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Office of Inspector General
Southeast Region
Audit Report

RISK MANAGEMENT AGENCY
CROP INSURANCE FOR SPECIALTY
CROPS
Crop-Years 1996 Through 1998



Report No.
05601-4-At
March 2001

EXECUTIVE SUMMARY

RISK MANAGEMENT AGENCY CROP INSURANCE FOR SPECIALTY CROPS CROP-YEARS 1996 THROUGH 1998 AUDIT REPORT NO. 05601-4-AT

RESULTS IN BRIEF

This report presents the results of our audit of the Risk Management Agency's (RMA) crop insurance program for specialty crops. We reviewed indemnities paid for crop losses

involving apples, canola, peaches, potatoes, popcorn, and sunflowers. Crop insurance claims paid for crop-year (CY) 1997, were reviewed to determine if reinsured companies are complying with RMA policies and procedures applicable to specialty crops. We also performed a limited review of indemnities paid for CY's 1996 and 1998.

This self-initiated nationwide audit consisted of reviews of crop insurance policies for specialty crops sold and serviced by companies reinsured by the Federal Crop Insurance Corporation (FCIC), as well as catastrophic crop insurance policies sold and serviced by Farm Service Agency (FSA) county offices.

Inadequate RMA and reinsured companies' internal controls contributed to improper and incorrect sales and loss adjuster activities for specialty crops. As a result, indemnities were improper or incorrect. We reviewed 89 loss claims paid to 58 insureds with indemnities totaling about \$16 million. We found that \$1.1 million in indemnities made to 19 insureds were incorrect and another \$1.1 million in indemnities made to 2 insureds were unsupported. The questionable indemnities totaled about \$2.2 million or 13.75 percent of the total indemnities (\$16 million) reviewed. Additionally, premiums totaling \$36,242 (\$29,496 and \$6,746 in over and underpayments, respectively) was incorrectly computed because of errors made during the application process.

We found that sales agents, loss adjusters, and insureds did not consistently adhere to FCIC procedures when establishing actual production history (APH) yields, calculating appraised production, and

establishing insurable acreage and value of production to count. Errors were made by sales agents, which caused improper indemnities totaling \$524,233 (\$428,558 and \$95,675 in over and underpayments, respectively). For example, one insured used popcorn ear weights instead of the required shelled popcorn weight, when reporting the prior year's production yields. The incorrect ear weights adversely affected the accuracy of the insured's guarantee and premium. As a result, the insured's indemnity was overpaid a total of \$257,263 for this and other errors. The overpayments and other improper payments could have been prevented had the (1) insureds been required to provide supportable, verifiable production data when applying for coverage and (2) sales agents performed the required verification of insured's application data.

Errors were also made by loss adjusters, which resulted in indemnity overpayments totaling \$609,011. For example, an insured received \$16 per ton for harvested potatoes; however, the loss adjuster only used \$1 per ton for the value of production to count when computing the insured's indemnity. As a result, the insured was overpaid \$426,119 for CY 1997. Furthermore, auditors were prevented from verifying reported production for two insureds' indemnities totaling \$1.1 million. The insureds did not provide adequate production records.

We also questioned the adequacy of quality control (QC) reviews, specifically (1) RMA's policy requirement for reinsured company reviews of loss claims equal to or greater than \$100,000 and (2) the adequacy of reviews performed by the reinsured companies. QC reviews if adequately performed, could have prevented improper indemnities and incorrect premiums.

Because of insureds' and loss adjusters' questionable activities, we provided information concerning the applicable producers and reinsured companies to the Office of Inspector General (OIG)-Investigations for their consideration and further review. The 5 insureds¹ received indemnities totaling \$1.7 million for CY's 1997 and 1998.

We transmitted our findings by issuing statements of condition to reinsured companies and to FSA State offices, as applicable. Officials from the reinsured companies and the one applicable FSA State office generally concurred with the findings.

¹Four insureds were referred, the fifth insured's indemnity was also determined by the same loss adjuster that performed questionable activities for two insureds already referred.

KEY RECOMMENDATIONS

We recommend that RMA recover overpaid indemnities totaling \$1,037,569 and underpaid premiums of \$6,746. Also, RMA should ensure premium overpayments and indemnity underpayments totaling \$125,171 are paid to the applicable insureds. In addition, RMA should (1) ensure that adjustments are made to correct APH yields and other data which may affect future guarantee amounts for the applicable policies, (2) assess and update, if necessary, loss adjuster instructions for estimating harvested production, (3) review and, if appropriate, collect the improper indemnities of \$1.1 million paid to the two insureds who failed to submit supporting loss documentation to the auditors, and (4) coordinate with OIG-Investigations regarding their investigation of 5 insureds and their reinsured companies. We also recommend that RMA's quality control policy be strengthened by making the \$100,000 threshold applicable to the insureds total indemnity amount received.

AGENCY POSITION

On December 20, 2000, RMA officials provided a written response on the findings and recommendations to the draft report. They stated that they (1) neither agreed or disagreed on three recommendations where they will review questioned insurance policies and make a final determination involving recovery of funds, (2) neither agreed or disagreed on two other recommendations that will require further study, (3) disagreed with one recommendation regarding the adequacy of QC reviews by reinsured companies, and (4) agreed with two recommendations and planned corrective actions. RMA's specific comments are presented in the relevant sections of the report for each finding. RMA's entire response is shown in exhibit F of the report.

OIG POSITION

Based on the information provided in RMA's written response, we could not accept management decision on any recommendations. Additional details are needed to accept management decisions as presented in the Findings and Recommendations sections of the report. RMA disagreed with one recommendation, but did not provide sufficient evidence that QC reviews had improved. We presented evidence that shows RMA continues to recognize problems with their ability to improve reinsured companies' QC reviews. Our specific comments are presented in the relevant sections of the report for each finding.

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INTRODUCTION

BACKGROUND

The Risk Management Agency (RMA), an agency of the U.S. Department of Agriculture (USDA), was established under the provisions of the Federal Agriculture Improvement and

Reform (FAIR) Act of 1996, Public Law 104-127. This 1996 Act amended the USDA Reorganization Act of 1994, Public Law 103-354, Title II, by requiring the Secretary of Agriculture to establish within USDA an independent agency responsible for the supervision of the Federal Crop Insurance Corporation (FCIC), and administration and oversight of the risk management and insurance programs authorized under the FCIC Act.

The purpose of the FCIC and RMA is to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and risk management programs. Multiple peril crop insurance (MPCI) provides comprehensive protection against weather-related causes of loss and certain other unavoidable perils. Coverage is available at 50 to 75 percent of the actual production history (APH)¹ of the farm. Producers may select an indemnity price election from 60 to 100 percent of the FCIC expected market price. Minimum Catastrophic Risk Protection (CAT) is available for an administrative fee of only \$60 per crop, per county. MPCI coverage provides protection against low yields, poor quality, late planting, replanting costs, and prevented planting. Additional insurance may be purchased at increased premium levels, which provides for greater levels of protection against crop losses than the level of protection provided under CAT.

In fiscal year (FY) 1997, producers in 36 States could choose to buy the CAT coverage either through insurance companies reinsured by FCIC or a Farm Service Agency (FSA) county office. Additional insurance coverage could only be purchased through the reinsured companies. Beginning with the 1997 crop-year (CY), the FAIR Act began phasing out the delivery of CAT through FSA offices. In 1998, both CAT and additional insurance coverage was only available through the reinsured companies. The reinsured companies provide marketing, underwriting, servicing, training, quality control (QC), statistical processing and reporting, and loss adjustment functions.

¹ APH - APH yield is determined from producer production records for a minimum of 4, up to 10 consecutive CY's.

The reinsured companies are also responsible for ensuring compliance with the Standard Reinsurance Agreement (SRA). The SRA is a cooperative financial assistance agreement between FCIC and the reinsured companies that establishes the terms and conditions under which FCIC provides premium subsidy, expense reimbursement, and reinsurance on policies sold or reinsured by the insurance

Based on the loss ratios and indemnity amounts paid in CY 1997, we selected specific specialty crops to concentrate on as part of the audit. Indemnities totaling \$968 million were paid in CY 1997 for all crops. Of this amount, specialty crop losses represented \$158 million. The loss ratio for both crop types was 55 percent. For the purposes of this audit, a "specialty crop" is defined as a crop that has not traditionally been a FSA program crop, such as cotton, peanuts, and tobacco.

OBJECTIVES

The overall objective of the audit was to determine if reinsured companies are complying with the SRA and other policies and procedures applicable to specialty crops.

Specific objectives were to (1) determine if RMA has effectively ensured the integrity of the crop insurance program for specialty crops and (2) verify the propriety of selected crop indemnities paid in CY 1997 and other periods if applicable.

SCOPE

The audit was performed in accordance with Government Auditing Standards. We reviewed 89 loss claims with indemnities totaling more than \$16 million paid to 58² producers for

specialty crop losses that were paid in CY's 1996, 1997, and 1998³. We performed a limited review of indemnities paid in CY's 1996 and 1998. When applicable, we also reviewed the QC reviews performed for the indemnities. The 58 producers were judgmentally selected for review based on (1) dollar values, (2) loss ratios, (3) ratio of the indemnity to the guarantee, and (4) leads developed during the audit.

² Two of the 58 producers did not provide adequate production records. As a result, indemnities totaling \$1.1 million paid to the 2 producers were not reviewed.

³ Indemnities of \$1.5 million, \$12.5 million, and \$2 million were reviewed for CY's 1996, 1997, and 1998, respectively.

The audit was primarily based on indemnities of about \$81 million paid to insureds in CY 1997 for 6 specialty crops⁴. We selected the six crops based on high indemnities and/or high loss ratios. The selected crops represented 51 percent of indemnities paid nationwide on all specialty crops in CY 1997. Indemnities were paid for both CAT and additional coverage loss claims.

The following table shows CY 1997 insurance data and indemnity amounts for the six crops.

TABLE 1

CROP TYPE	POLICIES SOLD	LIABILITY	PREMIUM	INDEMNITY	LOSS RATIO	1996 LOSS RATIO
APPLE	3,649	\$253,911,887	\$14,260,710	\$12,282,420	.86	.79
CANOLA	4,128	25,618,839	3,621,878	5,335,884	1.47	1.69
POPCORN	4,203	43,838,713	3,581,160	7,258,094	2.03	.85
PEACH	1,153	21,253,844	2,977,411	4,110,086	1.38	4.73
POTATO	4,764	447,125,931	28,525,656	25,483,097	.89	1.02
SUNFLOWERS	41,166	162,590,407	20,317,245	26,889,883	1.32	1.12
TOTALS	59,063	\$954,339,621	\$73,284,060	\$81,359,464	1.11	1.21

The audit was conducted at RMA and FSA Headquarters in Washington, D.C., regional RMA compliance and service offices, FSA State and county offices, reinsured company offices, and other locations as necessary (see exhibit B for specific locations). Fieldwork was performed from September 1998 through October 1999.

METHODOLOGY

To accomplish our audit objectives, our examination consisted of the following.

- Review of applicable Federal laws and regulations, and RMA and FCIC policies and procedures.
- Review of CAT and additional insurance coverage instructions.
- Review of prior audits and other examinations and analyses performed

⁴ The six crops were apples, canola, peaches, popcorn, potatoes, and sunflowers.

by the Office of Inspector General (OIG), FSA, RMA, and the General Accounting Office.

- Interviews with officials of RMA, FSA, the Office of the General Counsel, and reinsured companies.
- Tests of loss adjusters' indemnity determinations.
- Reviews of reinsured companies' QC reviews.
- Interviews with insureds, reinsured company sales agents and loss adjusters, and crop purchasers.
- Reviews of insureds, sale agents, and loss adjuster files.
- Field visits to insureds' farming operations.
- Audit findings were provided to reinsured companies and FSA and their written responses were obtained and reviewed.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	WEAKNESSES IN RMA INTERNAL CONTROLS RESULTED IN INCORRECT INDEMNITY AND PREMIUM PAYMENTS
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Weaknesses in internal controls contributed to improper and incorrect actions by sales agents and loss adjusters. Sales agents, loss adjusters, and insureds did not consistently adhere to agency regulations when establishing APH yields, calculating appraised production, and establishing insurable acreage and production to count. As a result, incorrect indemnities totaling \$1,133,244 (of \$16 million) were paid to 19 (32 percent) of the 58 insureds reviewed. These errors subsequently caused premiums totaling \$36,242 to also be incorrect.

FINDING NO. 1 ERRORS MADE WHEN ESTABLISHING GUARANTEES

Reinsured company sales agents made errors or did not follow procedures when computing APH's, which effected guarantees, premiums, and indemnities for 14 of 58 insureds reviewed. The 14 insureds received indemnities totaling \$6.3 million of which \$524,233 (or 8 percent) was paid in error. The agents did not verify

producers' prior years' yields used to determine APH's. In addition, sales agents did not always verify the insurability of insureds' crops. As a result, guarantees, premiums, and indemnities were incorrect. These errors caused indemnity overpayments and underpayments of \$428,558 and \$95,675, respectively, which also resulted in over and underpaid premiums of \$29,496 and \$6,746, respectively.

The SRA states, "The Company must verify all yields and other information used to establish insurance guarantees and indemnity payments in accordance with the procedures approved by FCIC. Guarantees must be verified in accordance with the requirements of the approved Manual 14 and applicable procedures."⁵ Additionally, the insured is required to retain acreage and production evidence for 3 CY's following the CY that was initially certified.⁶

⁵ SRA between the FCIC and the Reinsured Company, Section V, paragraph g.2.f, effective July 1, 1997.

⁶ 1997 Crop Insurance Handbook, FCIC 18010, Section 7, effective July 1996.

Of the 58 insureds reviewed, we found 14 insureds with sales agent deficiencies that caused incorrect indemnities and premiums. The inaccurate indemnities and premiums were generally caused by incorrect calculation of acreage, yields, and/or APH errors. APH errors not only effect current year's but also subsequent year's guarantees, premiums, and indemnities. The following examples depict common sales agent errors found during our audit.

For insured C, we found that the sales agent made a series of APH computation and production errors in CY 1997. Insured C was overpaid by \$257,263, of which \$144,158 was caused by sales agent errors.⁷ This insured received indemnities totaling \$327,929 for CY 1997 damage to his popcorn crop.

During the application process, the sales agent did not follow the requirements of the SRA and used the insured's unverified popcorn production records to calculate the CY 1997 APH for each insurable unit by computing 7 year's of APH's. The sales agent incorrectly used ear popcorn weights for each of the 7 years provided by the insured's contractor instead of actual shelled popcorn weights as required by the policy. RMA instructions require ear production to be converted to shelled popcorn weights.⁸ We recomputed the CY 1997 APH for each unit of this policy and found the APH's were overstated by 11.06 to 16.72 percent. RMA instructions require APH's to be corrected when the discrepancy is greater than 5 percent.⁹ As a result of the above APH errors, the insured was overpaid \$144,158 for CY 1997, as shown in the following table.

TABLE 2

Unit No.	Acres	Correct APH	Coverage Level	OIG Computed Guarantee	Reinsured Co. Guarantee	Difference
0101	2,119.0	4,125.0	.75	6,555,656	7,437,690	882,034
0102	71.7	4,076.7	.75	219,225	225,210	5,985
0103	217.1	4,006.4	.75	652,342	737,706	85,364
0104	238.5	4,294.8	.75	768,232	863,847	95,615
0105	263.4	4,267.5	.75	843,045	975,370	132,325
Total Guarantee Difference (pounds)						1,201,323
Pound to Dollar Conversion						\$ 0.12
Total Dollar Difference (overpayment)						\$ 144,158

⁷ The \$113,105 difference (\$257,263 - \$144,158) is explained in Finding No. 2, on page 9.

⁸ RMA Crop Insurance Handbook, section 6, J, (9), dated July 1996.

⁹ RMA Crop Insurance Handbook, section 14, dated July 1996.

In its March 25, 1999, written response to OIG's Statements of Conditions (SOC) reporting these conditions, the reinsured company generally agreed with the reported errors and the questioned indemnity amounts.

In another example, the sales agent did not verify the insured's application data, which resulted in improper indemnities and premiums. Insured O purchased crop insurance coverage on 456.9 acres of apple orchards with a liability of \$710,591 to the Government. The insured paid a premium of \$22,739 for this CY 1997 coverage and received indemnities totaling \$252,080 for damages caused by hail. During our review of the loss claim, we noted that incorrect acreage and APH amounts were used to compute the indemnity. The insured's general manager informed the auditors that apple production amounts provided to the sales agent for CY's 1993 through 1997, also appeared to contain pear production tonnage. He provided us with the correct apple production tonnage for the 5-year period. Using this data, we computed the correct CY 1997 APH to be 916 boxes per acre instead of the 969 boxes used to determine the guarantee.

The general manager also informed auditors that the acreage amount was incorrect because the insured had sold 8.9 acres of the orchard in 1996, which should not have been included in the 1997 indemnity calculation. As a result, this insured received an indemnity overpayment of \$51,949 and overpaid his premium by \$1,663.

In its March 26, 1999, written response to the SOC, the reinsured company stated that they were in general agreement with the OIG indemnity determinations.

In another situation, insured J purchased CY 1996 coverage on 560.1 acres of peach orchards with a total liability of \$217,142 for which he paid premiums totaling \$34,809. The insured subsequently received indemnities totaling \$217,142 for losses caused by freezing weather. The insured included 97 acres of uninsurable peach trees planted in December 1993, in this claim. The trees were not insurable because they did not reach the required fourth leaf-year for CY 1996.¹⁰ The insured did not report the month the trees were planted; just the year, and the sales agent did not verify the actual planting date. Both the insured and the reinsured company sales agent agreed that the trees were uninsurable for CY 1996. The sales agent did not determine the month of planting and assumed they were planted in the spring of 1993. However, the trees were actually planted in December 1993, thus making 1994 the first leaf-year. The first year that the trees were eligible for crop insurance coverage was CY 1997. Verification of the planting month by the insured and accurate planting dates would have prevented indemnity and premium overpayments of \$41,632 and \$6,673, respectively, for the uninsurable peach trees.

¹⁰ Trees planted in 12/93 would not reach their fourth leaf (growth) year until 1997, the first leaf-year would be 1994.

To date, the reinsured company had not provided OIG with a written response to the SOC that reported these conditions. However, the reinsured company officials verbally agreed with the reported conditions and OIG indemnity determinations.

We noted similar errors occurred during the application and sales process for other insureds that resulted in incorrect indemnities and premiums (see exhibit D). These errors may have been prevented had sales agents verified insureds' application data and/or had the insureds been required to provide accurate supportable documentation to the reinsured company.

Reliable production and acreage data is essential to the integrity of the crop insurance program. This data is used to establish the (1) guarantee, (2) premium, and when applicable, (3) indemnity amounts. Moreover, if not corrected, subsequent years' premiums, guarantees, and indemnities are also impacted.

At the exit conference, RMA officials stated that revisions have been made to Manual 14 that will correct the stated deficiencies. We will evaluate these changes when provided by RMA.

RECOMMENDATION NO. 1

Require reinsured companies to adjust monthly draws to collect or refund incorrect indemnities and premiums totaling \$524,233 and \$36,242, respectively, as cited

in exhibit D.¹¹

RMA Response

In its December 20, 2000, response, RMA stated that once the Regional Compliance Offices (RCO) complete their review of the policies cited in exhibit D, a final determination will be issued to the responsible reinsured company. RMA will also provide a copy of each determination to OIG.

OIG Position

To accept management decision for this recommendation, we need the details and applicable timeframes for collection or refund of the cited incorrect indemnities and premiums from the insurance companies after the RCO's complete their reviews.

¹¹ Reinsured companies receive monthly draws from FCIC which include reimbursements for indemnities paid by the reinsured companies. When RMA makes a final determination that an overpayment has occurred the reinsured company reduces their draw amount through an accounting adjustment made in their data acceptance system.

RECOMMENDATION NO. 2

Require reinsured companies to instruct sales agents to properly verify yield and acreage information provided by producers before approving their applications for crop insurance coverage. Provide a current version of Manual 14 along with supporting explanations, which RMA management believes will resolve the cited deficiencies. Also, provide a corrective action plan for these cited companies to ensure known deficiencies do not reoccur.

RMA Response

In its December 20, 2000, response, RMA stated, in part:

* * * * *

*RMA is planning to incorporate additional review requirements into Manual 14 * * *. RMA is proposing the following: (1) establish a tolerance of \$250.00 when errors are found per county per crop, (2) DAS yields and tolerances would be based upon the DAS minimum. Review required when the yield does not pass a DAS edit, (3) recommend the loss adjuster be allowed to verify production at loss time which could also be used for the producer certification, and (4) retain all other review requirements. RMA estimates the above-proposed actions can be completed by February 2001.*

OIG Position

We concur with RMA's position that loss adjusters, rather than sales agents should verify yield and and acreage information. The timeframes RMA proposed for revising Manual 14 has passed. In order to reach management decision, RMA should provide copies of the changes made to review requirements in Manual 14.

FINDING NO. 2

LOSS ADJUSTMENT ERRORS CONTINUE

Loss adjusters did not adequately verify insureds' harvested production and insureds did not always correctly report production, which contributed to erroneous indemnities. As a result, questionable and improper indemnities totaling \$609,111 were paid to 9 insureds and unsupported indemnities totaling \$1.1 million were paid to 2 insureds, for CY's 1996, 1997, and 1998.

Adjusters are required to identify and verify all production to count when computing loss claims.¹² The following examples of improper indemnities

¹² RMA Loss Adjustment Manual, Chapter 9, B(7)(d), dated April 1997.

could have been prevented if loss adjusters performed all their responsibilities as required, specifically verifying production.

A loss adjuster understated insured B's production to count when calculating the CY 1997 indemnity. This occurred because the loss adjuster did not use the actual value of the harvested potato crop when determining the production to count. As a result, the insured's indemnity of \$1,263,214 was overpaid \$426,119.

FCIC instructions require the value of production to count for any potatoes sold to be the lesser of the total dollar value received, divided by the highest price election, or the actual production.¹³

In 1997, insured B claimed a potato loss but was able to sell 28,377 tons of potatoes to a food processor at \$16 a ton or \$454,032. However, when computing the indemnity, the loss adjuster only used \$1 per ton for the value of this production because the processor charged the producer \$15 a ton for cleaning and transportation costs which resulted in a net of \$1 per ton to the insured. By using the \$1 per ton value instead of the correct \$16 per ton value, the loss adjuster computed the insured's indemnity to be \$1,263,214 when the correct amount should have been \$837,095. As a result, the insured received improper indemnities totaling \$426,119.

RMA officials agreed that the actual value of the contracted potatoes should have been \$454,032 or the full \$16 per ton price because the insured received value (in the form of not having to pay for the transportation and cleaning costs) for the potatoes.

In its March 26, 1999, written response to our SOC's, the reinsured company generally agreed with the conditions as reported and also agreed with the indemnity determinations for insured B.

In another instance, insured C harvested and stored his CY 1997 popcorn production to be picked up by the buyer at a later date. The loss adjuster examined and estimated the stored production to be 7,507,080 pounds of popcorn, which he used to compute the insured's indemnity. However, when the buyer took possession of the popcorn, the harvested production was actually 8,449,618 pounds, or 942,538 pounds more than the estimate. Because the 942,538 pounds of production was not included in the indemnity determinations, the insured was overpaid \$113,105 for production that was neither destroyed nor damaged. The auditors brought this issue to the reinsured company's attention and they agreed that the adjuster should have used actual production instead of estimated production. Reinsured company officials also agreed actual production should have been further

¹³ FCIC 1997 Potato Handbook, section 9, paragraph C, 3, b, (1).

investigated when the sales agent included that production when determining the insured's APH for 1998.

In their March 26, 1999, written response to the SOC, reinsured company officials generally agreed with the reported errors and questioned indemnity amounts. However, in a June 29, 1999, letter to OIG, reinsured company officials questioned the prescribed methodologies for estimating harvested production. The officials stated, "We believe the delivered production in excess of our computed measured production (loss adjuster's calculation) was caused by a built in flaw within the loss adjustment procedures. The flaw being FCIC's discontinued use of the pack (compaction) factor. * * * A return to the pack factor adjustment would establish an accurate method to determine stored grain production." Their letter also included FSA officials' statements which reported that "it is quite common that our bushel calculations (estimates) for corn are less than what the producer actually delivers * * *. For example, using our charts (depending on grain bin size) estimates will run from 5 to 15 percent less."

These and other loss adjuster errors depicted in exhibit E not only jeopardize the integrity of the crop insurance program but also, will cause improper indemnities to continue, if not corrected.

Furthermore, auditors were prevented from verifying reported production for two insureds (A & F) because insureds did not provide adequate production records. Insured A received \$1,066,639 in indemnities for potato losses in CY's 1996 and 1997. We obtained sales and loss records from the reinsured company for the insured. However, the insured was unable to provide adequate documentation to support the loss claim. The sales agent and loss adjuster could not provide records, which support \$17,889 of the indemnity received by insured F. As a result, we questioned indemnities totaling \$1,084,528 received by the 2 insureds.

We also noted questionable insureds' and loss adjusters activities for five insureds. (See exhibit C.) This information was provided to OIG-Investigations for their consideration and further review. The 5 insureds received indemnities totaling \$1.7 million for CY's 1997 and 1998.

RECOMMENDATION NO. 3

Require reinsured companies to adjust monthly draws to collect overpaid indemnities totaling \$609,011, as cited in exhibit E. Inform reinsured companies' claims divisions of loss adjuster errors and require additional production verification training for loss adjusters.

RMA Response

In its December 20, 2000, response, RMA stated that once RCO's complete their review of the policies cited in exhibit E, a final determination will be issued to the responsible reinsured company. RMA will also provide a copy of each determination to OIG.

RMA did not concur with the second part of the recommendation. RMA officials stated that our audit sample size represented .0098 percent of the policies indemnified during the 3 CY's reviewed, and disagreed that the overall impact of the loss adjuster errors identified in the audit report is sufficient justification for the recommended action. RMA officials stated that they believe the action taken by each OIG Regional office to provide to each insurance provider a copy of their statement of conditions, and by RMA's RCO to followup to ensure completion of the problems noted, provides sufficient notification to each insurance provider about the errors.

OIG Position

As discussed in the scope section of the report, our audit universe was based on 1997 crop insurance policies sold for 6 specialty crops with indemnities totaling \$81 million paid for CY 1997 losses. The \$81 million represented 10,141 indemnified policies as compared to RMA's quote of 173,841 policies in CY 1997.

From the 10,141 policies indemnified, we selected 58 producers for review based on their CY 1997 indemnities totaling \$12,522,482 paid on 63 policies. These numbers show that our sample selection actually represent 15.4 percent of the indemnities paid in CY 1997. A very limited review of the 58 producers' CY 1996 and CY 1998 loss claims was also performed. The additional reviews were necessitated by conditions noted during review of the 58 producers' CY 1997 loss claims. As a result of (1) OIG's limited reviews of CY 1996 and 1998 loss claims and (2) RMA's inference of a sample universe of 173,841 policies instead of the actual universe of 10,141 policies, RMA's statement that the 89 loss claims paid to 58 producers represents .0098 percent of the indemnified policies for CY's 1996, 1997, and 1998 is misleading.

However, in light of the insurance companies' involvement in the statements of conditions process, OIG accepts RMA's response regarding the second part of the recommendation.

To accept management decision for the first part of the recommendation, we need the details and applicable timeframes for collection of the cited overpaid indemnities from the insurance companies after the RCO's complete their reviews.

RECOMMENDATION NO. 4

Analyze popcorn indemnities based on measured harvested production to determine if significant differences exist between measured and actual production sold. Also, address the

reinsured company's concerns on its ability to measure popcorn without a pack factor. Obtain and review FSA's pack factor adjustment procedures and determine if this process or another process would more accurately reflect measured popcorn.

RMA Response

In its December 20, 2000, response, RMA states:

OIG's own Finding No. 2, Loss Adjustment Errors Continue, note that the reinsured company should have used actual production (weights and farm-stored records) in lieu of estimated production. The Loss Adjustment Manual (LAM) allows this and encourages the adjusters to use the most accurate methods available. If the adjuster had used the actual production, this situation would not have occurred and the insured would have not received an overpayment.

* * * * *

There appear to be at least two omissions in the subject report:

- 1. The report does not state whether it can be proved the measurement was correct and that the calculations were correct.*
- 2. There does not appear to be any quantitative evidence of multiple findings wherein OIG demonstrates the volume calculations and measurements were correct and yet the bushel calculation was out of normal quantity allowance deviation parameters in regards to measured popcorn harvested production. To analyze all popcorn indemnities based upon a single instance a globally sweeping recommendation that the findings do not seem to warrant.*

In its response to that part of the recommendation regarding pack factors, RMA states that pack factors were used in the crop insurance program many years ago; but based on a 1984 North Dakota State University (NDSU) study and complaints from insureds, FCIC determined that pack factors should be removed from the crop insurance program. FSA uses pack factors for sunflowers, canola, rapeseed, grain sorghum, flax, popcorn, barley, wheat, oats, rye, corn, soybeans, and rice. RMA stated that they will consult with program participants to determine if an independent study

should be conducted to review FSA's pack methods or other alternative processes, that may be adapted for use in the crop insurance program to more accurately reflect measured small and coarse grains. A cost benefit analysis will be very important to ensure any benefits received from utilizing pack factors would be worth the added time, expense, and complexity which their use would add to the crop insurance program. RMA will evaluate its financial resources and priorities, and attempt to identify any changes that have occurred since the NDSU study was performed.

OIG Position

Actual production records and other LAM accepted harvested production records were not available to the loss adjuster at the time the adjuster calculated the loss, therefore, the loss adjuster properly measured the farm-stored harvested production. RMA officials informed OIG during the exit conference that it is not customary for loss adjusters to recalculate indemnities after the indemnity has been paid even though more accurate production information has become available. Auditors evaluated the loss adjuster's measurement of the harvested production and concluded the calculations were correct using the methodology prescribed by the LAM. The reinsured company also assessed the adjuster calculations and concluded they were correct but expressed concern with the accuracy of measuring farm-stored harvested production without using a pack factor adjustment. OIG's position remains as stated in the report.

We recommended that RMA review only those indemnity calculations based on measured harvested production, not all popcorn indemnities. As an alternative measure, RMA officials should provide documented evidence that indemnities paid on measured harvested production are insignificant in size and amount.

To accept management decision for this recommendation, RMA needs to conduct the study of measured production, not rely on comments from program participants, such as insureds and reinsured companies to decide whether a study is needed. We will need the details of (1) RMA's analysis on popcorn indemnities with measured harvested production and (2) the details and timeframes for RMA's analysis and/or implementation of pack factors or alternative processes, if applicable.

RECOMMENDATION NO. 5

Review the loss claims of the two insureds that did not provide adequate records to the auditors and determine if indemnities totaling \$1.1 million were proper. If applicable, ensure appropriate accounting adjustments for improper indemnities are made for unsupported loss payments.

RMA Response

In its December 20, 2000, response, RMA stated that once RCO's complete their review of the policies cited in this recommendation, a final determination will be issued to the responsible reinsured company. RMA will also provide a copy of each determination to OIG.

OIG Position

To accept management decision for this recommendation, we need the details of the RCO's review results and if applicable, the details and timeframes for collection of the improper indemnities from the insurance companies.

RECOMMENDATION NO. 6

Coordinate with OIG-Investigations regarding its investigation of the five insureds and the applicable reinsured companies and if necessary, ensure appropriate actions are

taken to recover any improper loss payments and to sanction both the insureds and the reinsured companies.

RMA Response

In its December 20, 2000, response, RMA stated that "once OIG-Investigations has completed their investigation of this matter and has given RMA permission to take action, RMA will evaluate the matter and take whatever action is deemed appropriate."

OIG Position

To accept management decision for this recommendation, we need the details and timeframes regarding actions taken, if applicable, to recover improper indemnities and to sanction insureds and/or the insurance companies, and any administrative actions that could be taken now against the producers or reinsured companies.

FINDING NO. 3**QC POLICY AND PROCEDURES
NEED STRENGTHENING**

RMA guidelines for QC reviews of large loss claims need improvement. Current RMA regulations require reinsured company QC reviews of losses equal to or greater than \$100,000. The guidelines do not provide for combining losses on multiple units. We also noted required reinsured companies' QC

reviews were either inadequately performed or were not performed at all. As a result of inadequately performed QC reviews and the per-unit limitation regarding when QC reviews are required, indemnities occurred which may have been prevented.

Inadequate QC Reviews - We found that QC reviews were performed on 6 of the 8 insureds' indemnities that met current policy requirements for QC reviews. However, we found that the QC reviews did not always identify incorrect or improper indemnities. The 6 insureds received indemnities totaling about \$3.8 million of which we questioned approximately \$1.8 million. QC reviews were not performed on indemnities received by 2 insureds who received indemnities totaling about \$1.4 million of which we questioned \$194,791.¹⁴

Examples of inadequate reinsured companies' QC reviews follow.

Insured B received an indemnity overpayment of \$426,119 because the loss adjuster did not use the actual value of harvested production when calculating the indemnity amount for the producer's potato loss. (See Finding No. 2.) In another situation, an adjuster assigned zero potential production for insured I's potato loss on 190 acres of potatoes. However, the appraisal worksheet showed insured I actually had potential production of 1.6 hundredweight per acre, or 304 hundredweight total for the 190 acres. When computing the indemnity, the adjuster used zero production instead of the correct appraised potential production of 304 hundredweight. The reinsured company's QC review did not detect the error. As a result, insured I received an overpayment of \$3,770.

In another example, an improper indemnity may have been prevented had a QC review been performed. We found that insured O was paid indemnities totaling \$252,080, which included improper indemnity of \$51,949 for apple losses. The improper indemnity was caused by incorrect inclusion of pear

¹⁴ Questioned amounts include both indemnity over and underpayments.

production in apple production records when determining the APH. Incorrect acreage also contributed to the improper indemnity. When auditors asked for a copy of the QC review, which was required, the reinsured company representative stated that one could not be found and assumed a QC review had not been performed. If a QC review had been performed, the misreported production and acreage may have been identified and the \$51,949 improper indemnity may not have been paid.

Policy Limitations - Reinsured companies are required to provide oversight of the crop insurance program to ensure it is being administered in accordance with the SRA, the Act, and FCIC policies and procedures. To fulfill this responsibility, reinsured companies are required to conduct field reviews for all loss claims equal to or greater than \$100,000. However, the \$100,000 amount applies to a single unit and not the insured's total loss amount. We found incorrect indemnities were paid to 19 of the 58 insureds reviewed. Fourteen of the 19 insureds received total indemnities, which exceeded \$100,000 each. However, current RMA policy only required QC reviews to be performed on 8 insured's indemnities because they each had at least one unit with a loss exceeding \$100,000. The remaining 6 insureds of the 14 were not required to have QC reviews performed of their indemnities because each of their unit losses were less than \$100,000.

In one example, insured N received indemnities totaling \$340,284 for potato losses occurring in CY 1997. However, the reinsured company did not perform a QC review of the producer's indemnities because the total loss occurred on 8 units, with no one unit having a loss equal to or greater than \$100,000. During our review of insured's N's indemnities, we found that the reinsured company staff made yield computation errors and misapplied county actuarial data. These errors caused overpaid indemnities and premiums totaling \$47,182 and \$12,236, respectively.

Specifically, the sales agent used incorrect production data to compute the insured's master yield, which caused the total guarantee to be overstated by 13,092 hundredweight.¹⁵ These yield variances exceeded the 2percent tolerance provided for in RMA guidelines. The sales agent also used county actuarial data from a different county than where the farm units were located in. For example, a county map adjustment factor of 1.80 was improperly assigned to one farm unit instead of the 1.0, the correct crop adjustment factor. The incorrect adjustment factor improperly inflated the insured's guarantee.

In our June 14, 1999, SOC to the reinsured company, we reported that the lack of a QC review contributed to the company's failure to detect errors identified by the auditors. The reinsured company in their August 23, 1999,

¹⁵ Master yields are used where crop rotation and land leasing limit the APH crop years of yield history available on individual units.

written response stated, "they were in general agreement with indemnity determinations but were acting in accordance with FCIC instructions when they did not perform QC reviews on this insured's loss claim."

Moreover, improper indemnities reported in Finding Nos. 1 and 2, were caused by errors made in acreage and APH determinations and incorrect production to count. These improper indemnities may have been prevented had QC reviews been performed. Because of this weakness in the policy, insureds may manipulate unit structure and harvested production to maximize indemnities and minimize the risk of QC reviews on crop losses.

During the exit conference, RMA officials stated that changes to Manual 14 would improve agency oversight. However, these changes have not been provided.

RECOMMENDATION NO. 7

Develop corrective action plans for the cited companies to ensure adequate QC reviews. Also, provide changes and supporting explanations to Manual 14 that will show

agency oversight has improved since our fieldwork date.

RMA Response

In its December 20, 2000, response, RMA officials did not concur with the recommendation and stated:

This recommendation is based upon a finding that QC reviews were either inadequately performed or not performed at all on 8 individual insureds.

* * * * *

RMA does not believe that a very limited number of widely scattered individual findings, that were judgmentally selected, provides sufficient justification for taking the recommended action. There is no correlation between the findings nor sufficient statistical basis to show there is a systemic problem with company's QC programs.

RMA officials stated that they believe a process is now in place for addressing the issue of inadequate QC reviews by insurance providers. This process was initiated in CY 1998 and found that insurance providers were doing a satisfactory job in reporting results of required QC reviews.

In addition, RMA RCO's will review each individual finding and issue an initial determination to each insurance provider for response then will issue a final determination based on the insurance provider's response to the initial determination. This process puts the insurance provider on

notice of a discrepancy, requests them to determine whether or not they are responsible for it, and if so, requires them to correct it.

OIG Position

RMA's response does not show specific improvement of agency oversight in this area. At the exit conference, the agency reported that changes to Manual 14 would address inadequate QC reviews performed by the insurance providers and RMA's response explained that RMA conducts a review on a random sample of statistically selected policies for each insurance provider for a specific CY. The response also stated that the insurance providers did a satisfactory job in reporting the results of the required QC reviews in accordance with Manual 14 requirements. However, in its FY 2001-2002 Annual Performance Plan, RMA reported that reinsurance companies' QC systems varied greatly from company to company, and RMA's goal was to upgrade the level of the companies' QC systems and reports. RMA also reported that they have been unable to develop an accurate error rate for insurance policies because the QC data contained errors and was unreliable.

To accept management decision for this recommendation, we need the details and timeframes on the additional revisions that were or will be made to Manual 14 which show increased agency oversight of the insurance companies' QC process.

RECOMMENDATION NO. 8

Review and revise policy instructions to make the \$100,000 threshold for QC reviews applicable to the insured's total indemnity for each crop received.

RMA Response

In its December 20, 2000, response, RMA stated, in part, that:

RMA is proposing a change in the \$100,000 threshold for QC reviews. Proposed changes to Manual 14 are as follows: (1) Include requirements that crops are not to be destroyed until the review is complete, (2) Second level review is required prior to claims payment, and (3) The trigger for the \$100,000 indemnity will be on a crop basis rather than a unit

basis. RMA believes that the above-proposed actions can be completed by February 2001.

OIG Position

We concur with the proposed changes to thresholds for QC reviews. However, the timeframe RMA proposed for revising Manual 14 changes has passed. Therefore, to accept management decision, RMA should provide copies of the Manual 14 changes to us for review.

GENERAL COMMENTS

In a February 24, 2000, Management Alert to RMA, we reported an issue regarding the nursery crop insurance program which required immediate review and correction to prevent a reinsured company from receiving unearned financial benefits.

Based on a limited review of the nursery crop insurance program for CY 1999, we found that a reinsured company sold CAT coverage for two types of pine seedlings. However, one of the seedling species was uninsurable because the nursery was located in a zone that did not meet the hardiness requirements. The inclusion of the ineligible seedlings in the policy overstated the imputed premium for this policy by \$55,440. We reported that if RMA does not correct the situation, the reinsured company will receive overstated marketing gains and loss adjustment expense reimbursement for CY 1999.

The reinsured company sold a CY 1999 CAT policy to a large paper producing company for coverage on its nursery's pine seedlings. The policy provided coverage for 14 million slash pine seedlings and 14 million loblolly pine seedlings at a stated value of \$1 each, or \$28 million. However, the slash pines were uninsurable because the location of the nursery did not meet the hardiness zone requirements for those seedlings. To be insurable, slash pines cannot be planted in a county with a hardiness zone of less than 9. However, the reinsured company approved coverage for the 14 million slash pine seedlings even though they were planted in a county with a hardiness zone code of 8.

Since the pine seedlings were improperly insured, the Government's liability was overstated. Also, the imputed premium for this policy, which totaled \$110,880, was inflated by 50 percent; which was the amount attributable to the uninsurable slash pines. The underwriting gain for CAT in each State consists of the total CAT imputed premium amount less CAT loss claims paid. The percentage of gain retention depends on the State's CAT loss ratio. As a result, if CAT imputed premiums are overstated, the reinsured companies will also receive overstated marketing gains.

Additionally, the reinsured companies receive 11 percent of the CAT imputed premium to cover loss adjustment expenses. Because the Government's reimbursement to the reinsured company is directly related to the imputed premium level, the Government will reimburse the reinsured company unearned revenues and fees unless the imputed premium is corrected to only include the insurable loblolly pines.

In our Management Alert, we recommended that RMA should:

- A. Determine why the reinsured company issued an insurance policy on the uninsurable slash pine seedlings. Require the reinsured company to
-

- (1) immediately notify the nursery that the slash pines are uninsurable and
- (2) ensure plants, which do not meet the hardiness zone requirements, are not insured.

B. Assess the impact of the imputed premium for the slash pines on the amount of administrative reimbursement and revenue gains paid to the reinsured company for CY 1999 and take appropriate corrective action.

In its March 14, 2000, response to the Management Alert, RMA stated that the contractor who developed the hardiness zone codes for the CY 1999 nursery crop insurance program was provided additional information which supports the growth of slash pines in hardiness zone 8. As a result, the slash pines will be insurable in hardiness zone 8 for CY 2001. RMA also stated that the Compliance Regional Office will perform a review of the reinsured company's CY 1999 policy for the slash pines and OIG's workpapers. Upon completion of the review, the compliance office will require appropriate corrective actions based on the results of the review.

EXHIBIT A - SUMMARY OF MONETARY RESULTS

RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	Indemnities Were Overpaid Due to Sales Agent Errors Made When Establishing Guarantees.	\$428,558	Questioned Costs - Recovery Recommended
1	Premiums Were Underpaid Due to Sales Agent Errors Made When Establishing Guarantees.	\$6,746	Questioned Costs - Recovery Recommended
1	Indemnities Were Underpaid Due to Sales Agent Errors Made When Establishing Guarantees.	\$95,675	Underpayment - Payment Recommended
1	Premiums Were Overpaid Due to Sales Agent Errors Made When Establishing Guarantees.	\$29,496	Overpayment - Payment Recommended
3	Indemnities Were Overpaid Due to Adjuster Errors Made When Computing Loss Amounts	\$609,011	Questioned Costs - Recovery Recommended
4	Insured's Records Not Provided to OIG	\$1,084,528	Unsupported Costs and Loans - Recovery Recommended
TOTAL MONETARY RESULTS		\$2,254,014	

EXHIBIT B - LOCATIONS VISITED

ORGANIZATION/ENTITY	LOCATION
<u>U.S. Department of Agriculture</u>	
Risk Management Agency National Office Regional Service Offices	Washington, D.C. Raleigh, North Carolina Saint Paul, Minnesota Spokane, Washington Springfield, Illinois
Regional Compliance Offices	Raleigh, North Carolina Kansas City, Missouri Saint Paul, Minnesota Indianapolis, Indiana Sacramento, California Dallas, Texas
Farm Service Agency Florida State Office Lee County Office Dade County Office Hillsborough County Office St. Johns County Office	Gainesville, Florida Fort Myers, Florida Homestead, Florida Plant City, Florida East Palatka, Florida
South Carolina Aiken County Office Edgefield County Office Spartanburg County Office	Aiken, South Carolina Edgefield, South Carolina Spartanburg, South Carolina
North Carolina Cleveland County Office	Shelby, North Carolina
North Dakota Foster County Office Griggs County Office Stutsman County Office Pembina County Office Walsh County Office	Carrington, North Dakota Coopertown, North Dakota Jamestown, North Dakota Cavalier, North Dakota Park River, North Dakota
Virginia State Office Albermarle County Office Botetourt County Office Frederick County Office Northampton County Office Virginia Beach County Office	Richmond, Virginia Charlottesville, Virginia Roanoke, Virginia Stephens City, Virginia Accomac, Virginia Chesapeake, Virginia
West Virginia Berkeley County Office Hampshire County Office	Martinsburg, West Virginia Romney, West Virginia

EXHIBIT B - LOCATIONS VISITED, cont.

ORGANIZATION/ENTITY	LOCATION
<u>U.S. Department of Agriculture</u>	
Ohio	
Licking County Office	Newark, Ohio
Minnesota	
West Polk County Office	Crookston, Minnesota
Roseau County Office	Roseau, Minnesota
Michigan	
Berrien County Office	Berrien Springs, Michigan
Indiana State Office	Indianapolis, Indiana
White County Office	Monticello, Indiana
Idaho State Office	Boise, Idaho
Teton County Office	Tetonia, Idaho
Gem County Office	Emmett, Idaho
Canyon County Office	Caldwell, Idaho
Washington State Office	Spokane, Washington
Okanogan County Office	Okanogan, Washington
Adams County Office	Ritzville, Washington
Chelan County Office	Wenatchee, Washington
Lincoln County Office	Davenport, Washington
Skagit County Office	Mt. Vernon, Washington
Texas	
Dallam County Office	Dalhart, Texas
Hidalgo County Office	Edinburg, Texas
State/County Extension Offices	
Florida	
Putnam County Extension Service	Palatka, Florida
South Carolina	
Edgefield County Office	Edgefield, South Carolina
Aiken County Office	Aiken South Carolina
West Virginia	
West Virginia University Extension Service	Kearneysville, West Virginia
Virginia	
Virginia Cooperative Extension Service	Exmore, Virginia
Texas	
Hidalgo County Extension Office	Edinburg, Texas
Dallam County Extension Office	Dalhart, Texas
Corpus Christi District Extension Office	Corpus Christi, Texas
Natural Resources Conservation Service County Office	Edinburg, Texas

EXHIBIT C - CLAIMS WITH EXCEPTIONS

Producer Code	Crop Year	Crop	State	Indemnity Amount
A	1996	Potatoes	Florida	\$402,120
A	1997	Potatoes	Florida	664,519
B ¹	1997	Potatoes	Washington	1,020,467
B	1997	Potatoes	Washington	242,747
C	1997	Popcorn	Indiana	327,929
D	1997	Potatoes	Florida	522,462
E ¹	1997	Apples	West Virginia	54,008
F ¹	1997	Apples	West Virginia	41,775
G	1996	Apples	North Carolina	50,200
G	1997	Apples	North Carolina	87,045
G	1998	Apples	North Carolina	52,333
H	1997	Potatoes	Washington	306,812
I	1998	Potatoes	Texas	425,320
J	1996	Peaches	South Carolina	217,142
J	1997	Peaches	South Carolina	28,451
J	1998	Peaches	South Carolina	94,394
K ¹	1997	Apples	Virginia	153,344
L	1996	Peaches	South Carolina	616,382
L	1997	Peaches	South Carolina	174,875
M	1996	Peaches	South Carolina	223,881
M	1997	Peaches	South Carolina	170,500
13 Insureds/21 Claims				
Total				\$5,876,706

EXHIBIT C - CLAIMS WITH EXCEPTIONS, cont.

Producer Code	Crop Year	Crop	State	Indemnity Amount
N	1997	Potatoes	North Dakota	\$340,284
O	1997	Apples	Washington	252,080
P ¹	1997	Sunflower	North Dakota	24,603
P	1997	Sunflower	North Dakota	50,631
P	1997	Sunflower	North Dakota	10,962
P	1997	Sunflower	North Dakota	17,126
P	1998	Sunflower	North Dakota	16,006
P	1998	Sunflower	North Dakota	8,362
Q	1997	Popcorn	Indiana	10,537
R	1997	Peaches	Michigan	4,134
S	1997	Apples	Washington	152,204
6 Insured/11 Claims			Subtotal	886,929
13 Insured/21 Claims			Subtotal	5,876,706
19 Insured/32 Claims			Total	\$6,763,635
¹ Insureds referred to OIG-Investigations.				

EXHIBIT D - CLAIMS WITH SALES AGENT ERRORS¹

Producer Code	Crop Year	Questioned Indemnity	Questioned Premium	Error Type Code
C	1997	\$144,158	0	Incorrect Acreage/Production Weights Used
E	1997	0	902	Incorrect Acreage Used
F	1997	18,873	2,601	Abandoned Orchard Insured
G ²	1997	8,837	313	Incorrect Acreage/Production Used
G	1998	6,081	399	Incorrect Production Used
K	1997	5,996	278	Yield Variance Incorrect
K	1997	(4,065)	(377)	Yield Variance Incorrect
L	1996	64,615	3,681	Incorrect Acreage/APH
L	1997	(1,339)	(81)	Incorrect Acreage/APH
M	1996	(43,900)	(2,808)	Incorrect Production/APH Used
M	1997	(32,988)	(2,215)	Incorrect Production/APH Used
J	1996	44,392	7,116	Uninsurable Acreage Insured/Insurable Acreage Not Included
J	1997	(2,805)	(485)	Uninsurable Acreage Insured/Insurable Acreage Not Included
J	1998	4,152	307	Uninsurable Acreage Insured/Insurable Acreage Not Included
J	1998	(10,578)	(780)	Uninsurable Acreage Insured/Insurable Acreage Not Included
N	1997	47,182	7,036	Incorrect Production/County Actuarial Data Used
N	1997	0	5,200	Incorrect Production/County Actuarial Data Used
O	1997	51,949	1,663	Incorrect Insured Acreage/APH
P	1997	17,300	0	Uninsurable Acreage Insured/Incorrect Acreage
P	1997	2,800	0	Uninsurable Acreage Insured/Incorrect Acreage
p	1998	3,100	0	Uninsurable Acreage Insured/Incorrect Acreage
Q	1997	7,407	0	Production Incorrectly Allocated Between Units
R	1997	881	0	Unsupported Yield Data
S	1997	835	0	Incorrect Yield Factor Used
Total Questioned Amounts		\$524,233	\$36,242	
<p>1 SOC and auditor's workpapers for the insureds and questioned indemnities and premiums will be provided to RMA for their review.</p> <p>2 CAT policy sold by FSA.</p>				

EXHIBIT E - CLAIMS WITH LOSS ADJUSTMENT ERRORS¹

Producer Code	Crop-Year	Indemnity Overpayment	Error Type
B	1997	426,119	Value of Production to Count Incorrectly Determined
C	1997	113,105	Estimated Production to Count Used Instead of Actual Production
D	1997	27,860	Incorrect Production Used to Determine Indemnity
E	1997	20,080	Value of Production to Count Incorrectly Determined
G	1996	12,130	Estimated Production to Count Used Instead of Actual Production
H	1997	4,236	Estimated Production to Count Used Instead of Actual Production
I	1998	3,770	Estimated Production to Count Used Instead of Actual Production
J	1997	860	Incorrect Production Used to Determine Indemnity
K	1997	851	Estimated Production to Count Used Instead of Actual Production
Total		\$609,011	
¹ SOC's and auditor's workpapers for the questioned indemnities and premiums will be provided to RMA for their review.			

EXHIBIT F - RMA RESPONSE TO DRAFT REPORT




United States Department of Agriculture

DEC 20 2006

Farm and Foreign Agricultural Services
Risk Management Agency

TO: James R. Ebbitt
Assistant Inspector General for Audit
Office of Inspector General

FROM: Kenneth D. Ackerman 
Administrator

SUBJECT: Office of Inspector General (OIG) Official Draft Audit Report No. 05601-4-At:
Crop Insurance for Specialty Crops

Outlined below is our response to the subject report.

RECOMMENDATION 1

Require reinsured companies to adjust monthly draws to collect or refund incorrect indemnities and premiums totaling \$524,233 and \$36,242, respectively, as cited in exhibit D.

Risk Management Agency (RMA) Response:

RMA's Regional Compliance Offices (RCO) are in the process of reviewing the policies cited in exhibit D. Once the RCO have completed their review, a final determination will be issued to the responsible reinsured company. At that time, a copy of each final determination will be provided to your office.

RECOMMENDATION NO. 2

Require reinsured companies to instruct sales agents to properly verify yield and acreage information provided by producers before approving their applications for crop insurance coverage. Provide a current version of Manual 14 along with supporting explanations, which RMA management believes will resolve the cited deficiencies. Also, provide a corrective action plan for these cited companies to ensure known deficiencies do not reoccur.

RMA Response:



1400 Independence Ave., SW • Stop 0801 • Washington, DC 20250-0801

The Risk Management Agency Administers and Oversees
All Programs Authorized Under the Federal Crop Insurance Corporation

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EXHIBIT F - RMA RESPONSE TO DRAFT REPORT

James R. Ebbitt

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RMA does not concur with the recommendation.

Section V.G.2.b of the Standard Reinsurance Agreement (SRA) prohibits agents from verifying yields when the yields are established for the purposes of providing coverage or a guarantee. Yield verification is the responsibility of the reinsured company and the loss adjuster, not the crop insurance agent. Agents also do not verify planted acreage because of the opportunity to falsify acreage information to increase commissions or the amount of loss payable to the insured.

Also, because of a potential conflict of interest, it is not practical to require the verification of yields or acreage upon the sale of a crop insurance policy. In most cases, acreage information based on planting is not known at the time the application is taken. Yield reports for the previous year are not due until the acreage reporting date or 45 days from the cancellation date, whichever is earlier.

RMA is planning to incorporate additional review requirements into Manual 14. In addition to the other current review requirements, Manual 14 page 12, **RMA is proposing the following:** (1) establish a tolerance of \$250.00 when errors are found per county per crop, (2) DAS yields and tolerances would be based upon the DAS minimum. Review required when the yield does not pass a DAS edit, (3) recommend the loss adjuster be allowed to verify production at loss time which could also be used for the producer certification, and (4) Retain all other review requirements.

RMA estimates the above proposed actions can be completed by February 2001.

RECOMMENDATION NO. 3

Require reinsured companies to adjust monthly draws to collect overpaid indemnities totaling \$609,011, as cited in exhibit E. Inform reinsured companies' claims division of loss adjuster errors and require additional production verification training for loss adjusters.

RMA Response:

RMA's Regional Compliance Offices (RCO) are in the process of reviewing the policies cited in exhibit E. Once the RCO have completed their review, a final determination will be issued to the responsible reinsured company. At that time, a copy of each final determination will be provided to your office.

RMA does not concur with the second part of the recommendation which states, "*Inform reinsured companies' claims division of loss adjuster errors and require additional production verification training for loss adjusters.*"

The finding for this recommendation states, for 11 insureds, loss adjusters did not adequately verify insured's harvested production and insureds did not always correctly report production. The cited individuals were part of a sample of 89 loss claims paid to 58 individuals selected from losses paid during crop years 1996, 1997, and 1998. The 58 producers were judgementally selected for review based on (1) dollar values, (2) loss ratios, (3) ratio of the indemnity to the

EXHIBIT F - RMA RESPONSE TO DRAFT REPORT

James R. Ebbitt

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guarantee, and (4) leads developed during the audit. According to RMA's summary of business, there were 296,865 policies indemnified in CY 1996, 173,841 policies indemnified in CY 1997, and 221,130 in CY 1998, for a total of 591,836 policies indemnified for the three years represented by the sample. The 89 loss claims used in the audit represents .0098 percent of the policies indemnified during the three CY's reviewed. RMA does not believe a very limited number of widely scattered individual findings, that were judgementally selected, provides sufficient justification for the recommended action. There is no correlation between the findings nor sufficient statistical basis to show there is a systemic problem with a particular loss adjuster, or a company's set of loss adjusters. Also, it should be noted, the policies identified in this finding were during either the 1996, 1997, or 1998 crop year, and that in some cases two or maybe three or four years have past since the individual adjusted the loss.

RMA believes, the action taken by each OIG Regional Office to contact and provide to each responsible insurance provider a copy of their statement of conditions, and by RMA's RCO to issue an initial determination to each insurance provider, followed by a final determination based on the insurance provider's response to the initial determination, and their follow up to assure completion of corrective actions, provides sufficient notification to each insurance provider about the errors, and corrective action to address each individual finding.

RECOMMENDATION NO. 4

Analyze popcorn indemnities based on measured harvested production to determine if significant differences exist between measured and actual production sold. Also, address the reinsured company's concerns on its ability to measure popcorn without a pack factor. Obtain and review FSA's pack factor adjustment procedures and determine if this process or another process would more accurately reflect measured popcorn.

RMA Response:

Part 1: *Analyze popcorn indemnities based on measured harvested production to determine if significant differences exist between measured and actual production sold.*

OIG's own **Finding No. 2, Loss Adjustment Errors Continue**, note that the reinsured company officials should have used actual production (weights and farm-stored records) in lieu of estimated production. The Loss Adjustment Manual (LAM) allows this and encourages the adjusters to use the most accurate methods available. If the adjuster had used the actual production, this situation would not have occurred and the insured would have not received an overpayment.

LAM, Paragraph 105, *Verifying Harvested Production*, states in part:

Harvested production will be determined by the following:

- Acceptable evidence of sales and/or commercial storage.
- Measuring farm-stored harvested production.
- Weighed and farm-stored records (See Par. 122).

EXHIBIT F - RMA RESPONSE TO DRAFT REPORT

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LAM, Paragraph 122, *Production Weighted and Farm-Stored*, states in part:

Weigh production weighed either by farm scales or commercial elevator scales prior to storing on the farm may be used to determine production, provided:

- Acceptable weight tickets are available...
- The weighted production is reasonable for the unit ...

There appear to be at least two omissions in the subject report:

- 1) The report does not state whether it can be proved the measurement was correct and that the calculations were correct.
- 2) There does not appear to be any quantitative evidence of multiple findings wherein OIG demonstrates the volume calculations and measurements were correct and yet the bushel calculation was out of normal quantity allowance deviation parameters in regards to measured popcorn harvested production. To analyze all popcorn indemnities based upon a single instance is a globally sweeping recommendation that the findings do not seem to warrant.

Part 2: Also, address the reinsured company's concerns on its ability to measure popcorn without a pack factor. Obtain and review FSA's pack factor adjustment procedures and determine if this process or another process would more accurately reflect measured popcorn.

The use of pack factors was reviewed in the early 1980s. North Dakota State University (NDSU) conducted a study (attached) and determined that many factors affected grain packing (time in the bin, condition of the crop, size of the kernels, height of the drop in the bin, drying bin verses non drying bins, etc.) to create effective packing tables. Pack factors were used in the crop insurance program many years ago; but based on the study and complaints from insureds, FCIC determined that pack factors should be removed from the crop insurance program.

FSA uses pack factors for sunflowers, canola, rapeseed, grain sorghum, flax, popcorn, barley, wheat, oats, rye, corn, soybeans, and rice. They began using pack factors in the late 1930's. RMA will consult with program participants to determine if an independent study should be conducted to review FSA's pack methods or other alternative processes, that may be adapted for use in the crop insurance program to more accurately reflect measured small and coarse grains. A cost benefit analysis will be very important to assure any benefits received from utilizing pack factors would be worth the added time, expense, and complexity which their use would add to the crop insurance program. RMA will evaluate its financial resources and priorities, and attempt to identify any changes that may have occurred since the NDSU study was performed.

RECOMMENDATION NO. 5

Review the loss claims of the two insureds that did not provide adequate records to the auditors and determine if indemnities totaling \$ 1.1 million were proper. If applicable,

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ensure appropriate accounting adjustments for improper indemnities are made for unsupported loss payments.

RMA Response:

RMA's Regional Compliance Office (RCO) is in the process of reviewing the policies cited in this recommendation. Once the RCO have completed their review, a final determination will be issued to the responsible reinsured company. At that time, a copy of each final determination will be provided to your office.

RECOMMENDATION NO. 6

Coordinate with OIG-Investigations regarding their investigation of the five insureds and the applicable reinsured companies and if necessary, ensure appropriate actions are taken to recover any improper loss payments and to sanction both the insureds and the reinsured companies.

RMA Response:

Once OIG-Investigations has completed their investigation of this matter and has given RMA permission to take action, RMA will evaluate the matter and take what ever action is deemed appropriate. We will keep your office informed as we proceed on this matter.

RECOMMENDATION NO. 7

Develop corrective action plans for the cited companies to ensure adequate QC reviews. Also, provide changes and supporting explanation to Manual 14 that will show agency oversight has improved since our field work date.

RMA Response:

RMA does not concur with the recommendation.

This recommendation is based upon a finding that Quality Control reviews were either inadequately performed or not performed at all on 8 individual insureds. The cited individuals were part of a sample of 89 loss claims paid to 58 individuals selected from losses paid during crop years 1996, 1997, and 1998. The 58 producers were judgementally selected for review based on (1) dollar values, (2) loss ratios, (3) ratio of the indemnity to the guarantee, and (4) leads developed during the audit. According to RMA's summary of business, there were 296,865 policies indemnified in CY 1996, 173,841 policies indemnified in CY 1997, and 221,130 in CY 1998, for a total of 591,836 policies indemnified for the three years represented by the sample. The 89 policies used in the sample represents .0098 percent of the policies indemnified during the three CY's reviewed. RMA does not believe a very limited number of widely scattered individual findings, that were judgementally selected, provides sufficient justification for taking the recommended action. There is no correlation between the findings nor sufficient statistical basis to show there is a systemic problem with company's quality control programs.

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RMA believes it has in place a process for addressing the issue of inadequate quality control reviews by insurance providers. Manual 14, Guidelines and Expectations for Delivery of the Federal Crop Insurance Program (Manual 14) was revised in September 1997. The new manual outlines minimum guidelines the insurance providers would employ to assure an effective quality control program. RMA has a review process for determining whether insurance providers (i) quality control reviews reported in their annual summary reports were conducted in accordance with the Manual 14 requirements and (ii) whether they conducted training of sales agents and loss adjusters in accordance with the Manual 14 requirements. To make these determinations, RMA conducts a review on a random sample of statistically selected policies for each insurance provider for a specific crop year. This process was initiated in crop year 1998 and found the insurance providers did a satisfactory job in reporting the results of the required quality control reviews in accordance with Manual 14 requirements. Individual exit conferences were conducted by Regional Compliance Offices with insurance providers to discuss the results of their review. Also, a briefing was given to the 16 insurance providers on the overall results of the review. If RMA's assessment of insurance providers' quality control reviews shows there is a need for additional action, Paragraph 7 B of Manual 14, authorizes RMA to develop a corrective action plan for companies. It is worth noting, the subject report does not identify for each of the 8 individuals cited, which crop year was found to be in error. For those individuals cited, where it can be determined, the crop year was either 1996 or 1997.

In addition, as stated in our response for recommendation numbers 1, 3, and 5, RMA's Regional Compliance Offices (RCO) will review each individual finding and will issue an initial determination to the responsible insurance provider for response. Based upon the response by the insurance provider, the RCO will then issue a final determination on this matter. This process puts the insurance provider on notice of a discrepancy, requests them to determine whether or not they are responsible for it, and if so, requires them to correct it.

For all of the above reasons, RMA believes it has a system in place to address findings such as those identified in this recommendation.

RECOMMENDATION NO. 8

Review and revise policy instruction to make the \$100,000 threshold for QC reviews applicable to the insured's total indemnity for each crop received.

RMA Response:

RMA is proposing a change in the \$100,000 threshold for QC reviews. Proposed changes to Manual 14 are as follows: (1) Include requirements that crops are not to be destroyed until the review is completed, (2) Second level review is required prior to claims payment, and (3) The trigger for the \$100,000 indemnity will be on a crop rather than a unit basis.

RMA estimates the above proposed actions can be completed by February 2001.

If there are any questions, please contact Alan Sneeringer on (202) 720-8813.

Attachment

ABBREVIATIONS

APH	
Actual Production History	i
CAT	
Catastrophic Risk Protection.....	1
CY	
Crop-Year.....	i
FAIR	
Federal Agriculture Improvement and Reform	1
FCIC	
Federal Crop Insurance Corporation	i
FSA	
Farm Service Agency	i
FY	
Fiscal Year	1
LAM	
Loss Adjustment Manual.....	13
MPCI	
Multiple Peril Crop Insurance.....	1
NDSU	
North Dakota State University	13
OIG	
Office of Inspector General	ii
QC	
Quality Control.....	ii
RCO	
Regional Compliance Offices	8
RMA	
Risk Management Agency.....	i
SOC	
Statements of Conditions	7

ABBREVIATIONS

SRA	
Standard Reinsurance Agreement.....	2
USDA	
U.S. Department of Agriculture.....	1