U.S. Department of Agriculture

Office of Inspector General
Southwest Region

# Audit Report

## Risk Management Agency
## Survey of Pilot Programs

Audit Report 05601-12-Te
May 2005

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

May 24, 2005

TO: Ross J. Davidson, Jr.
Administrator
Risk Management Agency

ATTN: Michael Hand
Deputy Administrator
for Compliance

FROM: Robert W. Young /s/ R. W. Young
Assistant Inspector General
for Audit

SUBJECT: Audit Report 05601-12-Te - Risk Management Agency Survey of Pilot Programs

This report presents the results of the subject audit. Your response to the official draft report, dated April 21, 2005, is included in its entirety as exhibit D with excerpts and the Office of Inspector General's (OIG) position incorporated into the Findings and Recommendations section of the report. Your response contained sufficient justification to reach management decision on Recommendation 7. Please follow Departmental and your internal agency procedures in forwarding final-action correspondence to the Director, Planning and Accountability Division, Office of the Chief Financial Officer.

Based on the response, management decisions have not been reached for Recommendations 1, 2, 3, 4, 5, and 6. The information needed to reach management decisions is set forth in the OIG Position section after each recommendation. In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation for those recommendations for which a management decision has not yet been reached. Please note that the regulation requires a management decision to be reached for all recommendations within a maximum of 6 months from the date of report issuance. Final action on the management decisions should be completed within 1 year of the date of the management decisions to preclude 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 the audit.

# Executive Summary

***Risk Management Agency Survey of Pilot Programs (Audit Report 05601-12-Te)***

**Results in Brief**

Under pilot programs, the Risk Management Agency (RMA) will extend insurance coverage to previously uninsured agricultural commodities to gain experience with those commodities and test expectations (e.g., size of participation, premium income, cost to the Government, etc.). Although the primary objective of our audit was to determine if the actuarial soundness of pilot programs had improved through changes enacted by the Agricultural Risk Protection Act of 2000, we concluded that the act was too new for program data to show any impact. None of the nine pilot programs being developed by the RMA Research and Evaluation Division (RED), through contracts since passage of the act, had reached the stage where participants might actually seek coverage. Consequently, we focused our review on RMA's monitoring to ensure the actuarial soundness of the pilot programs in place during the phasing in of the act and the efforts by RMA to incorporate the act's changes into its policies and procedures.

RMA needs to strengthen its monitoring of pilot programs during its evaluation periods. For the three commodities we reviewed - sweet potatoes, fresh market beans, and processing cucumbers - RMA experienced mounting losses through consecutive years but either made no adjustments to program provisions or made adjustments that had no perceptible effect on the losses themselves. RMA has in place a monitoring process through which the agency is to measure on a yearly basis each pilot program's performance against its established goals of participation, premium income, etc. However, we found that the monitoring process was ineffective.

- RMA staff members were never directed to perform any formal annual reviews of the three commodities we reviewed. In the case of sweet potatoes, RMA waited until the fifth year of the program before contracting for an evaluation. No goals for this program had been established. Total indemnities to the program exceeded $47 million through crop year 2003.

- RMA relied on informal monitoring of its pilot programs, with no requirement to measure performance against goals and no requirement to justify any program adjustments that resulted from the monitoring. Adjustments made to the processing cucumber and fresh market bean programs did not reduce the $29 million in indemnities incurred over the first 4 years of informal monitoring.

Program costs are measured in terms of “loss ratios,” or the dollars paid in indemnities compared to the dollars collected in premiums. Legislation had established a loss ratio of 1.075 ($1.07 in indemnities paid for every $1 in premiums collected) as a target for RMA to work towards for all insurance programs. The average-loss ratio for sweet potatoes for the first 6 years of the program was 4.06. The averages for processing cucumbers and fresh market beans were 2.97 and 2.78, respectively, for the first 4 years of data availability (see exhibit B). We concluded that continuing high-loss ratios such as those exhibited by the three programs we reviewed were sufficient indicators that some measure of program performance against established goals was needed and that meaningful program adjustments were warranted.

In general, RMA needs to establish clearer direction for its pilot program monitoring process. Existing procedures describe the content of the annual evaluations, but they do not clarify which level, regional or division, is responsible for documenting program specifications and analysis of field reviews. Informal monitoring is similarly without guidance. Program changes made as a result of informal monitoring show minimal analysis to support the changes or explain what concern (i.e., from trade groups, insurers, etc.) the changes intended to address. We concluded that the adjustments made to the processing cucumber and fresh market bean programs had little impact during the first 4 years on the losses sustained by those programs.

RMA also has been slow to incorporate changes set forth by the Agricultural Risk Protection Act of 2000 into its policies and procedures. Under the act, RMA must retain contractors to determine if a crop is actuarially feasible and to develop an insurance program for that crop. Of the nine pilot programs being developed by contractors, we reviewed the Hawaii Tropical Fruits and Trees Pilot Program, predicted to be the first made available to producers. Our review disclosed that although the changes set forth in the act for contracting had been implemented, RMA had not developed written procedures that reflected these changes. Since the passage of the act over 4 years ago, RMA is still in the process of revising the procedures in the 1997 New Program Development Handbook.

## Recommendations In Brief

We recommend that RMA establish and implement management controls to ensure that prescribed procedures for monitoring and reviewing pilot programs are timely performed on a routine basis. In addition, RMA should review the monitoring and any other evaluations of the Sweet Potato Pilot Program and determine if any personnel action should be initiated against any responsible individual for the losses incurred by this program. We also recommend that RMA implement comprehensive policies and procedures to prescribe monitoring activities, analyses requirements, and oversight responsibilities within the RED staff and the field offices. Finally, RMA should implement standardized procedures for developing pilot programs to include contracting for feasibility, development, and post-pilot program evaluations. These procedures also should include the newly established oversight and annual review process.

### Agency Response

In a letter dated April 21, 2005, RMA disagreed with some of our conclusions, but it nonetheless generally concurred with the recommendations and provided corrective actions. (See exhibit D.) RMA agreed to revise the New Program Development Handbook to include procedures and scheduling for monitoring of pilot programs. The agency proposed a completion date of May 30, 2005, for the new handbook.

RMA also conditionally agreed, pending further analysis and evaluation, to assess the performance and conduct of employees responsible for the monitoring of the Sweet Potato Pilot Program and to determine if there are performance and/or conduct problems warranting disciplinary action.

Even though RMA concurred with Recommendations 3, 4, and 6, it raised a number of issues on the Office of Inspector General's recommendations. For Recommendation 3, RMA believed that it was redundant with Recommendation 1. Furthermore, RMA was not in full agreement that it must prescribe specific duties and responsibilities beyond those contained within position descriptions and performance standards. For Recommendation 4, RMA believed that the recommendation is similar to Recommendations 1 and 3 and, therefore, referred to its response to those recommendations. For Recommendation 6, RMA believed that this recommendation was redundant with Recommendation 4.

### OIG Position

Although RMA generally concurred with the recommendations and provided corrective actions, the agency believed that the pilot programs were monitored and that modifications addressed identified vulnerabilities. However, RMA failed to address in its response that required annual reviews were not performed for the three pilot programs reviewed and that changes were not made to the Sweet Potato Pilot Program to address mounting losses during the first 5 years of that program. RMA also failed to address that, because required annual reviews were not performed, potential vulnerabilities may not have been identified. Nevertheless, RMA agreed to improve its processes, policies, and procedures for overall strengthening of its pilot programs.

We accept the management decision for Recommendation 7. For Recommendations 1, 2, 3, 4, 5, and 6, we have explained in the Findings and

Recommendations section of the report the actions RMA needs to take for acceptance of management decision. RMA's written response is included as exhibit D of the report.

## *Abbreviations Used in This Report*

| | |
|---|---|
| ARPA | Agricultural Risk Protection Act of 2000 |
| CY | Crop Year |
| FCIC | Federal Crop Insurance Corporation |
| HTFT | Hawaii Tropical Fruits and Trees |
| OCFO/PAD | Office of the Chief Financial Officer/Planning and Accountability Division |
| OIG | Office of Inspector General |
| RED | Research and Evaluation Division |
| RMA | Risk Management Agency |

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# Background and Objectives

## Background

The Federal Crop Insurance Corporation (FCIC), a wholly owned Government corporation, was created to improve the economic stability of agriculture through a secure system of crop insurance.[1] The Federal Agricultural Improvement and Reform Act of 1996 authorized the formation of the Risk Management Agency (RMA) to handle the day-to-day operations of the Federal crop insurance program. The program provides producers with insurance coverage against crop failures due to crop diseases, hurricanes, and other risks of production.

The Federal Crop Insurance Act of 1980 contained provisions for expanding crop insurance to more crops and for providing coverage in most counties throughout the United States. To implement these provisions, RMA developed pilot programs for crops not previously covered by Federal crop insurance. These new programs came about primarily as a result of requests from individual producers, producer associations, and others. RMA's Research and Evaluation Division (RED) was responsible for developing, implementing, and monitoring the pilot programs. These activities consisted of studying the actuarial feasibility of insuring the crops, developing the rates and terms of insurance once feasibility was demonstrated, introducing the coverage in pilot areas, evaluating its effectiveness, adjusting the provisions of the coverage if the program's performance did not match its expectations, and terminating the program if losses could not be controlled. RED's New Program Development Handbook contains the standards and guidance used in these activities.

The Agricultural Risk Protection Act (ARPA), dated June 20, 2000, changed the process by which RMA is allowed to research and develop pilot programs. Section 131 of ARPA prohibits FCIC from conducting research and development for any new policies for agricultural commodities and requires that new product development be accomplished through contracts.

Two contracts are awarded for each crop, the first for a feasibility study and the second for program development. ARPA then requires the development package to be reviewed by a panel of at least five experts, such as actuaries or underwriters. The FCIC Board of Directors then makes a final decision to approve the programs for pilot status.

RED is responsible for awarding and overseeing the contracts and for monitoring the programs once their pilot status is confirmed. As a result, sections of the RED handbook dealing with research and development are no

[1] The FCIC was created February 16, 1938, under Title V of the Agricultural Adjustment Act of 1938.

longer relevant, while the sections that were not affected by ARPA (maintenance, evaluation, and expansion) are still applicable. According to the handbook, a pilot program must be evaluated at the end of its duration. This review is a post-pilot evaluation, and currently the majority of these are contracted out. The FCIC Board must then approve conversion to permanent status, previously the RMA Administrator's responsibility.

Of primary concern during the evaluation phase of any pilot program is its cost to the Government, expressed as a "loss ratio." This number compares the total premiums collected on the policies to the total indemnities paid on the loss claims. If RMA achieves a loss ratio of 1.00 on a crop, then it is paying $1 in indemnities for every $1 it collects in premiums. Loss ratios of less than 1.00 show actuarially sound insurance programs, while loss ratios greater than 1.00 may indicate actuarially deficient programs. Congress has mandated that RMA try to achieve a loss ratio of no more than 1.075 ($1.07 paid for every $1 collected) in all its programs.

Legislation[2] also allows grower organizations and other groups to develop new policies at their own expense and request reimbursement from FCIC after products are approved and reach a certain level of marketability. RMA's Product Development Division reviews these policies to ensure their completeness and submits them to the FCIC Board for approval as pilot programs. We did not include any of these programs in our review.

A previous Office of Inspector General (OIG) audit disclosed several weaknesses in the development of pilot programs. OIG Audit Report 05601-8-Te, Viability of Fall Watermelons in Texas and Their Inclusion in the 1999 Watermelon Insurance Pilot Program, issued September 2002, disclosed that RMA approved coverage of fall watermelons in its 1999 Watermelon Crop Insurance Pilot Program, even though evidence existed that this crop was not suitable to South Texas and was unlikely to produce a harvestable fruit. The coverage was nevertheless approved because RMA managers did not exercise adequate control over the program preparation and approval process to ensure that the development package, which set forth the scope of the pilot program, was complete, accurate, and specific as to the level of actuarial risk associated with each crop.

## Objectives

The objectives of our review were to determine if the pilot programs developed were actuarially appropriate and if the pilot program development process had incorporated the changes promulgated by ARPA.

[2] Title 7, United States Code, section 1508, subsection (h), dated January 2002.

# Findings and Recommendations

## Section 1. Monitoring of Current Pilot Programs

While ARPA mandates that RMA relinquish its authority to develop pilot programs, RMA remains responsible to monitor those programs and ensure their ongoing actuarial soundness. Consequently, how RMA monitors its current pilot programs will affect its performance under the act. We concluded that RMA needs to strengthen its monitoring policies and procedures to ensure that adjustments made to the current programs effectively control program costs to the Government. Half of the 34 pilot programs that were active in crop year (CY) 2002 exceeded the target-loss ratio of 1.075. These 17 programs had total premiums of $32.7 million and indemnities of $82.5 million, for a total loss to the Government of approximately $50 million for that 1 year.

RMA's monitoring was ineffective because RMA did not perform the required annual evaluations that would measure program performance against established program goals (e.g., premium income, volume of participation, etc.) and because it relied on an informal process that did not define clear levels of responsibility between the regions, the risk management specialists, and the Director of RED. Our review of the sweet potato program found that no evaluation had been performed during the first 4 years of the program while losses mounted. Our review of the processing cucumber and fresh market bean programs determined that while RMA made yearly adjustments to these programs, the adjustments had no perceptible effect on the losses and did not result from any formal documented analyses.

Ensuring that annual evaluations are performed is the responsibility of RED. Because the losses from the sweet potato program were so great, we are recommending that RMA review the monitoring activities of this program and determine if any administrative action should be initiated against any responsible individual within that division. We are also recommending that RMA develop comprehensive policies and procedures for monitoring pilot programs and include them in the New Program Development Handbook.

## Finding 1 RMA Did Not Complete Required Annual Reviews of Pilot Programs

Although RMA RED was responsible to conduct annual reviews of the pilot programs in place to ensure they performed according to the goals established for them, these reviews were not done. We found that for three of the programs - sweet potatoes, processing cucumbers, and fresh market beans - RMA experienced mounting losses through consecutive years, but either made no adjustments to program provisions or made adjustments that had no perceptible effect on the losses themselves. Program managers and regional personnel who would have carried out the annual reviews were never asked by the director to do them. For the three crops mentioned above, indemnities exceeded premiums by $54 million over the years 1998 through 2003.

Departmental guidance[3] states that agency heads and heads of staff offices are responsible for establishing and maintaining a system of management control in accordance with the Government Accountability Office's standards. Part of this responsibility includes ensuring timely correction of all agency-identified program and operational material deficiencies.

RMA's New Program Development Handbook states that, "the RED is responsible for ensuring that the pilot program is maintained by performing or coordinating with other appropriate units, activities such as * * * performing the annual evaluations of the pilot program." According to the handbook, the annual evaluation is to provide an overview of the pilot program through nine evaluation parameters. These parameters include measuring actual performance against established goals (e.g., size of participation, premium income, cost to Government, etc.), determining program adjustments that are warranted based on experience gained in delivering the program, and determining what specifically should be done to improve the program or whether the program should be terminated.[4]

The handbook also calls for a post-pilot evaluation of each program, to be conducted during the last year (usually fourth year) of the pilot program duration. This evaluation is to include an overview and a summary of all the annual evaluations.

We reviewed the evaluation process for three commodities: sweet potatoes, processing cucumbers, and fresh market beans. Processing cucumbers and fresh market beans showed consistent high-loss ratios since they were introduced in 2000. Sweet potatoes, introduced as a pilot program in 1998,

[3] Departmental Manual 1110-2, U.S. Department of Agriculture's Management Control Manual, chapter 1, section 4, General Policies and Responsibilities, dated November 29, 2002.
[4] RMA New Program Development Handbook, section 12A, dated October 1997.

had the highest 4-year, average-loss ratio. We did not find any documentary evidence that RED had performed annual reviews of the Sweet Potato Pilot Program. The Raleigh and Jackson regional offices performed reviews during the fifth year of the program. A "Mini Evaluation" was conducted for the Processing Cucumber Pilot Program in February 2002. However, the report did not cover any recommendations for the issues identified and did not cover the elements for annual reviews in the handbook. The Raleigh regional office submitted to RED an evaluation of the Fresh Market Bean Pilot Program in July 2002 and an evaluation of processing cucumbers in November 2002. Several recommendations were made and implemented into the special provisions of insurance. These evaluations were not requested by RED and did not include the elements in the handbook. No other regional offices conducted such reviews. There were no performance summaries of the program deficiencies that included recommendations for improvement and measurement of actual performance relative to performance goals. The risk management specialists at RED stated that the RED Director had not requested any annual pilot program reviews. Consequently, the RED risk management specialists did not review the performance data against performance goals for the pilot programs each year. Of these programs, 17 exceeded the overall program target-loss ratio of 1.075 in CY 2002.

Agency officials explained that there is not enough data available after 1 year to review a pilot program. Even if enough data were available, the officials said that limited resources would not allow them to conduct a formal review.

Considering the continued high losses that the Government was sustaining for the three commodities we reviewed, we concluded that it was not reasonable for RMA to forego annual evaluations of them every year. The sweet potato program consistently experienced loss ratios well above RMA's overall program target-loss ratio of 1.075. In fact, for its first 6 years (1998 through 2003), the program had an average-loss ratio of 4.06. For their first 4 years (2000 through 2003), processing cucumbers had an average-loss ratio of 2.97 and fresh market beans, 2.78.[5] (See exhibit B.) The history of losses throughout these periods is shown on the table below. For each year, losses exceeded twice the target-loss ratio (1.075 x 2 = 2.15).

[5] Because settlements for loss claims occur in years subsequent to the crop year, adjustments to loss ratios are made on a weekly basis and depend on the week they are reviewed. These loss ratios were calculated as of December 13, 2004.

**Table 1: Consecutive Yearly Losses Sustained for Sweet Potatoes, Processing Cucumbers, and Fresh Market Beans (as of February 21, 2005)**

| Crop | Year | Premiums | Indemnities | Loss Ratio |
|---|---|---|---|---|
| Sweet Potatoes | 1998 | $ 678,217 | $ 1,527,781 | 2.25 |
| | 1999 | $1,815,409 | $ 9,437,288 | 5.20 |
| | 2000 | $2,006,947 | $ 8,302,996 | 4.14 |
| | 2001 | $2,601,524 | $10,898,557 | 4.19 |
| | 2002 | $2,457,326 | $11,452,680 | 4.66 |
| | 2003 | $2,029,179 | $ 5,392,915 | 2.66 |
| | | | | |
| Processing Cucumbers | 2000 | $373,037 | $ 984,389 | 2.64 |
| | 2001 | $468,294 | $1,300,052 | 2.78 |
| | 2002 | $669,266 | $2,425,196 | 3.62 |
| | 2003 | $577,324 | $1,485,525 | 2.57 |
| | | | | |
| Fresh Market Beans | 2000 | $1,487,168 | $ 4,888,629 | 3.29 |
| | 2001 | $1,887,359 | $ 4,197,397 | 2.22 |
| | 2002 | $3,322,196 | $10,710,147 | 3.22 |
| | 2003 | $1,620,532 | $ 3,324,453 | 2.05 |

We maintain that the performance of these programs, as shown above, raises questions about their actuarial soundness under the provisions by which they were being delivered. The continued losses suggest that some adjustments to the provisions would be necessary, and that an annual evaluation would be required to determine the nature of those adjustments. However, a risk management specialist stated that no one asked him to conduct an annual review of the program performance. Consequently, no adjustments were made to the sweet potato program's special provisions throughout the first 5 years, depicted in table 1. Some adjustments were made to the processing cucumber program and the fresh market bean program, but these adjustments were not based on any formal documented reviews, and they did not seem to have a measurable impact on the continuing losses. (See Finding 2.)

The annual evaluation requires a measurement of actual performance relative to performance goals and determining program adjustments that are warranted. This information was not formally compiled for the sweet potatoes, processing cucumbers, and fresh market beans for the first 3 to 4 years of the pilot programs. The annual evaluation must also include a determination of whether the pilot program should be terminated. Again, this question was not addressed during the first 3 to 4 years of the programs.

In March 2003, a non-Government organization was awarded a contract to evaluate the sweet potato program. Additional changes were made to the special provisions as a result of the recommendations from this evaluation, and, after 5 consecutive years of high-loss ratios, RMA was required to develop a new sweet potato program to be implemented in CY 2005. The contractor specifically recommended that RMA gain a clear understanding of the reasons for the extremely poor loss experience in specific areas before allowing the program to continue in these areas.

We concluded that it was the responsibility of RMA RED to manage the pilot programs in such a way as to maintain their actuarial soundness, and that the annual evaluation was the method provided to the division to fulfill this responsibility. In the case of the sweet potato program, annual evaluations and subsequent program adjustments may have reduced the $47 million in loss claims made over the first 6 years the program was active. (See exhibit B.) Because of the large losses to the Government, we are recommending that RMA determine whether any individual in RED failed to exercise appropriate responsibility in their duties to oversee the Sweet Potato Pilot Program in a timely manner.

## Recommendation 1

Establish and implement management controls to ensure that prescribed procedures for monitoring and reviewing pilot programs are timely performed on a routine basis.

### Agency Response.

RMA concurs with this recommendation. RMA is revising its procedures in the New Program Development Handbook to include formal procedures and scheduling for monitoring of pilot programs. The revised handbook is scheduled to be finalized by May 30, 2005.

### OIG Position.

We cannot accept the RMA management decision for this recommendation. The previous handbook provided for annual evaluations that in some cases were not performed. In order to accept management decision, we need to know what specific management controls will be established and implemented to ensure that prescribed procedures for monitoring and reviewing pilot programs are timely performed on a routine basis.

## Recommendation 2

Review monitoring and any other evaluations of the Sweet Potato Pilot Program and determine if any personnel action should be initiated against any individual in RED for the losses incurred by this program.

## Agency Response.

RMA conditionally agrees with this recommendation pending further analysis and evaluation of this matter. Within a year, RMA will assess the performance and conduct of the employees responsible for the Sweet Potato Pilot Program, to determine if there are performance and/or conduct problems that warrant disciplinary action.

RMA also believes that its assessment of the employees' actions must take into consideration the innate risk associated with running a pilot program. RMA will address any performance and/or conduct issues without impairing its employees' ability to take risks.

## OIG Position.

We concur with RMA's decision to assess the performance and conduct of the employees responsible for the Sweet Potato Pilot Program and to determine if such actions warrant disciplinary action. However, we cannot accept management decision until we have been informed of RMA's determination of the action, if any, to be undertaken.

## Finding 2 Pilot Program Monitoring Processes Need Clearer Direction

We found that the processes available to RMA to monitor the pilot programs need strengthening to ensure the programs perform according to the goals established for them. Current guidance does not make clear distinctions between the responsibilities of the program manager and those of the regional office field personnel, and it does not define the procedures required to ensure that adjustments to the programs have been properly analyzed. For the three programs we reviewed, concerns and comments about the programs were either not communicated to the program manager or were communicated informally through verbal and electronic conversations. Adjustments made to the fresh market bean and processing cucumber programs, based on monitoring activities, had no perceptible effect on the losses experienced by these programs.

Although RMA currently is in the process of revising its guidance for pilot programs in the New Program Development Handbook, the evaluation section of the handbook, which covers annual and post-pilot reviews, remains unchanged. This section delineates the content of the annual evaluations, but it does not clarify which level, regional or division, is responsible for documenting program specifications and analysis of field reviews. For example, the risk management specialist in charge of the sweet potato program stated that he did not presume to measure the performance of the program against its established goals because there were no established goals.

Although the handbook lists the categories of performance goals of pilot programs (premium income, insured acreage, participation, etc.), it does not assign responsibility to anyone to determine the numerical goals for each program. The handbook also prescribes no oversight of the monitoring process to ensure the elements of an annual evaluation, such as performance goals, have been established. We concluded that such goals are critical to the actuarial soundness of a program. Low participation, for instance, could affect the level of risk borne by the Government. High participation, on the other hand, could expose the Government to greater liabilities.

The handbook also does not contain any guidance concerning the informal monitoring that occurs throughout the regions. RED uses this informal monitoring process to make changes to the pilot programs through the annual filing process. This occurs before the planting season each year, when actuarial documents for each pilot program are updated for the new crop year. The risk management specialist in charge of the pilot program communicates with the regional office where the program is piloted. The regional office has contact with the insurance company personnel, trade groups, and producers and has knowledge of how the program is working in the region. Their comments are relayed to the RED risk management specialist through e-mail and phone conversations. This monitoring is performed on a continuing basis when problems arise in the field. If changes are needed, they are relayed to the risk management specialist, who initiates the changes during the filing process for the pilot programs. Through this process, several changes were made to the pilot programs for processing cucumbers and fresh market beans during CYs 2001, 2002, and 2003.

We determined that, although the informal monitoring resulted in changes to the programs mentioned above, these changes were unsupported by any formal analysis and did not appear to affect the high losses that both programs were experiencing. For example, in the second year of the processing cucumber program, one region requested a change in the minimum value used for harvested and appraised production, lowering it to the lesser of the contract price or $3.75 per 50-pound bushel. While this change appears aimed at controlling the cost of the program to the Government, no documented analysis was available to explain the change or account for the stated value. In another example, a region requested an addition to the special provisions of the processing cucumber program to clarify that a landlord’s share of acreage is considered grown under a contract if the operator possesses a valid processor contract. In the absence of any analysis, it is unclear what this change was intended to correct or what performance goal it may have affected.

The documentation generated by the regional monitoring activities consisted largely of informal e-mail messages submitted by the regions to RED, informing RED of concerns the producers or insurance companies had and occasionally requesting changes to the provisions of the pilot programs. These documents appeared for all three pilot programs we reviewed. Changes were made to the processing cucumber and fresh market bean programs because these programs were based on a new concept (dollar plan) and required some adjustments. No policy flaws were noted for the sweet potato program because it was based on the standard concept of actual production history.

We also noted that, whereas the informal monitoring was coordinated to have program changes in place before producers would file applications for the next year's crop, the annual evaluations required by the handbook were not so constrained. Consequently, formal monitoring could result in program adjustments that would not take effect until another crop year had passed, and losses would continue unabated. We concluded that RMA should coordinate all its monitoring activities to allow for program changes on a yearly basis. Although the first year may not produce enough data to make reliable decisions about the program, the 5 years that RMA waited before reinventing the sweet potato program is clearly too long to endure the losses that the program experienced. Yearly adjustments would offer the most reasonable response to program concerns.

RMA needs to expand the monitoring policies and procedures in its New Program Development Handbook to clarify the duties and responsibilities of all parties involved in monitoring the pilot programs. The clarifications should include designating which personnel will develop performance goals, which will be responsible for ongoing monitoring, and which will have oversight and review responsibilities. The clarifications also should include guidance on documenting the analyses involved in requesting changes to the provisions of the pilot programs and should allow for more timely adjustments to those programs.

### Recommendation 3

Develop and implement more detailed, comprehensive policies and procedures for monitoring pilot programs, including prescribed ongoing monitoring activities, prescribed documentation of any analyses resulting in changes to the pilot programs, and prescribed duties and responsibilities for agency personnel and the Director of RED.

### Agency Response.

RMA concurs with this recommendation to the extent that it is revising its procedures to provide additional detail and direction for monitoring; however, this recommendation seems redundant with Recommendation 1.

RMA is not in full agreement that it must prescribe specific duties and responsibilities for agency personnel and the Director of RED beyond those contained within position descriptions and performance standards as required by the Office of Personnel Management. Lastly, Directors should not have such detailed procedures that they cannot act as necessary for situations or events as they arise, or as the nature of the job may change.

**OIG Position.**

We cannot accept the RMA management decision for this recommendation. This recommendation is not redundant with Recommendation 1. This recommendation requires the development and implementation of more detailed comprehensive polices and procedures for monitoring pilot programs, including prescribing the general duties and responsibilities for agency personnel, particularly the Director of RED, and relationship of RED to the field offices in the performance of the prescribed duties. In contrast in Recommendation 1, we are recommending the establishment and implementation of management controls to ensure that the currently prescribed procedures for monitoring and reviewing pilot programs, such as the annual evaluations, are timely performed on a routine basis. Furthermore, we believe that the duties and responsibilities of program staff monitoring the pilot programs should be contained in the program procedures, not simply within position descriptions and performance standards that conform to personnel procedures, which are not program procedures. In order for OIG to accept management decision, RMA needs to provide a copy of the more detailed, comprehensive policies and procedures for monitoring pilot programs to include a description of the general duties and responsibilities of agency personnel and the Director of RED along with the relationship to the field offices.

## Recommendation 4

Develop and implement a more timely review or evaluation process to effect expeditious changes to the pilot programs.

**Agency Response.**

RMA concurs with this recommendation but believes it is similar to Recommendations 1 and 3.

**OIG Position.**

We cannot accept the RMA management decision for this recommendation. The intent of this recommendation is not redundant with Recommendations 1 and 3. In Recommendation 3, we recommend strengthening RMA's policies and procedures by prescribing the duties and responsibilities of agency personnel, including field personnel, in monitoring and reviewing the pilot programs. In Recommendation 1, we recommend that RMA's establish controls to ensure that already prescribed monitoring and reviewing procedures are timely performed. We found that annual evaluations were not completed. Although the annual evaluations are comprehensive and can be used in identifying appropriate changes to the pilot programs, we found that, because of the time frame for initiating and completing the annual evaluation, appropriate changes to the pilot program could not be implemented until two crop years after the impacted year. We believe that this timing lapse contributes to unnecessary or avoidable losses to the pilot program. RMA needs to implement more timely reviews to effect more timely adjustments to the pilot programs, hopefully for the subsequent crop year (and not two crop years later). In order to accept management decision, we need more information on how RMA expects to conduct more timely reviews of pilot programs to effect expeditious changes.

### Recommendation 5

Include the newly established policies and procedures and review process in the revised New Program Development Handbook (procedures manual).

#### Agency Response.

RMA concurs with this recommendation but believes it is redundant with Recommendations 1 and 3. Whether RMA incorporates these changes into the New Program Development Handbook, or some other agency accepted or recognized handbook or administrative procedure, the changes would be applicable. The level of specificity should not be a basis for an OIG audit recommendation, or, at a minimum, Recommendations 1 and 3 revised accordingly.

#### OIG Position.

We cannot accept the RMA management decision for this recommendation. This recommendation is not redundant with Recommendations 1 and 3, which call for specific management controls to strengthen the monitoring and review of the pilot programs. In Recommendation 5, we recommend that these strengthened management controls be incorporated into an updated New Program Development Handbook. RMA contends that whatever changes are implemented, that they would be applicable regardless where they are incorporated. However, we believe that these changes be included in a permanent handbook or administrative procedure that will not expire by a specified date. At the time of our review, the New Program Development Handbook was the recognized handbook for monitoring pilot programs. In order for OIG to accept management decision, RMA needs to specify in what permanent handbook or procedure it expects to incorporate the anticipated changes called for in the above recommendations and the timeframe for incorporating such changes.

### Recommendation 6

Evaluate the current pilot programs and perform annual reviews immediately for those pilot programs that have not been reviewed.  Changes to the pilot programs should be instituted at the earliest possible date.

#### Agency Response.

RMA concurs with this recommendation but considers it redundant with Recommendation 4.  The timing and any potential changes implemented must occur within contractual change deadlines, which may not always equate to an annual basis.

#### OIG Position.

We cannot accept the RMA management decision for this recommendation. RMA needs to evaluate its current pilot programs and determine which programs have not been reviewed.  Annual reviews should be performed immediately for these pilot programs.  In order to reach management decision, RMA needs to provide a list of pilot programs for which annual reviews have not been performed and a timetable for performing such reviews.

## Finding 3 — Policies and Procedures Need to Be Updated to Reflect Changes in ARPA

Four years after the passage of the Agricultural Risk Protection Act of 2000 (ARPA), RMA's RED had not issued formal policies and procedures related to the research and development of pilot programs. This occurred because RED did not assign a staff member to complete the policies and procedures manual after a general services contract employee left the agency. Therefore, RED has no assurance that the research and development of new programs is conducted in a consistent and timely manner. As of May 10, 2004, RMA RED had contracted for 20 feasibility studies of new pilot programs and 9 pilot program development projects.[6]

The RED procedures manual (New Program Development Handbook) was used to develop pilot programs before the passage of ARPA. The manual directed the RED staff to research the feasibility of insuring each crop proposed for Federal coverage. The feasibility study would determine if the crop was viable in the pilot areas chosen for coverage. Once the crop was determined to be actuarially feasible, the RED staff would develop the rates and terms under which the program would be delivered. After the FCIC Board approved the program, RMA would open it for participation.

ARPA changed this process by prohibiting RMA from conducting research and development for any new policies for agricultural commodities. Instead, the research and development for new products must be accomplished through contracts. Two contracts are involved: the first is awarded for a feasibility study to determine the viability of the crop, and the second is awarded to a separate contractor to develop the rates and terms. RED also began using contracts for post-pilot evaluations, which usually occur after 3 to 4 years of data have accumulated to determine whether a program should be converted to permanent status. Because the policies and procedures in the RED manual did not address contract work, they became obsolete under the mandates laid down by ARPA.

Of the nine pilot programs under development by contractors, none was in the pilot stage where their actuarial soundness could be demonstrated during our audit. To determine how effectively RMA incorporated the requirements of ARPA in its procedures, we reviewed the Hawaii Tropical Fruits and Trees (HTFT) Pilot Program, which agency officials told us was closest to submission to the FCIC Board. We found that no new written procedures had been issued for developing new pilot programs under the new

[6] No new programs had been implemented under the new development process. The Cost of Production Pilot Program was submitted to the FCIC Board but was not approved for pilot status.

contracting procedures required by ARPA. RED officials stated that they were in the process of revising the procedures manual but had not completed the task. Initially, RED entered into a general services contract with a contractor who provided an employee to work on a new procedures manual. The contract employee submitted an initial draft of the new procedures manual in May 2003 and turned in the latest revision in July 2003. Before completing the project, the contract employee found another job and left the employment of the contractor. RED officials determined that they did not want another contract employee on staff and would use internal resources to complete the project.

RED managers told us they had a goal of issuing a revised procedures manual by March 2005. However, we noted that after the contractor left, the managers did not take action to ensure that other personnel completed the project in a timely manner. They currently have flowcharts and examples of forms that have to be completed during the contracting process, but there are no written internal procedures for the new contract research and development process relating to feasibility studies, program development, and post-pilot evaluations. Nor is there a specific timetable for revising the manual, other than the March goal announced to us during the audit.

RED officials stated that their division has been in transition since the passage of ARPA - that is, they went from developing pilot programs themselves to contracting for the development of pilot programs. This required staff to learn new skills, and to some extent, they still are adjusting to and developing the new process. Although RED has been in transition, over 4 years have passed since the passage of ARPA. We concluded that RED management was remiss in not acting sooner to complete the procedures they needed to follow to comply with ARPA. Without these procedures, RED has no assurance that program research and development is being conducted by contractors in a consistent and timely manner, and that oversight of the contracts by RMA is systematic and effective.

## Recommendation 7

Develop and implement standardized procedures for developing pilot programs to include contracting for feasibility, development, and post-pilot program evaluations.

### Agency Response.

RMA concurs and plans to include revised procedures in the New Program Development Handbook scheduled to be finalized May 30, 2005.

### OIG Position.

We accept the RMA management decision for this recommendation. For acceptance of final action, RMA needs to provide OCFO/PAD with a copy of the revised procedures for developing pilot programs to include contracting for feasibility, development, and post-pilot program evaluations.

## General Comments

We noted that although the implementation of ARPA has been underway for over 4 years, no new programs have been developed as far as the pilot stage. (See exhibit C.) Under ARPA, RMA is prohibited from conducting research and development for any new policy for an agriculture commodity but may enter into contracts to carry out the research and development. In defense of the time it is taking to implement pilot programs, an RMA official stated that the agency was in transition after the passage of ARPA and had to retrain its staff for the new contracting-out procedures. According to RMA, several pilot programs are scheduled to reach the FCIC Board during the first quarter of 2005.

RMA RED estimates that it will take a minimum of 3½ years to implement a pilot program. This includes the statement of work, contract award, feasibility study, program development, expert review, and FCIC Board consideration. All pilot programs are required to go through expert review and be approved by the FCIC Board before they may be piloted. Program implementation may take less than 3½ years if feasibility and development are combined into one contract.

Among the first feasibility contracts to be awarded were those for the HTFT Pilot Program (June 28, 2001) and the Cost of Production Pilot Program (July 6, 2001). The cost of production program, the result of a combined feasibility and development contract, was the first plan of insurance to be considered by the FCIC Board of Directors. The FCIC Board reviewed the proposed product during 2002. The Board identified several concerns but decided to continue development. The contractor made a final submission in the summer of 2003. Four of the six independent experts who reviewed the final package rejected it.

The HTFT program should have been the next pilot development presented to the FCIC Board. The development has taken 2 years, which is longer than the estimated development timeframe of 1 year. The RED Director stated that because the HTFT is for two policies for multiple crops, it is very complex and has taken more time than estimated due to technical reviews and changes. HTFT should be presented to the FCIC Board during the first or second meeting in 2005.

As of May 10, 2004, RMA RED had awarded 20 feasibility studies with 9 of them becoming development projects for new pilot programs. Of the 20 feasibility studies, 4 resulted in no further program development, and the remaining feasibility studies have either moved into the development stage or are still in process.

# Scope and Methodology

Audit work was performed at the RMA RED in Kansas City, Missouri, and at the firm of a contractor that had been developing pilot programs for RMA. The contractor was selected because it was one that had been awarded the most contracts for feasibility studies, development, and evaluations of pilot programs. Our fieldwork was performed during the period of January 2004 through August 2004. The period covered by the survey included pilot programs approved during CYs 2002 and 2003. As of May 10, 2004, we determined that no new pilot programs have been implemented under the new research and development process mandated by ARPA.

RMA RED had contracted for 20 feasibility studies of new pilot programs and 9 pilot program development projects (see exhibit C). There were also four partnerships and three economy act agreements for feasibility studies, and there were two contracts, administered by RMA's Product Development Division, for enhancements to permanent crop programs. These were not included in our review. Since the FCIC Board had accepted no pilot programs under the new development process, we reviewed the feasibility and program development process of the HTFT Pilot Program because agency officials told us that it was the pilot program closest for submission to the FCIC Board. Since there was no participation data for any pilot programs developed after the passage of ARPA, we were unable to determine if any post-ARPA programs were actuarially appropriate. Therefore, we decided to expand our scope to include the performance of active pilot programs developed prior to ARPA. We determined that there were 34 active pilot programs in CY 2002. The Millet Pilot Program was approved for conversion to permanent status prior to the passage of ARPA and completed the regulatory process to become a permanent program during CY 2002. As a result, there were 33 active pilot programs in CY 2003. Sixteen contracts were awarded for evaluation of active pilot programs, and another two contracts for revision of current pilot programs. However, we determined that the CY 2003 participation data was incomplete at the time of our initial review; therefore, we did not use it for our analysis in exhibit A.

We obtained the participation data for all pilot programs available during CYs 1999 through 2002 and determined that the 4-year, average-loss ratio for all pilot programs during this period was 1.51. This included some pilot programs with less than 4 years of data, if the pilot programs were initiated after CY 1999. We determined that there were 13 pilot programs that had a 4-year, average-loss ratio that exceeded the average of 1.51. We elected to review the evaluation process for the sweet potato program because it had the highest 4-year, average-loss ratio of 4.55. We then selected processing cucumbers and fresh market beans because consistently high-loss ratios were reported since they were introduced in CY 2000. Processing cucumbers had an average-loss ratio of 3.01 (CYs 2000-2002), while fresh market beans incurred an average-loss ratio of 2.91 (CYs 2000-2002). (See exhibit A.) We updated the information for these three crop programs on February 21, 2005. Based on this data, sweet potatoes had a 6-year, average-loss ratio of 4.06, and processing cucumbers and fresh market beans had 4-year, average-loss ratios of 2.97 and 2.78, respectively. (See exhibit B.)

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

- Reviewed regulations, policies, and procedures relating to pilot programs.

- Interviewed RMA RED personnel, RMA regional office officials, and development organization officials to document the new research and development process, determine the extent of any review and monitoring procedures performed, and obtain any concerns they had regarding pilot programs.

- Reviewed the most recent Federal Managers Financial Integrity Act report, RMA accomplishment reports, RMA compliance review reports, reports issued to Congress by RMA RED, and the FCIC Board's meetings' minutes.

- Obtained and reviewed RED listings of CYs 2002 and 2003 pilot programs.

- Obtained and analyzed CYs 1998-2002 participation data for the listing of pilot programs and selected pilot programs to review based on this analysis.

- Obtained and reviewed internal RED research, development, and evaluation documentation related to the selected pilot programs.

- Obtained and reviewed selected feasibility, developmental, and evaluation reports completed by contractors.

The audit survey was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit survey included such tests of program and accounting records as considered necessary to meet the survey objectives.

# Exhibit A – Listing of Pilot Programs *(as of February 23, 2004)*



| Pilot Program (1) | | | Crop Year Introduced | 2002 Premium | 2002 Liability | 2002 Indemnity | 2002 Loss Ratio (2) | 4-Year, Average-Loss Ratio |
|---|---|---|---|---|---|---|---|---|
| Rangeland **(3)** | GRP | 1 | 1999 | $ 2,210,857 | $ 46,497,641 | $ 16,806,158 | 7.60 | 3.60 |
| Millet **(4)** | APH | 2 | 1996 | 592,748 | 4,371,620 | 2,825,907 | 4.77 | 2.32 |
| Sweet Potatoes **(5)** | APH | 3 | 1998 | 2,457,326 | 23,945,340 | 11,452,680 | 4.66 | 4.55 |
| Processing Cucumbers **(12)** | DOL | 4 | 2000 | 669,266 | 8,251,182 | 2,425,196 | 3.62 | 3.01 |
| Cotton **(6)** | IP | 5 | 1996 | 245,509 | 3,042,442 | 836,179 | 3.41 | 4.54 |
| Apple Quality Option **(14)** | | 6 | 2001 | 506,931 | 5,964,247 | 1,708,768 | 3.37 | 3.16 |
| Fresh Market Beans | DOL | 7 | 2000 | 3,231,060 | 25,447,020 | 10,421,785 | 3.23 | 2.91 |
| Onion Stage Removal Option **(14)** | APH | 8 | 2000 | 1,174,484 | 8,238,420 | 3,767,566 | 3.21 | 2.58 |
| Grain Sorghum **(6)** | IP | 9 | 1997 | 107,294 | 1,002,807 | 314,303 | 2.93 | 3.09 |
| Barley **(6)** | IP | 10 | 1999 | 1,612,537 | 18,384,044 | 3,815,772 | 2.37 | 2.40 |
| Mustard **(7)** | APH | 11 | 1999 | 1,010,550 | 6,723,661 | 2,186,592 | 2.16 | 1.03 |
| Cultivated Clams **(12)** | DOL | 12 | 2000 | 2,180,703 | 59,952,613 | 3,923,031 | 1.80 | 1.80 |
| Coverage Enhancement Option **(9)** | | 13 | 2000 | 6,235,094 | 87,599,277 | 9,317,827 | 1.49 | 0.73 |
| Forage Seed | APH | 14 | 2002 | 402,391 | 5,364,198 | 551,945 | 1.37 | 1.37 |
| Adjusted Gross Revenue **(6)** | RA | 15 | 1999 | 8,985,199 | 245,411,792 | 10,831,181 | 1.21 | 1.41 |
| Wheat **(6)** | IP | 16 | 1996 | 276,687 | 4,100,689 | 329,199 | 1.19 | 2.22 |
| Cabbage **(8)** | APH | 17 | 1999 | 830,769 | 12,755,672 | 970,364 | 1.17 | 1.52 |
| Cherry **(12)** | DOL | 18 | 1999 | 4,963,405 | 52,647,539 | 5,087,032 | 1.02 | 1.08 |
| Pecan **(11)** | RA | 19 | 1998 | 2,266,616 | 29,501,035 | 2,294,430 | 1.01 | 0.46 |
| Winter Squash **(12)** | DOL | 20 | 1999 | 129,324 | 1,319,931 | 123,061 | 0.95 | 0.96 |
| Strawberries **(12)** | DOL | 21 | 2000 | 2,723,164 | 63,574,738 | 2,332,103 | 0.86 | 1.04 |
| Corn **(6)** | IP | 22 | 1996 | 5,200,649 | 151,303,760 | 3,752,392 | 0.72 | 0.67 |
| California Citrus Fruit **(12)** | DOL | 23 | 2001 | 2,001,970 | 30,951,485 | 1,236,000 | 0.62 | 0.31 |
| Cultivated Wild Rice **(8)** | APH | 24 | 1999 | 344,092 | 5,602,661 | 206,269 | 0.60 | 1.35 |
| Mint **(8)** | APH | 25 | 2000 | 361,341 | 7,054,181 | 208,193 | 0.58 | 0.46 |
| Processing Chile Peppers **(12)** | DOL | 26 | 2000 | 335,617 | 4,512,812 | 166,512 | 0.50 | 0.87 |
| Blueberries **(10)** | APH | 27 | 1995 | 1,818,845 | 22,182,333 | 871,894 | 0.48 | 0.49 |
| Raspberry/Blackberry | DOL | 28 | 2002 | 76,977 | 1,077,045 | 19,591 | 0.25 | 0.25 |
| Soybeans **(6)** | IP | 29 | 1997 | 2,666,382 | 84,335,182 | 527,102 | 0.20 | 0.57 |
| Florida Fruit Trees **(12)** | DOL | 30 | 1996 | 26,882,206 | 1,092,288,317 | 2,755,793 | 0.10 | 0.19 |
| Avocado (California) **(12)** | RA | 31 | 1998 | 5,582,897 | 38,083,953 | 538,252 | 0.10 | 0.11 |
| Crambe **(9)** | APH | 32 | 1999 | 3,050 | 26,590 | - | - | 0.30 |
| Avocado/Mango Tree **(12)** | DOL | 33 | 1998 | 172,028 | 5,952,928 | - | - | 0.04 |
| Avocado (Florida) **(13)** | APH | 34 | 1999 | 47,045 | 978,164 | - | - | 0.00 |
| **Totals** | | | | **$ 88,305,013** | | **$ 102,603,077** | | |
| **Total Average Ratio** | | | | | | | | **1.51** |

**(1) Programs introduced after CY 1999 do not have 4 years of data for the 4-year, average-loss ratio.**
**(2) The loss ratio is computed by dividing the indemnity by the premium. The target-loss ratio is 1.075 ($1.075 in indemnities paid for every $1 in premiums collected.)**
**(3) An evaluation was initiated during March 2002 to evaluate the program. Based on the review, a new program was contracted out for development. On October 28, 2004, the FCIC Board of Directors terminated the existing pilot group risk plan rangeland program and replaced it with a new rangeland program effective for CY 2005.**
**(4) The Millet Pilot Program was converted to permanent status on December 18, 2001. The changes were effective for CY 2003.**
**(5) A contract was awarded to evaluate the sweet potato program on March 28, 2003. On October 29, 2003, the FCIC Board made several changes to the sweet potato program and directed RMA to develop a new or revised program. A contract was awarded during February 2004 to redevelop the program. On October 28, 2004, the FCIC Board terminated the existing sweet potato program and implemented a new one.**
**(6) An evaluation was completed on the Income Protection Pilot Programs in September 2003. The Income Protection Pilot Program plan of insurance will be combined with the crop revenue coverage and revenue assurance plans of insurance.**
**(7) The FCIC Board converted mustard to a permanent program on July 29, 2004, effective for CY 2006.**
**(8) The FCIC Board voted to convert the Cabbage, Wild Rice, and Mint Pilot Programs to permanent status on September 2, 2004.**
**(9) The FCIC Board terminated the coverage enhancement option and crambe programs on July 29, 2004.**
**(10) The FCIC Board approved the blueberry for permanent status on February 7, 2002.**

**(11) The FCIC Board approved the pecan revenue for permanent status on September 19, 2002.**
**(12) Contract review is in process or has been completed and awaiting final decision on conversion to permanent.**
**(13) Internal evaluation completed and waiting on final decision.**
**(14) These pilots were options added to existing permanent pilot programs and were not part of our review, which were developed by the Product Development Division.**

# *Exhibit B – Summary of Data on the Sweet Potato, Processing Cucumber, and Fresh Market Bean Pilot Programs* *(as of February 21, 2005)*



| Crop | Year | Liability | Premium | Indemnity | Loss Ratio |
|---|---|---|---|---|---|
| **Sweet Potato** | 1998 | 9,422,130 | 678,217 | 1,527,781 | 2.25 |
| | 1999 | 22,277,115 | 1,815,409 | 9,437,288 | 5.20 |
| | 2000 | 23,271,109 | 2,006,947 | 8,302,996 | 4.14 |
| | 2001 | 27,463,809 | 2,601,524 | 10,898,557 | 4.19 |
| | 2002 | 23,945,340 | 2,457,326 | 11,452,680 | 4.66 |
| | 2003 | 19,928,765 | 2,029,179 | 5,392,915 | 2.66 |
| Crop Subtotal | | $126,308,268 | $11,588,602 | $47,012,217 | 4.06 |
| **Processing Cucumbers** | 2000 | 4,916,287 | 373,037 | 984,389 | 2.64 |
| | 2001 | 6,112,633 | 468,294 | 1,300,052 | 2.78 |
| | 2002 | 8,251,182 | 669,266 | 2,425,196 | 3.62 |
| | 2003 | 7,244,030 | 577,324 | 1,485,525 | 2.57 |
| Crop Subtotal | | $ 26,524,132 | $ 2,087,921 | $ 6,195,162 | 2.97 |
| **Fresh Market Beans** | 2000 | 16,239,620 | 1,487,168 | 4,888,629 | 3.29 |
| | 2001 | 17,086,994 | 1,887,359 | 4,197,397 | 2.22 |
| | 2002 | 25,979,981 | 3,322,196 | 10,710,147 | 3.22 |
| | 2003 | 14,714,795 | 1,620,532 | 3,324,453 | 2.05 |
| Crop Subtotal | | $ 74,021,390 | $ 8,317,255 | $23,120,626 | 2.78 |
| **All-Crop Total** | | **$226,853,790** | **$21,993,778** | **$76,328,005** | |

# Exhibit C – *Feasibility and Development Projects* *(initiated as of May 10, 2004)*



| RESEARCH AND DEVELOPMENT PROJECTS | FEASIBILITY | | | DEVELOPMENT | | | Date Pilot Program Estimated To Board | Targeted Crop Year Available As Pilot Program |
|---|---|---|---|---|---|---|---|---|
| | Number | Award Date | Scheduled End Date | Number | Award Date | Scheduled End Date | | |
| Biomass | 1 | Sep-02 | Jun-03 | | Research report indicates no further development warranted. | N/A | N/A | N/A |
| Christmas Tree (Note 10) | 2 | Dec-02 | Ongoing FS and Dev in one contract. * | 1 | Ongoing FS and Dev. in one contract. * | Nov-04 | Dec-04 | CY 06 |
| Cut Flowers and Cut Cultivated Floral Greens | 3 | Jul-01 | Sep-02 | | Feasibility study recommends covering cut flowers via adjusted gross revenue. | N/A | N/A | N/A |
| Direct Marketing of Perishable Agriculture Crops | 4 | Jan-03 | Postponed until adjusted gross revenue evaluation completed. | | TBD ** | TBD ** | TBD ** | TBD ** |
| Hawaii Tropical Fruits and Trees (Note 1) | 5 | Jun-01 | Mar-02 | 2 | Sep-02 | Mar-04 | Jul-04 | 1st Qtr 05 |
| Hybrid Sunflower Seed, Sesame, and Spelt Crop | 6 | Mar-03 | Mar-04 (Completed May-04) | | Feasibility recommends not proceeding with separate plan for these crops. | N/A | N/A | N/A |
| Lawn Seed (Note 2) | 7 | May-03 | May-04 | | TBD | TBD | TBD | TBD |
| Livestock | 8 | Sep-02 | Dec-04 | | TBD | TBD | Jul-06 | CY 07 |
| Melon (Note 3) | 9 | May-03 | Mar-04 | | TBD | TBD | TBD | TBD |
| Pasture & Rangeland | 10 | Aug-01 | Oct-02 | 3 | Aug-03 | Oct-04 | Dec-04 | CY 06 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Preferred Producer Discount Multi-year Coverage (Note 4) | 12 | Aug-01 | Jul-02 | 4 | Apr-04 | Jan-05 | N/A | N/A |
| Quarantine Crop Research & Program Design Report (Note 5) | 13 | Sep-01 | Apr-03 | 5 | Sep-03 | Dec-04 | Feb-05 | CY 06 |
| Research & Development of Cost of Production | 14 | Jul-01 | Ongoing FS and Dev. in one contract. * | 6 | Ongoing FS and Dev. in one contract. * | Oct-03 | Rejected by FCIC Board in October 2003. | N/A |
| Revenue Coverage (Note 6) | 15 | Sep-01 | Jul-02 | 7 | Jun-03 | Sept-05 | Nov-05 | CY 06 |
| Tree, Vine, Bush Replacement Risk Management (Note 7) | 16 | Sep-02 | Feb-04 | | TBD | TBD | Mar-06 | CY 07 |
| Vegetable and Flower Seed (Note 8) | 17 | Nov-03 | Apr-04 | | TBD | TBD | TBD | TBD |
| Vegetables | 18 | Aug-01 | Jun-02 | 8 | Sep-03 | Jan-06 | 2nd Qtr 2006 | CY 07 |
| Florida Fruit Tree (Note 9) | 19 | Sep-02 | Ongoing FS and Dev. in one contract. * | 9 | Ongoing FS and Dev. in one contract. * | Jun-04 | 1st Qtr 2005 | CY 06 |
| Small Value Crops | 20 | Apr-04 | Aug-05 | | TBD | TBD | TBD | TBD |

These notes were updated as of December 23, 2005.

1) The last deliverable was due to RMA on December 10, 2004. It was on the FCIC Board's agenda for January 2005 and will not be available until CY 2006.
2) The project has been delayed while approval is being obtained from Office of Management and Budget for a survey that will request data from lawn seed growers about production practices, marketing practices, and other aspects of lawn seed production.
3) The contract was delayed due to scheduling producer listening sessions when optimal attendance was available and in conjunction with the National Watermelon Association's annual meeting.
4) The contractor presented the findings of the first deliverable on September 15, 2004. RMA management decided it should be presented to the FCIC Board before proceeding due to major program policy implications it raised. The FCIC Board briefing was scheduled for early 2005.
5) Work continues on this project and presentation to the FCIC Board is scheduled for Fourth Quarter 2005.
6) There are nine crops covered under this program. The first two crops should have been reviewed by FCIC in January 2005 and should be available in CY 2006.
7) The development for a new program is on hold while the agency reviews the various tree-related policies under development for consistency and uniformity in approach.
8) A decision memo is currently being drafted for feasibility study.
9) RMA planned to submit the pilot program to the FCIC Board at the February 2005 meeting.
10) The contract has been on hold while approval is obtained from Office of Management and Budget for collection of historical data necessary for rating and pricing development.

* FS and Dev. = feasibility study and development
** TBD = to be determined

# Exhibit D – Agency Response



USDA

United States Department of Agriculture

Risk Management Agency

1400 Independence Avenue, SW
Stop 0801
Washington, DC
20250-0801

TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General

APR 21 2005

FROM: Michael Hand
Audit Liaison Official

SUBJECT: Office of Inspector General (OIG) Draft Audit Report 05601-12-Te, Survey of Pilot Programs

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

**GENERAL COMMENTS**

RMA believes the audit report fails to express a full understanding and appreciation of the complexity, research and related data/experience needs and policy challenges associated with devising and establishing new and untested pilot crop insurance programs. These important factors also present challenges in the monitoring and evaluation of pilot program performance related to subsequent changes consistent with contractual requirements. As envisioned by the passage of the Agricultural Risk Protection Act many commodities for which little or no current risk management alternatives exist, are under consideration for new and innovative risk management approaches not previously tried or tested before in either the public or private sector. This is a key purpose as outlined in the Federal crop insurance program enabling legislation, and why today crop insurance is a primary risk management program for many non-program crops.

Evaluating pilot programs within relatively short timeframes, at least in terms of general insurance, is difficult since many factors can impact a program's performance. Generally, a new program needs to be operational for some reasonable time period before a meaningful evaluation is conducted so one can draw valid and supportable conclusions as to the program's performance. RMA attempts to maintain stability within a program to the extent practical during the initial years the product is offered in the marketplace. Making frequent changes from year to year can skew the findings of any evaluation. Unless a major flaw in policy provisions, premium rate establishment or underwriting rules is identified, RMA's practice is to administer the pilot program with little disruption and limited revisions so a sufficient amount of insurance experience is gained to conduct a meaningful evaluation and draw supportable conclusions.

The audit report suggests that some pilot programs have not been reviewed on a regular basis and that certain changes made to the pilot programs were not effective. RMA believes it has monitored these pilot programs and that modifications made addressed identified vulnerabilities.

The contention that changes made to pilot programs were not effective based solely on 1, 2 or even 3 individual crop year's loss ratio, may not always be a valid conclusion. Generally, crop insurance program performance and associated premium rate adjustments are established over much longer timeframes.

The OIG report uses loss ratio for three pilot programs as a focal point for its findings. A programs loss ratio, whether pilot or permanent, is one component in considering how the program may be operating; however, it can not be used as a sole basis to conclude the program is flawed. The loss ratio may be the result of insured crops devastated by a hurricane, prolonged drought or some other insurable cause of loss. If paid losses result because insured crops are legitimately destroyed by insurable causes of loss, the insurance program may very well be working as designed. The amount of data has to be sufficient, credible and supported by other information before using the data to make significant revisions to the pilot program.

Using loss ratio as an indicator of program performance, as was done in the audit, for all pilot programs would indicate they have performed well. The performance of pilot programs shows a cumulative loss ratio from 1999 through 2004 of .96, slightly lower than the .98 loss ratio for all other crops. For the 2002 crop year, pilot programs incurred a loss ratio of 1.14 compared to all other crops loss ratio of 1.40. In 2003, the last year included in the audit, the loss ratio for all pilot programs was .76, compared with a loss ratio of .95 for all other crops. The audit report reviews activity for 34 pilot programs but only reviewed in detail the three pilot programs with the highest loss ratios.

The audit report suggests that annual monitoring did not occur with all or some programs. RMA reviewed program provisions, special provisions and made changes to pilot programs to address program vulnerabilities, demonstrating RMA did monitor pilot program performance. RMA provided a summary of such changes per the OIG's request. For example, modifications were made to both the fresh market bean and processing cucumber programs each year since their inception in 2000. The changes made in both programs for 2001 and 2002 were relatively minor as the programs had little experience on which to base significant modifications. However, significant changes to fresh market beans occurred in 2003 and 2004. Modifications were made to the processing cucumber pilot program for the 2002 crop year and additional changes made every year since, thus demonstrating that monitoring was being conducted.

In general, RMA believes it has administered its pilot programs in a responsible manner contrary to some of the audit report's conclusions. To the extent RMA can improve its processes, policies and procedures for overall strengthening of its pilot programs, it is in agreement with such activity.

**RECOMMENDATION NO. 1:**

**Establish and implement management controls to ensure that prescribed procedures for monitoring and reviewing pilot programs are timely performed on a routine basis.**

**<u>RMA Response:</u>**

RMA concurs with this recommendation. RMA is revising its procedures in the New Product Development Handbook, FCIC-23010, to include formal procedures and scheduling for monitoring of pilot programs. The revised handbook is scheduled to be finalized by May 30, 2005.

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 2:**

**Review monitoring and any other evaluations of the Sweet Potato Pilot Program and determine if any personnel action should be initiated against any individual in Research and Evaluation Division (RED) for the losses incurred by this program.**

**<u>RMA Response:</u>**

We conditionally agree with this recommendation pending further analysis and evaluation of this matter. Within a year, RMA will assess the performance and conduct of the employees responsible for the Sweet Potato Pilot Program, to determine if there are performance and/or conduct problems that warrant disciplinary action.

We also believe that our assessment of the employee's actions must take into consideration the innate risk associated with running a pilot program. We will address any performance and/or conduct issues without impairing our employees' ability to take risks.

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 3:**

**Develop and implement more detailed, comprehensive policies and procedures for monitoring pilot programs, including prescribed ongoing monitoring activities, prescribed documentation of any analyses resulting in changes to the pilot programs, and prescribed duties and responsibilities for agency personnel and the Director of RED.**

**<u>RMA Response:</u>**

RMA concurs to the extent that it is revising its procedures to provide additional detail and direction for monitoring; however this recommendation seems redundant with recommendation number 1. (See RMA's response to recommendation number 1.)

RMA is not in full agreement that it must prescribe specific duties and responsibilities for agency personnel and the Director of RED beyond those contained within position descriptions and performance standards as required by the Office of Personnel and Management. Lastly, Directors should not have such detailed procedures that they cannot act as necessary or needed for situations or events as they arise, or as the nature of the job may change.

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 4:**

**Develop and implement more timely review or evaluation process to effect expeditious changes to the pilot programs.**

**RMA Response:**

RMA concurs but believes this recommendation is similar to recommendation numbers 1 and 3. Please see our response to these recommendations.

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 5:**

**Include the newly established policies and procedures and review process in the revised RED New Product Development Handbook (procedures manual).**

**RMA Response:**

RMA concurs but believes this recommendation is redundant with recommendation numbers 1 and 3. Whether RMA incorporates these changes into the New Product Development Handbook or some other Agency accepted or recognized handbook or administrative procedure, the changes would be applicable. The level of specificity should not be a basis for an OIG audit recommendation, or at a minimum recommendation numbers 1 and 3 revised accordingly. (See RMA's response to recommendation numbers 1 and 3.)

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 6:**

**Evaluate the current pilot programs and perform annual reviews immediately for those pilot programs, which have not been reviewed. Changes to the pilot programs should be instituted at the earliest possible date.**

**RMA Response:**

RMA concurs. (However, this recommendation is redundant with recommendation 4.) The timing and any potential changes implemented must occur within contractual change deadlines, which may not always equate to an annual basis.

*RMA requests management decision for this recommendation.*

**RECOMMENDATION NO. 7:**

**Develop and implement standardized procedures for developing pilot programs to include contracting for feasibility, development and post-pilot program evaluations.**

**RMA Response:**

RMA concurs and plans to include revised procedures in the New Crop Development Handbook scheduled to be finalized May 30, 2005.

*RMA requests management decision for this recommendation.*

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