analyses; hundreds of staff years to detect, process, and resolve suspected cases of violations; and thousands of instructional and compliance visits each year to food retailers.

In 1977 the Service reorganized its field operations because it believed that too much of its resources were being devoted to monitoring activities. The number of field offices was reduced from 185 offices with 859 people in 1976 to 96 offices with 496 people in 1977. During this period the number of retailers and wholesalers in the program increased several thousand. Because fewer Service employees are now available for monitoring coupon redemptions, effective in-place controls to achieve compliance with program regulations and minimize abuses are even more important.

SYSTEM FOR MONITORING AND CONTROLLING REDEMPTIONS IS UNRELIABLE

The computerized information system for monitoring redemptions is unreliable because retailer food sales and coupon redemption data entered into the system is inaccurate. Also, no independent controls have been instituted to ensure

that banks properly accept food coupons only from authorized retailers and verify the accuracy of retailers' reports to the Service on coupons redeemed.

No effective means have been developed to obtain verified food sales data from retailers. The Service does not require retailers to certify that the food sales data is accurate and does not independently check the data to verify its accuracy. Coupon redemption data is inaccurate because of errors in preparing redemption documents and improper handling of the coupons and related documents by some commercial banks.

The computerized system's primary output for monitoring redemptions is a quarterly report which summarizes each authorized retailer's coupon redemptions and compares them with the retailer's reported food sales data. However, retailers are required to submit food sales data only annually and the data is projected to subsequent quarters, which makes the quarterly report less effective.

The quarterly report shows redemption ratios (coupon redemptions as a percentage of food sales) for each retailer and compares them with the ratios for other stores in the same vicinity, usually based on census tracts. The quarterly report identifies as potential violators those firms whose redemption ratios exceed the average ratio of all retailers in the same tract by 100 percent. These firms must then be scheduled for compliance visits by the field offices.

Inaccurate sales and coupon redemption data have caused distortions in redemption ratios and have caused the quarterly reports to be unreliable and less effective as a monitoring tool. Our analysis of the report segments for four field offices showed that 26 percent of the firms identified as suspected program violators were incorrectly identified because of erroneous data. Although the firms' redemption ratios were later found to be reasonable, field office staffs had to spend considerable time examining these cases before they found that errors caused the problems. Based on a Service official's estimate that it took 3 hours to resolve an error, we estimated that, for 1976 in the four field offices, 470 staff days were used to determine that over 1,200 firms were erroneously identified on the quarterly reports as suspected program violators.

These errors can also prevent detecting retailers whose redemption ratios are actually high by improperly increasing the average redemption ratios for individual census tracts. When this happens, a retailer, whose redemption ratio is

much higher than the actual average for its tract, might not show up on the quarterly report as an unusually high redeemer.

Problems in obtaining valid
food sales data from retailers

Service field offices have been unable to obtain valid food sales data from some authorized retailers. Although retailers are required to furnish data on total sales and food sales at the time of authorization and, under recently issued regulations, are required to update these figures once each fiscal year, the Service has not developed a procedure to help ensure the accuracy of the figures provided.

A Service official in Louisiana said that sales data is not reliable because figures may be understated to avoid Federal and State taxes. Situations with unreliable sales data usually come to light when a retailer is confronted with information that coupon redemptions are excessive compared with food sales figures. The retailer will usually increase the sales figures to justify the redemptions.

Service officials stated that they would need additional trained staff to verify sales data. Also, Service instructions would need revision to provide specific authority for this verification. Although it might not be feasible to verify most of the sales data the Service receives due to staffing limitations, such verification should be authorized and made in selected cases in which Service officials suspect that the sales data is not accurate.

Retailers' sales data is submitted only annually which also diminishes the effectiveness of the monitoring information system. Retailer redemptions are summarized quarterly and compared with the previously reported sales data to identify retailers that are high redeemers. The effectiveness of this analysis is reduced because the period covered by the sales data does not coincide with the period covered by the coupon redemption data. Sales data for a different period must be projected to the quarter covered by the report although actual sales data for the quarter may be significantly different. For the Service's comparison and analysis of food sales data and coupon redemption data to have optimum effectiveness, the data being compared and analyzed must cover the same time periods.

In most of the locations we visited, retail grocers had to accumulate food sales data in the normal course of their business because of State or local tax laws. In any event, because the authorized retailers must accumulate food sales

data to comply with the annual reporting requirement, it would not seem to be too burdensome to require them to report such data quarterly to the Service.

Inaccuracies in coupon redemption data

The Service's system for monitoring coupon redemptions has been impaired because of errors and inaccuracies in preparing and processing redemption documents by retailers and banks.

The redemption data used for monitoring coupon redemptions is computer summarized from redemption certificates which the Service receives from commercial banks. The retailers prepare the certificates and submit them with coupon deposits to commercial banks. The banks must submit the coupons to a Federal Reserve Bank to obtain credit. Within 1 week after receiving credit, the banks are supposed to forward the certificates to the Service's computer center.

Retailers' deliberate or inadvertent errors on these certificates can distort the data for the particular retailers and diminish the overall reliability of the computerized system for monitoring redemptions. Also, if banks do not insist on properly prepared documents and process them in a timely manner, the reliability of the data for monitoring purposes is further reduced.

Incorrect mark-sensing--the process of marking computer cards to enable the amount of coupons redeemed to be read by an optical scanner--is one of the most common errors. For example, in preparing a certificate, a retailer might enter the correct amount in the block provided for the arabic numerals but enter some larger amount in the certificate's mark-sense area. This distorts the retailer's redemption data and inflates the tract average because the amount mark-sensed is the amount entered into the computer. This type of error could prevent the identification of possible program violators because of the inflated tract average.

Conversely, if the retailer enters a smaller amount in the mark-sense area, it deflates the tract average and may cause other retailers to be erroneously identified as possible program violators. A retailer aware of the purpose of the mark-sense area could deliberately enter lesser amounts there and redeem illegally acquired coupons. This kind of violation would be detected only if the bank compared the mark-sense area with the coupons actually redeemed.

Distorted redemption data also results when banks hold the certificates for excessive periods before forwarding

them to the computer center. For example, a Service field office in Louisiana discovered that a commercial bank had held 385 certificates with a total coupon value of \$114,150 which had been deposited at the bank over a 190-day period from August 1976 to February 1977. For the period the bank held these certificates, the redemption ratios for the affected retailers and their respective tracts were understated. After March 1977, when the certificates were processed, the ratios were overstated.

Absence of controls over coupon redemption by banks

Our observations at 32 selected commercial banks in five States showed a general lack of control in handling food coupons and certificates, which compounded the problem of obtaining accurate redemption data for retailers. The lack of controls also provides an opportunity for improperly obtained coupons to be channeled through banks without detection.

Most banks have internal instructions for handling food coupons and certificates, and bank managements were usually aware of these procedures. Generally, bank tellers we interviewed confirmed the amount of food coupons redeemed by referring to the related deposit slips, but seldom compared the mark-sensed amount of the certificate to the actual deposit. Any error in mark-sensing would not have any effect on the bank's finances and controls.

The Food Stamp Act (7 U.S.C. 2019) states:

"Regulations issued pursuant to this chapter shall provide for the redemption of coupons accepted by retail food stores through approved wholesale food concerns or through banks, with the cooperation of the Treasury Department, * * *."

The food stamp program regulations state:

"Banks may redeem coupons only from authorized retail food stores * * * and wholesale food concerns in accordance with this part and the instructions of Federal Reserve Banks. Coupons submitted to banks for credit or cash must be properly endorsed * * * and shall be accompanied by a properly filled-out and signed redemption certificate."

We found that one bank in Louisiana prepared substitute redemption certificates for coupon deposits that retailers made without redemption certificates. Three Pennsylvania banks accepted several coupon deposits supported by redemption certificates without retailers' names, addresses, or authorization numbers. The incomplete certificates were rejected by the optical scanner at the computer center and shipped to the field office for possible identification and completion. If complete and proper (not substitute) redemption certificates are not submitted, the redemptions cannot be attributed to specific retailers and the Service's redemption data for the retailers involved would be understated. As discussed previously (see p. 18), erroneous coupon redemption data can prevent violations from being detected.

Both the Federal Reserve System and the Service have issued instructions to commercial banks on the proper handling of coupons and redemption certificates, but these do not contain enforceable regulations or penalties for banks that do not follow these instructions.

How controls over redemptions could be improved

Improved controls by banks offer a good opportunity for assuring reliable data on retailer coupon redemptions and for providing high level integrity over coupon redemptions. However, if coupon deposits are not matched against the amounts shown and mark-sensed on the certificates at the time they are accepted by the bank, a vital link in the control chain is lost.

The certificates do not accompany the food coupons that are submitted to the Federal Reserve Banks for credit to the redeeming bank. No supporting documentation is required by the Federal Reserve Banks. Commercial banks receive credit for the full amount of the coupons they submit, regardless of amounts shown on the redemption certificates which stay at the redeeming banks until they are sent to the Service's computer center.

No procedures have been established to ensure that coupons redeemed by banks and ultimately deposited at a Federal Reserve Bank were accepted from authorized retailers. Also, current procedures do not ensure the accuracy of the redemption certificates and the redemption data entered into the Service computer system. Changes are needed in these areas to improve the monitoring system and provide a means of detecting banks that accept and subsequently receive credit for coupons acquired from unauthorized sources.

One method of providing the needed controls would be to require all commercial banks to make daily deposits of coupons accompanied by supporting retailer redemption certificates to their respective Federal Reserve Bank. The Federal Reserve Bank would ascertain the total dollar amount from the mark-sensed areas of all certificates and compare this total with the coupons deposited. If the two amounts agreed, the Federal Reserve Bank would send the certificates to the computer center for processing. If the two amounts differed significantly, the Federal Reserve Bank would return the coupons and the certificates to the bank for investigation and correction. If the difference was not significant, the Federal Reserve Bank would handle the discrepancy in accordance with normal banking practices.

Such procedures would force banks to make sure that all deposits of food coupons are accompanied by redemption certificates which are properly mark-sensed. Because the Service gives redemption certificates only to authorized retailers and enters each retailer's identification number on the certificates (both in arabic numerals and by key-punching) before giving them out, every redemption would be associated with an authorized retailer. A bank's failure to require a redemption certificate or its acceptance of a certificate on which an incorrect amount was entered would result in the Federal Reserve Bank's finding a difference between the total from the redemption certificates and the total coupons deposited.

Daily deposits would make it easier to pinpoint errors when they occur and would result in timely submission of redemption certificates. Any irregularities would be detected when the coupons and certificates reached the Federal Reserve Bank (or before) or in the case of forged or counterfeit redemption certificates, when the computerized reports on redemptions were examined by Service field offices.

We discussed this control method with representatives of the Board of Governors of the Federal Reserve System and with officials of Federal Reserve Banks. They pointed out that the Federal Reserve Banks would incur additional costs which the Service would have to pay. No estimates were available as to the amount of these costs.

We believe that the Service should consider this control method, or other similar methods, to improve the redemption procedures.

PROBLEMS IN MONITORING RETAILER REDEMPTIONS
MADE THROUGH WHOLESALERS

The Service does not effectively monitor coupon redemptions made through wholesalers which sometimes act as intermediate redemption agents for some retailers. Some of the 4,100 wholesalers authorized to accept food coupons have improperly acquired and redeemed them and have gone undetected for extended periods.

When accepting coupons from retailers, the wholesaler is supposed to make sure that the retailers present properly prepared and valid redemption certificates. The wholesaler then prepares a special wholesaler redemption certificate for the total amount of coupons to be deposited in a commercial bank. Both retailer and wholesaler certificates accompany the deposit, but the banks are required to send wholesaler certificates directly to the cognizant Service field office rather than to the computer center, as is done with the retailer certificates.

The local field offices are supposed to use the wholesaler redemption certificates to monitor wholesaler redemptions, but the field offices we visited gave the wholesaler certificates only a cursory review or no review at all.

Officials of the Department's Office of Investigation have stated that the lack of controls over wholesalers presents a high potential for abuses to go undetected. Overall information on wholesaler abuses is not available, but Office of Investigation personnel told us that there have been several cases of illegal redemptions by wholesalers, some involving organized criminal activities.

If improved controls over coupon redemptions were instituted as discussed on page 21, it would be considerably more difficult for abuses by wholesalers to go undetected because the banks would be forced to make sure that coupon deposits are accompanied by properly mark-sensed retailer redemption certificates. Also, under the changes made by the Food Stamp Act of 1977, the Service may be able to withdraw authorization from many wholesalers because they will no longer be needed in the program to enable retailers to redeem food coupons. However, many other wholesalers may be unaffected because they will still be needed in the program to deposit retailers' coupons.

CHAPTER 5

NEED FOR MORE TIMELY AND EFFECTIVE INVESTIGATION

AND RESOLUTION OF SUSPECTED VIOLATIONS

The Service has had difficulty identifying and imposing timely and effective penalties against firms that do not adhere to program regulations because

- the Department of Agriculture's Office of Investigation usually has had higher priority calls on its investigative resources and has been unable to promptly initiate requested investigations of authorized firms suspected of violating program regulations;
- the investigations, once initiated, have had a low success rate;
- it has taken field offices a long time to administratively process cases and impose penalties after investigation reports were received;
- the administrative appeal and review process has been time consuming; and
- administrative appeal review officers have had wide latitude in considering factors not related to detected violations or events occurring after the violations, which resulted in reducing or overturning previously imposed periods of disqualification.

While the above processes and actions were going on, the firms involved were allowed to continue accepting food coupons.

An analysis of data on the 1,038 investigations conducted in five States--California, Louisiana, Michigan, Pennsylvania, and New Jersey--between July 1973 and May 1977 showed that an average of 174 days was required to obtain investigative reports and that of the 1,038 investigations, only 220, or about 21 percent, detected violators. An average of 252 days elapsed from the date of the investigative report to the time a penalty was imposed or other final action was taken. Thus, an average of 426 days elapsed from the time a suspected violator was first identified until an investigation was made and final action was taken by the Service. Some penalties imposed seem rather minor and may not present much deterrence to future violations.

Before January 1977 the Office of Investigation had complete responsibility for investigating firms suspected of violating program regulations. In January 1977 the Service established a compliance branch responsible for routine investigations to determine if authorized firms are complying with regulations. The Office of Investigation continues to be responsible for investigations involving possible felonies and trafficking in coupons. The results achieved by the compliance branch during 1977 were mixed. (See p. 37 for a detailed discussion.)

HOW VIOLATIONS ARE DISCOVERED AND HANDLED

Accepting coupons for ineligible items, such as beer, liquor, cigarettes, and household supplies, is the most common violation discovered during investigations of retailers. Other violations include such things as accepting coupons in exchange for cash and accepting coupons as payment on credit accounts, major items of furniture, automobiles, and television sets. Office of Investigation personnel told us that there is also trafficking in coupons by organized criminal elements

The Service identified these violations through

- complaints that a retailer was violating program regulations;
- violations Service field personnel observed during visits to firms; or
- retailers with unreasonably high coupon redemptions being identified through the Service's computerized analysis of food sales and redemption data, as discussed in chapter 4.

When a retailer is suspected of violating program regulations, Service personnel first visit the retailer, explain program regulations, and warn that continued violations may result in suspension from the program. If there is evidence that the retailer continues to violate the regulations after these monitoring visits, field office personnel usually request an investigation. The investigation usually consists of an undercover investigator attempting to engage the retailer in prohibited transactions.

Service field and regional food stamp officials review the investigation report and if it shows that violations have occurred, determine and impose a penalty on the retailer--usually a period of suspension--based on Service criteria

described on page 31. If the retailer wants to appeal the decision, the Service must be notified within 10 days, and the case is referred to a Service administrative review officer who is independent from the Service's food stamp and regional office personnel. The administrative review officer can sustain or overturn the regional decision, or reduce the penalty. If the retailer wants to appeal further, he must do so in the U.S. District Court or further through the Federal court system.

DELAYS IN OBTAINING INVESTIGATIONS

During our review we examined the 1,038 investigations requested and completed from July 1, 1973, to May 3, 1977, in the five States included in our review. The following table shows the results of that analysis in terms of the number of days that elapsed from the time investigations were requested until the Service took final action.

	<u>Cali-</u> <u>fornia</u>	<u>Louis-</u> <u>iana</u>	<u>Michi-</u> <u>gan</u>	<u>New</u> <u>Jersey</u>	<u>Pennsyl-</u> <u>vania</u>	<u>Total</u>
Total cases examined	152	203	111	293	279	1,038
Average days from request for investigation to report	217	195	156	191	126	174
Range of days	9 to 504	0 to 762	34 to 546	2 to 727	7 to 672	0 to 762
Positive cases	36	41	41	48	54	220
Average days from report to final action by Service	306	289	250	244	196	252
Range of days	77 to 809	62 to 840	4 to 814	67 to 815	73 to 546	4 to 840
Average days from request for investigation to final action by Service	501	535	431	391	322	426
Range of days	184 to 973	0 to 1,014	119 to 987	181 to 976	117 to 739	0 to 1,014

Office of Investigation officials cited the following factors contributing to the lack of prompt investigations of retail and wholesale firms.

--The Office had responsibility for a wide variety of program and personnel investigations affecting 26 agencies of the Department and it was necessary to assign priorities. These kinds of food stamp cases received a lower priority than other cases because some of the other cases had to be investigated and completed in a specified period, food stamp cases lack "prosecutorial appeal," and individual food stamp violations usually did not involve significant amounts of money.

--The Office attempted to cluster pending food stamp cases and perform several investigations in one area at the same time. Consequently, action on some requests was delayed until other requests were received on firms in the same area.

LOW SUCCESS RATE OF INVESTIGATIONS

Of the 1,038 cases we reviewed, 1/ only 220--21 percent-- were found to involve violations, as shown below.

<u>State</u>	<u>Cases investigated</u>	<u>Violations found</u>	<u>Percent</u>
California	152	36	24
Louisiana	203	41	20
Michigan	111	41	37
New Jersey	293	48	16
Pennsylvania	<u>279</u>	<u>54</u>	19
Total	<u>1,038</u>	<u>220</u>	21

Office of Investigation officials cited the following factors which may have contributed to the low percentage of positive investigations.

1/These cases were handled by the Office of Investigation. As stated on p. 36, responsibility for investigating firms suspected of routine violations was transferred to the new compliance branch in January 1977.

--The Service's primary method of identifying firms as possible violators is based on monitoring firms' coupon redemptions through computer-generated reports which were found to be invalid and unreliable. Historically, investigations of these firms have had negative results.

--The Office of Investigation prefers to use its own full-time agents in investigations; however, in rural areas and ethnic neighborhoods, firms being investigated are hesitant to transact business that violates program regulations with people, such as the agents, who are strangers or who do not appear to be members of the community. Therefore, investigative aides from the community were used and, since they are not trained, the investigative results often are negative or unsupportable.

--Firms become aware of an agent's presence in the area and do not commit violations.

The above reasons point up the difficulty in proving suspected violations. The first reason--dealing with the reliability of coupon redemption reports--is discussed at length in chapter 4. Improvements can be made in this area.

DELAYS IN ADMINISTRATIVE PROCESS OF DISQUALIFICATION

As shown in the table on page 25, the imposition of administrative sanctions in 220 positive investigation cases required an average of 252 days after the Service received the investigation reports. Service officials attributed these delays to

--requesting the Office of Investigation to clarify information in a report;

--referring cases to the U.S. Attorney for a decision on whether to prosecute and holding administrative action in abeyance until a decision was made;

--the time-consuming clerical functions of notifying the firm of the violations, preparing a case summary, and reaching a decision on the disqualification; and

--the time-consuming administrative review process when the retailer appeals the initial administrative action.

In 78 of the 220 cases, or about 36 percent, the Service took 250 days or more to effect final action against the violating firms after receiving the investigation reports. Following are examples of some of these cases.

Example 1

An investigation report received on April 7, 1975, revealed that a Louisiana retailer accepted coupons for cash, sold ineligible items, and gave change in cash. On May 2, 1975, the U.S. Attorney refused to prosecute; however, the Service for unknown reasons, delayed charging the retailer until August 25, 1975. It was later determined that the firm would be suspended for 1 year, and on November 10, 1975, an administrative review was requested. The 1-year suspension period was sustained, and the retailer was suspended for 1 year effective February 5, 1976--304 days after receipt of the investigation report.

Example 2

On June 16, 1975, a Pennsylvania retailer was charged with three counts of accepting coupons for ineligible items on the basis of a May 13, 1975, investigation report. When notified on July 25, 1975, that a 60-day disqualification would be imposed, the retailer requested an administrative review. The review officer sustained the disqualification in a decision issued on March 16, 1976--232 days after the request--and the disqualification became effective on April 2, 1976--325 days after the investigation report.

Example 3

A November 14, 1975, investigation report revealed that the owner of a Michigan firm accepted coupons for major nonfood ineligible items during three transactions. The report was referred to the U.S. Attorney on November 19, 1975, and two misdemeanor counts were filed against the retailer on January 7, 1976. The retailer entered a guilty plea to one count on April 14, 1976, and on June 2, 1976, the court imposed a \$500 fine and 2-year probated sentence, 195 days after referral to the U.S. Attorney. The Service held administrative action in abeyance pending completion of the criminal proceedings and on July 29, 1976, charged the firm with accepting coupons for ineligible items. Although the retailer was under a 2-year probated

sentence, the firm was disqualified for only 60 days effective December 11, 1976--393 days after the investigation report showed that the firm was violating program regulations. The retailer was allowed to continue program participation for 241 days after entering the guilty plea to violating program regulations and for 192 days after being sentenced by the court. Further, the retailer applied for reauthorization on February 11, 1977, and was authorized on March 1, 1977, even though he was still fulfilling the court-imposed probation.

Example 4

An April 22, 1974, investigation report revealed that two co-owners of a California firm violated program regulations by accepting coupons for 32 major ineligible items including liquor, beer, and cigarettes in five separate transactions. The administrative action was held in abeyance pending disposition of criminal charges which resulted in each co-owner receiving a \$1,250 fine and a 2-year probated sentence. Because of an administrative review and other delays, final action was not taken by the Service until September 13, 1975--509 days after receiving the investigation report. The co-owners received a 6-month disqualification.

Also, Service policy was that, for cases appealed to administrative review, notices of adverse determinations based on administrative review findings were not to be sent to firms during the Christmas season. The reason is that the firms have large inventory investments then and the Service should not place a financial burden on them. We did not try to identify the number of determinations that were delayed as a result of this policy; however, a firm could conceivably be allowed to continue program participation for about 6 weeks after the Service determined that a suspension period is warranted. Service officials stated that this policy was under review.

Delays in completing administrative reviews

As noted in the above examples, administrative reviews excessively increase the Service's time for completing final action against violators. Of the 220 positive investigations, we reviewed 141 and found that 47 administrative reviews were made. It took from 10 to 310 days, an average of 116 days,

from the time administrative reviews were requested until final actions were taken. Service officials said that the following factors contributed to the delays.

- The act provides that a firm may request an administrative review of an adverse determination on an application for authorization, a withdrawal of authorization, a disqualification, or a denial of a claim for food coupons. Consequently, officers must make several types of reviews.
- Before January 1977 there were no more than six review officers nationwide to handle the total workload and as of July 1977 there were only eight. During the 15 months ended September 30, 1976, 529 administrative reviews were made; data was not readily available on how many were requested.
- A firm notified of impending disqualification, and after requesting a review within 10 days, is allowed an additional 3 weeks to submit information supporting its position. The review officer may grant an extension, at his discretion, if the firm needs additional time to fully support its position. Thus, the system has at least a 3- to 4-week delay built in before the actual review can commence.
- The firm may ask to appear before the review officer and may be represented by counsel. The review officers have been authorized to arrange meetings, even though not specifically requested, if they determine that a personal meeting is needed for a fair and impartial judgment.
- Review officers make every effort to conduct several meetings within the same geographic area on every trip to better manage travel funds and time. A case may be delayed 30 days until receipt of another case in an area nearby.

We did not try to determine if the present number of administrative review officers could, through improved operations, handle all review requests timely. We note, however, that the number of administrative reviews probably will increase as more violations are identified. Improved monitoring, as discussed in chapter 4, and full operation of the compliance branch should result in more violations being

identified. We believe that the number of administrative review officers should be increased to ensure that review requests are handled expeditiously.

If the Department expects to obtain largely voluntary retailer compliance with the law and regulations, action against violators must be timely. As shown in the preceding examples, flagrant violators have not been punished for months after the violations were identified. This type of delay hurts the entire compliance effort. Firms inclined to violate the law and regulations will not be deterred if penalties are not imposed promptly. Late penalties ruin the credibility of the entire program among honest retailers and the general public.

PENALTIES IMPOSED DO NOT SEEM TO
PROVIDE AN EFFECTIVE DETERRENT

Deterrence to retailers' violating the Food Stamp Act or Service regulations seems to be lacking because penalties imposed, in some cases, seemed too lenient, especially cases appealed to administrative review in which the penalties were frequently reduced. Administrative review officers may use the standard Service criteria as guides in determining the reasonableness of penalties imposed, but they frequently deviate substantially from these criteria.

Many retailer violations constitute felonies or misdemeanors under Federal law and accordingly can be prosecuted in Federal courts. To prosecute most of these cases apparently is fruitless, however, because the penalties imposed generally are very light--much lighter than those imposed through the administrative process--and the results are not worth the time and resources required. Administratively imposed penalties, if properly applied, could be much more effective.

Service criteria on penalties
need some strengthening

For some types of violations, the Service provides for reasonable penalties but the minimum penalties--short suspensions or a warning letter--do not seem effective. Service instructions specify the following suspension periods based on the extent of program harm, the nature of the violations, and whether previous violations have occurred and penalties have been imposed.

--Three years is the maximum suspension period and is to be reserved for unusually serious cases. This period is to be assigned to a firm previously

suspended for a substantial period and again found to be seriously violating the program regulations or in any case involving flagrant violations resulting in major diversions of funds.

- A 1-year period is normally the maximum suspension assigned to a firm not previously suspended. The period is to be assigned when the firm buys coupons for cash at less than their face value (discounting) or sells ineligible items such as alcoholic beverages and other major nongrocery items, and Service personnel have taken significant previous compliance action (such as several visits and letters) to prevent violations. The previous compliance action is important because violations after such action indicate either that it is store policy to violate the regulations or that management was lax in assuring that employees follow the regulations. Manager or owner involvement in violations also shows that it is store policy to violate.
- A 6-month suspension period is to be assigned when the evidence reflects, to a limited extent, that coupons are discounted for cash or that major nongrocery items are sold but compliance action is either lacking or too limited to support a 1-year disqualification. This period is also to be specified in cases where Service personnel have taken significant previous compliance action to prevent violations and the firm (1) sold common grocery-type ineligible items in amounts found in a normal shopping basket or (2) committed violations on the condition that recipients spend their coupons at the violating store.
- A 90-day suspension period is to be assigned in cases where common grocery ineligible items were sold in amounts found in a normal shopping basket, or for any violations committed on the condition that recipients spend their coupons at the violating store but the previous compliance action will not support a 6-month suspension.
- A 30- or 60-day suspension period is to be assigned, depending on the extent of the violations, the position of the store personnel involved, and the extent of the previous compliance action. One of the periods is assigned in situations involving poor supervision and general carelessness within the store which contributed to the violations.

--A warning letter is to be sent to the firm in circumstances similar to those supporting a 30- or 60-day suspension but where previous compliance actions were absent or very limited.

In general, the penalties initially imposed in the cases we reviewed complied with these criteria.

A 30- or 60-day suspension or a warning letter, as was applied in 36 percent of the cases we reviewed, seems to provide little or no deterrence to a firm inclined to violate the law or program regulations.

Criminal prosecution seems
fruitless in most cases

Cases prosecuted in Federal courts, upon conviction, generally result in a minor fine and probated sentence. Suspension is not automatic in such cases, although it is frequently imposed through administrative action. Also, prosecution usually involves long delays and substantial costs. It seems to us that even short suspensions, with their associated economic loss, would be a more effective deterrent than the relatively minor penalties which frequently result from criminal prosecution. Accordingly, we believe that criminal prosecution should be undertaken in only the most serious retailer violation cases; most cases should be handled administratively.

On June 20, 1978, after negotiations with the Department of Agriculture, the Department of Justice issued guidelines on what categories of food stamp cases should and should not be referred to it for prosecution. The guidelines are designed to expedite Justice's prosecution of significant cases while permitting Agriculture latitude for prompt administrative action in categories not warranting prosecution.

We believe that establishing such guidelines is a step in the right direction. However, certain of the categories to be referred to Justice are very broad (e.g., accepting coupons for cash regardless of amount involved) and may result in many cases being referred to Justice. Accordingly, both Departments will need to periodically review the results of these guidelines to make sure that most cases being referred justify criminal prosecution.

Lack of guidelines governing
administrative review determinations

The Service has not established guidelines for administrative review officers to follow in reaching their decisions; consequently, review officers have considered factors unrelated to the proven violations and events occurring after a violation. This absence of guidelines has resulted in decisions, especially penalty reductions, which seem to be unsupported by fact and without specific guidance in law or regulation.

In 29 of the 47 cases we reviewed (60 percent) where administrative reviews were conducted, the penalty originally assessed was reduced by the administrative review, as shown in the following table. Also, Service records show that of the 852 disqualification cases adjudicated by the administrative review staff from July 1, 1973, to May 3, 1977, the original penalty was reduced in 32 percent of the cases.

<u>Number of cases</u>	<u>Penalty initially assessed</u>	<u>Penalty after administrative review</u>
7	1 year	6 months
1	1 year	60 days
1	1 year	Warning letter
7	6 months	90 days
2	6 months	60 days
2	6 months	30 days
1	6 months	Warning letter
2	60 days	30 days
<u>6</u>	60 days	Warning letter
<u>29</u>		

In 19 of these 29 cases, the review officers considered what seemed to be extraneous factors in reaching their decisions. The following examples are typical of these cases.

Example 1

A Pennsylvania firm received notice in August 1975 that a 6-month suspension would be imposed for accepting coupons for 23 ineligible items (mainly household products) in 5 transactions. The owner had accepted coupons in three transactions and the owner's husband (the store manager) and son each accepted coupons in two other transactions. An administrative review was requested and the suspension period was reduced to 90 days. The review officer concluded that the violative transactions had occurred but were not the result of store policy even though the owner, the manager, and the owner's son were involved. In reaching this conclusion, the review officer considered the manager's refusal to sell two packs of cigarettes for coupons; his refusal to exchange coupons for cash; and the owner's mother being ill and the death of the husband's father as resulting in laxness in store operations. The review officer also considered the owner's general statement that necessary steps had been taken to correct the laxity in operations.

Generally, violations involving store owners or managers or their family members are regarded as evidence of store policy to violate the regulations. Also, in this case, Service field personnel had made compliance visits to the store nine times in the 4 years prior to its being charged with violations. These visits were conducted because the store seemed to be redeeming an unusually large amount of coupons. During these visits, the store owner and manager were cautioned on how to avoid violations and told that violations could result in the store's suspension.

Example 2

On November 8, 1974, a Michigan retailer was charged with selling ineligible items for coupons during six transactions. Items included insect killers and various household items. The sales were made by the owner and two clerks, which, according to Service criteria, established that it was store policy to sell ineligible items. The owner was notified on January 3, 1975, that the firm would be suspended for 6 months. The firm requested an administrative review on January 8, 1975. On May 30, 1975, 142 days later, the review officer reduced the suspension period to 90 days. In making the determination, the review officer considered that the owner had not been cautioned in writing that violations

could result in suspension although he was orally warned. The review officer also considered a suspension imposed against a firm in a similar case in which one co-owner and wives of both co-owners participated in violative transactions, which was sufficient to establish store policy, and similar items were sold. The other retailer received only a 90-day suspension which was sustained by an administrative review in April 1971.

We can see no justification for considering the penalty imposed in the similar case, especially since under Service criteria, 6-month suspensions seemed to be in order in both cases.

We believe that the review officers need specific guidelines as to what they may and may not do and under what conditions. Especially when they determine that a violation occurred as charged, their consideration of the penalty should be limited to determining whether the Service criteria were followed.

CHANGES IN INVESTIGATIVE RESPONSIBILITY

In March 1976 the Department placed a moratorium on requests to the Office of Investigation for investigations of retailers suspected of committing routine violations, such as accepting food coupons for ineligible items. Because the Office of Investigation had higher priority work, it was unable to respond promptly in these kinds of cases and the Service planned to establish its own compliance branch to handle such cases.

The new compliance branch was established in January 1977 and the Service entered into an agreement with the Office of Investigation whereby routine investigations of firms suspected of violations would be handled by the compliance branch and felony-level investigations--those involving coupons valued at \$100 or more--would be coordinated with the Office of Investigation which continued to have responsibility for felony-level investigations.

Under the agreement, the compliance branch was to refer routine violations--those involving sale of a few ineligible items--to the respective regional offices for disqualification action or other appropriate measures. More serious cases were to be referred to the Office of Investigation which was to advise the Service within 10 working days whether an investigation would be made. If an investigation was not initiated within 90 days, the Service could, upon notifying

the Office of Investigation and barring specific objection, proceed with administrative action.

The compliance branch began making investigations in February 1977. While the branch's achievements were limited in 1977, we believe this approach to investigating retailers can work successfully.

Compliance branch operations

At the time the compliance branch was established, there were about 4,600 cases of suspected violations awaiting resolution. Some were retained by the Office of Investigation; hundreds were written off on the basis of reassessments of the case information and circumstances; and the remaining cases were assigned to the compliance branch. The following table shows the progress in handling cases of suspected violations.

	<u>Older cases</u>	<u>Newer cases</u>	<u>Total</u>
On hand January 17, 1977	2,924	-	2,924
Add:			
New cases received	---	6,378	6,378
	2,924	6,378	9,302
Deduct:			
Cases completed	2,717	3,318	6,035
On hand August 2, 1978	<u>207</u>	<u>3,060</u>	<u>3,267</u>

As shown above, the compliance branch has been unable to decrease the overall backlog because new cases were being received faster than cases were being resolved. In the meantime, suspected violators continued to participate in the program.

The compliance branch director told us that he expects a perpetual backlog of cases because many new requests were being received and because requests involving geographically isolated firms probably would not be investigated until additional requests on other firms in the same geographical area are received.

The compliance branch has completed over half of the investigations with positive results--the branch obtained enough evidence of violations to recommend action against the firms.

The compliance branch began operations with a staff of 81 but by July 1978 staffing had decreased to a low of 74. Even though the case backlog continues to increase, it is projected that full-time staffing will be reduced to 72 in fiscal year 1979.

The Service will need to watch the branch's workload and backlog carefully to determine whether additional resources are necessary to reduce the backlog to a minimal level and keep it there. In this regard, the Department's Office of Audit was undertaking a review of the compliance branch's operations, including an evaluation of its efficiency. This review should provide additional information as to whether additional resources are needed to avoid large case backlogs.

Limitations on compliance branch operations

Under the agreement with the Office of Investigation, the compliance branch is limited primarily to determining whether a firm will accept food coupons for ineligible items and only at a misdemeanor level. This means that branch staff (acting under cover) generally do not attempt to purchase ineligible items valued at more than \$65--the total value of a coupon book normally used in a compliance review--when checking on retailer activities. Also, the staff cannot initiate offers to exchange coupons for cash. Office of Investigation personnel said these limitations were instituted because compliance branch personnel were not experienced investigators and might entrap retailers.

The compliance branch director said that the branch's inability to concern itself with felony-level transactions will prevent it from checking on and detecting the more serious program violations. As of August 1978, the compliance branch had referred over 2,400 compliance cases to the Office of Investigation for further action. The Office of Investigation had accepted only 205 referrals; it returned the remainder to the compliance branch for more timely administrative action. The Office of Investigation had completed action on 75 accepted cases.

The compliance branch director said that under new guidelines now being finalized by the Office of Investigation, the number of cases referred to the Office of Investigation should be reduced.

In view of the new policy of referring only certain types of retailer violations for criminal prosecution (see p. 33), it would make sense to allow the compliance

branch to investigate violations more serious than those they can investigate under the present agreement because the Office of Investigation has a heavy workload and departmentwide responsibilities. We believe the compliance branch should be responsible for investigating all cases in which criminal prosecution is unlikely.

The Service and the Office of Investigation should also explore the possibility of giving compliance branch personnel additional training so that the information and evidence they gather can be used in criminal prosecutions if necessary. Although the branch has been unable to reduce its backlog, the chances of a positive, timely investigation appear better if the branch handles it rather than the Office of Investigation.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The Food Stamp Act of 1964 as well as the 1977 amendments have given the Secretary of Agriculture broad authority to implement the food stamp program in a manner that best serves the needs of its recipients. However, if the program is to achieve its objectives, better regulation and surveillance of food retailers is necessary to encourage recipients to use their increased purchasing power to buy the staple foods needed in their diets.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

The Secretary of Agriculture should direct the Administrator, Food and Nutrition Service, to:

- Establish specific criteria for authorizing retailers to accept food coupons which will prevent participation by retailers not advancing program objectives.
- Require retailers to furnish food sales data for time periods compatible with the Service's analyses of sales and redemption data (now quarterly) and to certify its accuracy and agreement with data furnished State or local authorities for tax purposes. The data should be subject to verification by Service field offices on a selected basis.
- Develop, in cooperation with commercial banks and the Federal Reserve System, procedures under which the Federal Reserve Banks would compare the coupons they accept from commercial banks with amounts shown on the related retailers' redemption certificates and require the banks to investigate and correct any differences.
- Improve the consistency and equity of administrative review determinations in retailer suspension cases by requiring review officers to explain, in writing, the relevance of all factors considered in their decisions and to demonstrate that penalties they assess conform to Service criteria.
- Monitor the activities and decisions of administrative review officers to assure that the

requirements are being followed, with special emphasis on cases where the review officer reduces or eliminates the penalty.

- Designate additional administrative review officers until the backlog of cases is eliminated and cases can be reviewed expeditiously.
- Determine whether additional resources are necessary in the compliance branch to reduce the backlog of suspected retailer violations awaiting investigation to a minimal level and keep it there.
- In cooperation with the Attorney General, periodically review the guidelines for referring retailer violations to the Department of Justice to make sure that all cases are handled in a reasonable and timely manner.
- Make the Service's compliance branch responsible for investigating all suspected retailer violations in which prosecutions appear unlikely and consider giving branch personnel additional training so that the information and evidence they gather will be usable in criminal prosecutions if necessary.

The President has proposed eliminating the food stamp program as part of a reform of the Nation's welfare system. If such a proposal is adopted, our recommendations would not be applicable.

AGENCY COMMENTS AND OUR EVALUATION

Department of Agriculture

The Department of Agriculture commented on the matters discussed in this report in a letter dated September 25, 1978. (See app. I.) The Department generally agreed to either adopt or consider our recommendations or it proposed its own actions to solve the problems.

Despite this general agreement, the Department took exception to certain statements in the draft report. Some of these statements have been modified in the final report. In other instances, we have added material addressing the Department's concerns. Some differences remain.

Comments on recommendations

As discussed on page 14, the Service issued regulations on September 22, 1978, for implementing the Food Stamp Act of 1977's retailer authorization provisions. Although the new regulations are not very specific, the Service plans to make its instructions for carrying out the regulations as specific as possible while allowing its field staff latitude in determining which firms should participate. As noted in this report, regulations and instructions which were not specific enough were stretched to allow retailers that did not advance program objectives to participate.

The Service's approach, if properly implemented, could keep retailers that do not advance program objectives out of the program, depending on the judgments exercised in specific cases. If the Service keeps out of the program retailers whose primary business is other than the sale of food for home consumption--except those whose participation is needed because there are no other authorized retailers nearby--and whose staple food sales are less than 50 percent of their total food sales, only those firms that advance program objectives should be retained.

The Department agreed that obtaining more exact sales data from authorized retailers would help the Service's limited field staff identify firms that might be accepting food stamps illegally and that quarterly sales data would improve the Service's monitoring. It noted, however, that obtaining quarterly sales reports would increase the Service field staff's workload. The Service plans to evaluate the idea of obtaining more frequent sales data in connection with its new procedure of obtaining annual sales data by mail. According to Service officials, retailers will also be required to certify the accuracy of the data they submit in early 1979; the Service is considering requiring certifications on subsequent data submissions. The Service should also verify sales data in cases where it appears questionable.

The Department agreed that having the Federal Reserve Banks compare the coupons' and redemption certificates' values would improve the accuracy of the Service's redemption reports, thereby assisting its field staff in monitoring retailers. The Department noted, however, that having the Federal Reserve Banks reconcile coupons and certificates might cost more than it would be worth and could complicate the Federal Reserve Banks' counting of coupons. The Service plans to explore the matter further with the Federal Reserve System.

We believe the Service's planned action is appropriate but it should be noted that our recommendation calls only for a comparison by Federal Reserve Banks; if the comparison shows significant differences, the individual banks would have to reconcile the differences.

The Department said that the Service plans to establish guidelines for administrative review officers requiring them to explain, in writing, the relevance of all factors considered in their decisions and to demonstrate that penalties they assess conform to Service criteria.

According to the Department, the Service also plans to monitor review officers' activities by reviewing sample decisions each month. This is the kind of monitoring we believe is necessary, but special emphasis should be given to cases in which the review officer reduces or eliminates the penalty.

The Service also plans to add another administrative review officer to expedite its reviews and to reassess the administrative review staff's workload, operations, and staffing needs as of the end of fiscal year 1978. This is consistent with our recommendation.

The Department said that the Service is monitoring the compliance branch's workload. It said that, optimally, a workload of about 1,500 cases would ensure a constant work flow and facilitate scheduling and travel requirements (3,267 cases were on hand as of August 2, 1978). The Department said that 20 more full-time staff members would be necessary to maintain this optimal workload and that this additional staff would cost about \$511,000 more than allocated in fiscal year 1978. The Department said that the Service is operating under a very tight budget and that the resource needs of the compliance branch are being considered in the context of overall Service needs.

In the report sent to the Department for comment, we suggested that the Secretary of Agriculture, in consultation with the Attorney General, develop criteria and guidelines under which only the most serious retailer violation cases would be referred for criminal prosecution because of the long delays and light penalties frequently associated with such prosecution. As discussed on page 33, the Departments of Agriculture and Justice have developed guidelines for determining which food stamp program cases should be referred for criminal prosecution. Because many cases could still be referred, however, this situation should be monitored and the two Departments should reevaluate the guidelines as necessary.

The Department believes that more serious violators should be prosecuted. It said that the penalties and attendant publicity given to prosecution have a significant deterrent effect on potential violators. We agree that prosecutions can have a deterrent value, but the associated costs and delays must also be considered, especially if many cases are to be prosecuted.

The Department said that the problem of delays in taking disqualification action has been corrected somewhat since the compliance branch began operating. It said that disqualification action proceeds immediately on all cases in which the Office of Investigation declines further criminal investigation; because only a few cases are scheduled for further investigation, disqualification action can usually begin within 2 weeks after the compliance branch's report is issued. The Service wants to prosecute misdemeanor cases before U.S. magistrates instead of in U.S. District Courts, as allowed by the Food Stamp Act of 1977. This can be quicker and easier.

In addition to these measures, the Department offered another proposal for expediting administrative action against firms--taking immediate administrative action (such as suspension from program participation) in cases referred for possible prosecution rather than withholding administrative action until prosecution is completed. This would have to be arranged with the Department of Justice. This arrangement has already been made in certain U.S. attorneys' districts and has been quite successful. Experience has shown that suspension has a greater impact on retailer compliance than criminal prosecution. We believe the Department's proposal has considerable merit and commend the Department for developing it. Working out such an agreement should be given high priority.

On the matters of giving the compliance branch authority to investigate more serious cases and training branch personnel in handling these cases, the Department said that, for the most part, the compliance branch's limited authority has not hindered the removal of violators from the program. It added that the Office of the Inspector General has recently given the branch increased authority. The Department also said that although it is improper to ignore serious program violations, expanding the compliance branch's investigations could be counterproductive due to delays in administrative actions presently associated with referring cases to U.S. attorneys for prosecution.

The Department said that if the above agreement is worked out with the Department of Justice so that the Service could take immediate administrative action in cases being referred for prosecution, giving compliance branch personnel additional training and authority to investigate more serious cases would be beneficial. The benefits of such an agreement and the additional training and authority would include:

- Violators being quickly removed from the program.
- Stronger administrative actions against violators.
- Bringing serious violators to justice in the court system.
- Negligible increases in the Service's resources because obtaining evidence of more serious violations would be no more costly than for less serious ones.
- Devoting the Office of Investigation's (Office of the Inspector General) resources to the more serious retailer violation cases.

The Department did not see any disadvantages in following this proposed course of action.

Comments on report content

In addition to commenting on our proposed recommendations, the Department also provided comments on various other report sections. The following are our responses to Department comments with which we did not fully agree.

The Department commented that the draft report did not clearly show the reader the time frames involved in the review. By necessity different review aspects covered different time periods and took place at different times. Where pertinent, these time frames were indicated in the draft report as it was given to the Department for comment. It is not feasible to discuss all the time frames in the report's Scope of Review section; however, a statement that pertinent time frames are noted throughout the report has been added. (See p. 3.)

The Department said that the Food Stamp Act of 1977 enables it to tighten retailer authorization criteria. As discussed in chapter 2, we believe that the Food Stamp Act of 1964 also enabled the Department to establish authorization criteria based on the type and quantities of food a

firm sold. Under the 1977 act, the Department is required to implement certain specific retailer authorization criteria.

The Department objected to our blanket statement that firms selling only token amounts of staple foods do not advance program objectives. Our statement was based on the fact that at all locations we visited authorized retailers were accessible in addition to the firms selling only token amounts of staple foods. We are well aware that in certain instances there may have been a need to authorize individual firms selling only token amounts of staples and have developed our recommendation accordingly.

The Department said that our characterizing the program as having increased participation, enormous cost, and highly publicized abuses was misleading. We note that despite recent decreases in the number of food coupon recipients, participation has increased substantially since the program was inaugurated, that a program currently budgeted at nearly \$6 billion could properly be described as enormous, and that there has been substantial publicity given to proven as well as alleged abuses in the food stamp program. Some change in this section's wording has been made. (See p. 2.)

The Department disputed that weakness in Service authorization criteria constituted a systemic problem. We believe it logical to consider deficiencies in program rules or criteria as program or systemic weaknesses because they apply programwide. Further, we do not believe that the instances we identified indicate isolated problems. As discussed on pages 9 and 10, our conclusion was based on a thorough review of the procedures and criteria the Service uses nationwide, as well as visits to retailers in two States and examinations of selected files pertaining to retailer authorizations in these and three other States. We believe the total picture presented in the report clearly demonstrates systemic weaknesses.

The Department said that findings relating to retailer authorizations in two States should not be applied to all States. We explained to Department officials when their response was being prepared that this statement refers only to the five States included in our review and we clarified this section in the report. (See pp. 9 and 10.)

The Department said that our statement that authorizing retailers selling only token amounts of staple foods seriously weakens the primary control for channeling food

coupon use to staple foods was an overstatement. The Department added that the vast bulk of coupons flow through conventional grocery stores or supermarkets. We agree with the latter statement and have revised the report accordingly. However, we believe that although the number of authorized retailers selling only token amounts of staple foods is small, the damage they cause to the food stamp program's public image and the resulting administrative burden on the Department's scarce program resources require that steps be taken to allow only those retailers which advance program objectives to be authorized.

The Department objected to our conclusion that there are no controls to ensure that commercial banks are properly and legally accepting coupons. Department officials believe that existing procedures provide such controls. Our report clearly shows that as discussed on pages 19 to 21, controls over food coupon redemptions within commercial banks are inadequate. We observed that not all banks followed their established internal procedures. Additionally, external procedures do not control coupon redemptions because they are not designed to detect redemptions from unauthorized retailers or those made without proper redemption certificates. While fraud may not yet have been detected in this regard, we believe that there is sufficient potential for fraud and abuse to warrant prompt corrective action.

Department of Justice

In a letter dated November 1, 1978, the Department of Justice commented on criminal prosecution of violators. (See app. II.) It said that our conclusions and recommendations generally complement its position relating to fraud in Federal programs. It also noted the efforts it and the Department of Agriculture have underway to expedite such cases. (See pp. 59 and 57.)

In commenting on our suggestion that Justice and Agriculture develop guidelines under which only the most serious cases would be referred for criminal prosecution (see p. 60), Justice expressed concern that formal guidelines might impair using more flexible enforcement strategies or otherwise hamper Federal law enforcement efforts. We share Justice's concern and do not envision the need for more formal guidelines. (See p. 33.)

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE

WASHINGTON, DC 20250

SEP 25 1978

Mr. Henry Eschwege
Director, Community and
Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This is in reponse to the GAO draft report "Improvements Needed in the Regulation of Retailers Authorized to Accept Food Stamps."

We will first respond to your proposed recommendation(s) to the Secretary. Our comments on the content of the report follow.

1.

[See GAO note 1, p. 58.]

The new Food Stamp Act contains a provision requiring that stores participating in the Program have over 50 percent of their food sales in staple foods. Further, the proposed regulations state that in determining whether to authorize firms whose primary business is not the sale of food for home preparation and consumption, FNS shall consider not only the requirement that 50 percent of food sales be staple foods, but also the amount of sales of staple foods compared with other business conducted by the firm and the availability of other authorized food stores in the area. Hence, a firm meeting the staple foods requirement will not necessarily have to be authorized.

We believe that our proposed regulations will sensibly implement the intent of Congress that participation in the Program be limited to stores that will effectuate the purpose of the Program.

[See GAO note 1, p. 58.]

We share GAO's concern that the Food Stamp Act of 1964 did not provide the Department with sufficient latitude in determining whether to deny applicant firms. But we believe that the new Act and our regulations will address this problem to our and to GAO's satisfaction. Instructions implementing the authorization provisions of the new regulations will be as specific as possible; however, FNS field staff must be given latitude in determining which stores should participate. Part 278.1 of the proposed regulations allows flexibility to the FNS field staff to deny those firms who, although they meet the 50 percent staple food requirement, do not sell a substantial amount of staple food in comparison to other nonfood sales and are not essential to the Program.

2. It is recommended that retailers be required to furnish food sales data on a quarterly basis and to certify that it is accurate and that it agrees with data furnished State or local tax authorities. GAO also recommends that the data be subject to verification on a selected basis by our field staff.

We agree that more exact sales information would assist our limited field staff in analyzing and evaluating the redemptions of authorized firms as a means of identifying stores that are possibly accepting food stamps illegally. The quarterly food sales update system recommended by GAO would improve the accuracy of the food sales data in the automated redemption system. However, it would also increase the workload of our field staff significantly.

This year FNS field-tested a system of obtaining sales data by mail in selected field offices in each Region. As a result of this test, a decision has been made to implement the system

on a nationwide basis. Beginning in January 1979, retailers will be mailed a form to collect sales data (gross, food and staple food) on an annual basis. Even collection on an annual basis requires considerable staff time to verify, record, file, etc. For this reason we are reluctant to agree to collect sales data quarterly. However, after the nationwide implementation in January, we will have a better understanding of the staff requirements and can decide if a more frequent collection of sales data is warranted.

3. It is recommended that we develop procedures whereby Federal Reserve Banks would compare the coupons they accept from commercial banks with amounts shown on the retailers' redemption certificates and investigate and correct differences.

We agree that a comparison of redemption certificates and coupons by the Federal Reserve would improve the accuracy of redemption reports used by the field in evaluating retailer compliance. The proposed system would make commercial banks check the amount on the redemption certificates and to submit the redemption data to the Minneapolis Computer Center on a more timely basis. Improved data in the system would improve the accuracy of the report. More accurate redemption information would assist the field staff in identifying firms who require investigation. However, the cost of having the Federal Reserve reconcile the redemption certificates may be much greater than the benefits to the program merit. The proposed reconciliation process would complicate the counting of food stamps by the Federal Reserve Bank thus adding to our program costs. Presently, the agency pays the Federal Reserve approximately \$6 million annually to process food stamps. This cost could increase significantly if they were required to reconcile the redemption certificates. We are presently exploring the feasibility and cost of requiring commercial banks to forward redemption certificates through the Federal Reserve System. If the Federal Reserve is agreeable and the cost not prohibitive, the adoption of such a system will be considered.

- 4.

[See GAO note 1, p. 58.]

We agree with the recommendation as to the establishment of guidelines for the Review Officers and will establish such guidelines when final Regulations are published implementing the Food Stamp

Act of 1977. The guidelines will require the Review Officers, in their memoranda to the files, to clearly and adequately explain the relevance of all factors considered in determining their final decisions and to demonstrate that penalties conform to service criteria.

[See GAO note 1, p. 58.]

5. It is recommended that the Service monitor the activities and decisions of administrative Review Officers to assure that the guidelines are being followed.

Regulations issued pursuant to the Food Stamp Act of 1977, contain basic criteria for determining the period of disqualification to be assigned those cases involving violations of program requirements. Guidelines will be established for Review Officers based upon the new Regulations. The Director, Administrative Review Staff, will be responsible for monitoring, on a monthly basis, a random sample of cases adjudicated by each Review Officer.

6. It is recommended that the Service designate additional administrative review officials until the backlog of cases is eliminated and cases can be reviewed expeditiously.

The Administrative Review Staff presently consists of eight Review Officers. A ninth Review Officer will be added to the staff within the next 60 days. At the end of the current fiscal year (FY '78), the workload, staffing needs, and methods of operation of the Administrative Review Staff will be reassessed.

7. It is recommended that the Service monitor the workload and backlog of FNS' Compliance Branch to determine whether additional resources are necessary to reduce the pending workload awaiting investigations to a minimal level and keep it there.

The Service is monitoring the workload of the Compliance Branch. Optimally, a pending workload of approximately 1500 cases would ensure constant work flow and facilitate scheduling and travel requirements. This would allow for a timely turnaround of requested investigations. However, in order to maintain a pending workload of approximately 1500 cases, the Compliance Branch staff ceiling would have to be increased from 74 to 94 full-time personnel. In addition, the travel, salaries and benefit funds provided to the Compliance Branch would be increased approximately \$511,000 over the FY 1978 allotted funds to cover the cost of increased investigative personnel. The Service is operating under a very tight ceiling. In recent years, ceiling has been reduced by several hundred personnel while our programs have expanded and Congress has created additional programs for us to administer.

FNS' budget is also limited. The Service, like a number of other agencies, is well aware that there are a number of areas in which program operations could be improved if more personnel were added--but at the likely cost of increased federal employment. The Service is considering the resource needs of the Compliance Branch in the context of resource needs throughout the Agency and available Agency resources.

8. It is recommended that we develop criteria and guidelines under which only the most serious retailer violations would be referred for prosecution.

This recommendation was offered as a solution to the problem of having disqualification action delayed indefinitely in some retailer violation cases pending a U.S. Attorney's decision to prosecute or pending criminal prosecution by a court. Disqualification action has been delayed for many months in some situations while a violating firm continues to accept food stamps.

The problem was somewhat corrected when the Compliance Branch started operating in February 1977. Since that time, all positive Compliance Branch investigations have been referred to the Office of the Inspector General (OIG) for possible further criminal investigation. Only those cases that are investigated further by OIG are referred to U.S. Attorneys for prosecution. Disqualification action proceeds immediately on all cases in which OIG declines further investigation. OIG has scheduled investigations in a very small percentage of the cases referred to them so in a vast majority of cases, disqualification action can proceed within 2 weeks after the Compliance Branch issued the report on its investigation.

We believe that more firms involved in serious Food Stamp Program violations should be prosecuted. The penalties and the attendant publicity given to the prosecution of violators have a significant deterrent impact on potential violators.

The Food Stamp Act of 1977 provides for a maximum penalty of \$1000 in misdemeanor cases and thus will give Magistrate Courts jurisdiction in misdemeanor food stamp violations such as those uncovered by the Compliance Branch investigations. (Presently, the Magistrate Courts do not have jurisdiction in these cases because the Act of 1964 provides for a \$5000 maximum penalty for misdemeanor offenses). Therefore, when the provisions of the new Act are implemented, we would like to have the cases that are not escalated by OIG to criminal investigations referred to the Magistrates for action.

While we feel that the prosecution of more violators is important to maintaining a high level of compliance, we believe that prosecution either by Magistrates or by U.S. Attorneys in Federal District Courts should not precede or supercede disqualification action taken by this agency. We believe the prosecution should proceed simultaneously with disqualification, for maximum effect on a timely basis. Experience has shown that disqualification generally has a greater impact than prosecution on compliance.

Therefore, in response to GAO's recommendation in this area, FNS, OIG and OGC jointly will explore with the Justice Department an agreement to allow FNS to proceed immediately with administrative action in retailer violation cases separate and apart from the prosecutive action. Such an arrangement has already been made in certain U.S. Attorney's districts and has proven quite successful.

9. It is recommended that the FNS Compliance Branch be given greater authority to investigate more serious retailer violations. Currently, the Branch is restricted from investigating any felony-level violations.

For the most part, the restrictions on the Compliance Branch do not hinder FNS's primary objective of removing violating authorized retailers from the Food Stamp Program. The Office of the Inspector General has given the Branch increased authority since the time of the GAO report. Even with the restrictions, FNS is able to obtain sufficient evidence of violations to disqualify violating retailers from the Food Stamp Program for significant periods of time.

Because of the delays in administrative action which presently occur on cases referred to U.S. Attorneys for prosecution, it could be counterproductive to have the FNS Compliance Branch expand their investigations to include more serious retailer violations. However, at the same time, it is not proper to ignore the existence of serious Food Stamp Program violations because of the inconvenience of having to bring such investigations into court.

Under recommendation number 8 above, a proposed agreement between USDA and the Justice Department was discussed whereby FNS administrative action could proceed simultaneously with prosecutive action. If this type of agreement can be achieved, then it would be beneficial to provide additional training to Compliance Branch personnel so that evidence they gather will be usable in criminal prosecutions, if necessary, and the Branch will be given authority to investigate more serious Food Stamp Program violations.

The benefits to the Department would be: (1) violating retailers would continue to be swiftly removed from the Food Stamp Program; (2) administrative actions will be stronger against retailers found to be committing violations; (3) serious violations would be brought to justice in the court system, with the deterrent benefit of resultant publicity; (4) this could be accomplished with a negligible increase in the Department's resources since the cost of obtaining evidence of more serious violations would be no more than is already being expended for the currently restricted Compliance Branch investigations; (5) the Office of the Inspector General could devote their valuable resources to more serious Food Stamp Program retailer violation cases. Assuming that an acceptable agreement can be obtained from the Justice Department, there are no obvious disadvantages to USDA in following this proposed course of action.

COMMENTS [See GAO note 2, p. 58.]

We strongly urge that this and future GAO reports clearly indicate the period of time covered by GAO review and the date GAO's review began and ended. There is no mention of timeframes in the section of this draft report entitled "Scope of Review" and it is difficult for the reader of the report to readily determine how timely the report is.

On page iii, the report mentions several types of firms that are authorized and, in the opinion of GAO, are of questionable value to the program. Any taverns, pastry shops, gas stations and other marginal firms that have been authorized are authorized to accept stamps only for eligible food for home preparation and consumption. There is no provision in the current law stipulating the nature of firms authorized, and in some locations it has been necessary to authorize some firms that are not primarily grocery stores. Regulations to implement the Food Stamp Act of 1977 tighten the criteria for the authorization of firms participating in the program. Our comments elsewhere on this subject apply to this reference as well.

[See GAO note 3, p. 58.]

On page 2, GAO states that "The increased participation, enormous cost, and highly publicized abuses that are often associated with the food stamp program have caused much public and congressional concern about its administration." We feel that this is a somewhat value-laden and misleading characterization of the program. In fact, participation has declined from a high of 19.3 million persons in March of 1975, to 15.5 million persons in June of 1978, the most recent month for which data are available. Whether the cost of the program should be considered "enormous" will depend in part upon how one views the benefits the program delivers. The program is currently providing an average monthly benefit of \$26.50 to 15.5 million persons. With respect to "abuses", it should be noted that many of these "highly publicized abuses" were alleged, not proven. Further, this publicity seems to have subsided somewhat since the years of peak program participation and does not seem a fair characterization of the climate surrounding the program today. We would recommend, then, that this sentence be rewritten to state, "The size and cost of the program, coupled with publicity given to alleged abuses associated with the program in the past, have caused..."

See GAO note 3. p. 58.]

On page 11 of the report, GAO acknowledges that its review methodology does not permit it to project its results nationwide or even statewide, and that it thus cannot determine the actual magnitude of the problem. However, based on what it admits is limited observation, GAO asserts that the examples of problems found are not isolated instances and that weakness in FNS' criteria for authorization constitute a systemic problem. This assertion should be substantiated in the report.

On page 13 of the report, GAO states that on the basis of its examinations and visits, it believes that 24 out of the 44 firms it investigated should not have been authorized "and many of the firms in the other States should not have been authorized." This last assertion seems to be merely speculative. On what basis did GAO extrapolate its findings in two States to apply to all States? This assertion, too, should be substantiated in the report.

[See GAO note 3, p. 58.]

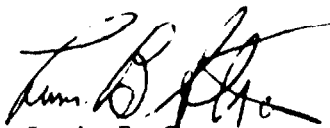
Finally, this Agency is extremely concerned about the language of the Report's Cover Summary. Many casual readers will read only the Summary and will skim through the Report. The Summary leaves misleading impressions on several scores.

First, the summary makes no reference at all to the fact that the Food Stamp Act of 1977 enables the Department to tighten criteria for authorization of both retailers and wholesalers. Second, as discussed above, GAO's blanket statement that firms selling only "token" amounts of staple foods do not advance program objectives is not fully supported by GAO's own recommendation on this issue, which would permit authorization of such stores where no other food stores are reasonably accessible; and is inconsistent with the legislative history of the new Act.

The Summary leaves the misleading impression that such stores do not have a legitimate role to play in the Program.

Third, to state that authorization of retailers selling only "token" amounts of staple foods "seriously weakens the primary control mechanism for channeling food stamp usage" to staple foods is surely a gross overstatement. The overwhelming majority of authorized firms are conventional grocery stores or supermarkets, and it is through these stores that the vast bulk of coupons flows.

Fourth, as an isolated statement on the Cover Summary, GAO's statement that there are "no controls to ensure that commercial banks are properly and legally accepting food coupons" raises the spectre of a situation wide open to abuse. This is somewhat at odds with the body of the Report itself, which acknowledges that "most banks have internal instructions for handling food coupons and certificates" and that "Both the Federal Reserve and the Service have issued instructions to commercial banks on the proper handling of the coupons and redemption certificates." The Report states what is true: Federal instructions do not contain enforceable regulations or penalties. However, banks are subject to extensive Federal and State monitoring and there are not known cases of food stamp fraud by banks. We suggest that the Summary statement be modified to read, "Improved controls by banks over coupon redemptions could result in more reliable retailer redemption data and could ensure that coupons are only accepted from authorized retailers."



Lewis B. Straus
Administrator

- GAO note 1: The deleted comments relate to proposals in the draft report which have been omitted or substantially revised in this final report.
- GAO note 2: These comments are discussed and evaluated beginning on p. 45.
- GAO note 3: The deleted comments relate to matters which were discussed in the draft report but revised in this final report.



UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the
Division Indicated
and Refer to Initials and Number

NOV 1 1978

Mr. Allen R. Voss
Assistant Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Voss:

This letter is in response to your request for comments on the draft report entitled "Improvements Needed in the Regulation of Retailers Authorized to Accept Food Stamps."

The conclusions and recommendations in the report regarding the need for more timely and effective investigation and resolution of suspected violations of program regulations and of fraud by retailers in the food stamp program generally complement the Department's position relating to fraud in Federal programs. The Attorney General has set the detection and prosecution of those who commit fraud in Federal programs as one of the Department's highest priorities and United States attorneys are committed to honor such priorities.


Officials of the Criminal Division are working closely with the Department of Agriculture to devise means of expediting the referral of significant cases to United States attorneys for prosecutive consideration. At the same time, they are trying to develop a policy which will permit latitude for prompt administrative action by the Department of Agriculture in categories of cases not deemed to warrant prosecution. In some localities the Department of Agriculture and United States attorneys have proceeded to implement this policy, and initiatives are being taken to extend the policy nationwide. The development of this policy is being accom-

plished on the basis of informal guidelines so that it will be possible--through consultation between the Departments of Agriculture and Justice--to alter the policy without resorting to formal actions.

We are not convinced of the need for formal guidelines as implied by the report, and we are concerned that the adoption of formal guidelines, under which only the most serious cases would be referred for prosecution, might impair the use of more flexible enforcement strategies or otherwise hamper Federal law enforcement efforts. For example, the Fraud Section of the Criminal Division has been working with the Department of Agriculture to develop innovative approaches to food stamp fraud, such as the use of "cluster prosecutions"--criminal actions brought against a number of suspected violators in a limited geographic area. The deterrent effect of this approach depends not on the conviction of major violators, but rather on the overall impact in a given region of prosecuting a number of offenses, each of which might be considered relatively insubstantial by itself. Moreover, the formulation of effective guidelines presents serious difficulties. A delicate balance must be achieved between the specificity needed to make guidelines meaningful and the flexibility necessary to allow for the uniqueness of particular cases and variations in local conditions. In addition, it is extremely important to avoid any prosecutorial criteria or guidelines that might be construed as creating enforceable rights on the part of defendants which could be used to burden our enforcement efforts with additional procedural litigation. For all of these reasons, we think it unnecessary and unwise to adopt formal guidelines to govern the prosecution of food stamp violations.

We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact us.

Sincerely,


Kevin D. Rooney
Assistant Attorney General
for Administration

(02390)

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