U. S. Department of Agriculture
Office of Inspector General
Audit Report

Food and Nutrition Service's
Fiscal Year 1997 Financial Statements
Alexandria, Virginia

Audit Report No.
27401-11-Hy
May 1998

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: May 21, 1998

REPLY TO
ATTN OF: 27401-11-Hy

SUBJECT: Food and Nutrition Service's Financial Statements for Fiscal Year 1997

TO: George A. Braley
Acting Administrator
Food and Nutrition Service

This report presents the results of our audit of the Food and Nutrition Service's (FNS) principal and combining financial statements for the fiscal year (FY) ended September 30, 1997. The report contains our qualified opinion on the FY 1997 statements and the results of our assessment of FNS' internal control structure and compliance with laws and regulations.

Our qualified opinion was the result of the agency's inability to substantiate the reported amount of Food Stamp Program (FSP) recipient claims against households. This has been a long-standing problem that we first reported in our FY 1991 financial statement audit. Our audit fieldwork has determined that material internal control problems continue to exist in establishing and reporting FSP claims. FNS made significant commitments in FY 1997 to address this long-standing issue. For example, FNS issued comprehensive review and self-assessment guidance to regional offices and State agencies. This guidance represents the common standards that FNS will use to provide overall assurance for the management of the recipient claims process. FNS plans to be able to provide assurances in three areas: (1) The accuracy of information presented on the FNS 209, Status of Food Stamp Claims Against Households Report, (2) the validity of the beginning or ending balance for the State agency, and (3) whether significant backlogs exist for recipient claims' referrals. During FY 1998, FNS plans to use the guidance issued in FY 1997 to focus management reviews on recipient claims. Also, during FY 1998, FNS plans to complete the evaluation of the accuracy of State agency balances reported on the FNS 209 and ensure that corrective action plans are developed for any identified weaknesses by September 30, 1998.

During the course of the audit we also identified certain matters which, although not material to the financial statements, warrant corrective action and will be communicated to FNS management in a separate audit report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned, including applicable timeframes, on our recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

ROGER C. VIADERO
Inspector General

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(Chapters 6 to 8 prepared by FNS)

CHAPTER 1
EXECUTIVE SUMMARY

Purpose

We have audited the accompanying principal and combining statements of financial position of the Food and Nutrition Service (FNS), as of September 30, 1997, and the related statements of operations and changes in net position for the year then ended. These financial statements are the responsibility of FNS' management. Our responsibility is to express an opinion on these statements based on our audit.

Our audit objectives were to determine whether: (1) The principal statements present fairly in all material respects the financial position and results of operations in accordance with applicable accounting principles; (2) FNS has an internal control structure that provides reasonable assurance of achieving its internal control objectives; (3) FNS complied with laws and regulations for those transactions and events that could have a material effect on the principal statements; and (4) the information and manner of its presentation in the Overview of the Reporting Entity and Supplemental Financial and Management Information sections was materially consistent with the information in the principal statements.

We conducted work at the FNS National Office in Alexandria, Virginia and 4 of the 7 FNS regional offices, 4 selected food coupon issuance points, the Benefit Redemption Systems Branch in Minneapolis, Minnesota, 2 of 12 Federal Reserve Banks (FRB), and the food coupon printer and distributor.

The principal FNS programs are the Food Stamp Program (FSP), Child Nutrition Programs, and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). Congress appropriated FNS over $43.3 billion for fiscal year (FY) 1997, over 73 percent of the total U.S. Department of Agriculture budget.

Results in Brief

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to assess the reasonableness of the gross accounts receivable, non-Federal, for the FSP, and the related Unexpended Appropriations, Appropriated Capital Used, Operating Program Expenses, Provision for Losses, and Notes 1D, 5, and 8, the financial statements present fairly, in all material respects, the financial position of FNS as of September 30, 1997, and the results of its operations and its net position for the year then ended, on the basis of accounting described in Note 1A.

During FY 1997, FNS made progress in improving the agency's financial recording and reporting processes. For example, FNS Data Integrity and Reporting Branch of the Accounting Division became fully operational, with responsibilities for internal review of both internal and external financial reporting. FNS improved the preparation of its financial statements in accordance with Office of Management and Budget (OMB) Bulletin No. 94-01, Form and Content of Agency Financial Statements. In addition, FNS' SF 133, Report on Budget Execution was supported by FNS' Agency Financial Management System (AFMS). However, several material internal control weaknesses warrant corrective action, as discussed in our report on FNS' Internal Control Structure. One of these weaknesses was identified in prior years while five were initially identified in FY 1997.

- FNS has not corrected its material internal control weakness related to food stamp recipient claims which represents the material portion of FNS' account balance for gross accounts receivable, non-Federal. In FY 1997, this balance was based on the FNS 209, Status of Food Stamp Claims Against Households reports. In our prior financial statement audits, we reported that the FNS 209s were unsupported, inaccurate, and incomplete. FNS did not have compensating controls or procedures for providing relevant, sufficient, and reliable data on which to base a reasonable estimate of the account balance and its related allowance for bad debt. FNS' accounting records did not permit the application of alternative procedures that would enable us to satisfy ourselves as to the value of these assets. As a result, we were unable to assess the reasonableness of the more than $942.3 million included in the gross accounts receivable, non-Federal, balance for the FSP.

  FNS made significant commitments in FY 1997 to address the long-standing issue with food stamp recipient claims. In FY 1997, FNS issued comprehensive review and self-assessment guidance to regional offices and State agencies. A total of 15 reports related to reviews of the management of food stamp recipient claims were available for review in the four regions where audit work was performed. The scope of six of these reviews did not encompass all of the areas covered by the review guidance and followup reviews need to be performed. According to the FY 1997 FMFIA report, FNS plans to focus management reviews on recipient claims using this guidance and complete the evaluation of the accuracy of State agency balances reported on the FNS 209's during FY 1998. In response to our issue paper, dated February 11, 1998, FNS agreed to ensure that corrective action plans are developed for any identified weaknesses by September 30, 1998. FNS has appointed a staff member with extensive Food Stamp experience to coordinate all of the Agency's efforts related to FNS 209's.

- FNS' controls over reconciling with Treasury records needs to be improved. FNS adjusted their general ledger to agree with external reports they sent to Treasury without providing evidence that these adjustments were always supported. Additionally, FNS' procedures did not fully document the fund balance reconciliation process. FNS asserted that monthly, a six step reconciliation and identification process is performed to validate Treasury information. While the adjustments made during FY 1997 did not have a material effect on the agency's fund balance, FNS should ensure that the external reports are supported by their accounting system and detail documentation at the time the reports are submitted.

- FNS' AFMS procedures and State Option Food Stamp Program (SOFSP) guidance were not fully implemented. Our review of FY 1997 operations disclosed that FNS did not record in AFMS the issuance of almost $4.5 million in SOFSP benefits for two States nor was a receivable established or States charged interest for the cost of borrowing these funds. FNS agreed to reassess their accounting procedures. Additionally, FNS did not require States to timely submit required reports showing actual SOFSP issuance information. FNS needs to improve its controls and oversight of the SOFSP. In addition, the methodology for allocating State funded benefits redeemed needs to be modified. As the SOFSP continues to expand, there is potential, using the current methodology, for material misstatement of the FSP redemption account.

- In the financial statements presented for audit, FNS materially misstated the value of food coupons in inventory presented in Note 4(c) because this value included coupons printed under an FY 1998 serial number and coupons-in-transit that were already a part of States' inventory. Also, the amount FNS reported for Trust and Deposit Liabilities, Non-Federal was materially misstated. Although aware of this misstatement, FNS did not immediately contact Treasury's Financial Management Service (FMS) to coordinate the necessary resolution in accordance with Treasury guidance. In addition, FNS did not include Electronic Benefits Transfer (EBT) obligations in the calculation of the accounts payable writedown model for the FSP in FY 1997. In response to these issues raised during the course of the audit, FNS revised the amounts in the financial statements and notes and agreed to implement applicable procedures in the future.

Our Report on Compliance with Laws and Regulations contains a potential violation of the Anti-Deficiency Act and instances of noncompliance with other laws and regulations.

- FNS expended FSP appropriated funds for the SOFSP in violation of the Food Stamp Act. FNS did not receive payment from two States at the time of issuance, a violation of authorizing legislation. As a result, when State benefits were redeemed, Federal funds would have been used to pay retailers for the authorized transactions resulting in a potential Anti-Deficiency Act violation. FNS disagreed with our conclusions that a violation of the Anti-Deficiency Act may have occurred. FNS requested a legal opinion from the Office of the General Counsel on May 5, 1998, as to whether FNS violated the Anti-Deficiency Act in its implementation of the SOFSP.

Key Recommendations

FNS needs to continue its commitment to improving its financial systems, processes, and reporting. In FY 1997, FNS made significant progress to strengthen their internal control structure to provide a financial management system that contains sufficient discipline, effective internal controls, and reliable data. However, FNS' efforts should include the following.

- Perform followup reviews of State's claims systems that did not encompass the comprehensive review and self-assessment guidance issued in FY 1997.

- Modify existing reconciliation procedures to fully document the process used to reconcile fund balances with Treasury and ensure that an adequate audit trail exists.

- Ensure that States remit, on a timely basis, payment for the cost of all benefits issued and related administrative fees.

- Provide improved oversight of the SOFSP by revising accounting procedures related to both administrative and benefit costs and require that actual issuance be reconciled with funds received from States to pay for benefits and administrative costs on a more frequent than annual basis.

- Require that the coupon printer and distributor's delivery records be used to determine the actual amount of food coupons-in-transit at yearend.

- Develop and implement procedures for resolving errors reported to Treasury and determining whether supplemental reporting is necessary.

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

CHAPTER 2
REPORT OF THE OFFICE OF INSPECTOR GENERAL

TO: George A. Braley
Acting Administrator
Food and Nutrition Service

We have audited the accompanying principal and combining statements of financial position of the Food and Nutrition Service (FNS), an agency within the U.S. Department of Agriculture (USDA), as of September 30, 1997, and the related statements of operations and changes in net position for the year then ended. These financial statements are the responsibility of FNS' management. Our responsibility is to express an opinion on these statements based on our audit.

Except as discussed below, we conducted our audit in accordance with Government Auditing Standards issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 93-06, "Audit Requirements for Federal Financial Statements," as amended, and other OMB bulletins applicable to the period under audit. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

FNS could not provide sufficient, competent evidential matter to support its gross accounts receivable, non-Federal, for the Food Stamp Program, stated at more than $942.3 million at September 30, 1997, and the impact this balance would have on Note 1D to the financial statements, Unexpended Appropriations and its related Note 5 to the financial statements, Appropriated Capital Used, Operating Program Expense and its related Note 8 to the financial statements, and Provision for Losses. FNS' accounting records did not permit the application of alternative procedures that would enable us to satisfy ourselves as to the value of these assets, and related equity, revenue, and expenses.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to assess the reasonableness of the gross accounts receivable, non-Federal, for the Food Stamp Program, and the related Unexpended Appropriations, Appropriated Capital Used, Operating Program Expenses, Provision for Losses, and Notes 1D, 5 and 8, the financial statements referred to above present fairly, in all material respects, the financial position of FNS as of September 30, 1997, and the results of its operations for the year then ended, on the basis of accounting described in Note 1A.

We have also issued a report on the agency's internal controls which cites six material internal control weaknesses and a report on the agency's compliance with laws and regulations which cites five material instances of noncompliance with laws and regulations.

ROGER C. VIADERO
Inspector General

April 17, 1998

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

CHAPTER 3
REPORT OF THE OFFICE OF INSPECTOR GENERAL ON INTERNAL CONTROL STRUCTURE

To: George A. Braley
Acting Administrator
Food and Nutrition Service

We have audited the principal and combining financial statements of the Food and Nutrition Service (FNS) as of and for the year ended September 30, 1997, and issued our qualified opinion thereon, dated April 17, 1998.

Except as discussed in our opinion, we conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin 93-06, "Audit Requirements for Federal Financial Statements," as amended, and other OMB bulletins applicable to the period under audit. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

In planning and performing our audit of the principal and combining financial statements of FNS for the year ended September 30, 1997, we considered the agency's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL STRUCTURE

The management of FNS is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments made by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. One objective of an internal control structure is to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. The other objective is that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the agency's prescribed basis of accounting. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected.

Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In its fiscal year (FY) 1997 Federal Managers' Financial Integrity Act (FMFIA) report, FNS reported that their management controls provided reasonable assurance that their control objectives had been met except for certain material weaknesses identified in prior years by their evaluations and independent audits. Significant management weaknesses reported included: (1) The need for more intensive on-site review of administrative costs claimed for reimbursement by State agencies administering the Food Stamp Program (FSP) and Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (two weaknesses); (2) the need for more detailed guidance and more intensive oversight from FNS of the State agencies administering the WIC program in the area of food delivery systems management; (3) the participation by authorized retailers in illegal transactions involving the exchange of food stamps for cash, drugs, weapons, or other felony-level ineligible items; (4) the need for strengthened State agency and FSP procedures for establishing, recording, adjusting, collecting, and reporting on FSP recipient claims; (5) the over issuance of program benefits by State agencies administering the FSP at a rate exceeding established tolerances; (6) the need to strengthen the management and monitoring of weaknesses in the Child and Adult Care Food Program; (7) the need to strengthen FNS' accounting system and financial statement presentation; and (8) the need to increase oversight of State automated systems development.

OIG'S EVALUATION OF FNS' INTERNAL CONTROL STRUCTURE

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories.

- Budget Execution and Funds Control - includes policies and procedures associated with the receipt of annual apportionments, the distribution of funds to allowance holders, the commitment and obligation during spending actions, and issuance of budgetary reports to OMB and U.S. Department of the Treasury (Treasury).

- Grants - consists of the methods and records established to identify, assemble, classify, and record transactions used by FNS personnel to report the grant operating program expenses and unliquidated obligations. The unliquidated obligations amount establishes the accounts payable balance at year end.

- Food Stamp Issuance/Redemption - consists of policies and procedures associated with the printing, shipping, issuing, and accounting for unissued food coupons. This category also encompasses the redemption of food coupons at retailers, the accounting for this by FNS, and the application of the redemption amount to FNS' account at Treasury.

- Accounts Receivable - consists of policies and procedures associated with establishing, recording, collecting, and maintaining records of food stamp recipient claims.

- Commodities - includes transactions related to the planning, ordering, purchasing, storing, delivering, monitoring, and funding of commodities.

- Integrity of Agency Financial Management System (AFMS) Data - includes policies and procedures to ensure the accuracy and reliability of FNS financial information.

- Federal Managers' Financial Integrity Act - consists of policies and procedures which require agencies to establish internal accounting and administrative controls in accordance with standards established by the Comptroller General.

- Compliance with Laws and Regulations - includes compliance with laws and regulations for transactions and events that may have a material effect on the financial statements.

- Financial Reporting - includes policies and procedures associated with the culmination of previous cycles after financial transactions have been summarized and posted to the general ledger.

For each of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation. We assessed control risk and performed tests of FNS' internal control structure. We also obtained an understanding of relevant internal control structure policies and procedures designed to determine that data supported the reported performance measures in the Overview. However, our objective was not to provide an opinion on the performance measures. Accordingly, we do not express such an opinion.

In making our risk assessment, we considered FNS’ FMFIA report as well as our prior and current audit efforts and other independent auditor reports on financial matters and internal accounting control policies and procedures. We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization’s ability to have reasonable assurance that the following objectives are met:

(1) Transactions are properly recorded and accounted for to permit the preparation of reliable financial statements and to maintain accountability over assets.

(2) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

(3) Transactions, including those related to obligations and costs, are executed in compliance with (a) laws and regulations that could have a direct and material effect on the Principal Statements, and (b) any other laws and regulations that OMB, FNS, or we have identified as being significant for which compliance can be objectively measured and evaluated.

(4) Data that support reported performance measures are properly recorded and accounted for to permit the preparation of reliable and complete performance information.

Matters that we consider to be reportable conditions are presented in the following Findings and Recommendations.

Finding No. 1 Internal Control Weakness on Food Stamp Recipient Claims Still Not Corrected

FNS has not corrected its material internal control weakness related to food stamp recipient claims. The agency’s procedures for establishing, recording, adjusting, collecting, and reporting of claims needs strengthening. Food stamp recipient claims represent the material portion of FNS’ account balance for gross accounts receivable, non-Federal. In FY 1997 this balance was based on the FNS 209, Status of Food Stamp Claims Against Households reports. In our prior financial statement audits, we reported that the FNS 209s were unsupported, inaccurate, and incomplete. FNS did not have compensating controls or alternative procedures for providing relevant, sufficient, and reliable data on which to base a reasonable estimate of the account balance and its related allowance for bad debt. FNS’ accounting records did not permit the application of alternative procedures that would enable us to satisfy ourselves as to the value of these assets. As a result, we are unable to assess the reasonableness of the more than $942.3 million included in the gross accounts receivable, non-Federal, balance for the FSP.

In our FY 1991 through FY 1996 financial statement audit reports, we reported that food stamp recipient claims against households could not be substantiated. We found that not all State agencies performed reconciliations of supporting records to reported claim balances at the end of the fiscal year. As a result, we concluded that FNS did not have a system in place that could provide reasonable assurance that food stamp recipient claims against households reported by State agencies, and thus the net accounts receivable, non-Federal line item was reasonable.

We believe that FNS made significant commitments in FY 1997 to address the long-standing issue with food stamp recipient claims. For example, as noted in the FY 1997 FMFIA report, FNS issued comprehensive review and self-assessment guidance to regional offices and State agencies. This guidance represents the common standards that FNS will use to provide overall assurance for the management of the recipient claims process. The common standards were developed in consultation with the Office of Inspector General (OIG). By performing reviews that meet the common standards, FNS plans to be able to provide assurances in three areas: (1) The accuracy of information presented on the FNS 209, (2) the validity of the beginning or ending balance for the State agency, and (3) whether significant backlogs exist for recipient claim referrals. In FNS' FY 1997 FMFIA report, the agency reported that during FY 1998, it plans to use the guidance issued to focus management reviews on recipient claims. Also, during FY 1998, FNS plans to complete the evaluation of the accuracy of State agency balances reported on the FNS 209. If the reviews meet the common standards, the results should provide a basis for assessing the reasonableness of the amount included in the gross accounts receivable, non-Federal, balance for the FSP.

As part of the work performed for the FY 1997 financial statements audit at the FNS Regional Offices, we determined whether the regional offices' reviews of food stamp recipient claims complied with the FNS guidance issued in FY 1997. We performed work at four of FNS' seven regional offices: Boston, Massachusetts; Atlanta, Georgia; Chicago, Illinois; and San Francisco, California.

In the four regions, a total of 15 review reports related to the management of food stamp recipient claims were completed during FY 1997 and available for review. We concluded that seven of the reviews met the common standards issued by FNS during FY 1997 for providing overall assurance about the food stamp recipient claims process. Another two reviews met most of the common standards. Of these nine reviews, FNS concluded in three that the State and county systems accurately and completely supported the FNS 209 data. The remaining six reviews did not meet the common standards because the reviews were performed before the common standards were issued and the scope of these reviews did not encompass all of the areas covered by the common standards. FNS needs to followup on these reviews to ensure that the common standards are met. The States and one territory where FNS performed reviews represent over $6.5 billion of the more than $19.6 billion in total food stamp issuance for FY 1997. Also, they represent almost $341 million of the over $942 million in total reported food stamp recipient claims.

In FNS' February 20, 1998 response to OIG's issue paper on Accounts Receivable, Food Stamp Recipient Claims, FNS agreed to continue implementing corrective actions from prior financial statement audits. The agency also agreed to ensure that State corrective action plans for any identified weaknesses would be developed by September 30, 1998. They explained that regional offices have been instructed to use the review guide and documentation standards during their review of State agency operations. Also, a staff member with extensive Food Stamp experience has been appointed to coordinate all of the agency's efforts related to FNS 209's.

Recommendation No. 1a

Perform followup reviews of those States' FNS 209 and claims systems assessments that were performed prior to the issuance of the common standards.

Finding No. 2 Procedures for Reconciling Fund Balances with Treasury Need to be Strengthened

FNS adjusted their general ledger to agree with external reports they sent to Treasury without providing evidence that these adjustments were always supported. Moreover, FNS did not have procedures to fully document their fund balance reconciliation process. While the adjustments made during FY 1997 did not have a material effect on the agency's fund balance, FNS should ensure that the external reports are supported by their accounting system and detail documentation at the time the reports are submitted. In addition, FNS did not separately identify in Note 2 in the financial statements presented for audit, the $98 million cash balance remaining in their food stamp redemption fund at yearend.

Treasury Financial Manual (TFM) Bulletin 97-06, Yearend Closing, dated July 24, 1997, requires agencies to verify their records each month against the transactions recorded by Treasury, as shown on their monthly reports. FNS' implementation of Agency Financial Management System (AFMS) fund balance reconciliation procedures did not always result in timely resolution of differences. FNS posted the differences between its records and the reports FNS sent to Treasury by making adjustments at account summary levels at fiscal yearend. FNS could not provide an adequate audit trail leading back to the source of the transactions.

FNS advised us that they have a six step reconciliation process. However, their current procedures, AFMS 213, "Procedures for Reconciling the Accounting Data," dated July 21, 1997, did not fully document this process. AFMS 213 states: Manual Government On-Line Accounting Link System (GOALS) corrections must be supported by corresponding AFMS entries and all differences resulting from current year transactions must be corrected within two accounting periods. All differences resulting from prior fiscal year corrections must be noted (and explained by) a photocopy of the applicable fiscal year end trial balance page that displays the discrepancy. The accounting station must determine if the error is a GOALS reporting error or an AFMS error. GOALS reporting must either be adjusted in GOALS or the accounting station must post a corresponding entry in AFMS. Differences from AFMS input errors must be corrected.

Monthly, FNS reconciles AFMS records to Treasury Form 6653, Balance of Undisbursed Appropriation Ledger. According to FNS officials, differences can occur due to timing, inaccurate postings, and reversals of prior year summary level adjustments (SUC). FNS did not comply with their internal procedures for timely reconciling their accounts to Treasury during the year. At FY 1997 yearend, FNS made about 70 SUCs for reversals from prior and current year differences with Treasury and posting errors totaling almost $16.9 million. FNS stated that almost $7.5 million of this was posted in order to remove a portion of the summary level adjustments posted at FY 1996 yearend; over $8.9 million was to correct inaccurate entries; and almost $500,000 was posted as a result of reconciling with Treasury. FNS could not provide evidence that these adjustments to AFMS were always supported.

According to FNS officials the SUCs were made in order to follow Treasury's requirement that no differences be reported at yearend. At yearend, FNS posts the differences between its records and the reports FNS sent to Treasury by making adjustments at the account summary levels. At FY 1997 yearend, the 70 SUCs referred to above affected the Fund Balance with Treasury (net increase of $4.5 million), Operating Program Expenses (net decrease of $4.5 million), Liabilities for Deposit/Suspense (net decrease of $55,000), Appropriated Capital (net increase of $4.5 million), and Appropriated Capital Used (net decrease of $4.5 million) accounts, as well as various budgetary accounts.

In the April 13, 1998, response, FNS asserted that monthly, a six step reconciliation and identification process is performed to validate Treasury information. However, FNS could not provide the documented procedures describing this entire process or evidence that adjustments to AFMS were always supported. FNS justified adjusting cash account balances to equal Treasury's records based on Statement of Federal Financial Accounting Standards No. 1 which states that discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared. We do not disagree with this standard. However, FNS did not demonstrate that the adjustments were the result of efforts to resolve differences due to errors or timing. Rather, FNS tied the sum of differences to a particular fund and fiscal year and not to individual transactions. FNS advised us that these summary adjustments are reversed when detail information on these transactions is subsequently received. FNS needs to develop controls to substantiate the detail transactions that are associated with each summary adjustment.

FNS also agreed, in their response, that the redemption account balance was material and separate identification on the financial statements was necessary. In accordance with Office of Management and Budget (OMB) Bulletin No. 97-01, FNS revised Note 2 in the audited financial statements to provide separate identification of the $98 million cash balance remaining in the food stamp redemption fund at yearend.

Recommendation No. 2a

Modify the reconciliation procedures to fully document the process used to reconcile fund balances with Treasury.

Recommendation No. 2b

Develop controls to ensure that Treasury and AFMS reconciliation procedures are properly followed and that an adequate audit trail exists.

Finding No. 3 Implementation and Oversight of the State Option Food Stamp Program Needs Improvement

Based on our review of FY 1997 operations, FNS' oversight and implementation of the State Option Food Stamp Program (SOFSP) needs improvement. We noted that Agency Financial Management System (AFMS) procedures were not adequate, resulting in a potential Anti-Deficiency Act violation (see Finding No. 1 of our Report on Compliance with Laws and Regulations). Additionally, SOFSP guidance for States was not fully implemented and the methodology for allocating State-funded benefits redeemed needs to be modified. As the SOFSP continues to expand, there is potential for material misstatement of the FSP redemption account.

On June 12, 1997, the President signed into law the Supplemental Appropriations Act, Public Law 105-18. This law included the authority for States to purchase food coupons from the Federal government for use in a State-funded food assistance program for legal immigrants, and childless, able-bodied adults ineligible for the FSP. (These individuals were made ineligible for the FSP by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996.) Most of the participating States have elected to provide benefits primarily to legal immigrants. Based on FNS data, the SOFSP has the potential to grow to over $700 million.

During FY 1997, six States operated eight SOFSPs. During FY 1998, the number of participating States increased to nine, as of the date of audit fieldwork. The impact of the SOFSP was reported to be $13.3 million in FY 1997. Based on current program participation levels, we estimate that the program will exceed $193 million during FY 1998.

States operating a SOFSP utilize FNS' FSP infrastructure. That is, they purchase FSP coupons (or electronic benefits transfer (EBT) issued benefits) from FNS which are transacted at FNS authorized FSP retailers. These benefits are subsequently redeemed through the Federal Reserve Bank (FRB) system. Additionally, upon issuance, State-funded benefits are indistinguishable from Federally-funded FSP benefits.

We reviewed guidance, dated August 8, 1997, issued by the FSP National Office to all FNS regional administrators providing requirements for State agencies on submitting a request to purchase food coupons for use in State-funded nutrition programs. The guidance also provided information on the terms for reimbursing the Federal government for the value of food coupons distributed and the Federal administrative fees incurred under the program. We found that this guidance provided sufficient direction for States issuing benefits through coupons. Guidance addressing the issuance of benefits through EBT systems has not been issued, but is in the finalization stage.

In accordance with this guidance, a formal reimbursable agreement is required to be signed by both FNS and the State. The agreement requires that the State reimburse FNS for the value of benefits, printing, shipping, and redemption costs. States must submit a separate monthly FNS 388, State Issuance and Participation Estimates Report, to report State-funded issuance and participation estimates. This report is due by the 19th of the report month. Along with the FNS 388, States must submit payment to FNS to cover the cost of State-funded benefits to be issued during the month and the associated administrative fees. States must also indicate on their FNS 250, Food Coupon Accountability Report, the amount of actual issuance of State-funded coupons. The FNS 250 is due 45 calendar days after the last day of the coupon issuance month.

FNS also issued two AFMS accounting procedures (AFMS 107 and AFMS 108) on October 3, 1997. These procedures addressed FNS' financial policy and processing procedures to account for SOFSP benefits issued via coupons or through EBT. Based on our review, these procedures do not adequately address all necessary processes. Specifically, they do not indicate how to handle the issuance of benefits when the State has not timely submitted payment.

SOFSP Procedures Were Not Adequate or Fully Implemented

- <u>Issuance of Selected States' Benefits Not Recorded in AFMS</u>

  FNS did not record in AFMS, in FY 1997, the issuance of SOFSP benefits for two States. AFMS procedures, AFMS 107 and AFMS 108, state that entries are to be made in the accounting system when the receipt of payment is made. This resulted in FNS' accounting records understating SOFSP activity. Receipt of payment was recorded in November 1997.

  Additionally, FNS did not establish a receivable for almost $4.5 million in benefits issued but not paid for, in FY 1997, or charge the States interest for the cost of borrowing these funds. Based on the U.S. Department of the Treasury's interest rate for this period, 6.75 percent, interest costs of approximately $25,000 would have been incurred in FY 1997, because the States did not timely pay FNS.

Regulation 31 Code of Federal Regulations Part 205.12(c), implementing the Cash Management Improvement Act of 1990, State interest liabilities provision, states that "With respect to programs for which the Federal government makes payments on behalf of a State ... a State will incur an interest liability to the Federal government if a Federal agency pays out Federal funds for program purposes on behalf of the State. A State interest liability will accrue from the day the Federal agency pays out Federal funds for program purposes to the day State funds are credited to the Federal Government's account."

FNS should record in AFMS the applicable transactions for the SOFSP benefits issued and related administrative fees not paid in FY 1997. Also, FNS needs to modify AFMS procedures to record issuance of SOFSP benefits in their accounting system notwithstanding when payment is made. Additionally, FNS should establish a procedure for recording a receivable when timely payment is not made by a State.

In FNS' April 1, 1998, response, they agreed to record a receivable for benefits issued and administrative fees not paid. FNS recorded, in FY 1997, a receivable for $4.4 million, for only one State. This entry also impacted Unexpended Appropriations, Appropriated Capital Used, and Operating Program Expense. FNS stated this entry would be reversed in FY 1998. We do not agree with this accounting treatment. When recording this receivable, FNS should have recorded a receivable for the amount of benefits issued but not paid and followed AFMS procedures for recording benefits issued and reimbursement for administrative fees. In FY 1998, FNS should record the receipt of cash and the reduction of the receivable. By using this approach, FNS will consistently record in AFMS, SOFSP issuance and related administrative fees.

In FNS' response, they stated that AFMS procedures are correct. These procedures address the appropriate process rather than attempting to address what should be done if the procedures are not followed. FNS agreed to modify AFMS Procedures 107 and 108 to include a reference to AFMS Procedure 203, the Account Receivable process. If FNS follows AFMS 203, in addition to recording SOFSP benefit issuance when the FNS 388 is received, appropriate accounting entries will be made in the correct period. We will evaluate the sufficiency of this control during our FY 1998 financial statements audit.

- <u>Establish Procedures to Provide for Note Disclosure of the Amount of SOFSP Issuance</u>

FNS records, in AFMS and the agency’s financial statements Operating Program Expense line item, the cost of SOFSP benefits issued and related administrative fees. Note 8 to the financial statements breaks down the Operating Program Expense line item by OMB object classification. In Note 8 of the FY 1997 financial statements presented for audit, FNS did not separately identify SOFSP expenses. Because the SOFSP is a State program, these expenses should be distinguished from Federal expenses in this note.

In FNS’ April 1, 1998, response, they agreed to disclose in Note 8 the SOFSP expenses in the Operating Program Expense line item. This disclosure is included in the audited financial statements. FNS also agreed to establish a procedure for disclosure of SOFSP benefits in the notes to future years financial statements.

- <u>Procedures for the Collection of Administrative Fees Needs to be Modified</u>

FNS cannot determine whether they have collected the appropriate amount of administrative fees assessed to cover printing, shipping, and redemption of the State-funded food coupons. The administrative fee calculation is based on the number of coupons estimated to be issued and reconciled when actual issuance is determined. As noted previously, this information is not always timely received by FNS. Payments for administrative fees by States are required at the time of issuance based on estimates. Since timely information of actual issuance is not received, the appropriate amount of administrative fees due to FNS could not be determined. As a result, we could not determine the financial impact on FNS’ FY 1997 financial statements or calculate what effect, if any, there would be in FY 1998. According to FNS officials, in FY 1999, the administrative fee will be determined on a yearly basis as a result of the first year of operation. If FNS does not have the necessary data to calculate the fee, there is the potential that Federal funds may be used for administering the State program, which is a violation of the Federal law establishing the authority for the SOFSP.

AFMS procedures for both coupon issuance and EBT state that a receivable should be established under the appropriate account for administrative fees. AFMS procedures require that a receivable be set up when payment is remitted, rather than when the FNS 388 is submitted. Because payment is not always made when the FNS 388 is submitted, the accounts receivable and operating program expense balances may be misstated. FNS needs to modify its procedures to establish an accounts receivable when the FNS 388 is submitted rather than when payment is received.

In FNS' April 1, 1998, response to our issue paper on the SOFSP, FNS agreed to modify AFMS Procedures 107 and 108 to clarify the requirements to establish a receivable for administrative fees when the FNS 388 is received.

SOFSP Procedures Were Not Fully Implemented

FNS has not required States to comply with their approved State plans, which direct the State to establish procedures for reporting actual issuance data, on the FNS 250 report. As of March 1998, two of the largest States had not submitted their September 1997, FNS 250 report with this information. This report was due November 15, 1997. The data on the FNS 250 report is used by FNS to determine the actual amount of issuance and whether additional funds are due to FNS.

Initially, FNS anticipated that they would not need to spend a significant amount of staff time monitoring the SOFSP. This included reconciling, on an annual basis, reported issuance to payments received. In our opinion, an annual reconciliation is not adequate. FNS recognized that additional monitoring was necessary and has contracted with a vendor to design and implement a database system to track the operation of the SOFSP. In the April 1, 1998, response to our issue paper on the SOFSP, FNS did not specifically respond to our recommendation on changing the frequency of the reconciliation performed. This reconciliation should occur more frequently than on an annual basis.

Methodology for Determining the Amount of State-funded Benefits Redeemed Needs to be Modified

Upon issuance, Federally- and State-funded food coupons cannot be distinguished. The FSP redemption liability account includes both Federally- and State-funded food coupons and is used to record obligations and redemption of food coupons. As a result, FNS no longer has an accurate mechanism for determining the total dollar value of Federal food stamp benefits that are redeemed. FNS has chosen to report 100 percent of State benefits as redeemed. The balance of the FSP redemption account is considered a Federal liability. FNS indicated that they established this approach because it was the most feasible and because of the difficulty in identifying State versus Federal redemptions. This approach is not reasonable. FNS routinely assesses the balance in the FSP redemption account to ensure that there are enough funds to pay for benefits that have been issued. As a result of this process, FNS historically has determined that benefits issued are not always redeemed, potentially creating a surplus balance in the FSP redemption account. As a result, there is the potential for material misstatement of the FSP redemption account.

In FNS' April 1, 1998, response to our issue paper on the SOFSP, FNS disagreed with our conclusion and stated that FNS' policy of considering the States benefits as 100 percent redeemed is the most feasible solution. We disagree with this position because based on FNS' historical knowledge, 100 percent of food stamp benefits are not redeemed. Consequently, as the SOFSP increases the Federal liability for food coupon redemption could be significantly understated. Accordingly, FNS should revise the methodology used to record the redemption of State-funded benefits to ensure an equitable presentation of Federal versus State funded activities.

Recommendation No. 3a

Modify AFMS procedures to record issuance of SOFSP benefits when notified of issuance.

Recommendation No. 3b

Implement a procedure to record a receivable when payment for benefit issuance and administrative fees is not timely received. Additionally, FNS should bill States for interest costs incurred by the Federal government.

Recommendation No. 3c

Clarify the procedure for establishing a receivable for administrative fees when the FNS 388 report is submitted by the State.

Recommendation No. 3d

Revise the methodology used to record the redemption of State-funded benefits to provide an equitable presentation of Federal versus State funded activities.

Recommendation No. 3e

Require that actual issuance be reconciled with funds received from States to pay for benefits and administrative costs on a more frequent than annual basis.

Recommendation No. 3f

Establish a procedure to provide for disclosure in FNS financial statement notes for the amount of SOFSP benefits recorded in the Operating Program Expense line item.

Finding No. 4 Adjustment Needed to the Value of Food Coupon Inventory Reported in Note 4(c)

FNS materially misstated the value of food coupons in inventory at yearend disclosed in Note 4(c) of the FY 1997 financial statements presented for audit. This occurred because FNS did not properly disclose $333,780,000 in unredeemed and unissued food coupons that had been printed under an FY 1998 serial number. Additionally, FNS did not properly validate $374,102,000 in food coupons as being in-transit when they were already included in States inventory records. As a result, the value of these coupons was reported twice.

We reviewed each of the components used to calculate the FY 1997 food coupon ending inventory reported in Note 4(c) of the FY 1997 financial statements. Specifically, we evaluated the accuracy and reliability of the amount of food coupons, nationwide, by performing physical inventories of the amount of food coupons maintained by selected States and reconciling our physical inventory with the FNS 250, Food Coupon Accountability Report. Additionally, we performed a physical inventory of the food coupons maintained at the American Bank Note (ABN), food coupon distribution/storage and production facilities, as well as validated the amount of food coupons reported in-transit as of September 30, 1997.

Review of FY 1997 Yearend Food Coupon Ending Inventory at ABN

Based on our review of the FY 1997 food coupon ending inventory at ABN, we determined that food coupons had been printed under the FY 1998 serial number during FY 1997 and were included in the 1997 total inventory amount. To properly reflect the FY 1997 food coupon ending inventory, FNS needed to disclose in Note 4(c) that $333,780,000 in unredeemed and unissued food coupons included in inventory on September 30, 1997 were FY 1998 coupons in storage at the ABN printing facility.

On March 9, 1998, FNS agreed to make this revision to Note 4(c). This revision is included in the audited financial statements.

Review of FNS FY 1997 Food Coupons-in-Transit

We determined that of the $472,801,000 in coupons that FNS inventory records identified as being in-transit, $374,102,000 were actually delivered to the States and included in the States' inventory. As a result, the $374,102,000 was included in the food coupon ending inventory, twice, as part of the coupons-in-transit and as part of the States' inventory.

To calculate the food coupon inventory, FNS determines the face value of the food coupons that have been printed and are still located at the printer and distribution centers, the coupons that are in-transit, and the coupons that are in inventory at the States. The in-transit figure has historically been based on shipping records for the last three weeks of the fiscal year. In FY 1997, the in-transit figure was based on shipments dated between September 15 and September 30, 1997. To validate in-transit shipments, we obtained ABN delivery records from the contracting officer's technical representative. Review of these records disclosed that only $98,699,000 in coupons were still in-transit as of September 30, 1997. As a result, the unredeemed and unissued food coupons reported in Note 4(c) was overstated by $374,102,000.

On March 9, 1998, FNS agreed to make the necessary revision to Note 4(c). This revision is included in the audited financial statements.

Benefit Redemption Division staff confirmed that ABN delivery records are available mid-October. Therefore, FNS can implement a procedure to calculate food coupons in-transit based on delivery records. FNS agreed to incorporate this analysis in FY 1998.

Recommendation No. 4a

Develop procedures to use delivery records from ABN to determine the actual amount of food coupons in-transit at yearend.

Finding No. 5 Trust and Deposit Liabilities, Non-Federal Line Item Materially Misstated

FNS did not correctly report the Trust and Deposit Liabilities, Non-Federal line item on the FY 1997 financial statements presented for audit. A $3,000,000 advance, related to the SOFSP, was incorrectly presented as a part of the Trust and Deposit Liabilities, Non-Federal line item, resulting in the line item being materially misstated. This amount should have been included as part of the Accrued Program Liabilities, Non-Federal, line item.

In accordance with OMB Bulletin No. 94-01, Form and Content of Agency Financial Statements, dated November 16, 1993, FNS provided further disclosure of the Other Governmental Liabilities line item. In doing so, FNS designated two line items to represent Other Governmental Liabilities. Accrued Program Liabilities, Non-Federal, includes FNS' liability for issued but unredeemed food stamp coupons that are likely to be redeemed and the other estimated liabilities related to FNS programs which includes accrued payroll and benefits. Trust and Deposit Liabilities, Non-Federal, includes amounts held in deposit funds, suspense accounts and undeposited collections, including budget clearing accounts awaiting disposition or reclassification.

FNS used the wrong index code in AFMS, which resulted in the liability for this $3,000,000 advance being placed in the food stamp fund (400) rather than the food stamp benefit redemption fund (MGO). According to the FNS financial statements crosswalk, the liability for the food stamp benefit redemption fund should be presented on the financial statements as part of the Accrued Program Liabilities, Non-Federal line item. The Trust and Deposit Liabilities line item, as presented on the financial statements, totaled $4,715,000. Of this total, $3,000,000 should have been included as part of the Accrued Program Liabilities, Non-Federal line item. Accordingly, the Trust and Deposit Liabilities, Non-Federal was materially misstated.

FNS was aware of this error but stated that the amount had already been reported in September 1997, to Treasury, as part of the food stamp fund activity. FNS felt that this error should not be corrected within AFMS until it could be reported accurately to Treasury. FNS also stated that they were going to correct the error in October 1997 as part of FY 1998. However, because this amount is a material portion of the Trust and Deposit Liabilities line item an adjustment needs to be made to the FY 1997 financial statements.

In FNS' March 3, 1998, response to OIG's issue paper on the Trust and Deposit Liabilities line item, FNS agreed to adjust the presentation of the Trust and Deposit Liabilities, Non-Federal, and Accrued Program Liabilities, Non-Federal, line items on the FY 1997 financial statements. This revision is included in the audited financial statements. The agency explained that by processing reversing entries from FY 1998 to FY 1997 accounting records would create an out of balance condition with Treasury. We confirmed this position with staff of Treasury's Financial Management Service (FMS) Reports Management Division. However, they explained that if this error had been detected earlier, FNS may have been able to correct this during the yearend closing process.

Treasury Financial Manual Part 2, Chapter 4200, dated July 1995, prescribes procedures for submitting FMS Form 2108, Yearend Closing Statement. Section 4255.40, Verification and Adjustment of Reports by Agencies, states that if data furnished in column (1) or (2) of FMS Form 2108 conflicts with agency records, the agency should immediately contact FMS and, with its approval, coordinate the necessary resolution. Also, if a reporting error is detected after the report is submitted, FMS is to be contacted to request authorization for supplemental reporting.

In accordance with the above described procedure, we believe that in the future when errors are detected, FNS should contact FMS to determine the appropriate resolution and whether supplemental reporting is necessary.

Recommendation No. 5a

Develop and implement procedures for resolving errors reported to Treasury and supplemental reporting when necessary.

Finding No. 6 Accounts Payable Model Incorrectly Applied to Determine FY 1997 Writedown Factor for the FSP

FNS did not include EBT obligations in the calculation of the accounts payable writedown model for the FSP in FY 1997 in the financial statements presented for audit. FNS based the FSP writedown factor on FY 1991 to FY 1995 data because EBT obligations were no longer a part of the regional closeout process starting with FY 1996. When the EBT obligations amount for FY 1996 was determined and included in the calculation, FNS reduced the amount of the writedown adjustment by more than $13.1 million for the FSP.

FNS issues grants to States for food assistance programs. At fiscal year end States report program funds (obligations) estimated to be expended for the current grant. The grant expenditure closeout process, performed at FNS Regional Offices, does not occur until 3-9 months after the end of the fiscal year, depending on the type of grant. Because FNS does not know the exact amount of funding needed by its grantees until the grant closeout process is completed, they use a statistical model to estimate accounts payable for current year grant obligations, for financial statement purposes. The model adjusts the current period accounts payable amount based upon the historical relationship between obligations at the end of the fiscal year and the actual obligations reported through the closeout process. These adjustments are made using an account specific factor. The account specific factor for each program is an average of the difference between actual and estimated obligations divided by estimated obligations, for the five most recent years.

In previous years, the model for the FSP included obligations for two variables, EBT payments and State Administrative Expenses (SAE). During FY 1996, FNS converted from the U.S. Department of Health and Human Services' Payment Management System to the Account Management Agent System operated by the Federal Reserve Bank of Richmond. As a result, EBT benefits were obligated by the FNS National Office allowance holder and were not included in the regional closeout process. Therefore, FNS did not include EBT obligations in their statistical model; only one variable, SAE, was used. FNS calculated the accounts payable estimate for FSP excluding FY 1996 data. This distorted the estimate of expenditures and resulted in actual obligations at closeout appearing to be significantly less than prior years. This was not consistent with how the accounts payable model was designed and did not provide a historical basis for the writedown. We recommended that FNS obtain EBT obligations for FY 1996 that would have been included in the closeout process and recalculate the FSP account specific factor. Using the revised factor resulted in an upward adjustment to the Accounts Payable, Non Federal, line item for FY 1997. The effect of this adjustment was to reduce the amount of the accounts payable writedown adjustment by $13,138,523.

In FNS' March 5, 1998, response to OIG's issue paper on the FY 1997 accounts payable model, they agreed to make this adjustment to the financial statements. This revision is included in the audited financial statements. Accordingly, no additional recommendation is being made.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe the reportable conditions described in Finding Nos. 1 to 6 are material weaknesses.

We also noted other internal control weaknesses that, although not reported herein, warrant corrective action to strengthen FNS' internal control structure and operations. These conditions will be presented in a separate report to FNS management.

ROGER C. VIADERO
Inspector General

April 17, 1998

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

CHAPTER 4
REPORT OF THE OFFICE OF INSPECTOR GENERAL ON COMPLIANCE WITH LAWS AND REGULATIONS

To: George A. Braley
Acting Administrator
Food and Nutrition Service

We have audited the principal and combining financial statements of the Food and Nutrition Service (FNS) as of and for the year ended September 30, 1997, and have issued our qualified opinion thereon, dated April 17, 1998.

Except as discussed in our opinion, we conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," as amended, and other OMB bulletins applicable to the period under audit. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The management of FNS is responsible for compliance with laws and regulations applicable to FNS. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of FNS' compliance with certain provisions of laws and regulations that might directly affect the financial statements and certain other laws and regulations designated significant by OMB and FNS. These laws and regulations are as follow:

- Chief Financial Officers Act of 1990
- Budget and Accounting Procedures Act of 1950
- OMB Statements of Federal Financial Accounting Concepts and Standards
- Federal Managers' Financial Integrity Act of 1982
- Anti-Deficiency Act and Federal Appropriations Law
- 31 U.S.C. 3512, Executive Agency Accounting Systems
- OMB Circular A-34, Instructions on Budget Execution
- OMB Bulletin Nos. 94-01 and 97-01, Form and Content of Agency Financial Statements
- Food Stamp Act of 1977, as amended
- Accounting and Auditing Act of 1950 (Public Law 81-784)
- Title 7 Code of Federal Regulations Parts 210, 226, 246, 271-277
- Cash Management Improvement Act of 1990
- Government Performance and Results Act of 1993
- Government Management Reform Act of 1994
- Federal Financial Management Improvement Act of 1996
- Debt Collection Improvement Act of 1996

As part of our audit, we also reviewed management's process for evaluating and reporting on internal control and accounting systems, as required by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), and compared the agency's most recent FMFIA reports with the evaluation we conducted of FNS' internal control structure. We also reviewed and tested FNS' policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the overview of the reporting entity and supplemental financial and management information. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests of compliance with the laws and regulations described above disclosed five material instances of noncompliance which are presented in Finding Nos. 1 and 2. Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations that cause us to conclude that the aggregation of misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause it to be perceived as significant by others.

Under the Federal Financial Management Improvement Act of 1996 (FFMIA), we are required to report whether FNS' financial management system substantially complies with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997. The results of our tests disclosed no instances where FNS' financial management systems did not substantially comply with these three requirements.

Material instances of noncompliance are presented in the following Findings and Recommendations.

Finding No. 1
FNS Violated the Food Stamp Act by Using FSP Appropriated Funds for the State Option Food Stamp Program

FNS expended FSP appropriated funds for the State Option Food Stamp Program (SOFSP) in violation of the Food Stamp Act. FNS did not receive payment from two States at the time of issuance, a violation of authorizing legislation. When these benefits were redeemed in FY 1997, through the Federal Reserve Bank (FRB), Federal funds would have been used to pay retailers for the SOFSP transactions, resulting in a potential Anti-Deficiency Act violation.

On June 12, 1997, the President signed into law the Supplemental Appropriations Act, Public Law 105-18. This law included the authority for States to purchase food coupons from the Federal government for use in a State-funded food assistance program for legal immigrants, and childless, able-bodied adults ineligible for the FSP.

States operating a SOFSP utilize FNS' FSP infrastructure. That is, they purchase FSP coupons (or electronic benefits transfer (EBT) issued benefits) from FNS which are transacted at FNS authorized FSP retailers. These benefits are subsequently redeemed through the FRB system. Additionally, upon issuance, State-funded benefits are indistinguishable from Federally-funded FSP benefits.

The purpose of the Food Stamp Act of 1977, as amended, which established the FSP, is to permit low-income households to obtain a more nutritious diet through normal channels of trade by increasing purchasing power for all eligible households who apply for participation. Funds appropriated for the FSP are to be used for necessary expenses of the program.

Congress amended the Food Stamp Act, June 12, 1997, authorizing the SOFSP, stating:

> "Not later than the date the State agency issues benefits to individuals under this subsection, the State agency shall pay the Secretary, in accordance with procedures established by the Secretary, an amount that is equal to -
> (i) the value of the benefits; and
> (ii) the costs of printing, shipping, and redeeming coupons, and other Federal costs, incurred in providing the benefits, as determined by the Secretary."

This language indicates that Congress' intent is not to use Federal funds to pay for the SOFSP; State funds are to be used.

Appropriation Law, 31 U.S.C. § 1301(a), states "Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." Simply stated, public funds may be used only for the purpose or purposes for which they were appropriated. Because FNS used Federal funds for unauthorized purposes, an Anti-Deficiency Act violation may have occurred. FNS officials believe that an Anti-Deficiency Act violation did not occur because authorizing legislation, a part of the Food Stamp Act, allows States to implement the SOFSP and issue benefits.

FNS issued guidance to States, on August 8, 1997, in accordance with the implementing legislation, that required States to submit an FNS 388, State Issuance and Participation Estimates Report, and payment to FNS for their estimated issuance for the month. We found that this procedure has not been followed.

We reviewed the supporting documents provided by both the FSP Program Information Division and the Accounting Division. Reconciliation of the information from these two divisions showed that FNS did not secure payment from two States, approximately $4.5 million of the more than $13 million in program benefits issued in FY 1997.

Upon issuance of State-funded FSP benefits, the food coupons lose their identity. When these benefits were redeemed in FY 1997, through the FRB, Federal funds would have been used to pay retailers for the authorized transactions.

In FY 1998, States are continuing to not submit payment for estimated benefits issued or for subsequent adjustments to estimated amounts on a timely basis. As of December 1997, three States owed FNS more than $7.6 million for the cost of benefits issued and the related administrative fees.

We recommended that FNS request a legal opinion from the Office of the General Counsel (OGC) on whether an Anti-Deficiency Act violation has occurred. Additionally, FNS needs to ensure that States remit, on a timely basis, payment for the cost of all benefits issued and related administrative fees.

In FNS' April 1, 1998 response to OIG's issue paper on the SOFSP, FNS disagreed with our conclusion that a violation of the Anti-Deficiency Act may have occurred. On May 5, 1998, FNS requested a legal opinion from OGC as to whether the Anti-Deficiency Act was violated in FNS' implementation of the SOFSP. Also, FNS agreed to stress the need for timely submission of reports to States.

Recommendation No. 1a

Require States to timely submit required reports and payment for benefits and related administrative fees.

Finding No. 2 Audit Reports Disclosed Areas of Noncompliance With Laws and Regulations

During FY 1997, three nationwide OIG audit reports, two for the FSP and one for the Food Distribution Program on Indian Reservations (FDPIR); and ten regional audit reports for the Child and Adult Care Food Program (CACFP) contained instances of noncompliance with laws and regulations in the FNS programs. These instances could be perceived as being significantly sensitive by others. OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements," as amended, contains reporting requirements for such instances of noncompliance. We reported the following instances of noncompliance. Because the detailed results of our reviews and recommended actions were reported to agency management in each audit report, we are making no further recommendations herein.

Food Stamp Program

Reinvestment of Quality Control Penalties. During our nationwide review of the FSP and FNS' efforts to control error rates, "Reinvestment of Quality Control Penalties, Audit Report No. 27099-4-At, dated June 1997, we found that FNS regional offices' monitoring of States reinvestment activities was not always sufficient to ensure that initiatives were accomplishing the planned objectives and projects, and their costs were eligible and properly accounted for. We also found that States claimed ineligible costs. As a result, FNS could not fully evaluate the effectiveness of error reduction activities.

We reviewed the reinvestment plans of 17 State agencies and visited 11 projects to evaluate how the projects were functioning and the actual activities that were performed. The 17 States had budgeted $70.8 million for 45 reinvestment projects, of which we questioned about $50.2 million of budgeted and actual costs.

- We questioned the eligibility of 11 projects budgeted for $42.3 million because the activity or a material portion of the work performed under the projects represented basic/minimum activities required for program administration rather than enhanced error rate control activities and/or were funded by reallocating existing resources rather than by new or increased expenditures. Program regulations require that a reinvestment activity must represent new or increased expenditures, be fully funded by the States, and not be funded by a simple reallocation of ongoing program resources.

- The States also charged ineligible costs to their reinvestment initiatives. We evaluated the propriety of costs charged to the 30 projects conducted by the 11 States that we visited. At the completion of fieldwork, the States had charged $40.5 million to the projects. We questioned $10.5 million of the costs charged because (1) States did not allocate the projects costs among all programs that received substantial and direct benefits from the activities, (2) cost accounting procedural errors resulted in improper charges, and (3) States claimed Federal matching funds for reinvestment expenditures. We also questioned the remaining budget of $10.9 million for projects that States had not allocated costs among benefiting programs.

  OMB Circular A-87, "Cost Principles for State and Local Governments," provides that costs are allocable to programs and functions to the extent of the benefits received by the programs and functions. Any cost allocable to a particular program or function may not be shifted to other programs. Program regulations set forth the principles for determining the allowable costs of administering the FSP. The principles are designed so that all federally assisted programs bear their fair share of the costs.

<u>Retailer Monitoring with Store Tracking and Redemption Subsystem</u>. During our nationwide review of the FSP, "Retailer Monitoring with Store Tracking and Redemption Subsystem (STARS)," Audit Report No. 27601-8-Ch, dated January 1997, we found that in 37 of the 214 cases reviewed, retailers were authorized or reauthorized under criteria not supported by their applications, or without requested documentation to verify applicants were bona fide retailers. In addition, field office authorization procedures did not include the use of STARS searches to ensure the eligibility of applicants or to ensure the timely removal of prior store owners. As a result, at the 6 field offices in our review, we found 49 out of 106 instances where field offices assigned multiple authorization numbers to a single location.

The Food Stamp Program Improvement Act of 1994, effective June 14, 1994, established new, more stringent criteria for evaluating retailer eligibility. FSP regulations require retailers to provide sufficient data for FNS to determine whether the retailer’s participation will further the purposes of the program.

Food Distribution Program on Indian Reservations

In Audit Report No. 27601-6-KC, dated June 1997, "Food Distribution Program on Indian Reservations," we found that controls used to verify and detect unreported income were not always applied or were not in place. Also, controls did not always assure the detection and prevention of households that were simultaneously participating in the FDPIR and the FSP. We determined that an estimated 7,567 households received FDPIR commodities valued at about $4 million for which they were not eligible because their income exceeded established eligibility guidelines. We also found that households were simultaneously participating in the FDPIR and FSP. We determined that an estimated 2,093 households obtained commodities valued at about $332,000 while participating in the FSP and an estimated 1,951 households obtained FSP benefits valued at about $1.4 million while participating in the FDPIR.

Current procedures allow participating FDPIR households to switch between the FDPIR and the FSP. However, households are not allowed to simultaneously participate in both programs. Regulations state that households are required to inform program officials of their intentions. Also, participating households are required to report all earned and unearned income to the Indian Tribal Organizations (ITO)/local agency. Prior to certification, the ITO/local agency must verify all reported income.

Child and Adult Care Food Program

During FY 1997, the Office of Inspector General (OIG) targeted 12 sponsors of the CACFP in 10 States and found 11 of them to be seriously deficient in their administration of the program. As part of the sponsor reviews, we conducted unannounced visits to a substantial number of day care homes and found widespread deficiencies in their operations. Many providers did not have adequate records to support the meals they claimed or had no records at all, as required by program regulations. Claiming of unallowable meals by providers appeared to be common. Many of the children for whom the providers claimed meals were not present when OIG visited, we questioned whether they were actually in care or whether some providers were eligible to claim the meals they served to their own children. We identified in the 10 regional reports approximately $4.4 million in questioned costs.

Because of the serious deficiencies, FNS has terminated the participation of 5 of 12 sponsors. Four of the five sponsors are being investigated for fraud-related activities.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion. This report is intended for the information of the management of FNS. However, this report is a matter of public record, and its distribution is not limited.

We considered these instances of noncompliance in forming our opinion on whether FNS' FY 1997 financial statements are presented fairly, in all material respects, in conformity with the applicable accounting standards now in effect for the preparation of FNS' financial statements, and this report does not modify the opinion on FNS' financial statements expressed in our report dated April 17, 1998.

ROGER C. VIADERO
Inspector General

April 17, 1998

CHAPTER 5
ABBREVIATIONS

ABN	-	American Bank Note Company
AFMS	-	Agency Financial Management System
CACFP	-	Child and Adult Care Food Program
EBT	-	Electronic Benefits Transfer
FDPIR	-	Food Distribution Program on Indian Reservations
FFMIA	-	Federal Financial Management Improvement Act
FMFIA	-	Federal Managers' Financial Integrity Act
FMS	-	Financial Management Service
FNS	-	Food and Nutrition Service
FRB	-	Federal Reserve Bank
FSP	-	Food Stamp Program
FY	-	Fiscal Year
GAO	-	General Accounting Office
GOALS	-	Government On-Line Accounting Link System
ITO	-	Indian Tribal Organization
OGC	-	Office of the General Counsel
OIG	-	Office of Inspector General
OMB	-	Office of Management and Budget
SAE	-	State Administrative Expenses
SGL	-	Standard General Ledger
SOFSP	-	State Option Food Stamp Program
STARS	-	Store Tracking and Redemption Subsystem
SUC	-	Summary Level Adjustments
Treasury	-	U.S. Department of the Treasury
USDA	-	U.S. Department of Agriculture
WIC	-	Special Supplemental Nutrition Program for Women, Infants, and Children

U.S DEPARTMENT OF AGRICULTURE

FOOD AND NUTRITION SERVICE

FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 1997

CHAPTER 6
FNS' OVERVIEW OF FISCAL YEAR 1997 OPERATIONS AND RESULTS

Introduction to the Agency

Agency Goals

The Food and Nutrition Service (FNS), previously the Food and Consumer Service, was established August 8, 1969, to administer the food assistance programs of the U.S. Department of Agriculture. The program goals are to provide needy persons with access to a more nutritious diet, to improve the eating habits of the Nation's children, and to help America's farmers by providing an outlet for the distribution of foods purchased under farm assistance authorities. Most FNS programs are operated in a Federal/State partnership, with State and local agencies administering the program at the actual service delivery level.

Programs

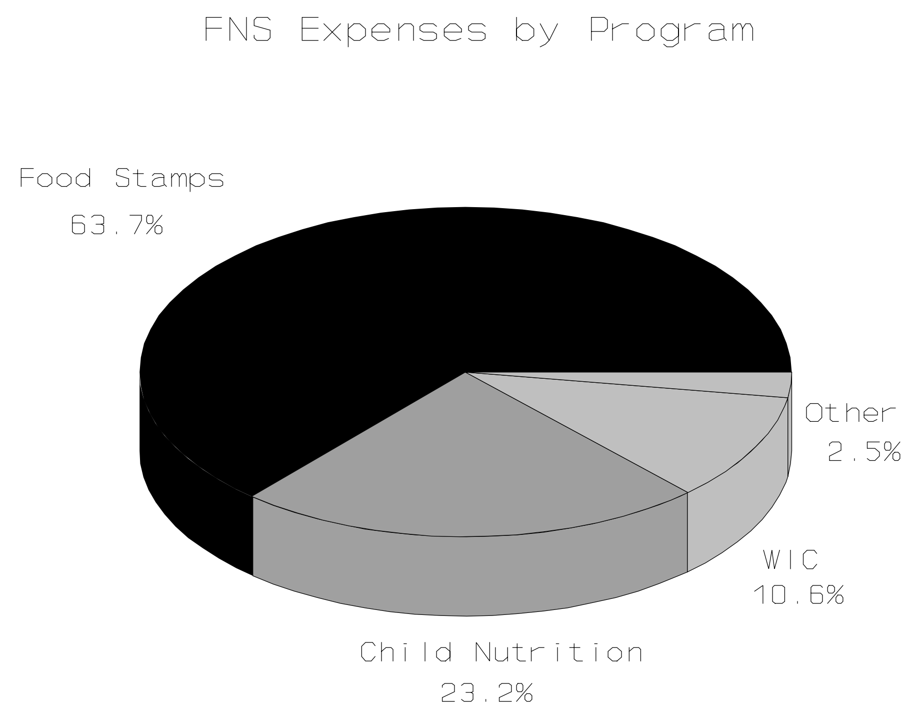
The major FNS programs fall into one of two program types: open-ended entitlement (e.g., Food Stamp and National School Lunch programs) or fixed grant (e.g., Supplemental Nutrition Program for Women, Infants, and Children (WIC)). Regardless of type, the program funding source is specific, direct appropriation. This has an impact on FNS financial and program performance. In entitlement programs, all persons requesting program benefits and meeting the established eligibility requirements must be served. When the growth of entitlement programs exceeds anticipated levels, it may be necessary to request supplemental appropriations. In fixed grant programs such as WIC, funding levels are set and participation levels must be managed to keep the program within the available budget.

FNS is responsible for paying program benefit costs and a portion of State administrative expenses for most food assistance programs, for planning and coordinating the purchase and distribution of commodities to State agencies, and for implementing program statutes through promulgation of regulations and instructions. FNS staff provide training and assistance to State agencies, assure proper funds allocation and control, conduct program monitoring and evaluation, and develop program policy. In a few instances, when State law prohibits a State from disbursing funds to particular types of entities or where no State agency has assumed administrative responsibility, FNS assumes operation of certain child nutrition programs.

FNS Funding

Total expenses for FNS programs in fiscal year 1997 totaled $35.8 billion. The Food Stamp Program ($22.8 billion) accounted for 63.7 percent of the total Agency appropriation while the Child Nutrition programs ($8.3

billion) accounted for approximately 23.2 percent and the Supplemental Nutrition Program for Women, Infants, and Children ($3.8 billion) accounted for 10.6 percent. All other programs and Federal administrative costs accounted for the remaining 2.5 percent.



FNS Locations and Staff

Agency headquarters are in Alexandria, Virginia. FNS maintains seven regional offices. The regional locations are Boston, Massachusetts; Robbinsville, New Jersey; Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; Denver, Colorado; and San Francisco, California. Additionally, as of the close of the fiscal year, the Agency maintained 70 field offices, 6 compliance offices, 1 administrative review office, two seasonal SFSP locations and one computer support center (Minneapolis, Minnesota). Whenever possible, these additional offices are co-located with one another and with the seven regional offices.

As of September 30, 1997, FNS had employed 1,806 full-time equivalents (FTE's) during fiscal year 1997. Of the FTE's, 692 were used in headquarter's functions and 1,114 were used in field functions. Of the field FTE's, 789 were used in the seven regional offices. The balance were used in satellite and special purpose field locations.

Limitations of Financial Statements

The financial statements that follow have been prepared to report the financial condition and results of operations of the Food and Nutrition

Service pursuant to the requirements of the Chief Financial Officers Act of 1990.

While the statements have been prepared from the records of the Food and Nutrition Service in accordance with the formats prescribed by Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Financial Statements" and OMB Bulletin 97-01, these statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

These statements should be read with the realization that they are for a sovereign entity, that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

Financial and program activity information in this document reflects the status of the Agency at the close of the fiscal year. Other Agency publications may reflect changes, usually minor, that have occurred subsequent to the preparation of this document.

Food Stamp Program

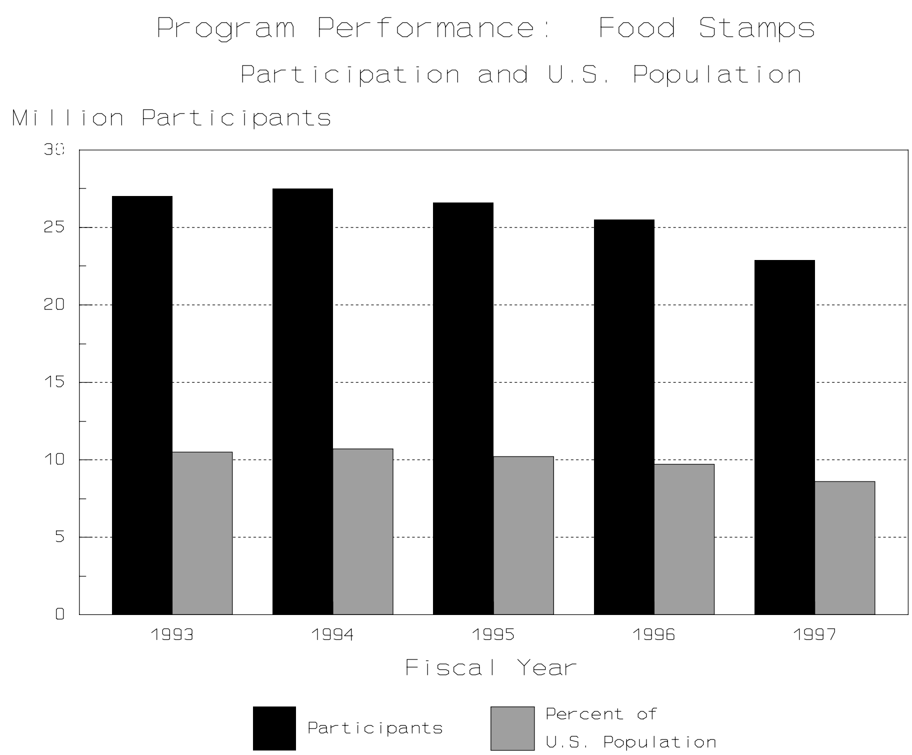
Program Mission

The Food Stamp Program is the Nation's principal food assistance program, a vital component of the Federal safety net that protects needy persons against hunger. Its initial authorization was granted by the Food Stamp Act of 1964. The program enables low-income households to improve their diets by issuing monthly allotments of coupons (or electronic benefits) redeemable for food at retail stores. Eligibility and allotment amounts are based on household size and income, asset limitations, housing costs, work requirements, and other factors. Benefits are adjusted annually to reflect changes in the cost of the Thrifty Food Plan (a market basket of foods for a nutritious low-cost diet). The Federal Government pays the full cost of benefits and funds over half of the expenses incurred by the States to administer the program.

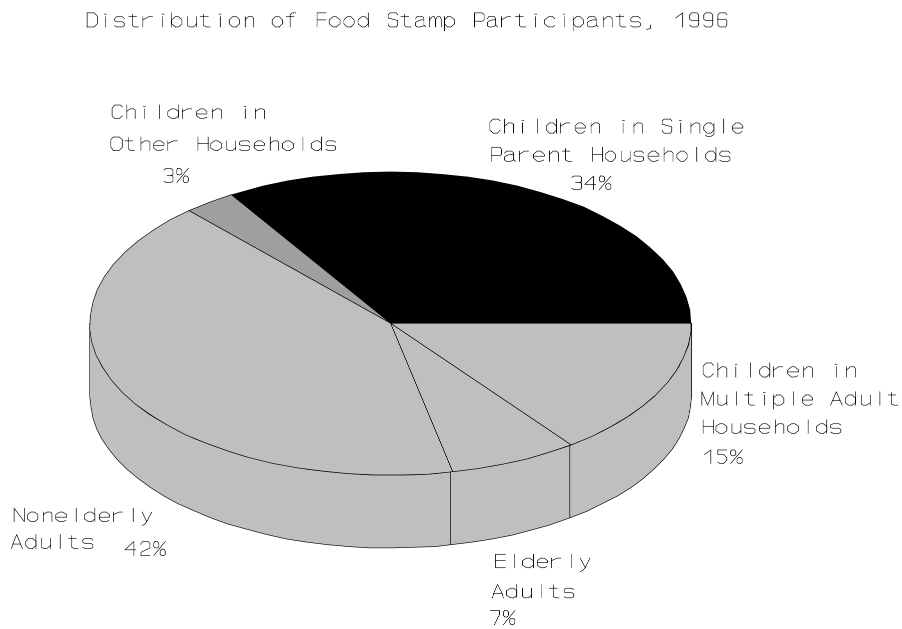
Participation

Participation in 1997 fell to an annual average of 22.9 million persons – down by 2.6 million persons (10.5 percent) from the annual average in 1996. Part of this decrease is attributable to favorable economic conditions and a continuation of the downward participation trend that began in 1995. In addition, a portion of the decrease is attributable to Welfare Reform legislation which affected eligibility for food stamps in a number of ways such as limiting eligibility for legal resident aliens, changing household definitions, and limiting the amount of time an able-bodied adult can receive food stamps. Whereas almost 11 percent of the total U.S.

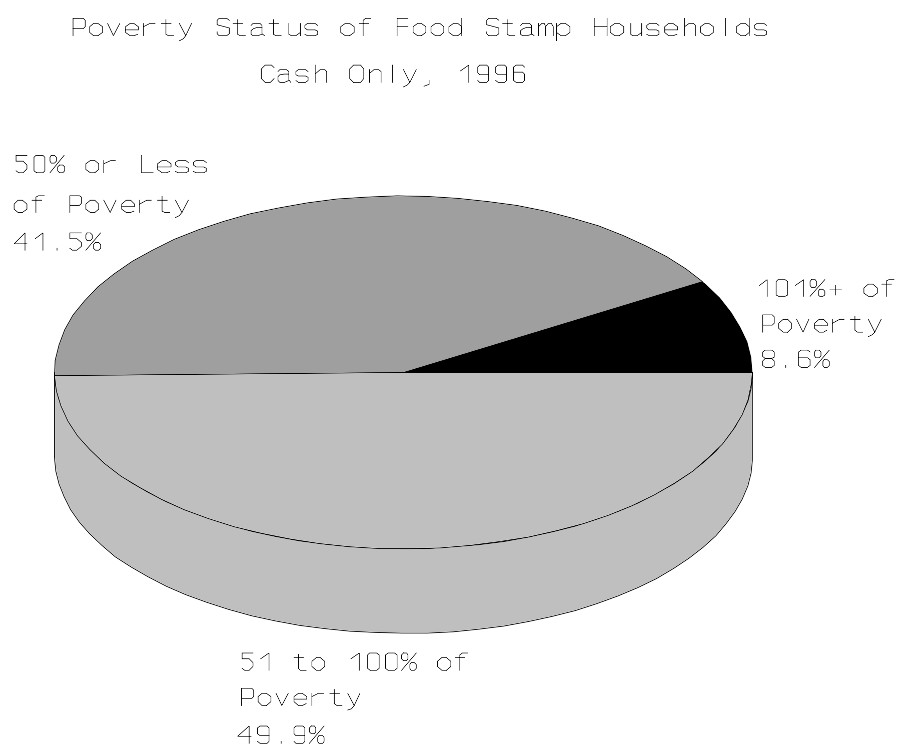
population received food stamps in 1994, less than 9 percent received food stamps in 1997.



The most recent survey of household characteristics, conducted during fiscal year 1996, indicates that 51 percent of all participants were children under 18 years of age – most of them in single parent households. Additionally, 7.3 percent of all participants were elderly adults age 60 or older.



The gross income of about 91 percent of "cash only" households was below the Federal poverty level; 42 percent were at or below 50 percent of poverty. Over 10 percent of food stamp households had no income.

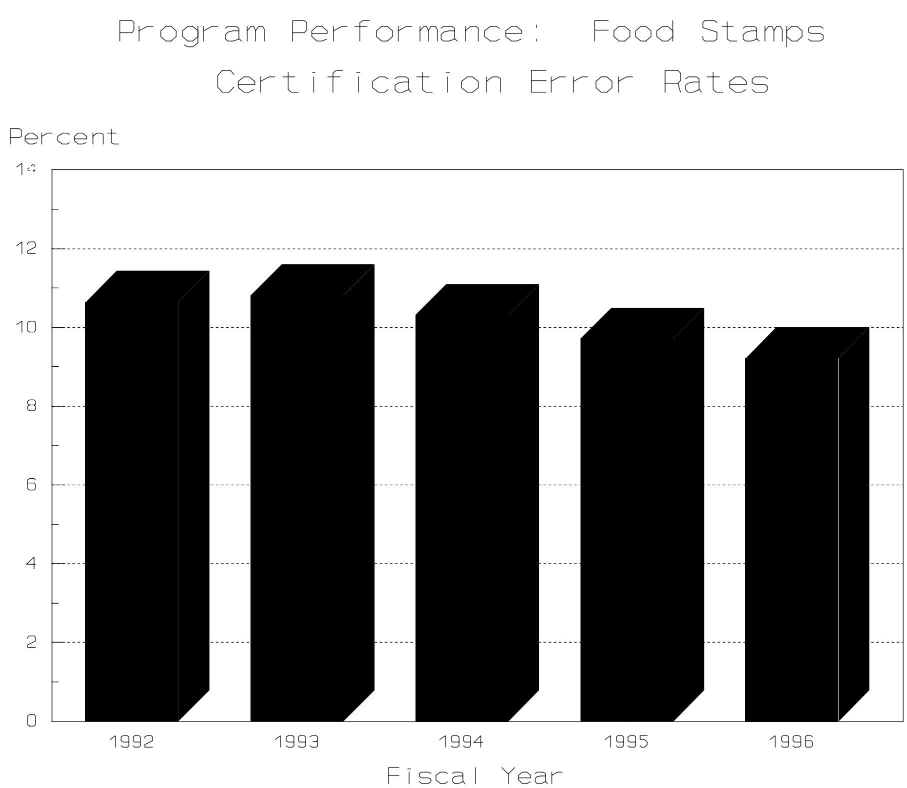


Benefits

Benefit costs were $19.57 billion in fiscal year 1997 compared to $22.44 billion in 1996. The average monthly benefit per person decreased (again, due to Welfare Reform legislation) from $73.22 to $71.34 during the same time period. In addition to benefit costs, the food stamp appropriation includes the Federal share of State administrative costs, grants to States for Employment and Training (E&T) activities, and other Federal costs such as printing and distribution of stamps. Total expenses for the Food Stamp Program (includes $1.2 billion for Puerto Rico) were $22.8 billion in fiscal year 1997.

Program Integrity

During fiscal year 1996, FNS continued its aggressive payment accuracy program with regional offices concentrating even greater efforts to work directly with their States towards improved accuracy. While payment accuracy involves a variety of techniques, State commitment, beginning at the top levels of management, is the most effective tool. FNS continued to promote the need for this commitment as the key to implementation of successful payment accuracy efforts. These efforts continue to be productive with the FY 1996 combined payment error rate (9.22) declining by half a percentage point from FY 1995 (9.72) and by 1.1 percentage points from the FY 1994 rate (10.32).



Besides the above mentioned payment accuracy initiatives, FNS continues to provide enhanced funding to those States who maintain error rates below a certain level. In fiscal year 1997, six State agencies received a total of $15,289,752 based on their fiscal year 1996 payment accuracy performance: Alabama, Arkansas, Hawaii, Kentucky, Massachusetts and South Dakota.

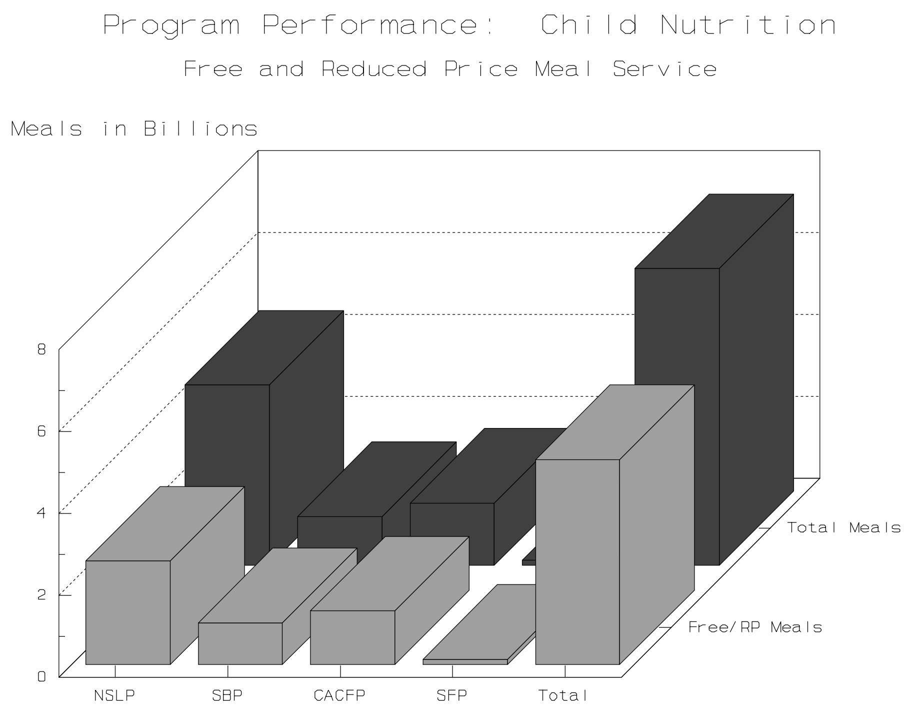
Child Nutrition Programs

Program Mission

Objectives of the Child Nutrition Programs are to provide children with access to nutritious meals away from home and to improve their diets. School feeding programs, such as National School Lunch and School Breakfast, enhance learning by reducing malnutrition and hunger, and fostering a healthy learning environment. The Child and Adult Care Food Program provides for the nutritional well-being of preschool children and adults in day care homes and centers. The Summer Food Service Program serves children in low-income areas during the Summer months. In each program, assistance to improve diets is provided for all children, but programs are targeted to economic needy children. FNS provides the States with cash payments based on per-meal rates that vary according to family income. Children from families with incomes below 130 percent of the poverty level qualify for free meals; reduced-price eligibility is set between 130 and 185 percent of the poverty level. Food donations are also provided. Minimum commodity support ("entitlement") is based on a per-meal rate; surplus ("bonus") commodities are provided based on available supplies from USDA surplus commodity purchases. Free/reduced-price eligibility, cash payment rates, and the commodity entitlement rate are adjusted annually.

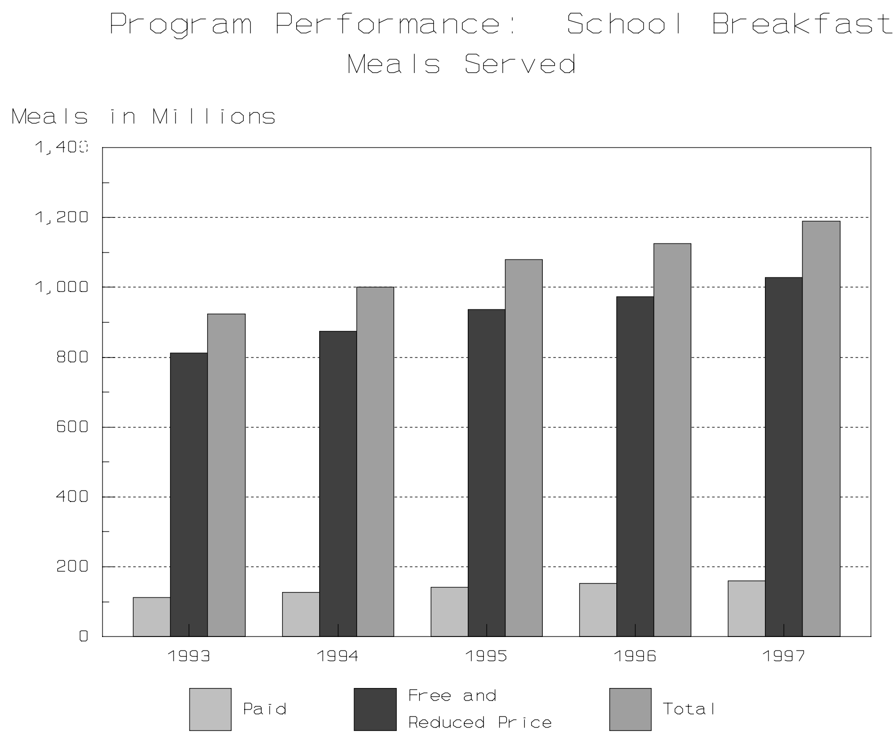
Program Performance

In fiscal year 1997, a total of 7.27 billion meals were served in Child Nutrition Programs, up from 7.09 billion in fiscal year 1996. The share of total meals served free or reduced-price was 69 percent slightly more than the 68.5 percent a year before, reflecting FNS' goal to target the programs to serve predominantly children from low income families.



On any given school day in fiscal year 1997, one of every two schoolchildren in America ate lunch through the National School Lunch Program. The program was available in over 94,740 schools and institutions with a total enrollment of 46.3 million children; reaching 87.8 percent of all school children. Average daily participation was 26.3 million, up 1.5 percent from fiscal year 1996. Free and reduced-price meals served increased 2.4 and 5.5 percent respectively, while full-price meals decreased by 0.3 percent.

Expansion of the School Breakfast Program, particularly in low-income areas, is mandated by Congress. Since fiscal year 1993, program availability has risen from 55,126 institutions with an enrollment of 25.8 million to 68,716 institutions with an enrollment of 33.9 million in fiscal year 1997. The program is now available to 64 percent (or two thirds) of the student population, as compared to only 53 percent in fiscal year 1993. Average daily participation in fiscal year 1997 was 6.9 million, up 5.2 percent from the prior year. The portion of meals served free or at reduced price remained almost unchanged from fiscal year 1996 to fiscal 1997, at 86.5 percent.



Total meal service in the Child and Adult Care Food Program grew by about one percent between fiscal years 1996 and 1997. In child care centers, approximately 70.4 percent of all meals were served free or at reduced price, slightly more than the 69.7 percent in fiscal year 1996. In family day care homes, all meals are reimbursed at the free rate.

The Summer Food Service Program experienced an increase in program activity in fiscal year 1997. Some 133.2 million meals were served in the program, about 6.3 percent more than in the previous year. All of these meals were served free.

Program Benefits

The Child Nutrition expenses totaled $8.3 billion, including cash, entitlement commodities and the Special Milk Program, in fiscal year 1997. In addition to subsidizing meal service, the appropriation also helps States pay administrative expenses of operating the programs, funds Nutrition Education and Training activities, and covers the cost of mandated nutrition studies and surveys.

The Supplemental Nutrition Program For Women, Infants, and Children (WIC)

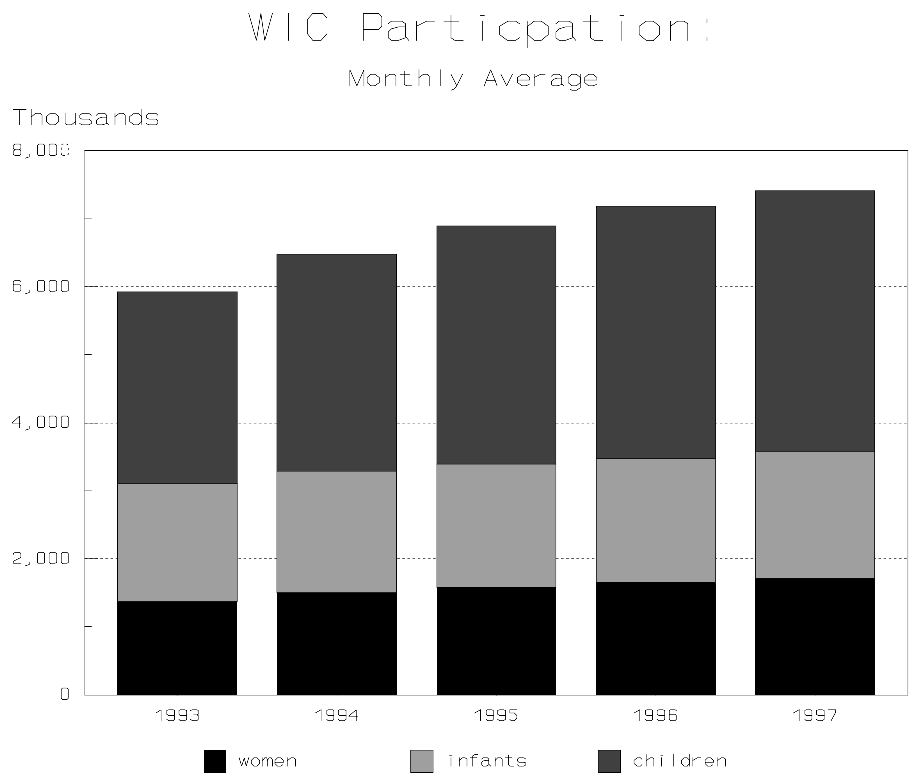
Program Mission

The goal of the WIC Program is to promote the health of nutritionally at risk low-income pregnant or postpartum women, infants and children up to age 5. It has three components: a supplemental food package rich in nutrients often lacking in the diets of the target population, nutrition education and counseling, and referrals to health care services (e.g., prenatal and well-baby care, immunization, smoking cessation, and drug and alcohol abuse counseling). Eligibility is based on income limitations (less than 185 percent of federal poverty guidelines), health risk, and State residency requirements. The WIC Farmers' Market Nutrition Program -- funded from the WIC appropriation-- provides many participants with fresh fruits and vegetables while promoting awareness and use of farmers' markets.

WIC's effectiveness was demonstrated in a five state study conducted in 1990. Women who participated during their pregnancies had lower Medicaid costs for themselves and their babies than non-participating women. WIC participation was linked to longer gestation periods, higher birthweights, and lower infant mortality.

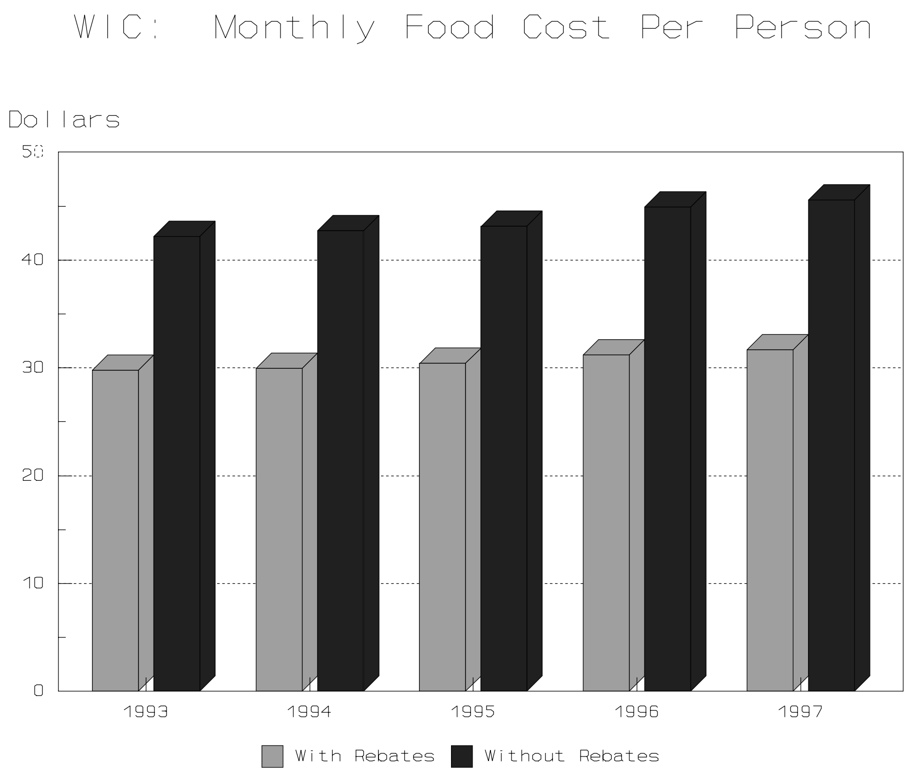
Participation

Since fiscal year 1993, participation has risen from 5.9 million to 7.4 million, an increase of 25.2 percent. However, the rate of growth has declined from 9.4 percent in fiscal year 1993 to 3.1 percent in fiscal year 1997. The slowdown is due to several factors: a high proportion of eligibles reached in some states , infrastructure limitations in others, and temporary retrenchments during fiscal year 1997 due to funding concerns (a supplemental was approved late in the year). Compared to fiscal year 1996, women increased by 3.8 percent, children by 3.3 percent, and infants by 2.0 percent. Program expenditures totaled $3.8 billion.



Cost Containment

A substantial portion of the participation growth reflects the impact of mandatory cost containment measures. Reducing the average food cost per person has enabled WIC to reach more participants with the same funds. The most successful strategy has been competitive rebate contracts between State Agencies and manufacturers of infant formula, the most expensive item. All states and major Tribal Organizations receive infant formula rebates; ten states received rebates for other foods in fiscal year 1997. The Infant Formula Procurement Act of 1992 enhanced competition by enabling FNS to solicit bids for multi-State contracts. In fiscal year 1997, ten state agencies, which included three multi-state contracts, were in effect for infant juice and cereal. Rebate savings in fiscal year 1997 are estimated at $1.30 billion. Rebates reduced the monthly food cost per person by nearly 30.5 percent (from $45.56 to $31.68). The chart below shows the monthly food cost, with rebates vs. without rebates, for the past five years.



Targeting High Risk Groups and Promoting Health

WIC assistance is targeted to the highest risk groups. During the July 1996-June 1997 period, 75.2 percent of all participants were in the top three priority categories. The percentage has gradually declined as WIC reaches a higher proportion of the eligible population. A major factor in WIC's effectiveness is promotion of nutrition education through individual and group counseling and through provision of educational materials. At least one-sixth of funds available for administration and program services must be expended on nutrition education activities. Emphasis is placed on teaching participants to deal with specific nutritional risks, on achieving positive change in dietary habits, and on the dangers of substance abuse during pregnancy. Breastfeeding is promoted through nutrition education during pregnancy, providing an enhanced food package to women who receive no infant formula, permitting breastfeeding women to participate longer than other postpartum women, and providing a support system to encourage success.

Commodity Assistance Programs

Program Mission

FNS provides assistance to a variety of groups through food distribution. In fiscal year 1997, the Commodity Assistance Programs appropriation included two programs: The Emergency Food Assistance Program (TEFAP) and the Commodity Supplemental Food Program (CSFP).

TEFAP helps States relieve hunger and distress by making both purchased commodities and surplus USDA foods available to soup kitchens, food banks, and other emergency feeding organizations. FNS also subsidizes State administrative costs, such as warehousing and delivering commodities. The allocation of food and administrative grants is based on a formula which combines the number of persons below the poverty level and the number of unemployed persons. CSFP is a food distribution predecessor of the WIC Program; its original goal—and its highest priority—is to serve a similar target group of women, infants and children. Its second priority is to provide food packages to improve the health of low-income elderly persons. As the WIC Program has expanded, the women-infant-children component of CSFP has contracted.

Participation

Total CSFP participation in fiscal year 1997 was 370.1 thousand, virtually identical to fiscal year 1993. However, the Elderly share has risen from 38.2 percent to 65.7 percent, proving that the women-infant-children component has decreased.

Program Costs

TEFAP costs totaled $151 million in fiscal year 1997. Program costs for CSFP were $90 million--$71.9 million for entitlement commodities and $18 million for administrative costs.

Other Commodity Programs

Other commodity assistance programs include the Food Distribution Program on Indian Reservations (FDPIR) and the Nutrition Program for the Elderly (NPE). FDPIR-- an alternative to the Food Stamp Program for tribal organizations—served an average of 124 thousand needy persons per month; FNS commodity and administrative costs totaled $66.2 million. The Nutrition Program for the Elderly subsidized 247 million meals served in senior centers or delivered to the homebound; FNS costs were $144.8 million.

CHAPTER 7
FNS' SUPPLEMENTAL INFORMATION FOR FISCAL YEAR 1997 OPERATIONS

Introduction

Purpose Information provided in this supplementary section is intended to assist the reader in the interpretation of the Food and Nutrition Service's operating results for fiscal year 1997. It is also intended to demonstrate the nation-wide scope of the Agency's programs. Note that the figures presented in the fiscal year 1996 Supplemental for fiscal years 1996 and 1995 were preliminary and subject to change; therefore, last year's and this year's Supplemental may not match.

FNS Regions The following data is primarily presented at the regional level. Food and Nutrition Service regions are as follows:

Food and Nutrition Service
Organization of Regional Offices

Region	Abbreviation	States Included
Northeast Regional Office	NERO	CT, ME, MA, NH, NY, RI, VT
Mid-Atlantic Regional Office	MARO	DE, DC, MD, NJ, PA, PR, VA, VI, WV
Southeast Regional Office	SERO	AL, FL, GA, KY, MS, NC, SC, TN
Midwest Regional Office	MWRO	IL, IN, MI, MN, OH, WI
Southwest Regional Office	SWRO	AR, LA, NM, OK, TX
Mountain Plains Regional Office	MPRO	CO, IA, KS, MO, MT, NE, ND, SD, UT, WY
Western Regional Office	WRO	AK, AZ, CA, GU, HI, ID, NV, OR, WA, Pacific Territories

Limitations Slight differences may exist between data presented in this supplementary section and similar data occurring elsewhere in this document. These differences result primarily from rounding at the regional level.

Food Stamp Program

Food Stamp Program Regional Activity: The following tables provide regional level Food Stamp Program performance data for the period fiscal year 1993 through fiscal year 1997.

Food Stamp Program
Average Annual Program Participation by Region
(Thousands)

REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	3,052	3,174	3,162	3,026	2,775
MARO	3,110	3,182	3,151	3,057	2,781
SERO	5,730	5,635	5,375	5,243	4,741
MWRO	4,622	4,626	4,375	4,053	3,572
SWRO	4,335	4,385	4,154	3,905	3,388
MPRO	1,702	1,691	1,616	1,551	1,380
WRO	4,431	4,774	4,785	4,706	4,222
TOTAL	26,982	27,468	26,619	25,541	22,859

Food Stamp Program Total Program Issuance by Region (Millions)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	2,534	2,704	2,834	2,801	2,461
MARO	2,601	2,703	2,747	2,736	2,410
SERO	4,683	4,679	4,591	4,615	3,972
MWRO	3,855	3,848	3,722	3,489	3,003
SWRO	3,589	3,672	3,598	3,468	2,917
MPRO	1,328	1,329	1,314	1,291	1,117
WRO	3,416	3,813	3,959	4,041	3,690
TOTAL	$22,006	$22,749	$22,766	$22,441	$19,570

Food Stamp Program Average Monthly Per Person Benefit by Region ($/Person)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	69.18	70.99	74.70	77.13	73.88
MARO	69.70	70.78	72.65	74.58	72.21
SERO	68.11	69.19	71.18	73.35	69.81
MWRO	69.50	69.32	70.89	71.73	70.04
SWRO	68.99	69.78	72.17	74.01	71.74
MPRO	65.02	65.47	67.74	69.34	67.46
WRO	64.25	66.54	68.95	71.56	72.83
NATIONAL	$67.96	$69.01	$71.27	$73.22	$71.34

Food Stamp Program Compliance Branch Activity: During fiscal year 1997, the Compliance Branch conducted investigations of 4,627 stores nationwide. Of these investigations, 2,084 (nearly 45% percent) documented evidence of food stamp program violations. The evidence was sufficient in 1,584 of these cases to warrant the store being disqualified from the program for a specified period of time, or to pay a Civil Money Penalty in lieu of being disqualified. Of those 1,584 cases, Compliance Branch investigators uncovered trafficking in 712 stores. Yearly food stamp redemptions of the 2,084 stores diverting program benefits totaled $154.5 million. Annual redemptions for the 712 stores found trafficking were $79.5 million.

Food Stamp Program Compliance Branch Activity		
Activity	FY 1996	FY 1997
Stores Investigated	4,862	4,627
Trafficking Found Occurring	743	712
Violations Detected	2,283	2,084
Violations Warranting Disqualification or Civil Money Penalties	1,418	1,584

Child Nutrition Programs

Child Nutrition Programs Regional Activity: The following tables provide regional level performance data for the National School Lunch Program, the School Breakfast Program, and the Child and Adult Care Food Program over the period fiscal year 1993 through fiscal year 1997.

National School Lunch Program Monthly Average Daily Program Participation by Region (Thousands)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	2,531	2,605	2,657	2,695	2,739
MARO	3,161	3,215	3,275	3,282	3,295
SERO	5,330	5,398	5,455	5,520	5,618
MWRO	4,198	4,261	4,336	4,343	4,391
SWRO	3,611	3,671	3,714	3,755	3,813
MPRO	2,319	2,329	2,355	2,360	2,380
WRO	3,667	3,767	3,861	3,957	4,055
DOD *	38	35	33	32	32
TOTAL	24,855	25,281	25,685	25,944	26,323

* The Department of Defense oversees schools.

School Breakfast Program Annual Average Daily Program Participation by Region (Thousands)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	481	539	589	618	648
MARO	655	691	749	743	786
SERO	1,445	1,546	1,637	1,704	1,791
MWRO	467	539	662	693	732
SWRO	1,128	1,182	1,230	1,273	1,330
MPRO	282	346	373	393	407
WRO	901	991	1,078	1,160	1,230
TOTAL	5,359	5,834	6,318	6,584	6,924

Child and Adult Care Food Program Average Daily Attendance by Region (Thousands)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	222	251	268	276	282
MARO	194	214	243	258	244
SERO	283	321	360	421	414
MWRO	365	393	415	414	421
SWRO	269	309	328	320	323
MPRO	270	293	301	296	292
WRO	374	404	441	430	439
TOTAL	1,977	2,185	2,356	2,415	2,415

Availability of National School Lunch Program: The following table displays the trend in National School Lunch Program participation in relation to the enrollment levels in participating schools.

National School Lunch Program Percent of Students Enrolled in Schools Participating in NSLP --Based on Average Participation-- (Thousands)					
Item	FY 93	FY 94	FY 95	FY 96	FY 97
Enrollment in NSLP Schools	43,468	44,465	45,136	45,309	46,269
Average Participation	24,855	25,281	25,685	25,944	26,324
Percent Participation of Enrollment	57.18	56.86	56.90	57.26	56.89

Cash Payments to States: The programs are operated under an agreement entered into by State agencies and the Department. Funds are made available by letters of credit to State agencies for use in reimbursing participating schools and other institutions. Sponsors make application to the State agencies and, if approved, are reimbursed on a per-meal basis in accordance with the terms of their agreements and the rates prescribed by law. The reimbursement rates are adjusted annually to reflect changes in the Consumer Price Index for Food Away From Home as provided for in Section 11 of the National School Lunch Act.

National School Lunch Program (NSLP). Assistance is provided to the States for the service of lunches and snacks to children in participating schools and institutions, regardless of household income. Additional assistance is provided to the States for serving lunches and snacks free or at a reduced price to needy children. States must match a portion of the Federal cash grant. Schools which, in the second previous school year, served at least 60 percent of their lunches at free or reduced prices receive an additional 2 cents per meal in assistance.

National School Lunch Program Reimbursement Rates: July Through June[1] (Cents)					
	92-93	93-94	94-95	95-96	96-97
LESS THAN 60% SERVED FREE:					
Paid	16.25	16.50	17.00	17.25	18.00
Reduced	129.50	132.50	135.75	139.50	149.00
Free	169.50	172.50	175.75	179.50	189.00
60% OR MORE SERVED FREE:					
Paid	18.25	18.50	19.00	19.25	20.00
Reduced	131.50	134.50	137.75	141.50	151.00
Free	171.50	174.50	177.75	181.50	191.00
MAXIMUM PAYMENT RATES:					
Paid	24.25	24.50	25.00	25.25	26.00
Reduced	146.50	149.50	152.75	156.50	166.00
Free	186.50	189.50	192.75	196.50	206.00
SUPPLEMENTS:					
Paid	4.25	4.25	4.50	4.50	4.00
Reduced	23.25	23.75	24.00	24.75	26.00
Free	46.50	47.50	48.25	49.25	51.75
Commodity Reimbursement Rate					
	14.00	14.00	14.50	14.50	14.50

[1] Rates higher in Alaska and Hawaii.

<u>School Breakfast Program (SBP)</u>. Federal reimbursement is based on the number of breakfasts served to children from low, lower, or upper income families. Schools that served at least 40 percent of their lunches at free or reduced prices in the second preceding year and had unusually

high preparation costs, which exceeded regular breakfast per meal reimbursement, receive higher subsidies in both the free and reduced-price categories. FNS also provides expansion grants as authorized by P.L. 101-147, the Child Nutrition and WIC Reauthorization Act of 1989.

School Breakfast Program
Reimbursement Rates: July Through June[1]
(Cents)

	92-93	93-94	94-95	95-96	96-97
NON-SEVERE NEED:					
Paid	18.75	19.00	19.25	19.50	20.00
Reduced	64.50	66.00	67.50	69.75	74.50
Free	94.50	96.00	97.50	99.75	104.50
SEVERE NEED:					
Paid	18.75	19.00	19.25	19.50	20.00
Reduced	82.25	84.25	86.00	88.50	94.50
Free	112.25	114.25	116.00	118.50	124.50

[1] Rates are higher in Alaska and Hawaii.

Child and Adult Care Food Program (CACFP). Nonprofit child care centers and family and group day care homes receive subsidies for meals served to preschool and other children. Profit-making child care centers receiving compensation under Title XX of the Social Security Act (Title XX) may participate in the program if 25 percent of the children enrolled are Title XX participants. Certain adult day care centers are also eligible for participation in this program if they provide meals to persons 60 years or older or to adults who are functionally impaired. They must be nonprofit unless they receive compensation under Title XIX or Title XX of the Social Security Act for at least 25 percent of their enrollees. The Child and Adult Care Food Program provides reimbursement to State agencies at varying rates for breakfasts, lunches, suppers, and meal supplements. Two percent of total CACFP obligations from the second preceding year are provided for audits and administrative reviews of CACFP institutions. Under the Regional Office Administered Program (ROAP), the Office of the Inspector General contracts with Certified Public Accounting firms for audits of the child care institutions directly administered by FNS. FNS may use some of these funds not needed for audits for administrative reviews of child care sponsors for which the regional office is responsible. As authorized in Public Law 101-147, FNS will, through the end of fiscal year 1995, continue to administer grants to homeless shelters to determine the most effective way of providing meals to homeless children under the age of 6 years.

Child and Adult Care Food Program Reimbursement Rates: July Through June[1] (Cents)					
	92-93	93-94	94-95	95-96	96-97
BREAKFASTS (in Centers):					
Paid	18.75	19.00	19.25	19.50	20.00
Reduced	64.50	66.00	67.50	69.75	74.50
Free	94.50	96.00	97.50	99.75	104.50
LUNCHES and SUPPERS (in Centers):					
Paid	16.25	16.50	17.00	17.25	18.00
Reduced	129.50	132.50	135.75	139.50	149.00
Free	169.50	172.50	175.75	179.50	189.00
SUPPLEMENTS (in Centers):					
Paid	4.25	4.25	4.50	4.50	4.00
Reduced	23.25	23.75	24.00	24.75	26.00
Free	46.50	47.50	48.25	49.25	51.75
COMMODITY REIMBURSEMENT RATE					
	14.00	14.00	14.50	14.50	14.50

[1] Rates higher in Alaska and Hawaii.

Special Supplemental Food Program for Women, Infants, and Children

Special Supplemental Food Program for Women, Infants, and Children (WIC): The following tables provide regional level performance data for the WIC Program over the period fiscal year 1993 through fiscal year 1997.

Special Supplemental Food Program for
Women, Infants and Children (WIC)
Average Monthly Participation Level by Region
(Thousands)

REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	651	686	714	729	742
MARO	813	873	891	913	928
SERO	1,192	1,267	1,321	1,353	1,391
MWRO	964	1,012	1,046	1,051	1,044
SWRO	880	948	1,008	1,031	1,072
MPRO	438	465	481	485	492
WRO	984	1,225	1,433	1,626	1,740
TOTAL	5,922	6,476	6,894	7,188	7,409

Special Supplemental Food Program for Women, Infants, and Children (WIC) Average Monthly Food Cost Per Participant by Region ($/Person)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	32.31	32.76	32.05	32.69	33.02
MARO	33.48	33.62	33.92	34.67	34.88
SERO	27.42	28.11	29.40	29.94	30.81
MWRO	29.27	28.57	29.39	30.76	30.77
SWRO	27.42	27.08	26.93	27.85	28.02
MPRO	29.26	29.26	29.54	30.80	30.84
WRO	30.65	31.07	31.78	32.12	33.13
TOTAL	29.76	29.91	30.40	31.19	31.68

Breastfeeding Promotion Efforts: The WIC program promotes breastfeeding as the best form of infant feeding through the provision of support and encouragement to new mothers and through nutrition education during pregnancy. In addition, breastfeeding WIC mothers receive a larger food package and, if otherwise eligible, are able to stay on WIC for a longer period of time than non breastfeeding postpartum women. By law, States are required to expend at least $21 per pregnant and breastfeeding participant for breastfeeding promotion and support. Many States spend more than this minimum requirement on breastfeeding promotion.

Between 1993 and 1996 the number of breastfeeding women served by the WIC Program has increased by over 50 percent, from 209,000 to 321,000. Over that same period, breastfeeding women accounted for 35-40 percent of the total WIC postpartum caseload in any individual year. Looking solely at the ratio of breastfeeding women to total postpartum women suggests that the rate of breastfeeding in the WIC Program did not improve over the time period and actually decreased from 1993 to 1996. However, this comparison obscures increases in high priority breastfeeding women because significant funding increases have allowed the program to expand participation among lower priority postpartum women at an even greater rate than higher priority breastfeeding women. Research has documented the positive impact of nutrition education on breastfeeding rates among WIC participants. Recently enacted legislation will provide FNS with accurate measures of the initiation and duration of breastfeeding among WIC participants.

Special Supplemental Food Program for Women, Infants, and Children (WIC) Percent of WIC Postpartum Women Who Breastfeed (Thousands)			
Fiscal Year	Breastfeeding Women	Total Postpartum Women	Percent Breastfeeding of Total
1993	209	544	38.4
1994	236	656	36.0
1995	268	743	36.1
1996	283	791	35.8
1997	321	839	38.3

Commodity Assistance Programs

Commodity Assistance Programs (CAP): The Commodity Assistance Programs appropriation includes two programs, the Commodity Supplemental Food Program (CSFP) and The Emergency Food Assistance Program (TEFAP). The following tables provide participation data by region and by program component for CSFP over the period fiscal year 1993 through fiscal year 1997.

Commodity Supplemental Food Program Average Monthly Participation Level by Region (Thousands)					
REGION	FY 93	FY 94	FY 95	FY 96	FY 97
NERO	24	26	34	36	44
MARO	15	14	13	12	12
SERO	34	31	29	26	24
MWRO	129	122	115	105	105
SWRO	77	79	82	86	92
MPRO	50	47	46	47	46
WRO	41	44	46	46	47
TOTAL	370	365	364	358	370

Commodity Supplemental Food Program WIC and Elderly Components (Thousands)				
Fiscal Year	Women, Infants, and Children	Elderly Persons	Total	Percent WIC of Total
1993	229	142	371	61.7
1994	200	163	363	55.1
1995	164	200	364	45.1
1996	137	219	356	38.5
1997	127	243	370	34.3

CHAPTER 8
FNS' FY 1997
FINANCIAL STATEMENTS AND NOTES

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

ASSETS	
Entity Assets	
Federal Assets	
Fund Balance with the U.S. Treasury and Cash (note 1F and 2)	$19,427,318
Accounts Receivable, net (note 1D)	837
Advances and Prepayments	151,330
Non-Federal Assets	
Accounts Receivable, Net (note 1D)	195,795
Property, Plant, and Equipment, Net (note 3)	9,436
Total Entity Assets	19,784,716
Non-Entity Assets	
Federal Assets	
Fund Balance with the U.S. Treasury and Cash	100,644
Non-Federal Assets	
Accounts Receivable, Net	30,436
Interest Receivable, Net	5,344
Total Non-Entity Assets	136,424
TOTAL ASSETS	$19,921,140
LIABILITIES	
Liabilities Covered by Budgetary Resources	
Federal Liabilities	
Accounts Payable	$563
Unearned Revenue	19
Resources Payable to the Treasury	35,780
Non-Federal Liabilities	
Accounts Payable (note 4B)	1,869,149
Accrued Program Liabilities	106,333
Trust and Deposit Liabilities	1,715
Total Liabilities Covered by Budgetary Resources	2,013,559
Liabilities Not Covered by Budgetary Resources	
Non-Federal Liabilities	
Annual Leave and FECA Liabilities (note 1J)	13,909
Other	1,120
Total Liabilities Not Covered by Budgetary Resources	15,029
TOTAL LIABILITIES	$2,028,588
NET POSITION	
Equity of the U.S. Government	
Unexpended Appropriations (note 5)	$17,898,145
Invested Capital (note 5)	9,436
Total Equity of the U.S. Government	17,907,581
Less Future Financing Sources	15,029
TOTAL NET POSITION	$17,892,552
TOTAL LIABILITIES AND NET POSITION	$19,921,140

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
COMBINING STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

	Food Program Administration and Non-Entity	Child Nutrition Healthy Meals Homeless and Special Milk	Food Stamps and Disaster Assistance
ASSETS			
Entity Assets			
Federal Assets			
Fund Balance with the U.S. Treasury and Cash (note 1F and 2)	$12,259	$2,022,994	$17,006,417
Accounts Receivable, net (note 1D)	406	0	431
Advances and Prepayments	0	72,221	48,809
Non-Federal Assets			
Accounts Receivable, Net (note 1D)	0	7,350	187,622
Property, Plant, and Equipment, Net (note 3)	0	2,019	6,454
Total Entity Assets	12,665	2,104,584	17,249,733
Non-Entity Assets			
Federal Assets			
Fund Balance with the U.S. Treasury and Cash	100,644	0	0
Non-Federal Assets			
Accounts Receivable, Net	30,436	0	0
Interest Receivable, Net	5,344	0	0
Total Non-Entity Assets	136,424	0	0
TOTAL ASSETS	$149,089	$2,104,584	$17,249,733
LIABILITIES			
Liabilities Covered by Budgetary Resources			
Federal Liabilities			
Accounts Payable	$563	$0	$0
Unearned Revenue	0	(2)	20
Resources Payable to the Treasury	35,780	0	0
Non-Federal Liabilities			
Accounts Payable (note 4B)	0	1,200,112	460,700
Accrued Program Liabilities	103,333	0	3,000
Trust and Deposit Liabilities	1,715	0	0
Total Liabilities Covered by Budgetary Resources	141,391	1,200,110	463,720
Liabilities Not Covered by Budgetary Resources			
Non-Federal Liabilities			
Annual Leave and FECA Liabilities (note 1J)	13,909	0	0
Other	0	0	749
Total Liabilities Not Covered by Budgetary Resources	13,909	0	749
TOTAL LIABILITIES	155,300	1,200,110	$464,469
NET POSITION			
Equity of the U.S. Government			
Unexpended Appropriations (note 5)	$7,698	$902,455	$16,779,559
Invested Capital (note 5)	0	2,019	6,454
Total Equity of the U.S. Government	7,698	904,474	16,786,013
Less Future Financing Sources	13,909	0	749
TOTAL NET POSITION	($6,211)	$904,474	$16,785,264
TOTAL LIABILITIES AND NET POSITION	$149,089	$2,104,584	$17,249,733

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
COMBINING STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

	Food Donations	Women, Infants and Children	Commodity Assistance Consolidated	Total
ASSETS				
Entity Assets				
Federal Assets				
Fund Balance with the U.S. Treasury and Cash (note 1F and 2)	$37,520	$305,135	$42,993	$19,427,318
Accounts Receivable, net (note 1D)	0	0	0	837
Advances and Prepayments	4,158	0	26,142	151,330
Non-Federal Assets				
Accounts Receivable, Net (note 1D)	554	269	0	195,795
Property, Plant, and Equipment, Net (note 3)	38	887	38	9,436
Total Entity Assets	42,270	306,291	69,173	19,784,716
Non-Entity Assets				
Federal Assets				
Fund Balance with the U.S. Treasury and Cash	0	0	0	100,644
Non-Federal Assets				
Accounts Receivable, Net	0	0	0	30,436
Interest Receivable, Net	0	0	0	5,344
Total Non-Entity Assets	0	0	0	136,424
TOTAL ASSETS	$42,720	$306,291	$69,173	$19,921,140
LIABILITIES				
Liabilities Covered by Budgetary Resources				
Federal Liabilities				
Accounts Payable	0	0	0	$563
Unearned Revenue	0	1	0	19
Resources Payable to the Treasury	0	0	0	35,780
Non-Federal Liabilities				
Accounts Payable (note 4B)	34,901	157,234	16,202	1,869,149
Accrued Program Liabilities	0	0	0	106,333
Trust and Deposit Liabilities	0	0	0	1,715
Total Liabilities Covered by Budgetary Resources	34,901	157,235	16,202	2,013,559
Liabilities Not Covered by Budgetary Resources				
Non-Federal Liabilities				
Annual Leave and FECA Liabilities (note 1J)	0	0	0	13,909
Other	0	0	371	1,120
Total Liabilities Not Covered by Budgetary Resources	0	0	371	15,029
TOTAL LIABILITIES	$34,901	$157,235	$16,573	$2,028,588
NET POSITION				
Equity of the U.S. Government				
Unexpended Appropriations (note 5)	$7,331	$148,169	$52,933	$17,898,145
Invested Capital (note 5)	38	887	38	9,436
Total Equity of the U.S. Government	7,369	149,056	52,971	17,907,581
Less Future Financing Sources	0	0	371	15,029
TOTAL NET POSITION	$7,369	$149,056	$52,600	$17,892,552
TOTAL LIABILITIES AND NET POSITION	$42,270	$306,291	$69,173	$19,921,140

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
STATEMENT OF OPERATIONS AND NET POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

REVENUES	
Interest and Penalties	
a. Federal	$0
b. Non-Federal	1,282
Other Revenue	3,455
Less: Taxes and Receipts Transferred to the U.S. Treasury or Other Agency	(4,737)
Total Revenues	0
OTHER FINANCING SOURCES	
Appropriated Capital Used (note 1M)	30,037,607
Reimbursements	10,122
Intra-USDA Transfers	
a. To USDA Agencies	0
b. From USDA Agencies (note 1E)	5,889,782
Total Other Financing Sources	35,937,511
Total Revenues and Other Financing Sources	$35,937,511
EXPENSES	
Operating Program Expenses (note 8)	$35,807,544
Provision for Losses	129,402
Interest Expense	
a. Federal	0
b. Non-Federal	7
Depreciation	380
Other Expenses	178
Total Expenses	$35,937,511
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses Before Extraordinary Items and Changes in Accounting Principles	$0
Extraordinary Item	0
Cumulative Effect of change in Accounting Principle	0
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	$0
STATEMENT OF CHANGES IN NET POSITION	
Net Position, Beginning Balance, as Previously Reported	$14,151,031
Adjustment	0
Net Position, Beginning Balance, as Restated	14,151,031
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	0
Financing from Appropriations	0
Plus (Minus) Non-Operating changes (note 7)	3,741,521
Net Position, Ending Balance	$17,892,552

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
COMBINING STATEMENT OF OPERATIONS AND NET POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

	Food Program Administration and Non-Entity	Child Nutrition Healthy Meals Homeless and Special Milk	Food Stamps and Disaster Assistance
REVENUES			
Interest and Penalties			
a. Federal	$0	$0	$0
b. Non-Federal	1,282	0	0
Other Revenue	3,455	0	0
Less: Taxes and Receipts Transferred to the U.S. Treasury or Other Agency	(4,737)	0	0
Total Revenues	0	0	0
OTHER FINANCING SOURCES			
Appropriated Capital Used (note 1M)	106,367	2,908,582	22,893,614
Reimbursements	807	1	9,142
Intra-USDA Transfers			
a. To USDA Agencies	0	0	0
b. From USDA Agencies (note 1E)	0	5,433,753	0
Total Other Financing Sources	107,174	8,342,336	22,902,756
Total Revenues and Other Financing Sources	$107,174	$8,342,336	$22,902,756
EXPENSES			
Operating Program Expenses (note 8)	$106,759	$8,342,005	$22,776,580
Provision for Losses	0	336	126,190
Interest Expense			
a. Federal	0	0	0
b. Non-Federal	7	0	0
Depreciation	408	(6)	(20)
Other Expenses	0	1	6
Total Expenses	$107,174	$8,342,336	$22,902,756
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses Before Extraordinary Items and Changes in Accounting Principles	$0	$0	$0
Extraordinary Item	0	0	0
Cumulative Effect of change in Accounting Principle	0	0	0
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	$0	$0	$0
STATEMENT OF CHANGES IN NET POSITION			
Net Position, Beginning Balance, as Previously Reported	$(8,891)	$601,393	$13,319,597
Adjustment	0	0	0
Net Position, Beginning Balance, as Restated	(8,891)	601,393	13,319,597
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	0	0	0
Financing from Appropriations	0	0	0
Plus (Minus) Non-Operating changes (note 7)	2,680	303,081	3,465,667
Net Position, Ending Balance	$(6,211)	$904,474	$16,785,264

The accompanying notes are an integral part of these statements.

UNITED STATES DEPARTMENT OF AGRICULTURE
FOOD AND NUTRITION SERVICE
COMBINING STATEMENT OF OPERATIONS AND NET POSITION
AS OF SEPTEMBER 30, 1997
(Amounts shown are in thousands)

	Food Donations	Women, Infants and Children	Commodity Assistance Consolidated	Total
REVENUES				
Interest and Penalties				
a. Federal	$0	$0	$0	$0
b. Non-Federal	0	0	0	1,282
Other Revenue	0	0	0	3,455
Less: Taxes and Receipts Transferred to the U.S. Treasury or Other Agency	0	0	0	(4,737)
Total Revenues	0	0	0	0
OTHER FINANCING SOURCES				
Appropriated Capital Used (note 1M)	151,937	3,794,323	182,784	30,037,607
Reimbursements	0	172	0	10,122
Intra-USDA Transfers				
a. To USDA Agencies	0	0	0	0
b. From USDA Agencies (note 1E)	456,029	0	0	5,889,782
Total Other Financing Sources	607,966	3,794,495	182,784	35,937,511
Total Revenues and Other Financing Sources	$607,966	$3,794,495	$182,784	$35,937,511
EXPENSES				
Operating Program Expenses (note 8)	$604,939	$3,794,481	$182,780	$35,807,544
Provision for Losses	3,027	(155)	4	129,402
Interest Expense				
a. Federal	0	0	0	0
b. Non-Federal	0	0	0	7
Depreciation	0	(2)	0	380
Other Expenses	0	171	0	178
Total Expenses	$607,966	$3,794,495	$182,784	$35,937,511
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses Before Extraordinary Items and Changes in Accounting Principles	$0	$0	$0	$0
Extraordinary Item	0	0	0	0
Cumulative Effect of change in Accounting Principle	0	0	0	0
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	$0	$0	$0	$0
STATEMENT OF CHANGES IN NET POSITION				
Net Position, Beginning Balance, as Previously Reported	$27,064	$138,090	$73,779	$14,151,031
Adjustment	0	0	0	0
Net Position, Beginning Balance, as Restated	27,064	138,090	73,779	14,151,031
Excess (Shortage) of Revenues and Other Financing Sources over Total Expenses	0	0	0	0
Financing from Appropriations	0	0	0	0
Plus (Minus) Non-Operating changes (note 7)	(19,695)	10,966	(21,179)	3,741,521
Net Position, Ending Balance	$7,369	$149,056	$52,600	$17,892,552

The accompanying notes are an integral part of these statements.

FOOD AND NUTRITION SERVICE
FOOTNOTES TO FISCAL YEAR 1997 FINANCIAL STATEMENTS
(Amount shown are in thousands exception as noted)

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Food and Nutrition Service (FNS), as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of FNS in accordance with Office of Management and Budget (OMB) Bulletin 94-01, "Form and Content of Agency Financial Statements," dated November 16, 1993, however, Footnotes no. 2 and no. 5 have been prepared in accordance with OMB Bulletin 97-01. These statements have therefore been prepared on an "Other Comprehensive Basis of Accounting."

B. Reporting Entity

The Food and Nutrition Service (FNS) was established August 8, 1969, per Secretary's Memorandum No 1659 and Supplement 1 pursuant to the authority contained in 5 U.S.C. 301 and Reorganization Plan No. 2 of 1953. The agency administers USDA's five nutrition assistance programs: Food Stamp (FS) Program, Child Nutrition (CN) Programs, Special Supplemental Food Program for Women, Infants, and Children (WIC), Commodity Assistance Program (CAP) as well as Cash and Commodities for Selected Groups (Food Donations). These nutrition programs are intended to provide access to a nutritionally adequate diet for families and persons with low incomes, and encourage better eating habits among the nation's children. The programs are also intended to help expand markets for food produced by American farmers. FNS also administers a food program administration appropriation, which provides funds for salaries and administrative expenses.

FNS is under the jurisdiction of the Under Secretary for Food, Nutrition and Consumer Services. FNS is headed by an administrator with overall policy formulated in the FNS headquarters in Alexandria, Virginia, and implemented through seven regional offices, 67 field offices, and 9 satellite locations. State departments of education have responsibility for food programs serving children in schools, child care centers, and summer recreation centers. State departments of health, welfare, and agriculture usually have responsibility for programs providing food stamp benefits or supplemental foods.

C. Basis of Accounting

FNS records transactions on an accrual accounting basis and a budgetary basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. These financial statements include all funds for which the FNS is responsible and are intended to comply with accounting principles prescribed by OMB Bulletin 94-01.

D. Accounts Receivable

Accounts receivable represent debts owed FNS by individuals, businesses, and state and local governments. Accounts receivable represent principally claims against individuals who have been overissued food stamp benefits. States are responsible for establishing and collecting claims against food stamp recipients. States report quarterly summary information to FNS on the status of claims and collection amounts. To encourage aggressive collection efforts, the Food Stamp Act of 1977, as amended, permits the states to retain a percentage of the amounts collected to certain categories of over-issuances. FNS records these collected amounts as they take place. All accounts receivable are shown at net of the allowance for doubtful accounts. FNS' FY 1997 recipient claims gross accounts receivable amount was based on certified reports received from the States.

Because of deficiencies in state food stamp recipient claims reporting systems, FNS adjusts the bad debt allowance for food stamp recipient claims at the end of each fiscal year using a regression-based statistical model which estimates the net realizable value of future claims collections as of the end of the accounting period (i.e., federal fiscal year) based on the actual food stamp issuance and net claims collections for prior years. The forecasting model draws its predictive power from the strong historical relationship between the level of Food Stamp Program benefit issuance and the level of recipient claims collections. Using the statistical technique know as generalized least squares, the relationship between Food Stamp Program issuance and claims collections can be estimated and then used to project future claims collection levels. Estimating the model over the period of FY 1985 through FY 1997, generates a coefficient of determination of 97.5%. The FY 1997 net collections projected by the model at the end of FY 1996 proved to be accurate within 2% of actual FY 1997 net collections. Because the expected cash flow from collections of such claims beyond one year is not expected to be material, FNS does not estimate collections after the initial year or discount the estimate produced by the statistical model to its present value.

This model methodology was used to estimate the allowance for loss and hence the bad debt expense. The revision to the allowance for loss accounting estimate has resulted in a $125 million dollar increase to the FY 1997 debt expense.

The allowance for doubtful accounts for all other types of receivables, both entity and non-entity is based on historical collection patterns. The analysis in FY 1997 decreased the estimate for account receivable allowance for doubtful accounts.

ACCOUNTS RECEIVABLE			
Category	**Gross Accounts Receivable**	**Allowance for Bad Debts**	**Net Accounts Receivable**
ENTITY ACCOUNTS RECEIVABLE			
Federal	849	12	837
Non-Federal	973,338	777,543	195,795
Total Entity Accounts Receivable	974,187	777,555	196,632
NON-ENTITY ACCOUNTS RECEIVABLE			
Federal	0	0	0
Non-Federal	37,281	1,501	35,780
Total Non-Entity Accounts Receivable	37,281	1,501	35,780
Grand Total Accounts Receivable	1,011,468	779,056	232,412

In accordance with program regulations, states are required to establish a “continuing performance reporting system” to monitor the Food Stamp Program. The Quality Control (QC) system is part of this effort and serves as a control for FNS' monitoring of certifications performed by state eligibility workers and to control program waste. At the end of the fiscal year each state agency's food stamp payment error rate is computed and compared to the error rate established by goals. If the state agency's error rate is in excess of goals, FNS will establish a QC liability. FNS initiates collection actions on the QC claims before the end of the fiscal year. However, as part of the QC reinvestment program, FNS can allow a state to invest in program improvements as an alternative to paying QC liabilities. Also, through the administrative appeals process, state agency's can appeal claims brought against the state agency to waive all or a portion of the claim. The Office of General counsel (OGC) has determined that it would not be appropriate to issue bills to state agencies with unresolved QC liabilities.

Consequently, FNS does not include QC liabilities in the accounts receivable until FNS has legal claim to the account receivable.

FNS does not receive information on QC liabilities for approximately 9 months after the end of the fiscal year. Therefore, current information on QC liabilities is not available for the FY 1997 financial statements. However, during Fiscal Years 1992-1996 there were 25 states that had QC liabilities amounting to $405,719. However, FNS waived $270,333 of these QC liabilities and reached settlement agreements in the amount of $135,386. Also, during this period upfront reinvestments amounted to $34,961. As of the FY 1997 financial statement audit the remaining $100,425 of the settlement agreement amount is considered contingent reinvestment.

E. Recognition of Financing Sources

FNS receives the majority of the funding it needs to support its programs through annual and multi-year appropriations. FNS also receives transfers of appropriated funds from two other Department of Agriculture bureaus, the Agricultural Marketing Service and the Farm Service Agency. (See Note 6, "Donated Commodities," for amounts transferred this fiscal year.) In addition, FNS receives transfers of food commodities which it donates to states for distribution to schools and other approved recipients. (See Note 6 for a description of current year donated commodities sources and amounts.) FNS uses these appropriations and transfers to fund operating expenses such as grants to states, as well as to fund other types of program expenditures for food stamp benefits and other types of food assistance.

FNS recognizes appropriations as revenues at the time they are used to pay program or administrative expenses. FNS recognizes appropriations expended for capitalized property or equipment as expenses when the assets are consumed in operations.

At the time grant awards are established, FNS records obligations for the full amount of expected program expenses as undelivered orders. Reductions in obligations occur as expenses are incurred by grantees. At year-end, the unused portions of grant awards are reclassified as unobligated balances and are shown on the statement of financial position as part of unexpended appropriations. Unobligated balances available for future periods are also shown as unexpended appropriations.

"Advances and Prepayments" represents advances to the Farm Service Agency for commodity purchases.

F. Funds with U. S. Treasury

FNS changed from the HHS Smartlink Payment Management System to the Treasury Automated Application for Payment System (ASAP). Commencing August 1995 FNS converted, on a state by state basis, all recipients which previously drew funds via HHS's LOC System to Treasury's ASAP system. As of September 30, 1997, all state agencies and Indian Tribal Organizations (ITO's) were converted to ASAP and are now drawing federal funds through Treasury's system.

FNS contracted with FRB, Richmond to serve as Account Management Agent (AMA) for operating the AMA system for electronic processing of Food Stamp Benefits through electronics benefit transfers (EBT). As the Account Management Agent, FRB, Richmond will monitor the operation of the AMA system. The state EBT contractor, known as processors report issuances to AMA. Obligations are incurred based on the issuances reflected in AMA and are passed to FNS' accounting system. Retailers are reimbursed for settlement amounts, which are also passed to the core accounting system.

Funds with U. S. Treasury consist of all unexpended balances on FNS accounts with the U.S. Treasury. As of September 30, 1997, the total outstanding fund balance was $19,527,962. Of this amount, $19,427,318 are entity funds, and $100,644 are classified as non-entity funds. The chart in Note 2, " Fund Balances with U.S. Treasury and Cash," reflects the status of the fund balance account.

G. Grants

FNS grant programs provide funds to states through a letter of credit process. This process allows the grantees to draw on established credit balances, as needed, to pay expenses associated with their grants. It also allows the federal government to hold funds until the grantees need the funds to pay program expenses. Each of FNS' regions is responsible for awarding and managing grants. In addition, the FNS regions authorize and monitor letters of credit cash needs. On a selective basis, FNS visits grantees and reviews the supporting data for the expenditure reports. In addition, FNS relies on audits of grantees performed by the USDA Office of Inspector General and independent auditors under the Single Audit Act, as amended.

H. Liability for Unredeemed Food Coupons

Food coupons are legal obligation instruments of the U.S. Government. FNS records a liability and related expense when notified by state agencies that they have issued coupons to recipients and records a reduction in liability when notified by the Federal Reserve Banks that they have redeemed coupons. The agency does not record in its general ledger or present on its financial statements a liability for the value of unissued food coupons which are carried as inventory by state agencies or by food coupon printers or which are in transit from printers to state inventory sites at the end of the reporting period. Those entities are responsible for maintaining coupon inventories in accordance with regulations and must indemnify FNS if inventory losses occur (see Note 4.C, "Commitments: Unredeemed and Unissued Food Coupons"). FNS records food coupon liabilities through monthly transfers of funds from the annual food stamp appropriation to the food stamp liability account, which is the account the Federal Reserve Banks charge as they redeem food coupons through the banking system. The balance in the food stamp liability account represents the value of unredeemed food coupons in the economy which are likely to be redeemed.

I. Inventories

FNS' inventories are comprised of small amounts of supplies that will be consumed in future operations and a non-material amount of food commodities not held for sale. Inventory is received and distributed using the first in/first out (FIFO) method to assure that the oldest product is used first. The inventory value represents the product held in storage based on the semi-annual physical count, with appropriate adjustments.

The food commodities represent items purchased with FNS appropriations and held for donation to states by the Farm Service Agency. The expenditures or expenses for product held in inventory are recognized for a specific program when the product is delivered to the state distributing agency. In accordance with USDA policy, FNS establishes a 100% allowance for loss on inventories held for donation at year end. Therefore, this item has a carrying value of zero and does not appear on the Statement of Financial Position.

J. Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent that current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

K. Retirement Plan

FNS employees participate in both the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). FNS makes matching contributions to the CSRS plan equal to 7 percent of pay, while contributions to the FERS plan are 11.4 percent of pay. For most employees hired since December 31, 1983, FNS also contributes the employer's matching share for Social Security. FERS went into effect pursuant to Public Law 99-335 on January 1, 1987. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. A primary feature of FERS is that it offers a savings plan to which FNS automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. FNS makes these and other contributions to employee retirement plans as shown in the following table:

FNS RETIREMENT CONTRIBUTIONS FOR FY 1997	
Type of Contribution	**Amount**
CSRS contributions	3,485
Transitional retirement contribution-Civil Service	179
FERS regular contributions	3,446
Thrift Savings Plan basic government contribution	297
TSP Matching contribution	1,014
Special Retirement Contribution (early out)	127
TOTAL	8,548

These contributions are reported as expenses in the Statement of Operations. FNS does not report CSRS and FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management's Federal Retirement System.

L. Contingencies

FNS is a party in various administrative proceedings, legal actions, and claims brought by or against it. In the opinion of FNS management and the Department of Agriculture's legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect FNS' financial position or results of operations for the current fiscal year.

M. Appropriations Expensed

Appropriations expensed is the amount of appropriations used during the current period to fund FNS' nutrition programs. This includes the food program administration (FPA) appropriation, which provides funds for salaries and administrative expenses.

Note 2. Fund Balances with U.S. Treasury and Cash

FUND BALANCES WITH THE U.S. TREASURY AND CASH			
Fund Balances with Treasury:	**Entity Assets**	**Non-Entity Assets**	**Total**
Trust Funds	0	0	0
Revolving Funds	0	0	0
Appropriated Funds	19,427,318	0	19,427,318
Other Fund Types	0	1,715	1,715
Other Fund Types: Food Stamp Redemption	0	98,929	98,929
Subtotal	19,427,318	100,644	19,527,962
Cash	0	0	0
Total	19,427,318	100,644	19,527,962

Note 3. Property, Plant, and Equipment, Net

Property and equipment are depreciated over their useful economic lives, which average 5-10 years, using the straight-line method. FNS owns no buildings or land. At year end, balances for Property, Plant, and Equipment were as follows:

PROPERTY, PLANT AND EQUIPMENT			
Classes of Fixed Assets	Acquisition Value	Accumulated Depreciation	Net Book Value
Furniture and Equipment	23,322	13,887	9,435

Note 4. Commitments

A. Undelivered Orders

FNS is committed under obligations it has incurred as of the fiscal year for goods and services which have been ordered but not yet received (undelivered orders). Aggregate undelivered orders amounted to $311,474 at year's end.

UNDELIVERED ORDERS	
Type	**Amount**
Advances	151,331
Contracts and Other	155,401
FPA	4,742
Total	311,474

B. Accounts Payable

The "Accounts Payable, Non-Federal" includes amounts for accounts payable at year's end for all grant programs and for food stamp benefits. The food stamp benefits payables include amounts for food coupon benefits, electronic benefits transfers (EBT), and food coupon shipping and printing.

FNS must estimate the accounts payable for current year grant obligations (other than obligations for coupon and EBT food stamp benefits) using a statistical model. This is because FNS does not know the exact amount needed by its grantees until the grant close out process is completed, which does not occur for 3-9 months after the end of the fiscal year, depending on the type of grant. At the end of the fiscal year, accounts payable and related obligations were adjusted downward by $271,617. This is the amount representative of the funds which will not be used by the grantees and will be deobligated as part of the grant close out process the following fiscal year. The downward adjustment made to the current period accounts payable is based upon the historical relationship between initial (September 30) grant account balances and the final grant account balances produced through the closeout process. Adjustments are made on an account specific basis. Each adjustment factor is based on an analysis of the most recent five years of account data. In this analysis, the initial (September 30) grant account balances and the final grant account balances were compared. A downward adjustment factor was calculated for each account and each year. Average factors, over the five years in the data set, were developed for each account. These average factors are then the basis for the adjustments to the current period accounts. Analysis of this estimating methodology indicates that, in aggregate, the projection will be accurate within 1.00%.

C. Unredeemed and Unissued Food Coupons

As discussed in Note 1.H, "Summary of Significant Accounting Policies: Liability for Unredeemed Food Coupons," FNS records a liability for the value of issued food coupons. FNS is also contingently liable for the value of all food coupons which have been produced but not yet issued. The value of food coupons in inventory at year end was $10,035,597. This includes $333,780 in unissued and unredeemed 1998 series coupons. Such food coupons are under the control of the companies which produce, distribute, and transport the coupons, as well as the states who control the inventories of food coupons available for issuance. Although FNS is indemnified for unaccounted food coupons by these companies, FNS must honor all redeemed food coupons. The Food Stamp Program is administered primarily by the states, in accordance with federal regulations. Monthly food coupon allotments are computed by the states' department of human services using standards for eligibility promulgated by FNS.

To assure that the supplies of food coupons are sufficient to meet monthly issuance amounts, states maintain several months' supply of food coupons in inventory. As participants in the administration of the food stamp program, states are responsible for the value of food coupons held under their control. State officials may manage inventory points directly or may enlist the services of private companies to provide storage and transportation services. Private companies indemnify the states and FNS against the value of any lost coupons. States regularly report inventory balances, issuance amounts, and transfer and shipping information to FNS regional offices. FNS regional offices routinely review state operations to assure that food coupons are adequately safeguarded and that the food stamp program is properly managed. In addition to state oversight by FNS Regional Offices, FNS maintains additional oversight operations to assure that the food stamp program is operating in compliance with relevant laws and regulations. For example, FNS compliance branch personnel review retailers participating in the food stamp program to determine that only eligible food items are exchanged for food coupons.

Food coupons are produced by one or more independent printing companies under contract with FNS. Throughout the production and shipment process, all food coupons are the responsibility of the printing, distribution, and shipping companies. FNS authorizes all production amounts and directly oversees the production process to assure that quality production standards are met and that all authorized food coupons are adequately accounted for and safeguarded. FNS relies on the cooperation of retailers, commercial banks, and the Federal Reserve Banks to adequately control the process for redeeming negotiated food coupons. FNS policies require retailers and commercial banks to cancel food coupons upon receipt to guard against food coupons being redeemed more than once. Federal Reserve Banks additionally cancel all food coupons that have been presented by commercial banks. All coupons presented by commercial banks to the Federal Reserve Banks are counted for accuracy, inspected for authenticity, and destroyed to prevent recirculation through the banking system.

D. Other Liabilities

OTHER LIABILITIES			
Description	**Current**	**Non-Current**	**Total**
Other funded liabilities, non-Federal	0	0	0
Total funded liabilities, non-Federal	0	0	0
Other funded liabilities, Federal	0	0	0
Total Liabilities covered by budgetary resources	0	0	0
Canceled Year Account Payables	0	1,120	1,120
Total Liabilities not covered by budgetary resources	0	0	0
Grand Total other liabilities	0	1,120	1,120

Note 5. Equity of the U.S. Government and Net Position

Equity of the U.S. Government consists of unexpended appropriations, invested capital, and the cumulative results of operations. "Unexpended Appropriations" include the undelivered orders and unobligated balances of the FNS appropriated funds. "Invested Capital" includes the net book value of FNS' capitalized property and equipment.

Obligations and advances of appropriated funds are recorded as undelivered orders. Undelivered orders amounted to $311,474 for the current year; of this amount, advances totaled $151,331. Undelivered orders are relieved by either an expenditure or an obligation cancellation. Appropriated funds which are not obligated are included in the Unexpended Appropriations on the Statement of Financial Position; these totaled $17,898,145 as of the end of the fiscal year. At the end of the fiscal year, certain multi-year appropriations which have unobligated balances remained available to FNS for obligations in future periods. Unobligated appropriations are available for obligational authority for a particular appropriation year until that appropriation is canceled.

EQUITY OF THE U.S. GOVERNMENT AND NET POSITION				
Category	**Revolving Funds**	**Trust Funds**	**Appropriated Funds**	**Totals**
A. Unexpended Appropriations:				
(1) Unobligated				
(a) Available	0	0	812,190	812,190
(b) Unavailable[1]	0	0	16,774,482	16,774,482
(2) Undelivered orders	0	0	311,474	311,474
(3) Invested Capital	0	0	9,435	9,435
Total Equity	0	0	17,907,581	17,907,581
Future Funding Requirements	0	0	15,029	15,029
Total Net Position	0	0	17,892,552	17,892,552

[1] Beginning in fiscal year 1991, Congress has appropriated a reserve as part of the annual one-year food stamp appropriation. These funds are available for use only in the year appropriated, but remain available for legitimate obligations of the period and are considered part of unexpended appropriations. The following table shows the amount of food stamp appropriation reserve by fiscal year:

FOOD STAMP APPROPRIATION RESERVE FUNDING		
Fiscal Year	**Total Reserve Amount**	**Unused Reserve Amount**
1992	1,500,000	0
1993	2,500,000	2,500,000
1994	2,500,000	2,500,000
1995	2,500,000	2,500,000
1996	500,000	500,000
1997	100,000	100,000
Total	9,600,000	8,100,000

Note 6. Donated Commodities

During the fiscal year, FNS distributed over $916 million in commodities, primarily through its CN programs, Commodity Assistance Programs, the Food Distribution Program on Indian Reservations, and the Nutrition Program for the Elderly. FNS acquires these commodities by purchase, using its own appropriations, and by intra-departmental transfer at no charge to FNS from FSA and AMS. These commodities are an integral part of FNS' mission and programs. Generally accepted accounting principles and OMB Bulletin 94-01 require that the entire cost of these commodities and their related financing sources be recognized. Therefore, the current year statements recognize the transfer of food commodities and the related expense of $456,029. FNS also received $5.4 billion from AMS as appropriation authority to fund the CN Programs. At year end, commodities in inventory totaled $14,845.

The following schedule provides details on the estimated commodities distributed by FNS by source and program for the current fiscal year:

FOOD AND NUTRITION SERVICE COMMODITIES DISTRIBUTED BY SOURCE AND PROGRAM			
Transferred from		**Purchased by**	**Total**
AMS	**FSA**	**FNS**	
454,957	1,072	460,443	916,472

Although overall authority to distribute these commodities to eligible recipients rests with FNS, FNS delegates this responsibility to the state and local governments, which are required to maintain complete and accurate records on the receipt, disposal, and inventory of the commodities and to provide FNS with monthly inventory reports. However, legal title to these commodities passes when the commodities have been delivered to states.

Note 7. Non-Operating Changes

The amount reflected on the Statement of Operations and on the table below represents the change in the account balance from the previous year for the items listed.

NON-OPERATING CHANGES	
Category	**Amount**
A. Increases:	
(1) Transfers-In:	
(a) Net change in unexpended balances	3,742,485
(2) Invested Capital	694
Total Increases	3,743,179
B. Decreases:	
(1) Transfers-Out	
(a) Future Financing Sources	1,658
(2) Other decreases	0
Total Decreases	1,658
C. Net Operating Changes	3,741,521

D. Other Information: Beginning in fiscal year 1991, Congress has appropriated a reserve as part of the annual one-year food stamp appropriation. These funds are available for use only in the year appropriated, but remain available for obligation and are considered part of unexpended appropriations. As of the end of FY 1997, $.1 billion of the amount reported on line A.(1)(a), "Net change in unexpended balances," represents food stamp appropriation reserve. See Note 5, "Equity of the U.S. Government," for more information about the food stamp appropriation reserve.

Note 8: Operating/Program Expense

The following table presents "Operating/Program Expenses" by OMB object classification. This categorization of operating/program expense does not include those items listed separately on the financial statements.

OPERATING PROGRAM EXPENSE BY OBJECT CLASS	
Object Classification	**Amount**
Personnel Services and Benefits	115,621
Travel and Transportation	5,102
Rent, Communications, and Utilities	2,281
Printing and Reproduction	22,336
Supplies and Materials	474,551
Equipment Not Capitalized	1,119
Grants, Subsidies, and Contributions	35,148,109
State Option Food Stamp Program	4,681
Insurance Claims and Indemnities	0
SUBTOTAL	35,773,800
Other Services	33,744
TOTAL	35,807,544