



United States Department of Agriculture
Office of Inspector General





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AUDIT
NUMBER: 05099-0114-KC

TO: William J. Murphy
Administrator
Risk Management Agency

ATTN: Michael Hand
Deputy Administrator for Compliance

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: RMA: Validity of New Producers

This report presents the results of the subject audit. Your written response, dated June 25, 2012, to the official draft report is included, in its entirety, at the end of this report. Excerpts from your response and the Office of Inspector General's position are incorporated into the relevant sections of the report. Based on your written response, we are accepting your management decisions for all audit recommendations in the report, and no further response to this office is necessary.

Please follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer. In accordance with Departmental Regulation 1720-1, final action needs to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions.

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RMA: Validity of New Producers

Executive Summary

As the agency within the Department of Agriculture responsible for administering the Federal Crop Insurance Program, Risk Management Agency (RMA) partners with private insurance companies known as approved insurance providers (AIP) to provide producers a range of crop insurance options for protecting themselves against yield and price losses. RMA administers the crop insurance programs, governs its contractual relationship with AIPs, and reinsures AIPs by taking on a portion of the costs and risks. AIPs assume primary responsibility for underwriting policies, adjusting any losses that may occur, and conducting quality control reviews. Of the 2.3 million total crop insurance policies administered during the 2007 and 2008 crop years, 144,000 policies received new-producer status, which could result in higher indemnity payments. RMA defines “new producers” as those insured persons who have no more than 2 years of history farming a specific crop. With premiums totaling approximately \$617 million, new producers received a total of approximately \$507 million in indemnities. The Office of Inspector General (OIG) initiated this audit to assess the administration of new-producer program procedures to prevent improper increases to insurance coverage, specifically to “yield guarantees,” i.e., insurance figures that establish minimum expected crop yields.

Initial reviews of information listed in records held by RMA and by the Farm Service Agency (FSA), identified that a total of 19,285 new-producer policies (13 percent) for crop years 2007 and 2008 had more than 2 years of data. Insured persons listed as new producers should not generally have more than 2 years of records.¹ Subsequent fieldwork disclosed that 154 of 176 new-producer-designated crop insurance policies in our sample were sold to insured producers who were not eligible for the new-producer status AIPs granted them for that crop.² AIPs sold and serviced these improper policies because they did not effectively validate new-producer status during the insurance process and used information throughout the process without verifying it against Federal records. AIPs widely stated they generally assumed RMA’s controls were sufficient and relied on simple and limited data validation tests (i.e., “edit checks”) in RMA’s automated data systems to identify errors in new-producer status. As a result of AIPs not carrying out their contractual responsibilities to verify information during the insurance process, RMA reinsured 154 policies not eligible for new-producer status—57 of these policies resulted in indemnities totaling \$2.4 million and \$910,000 in associated costs.³

Although we also found that RMA can improve the design of its edit check such that it could have stopped 49 of the 154 improper policies from being reinsured, we concluded that using an edit check as a main control over eligibility is not an adequate procedure to prevent improper increases to insurance coverage. RMA’s edit check was designed to protect against errors, and

¹ In some cases, producers can be eligible for new-producer status if they have more than 2 years of data due to technical reasons or exceptions.

² During our fieldwork, we assessed new-producer policies that had more than 2 years of data by reviewing a judgmental sample of 176 policies, which were serviced by a total of 11 AIPs.

³ In relation to the 57 policies, RMA provided \$670,000 in premium subsidies and \$240,000 in administrative and operating expenses.

was not intended to be the AIPs' main control over eligibility. As a result of the AIPs not carrying out their contractual responsibilities to submit accurate information to RMA and to verify information during the insurance process, RMA reinsured at least 57 crop policies that were not eligible for new-producer status. Given that AIPs issued indemnity payments on more than 6,000 policies for new producers with indemnities totaling \$56.2 million, RMA may have participated in reinsuring other policies ineligible for new-producer status as well. We conclude that since these cited AIPs did not properly fulfill their contractual obligations, the AIPs have jeopardized the integrity of the program and, thereby, breached their fiduciary responsibilities to RMA.

Recommendation Summary

We recommend RMA deny reinsurance for 57 policies with associated losses of about \$2.4 million and associated costs of \$910,000, take corrective action, and recover total losses of \$3,310,000. We also recommend that RMA require AIPs to verify new-producer eligibility for more than 6,000 policies that had more than 2 years of records and received indemnities, and take appropriate corrective action. Further, we recommend that RMA enact additional requirements for documenting verifications to ensure that AIPs strengthen controls over the underwriting processes and conduct required verifications at loss adjustment and during quality control reviews. Lastly, we recommend that RMA enhance its edit check over new-producer eligibility, and issue a bulletin to require AIPs to verify new-producer status at underwriting.

Agency Response

In its June 25, 2012, written response to the draft report, RMA generally agreed with the findings and Recommendations 4 through 7; however, due to a 3-year notification limitation in the Federal Crop Insurance Act, RMA is unable to implement Recommendations 1, 2, and 3. RMA has instead proposed alternative corrective actions. RMA's response to the draft report is included in its entirety at the end of the audit report.

OIG Position

We accept RMA's management decisions for all of the recommendations.

Background and Objectives

Background

RMA administers the Federal Crop Insurance Program, which helps producers offset the costs of potential crop failures due to natural disasters or commodity price declines. RMA administers the program through a cooperative effort with AIPs in which AIPs sell and service crop insurance policies. Through AIPs, producers purchase approximately 1.1 million crop insurance policies each year.⁴ In 2007 and 2008 combined, producers paid about \$6.9 billion out of the \$16.4 billion in total premiums, and the remainder was subsidized.⁵ For those years, producers received \$12 billion in indemnity payments. So long as AIPs responsibly administer these policies according to the provisions of the Standard Reinsurance Agreement (SRA), RMA reinsures the policies and participates in funding indemnities. RMA also reimburses the AIPs an administrative fee for operating expenses.

New-Producer Crop Insurance Policies

RMA allows AIPs to offer producers a number of different insurance products based on an individual producer's actual production history (APH). An APH is an individual producer's crop yield averaged across a 10-year period. Using APH as a basis for calculations allows a producer's history of success or failure with a crop to influence the premium the producer pays for a policy, and the indemnity payment the AIP would make to the producer if the producer suffers a loss.

Since not all producers have grown crops for the number of years required in order to complete an APH yield, the Federal Crop Insurance Act provided for additional methods for determining the yields to use as the basis for calculations.⁶ Essentially, if a producer does not have acceptable production records, these methods augment the APH of a producer with a transitional yield.⁷ As producers establish more years of actual yield production records, crop insurance models are better able to predict what producers are likely to yield, and can then adjust policy rates and coverage levels to reflect insurance risks more accurately.

RMA is required to make sure that basing insurance on previous production does not prevent beginning farmers—those who have little or no history with a particular crop—from getting adequate insurance.⁸ Accordingly, RMA established a new-producer option in which transitional

⁴ Sixteen AIPs operated in reinsurance years 2007 and 2008.

⁵ FCIC provided \$9.5 billion in premium subsidies for reinsurance years 2007 and 2008.

⁶ Public Law 103-66, Title I, *Agricultural Reconciliation Act of 1993* (part of the Omnibus Budget Reconciliation Act of 1993).

⁷ A transitional yield is an estimated yield provided by RMA to use in calculating average/approved APH yields when less than 4 years of actual, temporary, and/or assigned yields are available on a crop by county basis.

⁸ Public Law 103-66, Title I, *Agricultural Reconciliation Act of 1993*, section 1403, amended the Federal Crop Insurance Act to require FCIC to institute requirements for the documentation of the APH of insured producers to establish recorded or appraised yields for crop insurance coverage that more accurately reflect the associated actuarial risk, except that FCIC may not carry out this paragraph in a manner that would prevent beginning producers from obtaining adequate Federal crop insurance, as determined by FCIC. In response, FCIC introduced a new-producer yield option as part of the crop insurance program starting with the 1994 reinsurance year.

yields provide a substitute yield where there is a lack of production history. As a means of encouraging producers to begin farming crops, new producers are entitled to higher, substitute yields during their first years in the program.⁹ In effect, using this assigned yield gives new producers the opportunity to purchase insurance coverage at rates that would otherwise require some years of demonstrated success with a given crop. Coverage of higher yields results in higher indemnity payments from RMA to the insured producers if insured crops fail due to disease, adverse weather conditions, and other risks of production.

AIP Responsibilities in the Crop Insurance Process

The crop insurance process begins when a producer submits an application to an AIP for a policy with a certain coverage level. The AIP uses RMA-approved procedures to assess whether the application is properly completed and timely submitted. If the applicant is determined eligible, the AIP is to then accept and process the application. The insurance provider issues a summary of coverage and the appropriate policy discounts to the applicant. On or before the applicable reporting date, the insured producer must report specific information to the AIP.¹⁰ The insurance provider uses this information to establish the amount of coverage and premium for the crop.

The AIP's contractual obligation requires that companies must underwrite policies and adjust any losses that may occur. Underwriting is one of the primary functions of any insurance company. It includes the process of determining applicants' eligibility, the risk involved to insure crops, the amount of coverage and premiums, and the terms of the insurance policy.¹¹

When AIPs agree to participate in the Federal Crop Insurance Program, RMA writes the terms of the insurance policy and sets the premium rates.¹² The SRA provides that AIPs will determine applicants' eligibility, the risks involved in insuring crops, and the amount of coverage. According to the contractual provisions of the SRA, AIPs must follow RMA's underwriting policies and procedures.¹³

If producers suffer a loss, they make a claim, and the AIP sends a loss adjuster to the crop site to determine the amount of loss and the resulting indemnity and to review policy-related documents.¹⁴ RMA has established general procedures for this process and lists them in the *Loss Adjustment Manual Standards Handbook*. In addition, since RMA reinsures producers on a crop-by-crop basis, the agency publishes loss adjustment standards for each crop.

⁹ FCIC 18010, *Crop Insurance Handbook*, section 6C (1), dated June 26, 2006, provides that when an insured producer does not provide acceptable production records, then the insured producer would only be eligible for a percentage of the transitional yield.

¹⁰ The production reporting date is typically 45 days after the sales closing date for the crop in the county. Sales closing dates vary based on geographical location.

¹¹ The SRA defines underwriting as the determination of the terms and conditions by which the AIP will accept the risk for an eligible crop insurance contract.

¹² Title 7, *Code of Federal Regulations*, chapter 4, section 400.166, dated January 1, 2007.

¹³ 2005 SRA, section II.A.9(a)(i), dated June 10, 2004.

¹⁴ FCIC 25010, *Loss Adjustment Manual*, part 1, paragraph 8, dated January 26, 2007.

According to the SRA, AIPs are responsible for implementing a quality control process for all insurance products reinsured under the agreement.¹⁵ These responsibilities include conducting quality control reviews of high-dollar claims (all claims exceeding \$100,000). During these and other reviews, RMA requires AIPs to follow RMA-approved procedures to validate that claim-related information is accurate.

Crop Records Related to New-Producer Policies

Crop records relevant to verifying new-producer status exist in multiple locations. RMA maintains up to 10 years of production records related to the Federal Crop Insurance Programs in its database. Similarly, the Farm Service Agency (FSA) maintains acreage records related to FSA programs in its database and on paper at county offices. Additionally, the two agencies developed and implemented a common database of producer-related information known as the Comprehensive Information Management System (CIMS).¹⁶

AIPs can access these records in several ways to assist them in validating a policyholder's information. They can check RMA records by requesting individual records or 5 years of policy data from RMA. For FSA records, AIPs can contact FSA offices to obtain paper copies of documents or now access CIMS to review up to 5 years of FSA acreage records.

Objectives

The objective of our audit was to assess how RMA has administered the new-producer program procedures for the crop insurance program to prevent improper increases to yield guarantees.

¹⁵ 2005 SRA, Appendix IV, section III, *Quality Control Guidelines*, dated June 10, 2004.

¹⁶ Public Law 107-171, *Farm Security and Rural Investment Act of 2002*, Title X, Subtitle H, section 10706, dated May 13, 2002, instructed FSA and RMA to combine, reconcile, redefine, and reformat current acreage reporting data elements to allow both agencies to use CIMS as a single source of common information. CIMS was not available for use by AIPs for the reinsurance years under our review.

Section 1: New-Producer Option

Finding 1: AIPs Did Not Verify New-Producer Status

We found that producers who were not eligible for new-producer status held 154 of 176 new-producer-designated crop insurance policies in our sample.¹⁷ AIPs sold and serviced these improper policies because they did not effectively carry out their contractual responsibilities for validating new-producer status during the insurance process, and used information throughout the process without verifying it against RMA and FSA records. AIPs widely stated they generally assumed controls were sufficient and relied on RMA's data controls based on a belief that RMA identified ineligible new producers. However, RMA's controls were not designed to be a sole control over eligibility. As a result of AIPs not carrying out their contractual responsibilities to verify information during the insurance process, RMA reinsured \$5.5 million in liabilities for 154 policies not eligible for new-producer status—57 of these policies resulted in indemnities and associated costs totaling \$3.3 million.¹⁸

Specifically so that producers are not penalized for lacking a history of producing the insured crop, RMA established a separate insurance option. To be eligible for new-producer status, producers may have no more than a total of 2 years of experience producing the insurable crop.¹⁹ RMA requires new producers to certify their eligibility for new-producer status, including any history of producing the crop in the county.²⁰

When AIPs sign the SRA, they enter into a contractual agreement to underwrite, service, and process claims, and, if appropriate, pay indemnities on the policies for which they accept liability. The SRA states that AIPs must verify yields and other information used to establish insurance coverage and indemnity payments according to RMA's regulations and procedures, and does not exempt new-producer policies from this requirement. RMA requires AIPs to verify new-producer status before they pay an indemnity and to also verify it during quality control reviews on all claims exceeding \$100,000.²¹ Failure to identify ineligibility before indemnity payments are made can cause RMA to experience relatively significant losses.

AIPs have agreed to responsibly administer the new-producer option, but have not always administered adequate controls to prevent improper increases to insurance coverage by ensuring that they grant new-producer status only to producers without 2 years of production history on

¹⁷ We determined that AIPs sold 22 of the 176 policies to producers who qualified for new-producer status due to policy exceptions such as insurability or intended use of the crop—not all records affect the producer's status for the particular crop in the particular county.

¹⁸ Indemnities for the 57 policies totaled \$2.4 million and associated costs totaled \$910,000.

¹⁹ FCIC 18010, *Crop Insurance Handbook*, section 3, "Definitions," June 26, 2006.

²⁰ RMA requires this on "production report" forms, which are written records showing the insured producer's annual production used to determine the insured producer's yields for insurance purposes. The report contains yield information for previous years, including planted acreage and harvested production. A majority of producers interviewed were unaware that they had certified to new-producer status. Therefore, we did not refer any producers to investigations for criminal prosecution.

²¹ FCIC 18010, *Crop Insurance Handbook*, Exhibit 37 (3), June 26, 2006.

record during the period of our review. When we examined RMA yield records to evaluate whether insured producers were eligible for new-producer status, we found that 13 percent of the insured producers who held new-producer policies for crop years 2007 and 2008 had more than 2 years of data related to crop acreage on record with FSA.²² Such data conflicts with the not-more-than-2-year crop history requirement for new-producer status.²³

To determine whether producers with more than 2 years of records were eligible for new-producer status due to technical reasons or exceptions, we judgmentally selected a sample of 176 new-producer policies with more than 2 years of data for further review.²⁴ This sample included policies administered by a total of 11 different AIPs. Our review disclosed that AIPs underwrote 154 new-producer policies to insured producers not eligible for new-producer status because they had records in FSA's database, including 23 insured producers who had records in RMA's database as well.²⁵ We confirmed that each of the AIPs used producer self-certifications that AIPs did not verify with available records. They therefore improperly attributed new-producer status to producers who had more than 2 years of experience with the specified crops on record.

We concluded that AIPs used erroneous acreage and production information that conflicted with information available in *both* RMA and FSA records when underwriting policies and disbursing indemnity payments because AIPs generally did not verify whether the producers who self-certified as new producers were eligible for new-producer status. RMA officials agreed with us that AIPs are required to verify new-producer status at loss adjustment—including by checking RMA and FSA records. However, we found no indication that the respective AIPs checked records with either of these agencies to verify the status of 71 of the 72 policies in our sample that filed loss claims and received payments.²⁶ Our checks of these records revealed that a total of 57 of the 72 loss-adjusted policies were not eligible for new-producer status.²⁷

We observed significant AIP noncompliance with RMA's requirement to verify all provided information at loss adjustment, as well as AIP noncompliance with the SRA at underwriting and during quality control reviews.

²² We found that information listed in acreage histories on record with FSA and with RMA indicated that 19,285 out of 144,000 new-producer policies held in crop years 2007 and 2008 already had more than 2 years of experience in the crop.

²³ For technical reasons such as insurability or intended use of the crop, not all records affect the producer's status for the particular crop in the particular county.

²⁴ Since the majority of producers have records with both RMA and FSA, we compared records from both databases and verified records using a commonly accepted FSA form. Specifically, we compared Form FSA-578, *Report of Acreage*, with FSA's databases and RMA's database. FSA databases contain at least 10 years of records. AIPs can check FSA's records by contacting FSA county offices and obtaining paper copies of documents. AIPs can also now search FSA records electronically, through the CIMS that houses 5 years of FSA records. RMA has made a 5-year table in its historical database of producer records readily available to AIPs.

²⁵ The 23 had RMA records that AIPs could access.

²⁶ One AIP documented that it verified the new-producer status of one policy.

²⁷ We determined that for 72 policies that resulted in indemnities, AIPs serviced 15 policies for producers who qualified for new-producer status for technical reasons or who received other types of indemnity payments.

In particular,

- AIPs did not always adequately administer required underwriting controls such as policy documents to support the self-certification process. For example, we noted that almost half of the policies in our sample were supported by forms that AIPs did not develop to RMA's standards.²⁸ Although AIPs have a fundamental responsibility to protect program integrity, not all AIPs have ensured that they obtain acceptable certifications and minimize the number of errors.²⁹
- AIPs did not verify policy information at loss adjustment and subsequently provided indemnity payments calculated with new-producer rates for 57 policies that were not eligible for new-producer status.
- AIPs did not adequately conduct required quality control reviews of new-producer status prior to payment of all claims over \$100,000. Although AIP personnel are required to retrace all information collected during the insurance process and confirm that it is accurate, none of the AIPs examined FSA records to determine the accuracy of new-producer certifications when reviewing the four high-dollar claims in our sample.

Overall from our sample, we determined that AIPs did not verify new-producer status during the insurance process. Of the 176 new-producer policies we examined, AIPs paid out indemnities on 57 policies that were not eligible for new-producer status.

For instance, one producer in our sample who already had more than 2 years of experience received a \$172,913 indemnity payment from a new-producer-designated policy. Since this producer would have received an \$111,962 indemnity payment from a standard policy, the producer received an overpayment of \$60,951.³⁰ Because this producer, who was ineligible for new-producer status obtained a new-producer policy the following year as well and also experienced a loss that year, the producer then received a second overpayment of \$25,809.³¹ By twice obtaining a status for which he was ineligible, this producer received a total of \$86,760 in additional indemnity payments.

If the AIPs had better controls over eligibility for new-producer status, they could have prevented RMA from reinsuring 57 policies ineligible for new-producer status with \$2.4 million in crop insurance losses. They did not. Given that AIPs issued indemnity payments on a total of 6,026 policies for new producers outside our sample, with indemnities totaling \$56.2 million, RMA may have participated in reinsuring other policies ineligible for new-producer status as well.

²⁸ FCIC Handbook 24040, *Document and Supplemental Standards Handbook*, dated November 17, 2006, requires a new-producer checkbox on the Production Report. However, 5 AIPs developed production report forms for standard use during the underwriting process that did not have the required certification format of a checkbox for new-producer status. These 5 AIPs underwrote 90 of the 176 policies.

²⁹ We identified, for instance, that 5 AIPs accepted forms for a total of 11 policies that received new-producer status but which were either not signed by the required date or not marked for new-producer status.

³⁰ The payment was based on RMA's yield allowance calculation of 15 additional bushels per acre because new-producer yields were used to calculate the payment. However, the indemnity should have been calculated based on a percentage of the transitional yield reflecting the producer's APH.

³¹ The payment was based on a yield that was 5 bushels per acre higher than he should have received.

We concluded that AIPs violated the requirements they agreed to under the SRA by offering insured producers a type of policy to which they were not entitled and by failing to verify the eligibility status of these insured producers during the insurance process. As the SRA states, RMA reserves the right to deny reinsurance for any insurance contract sold or serviced in violation of the terms of the agreement.³² As such, RMA should deny reinsurance on these policies and recover RMA's share of \$2.4 million in new-producer crop insurance policy losses and \$910,000 in associated costs RMA incurred in relation to at least 57 policies that RMA participated in reinsuring. In addition, RMA should pursue other actions, including requiring AIPs to verify new-producer status for the remaining 6,026 new-producer policies with indemnities totaling \$56.2 million that we identified as having more than 2 years of acreage records with FSA. Finally, strengthening controls over new-producer eligibility would ensure that insured producers with more than 2 years of acreage experience obtain insurance coverage that reflects the proper rate and guarantee for their production experience and, in turn, reduce improper indemnities.

Recommendation 1

Deny reinsurance for \$5.5 million in liability underwritten by the 11 AIPs for crop years 2007 and 2008 for 57 policies with losses that were assigned to producers who were not eligible for new-producer status. Also, assess additional penalties on AIPs to the maximum extent allowed under the SRA.

Recommendation 2

Recover the Government's share of the \$2.4 million in indemnities that the 11 AIPs paid out on the 57 policies, along with \$910,000 in associated costs.

Recommendation 3

Require the AIPs to verify new-producer eligibility for the other 6,026 policies that received indemnities and had more than 2 years of FSA acreage records. Take appropriate corrective action on these policies, including any changes in indemnities, APH yields, premium, premium subsidies, and administrative and operating expenses for all years affected.

Agency Response

The agency is prohibited from taking any actions to address Recommendations 1 through 3, due to the 3-year notification limitation set forth in the Federal Crop Insurance Act, section 515, Program Compliance and Integrity which states the following under (b) Notification of Compliance Problems:

³² 2005 SRA, section IV.G.6, dated June 10, 2004.

- (1) Notification of errors, omissions, and failures. The Corporation shall notify in writing an approved insurance provider of any error, omission, or failure to follow Corporation regulations or procedures for which the approved insurance provider may be responsible and which may result in a debt owed the Corporation.
- (2) Time for notification.--Notice under paragraph (1) shall be given within 3 years after the end of the insurance period during which the error, omission, or failure is alleged to have occurred, except that this time limitation shall not apply with respect to an error, omission, or procedural violation that is willful or intentional.
- (3) Effect of failure to timely notify.--Except as provided in paragraph (2), the failure to timely provide the notice required under this subsection shall relieve the approved insurance provider from the debt owed the Corporation.

OIG Position

Based on the 3-year notification limitation placed on RMA, and its proposed actions to be taken under Recommendation 6, where RMA plans to identify and evaluate instances of non-compliance with the new-producer eligibility requirement and take the appropriate corrective action, we accept management decision for Recommendations 1 through 3.

Recommendation 4

Issue a bulletin to AIPs that specifically requires them to verify and document new-producer eligibility at the time of underwriting.

Agency Response

RMA concurred with this recommendation. RMA will instruct AIPs to use available system resources for new producer status verification, such as CIMS and RMA's policyholder inquiry system.

OIG Position

We accept RMA's management decision for this recommendation.

Recommendation 5

Require AIPs to maintain documents supporting their new-producer determinations made at the time of loss, including checks of RMA's database or records at the FSA county offices as necessary, and make them available to RMA upon request.

Agency Response

RMA concurred with this recommendation. RMA will incorporate procedures into the FCIC 25010, *Loss Adjustment Manual*, for the 2013 crop year requiring AIPs to maintain documentation in the file substantiating their determination that an insured producer qualifies for new-producer status. Supporting documentation may include underwriting verification from available system resources or records from the county FSA office.

OIG Position

We accept RMA's management decision for this recommendation.

Recommendation 6

Instruct AIPs to verify and document that new-producer eligibility determinations were properly made during the quality control review process, including through the use of RMA's database or by checking records at the FSA county offices as necessary, before indemnities were paid for each policy subject to a quality control review.

Agency Response

RMA concurred with this recommendation. RMA will instruct the Center for Agribusiness Excellence to conduct an analysis of producers using new producer yield types for crop years 2009 and 2010 to identify producers who do not meet the new-producer criteria. Instances of non-compliance will be assessed by RMA Compliance to determine and oversee the completion of appropriate corrective actions.

OIG Position

We accept RMA's management decision for this recommendation.

Finding 2: RMA Needs to Improve Data Processing Controls

RMA has implemented data entry system controls known as “edit checks” to prevent policies from erroneously being entered into RMA’s data system as new-producer policies.³³ However, our tests of RMA’s database identified that 49 of the 154 policies assigned to producers who were ineligible for new-producer status passed RMA’s edit check, even though the policyholders had more than 2 years of history data in RMA’s internal database records. This occurred because RMA’s new-producer edit check is limited by the way it currently functions. The edit check tests applicant-provided information against RMA’s producer history records, and was set up to identify discrepancies by testing only new-producer-designated years in tables of historical data rather than all years in the table. As a result of this limitation, the edit check did not identify all producers who were ineligible to receive new-producer status and stop them from entering RMA’s data system and being, effectively, reinsured.

RMA’s data validation handbook states that RMA employs a means of validating data to ensure that reimbursements are made based on accurate information. According to the handbook and SRA, RMA is responsible to perform checks of certain AIP data.

We observed that RMA’s edit check is limited to selecting and verifying only certain records, i.e., only those production history years specifically identified as new-producer policy option years. Currently, the edit check does not perform a comprehensive search of the entire 10 years of yield and acreage history for insured producers stored in RMA’s database to determine the total number of crop years for which the insured producer has histories. It checks only against yield records designated as new-producer and not other types of yield records. Thus, for example, the edit check will not reject an applicant with more than 2 years of acreage production records unless all three or more of those records had received a new-producer designation. Effectively, with current configurations, the edit check would not always identify if a producer with years of experience erroneously received new-producer status.

However, if RMA changed the edit check’s configuration, RMA could stop a number of erroneous policies from entering the data system and, thereby, being reinsured. RMA has indicated that it has the ability to change these configurations and has indicated its willingness to pursue future opportunities to enhance its edit checks by, for instance, checking submitted information against FSA data.

Recommendation 7

Enhance edit checks in RMA’s data validation system by specifically modifying the current edit check so that it validates against all consolidated yield records on file for insured producers.

³³ Edit checks are data validation tests intended to stop invalid data from entering the system.

Agency Response

RMA concurred with this recommendation. The new-producer edit was first introduced into the Data Acceptance System (DAS) with the 2003 Reinsurance Year (RY). The new producer Indexed Sequential Access Method (ISAM) file used by DAS to determine new producer status was built from 2001 forward at that time. As each new RY was programmed, a year was added to the new producer ISAM.

RMA randomly checked several of the 49 policies identified in the audit report to ascertain whether limitations in DAS edits allowed policies to be accepted with new-producer yields they were not entitled to. All of those policies randomly checked had the same problem. Data in the system that would have tripped the new-producer edits and rejected the data submitted was all before 2001 with the exception of one company policy. The policy in question had 2001 to 2005 acreage records in the database, but 2001 thru 2004 were prevented planting records that would not have changed the new producer status. 2005 had planted acres but would have still qualified for new-producer status with only 1 year producing the crop.

The limitation in the edit of only checking the "I" yield records instead of an edit to check all Yield Years after 2001 in the database against the new-producer ISAM will be corrected in the 2009 and 2010 DAS code, as these are the only active years of DAS processing. The Policy Acceptance and Storage System (PASS) code for all years (2011 forward) will have this modification done as well.

OIG Position

We accept RMA's management decision for this recommendation.

Scope and Methodology

Our audit examined crop insurance policies where insured producers claimed new-producer status. Using RMA's database systems, we identified 144,185 crop policies recorded as new-producer policies for crop years 2007 and 2008 with premiums of about \$617 million and losses of about \$507 million. We conducted fieldwork between June 2009 and August 2011.

For these 144,185 new-producer policies, we compared policy data with acreage report data obtained from FSA and identified 19,285 of those policies that had 3 or more years of FSA acreage history. For the 2007 crop year, we obtained and compared FSA reports from 1997 through 2006, and for the 2008 crop year, we obtained FSA acreage reports from 1998 through 2007. The 19,285 new-producer policies identified as having 3 or more years of FSA acreage history of producing the crop had total premiums of about \$58.6 million, and associated losses of about \$60 million.

Based on the number of new-producer policies identified in each State, we judgmentally selected and performed fieldwork in Colorado, Kansas, Louisiana, North Dakota, and Texas. We selected three States with the largest number of new-producer policies (Kansas, North Dakota, and Texas) and two States based on their location (Colorado and Louisiana) to ensure adequate geographical coverage. Within each State, we selected 2 counties with a minimum of 30 new-producer policies, as follows: Kiowa and Weld Counties in Colorado; Gray and Stevens Counties in Kansas; Morehouse and Richland Parishes in Louisiana; Towner and Benson Counties in North Dakota; and Parmer and Castro Counties in Texas. We also considered other factors when selecting counties, such as agents and AIPs with a large number of new-producer policies in the county. Therefore, our selection of new-producer policies included a total of 10 counties in 5 States.

In the 10 counties, there were 643 new-producer policies with total premiums of about \$3.5 million and losses of about \$3.3 million. We judgmentally selected 176 of these 643 new-producer policies for review based on factors such as the loss amount, crop, as well as policies without losses in order to obtain a combination of policies. Our sample included 72 policies with losses and 104 policies without losses. In total, these 176 new-producer policies included about \$1.85 million in total premiums and \$2.76 million in associated losses.

To accomplish our objectives, we performed the following audit procedures:

- We reviewed applicable laws, regulations, and procedures concerning administration of the Federal Crop Insurance Program, including those provisions pertaining to the new-producer policy option.
- We interviewed officials at the RMA national office in Washington, D.C., and RMA Office of Product Management in Kansas City, Missouri, to assess internal controls over the new-producer option and gain an understanding of RMA's expectations of the AIPs in administering the new-producer provision.

- We reviewed RMA policies and procedures specific to underwriting, loss adjustment, and quality control of policies with a new-producer designation.
- We performed analysis on RMA databases to identify new producers and used crop acreage data obtained from FSA to further identify instances where new-producer eligibility requirements may not have been met.
- We reviewed information related to 11 total AIPs, and interviewed officials at 6 AIPs regarding their roles in the underwriting, loss adjustment, and quality control process.
- We interviewed 90 insured producers, 40 loss adjusters, and 37 agents to verify underwriting and loss information, evaluate program delivery, ascertain their role and knowledge of new-producer eligibility requirements, and ascertain whether policyholders with more than 2 years of history of planting the crop in the county were aware they had received new-producer status.
- We reviewed acreage reports obtained from FSA to confirm the electronic FSA acreage data used in our analysis, confirm RMA data, and confirm documentation obtained from the AIP.
- We reviewed RMA's DAS controls and procedures for recording insurance policy information submitted by AIPs pertaining to the new-producer option to gain understanding of the process.
- We reviewed underwriting, loss adjustment, and quality control documents obtained from the AIPs for our sample of insured producers to verify their eligibility for the new-producer option claimed and indemnities paid to them.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For the 176 policies reviewed, the forms obtained from the AIPs matched the data recorded in RMA's databases.

Abbreviations

APH.....	Actual Production History
AIP	Approved Insurance Provider
CIMS.....	Comprehensive Information Management System
DAS.....	Data Acceptance System
FCIC.....	Federal Crop Insurance Corporation
FSA	Farm Service Agency
ISAM.....	Indexed Sequential Access Method
OIG	Office of Inspector General
PASS.....	Policy Acceptance and Storage System
RMA	Risk Management Agency
RY	Reinsurance Year
SRA.....	Standard Reinsurance Agreement

Exhibit A: Summary of Monetary Results

Finding	Recommendation	Description	Amount	Category
1	2	Indemnities, Premiums, and Administrative and Operating Expenses Paid	\$3,310,000	Questioned Costs Recovery Recommended

**USDA'S
RISK MANAGEMENT AGENCY
RESPONSE TO AUDIT REPORT**



June 25, 2012

**United States
Department of
Agriculture**

Risk
Management
Agency

1400 Independence
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Stop 0801
Washington, DC
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TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Michael Hand /s/
Audit Liaison Official

SUBJECT: Office of Inspector General Audit 05099-114-KC Official Draft Report,
Validity of New Producers

Outlined below is the Risk Management Agency's (RMA) response to the recommendations in the subject report.

RECOMMENDATION NUMBER 1:

Deny reinsurance for \$5.5 million in liability underwritten by the 11 AIPs for crop years 2007 and 2008 for 57 policies with losses that were assigned to producers who were not eligible for new-producer status. Also, assess additional penalties to the maximum extent allowed under the SRA.

RECOMMENDATION NUMBER 2:

Recover the Government's share of the \$2.4 million in indemnities that the 11 AIPs paid out on the 57 policies, along with \$910,000 in associated costs.

RECOMMENDATION NUMBER 3:

Require the AIPs to verify new-producer eligibility for the other 6,026 policies that received indemnities and had more than 2 years of FSA acreage records. Take appropriate corrective action on these policies, including any changes in indemnities, APH yields, premium, premium subsidies, and administrative and operating expenses for all years affected.

RMA Response to Recommendation Numbers 1, 2, and 3

The agency is prohibited from taking any actions to address these recommendations due to the 3-year notification limitation set forth in the Federal Crop Insurance Act, Section 515, Program Compliance and Integrity which states the following under (b) Notification of Compliance Problems:



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

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(1) Notification of errors, omissions, and failures. The Corporation shall notify in writing an approved insurance provider of any error, omission, or failure to follow Corporation regulations or procedures for which the approved insurance provider may be responsible and which may result in a debt owed the Corporation.

(2) Time for notification.--Notice under paragraph (1) shall be given within 3 years after the end of the insurance period during which the error, omission, or failure is alleged to have occurred, except that this time limitation shall not apply with respect to an error, omission, or procedural violation that is willful or intentional.

(3) Effect of failure to timely notify.--Except as provided in paragraph (2), the failure to timely provide the notice required under this subsection shall relieve the approved insurance provider from the debt owed the Corporation.

Due to the above restriction RMA is prevented from implementing the above recommendations and requests there closure.

RECOMMENDATION NUMBER 4:

Issue a bulletin to AIPs that specifically requires them to verify and document new-producer eligibility at the time of underwriting.

RMA Response:

RMA concurs with this action and expects to complete it by September 2012. Although producers certify to their new producer status, RMA will instruct AIPs to use available system resources for new producer status verification, such as CIMS and RMA's policyholder inquiry system.

RMA requests management decision for this recommendation.

RECOMMENDATION NUMBER 5:

Require AIPs to maintain documents supporting their new-producer determinations made at the time of loss, including checks of RMA's database or records at the FSA county offices as necessary, and make them available to RMA upon request.

RMA Response:

RMA concurs with this action and expects to complete it by March 2013.

RMA will incorporate procedure into the FCIC 25010 Loss Adjustment Manual for the 2013 crop year requiring AIPs to maintain documentation in the file substantiating their determination that an insured qualifies for new-producer status. Supporting documentation may include underwriting verification from available system resources, or records from the county FSA office.

RMA requests management decision for this recommendation.

RECOMMENDATION NUMBER 6:

Instruct AIPs to verify and document that new-producer eligibility determinations were properly made during the quality control review process, including through the use of RMA's database or by checking records at the FSA county offices as necessary, before indemnities were paid for each policy subject to a quality control review.

RMA Response:

RMA will instruct the Center for Agribusiness Excellence to conduct an analysis of producers using "new producer" yield types for crop years 2009 and 2010 to identify producers who do not meet the new producer criteria. Instances of non-compliance will be assessed by RMA Compliance to determine and oversee the completion of appropriate corrective actions. RMA expects to complete these tasks by May of 2013.

RMA requests management decision for this recommendation.

RECOMMENDATION NUMBER 7:

Enhance edit checks in RMA's data validation system by specifically modifying the current edit check so that it validates against all consolidated yield records on file for insured producers.

RMA Response:

RMA concurs with this action and expects to complete it by September 2012.

The new producer edit was first introduced into the Data Acceptance System (DAS) with the 2003 Reinsurance Year (RY). The new producer Indexed Sequential Access Method (ISAM) file used by DAS to determine new producer status was built from 2001 forward at that time. As each new RY was programmed a year was added to the new producer ISAM.

RMA randomly checked several of the 49 policies identified in the audit report to ascertain whether limitations in DAS edits allowed policies to be accepted with new producer yields they were not entitled to. All of those policies randomly checked had the same problem. Data in the system that would have tripped the new producer edits and rejected the data submitted was all before 2001 with the exception of one company policy. The policy in question had 2001 to 2005 acreage records in the database, but 2001 thru 2004 were prevented planting records that would not have changed the new producer status. 2005 had planted acres but would have still qualified for new producer status with only one year producing the crop.

The limitation in the edit of only checking the "I" yield records instead of an edit to check all Yield Years after 2001 in the database against the new producer ISAM will be corrected in the 2009 and 2010 DAS code as these are the only active years of DAS processing. The

Policy Acceptance and Storage System (PASS) code for all years (2011 forward) will have this modification done as well.

RMA requests management decision for this recommendation.

Should you have any questions or require additional information, please contact Alan Sneeringer at (202) 720-8813.

cc ORC Official File: 05099-114-KC
ORC/Chron

Informational copies of this report have been distributed to:

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Attn: Deputy Administrator, Compliance

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