

March 1989

FINANCIAL AUDIT

Food and Nutrition
Service's Financial
Statements for 1987





United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-223263

March 15, 1989

The Honorable Peter C. Myers
Acting Secretary of Agriculture

Dear Mr. Secretary:

This report presents the results of our examination of the financial statements of the Food and Nutrition Service (FNS) for the fiscal year ended September 30, 1987. Our report describes restrictions on the scope of our examination, the result of which was to limit our opinion to FNS' statement of financial position as of September 30, 1987. This is the first year that FNS' financial statements have been subjected to an audit in accordance with generally accepted government auditing standards. The report contains separate reports on FNS' system of internal accounting controls and on its compliance with laws and regulations.

The report on FNS' system of internal accounting controls discloses two material weaknesses. First, FNS does not record the value of (1) undeliverable food coupons that are returned to inventory and (2) coupons which actual experience indicates are never redeemed. This practice results in overstatements of both yearly food stamp expense amounts and the corresponding liability for unredeemed food coupons. Because the financial statements have been adjusted by \$477 million to more accurately reflect these amounts, this weakness did not affect our opinion on the statements. Second, due to weaknesses in FNS' system of internal accounting controls, FNS could not rely on its general ledger as the basis for preparing its external reports, such as the annual financial statements FNS is required to submit to Treasury.

Our report on compliance with laws and regulations discloses that FNS complied with the provisions of laws and regulations for the transactions we tested which could have materially affected its financial statements.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

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Sincerely y

A handwritten signature in black ink, appearing to read "Frederick I.", written in a cursive style.

Frederick I
Assistant C

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Abbreviations

FNS	Food and Nutrition Service
GAO	General Accounting Office
IG	inspector general
OMB	Office of Management and Budget
USDA	Department of Agriculture

**Accounting and Financial
Management Division**

B-223263

To the Administrator
Food and Nutrition Service

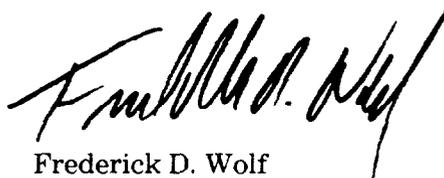
We have examined the accompanying statement of financial position of the Food and Nutrition Service (FNS), an agency of the Department of Agriculture, as of September 30, 1987, and the related statements of operations and changes in equity and funds with U.S. Treasury for the fiscal year then ended. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except as indicated in the following paragraph. This is the first year that FNS' financial statements have been subjected to an audit in accordance with generally accepted government auditing standards. In addition to this report on our examination of FNS' financial statements for fiscal year 1987, we are also reporting on our study and evaluation of FNS' internal accounting controls and on its compliance with laws and regulations. During our examination, we identified matters which do not affect the fair presentation of the financial statements but nonetheless warrant management's attention. We are reporting on them separately to FNS.

Since certain information with respect to opening balances of net accounts receivable, accounts payable, and unredeemed food coupons was not readily available, it was not practical for us to determine the reasonableness of those opening balances as of October 1, 1986, or whether the related amounts of revenue and expenses were recorded in the proper period. Accordingly, we do not express an opinion on the accompanying statements of operations and of changes in equity and funds with U.S. Treasury for the fiscal year ended September 30, 1987, or on the consistency of application of accounting principles with the preceding year.

As further discussed in our report on internal accounting controls, we determined that FNS' accounting system did not provide an accurate basis for financial information and, consequently, was not used to prepare its external financial reports, as required by title 2 of GAO's Policy and Procedures Manual For Guidance of Federal Agencies. Although this is a significant internal control weakness, it did not preclude us from issuing an opinion on the statement of financial position as of September 30, 1987. In addition, we found that the food stamp program expenses and the liability for unredeemed food coupons were overstated. As discussed in note 4 to the financial statements, for several years the amount of food coupons recorded as issued has exceeded the

amount of food coupons redeemed, thus resulting in a continuous growth in the liability for unredeemed food coupons. Two factors contributed to this overstatement. FNS did not reduce the liability for unredeemed food coupons by an amount equal to (1) the value of food coupons that are undeliverable and returned to inventory and (2) the value of food coupons which actual experience indicates are never redeemed. To address this overstatement, FNS reduced the liability for unredeemed food coupons by \$477 million, resulting in a corresponding increase in amounts due the U.S. Treasury. The events which contributed to this adjustment had taken place over a number of years, and it was not practical for FNS to determine the period or periods to which the adjustment should be applied. As a result, FNS included the entire amount of the adjustment in the statement of operations for the current year.

In our opinion, the accompanying statement of financial position presents fairly the financial position of the Food and Nutrition Service as of September 30, 1987, in conformity with generally accepted accounting principles for federal agencies.



Frederick D. Wolf
Director

June 1, 1988

Report on Internal Accounting Controls

We have examined the financial statements of the Food and Nutrition Service (FNS) for the fiscal year ended September 30, 1987, and have issued our report thereon. This report pertains only to our study and evaluation of the system of internal accounting controls for the fiscal year ended September 30, 1987.

As part of our examination, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the agency's financial statements. For the purpose of this report, we have classified the significant internal accounting controls into the following categories:

- food coupon issuance,
- food coupon inventory control,
- food coupon production and distribution,
- food coupon redemptions,
- grants/disbursements,
- payroll,
- budget,
- accounts receivable, and
- financial reporting.

Our study and evaluation included all of the control categories listed above except for the accounts receivable and financial reporting categories. For those two categories, we relied on substantive audit tests because recently issued GAO and Department of Agriculture Inspector General (USDA IG) reports identified accounting and internal control weaknesses which would have made it impractical to rely on these control systems. For each of the other categories, we also performed audit tests to substantiate the balances of accounts associated with the respective control category. Substantive audit tests can also serve to identify weaknesses within the system of internal accounting controls that could result in errors material to the financial statements taken as a whole.

FNS' management is responsible for establishing and maintaining a system of internal accounting controls in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related

costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over agency assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

FNS evaluated its system of internal accounting and administrative controls in accordance with the Federal Managers' Financial Integrity Act of 1982. FNS reported to the Secretary of Agriculture in November 1987, that its internal control system in effect during fiscal year 1987, taken as a whole, provided reasonable assurance that FNS' objectives were achieved within the limits described in the preceding paragraph. That report also identified a number of items that warranted corrective actions, stated what corrective actions had been taken or were being taken on previously or currently reported items, and indicated the completion or expected completion dates.

In a report entitled, Internal Controls: Food and Nutrition Service Lacks Effective Controls (GAO/AFMD-88-16, March 18, 1988), we identified several serious, fundamental internal accounting control weaknesses. Not all of the weaknesses identified in that report have been resolved. For example, as discussed in more detail below, FNS does not use its general ledger as the basis for preparing its external financial reports. We reviewed and considered all weaknesses identified in this and other GAO reports, FNS' statement on the adequacy of its controls, and the USDA IG report on FNS management of its various operations to determine the nature, timing, and extent of our audit procedures.

Our study and evaluation, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on FNS' system of internal controls taken as a whole or on the categories of controls identified in the second paragraph. However, during our study and evaluation, we identified two internal accounting control weaknesses

which we believe could result in errors or irregularities in amounts that are material in relation to FNS' financial statements which may not be promptly detected and corrected. The first involves accounting for undeliverable food coupons returned to inventory. The second is the accuracy of general ledger accounts which form the basis for preparing external financial reports. The results of our evaluation are described in detail in the following sections.

FNS Does Not Record Accounting Entries for Undeliverable Food Coupons Returned to Inventory

Our testing revealed material weaknesses in accounting for undeliverable food coupons returned to inventory. One of the primary food coupon issuance methods is through the mail. Food coupons mailed to recipients, however, cannot always be delivered and, consequently, are returned to the issuance points. When the coupons are returned to inventory, they must, according to agency regulations, be reported on the Food Coupon Accountability Report (FNS-250) as a return and an increase in ending food coupon inventory.

Reporting the increase in ending inventory on the FNS-250 report is required so that the reported inventory balance at month-end agrees with the results of the physical inventory at the issuance point, as required by FNS procedures. In order to maintain accurate issuance records, FNS would need to adjust the benefits issued and the related liability by the value of undeliverable coupons. We found, however, that in most cases, these adjusting entries were not made. Consequently, the food stamp program expense and related liability accounts were overstated by the value of issuance returns received in the mail.

Currently, 43 states distribute all or part of their food coupons by mail. Systemwide, over \$3.3 billion in food stamp benefits are issued by mail per year. Our review of the operations of 15 judgmentally selected mail issuance points showed that only 1 had adjusted its monthly FNS-250 reports for the amount of undeliverable coupons so as to prevent an overstatement of expenses and liabilities. Officials at that issuance point told us that they had reduced their issuance totals to take into account returned coupons and consequently accurately reflect program benefits issued. FNS regional offices and headquarters personnel did not know how many issuance points adjusted their reports in this manner. Thus, not knowing if the reporting of mail issuance returns was done uniformly, FNS could neither rely on the totals reported by issuance points, nor use a uniform procedure to adjust the benefits issued and related liability accounts.

Office of Management and Budget (OMB) Circular A-34 requires agencies to review the balances in their liability accounts at the end of each fiscal year and determine that the amount reported represents obligations supported by documentary evidence. Over the past several years, FNS officials have reported that the obligation related to the unredeemed food stamp liability was accurate, even though they were aware that the liability was probably overstated. The liability has grown from \$320 million in 1984 to \$549 million in 1987, prior to adjustment. This represents an increase of 70 percent, with virtually no significant growth in program benefits over the same period. FNS officials told us that they had not reduced the liability because they were not certain what factors were inflating the balance.

In order to assess whether the liability for unredeemed coupons was reasonable, as part of our substantive testing, we developed data on the approximate time between when food coupons were issued and when they were presented to the Federal Reserve Banks for reimbursement. Our testing of about 1,000 randomly selected coupons showed that food coupons were generally redeemed within 6 months. Consequently, we concluded that delays in using and processing the coupons could not be a major cause in the buildup of the liability. This information and other analyses of coupon issuance and redemption trends suggest that coupons are used quickly. Based on our testing, FNS reduced the related liability balance by \$477 million (from \$549 million to \$72 million). The \$72 million represents the increase in the liability account over the last 6 months of fiscal year 1987 and thus is a reasonable ceiling on the amount of the liability, given the results of our substantive audit testing.

**FNS Does Not Use Its
General Ledger to Prepare
External Financial Reports**

Title 2 of GAO's Policy and Procedures Manual For Guidance of Federal Agencies requires federal agencies to prepare their external financial reports from a budget and accounting system which is an integral part of the agency's overall management accounting system. FNS cannot rely on the data from its accounting system as the basis for its financial reports because information in its general ledger is inaccurate and cannot be reconciled to supporting subsystem balances. As discussed in more detail below, some accounting entries are not recorded in the accounting system. We reported this and other internal control and accounting system problems last year (GAO/AFMD-88-16, March 18, 1988).

This problem occurred because FNS did not effectively use its Financial Accounting and Reporting System. Specifically, the system was not used

to (1) summarize totals for account balances, (2) record entries to properly reflect outstanding year-end liabilities, and (3) review accounts to detect erroneous data, such as an understated cash balance of \$7 billion.

In preparing its financial reports, FNS relied on several alternative sources. For example, the amounts reported as funds available with Treasury came from information contained in reports provided to the agency from the Department of the Treasury. The year-end balance for accounts receivable was derived from a management report produced by a system separate from the budget and accounting system.

Even though FNS relied upon alternative sources of information as the basis for preparing its external reports, we were able to determine the reliability of the information used through our substantive audit tests. For example, we tested to determine whether accounts receivable balances were reasonable by reviewing reports which detail the accounts receivable balance and activity. These reports are sent to FNS from the responsible state agencies. FNS adjusted its recorded receivable balance based on differences identified by the above audit tests.

We also reviewed obligations outstanding at September 30, 1987, to identify those for which goods or services had been received by year-end. FNS then recorded this amount as accounts payable as of September 30, 1987. The agency has adjusted the financial statements and its accounting records for the effect of these and other problems identified by our substantive testing.

Conclusions

Although we were able to audit FNS' financial statements by performing additional substantive testing rather than relying on the system of internal accounting controls, many improvements are needed to generate reliable accounting data. They include efforts to obtain uniform reporting of issuance activity and to make routine accounting entries to reflect actual program benefits in the proper periods. After the automated accounting system is updated and provides accurate financial data, FNS' general ledger should serve as its basis for all external financial reporting.

Recommendations

To correct these weaknesses, we recommend that the Secretary of Agriculture direct the Administrator of FNS to do the following:

- Determine whether all issuance points are properly reporting food coupons returned to inventory on the FNS-250 reports and direct those who are not properly reporting them to do so.
- Reduce the food stamp expense and unredeemed food coupon liability accounts for the value of the coupons returned to inventory, as reported by the issuance points.
- Reconcile account balances to the relevant supporting documentation, such as Treasury account balances, and to supporting subsystem balances, such as the accounts receivable subsystem balance. Adjusting entries resulting from this reconciliation process should be recorded promptly.
- Record all relevant accounting transactions, such as year-end liability accruals, in the accounting system.

Completion of the above actions will result in more reliable data, enabling FNS to use its accounting system as the basis for preparing all external financial reports.

We further recommend that the two internal control weaknesses that we have disclosed be included in the next FNS Financial Integrity Act report.

Other Opportunities for Improvement

During the course of our examination, we identified several other weaknesses in internal accounting controls and procedures which, although not material to the FNS financial statements, merit corrective action. Accordingly, we are reporting them separately to the Administrator of FNS.

Agency Comments

We provided FNS officials with a draft of this report to which they responded. The agency generally agrees with our findings but would like us to acknowledge corrective actions that have been taken to date. Regarding the use of the general ledger to prepare its external financial reports, FNS' Administrator has directed resources and expertise toward correcting data in the general ledger and those systemic weaknesses which permitted inaccurate or incomplete data to be entered into the general ledger. As a result, FNS expects to use its general ledger to prepare all external reports beginning in November 1988. Additionally, FNS has begun development of a new, integrated financial management system to replace the current, automated core accounting system. The

agency believes that the new system will improve the overall efficiency, accuracy, and timeliness of accounting data.

In response to our finding that FNS does not properly account for undeliverable food coupons returned to inventory, FNS stated that one of its task force reports issued in July 1988 recommended revised reporting requirements to address food stamp internal control and reporting system weaknesses.

We recognize that FNS has been diligently working to correct the weaknesses we identified. However, the corrective actions have not been fully implemented, and, consequently, their results have not yet been evaluated. We will continue to monitor and evaluate these actions during our examination of FNS' financial statements for fiscal year 1988.

Report on Compliance With Laws and Regulations

We have examined the financial statements of the Food and Nutrition Service (FNS) for the fiscal year ended September 30, 1987, and have issued our report thereon. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances.

Our review of compliance with laws and regulations, made for the limited purpose described in the preceding paragraph, does not necessarily cover all laws and regulations which FNS is required to comply with. Accordingly, we are expressing an opinion only with respect to the transactions tested. In our opinion, FNS complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements.

In connection with our examination, nothing came to our attention that caused us to believe that FNS was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

Financial Statements

Statement of Financial Position

As of September 30, 1987
(Dollars in thousands)

Assets:

Funds with U.S. Treasury (note 7)	\$1,832,810
Accounts receivable, net of allowance for doubtful accounts of \$202,956	155,021
Property, plant, and equipment, net of accumulated depreciation of \$2,462	<u>966</u>
Total Assets	<u>\$1,988,797</u>

Liabilities:

Accounts payable, principally to grantees	\$1,203,656
Amounts due Treasury	633,171
Unredeemed food coupons (note 3)	72,148
Other liabilities	<u>2,477</u>
Total Liabilities	<u>1,911,452</u>

Equity of the U.S. Government:

Unexpended appropriations (note 8)	76,379
Invested capital	<u>966</u>
Total Equity of the U.S. Government	<u>77,345</u>

Total Liabilities and Equity	<u>\$1,988,797</u>
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The accompanying notes are an integral part of these financial statements.

Financial Statements

Statement of Operations

For the Fiscal Year Ended September 30, 1987
(Dollars in thousands)

Financing Sources:		
Appropriations and financing sources recognized		\$19,565,141
Reimbursements earned and other		<u>1,047</u>
Total Financing Sources		<u>19,566,188</u>
Operating Expenses:		
Grants and subsidies:		
Food Stamp program	\$12,482,266	
Child Nutrition programs	4,642,591	
Other programs	<u>2,009,674</u>	19,134,531
Bad debt expense		202,956
Supplies and materials		154,826
Salaries and benefits		74,465
Other expenses		<u>63,866</u>
Total Operating Expenses		<u>19,630,644</u>
Operating Expenses in Excess of Financing Sources Before Correction of Estimate		(64,456)
Correction of Estimate of Unredeemed Food Coupons (note 4)		<u>477,407</u>
Excess of Financing Sources over Operating Expenses After Correction of Estimate		<u>\$ 412,951</u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

Statement of Changes in Equity

For the Fiscal Year Ended September 30, 1987
(Dollars in thousands)

	<u>Unexpended Appropriation</u>	<u>Invested Capital</u>	<u>Cumulative Results of Operations</u>	<u>Total</u>
Balance, 10-1-86	\$ 908,750	\$1,055	\$ 102,873	\$1,012,678
Supplemental Appropriation for FY 1986 Expenses (Note 5)	<u>0</u>	<u>0</u>	<u>117,347</u>	<u>117,347</u>
Balance After Supplemental Appropriation	908,750	1,055	220,220	1,130,025
Excess of Financing Sources Over Operating Expenses For FY 1987	0	0	412,951	412,951
Excess Financing Sources Due to Treasury:				
FY 1986	0	0	(220,220)	(220,220)
FY 1987	0	0	(412,951)	(412,951)
Decrease in Unexpended Appropriations (Note 8)	(832,371)	0	0	(832,371)
Capital Acquisition	0	366	0	366
Current Year Depreciation	<u>0</u>	<u>(455)</u>	<u>0</u>	<u>(455)</u>
Balance, 9-30-87	\$ <u>76,379</u>	\$ <u>966</u>	\$ <u>0</u>	\$ <u>77,345</u>

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Funds With U.S. Treasury

For the Fiscal Year Ended September 30, 1987
 Increase (Decrease) in Funds
 (Dollars in thousands)

Appropriations Received		\$ 19,058,570
Funds Returned to U.S. Treasury:		
Prior year	\$ (27,892)	
Current year	(180,806)	(208,698)
Outlays:		
Grant payments	\$ (7,964,831)	
Reimbursements to Federal Reserve Banks for food stamp redemptions	(10,415,563)	
Administrative and other expenditures	(78,126)	
Collections on accounts receivable	17,018	(18,441,502)
Increase in Funds with U.S. Treasury		408,370
Funds with U.S. Treasury:		
Beginning of Year		<u>1,424,440</u>
End of Year		<u>\$ 1,832,810</u>

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Entity and Basis of Accounting

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 eight food assistance programs; Food Stamp Program, Child Nutrition Programs, Special Milk Program, Special Supplemental Food Program for Women, Infants, and Children, Commodity Supplemental Food Program, Cash and Commodities for Selected Groups, Nutrition Assistance for Puerto Rico and the Temporary Emergency Food Assistance Program. The food assistance 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. Each year these programs serve approximately 38 million recipients.

FNS is under the jurisdiction of the Assistant Secretary for Food and Consumer Services. FNS is headed by an administrator with overall policy formulated in the FNS headquarters in Alexandria, Virginia and implemented through 7 regional offices and 75 field offices. At the state level, 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.

FNS maintains eight appropriation funds. The financial statements include all funds for which the FNS is responsible and are intended to comply with accounting principles prescribed by Title 2 of the GAO's Policy and Procedures Manual for Guidance of Federal Agencies. All significant intra-fund balances and transactions have been eliminated.

B. Accounts Receivable

Accounts receivable represent principally claims against individuals who have been overissued food stamp benefits. States are responsible for identifying instances of over-issuance as well as processing related billings and pursuing collections. Periodically, states report summary

information to the FNS Regional Offices on the status of the claims and remit collections of past due amounts. To encourage aggressive collection efforts, FNS permits the states to retain a percentage of the amounts collected for certain categories of over-issuances. FNS records collection expense amounts when collections take place. All accounts receivable are shown net of an allowance for doubtful accounts. During 1987 FNS began the practice of reviewing the history of collections as the basis for determining the allowance for doubtful accounts. Because FNS performed its review at the end of fiscal year 1987, it was not possible to determine which portion of the 1987 bad debt expense should have been recorded in prior years. This review resulted in recording bad debt expense in the 1987 financial statements which should have been recorded in prior years' financial statements.

Net proceeds for the collections of accounts receivable are required to be remitted to the U.S. Treasury, and accordingly, FNS establishes a liability to Treasury for the amount of expected collections.

C. Recognition of Financing Sources

Financing sources are provided through Congressional appropriations on both an annual and multiyear basis. They may be used to fund operating expenses such as equipment, as well as program expenditures for food stamp benefits, grants, and other types of food assistance, as specified by law.

The current budgetary process does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of budgetary resources (outlays) as paid. For financial reporting purposes under accrual accounting, however, operating expenses are recognized currently while expenditures for capital assets are capitalized and are not recognized as expenses until they are consumed in FNS' operations. Financing sources for these expenses, which derive both from current and prior year appropriations, are recognized on these same bases.

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 portion of grant awards is shown on the statement of financial position as unexpended appropriations. Unobligated balances available for future periods are also shown as unexpended appropriations.

D. 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 and approve individual cash draws. The grant expenses recorded on the statement of operations are based on expenditure reports submitted by the grantees. FNS reviews the reports for reasonableness and uses a computer edit to verify the mathematical accuracy of the reports. 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 USDA/OIG and independent auditors under the Single Audit Act.

E. Liability for Unredeemed Food Coupons

FNS is liable for the unredeemed food coupons issued since the inception of the Food Stamp Program. Consequently, a liability is recorded when food coupons are issued to the recipients and reduced when redeemed. The agency does not record the redemption value of food coupons as inventory in the financial statements. Food coupons are recorded as expenses and related liabilities at the time they are issued. Although all food coupons presented to an approved retailer must be honored, FNS management believes that, based on actual experience, food coupons unredeemed after six months will not be redeemed.

F. Amounts Due Treasury

Amounts Due Treasury include expected collections on accounts receivable and funds no longer needed to satisfy the unredeemed food coupons liability.

Note 2. Intragovernmental Financial Activities

FNS' financial activities interact with and are dependent upon those of the federal government as a whole. Thus, FNS' financial statements do not reflect the results of all financial decisions and activities applicable to it, as if it were a stand-alone entity.

FNS' financial statements are not intended to report the agency's proportionate share of the federal deficit or of

public borrowing, including interest thereon. Financing for budget appropriations reported on FNS' statement of operations could derive from tax revenues or public borrowing or both; the ultimate source of this financing, whether it be tax revenues or public borrowing, has not been specifically allocated to FNS.

During fiscal year 1987, the majority of FNS' employees participated in the contributory Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS), to which FNS made matching contributions. Such contributions amounted to approximately \$4,885,000 for fiscal year 1987 and are reported as expenses in the statement of operations. FNS does not, however, report CSRS and FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees since this data is only reported in total by the Office of Personnel Management.

Note 3. Commitments and Contingencies

A. Undelivered Orders

FNS is committed under obligations it has incurred as of September 30, 1987, for goods and services which have been ordered but not yet received (undelivered orders). Aggregate undelivered orders amounted to \$45,157,000 at September 30, 1987.

B. Unredeemed and Unissued Food Coupons

As discussed in Note 1, 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. 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 for food coupons by these companies, they must honor all redeemed food coupons. As of September 30, 1987, unissued food coupons amounted to approximately \$7,525,000,000.

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 month's supply of food coupons in inventory. The total value of food coupons available for issuance and held under state control as of September 30, 1987, was \$3,462,000,000. As participants in the Food Stamp Program administration, 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 two independent printing companies under contract with FNS. As of September 30, 1987, the value of food coupons held at the printing companies awaiting shipment to the states was \$4,063,000,000. 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 the commercial banks to the Federal Reserve Banks are counted for accuracy, inspected for authenticity, and destroyed to prevent recirculation through the banking system.

Note 4. Correction of Estimate for Unredeemed Food Coupons

The adjustment of the unredeemed food coupon liability at September 30, 1987, reduced an overstatement that had developed over several years. Contributing to the overstatement was the practice by FNS of not recording as reductions to food stamp program expenses and unredeemed food coupons, the value of coupons returned as undeliverable through the mail. The effect of this practice was to create and maintain a balance in the unredeemed food coupons account higher than the value of food stamps actually redeemed. FNS also believes that a number of food stamps are lost or destroyed after issuance and, therefore, will never be redeemed. Both conditions contributed to the continuous growth of the unredeemed food coupon liability.

To rectify the overstatement, FNS reduced the unredeemed food coupon liability by approximately \$477,000,000, which caused financing sources to exceed expenses in the current year by approximately \$413,000,000. Because the amount of the overstatement pertaining to the current year could not be distinguished from the amounts pertaining to prior years, the full amount of the adjustment was recognized in the current year. Consequently the effect on prior year government equity was not determinable.

Note 5. Supplemental Appropriation for Child Nutrition Program

During 1986 grantees of the Child Nutrition Program incurred approximately \$117,000,000 of expenses in excess of appropriations. During fiscal 1987 FNS received a supplemental appropriation to cover the prior years' expense. In presenting the 1987 financial statements, the appropriation was recorded as an increase to cumulative results of operations.

Note 6. Statement of Reconciliation to Budget Reports

The following schedule reconciles total expenses, as reported in the statement of operations, with outlays, as reported in the Office of Management and Budget Report, SF-133, Report on Budget Execution, for the fiscal year ended September 30, 1987 (dollars in thousands).

Total Operating Expenses		\$19,630,644
Budgetary Outlays Not Included as Expenses:		
Capital Expenditures		366
Items Not Requiring Outlays:		
Bad Debt Expense	\$ (202,956)	
Net Increase in Accounts Payable	(1,086,663)	
Excess of Reserve for Food Coupon Redemptions Over Reimbursements to Federal Reserve Banks	(40,850)	
Depreciation and Other	<u>(457)</u>	(1,330,926)
Other Items Not Affecting Outlays:		
Receivables Offsetting Expenses	\$ 137,579	
Debit Vouchers Not Processed by U.S. Treasury	<u>3,839</u>	<u>141,418</u>
Outlays		<u>\$18,441,502</u>

Note 7. Funds with U.S. Treasury

Funds with U.S. Treasury consist of all unexpended balances on the FNS accounts with the U.S. Treasury. As of September 30, 1987, funds available to pay outstanding obligations amounted to \$1,323,000,000. The remaining balance includes amounts due Treasury and amounts available until expended or obligational authority lapses.

Note 8. Unexpended Appropriations

The following schedule details the changes in unexpended appropriations for the fiscal year ended September 30, 1987 (dollars in thousands)

	Fiscal Year 1987 <u>Appropriations</u>	Unexpended Appropriations		
		<u>Undelivered Orders</u>	<u>Unobligated Balances</u>	<u>Total</u>
Beginning Balance October 1, 1986		\$ <u>898,784</u>	\$ <u>9,966</u>	\$ <u>908,750</u>
Changes in Beginning Balances:				
Expenses Charged Against Prior Year Appropriations		(870,892)	(10,211)	(881,103)
Funds Withdrawn		(27,892)		(27,892)
Changes Attributed to FY 1987 Appropriations:				
FY 1987 Appropriations	\$ 19,058,570			
Expenses Charged Against FY 1987 Appropriations	(18,801,385)			
Unliquidated Obligations as of September 30, 1987	(45,157)	45,157		45,157
Unobligated 1987 Appropriations	(31,222)		31,222	31,222
Funds Withdrawn	(180,806)			
Treasury Funds Restored			<u>245</u>	<u>245</u>
(Decrease) in Unexpended Appropriations		(<u>853,627</u>)	<u>21,256</u>	(<u>832,371</u>)
Ending Balance September 30, 1987		\$ <u>45,157</u>	\$ <u>31,222</u>	\$ <u>76,379</u>

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